CITY OF SAN CLEMENTE, CALIFORNIA

Long Term Financial Plan 2022

Prepared By:

Finance and Administrative Services

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City of San Clemente

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Honorable Mayor and Council Members:

I am pleased to present to the City Council the City of San Clemente's 2022 *Long Term Financial Plan (LTFP)*. The City has been presenting the LTFP on an annual basis since 1993. The City's commitment to providing responsible financial oversight has allowed the City to maintain our AAA bond rating. The City's financial outlook has brightened, but there are still uncertainties which could cause annual financial impacts to the City in the future. However, the City has a strong financial base with reserves and continues to take advantage of opportunities to meet the ongoing needs of its citizens.

The City's LTFP is a long-range planning tool which provides the City Council information to make strategic decisions affecting the City's fiscal sustainability, both in the short and long term. The LTFP describes the City's financial structure, condition and prepares the City to address strategic issues. The LTFP is the *City Financial Reporting Overview, Financial Trend Analysis, Financial Forecast, Reserve Analysis*, and *Fiscal Policies.* It outlines specific recommendations and provides a forecasted position as the annual budget process is approached.

This approach allows the City to work towards a better financial position over the long term so issues or conditions can be prepared for and managed in a clear and transparent process. Currently, positive operating positions for FY 2022-23 and subsequent fiscal years are forecasted. This could all change quickly based on significant and multiple uncertainties. The goal of the LTFP is to provide context as the City Council works to address strategic items facing the City.

As we prepare to enter Fiscal Year 2022-23 the focus on the City's core responsibilities remains a priority. As we look out over the next five years, we could experience growing costs and limited revenue sources to fund those costs. The positive operating position of the General Fund offers an opportunity to review the financial base of the City and determine how to manage these uncertainties prior to the City to utilizing limited resources and expanding services. The City will also focus on Sewer and Clean Ocean rates addressing service considerations outside of the General fund through future separate action by Council.

The City's LTFP financial papers provide information and give a financial perspective and outlook. ***Overall, the City's reserves are being addressed through additional contributions, past financial indicators improved slightly from pandemic lows, the forecast is showing a positive operating position in future years, but there are multiple uncertainties that are identified and actions to mitigate the impacts.***

The ***General Fund*** is fully funding its Emergency Reserve at $14.8 million, which is 20% of the City's operating expenditures, but the General Fund's unassigned fund balance is a small percentage of costs and could be impacted by the identified uncertainties. Unassigned fund balance is essentially a savings account that is available for appropriation to fund one-time costs and capital activity. City staff annually reviews the number of capital and maintenance projects to make sure the timing is appropriate and make changes that lower future operating position. Working with a stable annual positive operating position provides funds for one-time activities and funding for future maintenance and capital projects.

General Fund Operating position (operating revenues less operating expenditures) is projected to be positive for the next fiscal year and the remaining years of the forecast. This improvement is due mostly to increases in property taxes and sales tax revenues exceeding the amount of cost increases. These two revenues are the largest revenues to the General Fund. Overall through the forecast period revenues are anticipated to keep pace with cost increases. However, there are uncertainties which could impact future periods that are identified along with consideration or actions that could be done to mitigate these concerns.

The 2022 LTFP issue papers are meant to educate and provide analysis for the future. The goal in presenting these is to inform City Council and citizens, seek direction, and work towards addressing issues these issues. The issue papers include:

- ***Pension Update*** This paper provides an update to the 2019 LTFP paper, the 2021 LTFP paper and discusses actions taken, including the current status of the "3-2-1 Pension Funding Strategy", and recommended actions related to pensions for Council consideration.

Our Spanish Village by the Sea has seen a number of challenges over the past several years, but City's amazing staff has been resilient and is always ready to address issues, with a priority to maintain a prudent financial approach to all aspects of City services.

Erik Sund
City Manager

City of San Clemente

City Council

Gene James, Mayor

Chris Duncan, Mayor Pro Tem

Laura Ferguson, Council Member

Steve Knoblock, Council Member

Kathy Ward, Council Member

City Manager

Erik Sund

Financial Plan

City Financial Reporting Overview
Jake Rahn, Financial Services Officer

Financial Trend Analysis
Sandee Chiswick, Senior Accountant

Financial Forecast
Jake Rahn, Financial Services Officer

Reserve Analysis
Jake Rahn, Financial Services Officer

Fiscal Policy
Jake Rahn, Financial Services Officer
Matthew Schmelzel, Management Analyst

Strategic Issues

Pension Update
Jake Rahn, Financial Services Officer

Mission Statement

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.

EXECUTIVE SUMMARY

LONG TERM FINANCIAL PLAN

City Financial Reporting Overview

Objective

To summarize the City's current Financial Reporting Structure and provide general information related to City operations, fund accounting and changes to improve the reporting structure of the City funds.

Financial Trend Analysis

Objective

A number of financial indicators are analyzed utilizing the International City Management Association's (ICMA) guidelines contained in "Evaluating Financial Condition". The analysis of these indicators is designed to present information on the fiscal health of the City of San Clemente as part of the Long Term Financial Plan. This annual financial trend analysis focuses on the City's General Fund.

Financial Forecast

Objective

To update the comprehensive five-year financial forecast for the General Fund, incorporating adopted City fiscal policies, expenditure patterns, revenue trends, fund balances 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, (b) meet program needs without unnecessarily obligating scarce dollar resources and (c) to ensure compliance with City fiscal policies and legal requirements by State, County or Local Ordinances.

Fiscal Policy

Objective

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

STRATEGIC ISSUES

Pension Update

Objective

To review the City's current pension plans, summarize actions taken after the 2019 LTFP Pension Update, and 2021 LTFP related to the ongong sustainability of the City's pension plans and recommendations to control city pension costs into the future.

Long Term Financial Plan (LTFP) Process

Governmental Finance Officers Association (GFOA) recommends that all governments regularly engage in long-term financial planning. The City of San Clemente annually provides a Long Term Financial Plan to City Council to assist with the development and financial allocation of resources and activities for the City through the upcoming budget process. The flow chart below graphically describes the steps that should go into a Financial Plan process.

Long Term Financial Plan

A long-term plan should include these steps.

- ***Mobilization Phase -*** The mobilization phase prepares the organization for long-term planning by creating consensus, aligning the project team, identifying services priority or policies, and identifying the purpose and scope.

  Staff addressed City Council during a meeting and discussed items to be addressed through the annual LTFP process and sought input from Council for other areas. A project team was developed based on these areas and the purpose and scope of the LTFP were communicated to the project team.

- ***Analysis Phase -*** The analysis phase is designed to produce information that supports planning and strategizing. The analysis phase includes the projections and financial analysis commonly associated with long-term financial planning. The analysis phase involves information gathering, trend projection and analysis to be provided to assist Council in making decisions.

  Staff prepares the Trends Section to provide past financial information, the Reserves Section to address current amounts/funding levels for significant amounts, existing Fiscal Policies are summarized and recommended changes are addressed, and a Forecast (based on identified assumptions) is presented to provide a perspective of General Fund resources.

- ***Decision Phase -*** After the analysis phase is complete, the government must decide how to use the information provided. Key to the decision phase is a highly participative process that involves elected officials, staff and the public. Finally, the decision phase should address the process for executing the plan to ensure tangible results are realized.

  Staff recommendations are presented based on the papers and information and is provided for City Council consideration related to possible budget actions to improve future operating positions. Strategic issues also facilitate discussions related to where to focus limited resources in budget development.

- ***Execution Phase -*** After the plan is officially adopted and input is received, strategies must be put into action (e.g. funding required in achieving goals). The execution phase is where the strategies become operational through the budget, planning, and financial performance measures.

  Staff will take input from the City Council and incorporate actions and Council's input into the budget. This will be done through the Decision Package process or through adding amounts and activities to program budgets. Council will receive the budget plan in a Budget Workshop in May to discuss any further changes or actions that should be taken.

GFOA recommends that certain elements be incorporated into the long-term financial plan. A long-term financial plan should include these elements:

Time Horizon - A plan should look at least five to ten years into the future. *The City of San Clemente utilizes a five year timeframe.*

Scope - A plan should consider appropriate funds, but especially funds used to address the main issues. *The main operating fund of the City of San Clemente is the General Fund, however other funds will be discussed as they relate to the different Council actions.*

Frequency - Governments should update long-term planning activities as needed in order to provide direction to the budget process, though not every element of the long-range plan must be repeated. *The City of San Clemente has being doing the Long Term Financial Plan annually as a result of forecasted future operating deficits and to address issues.*

Content - A plan should include an analysis of the financial environment, revenue and expenditure forecasts, debt position and affordability analysis, strategies for achieving and maintaining financial balance, and plan monitoring mechanisms, such as scorecard of key indicators of financial health. *This is currently done through the Trends, Reserves, Fiscal Policy and Forecast with recommendations incorporated into the plan.*

Visibility - The public and elected officials should be able to easily learn about the long-term prospects of the government and strategies for financial balance. *Annually, this is done through a public workshop.*

GFOA additionally started addressing a framework to promote financial sustainability for building a sustainable, resilient community. This leadership framework is less focused on finances and more focused on the process and participation of stakeholders. The framework consists of five pillars, which can be used to address and discuss strategic issues that arise. The five pillars include the following: 1) Establishing a Long-Term Vision, 2) Build Trust and Open Communication, 3) Use Collective Decision making, 4) Create Clear Rules, and 5) Treat Everyone Fairly. The City hopes the Long Term Financial Plan and budget addresses these pillars.

Strategic Issues presented in conjunction with the Long Term Financial Plan have been limited to the Pension Update as the City continues to implement actions based on the "3-2-1 Pension Funding Strategy".

OVERVIEW

The Long Term Financial Plan (LTFP) is discussed and LTFP information is summarized in the following pages. Each LTFP paper has more detail and a more comprehensive analysis. The LTFP Overview is in the following format:

- *Introduction*
- *Summary*
- *List of LTFP Recommendations*

INTRODUCTION

The LTFP provides a look at the current financial issues facing the City of San Clemente and outlines a plan to meet the needs of the community without sacrificing the City's financial future.

The 2022 Long Term Financial Plan (LTFP) Overview presents a snapshot of the papers and summarizes recommendations generated based on the LTFP sections. The LTFP sections have more detailed information and the information is summarized within the Summary in each paper.

Utilizing the financial tools already in place, the LTFP looks at the Financial Trends, Reserve Analysis and Financial Forecast, to diagnose the "fiscal health" of the City of San Clemente in order to chart a sound financial course. The LTFP offers analysis, education, and recommends solutions to current or future issues. The LTFP acts as a guide in developing the annual budget, acts as an instrument for developing financial policies, and offers proposals for the future of the City.

The LTFP is a financial plan and offers analysis and solutions for current and future issues

The focus continues to be building a solid foundation for the future. The City had ample reserves to address the pandemic, but American Rescue Plan funds and other grants allowed Emergency Reserves not to be utilized. Currently, the economy is solid with strong demand. The General Fund's main revenue sources of property taxes and sales taxes are exceeding initial expectations and are anticipated to remain strong through FY 2023. However, the long term outlook remains uncertain. Although the forecast shows positive operating positions into the future, there are uncertainties that could impact these future operating positions. These uncertainties include economic factors, a MOU required Class and Compensation Review, completion of the deputy sheriff's union MOUs, funding impacts, and service level changes based on concerns facing the City and its citizens. These uncertainties could all create annual impacts to the General Fund and its operating position. The Long Term Financial Plan is to be informational and act as a guide to Council, management and the citizens in these decisions.

Although the forecast shows positive operating positions into the future, there are uncertainties that could impact these future operating positions.

LTFP SUMMARY

The LTFP papers provide a foundation for the Council on past trends, current status, and what is expected in the future. These papers offer annual recommendations to ensure reserves are funded, fiscal policies are updated, and to provide Council with information on the General Fund's the past, current, and future financial factors within the City's operations to maintain a sustainable operating position into the future.

Prior to the 2008 recession, the General Fund had annual positive operating positions exceeding $1.0 million. This operating position allowed the City's finances to absorb some operating costs during the last economic recession, while only minimally impacting services to the public. The goal of the LTFP is to provide information so Council can prioritize services and provide direction to staff related to the operating position, while still maintaining services the citizens expect.

The City of San Clemente annually prepares a comprehensive Long Term Financial Plan (LTFP). The LTFP is intended to serve as a tool for City Council. Its purpose is to identify financial trends, shortfalls, reserves and outline policies so the City can proactively address them.

The *City Financial Reporting Overview* section summarizes the City's current Financial Reporting Structure and provides general information related to City operations, fund accounting and changes to improve the reporting structure of the City funds. Information on this is to consider the creation of an Endowment fund.

The *Financial Trend* section includes the analysis of twenty-two trends. These trends relate to revenue, expenditures, operating positon, debt, and community factors. The most significant impacted indicators were the Revenue Trends and Operating Position.

Revenue Trends were impacted due to the pandemic, but late in FY 2021 restrictions and guidelines were eased. Overall revenue improvements were noted, however revenue indicators did not change as improvements were not significant and only occurred near the end of the year. These impacts, although anticipated to be ongoing, were only in the first year of the reversal. Fees/charges should be reviewed to ensure they recover the cost of providing the service since inflation has grown. This recovery allows non-service related items to fund public safety and amenities utilized by all citizens.

Expenditure Trends indicators were unchanged, however cost reductions and additional pension payments contributed to the changing of two ratings. The Operating Surplus (deficit) and Pension Unfunded Liability changed from Warning to Favorable/Caution. The operating surplus remained positive and improved from the prior year which allowed funds to be allocated to pay down the pension liability. The pension funded status increased from the prior year despite discount rate reductions costs being phased in.

The Long Range *Financial Forecast* sets the stage for the upcoming budget process, facilitating both the City Manager and City Council in establishing priorities and allocating resources appropriately. This Long Range Financial Forecast is not intended as a budget, nor as a proposed plan. The forecast is based on current service levels, does not factor in future development, and uses general assumptions which may be different than actual amounts.

The forecast shows all five future years with a positive operating position. Revenues average an annual increase of 3.8% over the forecast period while operating expenditures are increasing annually by 3.6% a year. The initial year is driven by an anticipated revenue increase of 5% versus the 4.2% initial cost increase.

Over time, these assumption changes stabilize and flatten the future operating position as revenues keep pace with costs causing the operating position to remain stagnant at $1.1 million. This is better than previous years, but there are multiple uncertainties which need to be considered in the outlying years. Some of the uncertainties are listed in the table below with actions that are or should be considered to manage these uncertainties.

Uncertainty	Actions to Manage/Mitigate this uncertainty
Inflation	• Seek other revenue sources or adjust service fees to offset increases in cost*
Economic Downturn	• Maintain General Fund Emergency Reserves at 20%
Future Police Contract cost	• Maintain the positive operating position in the Forecast to absorb larger cost increases in the future • Utilize American Rescue Plan funds to offset the increased costs of the body camera's
Class and Compensation Review	• Maintain the positive operating position in the Forecast to absorb any cost impacts
Service changes – Homelessness, Trolley, Park Ranger program	• Seek other revenue sources or adjust service fees to offset increases in cost*

* City staff has asked HdL to present some information related to revenue options in conjunction with the LTFP forecast.

The City has already taken action on pension costs and unanticipated capital costs by making additional pension liability payments and continuing contributions to Capital Equipment, Facilities Maintenance, and Park Asset Reserves. Additionally, direction has been received from Council related to Clean Ocean funding. However, other smaller actions are recommended in the paper to offset certain costs with American Rescue Plan funds and to increase the CIP maintenance project levels to lessen the chance of unanticipated capital costs.

The *Reserve* section includes the assessment of current reserve levels for Operational, Capital/Infrastructure, and Emergency Reserves. Most reserves are fully funded, however there are recommendations for certain reserve transfers to lessen operational impacts. Additionally, Sewer rates, Clean Ocean rates and Storm Drain rates need modifications to better address future capital and operating needs.

The *Fiscal Policy* section includes a review of existing financial policies by major category. This is an opportunity for staff to address changes or propose policy related items. In the current year, there are no recommended changes.

The *Pension Update* section summarizes the actions taken after the 2019 LTFP Pension Update, and 2021 LTFP related to the ongoing sustainability of the City's pension plans and the implementation of the actions identified in those updates. These actions work to control city pension costs into the future. The Pension Update lists a summary of each plan, status of the "3-2-1 Pension Funding Strategy" and other actions related to each plan. Recommendations seeking Council direction to staff is also included in the report. *Staff recommendations are summarized in the following section for Council to provide direction.*

LTFP RECOMMENDATIONS

CITY FINANCIAL REPORTING OVERVIEW

- Staff is seeking Council direction as to the creation of an endowment.

TRENDS

No recommendations

FORECAST

- Direct staff to increase the annual CIP Maintenance project amount of $250,000 to $300,000 depending on the availability of General Fund operating position.
- Utilize American Rescue Plan grants to fund $800,000 for public safety. This amount will fund portions of the Police contract attributable to body cameras, the Fire Contract for the additional cost for the 4th firefighter/paramedic, and to fund a portion of the Community Outreach Worker position for outreach purposes.

RESERVE

- Transfer an annual amount of $400,000 from the General Fund to the Facilities Maintenance Reserve in FY 2022-23.
- Transfer a one-time amount of $1.5 million from the Water Operating Reserve in FY 2022-23 to the Water Depreciation Reserve to fund future capital replacement in the Water Depreciation Reserve.
- Transfer a one-time amount of $100,000 in FY 2022-23 to fund the Accrued Leave Reserve.

FISCAL POLICY

No recommendations

PENSION UPDATE

- Authorize staff to contract with Chandler Asset Management to update the existing City of San Clemente Pension Investment Policy (Policy #202-2) for City Council approval.
- Direct Staff to continue to pursue the creation of the Section 115 plan and to request funding for the trust when land sale proceeds become available or when one-time resources are available.

City Financial Reporting Overview

Objective

To summarize the City's current Financial Reporting Structure and provide general information related to City operations, fund accounting and changes to improve the reporting structure of the City funds.

Executive Summary

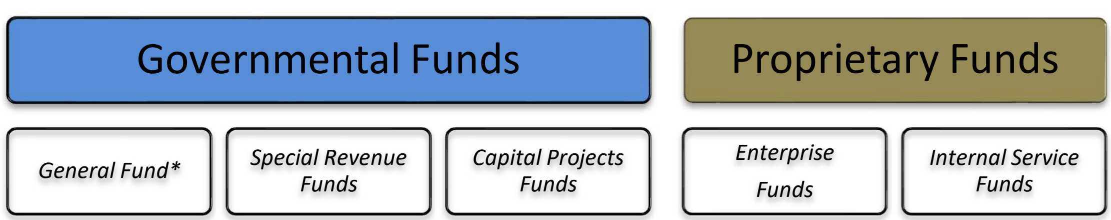
The City of San Clemente operates through a system of funds to manage the diverse streams of revenue that they receive and to monitor the restrictions often attached to that revenue. With the change in City Council and staff to provide more transparency to the public staff has prepared a summary of the Financial Reporting Structure to better identify and present a synopsis of the City Financial Reporting Structure.

Governmental accounting uses a fund structure to focus on accountability and proper stewardship. Fund accounting identifies revenue sources and provides transparency for the organization. It shows how revenue is being spent and determines if the revenue is being received, how funds are being directed to various programs or a specific purpose and the remaining amount of funds available. This approach to accounting is used by all types of government entities, including federal, state, county, municipal, and special-purpose entities.

A fund is not a separate legal entity. A fund is an accounting entity with a self-balancing set of accounts used to record financial resources and liabilities, as well as operating activities. Funds are segregated to carry on certain activities or attain targeted objectives so a government can more closely monitor resource usage.

Funds utilized by the City are grouped into generic fund types (Governmental, Proprietary, and Fiduciary). Governmental funds are largely supported by general taxes. Proprietary funds are operated to recover the costs of operation through charges for services. Fiduciary funds are funds held on the behalf of other individuals and are not discussed further in this report.

A chart of the fund types used by the City of San Clemente is in the following table:



Governmental Funds:

Governmental funds are made up of the General Fund, Special Revenue Funds, Debt Service, and Capital Project Funds. The General Fund is the primary governmental fund type and the purpose of a general fund is "to account for all financial resources except those required to be accounted for in another fund". Other governmental funds (Special revenue and Capital Project Funds) are used to account for tax-supported activities or specific revenues that are to be used for specific governmental purposes. The City of San Clemente does not have a Debt Service Fund.

A chart of the Governmental Funds follows:

Governmental Funds		
General Fund	*Special Revenue Funds*	*Capital Projects Funds*
	Street Improvement	Parks Aquisition and Development
	Gas Tax	Local Drainage Facilities
	Miscellaneous Grants	RCFPP
	Air Quality Improvement	Public Facilities Construction Fee
	Local Cable Infrastructure	Developers Improvement
	Police Grants	In-Lieu Housing
	Local Transit	Reserve
	Disaster Relief	Low/Moderate Income Housing

The **General Fund** is the general operating fund of the City. It is used to account for all financial resources traditionally associated with governments which are not required to be accounted for in another fund. The General Fund records departmental activity for General operations. Budgeted costs are generally summarized in the following departments: General Government, Finance & Administrative Services, Public Safety, Community Development, Public Works, and Beaches Parks and Recreation. Information by program category is summarized in the Trends and in budget documents. The following summaries the activities related to each department:

A summary of activities performed by each department follows:

- ***General Government*** – Includes City Council, City Manager, City Clerk, and City General activities. City General is a program where costs are for the General Fund as a whole and includes insurance, fund transfers, legal, animal services (CASA), and capital projects which benefit multiple departments. A portion of these costs are recovered from charges to other funds.

- ***Finance & Administrative Services*** – Includes Finance, Human Resources, and the Assistant City Manager costs. Activities include Accounting, Cashiering, Purchasing, Human Resources, RSVP, Business license, and investments/treasury. A portion of these costs are recovered from charges to other funds.

- ***Public Safety*** – Includes Police, Fire, and Marine Safety activities. This includes the public safety contracts for OCSD and OCFA and related costs for those operations.

- ***Community Development*** – Includes Building, Planning, Code Compliance, and the related Administration responsibilities.

- ***Public Works*** – Includes Engineering, Facility Maintenance, Beach Maintenance, Parks Maintenance, and Administration. Activities include Development, Traffic, Streets, street related items (slurry seal, street maintenance) and Emergency Planning. A portion of these costs are recovered from charges to other funds.

- ***Beaches, Parks and Recreation*** – Includes Recreation and Administration. Activities include Aquatics, recreation programs and events, recreation classes, and sports park operations.

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are restricted by law or administrative action to expenditures for specified purposes.

Capital Project Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed through proprietary funds).

Debt Service Funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs other than capitalized leases and compensated absences which are paid from the governmental funds. The only debt service fund of the City (Negocio Debt Service Fund) was closed in FY 2017-18.

Proprietary Funds:

Enterprise Funds are used to account for operations that are financed and operated in a manner similar to a private business enterprise. The intent of the City in using this type of fund is to determine that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Internal Service Funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the City, or to other governments, on a cost reimbursement basis.

Proprietary Funds

Enterprise Funds	*Internal Service Funds*
Water Fund	Central Services
Sewer Fund	Information Technology
Storm Drain	Fleet
Clean Ocean	Medical Insurance
Solid Waste	Workers' Compensation
Golf Course	General Liability

Additionally, Council has requested staff to bring back information on the potential to create an Endowment Fund to provide long term funding for City operations.

Endowment Fund and Activities:
The City of San Clemente is exploring the creation of an endowment fund to pay ongoing costs related to City operations. Based on IRS Publication 526, charitable contributions can be made to qualified organizations which include foundations, trusts, war veterans' organizations, fraternal societies, nonprofit cemetery companies, the United States or any state and its subdivisions. The City of San Clemente is considered a subdivision of the State of California. However, donations to government agencies must be voluntary and for public purposes.

A fund is not a separate legal entity. A separate fund would need to be created and its creation would need to address the purpose, use, and the creation or structure for the funds activities. If funds were left as part of an estate the treatment may be different than if the City created an endowment through a 501 (c)3 organization formed or if Council just created a separate fund.

Depending on the structure the endowment, investment restrictions placed on funds held could vary. Estate assets could be governed by probate law and a non-profit may be able to set up a separate investment policy, and City assets would probably be subject to governmental investment restrictions. Staff reviewed all Orange County city financial statements and identified two Cities which currently have Endowment or Permanent Funds. These cities were Irvine and Newport Beach and the funds were created to address specific activities or services. Irvine's endowment provides support for Senior Services, while Newport Beach's two funds are for technology and Newport Bay dredging. It appears as though these are set up through Estate donations, however additional research would need to be completed in order to determine the structure. No other Orange County cities reported these type of funds in their financial statements.

The City of San Clemente receives regular assistance from a variety of existing non-profits, including the Friends of San Clemente, the Pier Pride Foundation and Pet Project Foundation. These non-profits rely primarily on fundraisers and utilize the proceeds to assist the City in a variety of areas. Donations are then passed through these non-profits to the City to fund specific amenities, additional services and assistance. Some activities funded in the past by these non-profits include providing assistance to individuals taking recreation classes, providing funding for capital projects, and providing assistance in operations, such as at the animal shelter through funding of a dog trainer contract. The City also has an agreement with the Casa Romantica Cultural Center for the operational use of Casa Romantica which allows the organization to fundraise and put on cultural activities.

The City also has a donation program commonly referred to as the CARE/Wishbook program. This allows individuals or groups to donate funds for a community need or public purpose. The donations, based on City policy, are not for specific items; however, staff does their best to accommodate individual wishes and to fund various items. In the past these donations have been utilized to fund assistance for recreation classes, events, activities and other specific items, including memorial benches.

If the City Council would like to pursue the creation of an Endowment, staff will need to involve the City attorney to better address its creation or formation considerations. For example, creating a non-Estate endowment through a separate 501 (c)3 non-profit organization would involve various considerations. These would include the composition of the Board, control of the organization, investment policies, and other administrative filings with the State. Also, depending on the oversight and control by City Council, the organization and its funds may or may not need to be reported in the City's financial statements. The reporting would be dependent on the financial reliance on the City and the City oversight or governance. If the organization is dependent, integrated, or provides oversight the entity would need to be reported in the City Financial statements. The less control of the organization that can be imposed by the City Council the less the likelihood of the inclusion in the financial statements.

Recommendation:
Staff is seeking Council direction as to the creation of an endowment.

Financial Trend Analysis

Objective

A number of financial indicators are analyzed utilizing the International City Management Association's (ICMA) guidelines contained in "Evaluating Financial Condition". The analysis of these indicators is designed to present information on the fiscal health of the City of San Clemente as part of the Long Term Financial Plan. This annual Financial Trend Analysis focuses on the City's General Fund.

Background

The City's financial trends are analyzed annually with many factors considered in order to understand 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 desired level of services currently and as the City continues to grow;
- Fund balances and debt levels and their impact upon current City financial resources.

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 have been considered in connection with this analysis.

Data used in developing this financial trend report was drawn from the City's Comprehensive Annual Financial Reports for FY 2016-17 through FY 2020-21. Consequently, all trends are based on data available as of June 30, 2021 and do not incorporate any changes that have occurred since that time.

Executive Summary

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. The 22 trends have been categorized into five basic categories:

1) Revenues
2) Expenditures
3) Operating Position
4) Debt/Unfunded Liability
5) Community Indicators

One of the following ratings has been assigned to each of the twenty-two indicators:

Favorable (F):	This trend is **positive** with respect to the City's goals, policies, and national criteria.
Favorable (Caution) (F/C):	This rating indicates that a trend is in compliance with adopted fiscal policies or anticipated results. This indicator may change from a positive rating in the near future.
Warning (W):	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.
Unfavorable (U):	This trend is negative, and there is an immediate need for the City to take corrective action.

A summary of the indicators analyzed and the rating assigned to each is listed below. The past five trend reports are presented and identify strengths and weaknesses of the City's financial condition and illustrate any positive or negative changes.

			LTFP		
INDICATORS	**FY 2022**	**FY 2021**	**FY 2020**	**FY 2019**	**FY 2018**
REVENUE:					
Revenue Per Capita	**F/C**	F/C	F	F	F
Property Tax Revenues	**F**	F	F	F	F
Elastic Revenues	**F/C**	F/C	F	F	F
Sales Tax Revenues	**F**	F	F	F	F
Permits & Business License Revenues	**F/C**	F/C	F/C	F/C	F/C
Comm. Develop. Charges	**F/C**	F/C	F/C	F/C	F/C
Intergovernmental Revenues	**F**	F	F	F	F
One-Time Revenues	**F**	F	F	F	F
Revenue Overage	**F**	F	F	F	F
EXPENDITURE:					
Expenditures Per Capita	**F**	F	F	F	F
Expenditures by Function	**F**	F	F	F	F
Employees Per Capita	**F**	F	F	F	F
Fringe Benefits	**F/C**	F/C	F/C	F	F
Capital Outlay	**F**	F	F	F	F
OPERATING POSITION:					
Operating Surplus (Deficit)	**F/C**	W	F/C	F/C	F/C
Unrestricted Fund Balance	**F/C**	F/C	F	F	F
Liquidity Ratio	**F**	F	F	F	F
DEBT/UNFUNDED LIABILITY:					
Debt Service	**F**	F	F	F	F
Accumulated Comp Absences	**F**	F	F	F	F
Pension Unfunded Liability	**F/C**	W	U	N/A	N/A
COMMUNITY:					
Population	**F**	F	F	F	F
Property Values	**F**	F	F	F	F

Overview of the City's Financial Condition

The 2022 Long Term Financial Plan includes the analysis of twenty-two trends. Of these 22 trends, 9 are revenue trends, 5 are expenditure trends, 3 relate to operating position, 3 relate to debt service/unfunded liability and 2 relate to the community's needs and resources. The current year results improved from the previous year, as two indicators change from Warning to Favorable/Caution. This increase is due in part to State and Federal guidelines easing the pandemic business and travel restrictions during the latter part of FY 2021. The City has also been able to reassess and increase the payment to the Unfunded Pension Liability with savings from personnel, contractual services and capital outlay costs over the prior year. This year eight indicators received a Favorable/Caution rating, and fourteen received a Favorable rating. Information by Category is discussed in the following section.

Rating discussion by Trend Indicator Category

Revenue Category:

Nine trend indicators address revenues. Five of the trends are Favorable, four are Favorable/Caution, and all nine indicators remained the same with the prior year.

Changes in revenue indicators reflect the City seeing increases in revenues due to the easing some of COVID-19 pandemic business and travel restrictions in the latter part of FY 2020-21. *Revenues Per Capita*, *Elastic Revenues*, *Permits/Business License Revenues,* and *Community Development Charges* remain at Favorable/Caution, since some uncertainty still surrounds the pandemic and its ongoing effects on the economy.

During the pandemic, the City implemented cost saving measures and left certain positions unfilled to address revenue impacts. The City also took additional action by funding the Disaster Relief fund, utilized COVID Relief funding, and presented financial information frequently due to the current economic uncertainty.

Expenditure Indicators:

Five trend indicators address expenditures. Four of the trends are Favorable, and one trend remains Favorable/Caution.

Fringe Benefits remain a Favorable/Caution rating as fringe benefits, as a percentage of salaries, increased due to the additional payments made toward the unfunded pension liability. Although anticipated, the City will monitor fringe benefits to make sure the percentage of fringe benefits to salaries and wages levels out in the near future.

Operating Position Indicators:

Three Trend Indicators address operating position. One trend is Favorable and two trends are Favorable/Caution. One of the trends transitioned during the last year, from Warning to Favorable/Caution.

The *Operating Surplus (Deficit)* improved to a Favorable/Caution rating due to a larger surplus in FY 2020-21. During the last year, revenues in sales and property taxes increased and expenditure savings were realized in personnel, contractual services and capital outlay. In the past, revenue overages and budget savings assisted in building up fund balance. However, the City used a portion of the operating surplus to pay down the unfunded pension liability in FY 2021.

Consequently, the *Unrestricted Fund Balance* indicator remains Favorable/Caution as the normal build-up of fund balance from the operating surplus was utilized and fund balance is still not at the levels achieved pre-pandemic.

Debt/Unfunded Liability Indicators:

Three trend indicators address debt/liabilities. Two of the trends are Favorable, while one of the trends transitioned from a Warning to a Favorable/Caution rating.

Pension Unfunded Liability changes from a Warning to a Favorable/Caution rating as the City is starting to see the results of efforts to pay down the unfunded pension liability. Additional payments are being made to improve the funded status and acheive the fiscal policy goal of 90% funded status. Additional contributions of $1.3 million to the CalPERS and CSCERP plans was completed in FY 2020-21.

Community Indicators:

Two Trend Indicators address community factors. Both remain Favorable, with no large changes in *Population* costs and *Property Values* remain solid, showing a stable community base. These trends are showing stability or equilibrium, with no significant service impacts or changes.

Conclusion of Trend Analysis

The City saw the majority of increases in property and sales tax revenue, which was due in part to State and Federal guidelines easing the pandemic business and travel restrictions during the latter part of FY 2021. The City continues to review the budget monthly at the department level and presents quarterly updated financial information to City Council. Currently, the City has incorporated cost saving measures through the budget, and is leaving certain positions unfilled to address challenges due to the pandemic. A portion of this expenditure savings is being used to pay down the pension unfunded liability, while operating position and fund balance remains unchanged.

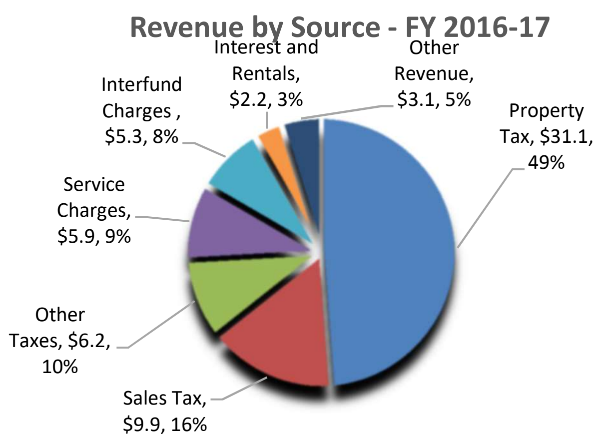
Analysis and discussion of the future outlook is in the upcoming Financial Forecast section.

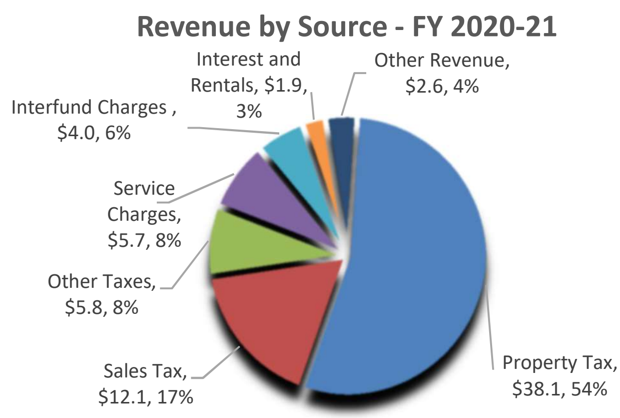
Revenue Trend Analysis

Overview of Revenues by Source:

The following is an overview of City revenue by source for FY 2016-17 and FY 2020-21. The following pages provide an analysis of the actual nine revenue trend indicators in detail.

Comparison of Revenues by Source
FY 2016-17 vs. FY 2020-21
(in millions)





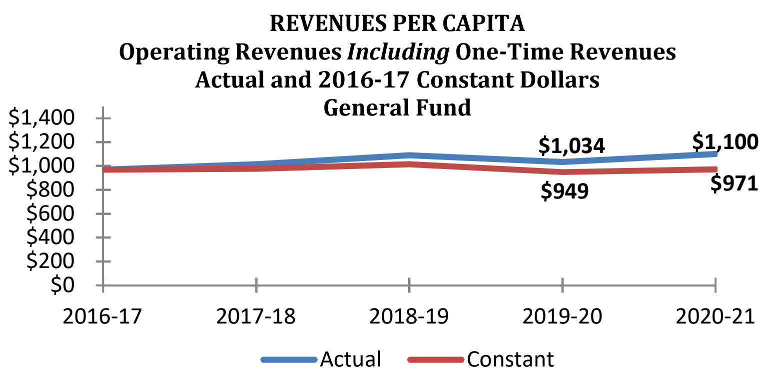
The above pie charts compare the current revenue sources amounts to those five years ago. Analysis of these changes are presented below:

- Property taxes, during the five-year period, increased due to assessed valuation growth and the build-out of Talega and the Sea Summit developments.
- Sales taxes increased due in part to the addition of the Outlets at San Clemente and also the *Wayfair* Decision in FY 2017-18.
- Other taxes decreased from $6.2 million to $5.8 million. Although business license tax receipts and franchise fees increased by $75,394 and $6,543 respectively; transient occupancy tax receipts decreased by $491,833 in FY 2020-21 due to the COVID-19 pandemic travel restrictions in place during the first half of the fiscal year.
- Service Charges decreased from $5.9 million in FY 2016-17 to $5.7 million in FY 2020-21, due to decreased construction inspection fees, recreation service charges, plan check fees, and parking meter permits and fees due to restrictions imposed during the COVID-19 pandemic.
- Other revenue decreases were due to decreases in construction permits of $0.3 million and a decrease in fines and forfeitures from $0.5 million in FY 2016-17 to $0.3 million in FY 2020-21 due to decreases in parking violations and vehicle code fines.
- Interfund charges decreased from FY 2016-17 to FY 2020-21. The general fund overhead allocation plan increased, however transfers and principal from advances decreased by a greater amount over the 5-year period.
- Decrease in Interest and Rentals from $2.2 million in FY 2016-17 to $1.9 million in FY 2020-21 is due to a decrease unrealized gain on investments in FY 2020-21 and a decrease in rents and commissions due to restrictions from the COVID-19 pandemic.

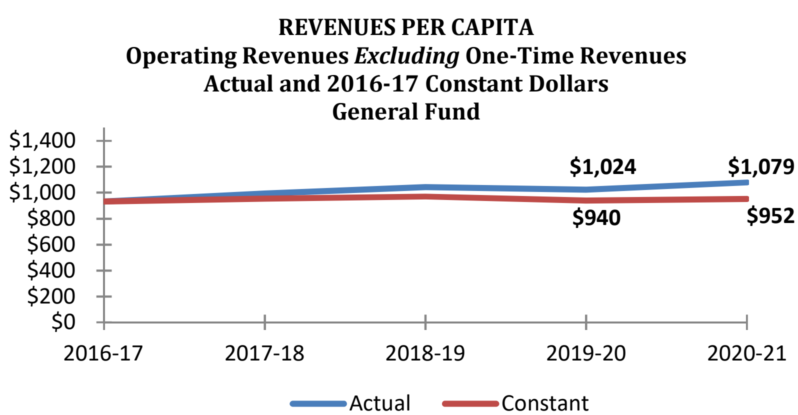
Revenue Trend Analysis

Indicator: *Revenues Per Capita*

Comments:
The first chart (which includes one-time revenues) shows an increase from $1,034 to $1,100 in actual dollars and a corresponding increase from $949 to $971 in constant dollars. Total revenues for Fiscal Year 2020-21 increased by $3.0 million from the prior year. While property, sales and other taxes, service charges, interfund, and other revenues saw an increase over the prior year, all other categories of revenues decreased. Revenue categories with the most significant increases include sales tax (19%), property tax (6%), and service charges (8%), while the revenue categories with the most significant decreases include interest and rentals (38%) and Intergovernmental (15%).



The second chart (which excludes one-time revenues) shows an increase in actual dollars from $1,024 to $1,079 and constant dollars increase from $940 to $952. 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 in accordance with the City's Fiscal Policy.



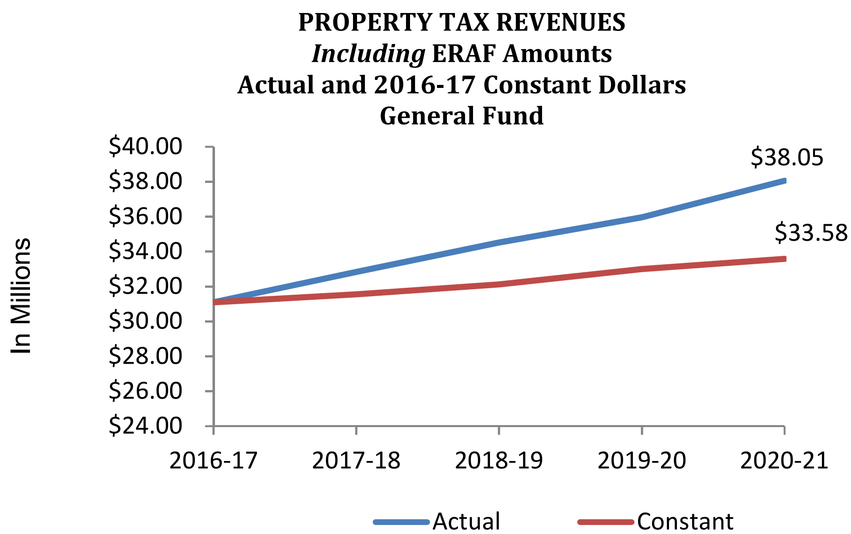
Status: *FAVORABLE/CAUTION*
Although increases are seen in revenues over the prior period, this trend remains a Favorable/Caution rating, as the City uptrend is only for one year and the City is still uncertain of the long-term impacts of the COVID-19 pandemic.

Revenue Trend Analysis

Indicator: *Property Tax Revenues*

Comments:
The chart below shows property tax revenues increasing from $35.96 million to $38.1 or 6% in actual dollars, and from $33.0 million to $33.6 million or 2% in constant dollars.

Property taxes have increased over the past year due mainly to the continued growth in assessed values as a result of development and a strong housing market. Property taxes show continued stable growth over the five-year trend period.



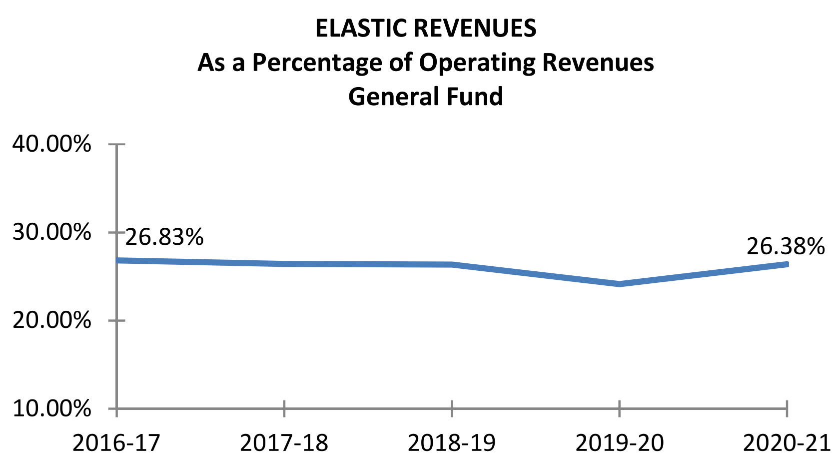
Status: *FAVORABLE*
This indicator remains Favorable due to a stable growth rate over the past five years.

Revenue Trend Analysis

Indicator: *Elastic Revenues (Sales Tax, Transient Occupancy Tax, Permits and Business License Taxes, and Community Development Service Charges)*

Comments:
Elastic revenues are revenues that are highly responsive to changes in the economy and inflation. The City has classified Sales Tax, Transient Occupancy Tax, Permits and Business License Tax, and Community Development Service Charges as Elastic revenue, because these revenues are the most sensitive to economic factors.

Elastic revenues increased by 14% from the prior year, and net operating revenues increased by 5%; causing Elastic revenues, as a percentage of total revenues, to increase from 24.13% in FY 2019-20 to 26.38% in FY 2020-21. Certain individual revenue indicators, which comprise the elastic revenues category, are examined further on the following pages.



Status: *FAVORABLE/CAUTION*
This indicator remains a Favorable/Caution rating. Although there is a one-year increase over the prior year, due to the current uncertainty surrounding the COVID-19 pandemic, these revenues need to be monitored over the next few years, since they are highly responsive to changes in the economy and inflation.

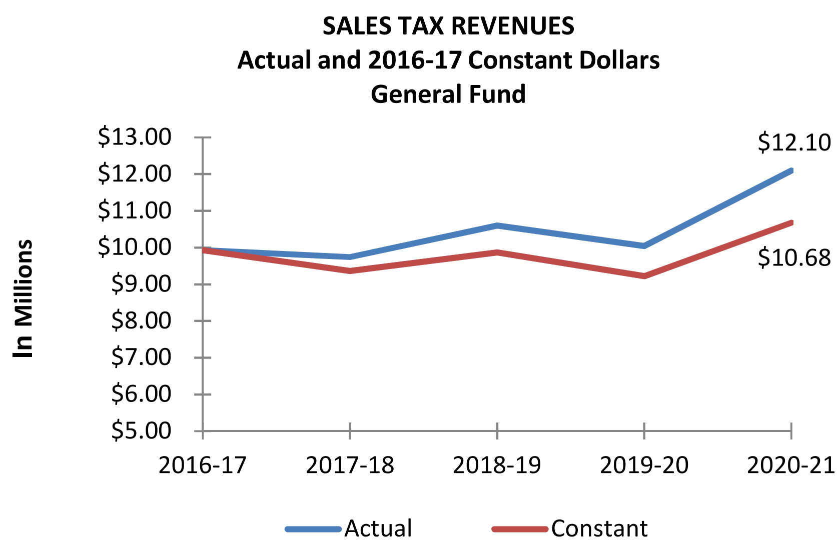
Revenue Trend Analysis

Indicator: *Sales Tax Revenues*

Comments:
As summarized in the chart below, sales tax revenues show an increase of $2.1 million, or 20.5% in actual dollars over the prior fiscal year. In constant dollars, there was an increase of $1.5 million, or 15.9% for FY 2020-21.

Sales tax receipts amount to $12.1 million, compared to $10.0 million in the prior year. This increase is partially due to the *Wayfair* decision, and the City taking proactive strides to accommodate restaurants and other business activity. The sales tax increase is also a result of higher activity levels as businesses and activities adjust after the initial release of pandemic shutdowns and restrictions in the later part of FY 2020-21.

The City receives 1% of the State Sales Tax charged in San Clemente.



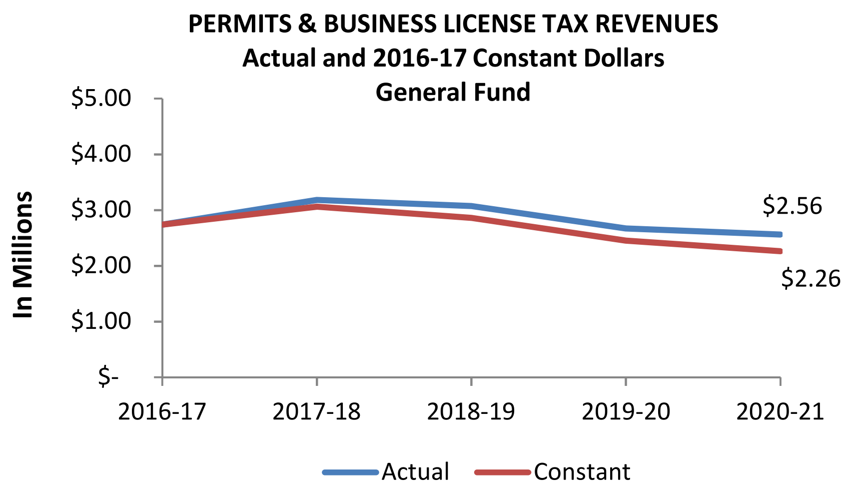
Status: *FAVORABLE*
This indicator remains a Favorable rating due to the large increase over the prior year.

Revenue Trend Analysis

Indicator: *Permits & Business License Revenues*

Comments:
Permits and Business License Tax revenues decrease in actual dollars in the amount of $110,255 or 4.1% from the prior fiscal year. The constant dollar decrease was $191,379 or 7.8% from FY 2019-20.

Construction permit revenue decreased $92,352, or 7.1% over the past year, which coincides with the decrease in construction activity in the current year. Business license tax revenue decreased by $44,625 or 3.8% from FY 2019-20 due to lower gross receipts and activity being reported by business owners in the current year due to the COVID-19 pandemic. Nonbusiness licenses and permits increases by $26,720 or 14.1%, mainly due to an increase in street encroachment permits.

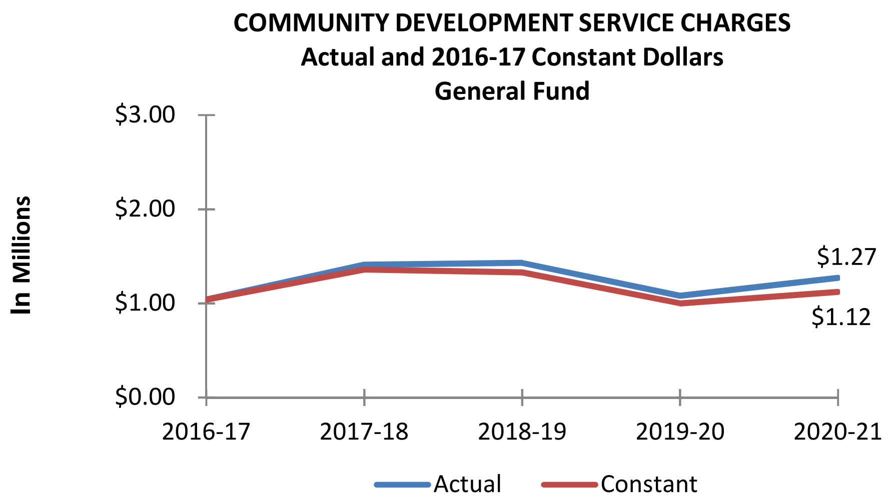


Status: *FAVORABLE/CAUTION*
Permits and Business License Tax maintains a Favorable/Caution rating, due to the decreases over the past three fiscal years. This indicator is currently being monitored and actions to facilitate permit activity as COVID-19 pandemic restrictions are considered.

Revenue Trend Analysis

Indicator: *Community Development Service Charges Revenues*

Comments:
Total community development service charges increased by 17%, or $184,498 from the prior year. There are increases in both total general government service charges and construction inspection fees in the amounts of ($99,404) and ($85,094) respectively.

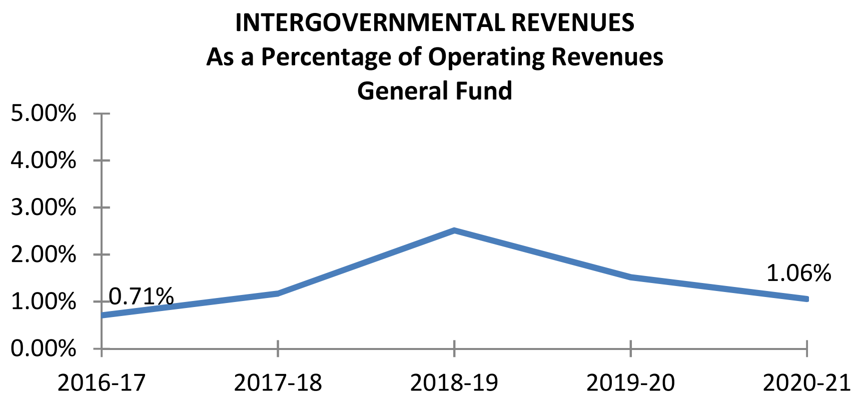


Status: *FAVORABLE/CAUTION*
Although this trend increased over the prior year, it remains a Favorable/Caution rating due to the uncertain economy surrounding the COVID-19 pandemic. The City continues to monitor these revenue sources, mainly consisting of business and permit fees, as they are highly responsive to changes in the economy and inflation.

Revenue Trend Analysis

Indicator: *Intergovernmental Revenues*

Comments:
General Fund Intergovernmental revenues, as a percentage of operating revenues decreased to 1.06% in FY 2020-21. Intergovernmental revenues decreased from $1.0 million in FY 2019-20 to $0.7 million in FY 2020-21. This decrease is mainly due to the completion and State reimbursement of the Safe Routes to Schools grant of $0.3 million in FY 2019-20. By analyzing intergovernmental 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.



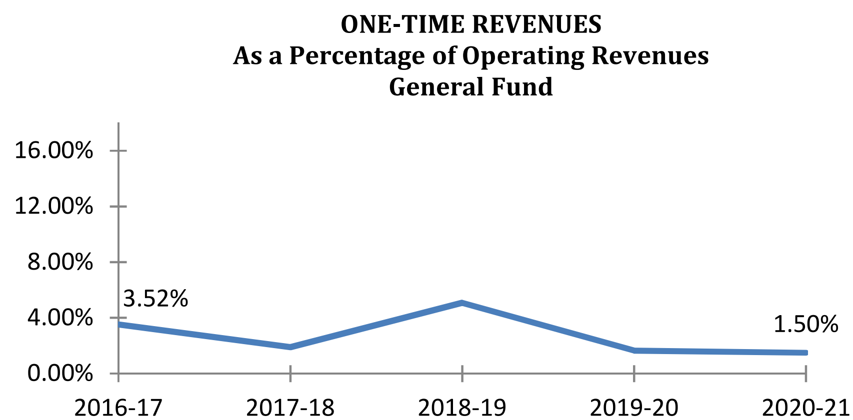
Status: *FAVORABLE*
This trend remains Favorable since the City receives a low percentage of revenues from other governmental agencies. When considering in-lieu property taxes totaling $7.6 million, the intergovernmental percentage would be 11.5% in FY 2020-21, which still supports the Favorable rating. The City has also placed COVID relief amounts in a separate fund to limit ongoing impacts or costs being charged to the General Fund.

Revenue Trend Analysis

Indicator: *One-Time Revenues*

Comments:
One-time revenues, as a percentage of total General Fund revenues, equaled 1.50% in FY 2020-21, a decrease over the prior year.

One-time revenues decreased by $51,678 or 4.7% from the prior fiscal year. FY 2020-21 one-time revenues of $1,049,659 include, $563,855 of grant funds, $194,856 from miscellaneous reimbursements, a transfer of $691 from Miscellaneous Grants Fund to reimburse capital related costs, and $290,250 for principal from advance. In accordance with the City's Fiscal Policy, one-time revenues are not utilized to fund ongoing operating expenditures.



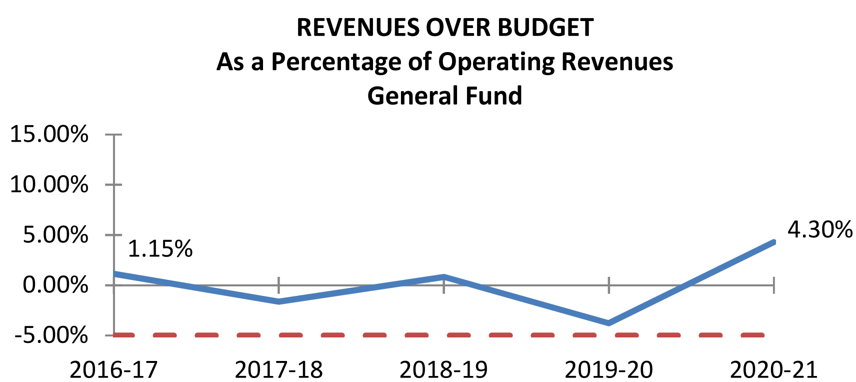
Status: *FAVORABLE*
This indicator continues with a Favorable rating, due to the City policy of not utilizing one-time revenues to fund ongoing operating expenditures. The City is not dependent on one-time revenues, which can be seen by them representing a low percentage of revenues throughout the past five years.

Revenue Trend Analysis

Indicator: *Revenues over Budget*

Comments:
Actual revenues were higher than the adjusted budget by $3.0 million for FY 2020-21 and ends with a positive revenue position of 4.30%. The City experienced revenues overages in taxes of $2.9 million, licenses and permits of $121,480, and charges for services of $893,152. The City has also experienced the largest budget shortages in intergovernmental ($0.8 million), Investment and rentals ($0.3 million), and fines and forfeitures ($0.1 million).

This trend began the five-year analysis with a positive revenue position of 1.15% and ended FY 2020-21 at a positive of 4.30% In order to accurately forecast revenues, the City monitors revenues through the annual budget and long term financial planning processes. The City continues to budget and receive revenues within the expected 5% range.



Status: *FAVORABLE*
The City ended this five-year trend in a positive revenue position, within the 5% expected range; therefore, this trend remains a Favorable rating.

Expenditures Trend Analysis

Overview of Expenditures by Function and Category:

The following is an overview of the expenditures by function and category for fiscal years 2016-17 and 2020-21. Following this overview are the actual five trend expenditure indicators.

The table below compares the FY 2016-17 General Fund expenditures by function to FY 2020-21. Increases are seen in Public Safety, Community Development, and Public Works; with decreases in General Government, and Beaches, Parks, and Recreation.

Comparison of Expenditures by Function
FY 2016-17 vs FY 2020-21

Expenditure Function	FY 2016-17	FY 2020-21	Difference	% Change
General Government	$ 13,761,839	$ 11,253,040	$ (2,508,799)	-18%
Public Safety	24,500,427	30,955,460	6,455,033	26%
Community Dev.	4,704,740	5,873,424	1,168,684	25%
Public Works	14,239,637	15,957,544	1,717,907	12%
Beaches, Parks & Rec	4,828,046	4,195,666	(632,381)	-13%
Total Expenditures	$ 62,034,690	$ 68,235,134	$ 6,200,444	10%

The largest dollar increases were in Public Safety and Public Works. These two are discussed in the following bullet points:

- General Government decreased by $2.5 million or -18%. General Government decreased over the five-year period due mainly to a one-time transfer of $2.1 million from the General fund to Facilities Maintenance fund and one-time unfunded liability payment of $594,000 in FY 2016-17.
- Public Safety increased by $6.5 million or 26% due to increases in the contract costs for both police and fire services over the five-year period. This change also includes the increase of the 4th firefighter/paramedic, higher ambulance service levels, as well as increases in Marine Safety services.
- Public Works increased by $1.7 million or 12% which is mostly due to moving the Beaches, Parks, and Recreation maintenance into Public Works. The net increase between the two functions is $1.1 million or 6%. This is mostly due to increases in utility charges as well as changes made to maintenance contracts, and other contractual services.
- Community Development increased by $1.2 million or 25% due to increases in salaries and benefits costs over the five-year period and the addition of Park Rangers to the Code Enforcement department in FY 2021.

The following table compares expenditures by category and shows increases in personnel, contractual services, and other charges, and decreases in supplies, capital outlay, and interfund payment expenditure categories between FY 2016-17 and FY 2020-21.

Comparison of Expenditures by Category
FY 2016-17 vs FY 2020-21

Expenditure Category	FY 2016-17	FY 2020-21	Difference	% Change
Personnel	$ 15,997,310	$ 17,873,111	1,875,801	12%
Supplies	1,104,946	937,670	(167,276)	-15%
Contractual Services	30,596,352	37,118,209	6,521,857	21%
Other Charges	1,821,060	2,834,427	1,013,367	56%
Capital Outlay	3,678,835	2,441,650	(1,237,185)	-34%
Interfund Payments	8,836,187	7,030,067	(1,806,120)	-20%
Total Expenditures	$ 62,034,690	$ 68,235,134	$ 6,200,444	10%

The largest increases were in contractual services and personnel costs. Information on the changes follow:

- Personnel (salary and benefits) increased 12% over the five-year period. The 12% increase (or 2-3% annually) is a result of COLA and benefit changes over the five-year period. Personnel and benefit costs were mitigated by controlling position growth (FTE's) and reassessment of positions as vacancies occur.
- Contractual Services increased by 21% or $6.5 million from FY 2016-17 to FY 2020-21 reflecting increases in contractual services for Police ($2.1 million), Fire ($2.0 million), ambulance services ($337,160), maintenance services ($0.8 million), other professional services ($283,383), and legal services ($543,982) from FY 2016-17 to FY 2020-21.

Other changes reflect the following:

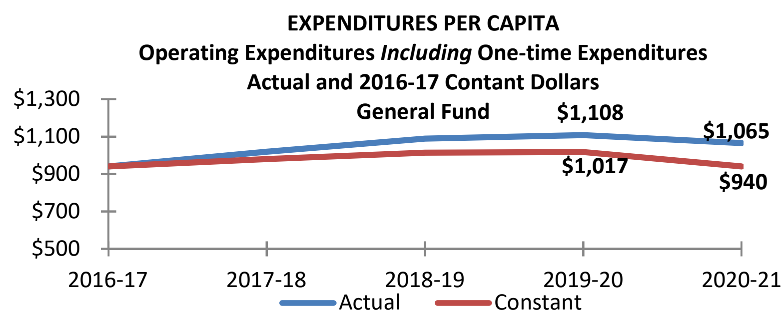
- Other Charges increased by 56% or $1.0 million due to an increase in the unfunded police and fire public safety CalPERS liability ($1.3 million) in FY 2020-21.
- Interfund payments decreased by 20% or $1.8 million. This decrease is due to one-time transfers to Accrued Leave and Facilities Maintenance funds in FY 2016-17 for the removal of the sustainability fund balance as approved by the FY 2015-16 LTFP.
- Capital decreased 34% or ($1.2 million) from FY 2016-17 to FY 2020-21, reflecting decreases in improvements other than buildings, major maintenance improvements, slurry seal program, and capital studies during the five-year period. Improvements other than buildings decreased over the five-year period as capital activity was reduced due to the pandemic. In FY 2016-17 projects included sidewalk projects, 800 MHZ Radio project, Ole Hanson Beach Club and the Pier Structural Construction projects. Several major maintenance improvements also completed; included Maintenance Rehabilitation program and North Beach Opportunistic Sand Replenishment in FY 2016-2017. The Slurry Seal program cost decreased due in part to a change of materials used and a decrease in staff in the Engineering division. Capital studies in FY 2016-17 included the Shoreline Feasibility study and City-Wide Tree Inventory.

Expenditures Trend Analysis

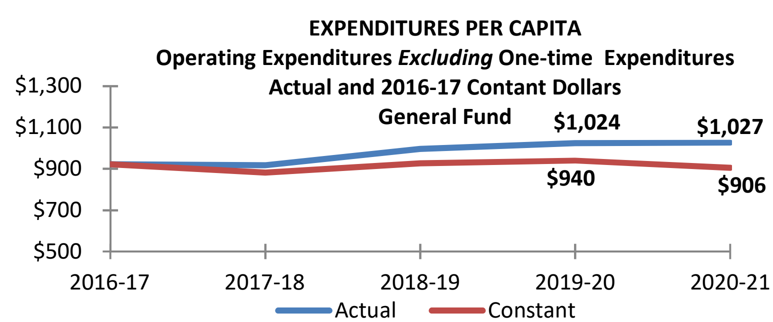
Indicator: *Expenditures Per Capita*

Comments:

The first chart, which includes one-time expenditures, shows a decrease from $1,108 to $1,065 in per capita actual dollars and a decrease from $1,017 to $940 in per capita constant dollars. This reflects the decrease in actual dollars of $3.3 million and the decrease in constant dollars of $5.4 million when compared to FY 2019-20. The decrease in actual dollars was mainly in General Government ($2.8 million), and Public Works ($0.4 million). The decrease in General Government is due to decreases in personnel costs ($290,556), legal services ($431,723); completion of the City Hall renovation project ($1.2 million), and transfers to other funds ($0.5 million) in FY 2020-21. The decrease in Public Works is due to decreases in maintenance services ($351,490), other contractual services ($288,820), and personnel costs ($163,059).



The second chart (which excludes one-time expenditures) shows an increase in actual dollars from $1,024 to $1,027, and a decrease in constant dollars from $940 to $906. One-time expenditures include one-time transfers to Facilities Maintenance reserve ($0.6 million), Clean Ocean ($333,000), Park Asset Maintenance ($200,000), Air Quality ($70,870) and to Affordable Housing fund ($66,393). Other one-time funds of $1.1 million, includes funds for 910 Calle Negocio Remodel, Pier Structural Construction, Shoreline Feasibility Study, End of Pier Restroom, Trafalgar Canyon Bridge rehabilitation, Del Mar Electrical Services and Tree remodel, and Rancho San Clemente Park Light Poles and Fixtures replacement projects, a one-time pension payment and special election fees.



Status: *FAVORABLE*

Expenditures per capita (including one-time expenditures) reflect a decrease when analyzing actual dollars over the prior fiscal year. Changes in per capita expenditures reflect the changes in expenditures relative to changes in the population.

This trend remains favorable because expenditures per capita have remained fairly stable over the five-year period.

Expenditures Trend Analysis

Indicator: *Expenditures by Function*

Comments:
Expenditures by function, as a percentage of the total General Fund expenditures (excluding debt service, interfund transfers, and capital outlay) shows that while all of the functional expenditures have increased except Beaches, Parks and Recreation, the percentage of total General fund expenditures have remained fairly-stable. The chart below indicates that the largest percent fluctuations are in General Government (-1%), Public Safety (1%), Public Works (1%), and Beaches, Parks, and Recreation (-1%).

When looking at the table, General Government decreased from 16% in FY 2016-17 to 15% in FY 2020-21. In actual dollars, General Government increased by $866,820. Public Safety increased from 46% in FY 2016-17 to 47% in FY 2020-21. In actual dollars, Public Safety increased by $4.6 million, or 19%. Community Development remained at 9% in both years, with an actual increase of $1.2 million or 25% over the five-year period. The Beaches, Parks, and Recreation category decreased from 8% to 7% in FY 2020-21 reflecting actual decreases in the recreation program during the period because of shifting of park maintenance to public works.

Comparison of Expenditures by Function
(Excluding debt service, interfund transfers, and capital outlay)
FY 2016-17 vs. FY 2020-21

Expenditure Function	FY 2016-17	% of Total 2016-17	FY 2020-21	% of Total 2020-21	Total Change
General Government	$ 8,256,625	16%	$ 9,123,445	15%	-1%
Public Safety	24,500,427	46%	29,102,925	47%	1%
Public Works	11,260,393	21%	13,829,387	22%	1%
Community Dev.	4,682,477	9%	5,873,424	9%	0%
Beaches, Parks & Rec	4,464,807	8%	4,195,666	7%	-1%
Total Expenditures	$ 53,164,730	100%	$ 62,124,848	100%	

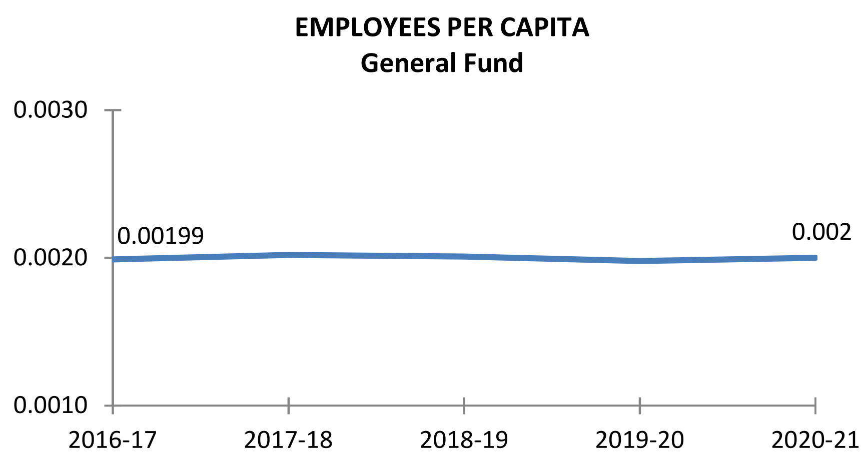
Based on this analysis, no single department is requesting significantly more resources, which would cause it not to be sustainable from a functional perspective.

Status: *FAVORABLE*
This trend remains a Favorable rating because when comparing the percentage of total expenditures change from FY 2016-17 to FY 2020-21, there is no single department requesting significantly more resources, which would cause it not to be sustainable from a functional perspective.

Expenditures Trend Analysis

Indicator: *Employees per Capita*

Comments:
Employees per capita have remained relatively stable over the last five years. This trend provides a perspective of how the City's workforce is in relation to population changes. This trend only includes general operations staff, which does not include the City's utilities staff or contracted police, fire, animal control and fleet employees. On a per capita basis general operations staff have remained essentially flat over the five-year period.



Status: *FAVORABLE*
This indicator is awarded a favorable rating as growth in Full Time Equivalents (FTE's) have remained consistent with populatin. This trend will be closely monitored to insure the City's ability to support current and future service levels.

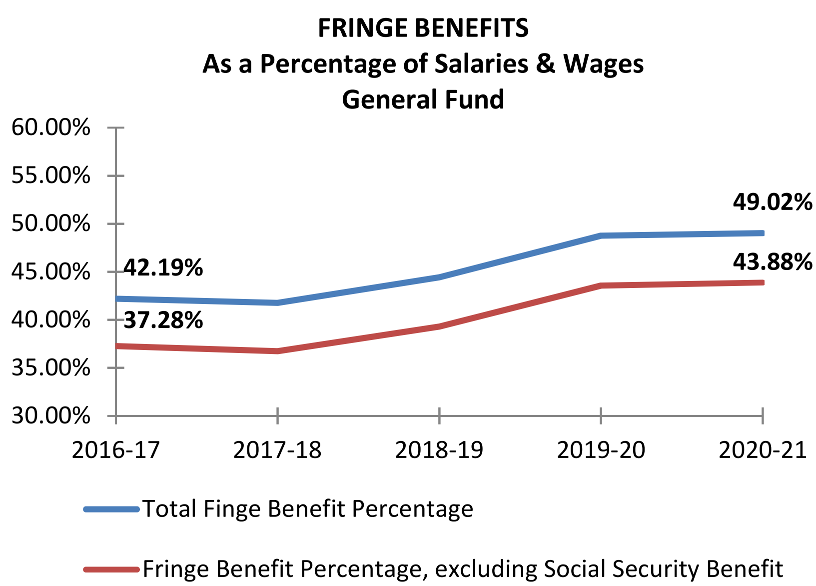
Expenditures Trend Analysis

Indicator: *Fringe Benefits*

Comments:
Fringe benefits (including social security benefits), as a percentage of General Fund salaries and wages, increased from 48.7% to 49.0%. Fringe benefits (excluding social security benefits) show a corresponding increase when compared to FY 2019-20. The actual amounts of General Fund benefits decreased from $6.1 million in FY 2019-20 to $5.9 million in FY 2020-21, a 3% decrease from the prior year. General Fund salary and wages were $12.5 million in FY 2019-20 and $12.0 million in FY 2020-21, which is a decrease of 4%.

This slight decrease was due mainly to a decrease in salaries and benefits as several long-time employees retired during FY 2020-21.

Employees are now contributing the full 7% employee contribution rate to the CalPERS plan.



Status: *FAVORABLE/CAUTION*
This trend remains a favorable/caution rating as the City continues to make additional payments toward the unfunded pension liability. This trend continues to be monitored for a lowering fringe benefit percentage as the pension liability lowers in future years. This change would create a Favorable rating.

Expenditures Trend Analysis

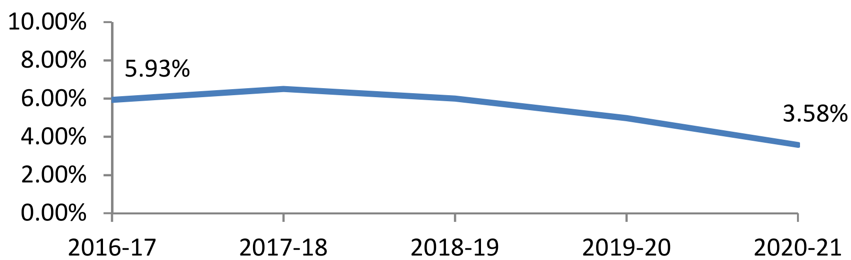
Indicator: *Capital Outlay*

Comments:
The Capital Equipment Replacement Reserve was established in FY 1994-95. This reserve fund ensures that obsolete and worn equipment is replaced in accordance with the City's preventive maintenance program.

Capital outlay expenditures decreased by $1.1 million, or 31.5%, from FY 2019-20. Capital outlay expenditures totaled $2.4 million.

Spending on capital outlay decreased as the Bonita Canyon and Vista Bahia Park Restroom Rehabilitation, the City Hall renovation, and Shoreline Feasibility study projects were completed in FY 2019-20.

CAPITAL OUTLAY
As a Percentage of Operating Expenditures
General Fund



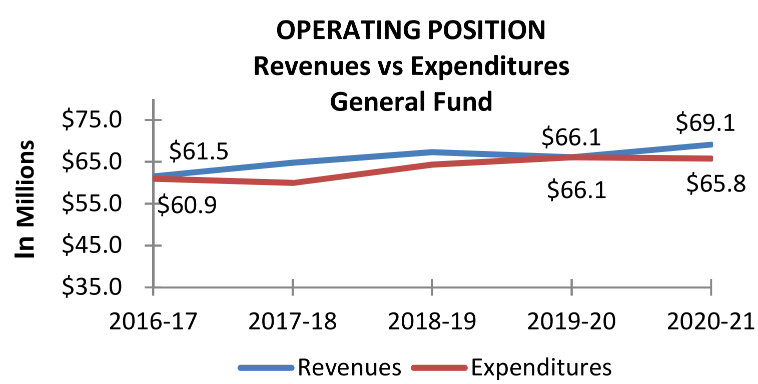
Status: *FAVORABLE*
This trend remains a Favorable rating due to the slight decreases over the last three fiscal years and the trend percentage flattening.

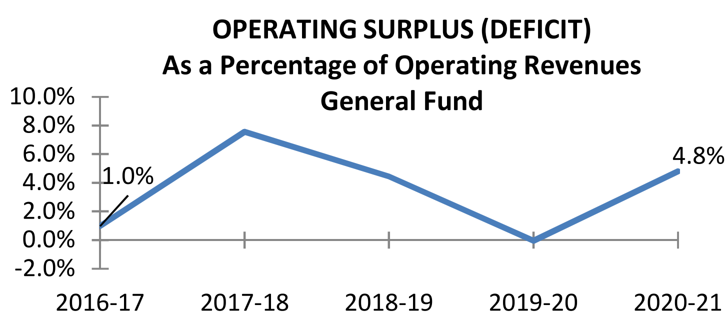
Operating Position Trend Analysis

Indicator: *Operating Surplus (Deficit)*

Comments:
Fiscal year 2020-21 ended with a positive operating position (surplus). An operating surplus is when revenues exceed expenditures, conversely when expenditures exceed revenues there is an operating deficit.

Revenues used to calculate the operating position do not include one-time transfers and revenues of $1.0 million, which includes $563,855 of grant revenue, $194,856 in miscellaneous one-time revenues $691 in transfers, and principal from advance of $290,250. Expenditures used to calculate this surplus do not include one-time capital costs of $0.5 million including $0.3 million for the 910 Calle Negocio Remodel project, $95,586 for End of Pier Restroom rehab, $40,152 for Rancho San Clemente Park Light Poles and Fixture replacement project, $33,780 for Trafalgar Canyon Bridge rehabilitation, and $32,389 for Del Mar Electrical Service and Tree Model project; transfers from the General Fund to the Facilities Maintenance, Clean Ocean, Park Asset Maintenance, Air Quality, and Affordable Housing funds of $0.6 million, $333,000, $200,000, $70,870 and $66,393 respectively; and other projects of $0.7 million. This calculation of operating expenditures does not exclude $3.0 million of capital costs for yearly maintenance and improvements. The total operating position was positive $3.3 million in FY 2020-21, compared to a negative ($30,052) in FY 2019-20.





Status: *FAVORABLE/CAUTION*
This trend changes from a Warning to a Favorable/Caution rating due to the large increase FY 2020-21. This trend continues to be monitored monthly due to the uncertain economy surrounding the COVID-19 pandemic.

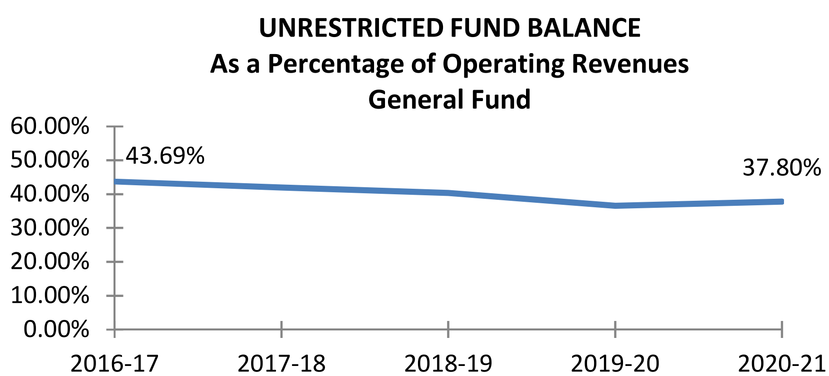
Operating Position Trend Analysis

Indicator: *Unrestricted Fund Balance*

Comments:
Unrestricted 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.

Unrestricted fund balance excluding long-term receivable reserves increased by 8% in FY 2020-21 from $24.6 million to $26.5 million. The City's General Fund maintains an unreserved fund balance, including Emergency Reserves, as a percentage of operating revenues. Even though Unrestricted fund balance increased in FY 2020-21, the City is still not up to the percentage of net operating revenues that it was before the pandemic.

Included within the total FY 2020-21 unrestricted fund balances of $26.5 million are committed funds of $14.4, which includes $13.6 million of emergency funding, and $0.7 million committed for other purposes. Also included is assigned to other purposes $6.4 million and unassigned fund balance comprises the remaining balance. The reserves are discussed in detail in the Reserve Analysis section of the LTFP.



Status: *FAVORABLE/CAUTION*
This trend remains a Favorable/Caution rating, as the normal build-up of fund balance by the end of the year operating surplus (deficit) did not contribute an increase to fund balance at the levels experienced pre-pandemic.

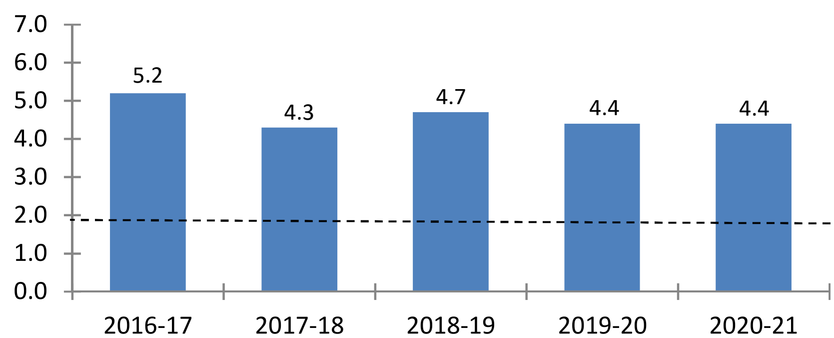
Operating Position Trend Analysis

Indicator: *Liquidity Ratio*

Comments:
In FY 2020-21, the City's liquidity ratio remains positive at 4.4:1. Credit rating firms consider a ratio of 1:1 Favorable. The City's 4.4:1 current asset to current liability ratio is considered excellent.

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 include accounts payable, accrued wages, accrued expenses and all obligations that can be immediately demanded for payment.

LIQUIDITY RATIO
Current Assets to Current Liabilities
General Fund

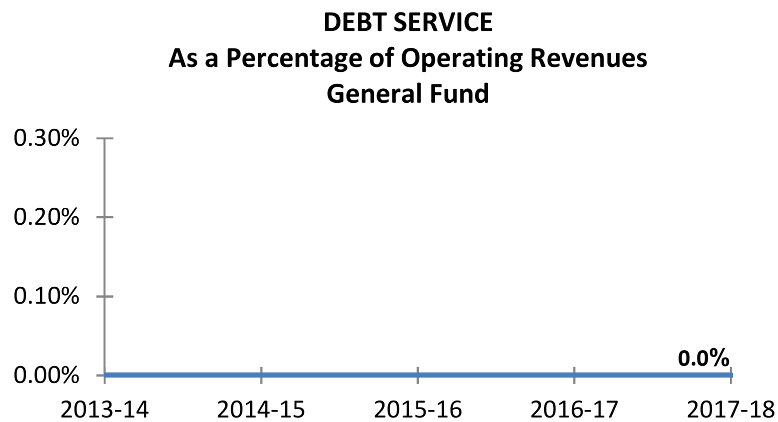


Status: *FAVORABLE*
This trend is favorable due to a ratio of over 1:1 throughout the past five-year period analyzed above.

Debt Service/Unfunded Liability Trend Analysis

Indicator: *Debt Service*

Comments:
The City does not include debt service payments in the General fund. Debt service for the City's capital equipment leases are accounted for in separate funds, and are not part of this analysis.



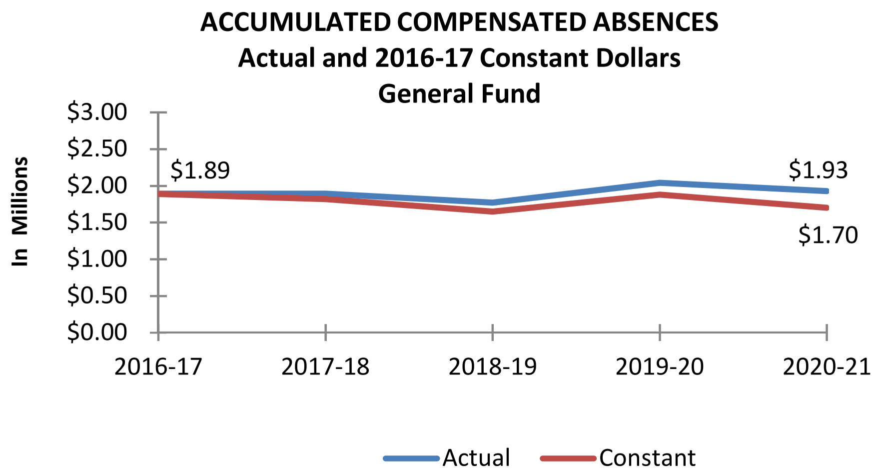
Status: *FAVORABLE*
General Fund debt service receives a Favorable rating, as it has remained immaterial (less than 1%) in comparison to total revenues over the last seventeen years. Credit rating firms generally view debt service as Unfavorable if debt service payments exceed 20% of net operating revenues.

Debt Service/Unfunded Liability Trend Analysis

Indicator: *Accumulated Compensated Absences*

Comments:
At June 30, 2021, the balance of the liability for compensated absences was $1.93 million consisting of $1.3 million for vacation, $0.5 million for sick leave, and $57,746 for compensatory time. This is a decrease of $116,998 or 5.7% from the prior year's liability of $2.04 million.

The Accrued Leave Reserve was established to pay accrued employee benefits for General Fund employees who terminate during the year. As of June 30, 2021, the Accrued Leave Reserve balance was $1.0 million.



Status: *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-half of the accrued leave reserve balance. The reserve policy was modified in FY 2016-17 to fund General Fund compensated absences.

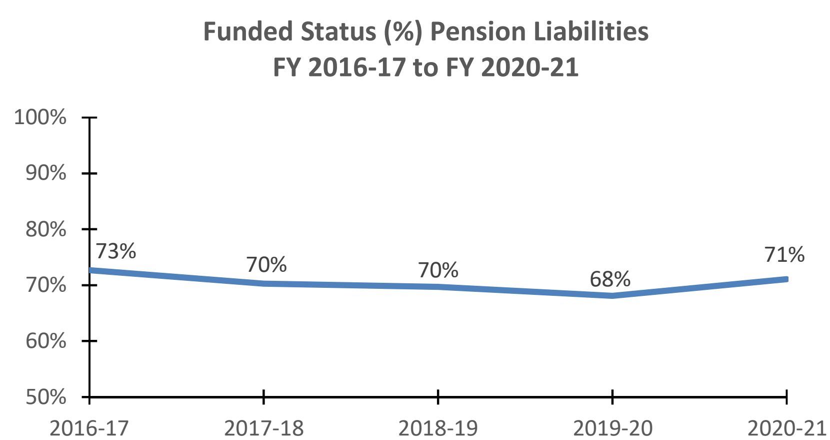
Debt Service/Unfunded Liability Trend Analysis

Indicator: *Pension Unfunded Liability*

Comments:
The City manages four pension plans that cover different employee groups and are funded at various levels. California Public Employees' Retirement System (CalPERS) plan includes safety-lifeguards, safety-inactive and miscellaneous employees since the transition to CalPERS. The CSCERP plan includes past city retirees and inactives, as well as, Coastal Animal Service Authority (CASA) employees.

The pension trend indicator provides ongoing reporting and analyzes funding levels compared to the target level of 90%. This trend shows past funding levels and the changes over the last five years. The City started making additional contributions in FY 2019-20 and in FY 2020-21 made additional contributions of $789,179 towards the CalPERS plans and $550,000 toward the CSCERP plan, specifically for CASA employees. The slight increase in funding status is the result of CalPERS discount rate staying to same as prior year at 7.15%, while the CSCERP plan lowering the discount rate from 6.25% to 5.75%. Increases to additional contributions and the near completion of the prior year lower discount rate phase-in has caused the funding status to start to stabilize.

The chart below shows the Funded Status for five-years ending June 30, 2021 (with information based on the prior year actuarial valuation). The lowest funded plan is CSCERP at 63% and the highest funded is safety-lifeguards at 86%. The fiscal policy objective for each plan is 90%. A Pension Update is included in this year's LTFP and provides more detail on each plan's liabilities and strategies to paying down the liability.



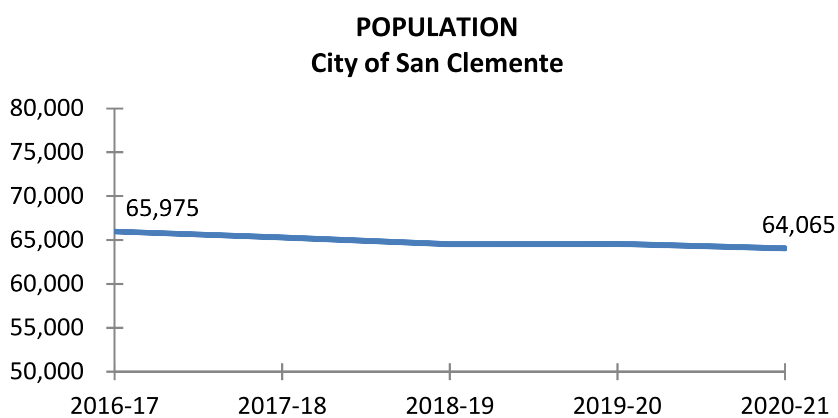
Status: *FAVORABLE/CAUTION*
This indicator changes from a Warning to Favorable/Caution rating as we start to see the results of the City's efforts to pay down the Unfunded Pension Liability as anticipated. Based on previous LTFP guidance, the City continues to make additional UAL payments from budget savings to improve the long-term funding (see the Pension Update paper).

Community Trend Analysis

Indicator: *Population*

Comments:
The City's population has decreased by 0.8% over the prior fiscal year. 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. Increased population generates increased expenditures over time such as public safety (i.e. additional fire stations, increased police, etc.). Conversely, a rapid decline in population allows for a smaller tax base for spreading City costs that cannot be reduced in the short run.

A Census is completed every ten years. A census was completed during calendar year 2020. The numbers used by the City between Census updates are based on numbers from the California Department of Finance and estimates of growth from the Planning department. As the City nearing build-out, the fiscal years 2016-17 through 2020-21 show a stabilization in the population rate.



Status: *FAVORABLE*
This indicator remains a Favorable rating due to a stable population over the five-year period.

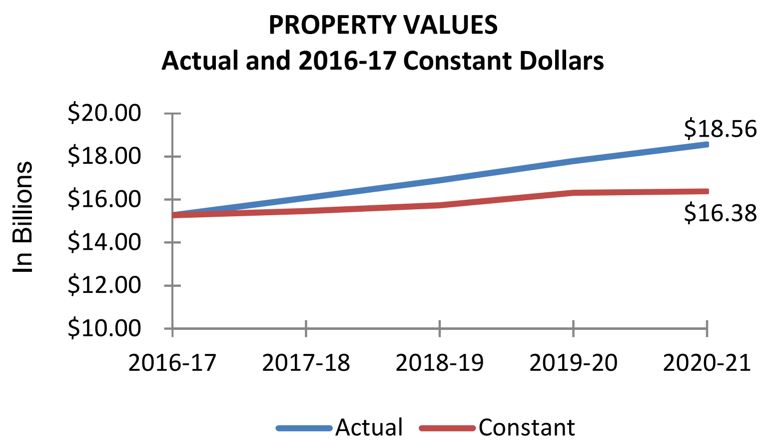
Community Trend Analysis

Indicator: *Property Values*

Comments:
The growth rate in property values as a percentage rate from the previous year in actual dollars was positive 4% or $776 million. This is a 0.4% or $58 million change in constant dollars, as seen in the chart below. The five-year trend shows a stable growth increase in property tax values.

Property values exhibited a positive-growth rate in FY 2020-21. Personal property in California is subject to a basic levy equal to one percent of the assessed value. The property tax share can fluctuate between cities within a county. The City of San Clemente receives $0.154 of each property tax dollar collected within the City.

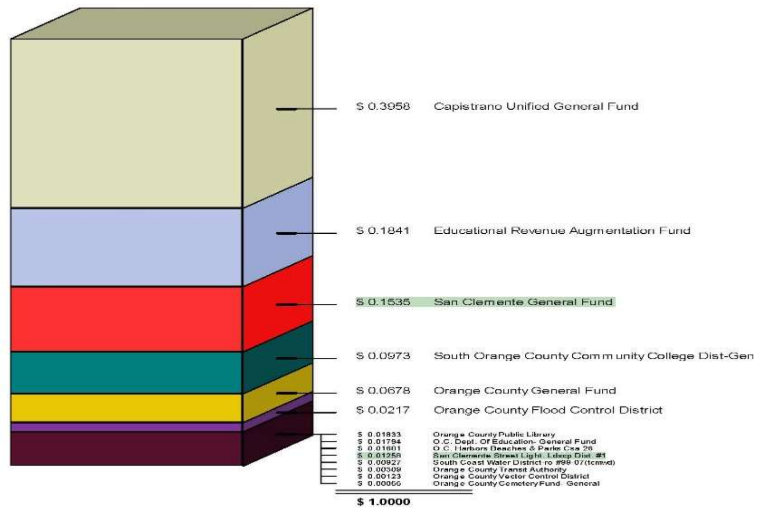
Please see attachment "A" graph that shows the distribution of the total property tax levy for each property tax dollar paid for the City and the ten year assessed value history.



Status: *FAVORABLE*
This indicator remains a favorable rating due to the stable and increasing trend over the last five years.

Attachment “A”

THE CITY OF SAN CLEMENTE
PROPERTY TAX DOLLAR BREAKDOWN



ATI (Annual Tax Increment) Ratios for Tax Rate Area 10000, Excluding Redevelopment Factors & Additional Debt Service
Data Source: Orange County Assessor 2020/21 Annual Tax Increment Tables Prepared On 8/31/2021 By MV
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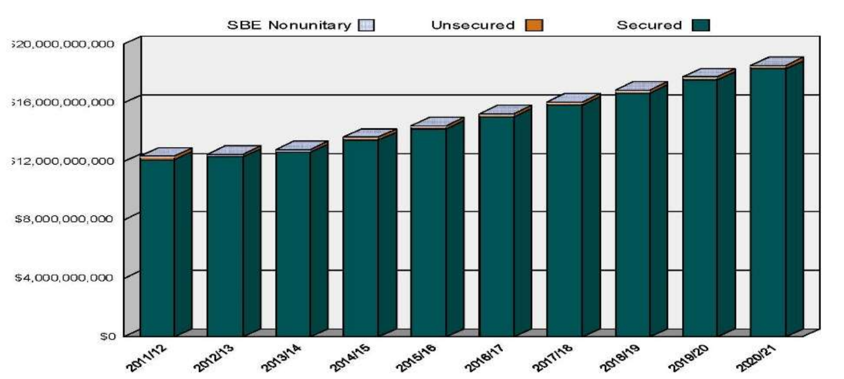
The chart above shows the portion each respective government agency receives of the typical Orange County property tax dollar.

THE CITY OF SAN CLEMENTE
NET TAXABLE ASSESSED VALUE HISTORY
2011/12 - 2020/21 Taxable Property Values

Lien Year	Secured	Unsecured	SBE Nonunitary	Net Total AV	% Change
2011/12	$12,125,854,115	$229,815,391	$240,000	12,355,909,506	
2012/13	$12,299,490,266	$206,380,508	$0	12,505,870,774	1.21%
2013/14	$12,625,733,738	$200,734,451	$0	12,826,468,189	2.56%
2014/15	$13,452,062,054	$211,221,901	$0	13,663,283,955	6.52%
2015/16	$14,249,172,795	$198,928,327	$0	14,448,101,122	5.74%
2016/17	$15,045,446,308	$217,602,523	$0	15,263,048,831	5.64%
2017/18	$15,861,270,659	$220,164,036	$0	16,081,434,695	5.36%
2018/19	$16,674,458,254	$224,092,728	$0	16,898,550,982	5.08%
2019/20	$17,557,945,770	$241,279,150	$0	17,799,224,920	5.33%
2020/21	$18,324,849,145	$243,240,338	$0	18,568,089,483	4.32%
				Average % Change	5.12%



* Net AV changes less than two percent are in purple font. Negative Net AV percent changes are in red.
Data Source: Orange County Assessor 0/ - 2020/21 Combined Tax Rolls Prepared On 8/31/2021 By MV
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Financial Forecast

Objective
To update the comprehensive five-year financial forecast for the General Fund, incorporating adopted City fiscal policies, expenditure patterns, revenue trends, fund balances and other known financial impacts and to provide an overview of important capital projects.

Executive Summary
In order to strategically address future needs and to ensure the City maintains a positive operating position in the long-term, the City's five-year forecast focuses on two critical elements, ***operating position*** and ***fund balances***, to determine the fiscal health of the City.

City of San Clemente Financial Condition
The five-year financial forecast was last updated with the adoption of the FY 2021-22 budget and it showed a small operating surplus in the first year of the forecast, followed by operating deficits in the remaining years. Projected operating surplus/(deficits) as part of that budget forecast were:

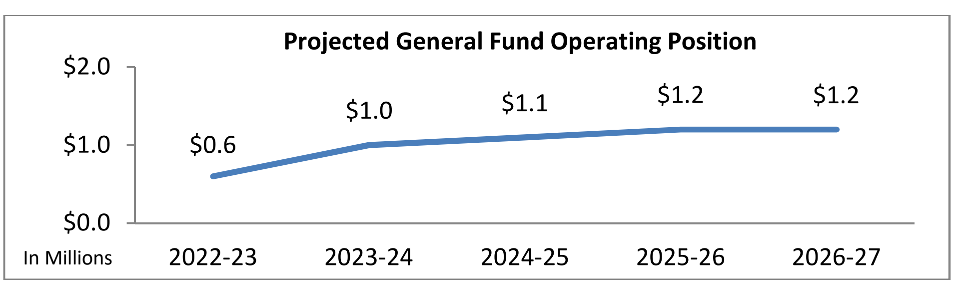
2022 Budget Forecast (In millions)	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
Projected surplus/(deficit)	$ 0.1	$ (0.8)	$ (1.4)	$ (1.6)	$ (1.8)

As part of the process to present a balanced budget to City Council during the uncertain pandemic revenue and cost impacts, the City left seven positions unbudgeted to ensure no other additional cuts were realized in the budget. Utilizing American Rescue Plan funds, three positions were funded to assist with service levels. This service increase was needed as pandemic restrictions eased and full operations were needed in City departments for the citizens.

The 2022 LTFP five-year financial forecast takes into consideration these changes and continues to add back positions to address the increased level of activity. This was made easier, as will be seen in the forecast, by strong property taxes driven by the real estate market and continued growth in sales tax, which is partially driven by consumer goods, dining and service station sales tax revenues.

The General Fund forecast operating position is improved from the FY 2022 Budget forecast. Information on the Assumptions used in the report are discussed later in this report and are based on recent economic forecasts, although there are still uncertainties at national and local levels. The goal of this forecast paper is to assist both City Council and management in managing these uncertainties as we move through the FY 2023 budget process and in future years.

The forecast reflects a positive operating position in all years of the forecast, increasing from a positive operating position of $0.6 million to $1.2 million. The following table and chart reflect the forecast results.



2022 LTFP Forecast (In millions)	2022-23	2023-24	2024-25	2025-26	2026-27
Operating receipts	$ 74.6	$ 77.5	$ 80.2	$ 82.9	$ 85.7
Operating disbursements	74.0	76.5	79.1	81.7	84.5
Projected surplus/deficit	$ 0.6	$ 1.0	$ 1.1	$ 1.2	$ 1.2

Operating positions are subject to change based on actions taken in the normal course of business and actions by City Council. These differences can occur in a variety of ways. For instance, higher receipts or lower disbursements can occur from the projection differences, position changes, additional payments on pension liabilities, and various other actions.

Operating position

Operating Position is the excess of operating revenues over the amount of operating expenditures. Operating revenues and expenditures exclude one-time revenue and expenditures. Based on the revenue and expenditure trends, the financial forecast indicates a positive operating position beginning in next fiscal year. These positive operating positions increase unassigned fund balance and are used to fund one-time costs, including capital projects, reserve transfers and other one-time activities. Revenues are averaging an annual increase of 3.8% over the forecast period while operating expenditures are increasing annually by 3.6% a year.

Operating revenue is forecasted to increase 5.0% in the first year. Property taxes, which represent 54% of all General Fund revenues, is forecast to increase 5.9% benefiting from a positive real estate environment and development. Sales tax is projected to increase 6.5% due to activity in consumer goods, dining and service stations. General Fund revenues other than property and sales taxes are forecasted to increase 0% and 6% depending on the revenue type.

Operating expenditures are forecasted to increase 4.2% in the first year due partially to public safety. The largest percentage increase in operating costs are from the Police contract. The OCSD police service costs are anticipated to go up 5% from FY 2022 current budget. This increase is a result of the final year of the multiyear MOUs with deputies reflecting COLA increases ranging from 2.5% to 3.5%. This increase also factors in amounts for additional substation costs and other cost increases that may be passed on due to information technology and other body camera related items. OCFA fire contract costs are projected to go up 3.3% based on prior year estimates, however these costs could be higher but are limited to a contract cap of 4.5% which excludes the 4th firefighter/paramedic position phase in cost (phase in completes in FY 2025).

The next largest percentage increases are in other contract services and salary and benefits. Contract costs are forecasted to increase 6.0% initially based on higher energy costs and impacts from contractors addressing inflation pressures. Salary and benefits increase 3.7% based on the existing MOU, merit increases, and filling positions to address City operations and meet citizen needs. Additionally, pension cost growth has started to stabilize, but the City is still addressing past discount rate changes and assumption changes, but these should lower over time with the additional phase-in of PEPRA impacts. Pension costs are discussed in the 2022 Pension Update with recommendations to achieve long term savings and improve the funded status.

Fund Balance
Fund balance is the excess of assets over the amount of liabilities. The 2022 LTFP Forecast operating position shows deficit operating positions and these operating deficits have an impact on available General Fund resources (fund balance).

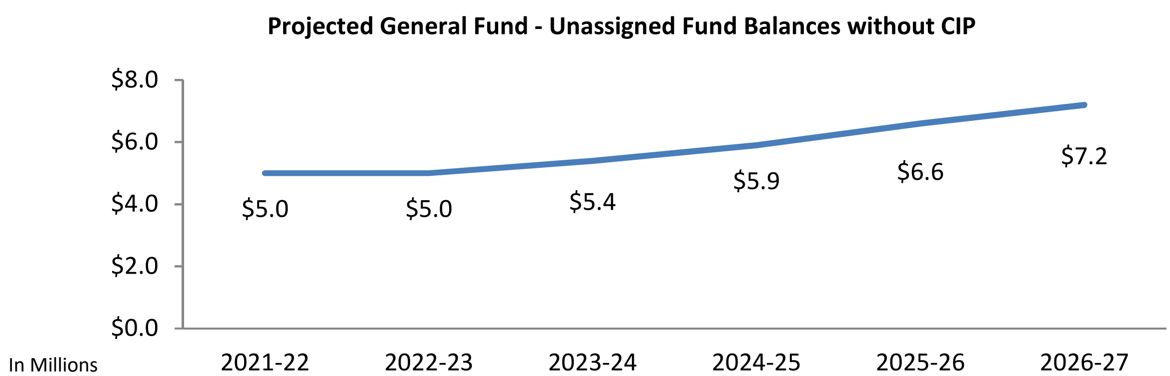
The City's *committed* portion of fund balance, approved by City Council action, includes the *Emergency Reserve* funded at 20% of operating expenditures. Annual contributions to maintain the Emergency Reserves (20% of operating expenditures) are included in the forecast. *Unassigned* fund balance is available for appropriation by the City Council, without any restrictions. A positive unassigned fund balance represents a financial resource available to finance one-time expenditures in future fiscal years.

Committed Fund Balance **-** One financial goal of the City, as defined in the City's Fiscal Policy, is to ensure that adequate resources will be available to fund the General Fund's emergency reserve. The emergency reserve level is maintained at the required level of 20% of operating Expenditures, based on current fiscal policies. The Emergency Reserve based on the 2021-22 Budget is $14.1 million. A summary of the Emergency Reserves by year is summarized below:

General Fund – Committed Reserves (in millions)

	2022-23	2023-24	2024-25	2025-26	2026-27
Emergency Reserve *(20% of Oper. Expenditures)*	$14.8	$15.3	$15.8	$16.4	$16.9

Unassigned Fund Balance - The General Fund's *unassigned fund balance* is projected to be $5.0 million at the end FY 2021-22. Based on the 2022 LTFP forecast the following chart below illustrates the projected unassigned fund balance in the General Fund for the next several years.



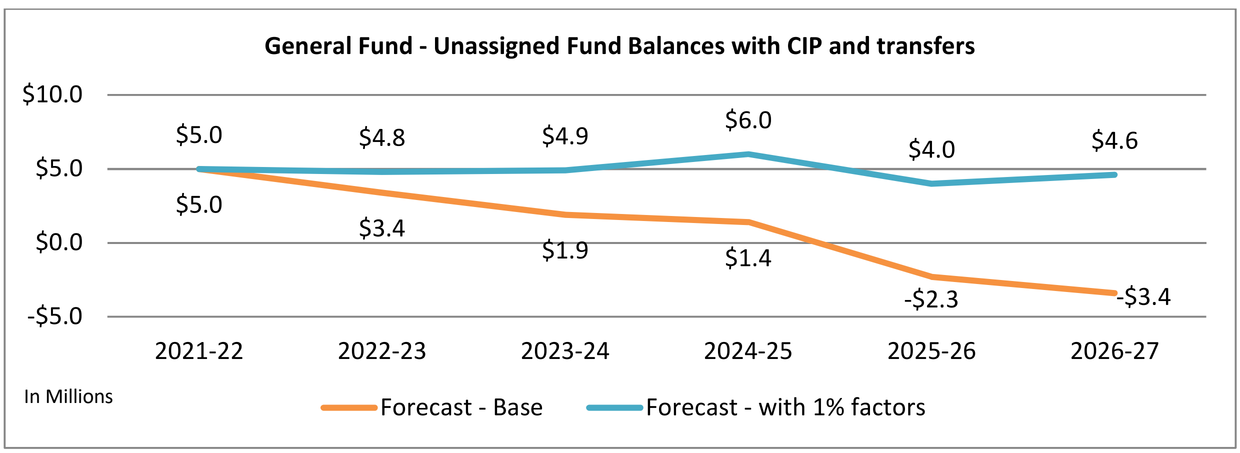
The above unassigned fund balance chart reflects the annual Emergency Reserve contributions, and $1,200,000 each year for ongoing maintenance projects (major street maintenance, slurry seal, sidewalk repair programs, and facility maintenance), but does not assume any spending for capital projects (including infrastructure and I.T. projects), or any one-time major maintenance projects and one-time transfers to reserves, which are based on the current year levels addressed in the Reserve paper.

The table below shows costs projected for General Fund capital and one-time major maintenance projects over the next five years based on what was presented in the CIP section of the FY 2020-21 budget, excluding the project costs to be funded by grant revenue:

Proposed Capital Projects (In millions)	2022-23	2023-24	2024-25	2025-26	2026-27
Capital Improvement Projects (non-ongoing)	$ 1.3	$ 1.6	$ 0.8	$ 4.1	$ 1.4
Transfers (one-time)	0.5	0.5	0.5	0.5	0.5
Totals	$ 1.8	$ 2.1	$ 1.3	$ 4.6	$ 1.9

General Fund Unassigned fund balance decreases over time if one-time CIP (capital and maintenance projects) amounts and one-time transfers are included in the 2022 base forecast. Due to these one-time items, the City's unassigned fund balance would decrease substantially from $5 million to a deficit of $3.4 million. The City typically experiences both a revenue overage and an expenditure underage which is typically used to finance these one-time items, utilizing a 1% factor for these operating amounts unassigned fund balance would be forecasted to remain stable over time and decrease from $5 million to $4.6 million.

The chart shows General Fund unassigned fund balance based on the Forecast with and without the 1% assumption:



This projection is based on the CIP program presented in the FY 2021-22 budget. Funding of capital projects is determined annually during the budget process and is dependent upon available funds. This forecast uses the FY 2021-22 CIP, however a revised CIP program for the next five years will be presented to the City Council as part of the FY 2022-23 budget process.

In summary, the revenue overages and cost savings should be sufficient to fund ongoing one-time costs, however this could be impacted by an economic downturn or emergency situation that effects either revenues and/or expenditures savings. If this occurs, the City would need to rely upon reserves or seek other alternatives to fund one-time items.

This forecast is only a projection and a negative position will not be proposed to the City Council. Adjustments will be completed to eliminate any proposed budget deficits.

Summary:
The operating position shows surpluses in all years, however there are various uncertainties which could affect the operating position either individually or in aggregate. The goal of this LTFP is to inform and assist both City Council and management. The forecast and other information is based on existing service levels and existing expectations. The operation position forecast in future years nears levels prior to the pandemic and the last property market recession that started around 2008.

The City Council should utilize the forecast as part of the decision making process to manage future uncertainties. Uncertainties facing the City in the upcoming years relate to both external and internal items and some actions may be outstanding and some items may have had actions implemented. A summary of outstanding items include the following:

- Class and Compensation Review – The approved MOU with the employees association stipulates that a Class and Compensation assessment will be budgeted in FY 2023. This assessment could require salary and other classification changes impacting salaries and related benefits.
- Police Contract costs – The County of Orange negotiations with the deputy and other unions under a MOU that is through June 2023. The unions will be subject to new negotiations and this could lead to higher costs in future contracts with OCSD. Additionally, body cameras and other technology costs could cause larger impacts to the police contract.
- Service changes or impacts – Service aspects of the City have increased recently and certain programs or activities may need to expand to address the citizen's desires. This could include trolley operations, park rangers, health care, homelessness, or other service needs, such as the Beaches, Parks, Recreation Master Plan facilities.
- Economic factors – Inflation recently is at high levels, but expectations are that this will decrease back in the forecast period to more normal ranges within the 2-3% range. This could effect costs and decrease purchasing power if inflation is not normalized or may lead to an economic downturn lowering revenues. Revenue or cost impacts could cause the fund balance to not materialize for one-time activities which would impact fund balances.
- Loss of funding – The Clean Ocean fee expired which provided funding to operate and maintain Clean Ocean assets constructed within the Storm Drain system. Additionally, this fee funded education, enforcement, and street sweeping services to keep San Clemente's ocean's cleaner. If not reinstated, the loss of this funding impacts General Fund and Storm Drain resources.

As part of past and current LTFP's, the City addressed some future concerns, but the outlook could change related to the following items.

- Pension costs – An Unfunded Accrued Liability (UAL) was created due to assumption changes and market returns. If market returns do not meet expectations, liabilities would increase and the City may not experience future cost savings as anticipated. The City currently is implementing a 3-2-1 Strategy to pay down past unfunded liabilities and lower future costs. Recommendations on this item are discussed in the Pension Update.
- Unanticipated capital costs – The City in previous years addressed maintenance of capital assets to minimize the need for one-time large capital outlays. The City has and continues to transfer funds to capital reserves. The City could increase the amount allocated annually to routine maintenance from $250,000 to $300,000.

Actions to address these can be done by increasing revenues - including a higher level of cost recovery for fee supported activities or through additional revenue measures or actions. Another option is to be strategic in the deployment of service levels or resources to contain costs or control on-going outlays. This would be done with the goal of improving future operating positions or to increase service levels.

Revenue:
City staff, as in the past, seeks input from City Council to review or increase revenues. The City could explore opportunities explored in the past like increases to the Transient Occupancy Tax rate or new opportunities like sales tax, parcel taxes or other taxes. The City will also be reviewing service charges in the near future which is a fiscal policy requirement.

Service Cost:
The City allocated funds to address service levels in a variety of areas including police, fire, ambulance, code enforcement, and facility maintenance. Also, certain projects have been funded to reduce operating costs like the Steed Park lighting and changing Traffic Signals to LED lights to lower energy costs. Properly maintaining assets can also provide savings on replacement life cycles. One action that staff, as part of the Capital Improvement Program, will be considering is maintenance activities and opportunities to increase maintenance costs to extend capital asset lives. Additionally, opportunities to save operating costs through capital project activities when appropriate is also considered as part of the Capital Improvement Program.

City Council could review amounts spent on existing programs and recommend activities where service levels could be adjusted or, as new programs are initiated, revenue sources could be sought to lessen the impact on the operating position. For example, the Community Outreach Worker which was initially funded by CDBG-CV funds for a limited term could now be funded through the American Rescue Plan by transferring funds to the General fund to pay the operating costs until other funds become available.

Use of one-time revenues
The City Council also allocated funds towards the payment of the UAL on pensions lowering future costs as part of the 3-2-1 Pension Strategy, however some of the 3-2-1 Strategy still needs to be funded. If one-time funds are available additional resources could be committed to the 3-2-1 Strategy by increasing the paydown or to increase the Section 115 trust contributions. The one-time revenues could increase the General Fund Emergency Reserve level to offset the greater dependency on property tax revenues and sales tax revenues within the General Fund, or to fund Capital Reserves to offset the cost of unanticipated capital costs. Staff will seek direction from City Council in these instances.

Staff Recommendations:

1) Direct staff to increase the annual CIP Maintenance project amount of $250,000 to $300,000 depending on the availability of General Fund operating position.

2) Utilize American Rescue Plan grants to fund $800,000 for public safety. This amount will fund portions of the Police contract attributable to body cameras, the Fire Contract for the additional cost for the 4th firefighter/paramedic, and to fund a portion of the Community Outreach Worker position for outreach purposes.

Forecast Background and Discussion

Annually, the City prepares a five-year financial forecast with the Long Term Financial Plan. The forecast identifies the City's current and projected financial condition to determine the forecasted operating position based on existing level of services. This forecast provides information to City Council related to available resources, fund balance and anticipated results in future years. The financial forecast, along with the Financial Trend Analysis, provides the foundation of the Long Term Financial Plan process and provides information on past history and anticipated results.

The forecast is developed based upon guidelines provided by the Government Finance Officer's Association (GFOA). The financial forecast allows the City to determine how current spending plans will impact future budgets. This forecast is *not* the budget. The Budget is presented to City Council at a later time. This forecast is used to provide preliminary information to Council to assist in the prioritization process.

The base forecast is developed using the City's *present level of services*. Inflation or historical growth rates are used to predict expenditure patterns. Revenues are projected by inflation, current trends, or by specific circumstances that are certain to occur during the forecast period. Information regarding economic indicators and the performance of the economy as a whole over the forecast period was taken from the Chapman University Economic and Business Review (December 2021). In addition, forecast information from HdL, Cal State Fullerton and other sources are utilized to assist staff with the assumption determinations.

During the Chapman forecast period, inflation is expected to moderate slightly from the higher levels as the Fed moves to curb the growth of inflation and ease supply chain issues. However, inflation can be stubborn and the timing as to the decrease in inflation and the Fed actions will need to be seen. Payroll and employment is anticipated to increase as COVID cases and death rates decrease and mandates are removed. Median home prices continue to rise, but mortgage rates are forecasted to increase with rate increases which could lead to slower home prices especially as population growth has been slowing or decreasing.

Overall the economy is anticipated to continue to grow, however there are prospects for a recession as interest rates climb. The CPI used in the forecast was higher initially (~5% range), with some higher factors built in for energy prices, and brought back to the normalized range of about 2-3% with population remaining flat over the forecast period.

FORECAST INFORMATION

The forecast is based on the General Fund only. The forecast does not include service level changes and impacts on the General Fund to pay for costs currently funded in other funds. Examples of cost factors which could effect future results:

- Revenues from future development, land sales or other enhancement actions (Property tax, sales tax, and transient occupancy tax, and land proceeds) are not included in this forecast.
- No new or enhanced programs or positions have been included in these forecast amounts. Costs funded through other funds, such as Clean Ocean costs, costs related to the Trolley program funded by external grants and other resources, and costs related to homeless activities funded through the Low and Moderate Income Housing Fund are not included.
- New or enhanced programs have been excluded, including any new positions or restructuring of positions.
- No provision has been included for one-time legal costs for new special projects or initiatives.

In addition, there are other items or actions which may improve or diminish the General Fund operating position. The financial forecast is based on current known service levels. Some potential impacts, not included in the forecast, are discussed in other sections of the LTFP.

The Assumptions section of this report is broken into two sections: *Revenues and Expenditures*. These sections, which are included in the last section of this Forecast paper, provide background on the assumptions used in the General Fund forecast. Information is summarized and presented by the City's major revenue and expenditure line items.

Forecast Results

Based on the economic data and the considerations discussed in the Assumptions section of the paper the following forecast outlines the current anticipated receipts and disbursements over the next five years for the General Fund. Over the five year forecast period, the City's operating revenues are anticipated to grow by an annual average increase of 3.8%, or $2.9 million, a year, while operating expenditures are projected to increase at an average rate of 3.6%, or $2.7 million. This annual disparity creates a small annual increase in the General Fund's operating position.

The financial forecast indicates an initial positive operating position of just over $600,000 beginning in FY 2022-23, based on forecasted revenues and expenditures. This is due to revenue growth for the forecast period in property taxes and sales taxes increasing beyond the growth rates in expenditures. These are projections only. Additionally, revenue changes from anticipated development and additional costs from service level changes are not incorporated into this forecast. The following table forecasts only existing development and current approved service levels. The presentation does not include any spending for one-time capital projects or one-time major maintenance projects or anticipated budgetary savings or revenue overages. The receipts and disbursements are presented by major category. The five year forecast follows:

GENERAL FUND – FORECAST					
	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
BEGINNING UNASSIGNED FUND BALANCE	**$ 5,049**	**$ 4,953**	**$ 5,388**	**$ 5,947**	**$ 6,592**
RECEIPTS					
Property Tax	40,781	42,582	44,421	46,342	48,302
Sales Tax	12,701	13,273	13,637	13,978	14,328
Other Taxes	5,866	5,992	6,106	6,207	6,297
Service Charges	5,908	6,085	6,253	6,409	6,569
Other Revenue	9,317	9,546	9,769	9,977	10,190
TOTAL OPERATING RECEIPTS	**74,573**	**77,478**	**80,186**	**82,913**	**85,686**
COSTS					
Salaries & Benefits	20,284	20,980	21,711	22,391	23,078
Police Contract Services	18,805	19,745	20,732	21,665	22,640
Fire Contract Services	10,685	10,975	11,235	11,684	12,210
Other Contractual Services	13,269	13,667	14,043	14,394	14,754
Other Charges/Supplies	3,822	3,897	3.956	4,015	4,074
Ongoing Maintenance	1,200	1,200	1,200	1,200	1,200
Other Expenditures	5,887	6,064	6,233	6,393	6,557
TOTAL OPERATING COSTS	**73,952**	**76,528**	**79,110**	**81,742**	**84,513**
OTHER FUND BALANCE CHANGES					
Funding 20% Emergency Reserve	(717)	(515)	(517)	(526)	(554)
ENDING UNASSIGNED FUND BALANCE	**$ 4,953**	**$ 5,388**	**$ 5,947**	**$ 6,592**	**$ 7,211**
**displayed in thousands*					

Operating revenues are categorized by Property Tax, Sales Tax, Other Taxes, Service Charges and Other Revenue. Operating revenues are forecasted to increase 5.0% in the first year. In total, operating revenues are forecasted to increase to $85.7 million over the five-year forecast period. Additional information on the revenues assumptions are discussed in the Assumptions section of this paper.

Operating costs are categorized by salaries and benefits, police contract, fire contract, other contractual, other charges/supplies, ongoing maintenance and other expenditures. Operating costs (expenditures) are forecasted to increase 4.2% in the first year with total operating expenditures increasing to $84.5 million over the forecast period. The largest percentage increase is the police contract. However, the fire contact, contract services, and salaries and benefits also are showing increases but at a slightly lower level over the five years. Additional information on the expenditure (cost) assumptions are discussed in the Assumptions section of this paper.

FORECAST ASSUMPTIONS - REVENUES

The following table summarizes the changes from year to year based on current assumption information. Each revenue is comprised of multiple revenue line items. Further information on each assumption is discussed in the following paragraphs by major revenue category:

Revenue	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Property Tax	5.88%	4.42%	4.32%	4.32%	4.23%
Sales Tax	6.50%	4.50%	2.75%	2.50%	2.50%
Other Taxes	3.57%	2.14%	1.90%	1.66%	1.45%
Service Charges	3.92%	3.00%	2.75%	2.13%	2.14%
Other Revenues	1.39%	2.46%	2.32%	2.31%	2.01%

Property Tax

Property Tax is the City's single largest revenue source and represents over 50% of total General Fund operating revenues. Property tax projections are based on information provided by HdL Coren and Cone, the City's property tax advisors. Property taxes are comprised of property taxes, (secured and unsecured), supplemental assessments, the vehicle license fee swap, property transfer taxes and penalties and interest. Property tax revenues are projected to increase by an average of 4.6% over the five year forecast period with a large increase in FY 2022-23 and lower but consistent increases of 4.2%-4.4% over the five year timeframe.

Four major factors contribute to year over year assessed valuation changes. First, Proposition 13 allows the County Assessor to increase property valuation by the net change in CPI growth, with a cap of 2% growth per year – FY 2022-23's CPI growth factor is the maximum 2%. Second, property valuation is increased or decreased annually by transfer of ownership transactions and property values. When compared to 2020 the number of single family home transactions increased by 24%, with the average price increasing from $1.3 million to $1.7 million at calendar year end. Third, when property values decline, Proposition 8 allows properties to be temporarily reassessed at a lower value by the County Assessor through individual appeals, or through mass appeals if warranted by market conditions. Once property values rise again, the County Assessor "recaptures" the value through valuation increases of more than 2% per year, until reaching the Proposition 13 cap. Finally, assessed valuation grows when new development is completed in the City.

According to HdL, property tax growth will average between 4-6% annually over the five-year forecast based on these growth factors, ownership transfers, Prop 8 recapture, and median home prices. Property transfer taxes and penalties and interest are anticipated to grow at a lower rate than the secured and unsecured property taxes.

Sales Tax

Sales tax included in the forecast is projected to grow based on the total taxable sales growth, which is forecast at 6.5%. There is currently no consensus, with Chapman analysis forecasting 10-12% and HdL forecasting 3-10%. Sales taxes are projected to increase over the forecast period by an average of 3.7%, starting with a large increase initially based on current activity and CPI. A general slowing of activity over forecast period is anticipated after larger initial increases as CPI lowers and growth stabilizes.

Ongoing sales tax revenues for the City are forecasted to increase 6.5% the first year, slow to 4.4% and then lower to 2.5% annually over the remaining timeframe. The 6.5% rate is based on the various forecasts and the FY 2023 sales tax total is in line with the most recent HdL analysis. This revenue source is being positively impacted by the *Wayfair* decision, increases in gas prices, and the City's desire to maintain restaurant operations through outdoor dining. The online sales activity is allocated through the County pool and the State of California is currently formulating procedures and compliance information. This amount will be revised in the proposed budget based on further projections provided by the City's sales tax advisors, HdL.

Other Taxes

Other taxes in the forecast include Transient Occupancy Tax (TOT), Franchises, and Business License revenues. These taxes are expected to grow in the 3.6% to 1.5% range based on growth within the City, lower pandemic impacts, franchise fees, and existing development. Franchise revenues are taxes paid through primarily utility providers based on revenues and will likely increase, but fluctuate with commodity prices, for example energy or natural gas. Recently, energy prices including gas have increased and this additional cost may drive these revenues, however the future outlook is uncertain. Transient occupancy tax revenues are anticipated to go up initially based on current activity and reductions to pandemic restrictions. However the longer term expectation is to increase at a slower rate more in line with the CPI over the five-year timeframe. No amount is included based on future anticipated development, but additional hotels/rooms would create a larger increase. Business license revenues are forecasted to increase around 3% range based on activity, GDP, and other impacts.

Service Charges

Charges for service include, public safety service charges, parking, public works, recreation and community development service charges. These are estimated to increase generally with CPI/GDP as costs go up, but factors such as population changes, number of transports, number of participants, services provided, and other factors can impact these revenue sources. These revenues in total are forecasted to increase around 2.5%-3.0% annually.

Other Revenues

Interest, fines, Interfund charges and transfers comprise the other revenue category. Interest revenue is anticipated to remain flat, with a slight increase over the timeframe as the low interest rate environment should improve in the future. Fines are anticipated to generally remain flat. Interfund costs are anticipated to increase between 2% - 3% over the five-year timeframe since these are costs charged to other funds to recover General Fund overhead related items. The amount related to the recovery of costs to support other funds is forecast at $3.2 million. Transfers are anticipated to have minor growth over the five years.

FORECAST ASSUMPTIONS – EXPENDITURES

The following table summarizes the changes from year to year based on current assumption information. Each expenditure is comprised of multiple line items. Further information on each assumption is discussed in the following paragraphs by major disbursement category:

Disbursement	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Salaries & Benefits	3.68%	3.44%	3.48%	3.13%	3.06%
Police Contract Services	5.06%	5.00%	5.00%	4.50%	4.50%
Fire Contract Services	3.27%	2.71%	2.37%	4.00%	4.50%
Other Contract Services	6.00%	3.00%	2.75%	2.50%	2.50%
Other Charges/Supplies	3.19%	1.95%	1.54%	1.47%	1.49%
Ongoing Maintenance	0.00%	0.00%	0.00%	0.00%	0.00%
Other Expenditures	2.49%	3.01%	2.79%	2.57%	2.57%

Salaries & Benefits

The forecast assumes anticipated growth in wages and benefits. In total, salaries and benefits are forecasted to increase 3.7% from the prior year and will range between 3.68% and 3.06% over the five years, considering the existing MOU, then adjusting for a CPI cost of living percentage, merit increases, medical cost changes, retirement and other benefit amounts. In total, salaries and benefits are forecasted to increase initially due the addition of employees to meet service needs as pandemic restrictions are eased. This rate will decrease to 3.06% in the last year of the forecast.

The City has focused on personnel-related costs to achieve savings to lower past structural deficits. A new Memorandum of Understanding (MOU) has been put into place through June 30, 2024. This MOU provided non-pensionable payments to employees, annual pay increases up to 1%, and the commitment to complete a Class and Compensation study to review pay and responsibilities for employees to ensure employees are fairly compensated.

Benefits, depending on the benefit, increase between 0% - 5%, with the largest increases occurring in medical and retirement costs. The medical increase offsets the increased costs of medical coverage and the retirement percentages are reduced over the forecast period. The future lower retirement costs are recognized as PEPRA employees are added and employer contributions will continue to decrease. Additionally, the City is paying down the UAL by making additional contributions to contain costs in future years. Other benefit expenditures include Social Security, Workers Compensation, disability and various other benefits.

Police Contract

Orange County Sheriff’s Department (OCSD) is a high-performing police organization, and the County Sheriff’s contract is a less expensive option compared to creating and operating a full-service, city police organization. Like most agencies in California, pension costs have contributed to a substantial rise in expenditures for police activities.

The County of Orange Sheriff’s contract costs are anticipated to increase 5% from the previous year’s adopted budget as a result of the implementation of the previous year multiyear MOU approved by the County unions which implements 2.5% to 3.5% annual Cost of Living Adjustments.

This incorporates COLA's and other benefit changes that include retirement, medical and benefit costs. Other cost increases including services and supplies, transportation, department overhead, and training. This category only shows the OCSD contract amount.

The forecasted growth rate is 5% for the first year to realize COLAs and other costs, however the existing County MOU ends in 2023 for most OCSD employees. Future years anticipated growth is estimated at 4.5% to 5.0% annually to maintain the existing levels of service. The annual average increase for the police contract services is 4.81% over the forecast period.

Police positions remain at the existing level for the term of the forecast. Any personnel additions will also result in increased costs above what the forecast assumes. Body cameras are included, however future costs required to improve implementation will be incurred and are not incorporated.

Direct City paid costs outside of the contract are not included in the contract amount, but are forecast in other categories. These costs include fleet charges, crossing guards, legal services for prosecution, and past police pension costs. The Police Contract Services category only shows the OCSD contract amount. Total FY 2023 police related costs are forecasted at $20.4 million.

Fire Contract Services

Fire Services costs are projected in the forecast to increase by 3.3% over the prior year, with most subsequent years at 4.5%. OCFA's fire contract costs are projected to go up as a result of the City paying for a 4th firefighter position, which is phased in through 2024 and lower annual contract percentages of 2% - 3% than the contract cap (4.5%) are anticipated through FY 2025.

This contract includes a maximum cap of 4.5% each year, the highest increase allowed by the City's contract with the Orange County Fire Authority (OCFA), excluding the additional paramedic/firefighter cost. The 20 year fire services contract with OCFA allows for a cap of 4.5% per year to the base service charge, as well as annual contributions to station maintenance and fleet replacement reserves. OCFA's actual contract increase for FY 2023 will be determined over the next several months through the budget process, but is expected to be in the 2-3% range. The annual average increase for the fire contract services is 3.4% over the forecast period.

The addition of a 4th firefighter/paramedic on full rotation for the City of San Clemente, as implemented by OCFA, started in FY 2017-18. The last portion of the full cost is paid by the City in FY 2025, with OCFA's last contribution occurring if FY 2024. The City's phased-in share of these costs are included in the forecast, based on projections by OCFA. These may vary over the five-year timeframe based on actual costs.

The Fire Contract Services category only shows the OCFA contract amount. Costs paid by the City outside of the contract are not included in this contract amount. These additional costs, include the ambulance contract, are forecast in other categories. Total Fire and ambulance related costs are forecasted at $12.9 million.

Other Contract Services

Contract services are substantial, as this category consists of a wide variety of contracts and services. This category includes maintenance costs, legal services, professional services, animal control, ambulance, utilities, printing, binding, and other various contract services. These are combined and anticipated to increase by inflation levels and other changes. The first year of 6% is a higher percentage recognizing both CPI, energy costs, service level changes, and other demand issues. Some costs may increase by more and some by less.

One of the larger individual contracts is for the ambulance transport services provided by Care Ambulance Services under contract through June 30, 2022 for two full-time ambulances. Projections for the five-year forecast assume continuation of the two full-time ambulance model currently in place. The forecast assumes the City will continue to operate with the two full-time ambulances in the contractual model currently in place.

Other Charges/Supplies

Other charges/supplies includes the CalPERS public safety payment, contract class instructors, street signs, materials, chemicals, special events, postage, tools, dues and subscriptions, and other general operating supplies. This has a higher increase the first year due to some service level expectation and the annual public safety CalPERS payment. The percentage increase slowly flattens in the future towards anticipated future inflation levels of around 2-3%. Some costs may increase more and some less, but generally the amounts should increase around inflation levels.

On-going Maintenance

The City annually budgets for routine capital maintenance for streets, sidewalks and other facility maintenance improvements. These amounts do not include separately identified one-time projects which are more non-routine in nature and are called out as part of the Capital Improvement Program through the budget process. These budgets do not increase annually and smaller routine maintenance projects are identified which fit within the dollar scope of the budget.

This allocation includes funds for street work, slurry seal, sidewalk maintenance and facility maintenance. There is no change to these amounts over the forecast period. A summary of the annual budget allocation by Fiscal Year included in the forecast follows:

Description	**FY 2023**	**FY 2024**	**FY 2025**	**FY 2026**	**FY 2027**
Street maintenance	$ 550,000	$ 550,000	$ 550,000	$ 550,000	$ 550,000
Slurry seal	250,000	250,000	250,000	250,000	250,000
Facilities maintenance	250,000	250,000	250,000	250,000	250,000
Sidewalk maintenance	150,000	150,000	150,000	150,000	150,000
Total	$1,200,000	$1,200,000	$1,200,000	$1,200,000	$1,200,000

Other Expenditures

The City's other expenses category is made up of transfers and interdepartmental charges. Transfers include the annual transfer of $500,000 to provide annual funding for the Street improvement Program from the General Fund. In addition, a $15,000 transfer to assist with Senior Mobility is forecasted along with a trolley subsidy of $250,000. Interdepartmental charges consist of charges to recover costs for specific activities. These include insurance charges, postage, duplicating, EDMS, information technology, communications, fleet, facilities and capital replacement. These costs are anticipated to increase from 0% to 3%.

Reserve Analysis

Objective

To analyze and recommend appropriate levels of reserves to (a) ensure that reserves are adequate to provide for the needs of each fund's program, (b) meet program needs without unnecessarily obligating scarce dollar resources and (c) to ensure compliance with City fiscal policies and legal requirements by State, County or Local Ordinances.

Background

Sound accounting and budgeting practices require that each fund maintain a positive fund balance and an appropriate level of reserve. The City's reserves are dictated by the City's fiscal policy and the annual LTFP review process. The City's Fiscal Policy defines the types and criteria for funding levels for each of the City's reserves based on industry practice, Government Finance Officers Association (GFOA) best practices, and other external consideration.

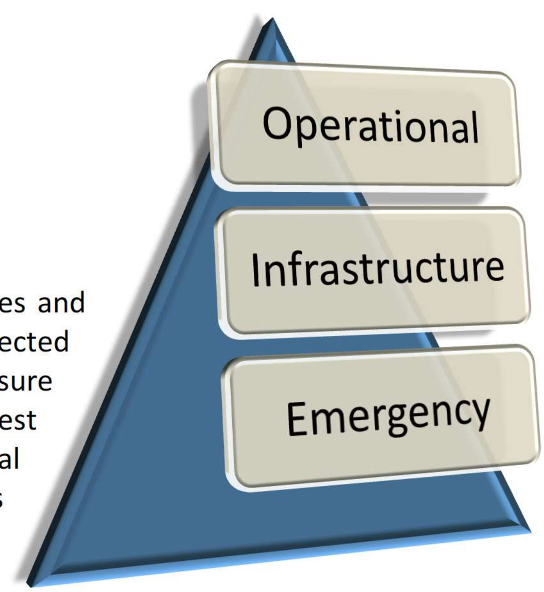
The General Fund, the primary governmental fund of the City, maintains the Emergency Reserve and a Sustainability Reserve to protect essential service programs during periods of economic downturn. An Accrued Leave Reserve exists for the payment of vested leave. The Park Asset, Capital Equipment Replacement, and Facilities Maintenance Capital Asset Reserves comprise amounts for asset maintenance in the Reserve Capital Projects Fund. These reserves are supported by charges and transfers from the General Fund. The General Liability Self-Insurance Fund, Workers' Compensation Fund, and Fleet Fund are classified as Internal Service Funds. These funds charge other City departments for services they provide and are designed to fully recover the costs of providing the services. Additionally, these internal service funds should not have excessive fund balances beyond the reserves required and to pay for operating costs.

The Water, Sewer, Golf, Storm Drain, and Solid Waste Funds maintain an emergency reserve per Fiscal Policy similar to the General Fund to protect essential service programs during periods of economic downturn. In addition, the Water, Sewer, Storm Drain and Golf funds maintain Depreciation Reserves for the maintenance and replacement of assets.

Executive Summary

This year staff has analyzed the reserves and categorized the reserves into three basic categories. The three basic categories are:

- Operational Reserves
    - Insurance Reserves
    - Miscellaneous Reserves
- Capital/Infrastructure Reserves
    - Depreciation and Replacement Reserves
- Emergency Reserves



The emergency reserves are the foundation of City finances and make sure operations and other capital projects are not affected by unforeseen events. Capital/Infrastructure reserves ensure that facilities are properly maintained to provide the best service delivery and facilities to the citizens. Operational reserves allow for the smoothing of costs so city operations are not effected by a significant cost or loss.

The City, as part of its annual assessment, reviews reserve amounts, future reserve needs, established fiscal policy, best practices (including GFOA), and other financial factors. The reserves presentation includes the following aspects for each reserve:

- Purpose – provides information on the general use and purpose of the reserve
- Funding – discussion on whether the fund receives amounts through charges, contributions, or transfers
- Fiscal Policy – this is the City Council adopted fiscal policy currently in place
- Discussion/Analysis and Assessment – provides a general discussion on funds required amounts available, and a history of the reserve and related funding
- Recommendation – this is staff's recommendation based on an analysis of the reserve, its funding, and future requirements.

As part of this year's assessment, staff's recommendations strengthen City reserves providing a strong financial foundation for the future. Summary of the review/analysis of the reserves is below by area: *Emergency Reserves, Capital/Infrastructure Reserves, and Operational Reserves*.

Emergency Reserves for the General Fund in FY 2021-22 reflect the General Fund Emergency Reserve funding level which is 20% of operating expenditures. No changes are recommended to the funding level in FY 2022-23. Enterprise Emergency Reserves have no recommendations to the reserve level. However, a recommendation was made previously to review rates in the Sewer Fund, which were last adjusted in 2016. Additionally, the Storm Drain funding from the Clean Ocean fee for Clean Ocean funded assets has been suspended, which is impacting the Storm Drain Emergency reserves. This will be considered as part of the Clean Ocean assessment. The Golf Course fund adjusted rates and with higher revenues the Emergency Reserve is now funded. This is facilitating repayments on the internal borrowing from Golf Depreciation and Improvement Reserves which funded Golf operations and Golf Clubhouse construction.

Capital/Infrastructure Reserves provide funds for replacement of capital assets, including infrastructure. The City has multiple reserves properly funded, however several lack proper funding. The shorter term assets, such as equipment and vehicles, are properly funded, as seen from the Fleet and Capital Equipment Reserves. The City is working to fund the replacement of long-term capital assets, such as water, sewer, and storm drain capital assets. These assets have longer lives and are substantially greater in cost. Capital/Infrastructure reserves mitigate the direct impact of funding requirements in any one year, setting aside funds over a longer period of time. Lucity, the City's Computerized Maintenance Management System, started the process to identify assets and determine upcoming needs to set aside for replacement.

Capital reserves funding cannot be accomplished in one year, especially with past underfunding. Water capital asset funding is improving, with transfers recommended to address capital needs. A Sewer cost of service study to allocate costs and recover those costs should improve long-term funding for capital asset replacements due to the aging of the Sewer facility and other infrastructure. The Storm Drain fund continues to reflect significant capital assets, which will need replacement in the future. The funding and fee originally adopted in 1993 has not kept place with inflation. To ensure ongoing funding, staff reviews alternative funding options, such as grant funding, or cooperative agreements rather than utilizing only reserve funds.

Operational Reserves are improving. These reserves include Accrued Leave, Debt and Liability Reserves which help reduce short term cost impacts on City operations. The Accrued Leave Reserve is fully funded, however lower interest earnings impact reserve levels now and in the future. The State Revolving Loan Reserve is funded in accordance with fiscal policy and the State loan agreement. Liability reserves are stable at current levels and can assist with uncovered claims or issues that arise in the future.

This analysis aims to improve Emergency Reserves, address capital assets, and strengthen the operating position of the City. Further information as to the balances and the funding status is addressed on each individual Reserve analysis sheet.

Reserve Analysis Summary:

Reserves by category, funding source, and June 30 estimated balances are in the following table. These balances will be used to fund the July 1, 2022 reserve requirements:

Reserves	Fund	Estimated Reserve Balances at June 30, 2022	FY 2022 Status
Emergency Reserves:			
General Fund Emergency Reserve	General Fund	$ 14,791,000	Properly Funded
Water Operating	Water Fund	$ 1,375,000	Properly Funded
Sewer Operating	Sewer Fund	$ 510,000	*Not Funded* [1]
Golf Course Operating	Golf Course Fund	$ 292,000	Properly Funded
Storm Drain Operating	Storm Drain Fund	$ 152,000	*Not Funded* [1]
Solid Waste	Solid Waste Fund	$ 33,000	Properly Funded
Capital/Infrastructure Reserves:			
Fleet Replacement	All Funds	$ 5,133,000	Properly Funded
Capital Equipment Replacement	General Fund	$ 1,962,000	Properly Funded
Facilities Maintenance	General Fund	$ 5,082,000	Properly Funded [2]
Park Asset Replacement	General Fund	$ 2,037,000	Properly Funded
Water Fund Depreciation	Water Fund	$ 9,657,000	*Partially Funded* [3]
Sewer Fund Depreciation	Sewer Fund	$ 5,299,000	*Partially Funded* [3]
Storm Drain Fund Depreciation	Storm Drain Fund	$ 2,004,000	*Partially Funded* [3]
Golf Course Fund Depreciation	Golf Course Fund	$ 2,059,000	Properly Funded
Golf Capital Improvement Reserve	Golf Course Fund	$ 1,193,000	Properly Funded
Operational Reserves:			
Accrued Leave	General Fund	$ 900,000	Properly Funded[2]
State Revolving Loan Reserve	Water Fund	$ 900,600	Properly Funded
General Liability Self-Insurance	All Funds	$ 6,236,000	Properly Funded
Workers' Compensation Insurance	All Funds	$ 1,474,000	Properly Funded

[1] These reserves are not properly funded. Rate reviews are recommended to obtain emergency reserve levels.

[2] These reserves meet the funding required at June 30, 2022, however based on anticipated future activity one-time transfers are recommended to fund future reserve levels.

[3] These reserves are below the funding required at June 30, 2022. Actions, such as funding increases or transfers, to narrow the funding gap are recommended to improve the funding level to achieve future compliance.

Staff will keep appraised of legislative developments to modify Storm Drain fees to meet the cost demands placed on the City's public storm drain system and continue to work on the Sewer Cost of Service Study to revise Sewer rates. Staff will bring further action to Council to address the Emergency Reserves and longer term capital funding needs as appropriate.

A summary of the recommendations based on the analysis by reserve category follows:

Emergency Reserves – No changes are recommended in the funding levels (percentages).

Capital/Infrastructure Reserves

- Transfer an amount of $400,000 from the General Fund to the Facilities Maintenance Reserve in FY 2022-23.
- Transfer a one-time amount of $1.5 million from the Water Operating Reserve in FY 2022-23 to the Water Depreciation Reserve to fund future capital replacement in the Water Depreciation Reserve.

Operational Reserves

- Transfer a one-time amount of $100,000 in FY 2022-23 to fund the Accrued Leave Reserve.

General Fund Emergency Reserve

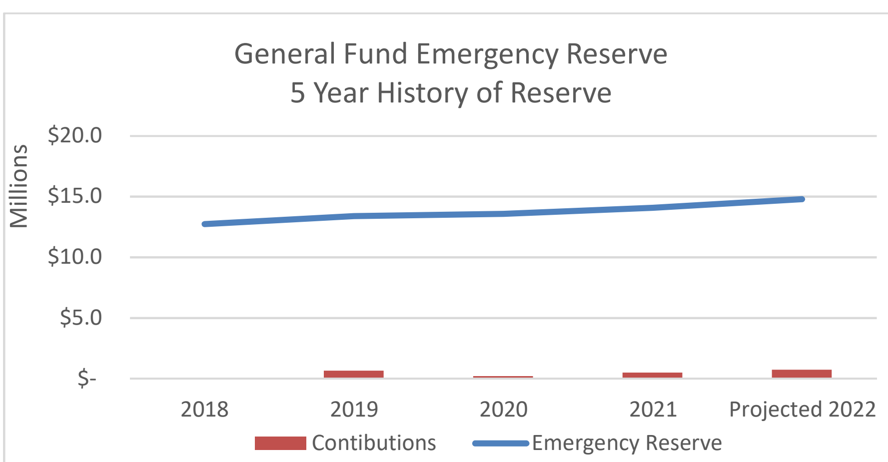
Emergency Reserve Category

Purpose: The City emergency reserves are to fund unanticipated costs from unforeseen disasters (fire, flood, earthquake, landslides or other disasters), to provide stability during a significant economic downturn where operating revenues decrease more than 10% and expenditure reductions cannot be achieved, or to offset a one-time loss of a state subvention.

Funding: The General Fund Emergency Reserve is funded through one-time transfers of unassigned fund balance. When this reserve is used, the Finance division will develop a plan as part of the Long Term Financial Plan to replenish the emergency reserve. This replenishment will be done through budgetary action and allocations of one-time resources.

Fiscal Policy: Maintain an emergency reserve equal to 20% of operating expenditures of the General Fund. The primary purpose of this reserve is to provide stability during a significant economic downturn, or to offset a significant one-time loss of revenue. The reserve exists in order to provide short-term funds to protect the City's essential service programs and funding requirements or to provide unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

Discussion/Analysis and Assessment: The Emergency Reserve provides resources to allow the City to continue operations in the occurrence of any serious conditions. In FY 2016-17, the Emergency Reserve and Sustainability Reserve were combined and the Emergency Reserve funding level was modified from 9% to 20%. The General Fund emergency reserve is a minimum of 20% of operating expenditures. This funding level is based on GFOA best practices which recommends emergency reserves equivalent to *at least* two month's operating expenditures, or 17%. Funding the reserve at 20% provides for cash flow fluctuations during a particular month and conservatively exceeds the GFOA minimum recommendation (17%). This additional 3% above the GFOA minimum recommendation could provide for economic stabilization in times of an economic downturn. In FY 2022-23, the reserve will increase to $14.8 million based on the forecast.



Recommendation: No changes recommended.

Enterprise Emergency Reserve

Emergency Reserve Category

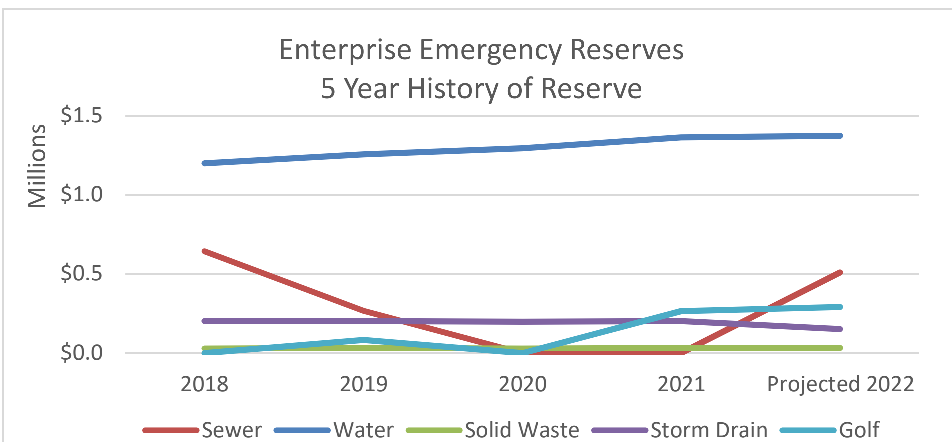
Purpose: The City's enterprise fund emergency reserves are to fund unanticipated costs from unforeseen disasters and to provide a financial buffer to prevent a need to dramatically change rates based on these unforeseen disasters.

Funding: The Enterprise Emergency Reserves are funded through one-time transfers of unassigned equity. After use of this reserve the Finance division will develop a plan, through the Long Term Financial Plan, to replenish the emergency reserve through rate changes or through cost savings over a set time frame.

Fiscal Policy: The City's Enterprise Funds will maintain at a minimum reserve level at least equal to 12% of operating expenses. The primary purpose of these reserves is to set aside funds to provide for unanticipated or emergency expenses that could not be reasonably foreseen during the preparation of the budget.

Discussion/Analysis and Assessment: Enterprise operating fund emergency reserves are funded at 12% of operating costs based on GFOA's best practices. Operating costs exclude capital, transfers, debt, and purchased water costs. Water, Storm Drain and Solid Waste Funds 12% emergency reserves are fully funded.

Sewer emergency reserves are not funded and the rate structure is under review. A transfer from Depreciation fund was completed in FY 2022 to maintain a positive working capital balance. The Storm Drain emergency reserve is not fully funded and is under pressure. Clean Ocean contributed assets to the storm drain system and provided funds to operate, which have been reduced. The Golf operating reserve is funded, so principal loan repayments to Golf capital reserves will resume.



The chart above summarizes reserve requirements for each Enterprise Fund emergency reserve to maintain the 12% of operating costs. Emergency reserve level's are as follows:

	Requirement at June 30, 2021	Requirement at July 1, 2022	Funding available at June 30, 2022
Water Fund	$ 1,364,000	$ 1,375,000	$1,375,000
Sewer Fund	1,338,000	1,350,000	Not funded (+$510,000)
Golf Course Fund	290,000	292,000	$292,000
Storm Drain Fund	202,000	198,000	Not funded (+$152,000)
Solid Waste Fund	33,000	33,000	$33,000

Recommendation: No changes recommended.

Fleet Replacement Reserve

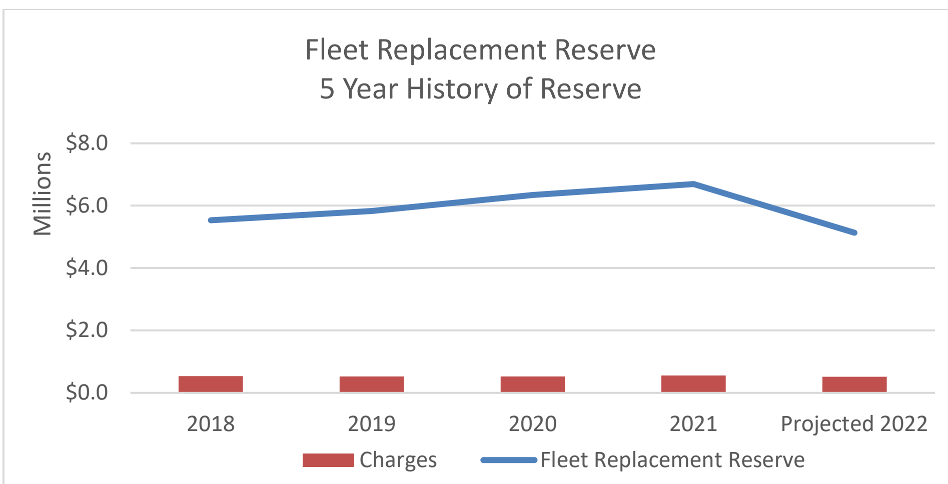
Capital/Infrastructure Reserve Category

Purpose: 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.

Funding: The Fleet Replacement Reserve is funded through annual replacement charges to funds which have fleet vehicles and equipment.

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.

Discussion/Analysis and Assessment: The reserve is reviewed annually to verify funding is adequate to cover projected replacement costs for the next five years. Currently, the City's fleet replacement is valued at $7.8 million. The estimated schedule for replacements are $4.2 million during the next five years and $3.6 million for vehicles to be replaced after six years. This reserve is fully funded with a projected balance of $5.1 million at June 30, 2022.



Recommendation: No changes recommended.

Capital Equipment Replacement Reserve

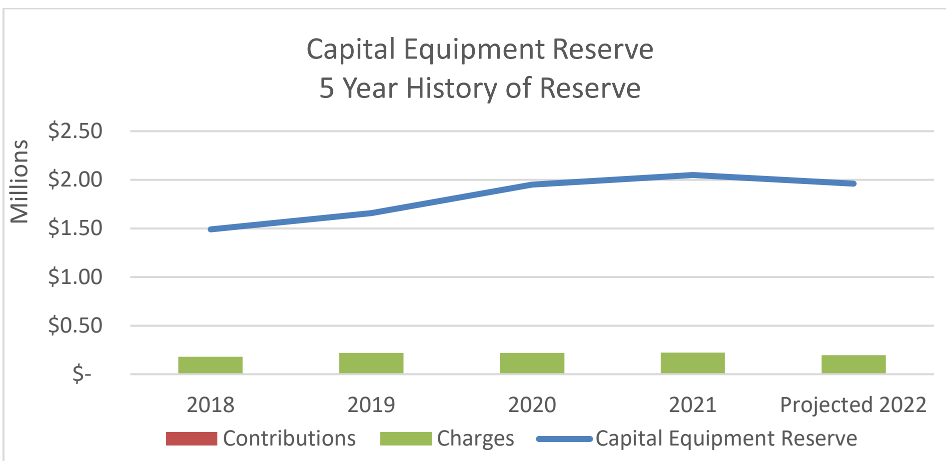
Capital/Infrastructure Reserve Category

Purpose: The City sets aside funds for the replacement of existing General Fund fixed assets as equipment or machinery becomes unserviceable or obsolete.

Funding: The Capital Equipment Replacement Reserve is funded by capital replacement charges to the City General Fund. These replacement costs are charged over the estimated service life of the asset to the General Fund program that benefits. Funds are also transferred on a one-time contribution basis based on the estimated future activity identified.

Fiscal Policy: Maintain a Capital Equipment Replacement Reserve for the accumulation of funds for the replacement of worn and obsolete equipment other than vehicles. These reserves will be maintained at a level at least equal to the projected five-year capital asset replacement costs.

Discussion/Analysis and Assessment: As General Fund capital equipment is replaced, the capital costs are paid from this reserve. 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. The projected fund balance at June 30, 2022 is $2.0 million and the anticipated five-year costs are fully funded.



Recommendation: No changes recommended.

Facilities Maintenance Reserve

Capital/Infrastructure Reserve Category

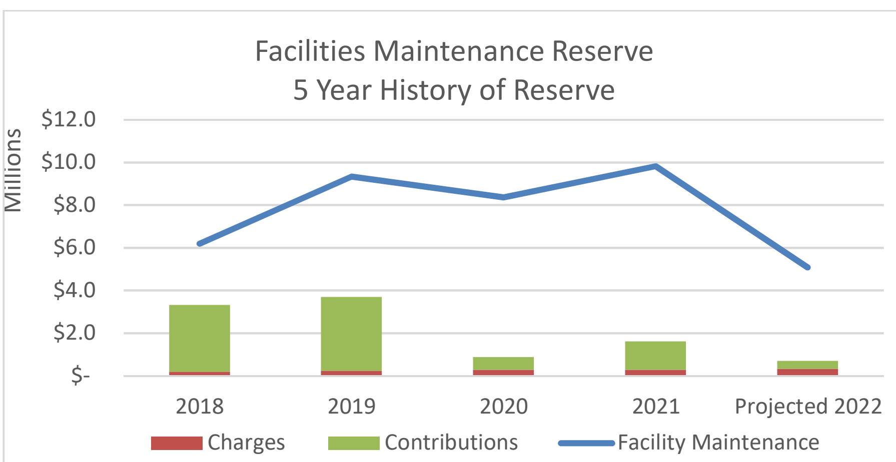
Purpose: The City established this reserve to provide funds for the maintenance of City facilities.

Funding: The Facilities Maintenance Reserve is funded by facility charges to the General Fund based on past facilities replaced, repaired or rehabilitated. These costs are charged over the estimated service life of the asset to the General Fund program that benefits. Funds are also transferred on a one-time basis based on the Capital Improvement Program activity anticipated.

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

Discussion/Analysis and Assessment: General Fund facilities are replaced through capital expenditures made from this fund. The City's capital activity includes long term projects, such as, the Marine Safety building, Maintenance building, and other buildings and facilities. The projected fund balance at June 30, 2022 of $5.1 million is insufficient to fund the replacement of all these buildings and facilities. The decrease is related to the budget for the Beach Trail Bridge Replacement which is budgeted at $5.0 million.

The General fund currently contributes a recurring amount of $400,000 with $200,000 for pier related rehabilitation and $200,000 for basic costs which exclude the larger projects. No additional transfer is currently recommended for these longer term projects from the General Fund unassigned fund balance. Staff will analyze capital asset categories, within Lucity, and identify assets funded for replacement in this reserve.



Recommendations: Transfer an amount of $400,000 from the General Fund to the Facilities Maintenance Reserve in FY 2022-23.

Park Asset Reserve

Capital/Infrastructure Reserve Category

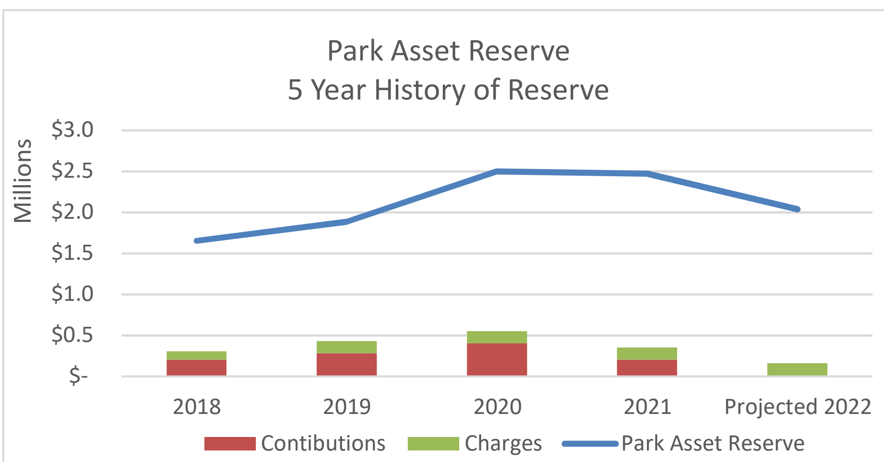
Purpose: The Park Asset Reserve is used for replacement of park capital assets valued over $50,000 within city parks. This reserve is funding playground equipment replacements and setting aside funds for artificial turf replacement at the Vista Hermosa Sports Park.

Funding: In FY 2009-10, the City started funding this reserve through one-time transfers and reached the $1.2 million minimum reserve level in FY 2011-12. The City provides funding through contributions and charges to the General Fund, which are reviewed annually as part of the LTFP.

Fiscal Policy: The City will establish a Park Asset Replacement Reserve with a target balance of $1.2 million for the replacement of park assets. The reserve balance will be reviewed annually and funded through one-time revenues, or unassigned General Fund balance transfers, when available.

Discussion/Analysis and Assessment: The City currently pays for most park asset replacements on a “pay as you go” basis. Park assets total more than $65 million. Significant annual contributions would be required to set aside funds for all park system assets. The City, realizing the need for maintaining high use park assets, identified artificial turf replacement and playground equipment for funding.

Currently, the projected balance at June 30, 2022 is $2.0 million. However, the City is utilizing the reserve based on a playground replacement schedule that includes upgraded playground equipment from the existing equipment. As replacement projects are completed, replacement charges to the benefiting program replenish the Park Asset Reserve based on an estimated asset life. These charges during FY 2022-23 are anticipated to be $180,000. Staff will review Lucity’s data to identify and add additional assets (such as lights, restrooms, fields, courts, etc.) to be funded through the Park Asset Reserve.



Recommendation: No changes recommended.

Water Fund Depreciation Reserve

Capital/Infrastructure Reserve Category

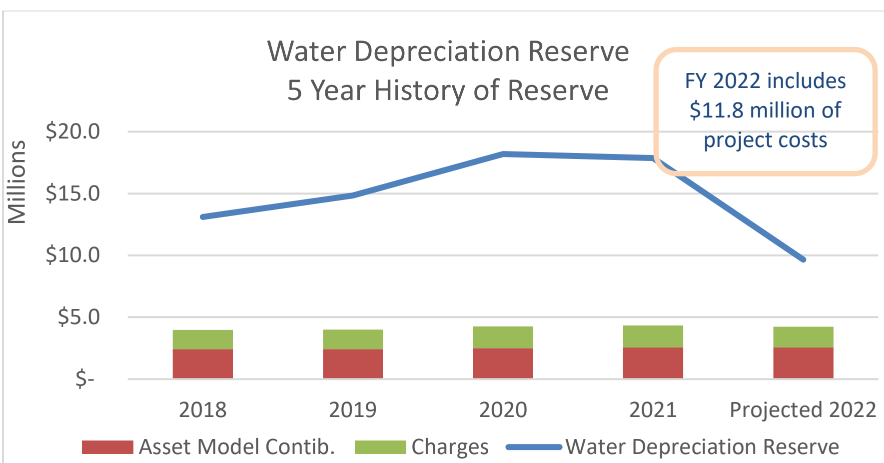
Purpose: The Water Depreciation reserve sets aside replacement funds for water capital assets and equipment that reach the end of their useful life and for major repairs to the water system infrastructure. This reserve includes Other Agency infrastructure assets that are owned, operated and maintained by Joint Regional Water Supply System and Santa Margarita Water District.

Funding: The Water Depreciation Reserve is funded through depreciation charges based on the useful life of the assets and additional transfers from the operating fund based on an Asset Model amount. Additional one-time contributions are considered from available operating equity.

Fiscal Policy: The City will establish a Water, Sewer, Storm Drain and Golf Depreciation Reserve for costs associated with the major maintenance and capital improvement costs included in the Enterprise Fund budgets. The minimum reserve level shall be at a level equal to the projected three-year costs.

Discussion/Analysis and Assessment: Water infrastructure reserves have been underfunded for a long period of time. Council has taken action to increase contributions based on an Asset Model to narrow this significant funding gap. The projected ending depreciation reserve balance at June 30, 2022 is $9.7 million if all projects are completed. The three-year capital costs total $15.7 million. Therefore, the Depreciation Reserves are underfunded by $6.0 million, as compared to last years $4.8 million underfunding. The City is progressing toward funding three years of capital project activity based on the fiscal policy.

The Water Operating Fund contributed depreciation amounts of $1.8 million based on the useful life of water capital assets. Asset model contributions of $2.5 million address past underfunding, major maintenance costs, and joint agency assets. The underfunding of this reserve has fluctuated but recently is remaining stable. Contributions funding the reserve are increasing and slowly improving the underfunding levels, however a one time transfer from the Water Operating Fund is recommended to improve funding levels. Staff will consider future additional reserve contributions based on funding levels.



Recommendation: Transfer a one-time amount of $1.5 million from the Water Operating Reserve in FY 2022-23 to the Water Depreciation Reserve to fund water asset replacement.

Sewer Depreciation Reserve

Capital/Infrastructure Reserve Category

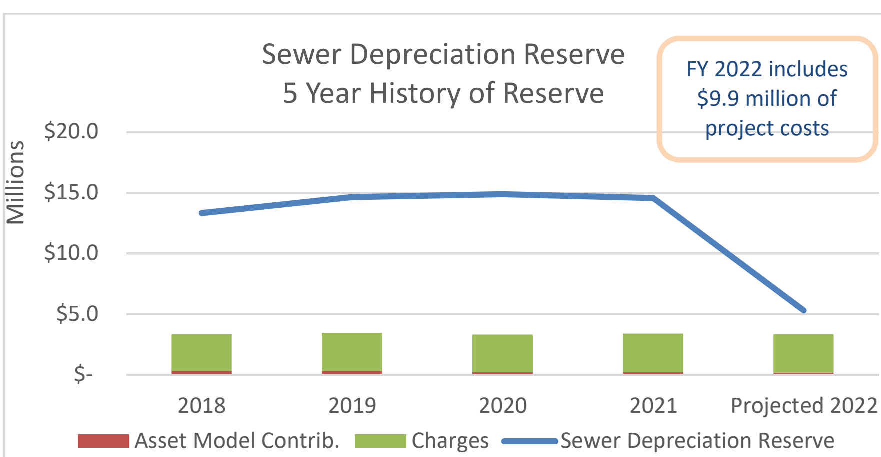
Purpose: The Sewer Depreciation reserve set aside replacement funds for sewer capital assets and equipment that reach the end of their useful life and for major repairs to the sewer system infrastructure. This reserve includes Other Agency infrastructure assets that are owned, operated and maintained by the South Orange County Wastewater Authority.

Funding: The Sewer Depreciation Reserve is funded through depreciation charges based on the useful life of the assets and additional transfers from the operating fund based on an Asset Model amount. Additional one-time contributions are considered from available operating equity.

Fiscal Policy: The City will establish a Water, Sewer, Storm Drain and Golf Depreciation Reserve for costs associated with the major maintenance and capital improvement costs included in the Enterprise Fund budgets. The minimum reserve level shall be at a level equal to the projected three-year costs.

Discussion/Analysis and Assessment: Sewer infrastructure reserves have been underfunded for a long period of time. Council has taken action to increase contributions based on an Asset Model to narrow this funding gap. The projected ending depreciation reserve balance at June 30, 2022 is $5.3 million if all projects are completed. The three-year capital costs total $15.3 million. Therefore, the Depreciation Reserve is $10.0 million underfunded. The City is in the process of reviewing the sewer rates and with the anticipated rate changes this funding level should be improved in the future.

The Sewer Operating Fund contributes $3.2 million based on depreciation and $0.2 million to set aside additional reserve funds. The depreciation funding amount is based on the estimated useful life of the capital assets. The reserves underfunding level remains, with the Sewer Treatment Plant continuing to age and new environmental regulations added, which will continue to add to the underfunding levels. Funding of the contributions should be maintained and if significant one-time resources are received staff will consider additional contributions to the depreciation reserves.



Recommendation: No changes recommended.

Storm Drain Depreciation Reserve

Capital/Infrastructure Reserve Category

Purpose: The Storm Drain Depreciation reserves set aside replacement funds for storm drain capital assets and equipment that reach the end of their useful life and for major repairs to the storm drain system infrastructure.

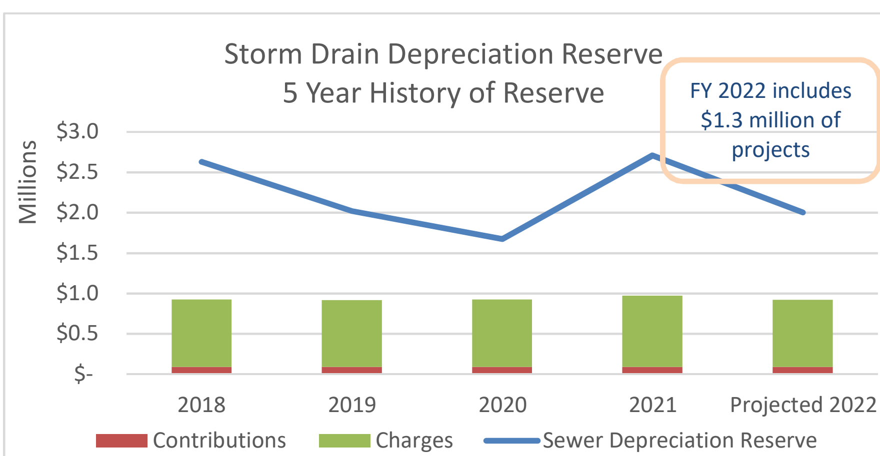
Funding: The Storm Drain Depreciation Reserve is funded through depreciation charges based on the useful life of the assets and additional transfers from the operating fund. Additional one-time contributions are considered from available operating equity.

Fiscal Policy: The City will establish a Water, Sewer, Storm Drain and Golf Depreciation Reserve for costs associated with the major maintenance and capital improvement costs included in the Enterprise Fund budgets. The minimum reserve level shall be at a level equal to the projected three-year costs.

Discussion/Analysis and Assessment: The projected ending balance at June 30, 2022 is $2.0 million and the three-year capital costs total $5.3 million. Therefore, the Depreciation Reserve is underfunded by $3.3 million. The Storm Drain charge was adopted in 1993 (Ord. 1120) and has not kept pace with inflationary increases. Currently, there is a Storm Drain Master Plan which identifies and determines the needs of the Storm Drain system. The Storm Drain Master Plan, will show a need to improve funding for storm drains. Funding options may include increases to the Storm Drain fee, assistance through any Clean Ocean renewal, grants, or actions based on recent or future legislative actions or interpretation. Recent legislation passed may allow increases to Storm Drain fees through a process similar to water and sewer rates if certain criteria and conditions are met, however the process is not validated through court opinions.

The Storm Drain Depreciation Fund contributes $830,000 based on depreciation funding and an additional reserve contribution of $90,000 for a total contribution of $910,000 in FY 2022-23. The depreciation funding amount is based on the estimated useful life of the capital assets. The additional contribution is estimated to fund past costs of the reserve.

Staff is keeping appraised of legislative developments to modify Storm Drain fees to meet the cost demands placed on the City's public storm drain system.



Recommendation: No changes recommended.

Golf Depreciation Reserve

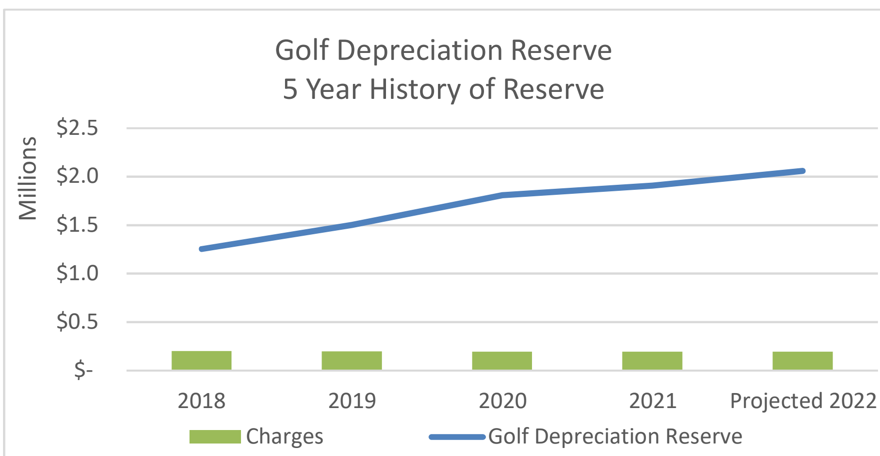
Capital/Infrastructure Reserve Category

Purpose: The Golf Depreciation reserve sets aside replacement funds for equipment, machinery, and buildings that reach the end of their useful lives. The Golf Depreciation Reserve assets (buildings, machinery, and equipment replacements) can have lives between 5-50 years.

Funding: The Golf Depreciation Reserve is funded through depreciation charges based on the useful life of the assets and from contributions made under the lease arrangement with Wedgewood, the restaurant concessionaire.

Fiscal Policy: The City will establish a Water, Sewer, Storm Drain and Golf Depreciation Reserve for costs associated with the major maintenance and capital improvement costs included in the Enterprise Fund budgets. The minimum reserve level shall be at a level equal to the projected three-year costs.

Discussion/Analysis and Assessment: The available ending balance projected at June 30, 2022 is $2.1 million. This amount does not include the receivable from an internal loan ($1,250,000) to Golf Operating, which is not considered available. Projected capital expenses for the next three years total $576,000. Therefore, the Depreciation Reserve is currently funded. Annual amounts placed into this reserve are based on the depreciation of the assets that will be replaced.



Recommendation: No changes recommended.

Golf Improvement Reserve

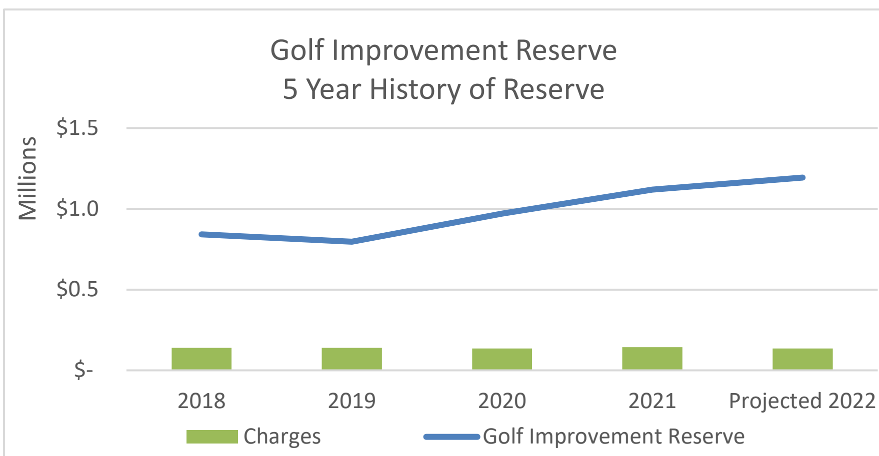
Capital/Infrastructure Reserve Category

Purpose: The Golf Capital Improvement Reserve was established to set aside funds for capital improvements in the Golf Course Fund. The Improvement Reserve is to provide funds for green and tee reconstruction, fencing and other miscellaneous golf improvements based on depreciation of these improvement assets.

Funding: The Golf Improvement Reserve is funded through depreciation charges based on the useful life of the assets.

Fiscal Policy: The City will maintain a Golf Capital 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 three-year costs.

Discussion/Analysis and Assessment: The Golf Capital Improvement Reserve at June 30, 2022 is projected to have an ending balance of $1,193,000. This amount does not include the receivable from an internal loan ($500,000) to Golf Operating, which is not considered available. Projected expenses for the next three years total $124,000. Therefore, the Improvement Reserve is currently funded. Annual amounts placed into this reserve are based on the golf improvement depreciation amounts.



Recommendation: No changes recommended.

Accrued Leave Reserve

Miscellaneous Reserve Category

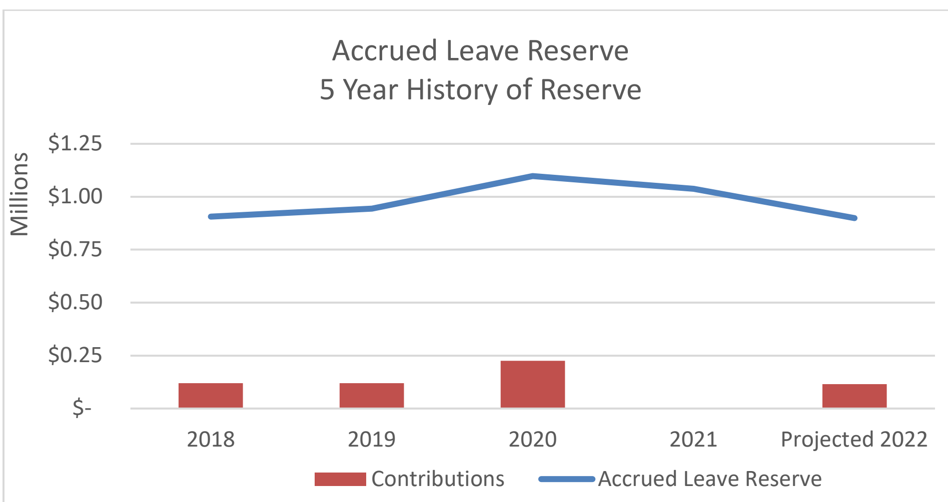
Purpose: The City reserves amounts for the payment of vacation and sick leave payoffs for General Fund eligible employees. Amounts are set aside in a separate reserve for this purpose. An annual amount is budgeted from this reserve to payoff General Fund employee's vacation and sick leave balances for employees eligible to retire based on the personnel policies of the City. These payments are due upon separating from the City.

Funding: The Accrued Leave Reserve is funded through transfers of unassigned General Fund balance. The reserve contribution is determined annually based on the reserve balance, funding requirements, and leave balances.

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

Discussion/Analysis and Assessment: When a General Fund employee leaves employment, their accrued leave is paid from this reserve. The reserve requirement (accrued leave dollar value) fluctuates annually based upon the eligible employees, length of service, pay rates and hours accrued. At June 30, 2021, the total General Fund accrued leave liability was $1.08 million, with $473,000 available to provide funds for retirement eligible employees. MOU salary increases and employee changes effect the status of this reserve. The projected ending balance for the Accrued Leave Reserve as of June 30, 2022 is $900,000 and the projected ending liability is $882,000.

The Accrued Leave Reserve is fully funded, however a contribution is required to address future salary/pay increases which are exceeding investment earnings on funds held in the Reserve.



Recommendation: Transfer a one-time amount of $100,000 in FY 2022-23 to fund the Accrued Leave Reserve.

State Revolving Loan Reserve

Miscellaneous Reserve Category

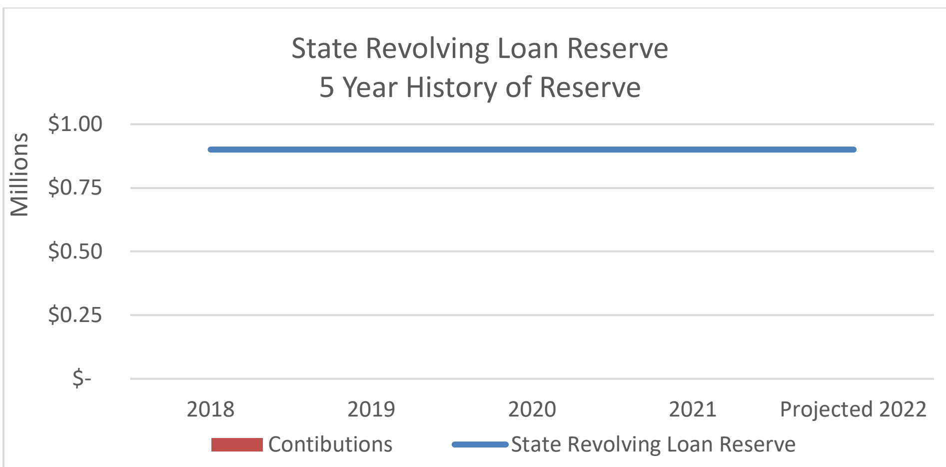
Purpose: The City of San Clemente entered into a loan agreement with the California State Water Resources Control Board under the Clean Water State Revolving Fund (CWSRF) loan program for financing construction of the Recycled Water System Expansion Project. As required under the State Revolving Loan, one year's annual debt service payment is to be maintained in a reserve.

Funding: The reserve was funded through a one-time contribution from the Operating Fund in the amount of $900,600. This is equal to one year's debt service.

Fiscal Policy: The City will establish a restricted reserve in the Water Operating Fund equal to one year's debt service on the State Revolving Loan. The purpose of this reserve will be to provide a debt reserve as required under the State Revolving Loan financing agreement.

Discussion/Analysis and Assessment: The City loan amount outstanding as of June 30, 2022 is projected to be $10.1 million. This loan is being amortized over a period of 20 years and the loan is anticipated to be paid in full in FY 2034-35. The reserve was first funded in FY 2015.

The repayment of this loan is secured by the net revenues of the Water Fund with a revenue coverage level of 110% of the annual debt service. There is no change in the reserve level.



Recommendation: No changes recommended.

General Liability Reserve

Miscellaneous Reserve Category

Purpose: The City is a member of California Joint Powers Insurance Authority (CJPIA). CJPIA administers programs for the pooling of self-insured losses, and the purchase of excess insurance or reinsurance. Losses excluded from the CJPIA coverage include 1) breach of contract, 2) land use entitlement, 3) eminent domain, 4) hazardous materials release, and 5) punitive damages. This reserve fund provides stabilization of the other fund charges and for losses not covered.

Funding: The General Liability Reserve is funded through charges to other funds. Charges are based on two key factors: 1) Five-year average of historical claims for risk by fund which accounts for 25% of the basis for the charge (limited to the claims coverage level). 2) A fund's budgeted expenditures as a percentage of total budgeted expenditures which accounts for 75% of the basis for the charge.

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 one times its annual insurance authority premium. In addition, the City will perform an annual analysis to document 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.

Discussion/Analysis and Assessment: The reserve requirement is at least one times the annual risk financing premium (contribution) to absorb contribution fluctuations based on claims activity. The City's CJPIA premium for FY 2021-22 is estimated at $2.2 million, which would be the reserve requirement. The projected General Liability balance at June 30, 2022 is $6.2 million.

The City has $4.0 million retained that exceeds the reserve requirement in the General Liability Fund to fund significant one-time costs and fund claims not covered through CJPIA coverage. The City is party to multiple lawsuits regarding non-covered items and other claims which may be outside of CJPIA coverage.

Recommendations: No changes recommended.

ATTACHMENT A – Insurance Charges

General Liability charges

The following table shows the calculations for charges to other funds for FY 2022-23:

	% of Past Claims (25%)	% of Budgeted Expenditures (75%)	Total % of General Liability Charges (weighted average)	Total Charge for General Liability FY 2022-23	Total Charge for General Liability FY 2021-22
General Fund	75.7%	66.2%	68.6%	$ 1,894,860	$ 1,826,990
Water Fund	16.7%	17.8%	17.5%	462,960	461,120
Sewer Fund	4.0%	7.6%	6.7%	155,280	180,830
Solid Waste Fund	0.0%	0.3%	0.2%	6,720	4,700
Storm Drain Fund	3.2%	0.8%	1.4%	18,090	37,170
Golf Course Fund	0.0%	2.1%	1.6%	41,790	39,900
Clean Ocean Fund	0.4%	1.6%	1.3%	35,520	41,070
Central Services Fund	0.0%	0.5%	0.4%	10,320	10,160
Information Services Fund	0.0%	2.0%	1.5%	40,380	39,980
Fleet Maintenance Fund	0.0%	1.1%	0.8%	22,080	22,080
Total	**100.0%**	**100.0%**	**100.0%**	**$2,688,000**	**$2,664,000**

Workers Compensation Reserve

Miscellaneous Reserve Category

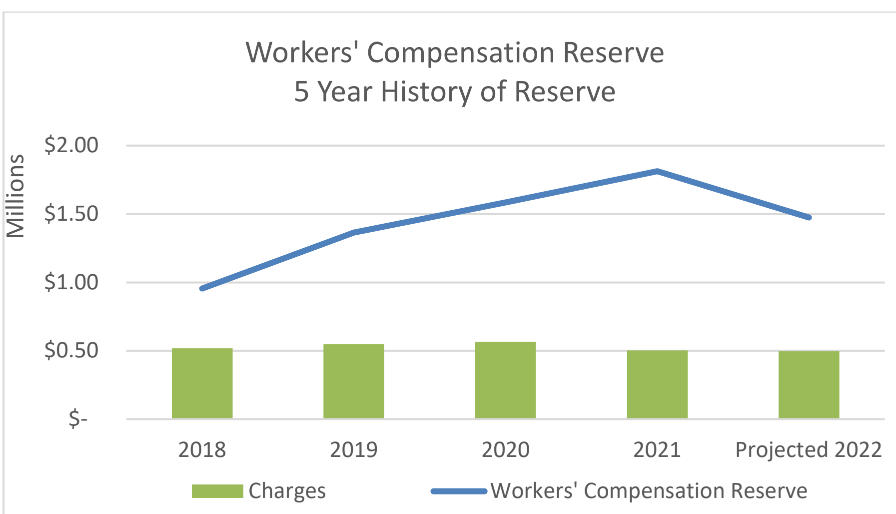
Purpose: The City is self-insured for Workers' Compensation coverage and purchases. The Public Risk Innovation, Solutions, and Management (PRISM) Insurance Authority provides coverage for Workers' Compensation claims in excess of $300,000, which is the City's Self-Insurance Retention (SIR) amount.

Funding: The Workers Compensation Reserve is funded through internal service charges to all City funds based on payroll costs. These charges are based on employee classifications and the type of work performed (e.g. manual labor, non-manual and clerical, etc.). These internal charges are placed into the Workers' Compensation Fund to pay workers compensation claims and administrative costs.

Fiscal Policy: Maintain a reserve 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. 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.

Discussion/Analysis and Assessment: The City's fiscal policy requires a reserve equal to $900,000 (three times the SIR). Staff modified the reporting of the reserve so claims reduce the asset amount to arrive at the reserve balance. At June 30, 2022, projected assets of $2.0 million are reduced by the claims payable of $0.5 million leaving a projected reserve balance at $1.5 million. The City exceeds the reserve level of $900,000 set through fiscal policy.

Based on cash amounts available, current claims and anticipated recoveries, staff is recommending no changes to the reserve policy of three times the SIR amount ($900,000 level). The rates have been adjusted downward and are anticipated to provide adequate funds to maintain the reserve level and fund claims activity. Rate increases would occur in future years if claims activity or the premium increases substantially lowering the reserve funds available.



Recommendation: No changes recommended.

Fiscal Policy

Objective

Review the City's adopted 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.

The Fiscal Policy statements are presented by major categories, which include:

- Core Values of Financial Sustainability
- Operating Budget
- Revenue
- Expenditure
- Utility Rates and Fees
- Capital Improvements
- Short Term Debt
- Long Term Debt
- Fund Balance and Reserves
- Investment Policies
- Accounting, Auditing, and Financial Reporting
- Long Term Financial
- Risk Financing
- Pension

A **Status** for each Policy Statement is presented, with a ✓ for "in compliance", or -- if the policy is "not in compliance" with the current Policy statement.

Comments are provided next to many of the policy statements to provide additional relevant information to the reader. Unless otherwise noted, reserve balances provided in the comment section are based on projected numbers as of June 30, 2022, presented within the Reserve Analysis Paper in this year's Long Term Financial Plan.

Based on this year's review, no changes are being proposed to the City's Fiscal Policies at this time.

Recommendations

None.

Core Values of Financial Sustainability

Financial stability – The City will create financial stability to provide the community with a consistent and adequate level of public services. The City will take a long-term approach to its finances by developing and maintaining long-term plans, carefully weighing the cost and benefits of development opportunities and adhering to sound debt, reserve and investment policies.

Quality of life and local economic vitality – The City will provide effective and efficient services to ensure a safe and healthy atmosphere for its residents, businesses and visitors, while preserving and enhancing its unique cultural and environmental attributes.

Accountability and Financial Planning – The City will institute financial planning that ensures City services are provided at the best value, and that the services are in alignment with the needs and wants of the community.

Environmental and economic sustainability – The City's financial strategy will support continued investment in the renovation and maintenance of physical infrastructure/facilities and in policies and programs that support a clean and healthy natural environment.

Transparency and engagement – The City will be accountable for producing value for the community by producing planning and report mechanisms that make it clear how the City plans to use its resources to achieve the community vision. The City is committed to engaging the public as a partner in formulating plans and delivering services.

	Fiscal Policy Statement	Status	Comments
	Operating Budget Policies		
1	The City will adopt a balanced budget by June 30 of each year. A balanced budget is defined as one in which total expenditures equal total revenue. An entity has a budget surplus if expenditures are less than revenues. It has a budget deficit if expenditures are greater than revenues.	√	
2	An annual base operating budget will be developed by verifying or conservatively projecting revenues and expenditures for the current and forthcoming fiscal year.	√	
3	Current revenues will be sufficient to support current operating expenditures and a budgeted positive operating position will be maintained.	√	

	Fiscal Policy Statement	Status	Comments
4	The City will annually review the General Fund operating position 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.	√	
	Revenue Policies		
5	The City will try to maintain a diversified and stable revenue system to shelter it from short-term fluctuations in any one revenue source.	√	
6	The City will estimate its annual revenues by an objective, analytical process utilizing trend, judgmental, and statistical analysis, as appropriate.	√	
7	All City Council-established General Fund User fees will be reviewed and adjusted annually as part of the budget process by each City department and the analysis with recommended changes will be provided to the City Council. The basis for adjustment will be the cost of providing services, inflationary impacts, or other budgetary factors as appropriate. User fees will be established 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.	√	Annual review is presented in the Fee Schedule section of the Operating Budget.
8	One-time operating, capital, and reserve revenues will be used for one-time expenditures. Exceptions must be formally adopted by Council Action and may only offset operating expenditures for a limited time period of less than five fiscal years.	√	
9	The City will annually identify developer fees and permit charges received from “non-recurring” services performed in the processing of new development and use those funds to meet peak workload requirements.	√	
10	General fund revenue categories (sales tax revenue by example) may not be committed directly to fund a specific expenditure line item or program.	√	

Fiscal Policy Statement	Status	Comments
Expenditure Policies	√	
11 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.		
12 The City will annually project its equipment replacement and maintenance needs for the next five years and will update this projection each year. A maintenance and replacement schedule will be developed and followed.	√	
Utility Rates and Fees Policies		
13 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.	√	Annual review completed. Revised water rates were implemented January 1, 2021. A Cost of Service study is in progress for Sewer rates.
14 Utility rates will be established for each of the next five years and this rate projection will be updated annually.	√	
Capital Improvement Budget Policies		
15 The City will make all capital improvements in accordance with an adopted capital improvement program and will include an annual six-year plan for capital improvements (CIP design, development, implementation, and operating and maintenance costs). The first year of the six-year plan must be fully funded in the adopted budget. Projects that are not fully funded must be removed or delayed until adequate funding exists for design, construction, operating and maintenance.	√	33 Capital projects totaling $21.4 million are in the 2022 CIP Budget
16 Capital improvement projects must project operating and maintenance costs for the five-year forecast period to ensure that future year budgets maintain a positive operating position.	√	

	Fiscal Policy Statement	Status	Comments
17	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.	√	

Short-Term Debt Policies

18	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.	√	
19	The City may issue interfund loans to meet short-term cash flow needs. Short-term is defined as a period of one year or less. Interfund loans will be permitted only if a specific source of repayment is identified within the "borrowing" fund. Excess funds must be available and the use of these funds will not impact the "lending" fund's current operations. The prevailing interest rate, as established by the City Treasurer, will be paid to the lending fund. Short-term interfund loans require Council approval.	√	

Long-Term Debt Policies

20	The City will confine long-term borrowing to capital improvements that cannot be funded from current revenues.	√	
21	The City may issue long-term interfund loans to fund capital improvements. Interfund loans will be permitted only if a specific source of repayment is identified within the "borrowing" fund. Excess funds must be available and the use of these funds will not impact the "lending" fund's long-term operations. Long-term interfund loans will be fully amortized (principal and interest included in payment). The prevailing interest rate and duration of the loan will be established by the City Treasurer. Principal and interest will be paid to the lending fund. Long-term interfund loans require Council approval. Long-term interfund loans will be disclosed in the City's annual Operating Budget.	√	

	Fiscal Policy Statement	Status	Comments
22	The City will establish and maintain a Debt Policy.	√	
23	The City will establish a restricted reserve in the Water Operating Fund equal to one year's debt service on the State Revolving Loan. The purpose of this reserve will be to provide a debt reserve as required under the State Revolving Fund loan financing agreement.	√	State Revolving Loan Reserve = $900,600

Fund Balance and Reserve Policies

	Fiscal Policy Statement	Status	Comments
24	The City will maintain emergency reserves equal to 20% of operating expenditures of the General Fund. The primary purpose of this reserve is to provide stability during a significant economic downturn, or to offset a significant one-time loss of revenue. The reserve exists in order to provide short-term funding to protect the City's essential service programs and funding requirements or to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during preparation of the budget.	√	Emergency Reserve = $14.8 million, or 20%, of General Fund operating expenditures
25	The City will maintain emergency reserves equal to 12% of the operating expenses for Enterprise Funds. The primary purpose of these reserves is to protect the Funds during periods of economic downturn, other unanticipated expenses, or emergency expenses that could not be reasonably foreseen during preparation of the budget.	--	Emergency Reserves for: Water = $1,375,000; Sewer = not funded; Storm Drain = not funded; Solid Waste = $33,000; and Golf = $292,000
26	The City will establish an account to accumulate funds to be used for payment of accrued employee benefits for 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.	√	Accrued Leave Reserve = $900,000

	Fiscal Policy Statement	Status	Comments
27	The City will establish a Capital Equipment Replacement Reserve and a Facilities Maintenance Capital Asset Reserve for the accumulation of funds for the replacement of worn and obsolete equipment other than vehicles and for costs associated with the maintenance of all City facilities. These reserves will be maintained at a level at least equal to the projected five-year capital asset replacement and maintenance costs.	√	Capital Equipment Reserve = $2.0 million Facilities Maintenance Reserve = $5.1 million
28	The City will establish Water, Sewer, Storm Drain and Golf depreciation reserves for costs associated with the major maintenance and capital improvement costs included in the Enterprise Funds. The minimum reserve level shall be at a level equal to the projected three-year capital and major maintenance costs.	--	Water Depreciation Reserve = $9.7 million; Sewer Depreciation Reserve = $5.3 million; Golf Depreciation Reserve = $2.1 million; and Storm Drain Depreciation Reserve = $2.0 million
29	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 three year costs.	√	Golf Course Improvement Reserve = $1,190,000
30	The City will establish a Park Asset Replacement Reserve with a target of $1.2 million for the replacement of park assets in the future. The reserve balance will be reviewed annually and funded through one-time revenues or undesignated General Fund balance transfers, when available.	√	Park Asset Replacement Reserve = $2.0 million
31	The General Liability self-insurance reserve will be maintained at a level which, together with purchased insurance policies, adequately protects the City. The City will maintain a reserve of one times its annual insurance authority premium. In addition, the City will perform an annual analysis 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.	√	General Liability Reserve = $6.2 million

	Fiscal Policy Statement	Status	Comments
32	The Workers' compensation self-insurance reserve 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.	√	Workers Compensation Reserve = $1.5 million
33	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.	√	Fleet Replacement Reserve = $5.1 million
Investment Policies			
34	The City Treasurer will annually submit an investment policy to the City Council for review and adoption.	√	
Accounting, Auditing & Financial Reporting Policies			
35	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.	√	
36	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.	√	
37	A fixed asset system will be maintained to identify all City assets, their condition, historical cost, replacement value, and useful life.	√	A Fixed Asset inventory is maintained as part of GASB34
38	Quarterly financial, capital improvement program and investment reports will be submitted to the City Council and will be made available to the public.	√	

	Fiscal Policy Statement	Status	Comments
39	An annual revenue manual will be prepared after the close of the fiscal year. The manual will provide information on the revenue source, legal authorization, timing of receipts and historical collection over the last five year period. Fee schedules or calculations will also be provided.	√	
40	Full and continuing disclosure will be provided in the general financial statements and bond representations.	√	
41	A good credit rating in the financial community will be maintained.	√	Standard & Poor's = AAA
42	Establish and maintain a formal compensation plan for all employee salary or wage ranges and maintain a formal salary schedule for every approved position title showing the current pay rate for each identified position. The salary schedule will be approved and adopted by the City Council and will be made publicly available	√	
43	Establish a position control system to ensure that staffing levels are maintained at the levels approved by City Council.	√	

Long Term Financial Policies

44	Annually prepare a five year forecast that maintains the current level of services, including known changes that will occur during the forecast period. If the forecast does not depict a positive operating position in all five-years of the forecast, the City will strive to balance the operating budget for all years included in the five-year financial forecast.	√	

	Fiscal Policy Statement	Status	Comments
45	Annually evaluate trends from a budget-to-actual perspective and from a historical year-to-year perspective to identify areas where resources have been over allocated. This would improve the accuracy of revenue and expenditure forecast by eliminating the impact of recurring historical variances.	√	Reviewed during the budget process

Risk Financing Policies

46	The City will maintain adequate insurance coverage, pooled coverage, or self-insurance for general liability, property, errors and omissions, subsidence, automobile liability, workers' compensation, and other identified loss exposures.	√	
47	The City will maintain a risk financing strategy, which shall include an annual review of insurance policy limits, types of coverage, reserve requirements, and self-insurance limits, if applicable.	√	

Pension Policies

48	The required actuarial contributions shall be made to cover the current service cost and unfunded liabilities based on the actuarially determined contribution rate.	√	
49	Annually, review the City Pension plans funding levels of and identify areas where funding may be utilized to target a funding ratio of 90% or higher for each of the City's individual pension plans.	√	

Legend:

√ *Budget Complies with Fiscal Policy Standard*
-- *Fiscal Policy Standard is not met in Budget*

Note: Reserve balances are the estimated amounts as of June 30, 2022.

Pension Update

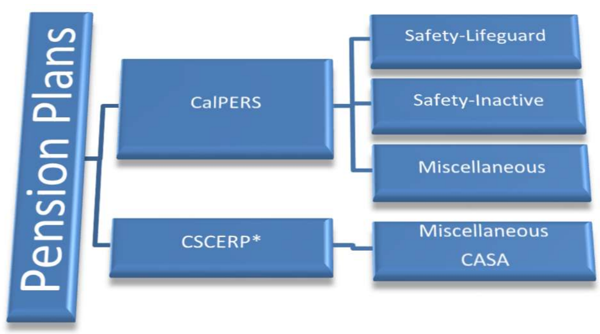
Objective
To review the City's current pension plans, summarize actions taken after the 2019 LTFP Pension Update, and 2021 LTFP related to the ongoing sustainability of the City's pension plans and recommendations to control city pension costs into the future.

Executive Summary
Pension reporting, disclosure, availability of information, and funding options have changed dramatically over the last 10-15 years to ensure service costs are recognized in the period earned (generational equity) and assets and liabilities are properly reflected in the financial statements with a focus to ensure adequate funding levels (financially sustainable).

The funded status of pensions has been a key focus in recent years of governmental agencies and in 2019 a Pension Update was provided to City Council with the LTFP to improve transparency and implement actions to improve the long term sustainability of the pension plans. The City implemented the following actions:

- Formalized a Fiscal Policy and added summary information to LTFP and Budget
- Additional contributions to CalPERS and modification of amortization bases
- Submitted a formal application to transfer active CASA participants to CalPERS

Information on the current pension plans identifying the different employee groups and administrator are below:



* City of San Clemente Employees' Retirement Pension Plan

Plan	Administrator/Trustee	Participants	Benefit
Lifeguard Safety	CalPERS	Lifeguards (Full Time)	3%@55 (Classic) 2.7%@57 (PEPRA)
Safety (inactive)	CalPERS	Former police and fire employees	2%@50 (Classic) 2.7%@57 (PEPRA)
Miscellaneous	CalPERS	General employees (non-safety)	2%@55 (Classic) 2%@62 (PEPRA)
City of San Clemente Employee Retirement Plan (CSCERP)	Milliman & Empower	Former city employees and Coastal Animal Services employees	2%@55 (Classic) 2%@62 (PEPRA)

The City has taken multiple actions based on the 2019 Pension Update and 2021 Pension Update, including the implementation of a CalPERS Pension Funding Strategy, which was approved by City Council in October 2021.

Pension Update

As part of this year's update, background information includes the 2019 Pension Update policy changes, information on additional payments to the pension liability including those during FY 2021, and the status of the "3-2-1 Pension Funding Strategy" since the approval in October 2021.

The City has made strides in funding pensions by contributing additional payments of $7.5 million since FY 2010. The City continues to work towards the new Fiscal Policy funding target of 90% implemented as part of the 2019 LTFP. To accomplish this goal, the Council approved the "3-2-1 Pension Funding Strategy" and staff has made the first payments as part of this strategy. However, additional funding will need to be allocated as one-time revenue sources are realized or unassigned fund balance is available. Staff will continue to pursue this funding strategy and is recommending a one time payment of $1 million as part of the mid-year adjustments. Additional information on the strategy and current status is in the Background Section.

The Pension funded status has improved over the prior year from 68% to 70% despite changes to assumptions by CalPERS. Next year, with the positive investments and additional payments the funded status should increase more. The Pension Plan Analysis goes through CalPERS plans and the CSCERP plan. The CalPERS plan funding strategy is to pursue the "3-2-1 Pension Funding Strategy" and continue to seek opportunities to shorten the amortization periods and lower costs. The CSCERP plan continues through the CalPERS application process, changing to CalPERS will minimize the long term responsibilities of City staff to manage a plan with active participants. Additionally, a review to update and modernize the CSCERP Pension Plan Investment Policy (last updated in December 2013) by an investment advisor will help address funding levels.

The City will also work to examine, set up, and fund a Section 115 trust to prefund pension costs and use the fund to stabilize any volatility experienced in contributions or investment returns. A section is included in this report which addresses the Section 115 trust.

Background

Fiscal Policy and Summary information added to the LTFP and Budget

During the 2019 LTFP Pension Update, staff identified a lack of formal fiscal policies related to pension funding. Simple fiscal policies were identified and approved by Council through the LTFP and the Budget process. These polices can be modified through Council action. Currently, the Fiscal Policy addresses contribution levels and sets a target funding level. These following policies were adopted and are included in the City Fiscal Policy. Staff is not currently recommending any changes to the established policies, which follow:

- *Contributions –*
  The required actuarial contributions shall be made to cover the current service cost and unfunded liabilities based on the actuarially determined contribution rate.
- *Funding Target –*
  Annually, review the City Pension plans funding levels and identify areas where funding may be utilized to target a funding ratio of 90% or higher for each of the City's individual pension plans.

In addition to the Fiscal Policies, a communication aspect was added to the Annual Budget and LTFP Trends section to provide the status on pension funding levels.

Pension contributions

The City of San Clemente makes the actuarial required contributions based on the annual CalPERS actuarial statements, which are available on the CalPERS website. As opportunities present themselves, additional payments are being made to pay down the unfunded liability.

The City has made additional payments in the past, including $4.6 million in FY 2009-10, $225,716 in FY 2013-14, and $500,000 in FY 2015-16. Over the last few years, the following additional pension payments to reduce the future liability and improve the funded status have been completed.

Pension Plans	FY 2018-19	FY 2019-20	FY 2020-21
Miscellaneous	$ 40,000	$ 29,157	185,000
Safety – Police and Fire	127,000	135,000	525,000
Safety - Lifeguard	4,206	435,293	79,179
CSCERP	-	-	550,000
Total Additional Payments	$ 171,206	$ 599,450	$1,339,179

3-2-1 Pension Funding Strategy

City Council in October 2021 approved the "3-2-1 Pension Funding Strategy", authorizing a $2 million paydown, which was the "2" portion of the strategy. Additional payments will be requested as funding is made available from one-time revenues or available fund balance to achieve the Fiscal Policy pension funding target of 90% for the CalPERS plans. This strategy is summarized in the following table. The table also lists the current status of each action.

Action	**Current Status**
$3 million Safety Plan payment	$1 million requested for paydown as part of mid-year adjustments
$2 million Miscellaneous Plan payment	$2 million completed in FY 2022
$1 million set aside in a Section 115 Plan	After completion of other paydowns further recommendation will be addressed through the City Treasurer and the Investment Advisory Committee

The 3-2 portion of the strategy is the most important part of the strategy, with the $1 million being funded to address potential future impacts from discount rate modifications, actuarial assumption changes, poor investment returns or to supplement contributions during economic downturns. The remaining $2 million, as part of the $3 million paydown, and the $1 million will be funded as resources become available from land sales or other one-time revenues of available fund balance.

Funded Status:

The following summary lists the pension plans, City funds responsible for the pension payment, market value of the assets, total liability (funded and unfunded), unfunded amounts, and the funded percentage by pension plan. CalPERS plans valuation information is as of June 30, 2020 and the CSCERP plan valuation information is as of June 30, 2021.

Plan	Respective Fund(s)	Market value of assets	Liability	Unfunded amount	Funding Percent	Estimated FY 2022-23 Cost
Lifeguard Safety *6/30/2020 valuation*	General Fund	$ 6,131,702	$ 7,139,652	$ 1,007,950	85.9%	$ 180,000
Safety (inactive) *6/30/2020 valuation*	General Fund	$ 28,341,695	$ 43,153,762	$ 14,812,067	65.7%	$1.4 million
Miscellaneous *6/30/2020 valuation*	All City Funds	$ 54,500,785	$ 71,976,359	$ 17,475,574	75.7%	$2.8 million
CSCERP *7/1/2021 valuation*	All Funds	$ 26,009,000	$ 41,396,000	$ 15,387,000	62.8%	$1.7 million
Totals		$ 114,983,182	$ 163,665,773	$ 48,682,591	70.3%	

The overall funded level of 70% is up slightly from the previous level of 68% due to additional payments and strong investment earning for CSCERP, which includes FY 2021 returns. For FY 2021, CalPERS investment returns will bolster the funded status of the CalPERS plans once the 2021 valuation is completed and has caused the lowering of the discount rate to 6.8% (from 7%) due to the Risk Mitigation strategy CalPERS has in place.

The City’s implementation of the “3-2-1 Pension Funding Strategy”, should achieve the Funding target level of 90% as stated in the fiscal policy. The strong investment returns of FY 2021 and the additional contributions in FY 2021 and FY 2022 should allow the City to achieve this level for the 2023 CalPERS valuation. However, this is ultimately dependent on actual results as compared to the actuarial assumptions.

The 90% level was set to prevent overfunding of any one plan. Overfunding of a specific plan would lock up assets within that specific pension plan, since pension assets are not shifted between plans. For example, if pension plans were funded at 100%, 85%, and 70%, a positive year of investment returns or actuarial assumption changes could cause the 100% plan to be overfunded. Assets would be tied up in the one plan, while the other plans remain below the minimum target.

The pension plan outside of CalPERS, CSCERP pension trust fund, will not be funded at 90%, however this plan includes CASA and is working to transition those active employees to CalPERS. This plan also includes inactive miscellaneous employees and retirees at the time of transition to CalPERS. After the transition of the CASA employees, this plan would be considered a “sunsetting” plan with no new participants being added and only have a responsibility to pay existing participants. Funding of this plan will naturally occur over time as the UAL continues to be paid down and payments and liabilities to participants decline over time. Based on the amortization payment, the funded status should increase by approximately 2.5% annually with each annual UAL payment, until 100% funding is met.

This CSCERP plan is shown in City of San Clemente financial statements and was the sole pension for active City employees. The pension trust was administered by Empower (formerly Great West) for over 20 years. In 2017, Empower discontinued its pension administration services, but still maintains the asset management function of the pension assets. The City then contracted with Milliman for pension administration services, which includes participant communication, benefit calculations, database maintenance and retiree payment services.

Pension Plan Analysis:

The following analysis by plan category summarizes the condition of each plan and recommended steps to improve the funding percentages of the various plans.

CALPERS PLANS

Lifeguard Safety Pension Plan

Plan Summary– This is the smallest plan in terms of market value and liability and is funded at 85.9%. The pension benefits of full time marine safety employees are funded through this plan and City contributions are funded annually by the General Fund based on the annual actuarial reports prepared by CalPERS. These payments are only funded by the General Fund.

Public Safety Pension Plan

Plan Summary – This plan is an inactive plan with no employees making contributions to the plan. This plan covers former public safety employees who served the City prior to the City contracting out police and fire services to county agencies (OCSD and OCFA). This plan is currently funded at 65.7%. These payments are only funded by the General Fund.

An additional $3 million payment, along with the FY 2021 positive investment returns should allow this plan to reach the 90% target funding level. Additional vacancy savings under the public safety contracts and an early payment discount are utilized to make additional payments as budget funds become available.

Miscellaneous Employee Pension Plan

Plan Summary – The Miscellaneous plan covers most of the active employees of the City. It includes the active employees at the date of conversion to CalPERS and any new hires since that date. This plan is currently funded at 75.7%. These payments are paid by City General, Water, Sewer and Golf Funds.

CalPERS Funding Strategy–

The FY 2021 CalPERS investment returns will improve the funded status and with the implementation of the “3-2-1 Pension Funding Strategy” plans should be at or near the 90% level by 2024 to ensure compliance with the Fiscal Policy. Staff should review budget saving opportunities and seek payments to shorten the amortization period lowering liability costs in the future.

CSCERP PLAN

City of San Clemente Employee Retirement Plan

Plan Summary - This plan has the lowest funding percentage. CSCERP participants are CASA employees and former employees that were no longer active with the City at the transition to CalPERS. This plan uses actuarial assumptions that generally mirror CalPERS and it has absorbed similar lifespan changes that have impacted funding levels. However, unlike CalPERS these changes were not phased-in over time. This plan's valuation has some actuarial assumption differences, including a lower discount rate (5.75%) and an amortization period (20 years level dollar) to pay any unfunded liability. These cause a lower funded level, but the higher level of contributions due to the shorter amortization period will improve the funded status faster than the CalPERS plans.

Based on the June 30, 2021 Report, the funding level is now at 62.8%, with the City portion funded at 61.4% and CASA funded at 75.5%. Plan contributions are made by all funds of the City, including CASA funds.

Since 2015, CASA (and the City) has been seeking to transition CASA's active employees to CalPERS. This would leave only inactive participants and retirees in this plan, which would lower ongoing administrative and other costs, on a very long-term basis, as the administration responsibilities are minimized when payments to retirees are completed. In order for CASA to transition there are two components to eligibility 1) legal eligibility as a "public agency" under Government Code Sections 20056 or 20057 and as an "agency or instrumentality" under the IRS' proposed regulations issued in 2011; and (2) financial eligibility. CASA, as part of the most recent application, was able to move past these requirements. The next step is to request the preliminary actuarial valuation analysis stating the pension plan's liability for transferred participants, based on information to be submitted. This information will be going to the CASA board for approval in the near future before CalPERS submission.

The CSCERP Pension Investment Policy (#202-2), last updated in December 2013, led staff to determine that the investment policy and objectives should be reviewed and updated. Currently, the City utilizes Chandler Asset Management to assist with the investment of City investment pool funds based on a percentage of overseen assets. As can be seen from Exhibit 1, which summarizes the current investment strategy for CSCERP, does not utilize a Real Estate component, such as a REIT like CalPERS utilizes and does not utilize Treasury Inflation Protection Securities at the level of the CEPPT. Chandler's expertise in working with these types of plans, including the City of Irvine, is beneficial and unique. This revision to the investment policy could lead to potentially higher returns, less volatility, and lower costs into the future.

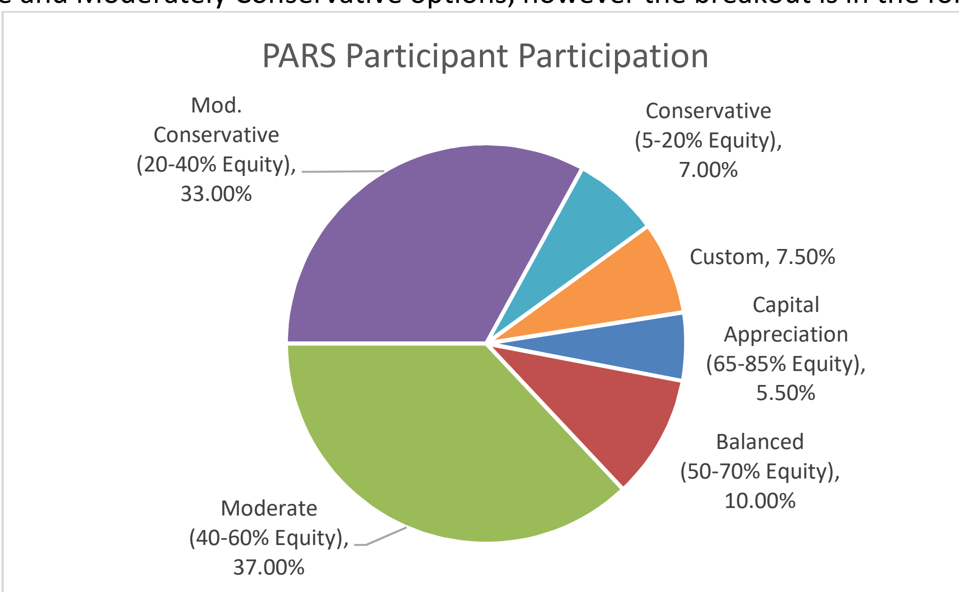
CSCERP Funding Strategy:

1) Continue the CASA application process with CalPERS.
2) CSCERPs investment policy should be reviewed and modified with assistance from the City's external Investment Advisor, Chandler Asset Management. Chandler can prepare changes to the existing Pension Investment Policy, with those changes brought back to the Investment Advisory Committee and then City Council for approval.

<u>Section 115 Trust:</u>
The City Council, as part of the 3-2-1 Pension Funding Strategy, will start setting aside funds in a pension prefunding trust as funds become available. A Section 115 Trust is an IRS approved irrevocable trust created to allow prefunding of pension costs and reduces the financial statement pension liability without funds being placed in one specific pension plan. This trust could be utilized as a stabilization fund during economic downturns or if there is a change in assumptions by CalPERS which increases the pension liability used to offset the effect of that change.

Section 115 funds offer flexibility and opportunities for higher returns than the limited City investment pool assets. Funds placed in the trust are no longer limited to low risk, shorter term investments, but rather allows an investment portfolio similar to existing pension funds which include a variety of investments (bonds, mutual funds, and stocks), which have higher risk but over the long term average higher returns. Section 115 Trust assets could be utilized to offer better long term returns than the City's investment pool portfolio but be invested more conservatively than CalPERS assets. The assets could fund any of the City's multiple pension plans, assist in making required actuarial contributions in tight budget years, or bolster funded status for pension funds which experience poor actuarial effects.

Section 115 Trusts are offered by both CalPERS and PARS (private company) and probably a few others. CalPERS has lower administration costs than the private companies. However, private companies typically have more investment options. PARS participants generally selected the Moderate and Moderately Conservative options, however the breakout is in the following table:



The City currently utilizes CalPERS for the OPEB trust and for retirement services.

Section 115 Funding Strategy:

1) When funds become available from land sale proceeds or when one-time resources and budget savings are available, staff will prepare an Agenda Report to City Council after investment options are considered with the Investment Advisory Committee.

Recommendations:

1) Authorize staff to contract with Chandler Asset Management to update the exiting City of San Clemente Pension Investment Policy (Policy #202-2) for City Council approval.
2) Direct Staff to continue to pursue the creation of the Section 115 plan and to request funding for the trust when land sale proceeds become available or when one-time resources are available.

Exhibit 1 – INVESTMENT ALLOCATION

The Table below summarizes the current strategy, CalPERS allocation and the CalPERS CEPPT (Section 115 Trust) allocations.

Asset Classification	**Mutual Fund**	**City of San Clemente Retirement Plan**	**California Public Employees Retirement Plan**	**California Employers' Pension Prefunding Trust**	
		Existing Allocation	7/1/ 2022 Allocation	Strategy 1 Moderate	Strategy 2 Conservative
Global Equity	Domestic Stock International Stock Private Equity**	52%	55%	40%	14%
Fixed Income*	Long Term Short Term Private Debt**	40%	35%	47%	73%
Treasury Inflation Protected Securities	TIPS	3%	-	5%	5%
All Asset	Hybrid Fund	5%	-	-	-
Global Real Estate	Real Estate/REIT's	-	-	8%	8%
Real Assets**	Commodities, real estate, equipment, and natural resources	-	15%	-	-
Leverage**		-	(5%)	-	-
TOTAL PORTFOLIO		100%	100%	100%	100%

* Includes the CSCERP stable value fund, which is considered a cash equivalent.

**CalPERS only items