CITY OF PALOS VERDES ESTATES
FISCAL HEALTH REPORT
FY 2001-2011

January 24, 2012
Judy Smith, City Manager

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Mayor and Members of City Council:

The Fiscal Health Report, with results of operations for fiscal year 2010-11, is presented in conjunction with the City's Comprehensive Annual Financial Report (CAFR). The report provides a graphic representation of the City's fiscal condition as a complement to the financial audit. It assists with viewing the financial performance over time as a means to ensure future fiscal health.

The Fiscal Health Report is a monitoring system that computes a number of financial factors and compares the results over time. Monitoring systems can give early warnings of trends before they become major problems. The report is based on systems developed by the ICMA and GFOA, using selected factors for our City. The Finance Department has prepared this report since 1995.

How the System Works

The financial factors are calculated and trends established and graphed from 2001 through the fiscal year ended June 30, 2011 however, data is maintained from1989 to the present. Unless otherwise noted, the data presented is for the general fund only. Expenditures for public safety (police and fire) are adjusted for inflation and represent constant dollar comparisons. Since the personnel costs related to these services are so large and influenced by inflation, adjustment to constant dollar comparison provides a clearer picture of the cost over time.

Factors and their trends are generally judged as favorable (green), stable (yellow) or unfavorable (red) and color-coded for easy reference. While we had noted in the past, those "stable" factors that required attention, we have now applied a tan color to the "watch" designation. This designation indicates that the rating could tip to either a favorable or unfavorable position, but that a clear trend is not yet discernible. Due to the unprecedented financial conditions of the past two years and the dramatic impacts to the residential real estate market, staff has been especially cautious in our financial assumptions and the City Council likewise has taken a conservative approach to budgeting.

Findings

The findings in the report can be divided into two sections with Factors 1 through 6 representing fiscal conditions and Factors 7 through 9 reflecting management performance. As highlighted in past reports, the City is in a period of stagnant revenues, lack of increases in property values, the always possible threat of negative state impacts and increasing pressure on the general fund caused by a variety of factors, including a drop in some special revenues, especially gas tax, and policy decisions that shift costs to the general fund. Hence, staff has taken a cautious approach both in budgeting and in rating of the health factors. Performance of significance is highlighted for several factors below.

"Growth in Assessed Values" (AV) is rated as unfavorable for the fourth year, though as noted in past reports, 8% annual increases, as experienced for four years (2004-2007), were very robust and unsustainable in the long term. The City's overall AV change for 2010-11 was a -0.37%, mainly due to a negative CPI factor applied under Proposition 13. The 2011-12 AV increase is +2.37%, which is very healthy considering the state of the residential real estate market. It appears we are entering an extended period of what might best be characterized as a "new normal" in annual assessed value increases, with changes running between 1% and 3%. Experts do not expect any significant improvement in values until at least 2014-15. Because the City has operated with a comfortable margin between revenues and expenditures (see Factor 4B), the lack of property tax growth has been coupled with a very conservative approach to expenditures, which has helped maintain this operating margin. Factors other than assessed values (#2 – 7) are again rated as "stable". Although over the past two years we have had several factors under "watch", with results of 2011, only personnel/benefit costs are rated as "stable – watch".

Personnel costs are closely monitored, as they represent a significant portion of the City's budget. Due to the uncertain economic conditions, the City and employee associations implemented one year agreements in both FY 2010 and FY 2011 that included an enhanced medical benefit contribution but no on-going salary adjustments. During 2011, overall general fund expenditures were $200,000 less than 2010. As a result, even with no wage increase, fixed personnel costs, including salary and benefits, comprised a larger percentage of total general fund expenditures – 68% in 2011 compared to 66.8% in 2010. Benefit costs as a percentage of total personnel costs comprised a slightly lower percentage; 29.6% in 2011 compared to 30.7% in 2010. This is due in part to the fact we had employees pursue accrued leave cash out, possibly as a result of no wage increase, as well as the severance pay provided to the former City Manager. Both these items increased total personnel costs, but did not affect benefits.

As in the past, the management factors (# 8 & 9) related to budgeting and operating position are rated as favorable. The City has a proven track record of realistic budgeting. Factor #7, "General Fund Balance", reflects a "stable" rating due to the Council policy of maintaining the general fund balance at 50% of the next year's total operating budget. The fund balance performance for 2011 (57%) is due to the fact that the FY 2010-11 budget did not provide for a use (transfer) of funds in excess of the 50% balance, which in the past has been directed to capital project financing. For the past several years, the Council has decided to wait for the presentation of the annual audit report, before considering policy options on the use of these funds.

As always, it is hoped the Council finds that this report provides additional insight regarding the City's fiscal health and that it is a useful supplement to the annual audit. I look forward to discussing these results with you.

Judy Smith
City Manager

FISCAL HEALTH REPORT

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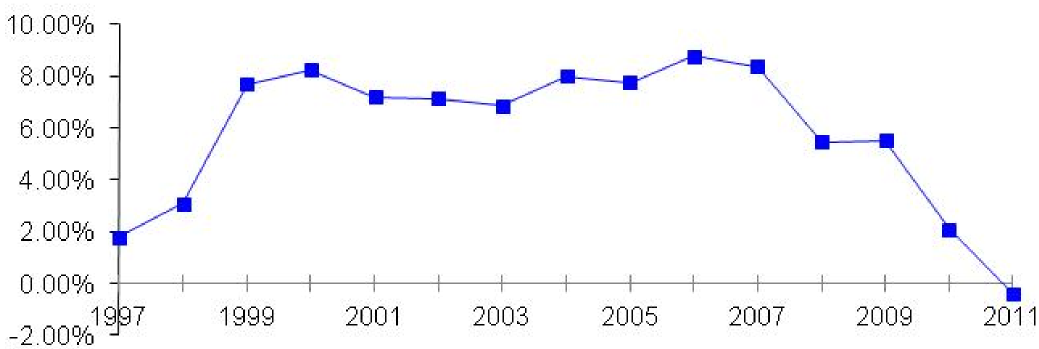
FACTOR 1 - GROWTH IN ASSESSED VALUES

DESCRIPTION – Assessed values (AV) are a key component of fiscal health since property tax represented 52% of total general fund revenue in 2011. This factor measures the growth in assessed values. AV increases are displayed from 1997 to the current year to provide context to the growth experienced in the intervening years (1999-2007). During FY 2011, total values for the City decreased 0.37%, due to a negative CPI adjustment under Proposition 13. This is the fourth year the assessed value factor is rated as unfavorable. We experienced a modest increase for current FY 2012 (+2.37%), but it is likely we will not see significant improvement in values until FY 2014-15. Again, as noted in the Executive Summary, general fund revenues continue to exceed expenditures by a comfortable margin. The City is in no danger of approaching a general fund operating deficit, even absent modest growth in assessed values.

FORMULA - Current Year Assessed Value Minus Last Year's Value / Last Year's Property Value

WARNING SIGN - DECREASING GROWTH OF ASSESSED VALUES



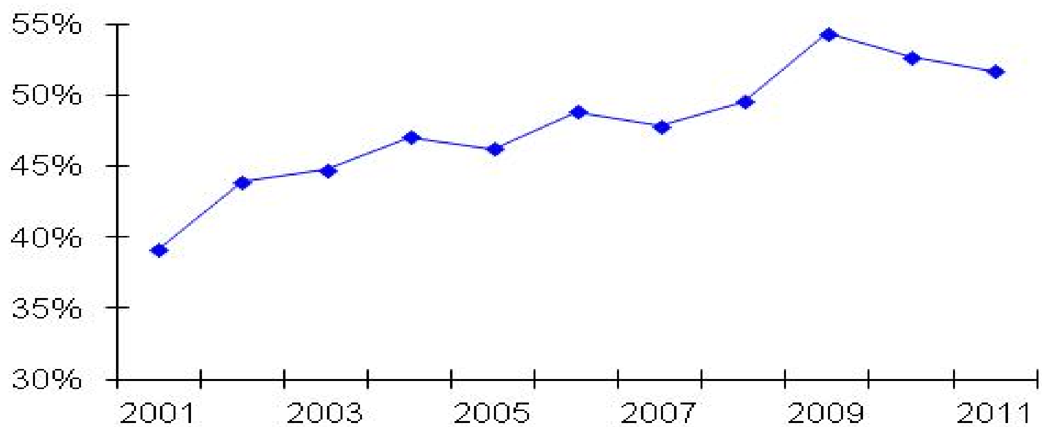
TREND ____________
Unfavorable

FACTOR 2 - PROPERTY TAX COLLECTIONS AS PERCENT OF GENERAL FUND REVENUE

DESCRIPTION – This factor focuses attention on property taxes, which are a key revenue source for most cities. An increasing or decreasing percentage of property tax compared to total revenue could indicate a problem. An increasing percentage may indicate a lack of revenue diversification and an over-reliance on property tax, while a decreasing percentage may indicate lack of assessed value growth and/or an increasing delinquency rate. For FY 2011, property tax revenue (all sources) equaled 51.6% of general fund revenue compared to 52.7% in 2010 and 54.3% in 2009. In the absence of an economic recovery, which would result in higher development revenue, sales taxes and other sources influenced by discretionary income (e.g. concession fees), the City by its residential nature will continue to show a heavy reliance on property taxes, though the trend line is heading lower due to the lack of growth in assessed values.

FORMULA - $\dfrac{\text{Property Tax Revenue}}{\text{General Fund Operating Revenue}}$

WARNING SIGN - SIGNIFICANTLY INCREASING OR DECREASING PERCENTAGE OF PROPERTY TAX REVENUE AS A PERCENTAGE OF GENERAL FUND OPERATING REVENUE



TREND
Stable

FACTOR 3 - GENERAL FUND REVENUE PER CAPITA

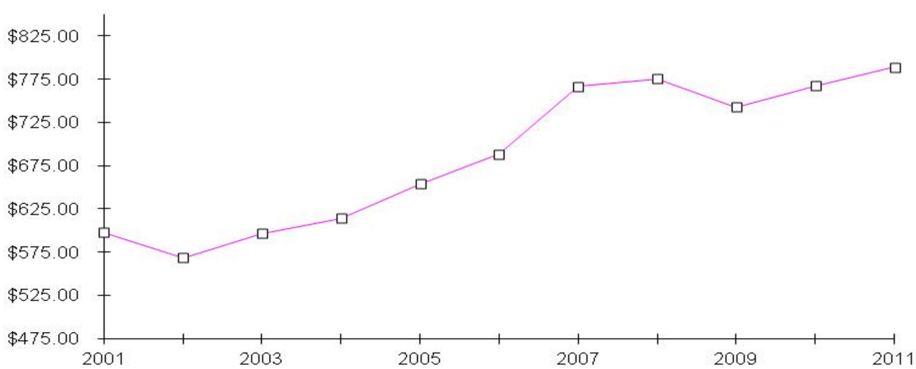
DESCRIPTION – This factor is designed to show whether revenues are keeping pace with growth in the community in order to gauge if there are resources to meet demands for service. While this is not a concern for Palos Verdes Estates, the per capita analysis does provide a useful approach to analyzing revenues and expenditures. The FY 2011 results include modification of the City's population based on the recent census. As a result, the City's population declined 4.3% from 14,085 in 2010 to 13,480 in 2011. This changed helped boost the per capita revenue performance.

Per capita revenue for 2011 totaled $788 compared to $767 in 2010. If we exclude one-time estate proceeds received in 2010 ($263,865) from the results, per capita revenue totaled $747, or essentially flat compared to 2009. If the population had remained unchanged from 2010, the per capita revenue performance for 2011 would total $753, or again, essentially flat. FY 2011 general fund revenue was ~$177,000 less than 2010; however, expenditures were lower by an even greater amount (-~$203,000) compared to the prior year. We expect the revenue trend line to remain flat for at least the next two years, given the lack of growth in assessed property values and the absence to date of any other indications of significant economic recovery.

Factor 4B (page 10) provides the graphic representation of both revenue and expenditures per capita, and it is important to view these factors in relation to each other.

FORMULA - $\frac{\text{General Fund Operating Revenue}}{\text{Population}}$

WARNING SIGN - DECREASING OPERATING REVENUE PER CAPITA



TREND Stable

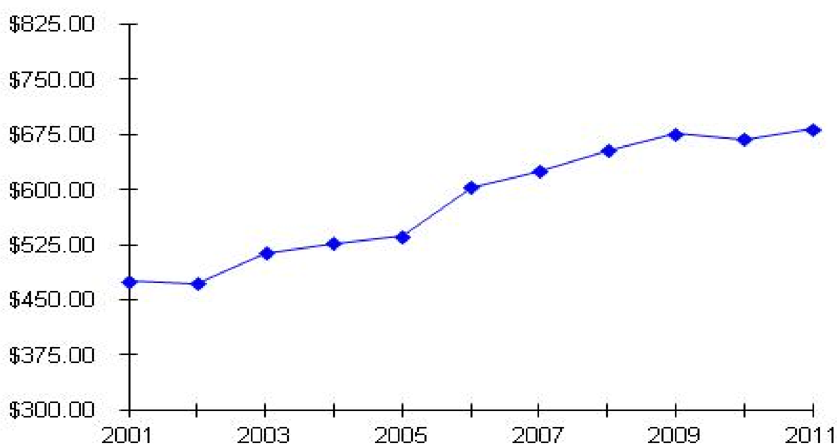
FACTOR 4 - GENERAL FUND EXPENDITURES PER CAPITA

DESCRIPTION - This factor is designed to show the cost-per-person of providing general fund City services. Increasing expenditures per capita are troublesome if revenues per capita are stable or declining, which reflects our current situation. Per capita expenditures, excluding the safety side fund liability payment, totaled $682 in 2011 compared to $668 in 2010. As mentioned under revenue per capita, actual general fund expenditures decreased in 2011 compared to 2010 (-$203,264); however, because of the census population adjustment (-4.3%), the impact shows a higher per capita cost. This factor is currently rated as stable. Steps taken to limit personnel cost increases, which are outlined in more detail in Factors 5 and 6, are largely responsible for the performance reflected below. Position vacancies within the Police Department also helped the bottom line performance.

As mentioned in previous reports, and displayed in Factor 4B (page 10), general fund revenues continue to perform in a manner which allows a comfortable margin above expenditures. As part of the budget preparation process, staff will perform various revenue and expenditure growth scenarios to determine potential impacts to the City's fiscal health.

FORMULA - $\dfrac{\text{Total Operating Expenditures}}{\text{Population}}$

WARNING SIGN - SIGNIFICANTLY INCREASING OPERATING EXPENDITURES PER CAPITA, ESPECIALLY WHEN COMBINED WITH A STABLE OR UNFAVORABLE TREND IN FACTOR 2 - REVENUES PER CAPITA.



TREND ____________

Stable

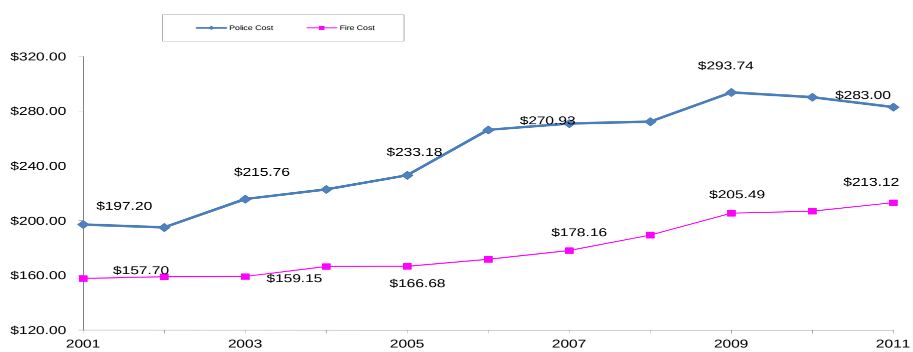
FACTOR 4.A. - PUBLIC SAFETY EXPENDITURES PER CAPITA

DESCRIPTION – Public Safety, police and fire costs, represented 62% of total operating expenditures in 2011. Personnel costs represent the vast majority of the costs for these departments – 87% in the Police Department and 78% within fire. The annual increase in the fire contract cost is capped at a maximum 4.2%. The Police Department costs are determined in large part by terms of the labor agreements, as well as employer PERS costs. In addition, since the analysis for the Police Department includes general fund costs only, the extent expenses are shifted to the general fund from restricted funds, as occurred beginning in 2006, affects the trending / per capita costs as well.

The cost per capita gap between police and fire hit a low of $32 in 2000, which was one of our lowest PERS safety rates. In 2011, the per capita cost differential between police and fire was $70, compared to $83 in 2010.

FORMULA - $\dfrac{\text{Public Safety Expenditures}}{\text{Population}}$

WARNING SIGN - SIGNIFICANTLY INCREASING PER CAPITA EXPENDITURES



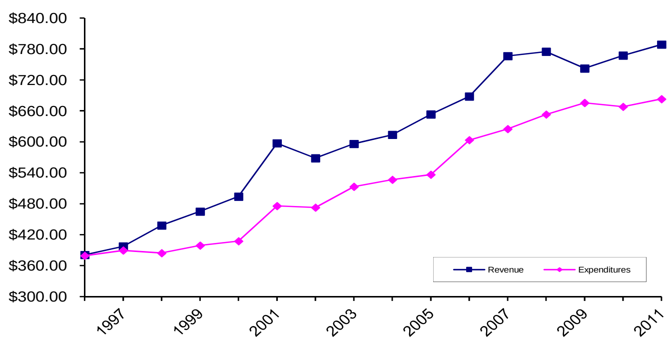
TREND ___________
Stable

FACTOR 4.B. - REVENUES AND EXPENDITURES PER CAPITA

DESCRIPTION - This item shows Factors 3 and 4, Revenues and Expenditures per Capita, in tandem. Data from 1996 forward is shown to provide a longer historical perspective. Recall that state property tax diversions occurred in 2005 and 2006 and in 2009, the City, through a state-wide program, was able to securitize and backfill the loss of $520,000 in property tax taken by the state. FY 2007 represented the peak of fiscal performance with the widest margin of revenue in excess of expenditures ($141), which coincides with the peak in median home values. The City continues to experience a general fund surplus. The challenge continues to be relatively stagnant revenues coupled with increasing expenditure pressure on the general fund, including expected increases in retirement costs over the next three years and the potential shift of expenditures from restricted funds to the general fund in future years, due to uncertainty posed by the state fiscal condition and budget process.

Per capita revenues have exceeded expenditures by the following margins:

1996	$ 1.39	2002	$ 95.60	2007	$141.35
1997	$ 7.86	2003	$ 82.99	2008	$121.79
1998	$ 53.62	2004	$ 87.01	2009	$ 66.69
1999	$ 65.85	2005	$116.79	2010	$ 99.38
2000	$ 86.36	2006	$ 84.61	2011	$105.80
2001	$121.65				



TREND ______________
Stable

FACTOR 5 - PERSONNEL COSTS AS PERCENT OF TOTAL GENERAL FUND EXPENDITURES

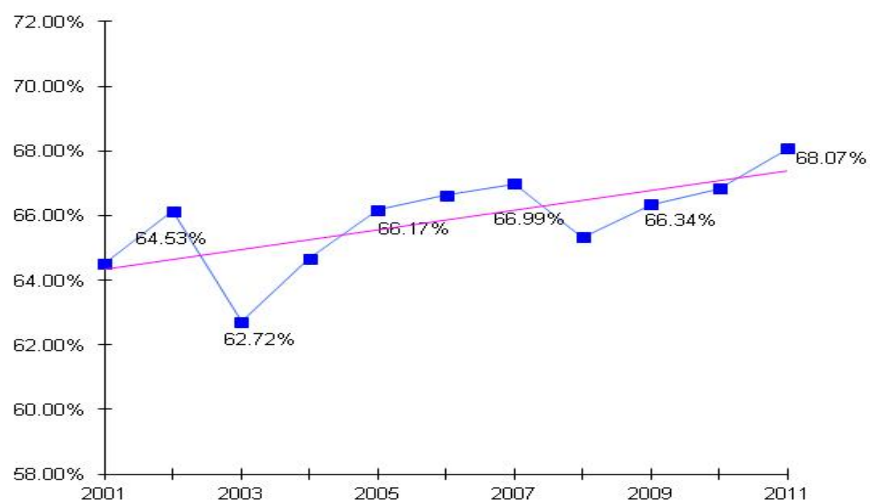
DESCRIPTION - This factor is designed to show the percentage of general fund expenditures devoted to personnel costs. There is no ideal percentage or municipal standard for this factor and services provided by City personnel as opposed to contract affects the percentage. Building and planning contract service costs related to development activity, are deleted from total general fund costs in order to give a more consistent picture.

Personnel costs have remained relatively constant as a percentage of total general fund expenditures. The trend line is slightly positive slope; indicating that the total for personal spending is not increasing dramatically compared to total spending for municipal operations. Personnel costs have represented around 66% of general fund spending, fluctuating within a range of 1.5%. As mentioned, the City implemented one-year wage-benefit agreements for 2010 and 2011 that provided a fixed stipend in-lieu of salary increases. Although there was no wage increase, personnel costs represented a higher percentage of total costs, because overall general fund expenditures were $200,000 less than in 2010. There was no single source for the lower cost; savings were spread across most departments. Also impacting personnel costs was the severance payment to the former City Manager and more employees cashing out accrued leave balances, possibly to supplement income due to the second year without salary increases.

FORMULA -

$$\frac{\text{Total Personnel Costs}}{\text{Total General Fund Expenditures-Cost for Development Services}}$$

WARNING SIGN - SIGNIFICANTLY INCREASING PERSONNEL COSTS COMPARED TO TOTAL EXPENDITURES ABSENT NEW EMPLOYEES OR BENEFITS



TREND ___________

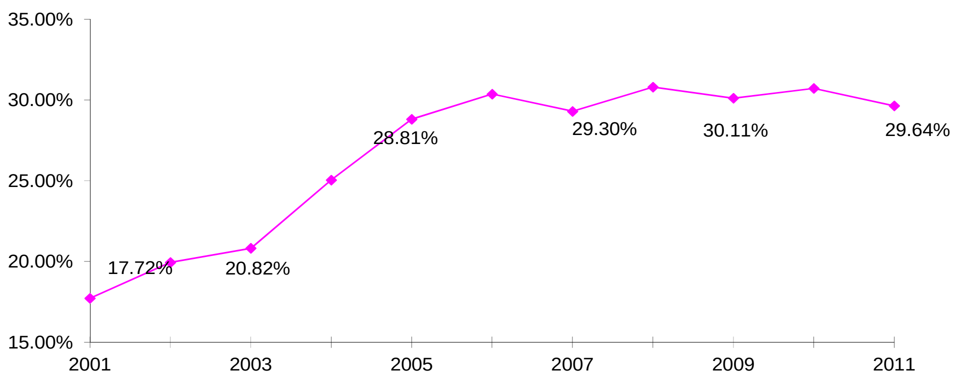
Stable "watch"

FACTOR 6 - BENEFIT COSTS AS PERCENT OF TOTAL PERSONNEL COSTS

DESCRIPTION - This factor is designed to demonstrate the impact of fringe benefit costs on a City's finances. Fringe benefits are sometimes viewed as low cost items compared to salaries, which may not always be the case. This factor was rate unfavorable from 2004-2006, when we experienced rapidly escalating retirement rates before PERS implemented rate smoothing and "pooled" plans for cities of less than 100 lives. Since 2007, the "watch" rating has been applied to this factor. As mentioned last year, we are again entering a period in a period of increasing PERS costs, beginning in FY 2011-12, as well as likely medical insurance increases due to cost uncertainties associated with health care reform. The City has some ability to control personnel costs by impacting the PERS employer costs through a further reduction in the Safety Plan side fund liability. The issue of a side fund contribution is also reflected as part of Factor 7 – Fund Balance.

FORMULA - $\dfrac{\text{Benefit Cost}}{\text{Total Personnel Costs}}$

WARNING SIGN - INCREASING FRINGE BENEFIT COSTS COMPARED TO TOTAL SALARY AND WAGE COSTS



TREND ____________
Stable – "watch"

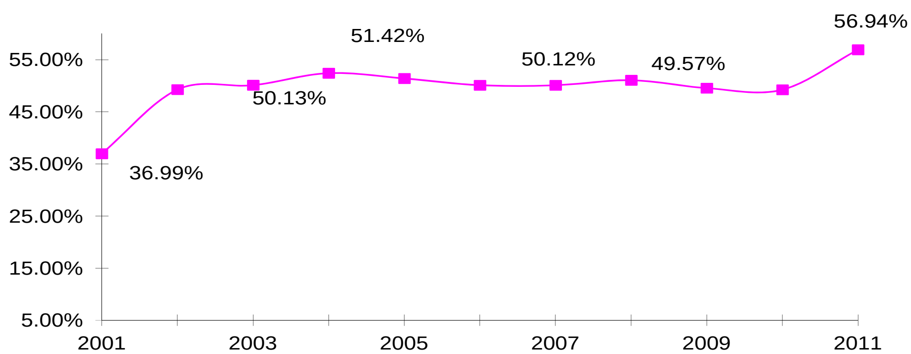
FACTOR 7 – GENERAL FUND BALANCE AS A PERCENT TO TOTAL OPERATING EXPENDITURES

DESCRIPTION - This factor is designed to show the undesignated portion of the general fund balance as a percentage of the next year's (FY 11-12) total operating expenditures, including the cost of fire service, which is financed outside the general fund. This provides a means to gauge a City's ability to respond to unforeseen emergencies, representing available funds expressed as a percentage of total expenditures. Since 2001, the City's policy is to maintain a 50% general fund balance, and with the adoption of GASB 54, the Council has now committed funds ($7.2 million) for purposes of economic uncertainties. In the past, funds in excess of the targeted balance were transferred to the capital fund. In both 2009 and 2010, the Council determined to use the excess balance to make a PERS lump sum payment to reduce the safety plan side fund liability. Results of operations for 2011 again reflect a general fund balance in excess of the targeted 50%. Staff is preparing an analysis for the Council on options related to the general fund balance, including a final contribution to eliminate the retirement side fund liability. Once a use is determined, the 2011 fund balance result will again reflect the stable trend at 50%.

FORMULA -

$$\frac{\text{General Fund Undesignated Balance}}{\text{Total Operating Expenditures}}$$

WARNING SIGN - DECREASING UNDESIGNATED GENERAL FUND BALANCE AS A PERCENT OF TOTAL OPERATING EXPENDITURES



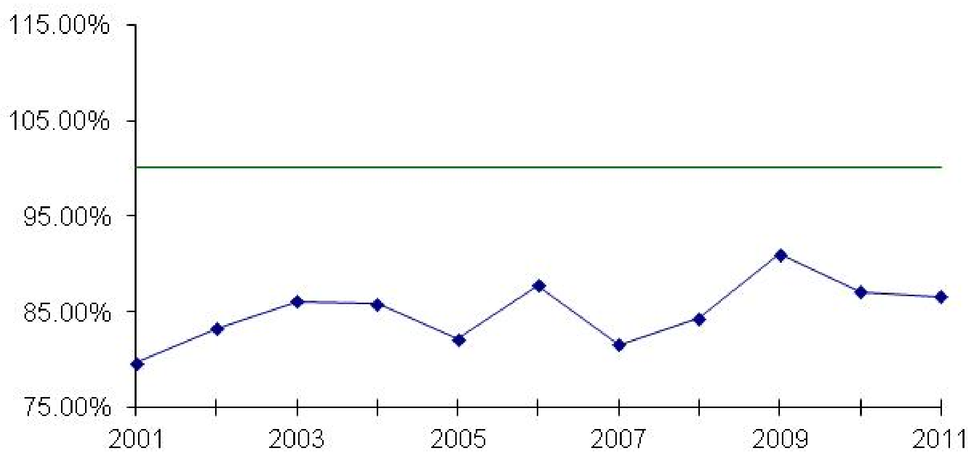
TREND ____________
Stable

FACTOR 8 - OPERATING POSITION

DESCRIPTION - This factor is designed to demonstrate whether a municipality is operating at "break even" or is relying on its fund balance to finance current operations. In this calculation, a number more than 100% means the City was operating at a deficit; 100% means the City broke even; less than 100% means the City had an operating surplus and earned more than was spent. The City has realized a general fund surplus each year since 1994. The results below exclude the lump sum expenditure ($1.2 million) toward the PERS safety liability, which occurred during FY 2011, but involved the prior year general fund undesignated balance (see Factor 7 above), not current year operating revenue. Dedicated special financing for fire contract costs are a critical component of the City's fiscal picture and as stated in past reports, property tax revenues alone do not cover the cost of operations for the Police Department.

FORMULA - $\dfrac{\text{General Fund Operating Expenditures}}{\text{General Fund Operating Revenues}}$

WARNING SIGN - INCREASING AMOUNTS OF GENERAL FUND OPERATING DEFICITS AS A PERCENTAGE OF TOTAL OPERATING REVENUE



TREND 
Favorable

FACTOR 9 - REVENUE SHORTFALL AND EXPENDITURE OVERRUN

DESCRIPTION - This factor is helpful in determining fiscal condition and the performance of municipal officials in controlling budgets. While estimating revenues and expenditures is not an exact science, some municipalities routinely over-estimate revenues to make budgets balance. Likewise, there could also be a continuing pattern of expenditures exceeding budget. Combined with revenue shortfalls, this can lead to a serious problem in a very short time. A calculation of 100% means an exact budget to actual match.

Our historic conservative budgeting has achieved consistent performance of revenues slightly in excess of budget and expenditures slightly below, resulting in general fund operating surplus (see Factor 8). While our goal would be to have our revenue and expenditure budgets track as closely to 100% as possible, the scenario reflected below is an acceptable alternative.

FORMULA - $\dfrac{\text{Year-end Actual Revenues and Expenditures}}{\text{Budgeted Revenues and Expenditures}}$

WARNING SIGN - INCREASING AND/OR CONSECUTIVE REVENUE SHORTFALLS OR BUDGET OVERRUNS

TREND ________
Favorable