City of Morro Bay

Financial and Organization Study

May 2015

Management Partners

Management Partners

May 20, 2015

Mr. David Buckingham
City Manager
City of Morro Bay
595 Harbor Street
Morro Bay, CA 93442

Dear Mr. Buckingham:

Management Partners is pleased to transmit this project report updating the results of our 2008 organization and financial study. The report first provides recommendations that apply to the entire city organization which are then followed by recommendations specific to each department. Recommendations for improvements in this report are focused on cost-effective service delivery systems, technology, and procedures. The long-term financial forecast is included as an attachment to the report.

Our team members were extremely impressed with the dedication and enthusiasm of staff. It is clear they care about and are interested in providing excellent customer service within the organization and to the residents and businesses of Morro Bay.

We will be providing an Implementation Action Plan under separate cover following our work session with City Council on May 26. We appreciate the opportunity to assist the City once again. If we can provide assistance as you implement the recommendations in this report please do not hesitate to call on us.

Sincerely,

Gerald E. Newfarmer
President and CEO

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Table of Contents

Tables

Figures

Executive Summary

Management Partners was retained by the City of Morro Bay in 2008 to conduct an organizational review and financial assessment. Much has happened since 2008. There was a major recession, a significant change in CalPERS funding methodology, the Dynegy plant has ceased operation, and there has been turnover in key elected and appointed officials. Management Partners was recently retained to update the 2008 assessment given all the changes that have occurred since that time.

Cities across the country continue to work in an era of reduced resources and increased demands, with stress placed on the importance of continuous improvement and gains in productivity. This study provides an opportunity to identify additional structure and process changes that will enhance efficiency, innovation, and a culture of excellence.

For discussion purposes, this study is divided into two main parts: an organization review and a financial forecast. Both parts informed each other.

The organization review is based on interviews, focus groups, document review, and benchmarking. The 2008 report included 38 recommendations, many of which have already been fully or partially implemented by the City of Morro Bay. During Management Partners' current review, project team members considered any recommendations from that study that were not fully or completely implemented to determine whether or not they were still valid. If relevant, they were included in the 65 recommendations listed in Attachment A.

Some of the recommendations in this report require little effort or cost to implement. Others require extensive study and investment of resources. Some of the recommendations include identifying alternative ways of delivering services, including requesting proposals for contracting with private vendors. It is very important that such proposals not be required to exactly match current service levels. For example, City employees currently provide a high level of service that often includes personal attention to individual resident's issues. A contractor might not want, or be able, to provide that kind of personal service. However, they may be able to provide a satisfactory service level at significantly lower cost than is currently incurred. Additionally, some services can be broken down into smaller elements if potential provider(s) cannot provide the entire service.

Another significant recommendation from this study is the need to review service fees and subsidies. This is especially important for the building and planning functions. In most cities, the fees for those services cover the entire cost of providing the services with no subsidies. Adopting a policy to fully recover planning and building fees will increase revenues and will also assure that taxpayers are not contributing to the cost of building someone's new home.

The assessment also included a financial forecast. Management Partners prepared a financial model for the City of Morro Bay that generates a long-term financial forecast, identifies structural imbalances, and determines the impact of addressing unfunded needs of the City. The model includes the General, Emergency Reserve, Vehicle Replacement, Facility Maintenance, and Measure Q funds.

Related to both the financial forecast and the organizational assessment are recommendations to ensure that equipment replacement and capital maintenance are adequately funded. The City's information technology (IT) infrastructure is of particular concern.

The purpose of the long-term financial forecast is to project the cost impacts of current (baseline) levels of staffing and services, including reasonable estimates of cost increases both within and beyond the City's control. Similarly, a baseline forecast projects a reasonable rate of growth for each of the General Fund's revenue sources given past history and likely economic trends. Alternative assumptions for the major revenues and expenditures with the greatest financial significance can then be tested to show their impact on the forecast's bottom line.

The result is an Emergency Reserve balance that declines rapidly though fiscal year (FY) 2020, and thereafter declines at a much slower pace. A deficit is avoided, but by FY 2023 the balance is expected to be just under $800,000, or 6% of total General Fund expenditures, compared with the City's goal of 27.5%. To get the reserve balance up to the City's goal will require either additional resources or a reduction in the projected level of spending.

Staff can update this financial model periodically and use it to guide the annual budget process, test the outcomes resulting from alternate economic outcomes and policy decisions, and measure the progress in meeting the City's financial goals.

Background

Management Partners was retained by the City of Morro Bay to update our previous organization and financial assessment of the City and provide recommendations for moving forward. In 2008 we completed a comprehensive study that included 38 recommendations. Many of these recommendations have already been fully or partially implemented by the City of Morro Bay. During Management Partners' current review, project team members considered any recommendations from that study that were not fully or completely implemented to determine whether or not they were still valid. If relevant, they were included in the 65 recommendations listed in Attachment A.

Much has happened since 2008. There was a major recession, a significant change in CalPERS funding methodology, the Dynegy plant has ceased operation, and there has been turnover in key elected and appointed officials. This assignment was to document how things have changed in the organization since then by identifying what has been implemented, examining the financial condition of the City, and identifying recommendations for improvement.

The first part of this report describes the methodology used in the organization assessment, including document review, employee interviews, focus groups, and benchmarking.

Since the financial forecast model contains a great deal of detail, it is described in the Financial Overview (Attachment B) at the end of this report.

Analysis and recommendations resulting from the organization review, starting with recommendations that apply city-wide, are followed by recommendations for each department. Although there are inevitable overlaps, we have broken down into "citywide" finance and budget recommendations, and individual departments for convenience. A list of all recommendations follows in Attachment A. Once this is accepted, Management Partners will work with City staff to provide an implementation schedule.

Management Partners' team members were extremely impressed with the dedication and enthusiasm of staff. It is clear they care about and are interested in providing excellent customer service within the organization and to the residents and businesses of Morro Bay. Recommendations for improvements in this report are focused on cost-effective systems and procedure. Management Partners did not assess individual employee performance and this report should not be used in that regard.

Methodology

Management Partners used a variety of analytical and management techniques throughout this project, as described below.

Review of Documents

Morro Bay staff provided Management Partners with numerous documents related to city operations. These included the City's budget, audited financial statements, and organization charts. We reviewed an update prepared by staff on the status of each recommendation included in the 2008 Management Partners report, which guided our initial research efforts. In addition, we looked at the City Council's Long Term Goals to understand the current Council's priorities.

Individual Interviews

Management Partners' team members conducted individual interviews with 17 employees. The purpose of these interviews was to understand each department's existing organization structure, staffing, and the major services provided. Staff also provided updates about the implementation status of recommendations made in 2008 and future opportunities for enhancing department efficiency and improvement.

Focus Groups

In addition to individual interviews, we conducted two focus groups with employees. The City Manager's office selected 24 employees to participate in these focus groups. Half of the participants represented a cross-section of supervisorial staff, and the other half represented line staff. Overall, participants expressed pride in the high level of services provided by the City. Challenges related to understaffing and inadequate information technology support were raised by both focus groups. Participants shared that almost all departments lack resources (time and/or funding) for staff training, and indicated an interest in improving communication between departments. Themes from the focus groups are included throughout the report, including staff ideas for revenue generation and operational efficiencies.

During focus groups, some participants expressed a desire to better understand the work of departments beyond their own to enable them to help residents get their concerns resolved. An online citywide calendar showing events and meetings was also requested.

Employee Survey

An online survey was developed and distributed to all full-time City employees. The response rate to the employee survey surpassed 90 percent, which is among the highest participation rates observed by Management Partners in our work with other cities.

Ninety percent of respondents agreed that the City of Morro Bay is a good place to work, affirming what focus group participants shared about a strong commitment to the City and its residents. Similarly, customer service was cited as a high priority within departments and for the city as a whole by more than 90 percent of survey participants. Employees provided suggestions for how their departments and the City as a whole could improve efficiency, save money, and increase revenue, which were incorporated into Management Partners' research.

Benchmarking

In coordination with the city manager and department heads, a variety of criteria for choosing peer jurisdictions were discussed. Ultimately, a group of seven cities was selected for benchmarking: Arroyo Grande, Atascadero, Capitola, Fort Bragg, Half Moon Bay, Pismo Beach, and Scotts Valley. Of those, four jurisdictions Atascadero, Capitola, Pismo Beach, and Scotts Valley responded with information on their cities' practices relating to strategic planning, financial policy and oversight, tourism development, code enforcement, recreation programming, fleet maintenance, and American with Disabilities Act compliance. Data provided from the responding cities are integrated throughout the report.

Table 1. Benchmarking Peer Characteristics

City	2014 Population	2013 Median Income	FY 2015General Fund Revenues	FY 2015General Fund Expenditures	General Fund FTE[1]
Morro Bay	10,276	$49,470	$10,591,390	$10,591,390	73.3
Atascadero	28,675	$65,344	$16,876,670	$17,538,670	101.5
Capitola	10,136	$54,064	$14,284,050	$14,744,854	71.3
Pismo Beach	7,705	$65,859	$16,845,958	$17,012,429	70.7
Scotts Valley	11,954	$101,837	$9,743,305[2]	$8,781,196	63.4[3]

Sources: 2014 Population Estimates from California Department of Finance; 2013 Median Income Estimates from American Community Survey Five-year Estimates; FY 2015 General Fund and Full-Time Equivalent information from FY 2014-15 city budgets.

[1]Note: FTE information excludes seasonal and temporary FTEs.

[2] Scotts Valley General Fund revenues includes a settlement payment from the County for $725,000, which will not be in the budget in future years.

[3] Scotts Valley General Fund and Total City authorized FTE includes five council members and 10.25 frozen positions.

Analysis and Recommendations

Management Partners' team members were impressed with the dedication and enthusiasm of staff. It is clear they care about and are interested in providing excellent customer service, as demonstrated by the responses to the employee survey and the extremely impressive response rate of over 90 percent. Compared with most organizations with which Management Partners works, employee morale and dedication to providing residents with quality service in Morro Bay is high.

Citywide Recommendations

Several issues were identified that affect the entire City of Morro Bay. Below are recommendations related to city-wide cost recovery and financial issues, tourism, code enforcement, and succession planning.

Cost Recovery

Many service fees are well below typical cost recovery rates. From interviews, we understand that several City Councils in the recent past were opposed to raising fees, even to cover expenses. Although the merits of this policy can be debated, it has not served the City well. Based on our experience working with cities throughout the country we know it is very unusual for a city not to require full cost recovery on individual building projects. Without fees that require 100% cost recovery, the taxpayer is effectively subsidizing private development.

There may be some services for which a subsidy is desirable, for example, to maximize participation in children's sports. However, such subsidies should be established with full understanding of their purpose and impact. Fees and cost recovery history are discussed in more detail in the Financial Overview section of this report (Attachment B). Specific suggestions are noted under several department analyses as well.

Recommendation 1. Conduct a City-wide review of cost recovery and fee policies and set fees accordingly. This review includes determining the subsidy, if any, to be provided for each service and requiring a cost allocation plan to assure overhead costs are covered. Many consultants do this kind of work and the project can be combined with the cost allocation project in the recommendation below. There is potential for a several hundred thousand dollar increase in revenues from all user-supported programs if subsidies are kept to a minimum.

The current Cost Allocation Plan (CAP) does not provide for all funds to contribute their fair share of administrative costs to the General Fund providing these services. This makes it difficult to determine the actual cost of providing some services.

A new CAP has the potential to increase revenues to the General Fund. It may also reveal that other funds levy inadequate user fees to support the total cost of their services, which includes their share of overhead. If this is borne out by the CAP study, then the fees imposed by these other funds may need to be increased so they make their full authorized contribution to the General Fund.

Recommendation 2. Require all funds to pay a share of General Fund costs such as accounting, investment, legal, and general administration. This recommendation applies to all funds, not just those funds that include labor costs.

Recommendation 3. Prepare an OMB A-87 compliant Cost Allocation Plan on which to base contributions from all funds. Doing so will allow the City to be sure each fund is truly paying its fair share of General Fund overhead costs. This could be included in the same project as the cost recovery recommendation above. (OMB A-87 establishes principles and standards for determining costs for federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments and is a good standard for cost allocation.)

Funding for equipment replacement and capital maintenance is almost non-existent, particularly in General Fund departments. For example, the Police Department’s roof leaks, the Harbor Department building is small and antiquated, and vehicles are kept beyond their useful, cost-effective life. In addition, most departments are operating with minimal resources, especially in terms of staff and contract services. This is especially true in Information Techology and Finance. As a result, important functions that are not time-critical, such as business planning and employee development, are not accomplished.

More specific information is provided in the discussion of individual departments below. More detail about current and historic funding levels can be found in the Financial Overview section.

Recommendation 4. Reestablish capital maintenance and equipment replacement reserves and add to them on an annual basis. The budget model can be used to show the impact on the forecast of funding these ongoing needs.

Tourism

The City is currently in the process of developing a local economic development plan. Some past economic development efforts, such as Measure D, have focused on Morro Bay's commercial fishing industry. Promoting tourism has also been a major economic development program in the past. In FY 2014-15, the City budgeted $715,000 for tourism development activities, which are financed primarily through the City's Tourism Business Improvement District (TBID) revenue ($575,000) and contributions from City reserves ($140,000). Morro Bay's tourism expenditures rank second only to the City of Pismo Beach, as shown in Table 2.

Table 2. Peer Tourism Development Budgeted Expenditures for FY 2014-15

City	Expenditures	Top Funding Sources
Morro Bay	$715,000	Tourism Business Improvement District (TBID), City contributions (reserves)
Atascadero	$177,000	General Fund, Transit Occupancy Tax (TOT), TBID Assessment
Capitola	$50,000	General Fund
Pismo Beach	$1,471,748	Lodging Business Improvement District, General Fund (via TOT and Sales Tax revenues)
Scotts Valley	N/A[1]	Assessment fee on lodging industry

[1] Within Santa Cruz County there is a County-wide Tourism Marketing District, which includes incorporated cities. Lodging businesses within the district are assessed a fee based on number of units. The lodging industry passes on the fee to its clients, which is then remitted to the Conference and Visitors Council.

As shown in Table 3, Morro Bay's General Fund receives significant revenues from the transit occupancy tax (TOT). Among peers, the City's TOT revenue is second only to the nearby City of Pismo Beach.

Table 3. Peer Cities Tourism Budgeted Revenue for FY 2014-15

City	General Fund TOT Revenue	Special Fund Business Improvement District (BID) Revenue	BID Assessment Levy
Morro Bay	$2,250,000	$575,000[2]	3% on hotels
Atascadero	$854,900	$163,090	2% on hotels[1]
Capitola	$1,273,400	Not Reported	Varies depending on number of units
Pismo Beach	$7,490,000	$749,000	1% on hotels, vacation rentals, RV Parks
Scotts Valley	$920,000	Not Reported	Varies depending on number of units

[1]The City of Atascadero retains 1% for administrative costs.

Pismo Beach is a clear outlier among its peer group for both TOT and BID revenue. Pismo Beach has a tourism department within City Hall (as does San Luis Obispo). In Pismo Beach, the City's TOT applies to all hotels, vacation rentals, and RV parks. Pismo Beach staff reported that several properties within the city are priced above $400 per night, which contributes to its high TOT revenue. As of April 2015 the County of San Luis Obispo is exploring the creation of countywide tourism marketing district. This regional effort, if successful, might complement and enhance Morro Bay's tourism development efforts and overall economic development.

Having a tourism department housed in city operations has several advantages, including enabling a city to have a cooprdinated approach to economic development. As Morro Bay's economic development plan is being completed it will be important to review existing economic development policies to ensure they are still appropriate.

Recommendation 5. Develop a proposal for integrating Tourism Bureau activities with City operations. This evaluation should include an assessment of the current Tourism Bureau organization and relationship. (Note: this is one of the goals the city manager recently discussed with Council.)

Code Enforcement

The Police, Harbor, Fire, and Community Development Departments all have noted the need for increased code enforcement since the former code enforcement officer position was eliminated. Among the peer cities surveyed, none reported a standalone department dedicated to code enforcement. Atascadero uses both contract and city staff for code enforcement, whereas Capitola, Pismo Beach, and Scotts Valley rely on city staff to perform code enforcement functions. The cities of Atascadero, Pismo Beach, and Scotts Valley reported that code enforcement duties typically comprise only a portion of overall staff workload.

Data compiled from the peer cities indicate that the code enforcement function can be housed in a variety of different departments, including fire and community development. Depending on how the position is supervised and directed in Morro Bay, a code enforcement officer will bring in revenues through increased collection of fines and delinquencies that will, in part, help pay for the position. However, cost recovery should not be a requirement of the position.

Recommendation 6. Hire a community service officer/code enforcement officer directly or via contract. The code enforcement officer is to be shared city wide. The position may be supervised from any department. A community service officer carries the enforcement powers of the Police Department. However, if most relevant issues occur in community development, that may be the best place for the position to be supervised. Alternatively, two part-time individuals could be hired to fill the City's needs.

The City uses a website function called "Let Us Know" so residents can report issues. Apparently the feedback loop does not work well and could use strengthening to inform both residents and staff of request status.

Recommendation 7. Fix the feedback loop for the "Let Us Know" function on the website.

Succession Planning

The City has not addressed succession planning, although several key employees are at or near retirement age. In particular, the Administrative Services Department is particularly vulnerable. Investing in succession planning would assist the already stressed department in dealing with retirements and resignations as they occur.

A best practice is to develop a succession planning framework that identifies positions at risk for retirement and includes a knowledge transfer plan so critical information is not lost when the incumbent leaves their position. The framework also should include the skills and competencies necessary for success in the position. Typically such a framework would be developed by a human resources professional.

Recommendation 8. Develop a succession planning framework and identify positions at high risk for turnover.

Financial Policies and Budget Best Practices

An important strategy for avoiding structural budget deficits is to adopt budget and financial policies that are relatively easy to understand and can serve as a meaningful framework for maintaining financial discipline. Another is to include sufficient information about the financial status of the City's different funds. Reporting the state of the municipality's finances to the governing body for public discussion is a way for the fiduciary responsibilities of the elected officials and executive managers to be understood by the public and organization.

Morro Bay's existing budget and policies are better than some cities that are many times its size. However, there is always room for improvement, so this section reviews financial policies and budget principles that should be adopted and practiced by Morro Bay as a financial sustainability strategy. It also contains recommendations for improving the utility and transparency of the City's budget document.

Financial Policies

The League of California Cities' Institute for Local Government has prepared a publication titled "*Financial Management for Elected Officials: Questions to Ask*." The publication provides guidance about financial planning policies that should be in place. The items below are cited by the League.

- *Budget policy:* Commitment to a balanced operating budget.
- *Long-range planning:* Financial analysis and strategies to assess the long-term implications of current and proposed expenditures and related financial obligations.
- *Asset inventory:* Requirement for a current listing of major capital assets, asset condition, and a plan for replacing assets.

- *Long-range planning for pension and other post-employment benefit costs:* Identification of how the agency will meet such obligations.
- *Reserve and other fund balances:* Requirements to maintain a prudent level of resources and method of setting aside monies to replace assets.
- *Revenue policies:* Focus on diversification of revenue sources to protect against fluctuations in individual sources.
- *User fees and charges:* Establishing expectations about covering the cost of providing services and how costs are determined.
- *One-time and unpredictable revenues:* Use of such revenues for one-time needs rather than ongoing expenses.
- *Limited purpose revenues:* Spending special purpose revenues for the intended use only.
- *Financial reporting:* Comparing actual expenses and revenues with what was predicted in the agency's budget.
- *Debt financing:* Specifying how debt financing will be used and the level of debt allowed.
- *Cash management and investments:* Ensuring prudent practices in investment.

Recommendation 9. Adopt a comprehensive set of financial and budget policies to provide a meaningful and easily understood framework for maintaining financial discipline. The League of California Cities and California Society of Municipal Finance Officers have materials that will assist in this effort.

Best Practice Budget Principles

The following budget principles reflect best practices in public financial management. It is a typical practice for cities to have adopted budget policies that address the issues described below. Morro Bay is following some of these practices, but City Council members have not always adopted formal policies to ensure expectations for adherence are clear and transparent.

Structurally-Balanced Budget. The annual budgets for all City funds should be structurally balanced throughout the budget process. Ongoing revenue should be equal to or exceed operating expenditures in both the proposed and adopted budgets. If a structural imbalance occurs, a plan should be developed and implemented to bring the budget back into structural balance.

> **Recommendation 10. Move resources from the General Fund and/or Emergency Reserve as needed to avoid deficits in other funds in future budgets.** Each fiscal year, transfers should be made in and out of reserves as necessary to bring the general fund balance to zero. This will ensure the actual net reserve remaining is shown and will avoid the use of pooled cash to cover fund deficits. Past budgets have displayed the fund balances for each fund, which is a good practice. However, these budgets have also allowed the General Fund to run deficits.

Multi-Year Financial Forecasting. To ensure that current budget decisions consider future financial implications, a long-term financial forecast should be developed and maintained. The annual General Fund proposed budget balancing plan should be presented and discussed in the context of this forecast. Any revisions to the proposed budget should include an analysis of the impact on the forecast for future years. If a revision creates a negative impact on the forecast, a funding plan should be developed and approved to offset the impact. The budget forecast should be updated annually to reflect changes in revenues and unexpected changes in expenditures. The forecast should be presented to the City Council for discussion and to provide information to the public.

> **Recommendation 11. Update the financial model prepared by Management Partners annually with any changes in actual or projected revenues and expenditures.**

Use of One-Time Resources. One-time resources (e.g., budget savings, sale of property, windfalls, and similar nonrecurring revenue) should not be used for ongoing operating expenses. Examples of appropriate uses of one-time resources include rebuilding reserves, retiring debt early, making capital expenditures (without significant operating and maintenance costs), and other nonrecurring expenditures.

Recommendation 12. Place one-time or limited-term revenues in the City's Emergency Reserve and/or Vehicle Replacement and Facility Maintenance funds, or designate them for capital outlay or other "one-time project expenses," rather than ongoing operating expenses. This is a best practice that the City has followed in the past and ought to continue.

Established Reserves. Cities maintain numerous funds based on different revenue sources and requirements. Because there are risks (both known and unknown), it is important that reserve levels in funds, depending on funding source eligibility, be maintained as a hedge against such risks. Without proper reserves, there can be major disruptions in services when unforeseen financial demands emerge, requiring immediate attention.

The City should maintain an adequate reserve level and/or ending fund balance for each fund as determined annually and as appropriate for each. City Council authorization should be required for the expenditure of established reserves, along with repayment requirements. The Government Finance Officers Association recommends that at a minimum, governments maintain unrestricted fund balance in the General Fund equivalent to two months of operating revenues or expenditures.

Recommendation 13. Review the historical basis for the 27.5% reserve goal established in 2010 and update the current reserve policy as appropriate. The review should test the sensitivity of the financial forecast using alternative growth assumptions to determine if the current circumstances warrant retaining, decreasing, or increasing the Emergency Reserve goal. Note that while the FY 2015 budget message states that Morro Bay did not use emergency reserves for General Fund operating expenditures during the Great Recession, by running deficits in the General Fund, the City effectively has used reserves. Implementing this recommendation will make available reserve levels clear.

The Risk Management Fund reserve was set at $500,000 in 2010. The primary purpose of this fund is to pay the premiums and claims for general liability, workers' compensation, unemployment, and property insurance. However, this fund has also been used for a variety of other purposes, which has led to a $2.8 million balance at June 30, 2009 dropping to a projected $687,000 balance at June 30, 2015. Over the past three years $592,000 has been diverted for non-insurance purposes (see Table 4). Although these expenditures were fully discussed and documented, and were in compliance with the Risk Management Fund policy, this trend cannot continue in coming years if this fund is to maintain its minimum $500,000 reserve against potential claims (or alternative level as may be determined).

Table 4. Non-Insurance Uses of Risk Management Fund Over the Past Three Fiscal Years

	FY 2012-13	FY 2013-14	FY 2014-15
General Fund operations subsidy	$100,000	-	-
Retirement payouts	$79,600	-	-
Emergency Reserve fund deficit	-	$38,195	-
Final year of Dynegy payment reduction	-	$100,000	-
Contribution to Tourism BID	-	$58,425	$40,000
City Council bequests	-	$56,000	-
Vehicle replacement - hybrid car	-	$20,000	-
Visitors Center	-	-	$100,000
Totals	**$179,600**	**$272,620**	**$140,000**

Recommendation 14. Determine the City's actuarial liability for future insurance claims to determine the appropriate level of reserve for the Risk Management Fund.

Debt Issuance. A municipality should not issue long-term (over one year) General Fund debt to support ongoing operating costs other than debt service unless such debt issuance achieves net operating cost savings and such savings are verified by appropriate independent analysis. All General Fund debt issuances shall identify the method of repayment or have a dedicated revenue source. The General Fund has a small ($36,000 per year) debt service payment for a California Energy Commission loan to make energy-efficient investments, which will reduce ongoing street lighting and other utility costs.

Employee Compensation. Negotiations for employee compensation should consider total compensation bargaining concepts and focus on all personnel services cost changes (e.g., step increases and the cost of benefit increases). Compensation costs should be included in the long-term budget forecast to ascertain affordability to the municipality, within the context of expected revenues. Morro Bay will have its next opportunity for negotiations when all current labor agreements expire June 30, 2016.

Fees and Charges. Fee increases should be utilized where possible to assure that program operating costs are fully covered by fee revenue. Opportunities should be explored to establish new fees for services where appropriate. As previously recommended, the City needs to pursue increased cost recovery by increasing fees and cost allocation plan reimbursements.

Grants. City staff should seek, apply for, and effectively administer federal, state, and other grants that address the City's priorities and policy objectives and provide a positive benefit. Before any grant is pursued, staff should provide a detailed pro forma that addresses the immediate and long-term costs and benefits to the City. One-time operating grant revenues should not be used to begin or support the costs of ongoing programs.

Grant-based revenues are not consistently available and are not a panacea for revenue shortfalls. For example, public safety staffing grants can be used to hire sworn personnel for a limited time but upon the grant expiration, the City is responsible for maintaining the higher staffing level for a certain number of years thereafter and thus must be able to absorb the added cost with its own resources. It should be noted that the City's grant revenues have fallen from an average of $235,000 a year during FY 2005 through 2008 to $62,000 annually over the past seven years.

Performance Measures. All requests for departmental funding should include outcome-based performance measurement data so that funding requests can be reviewed and approved in light of service level outcomes to the community and organization.

There is currently no performance measurement system in place. Department requests for funding have not been based on explicit outcomes. Implementation of a performance measurement system involves an administrative overhead component, which must be considered, especially for a small city with limited staff. A good first step is to incorporate objectives from the goal-setting sessions into the budget process to establish a linkage between funding requests and achieving Council priorities.

> **Recommendation 15. Incorporate objectives from the City Council goal setting session into the budget process to establish a linkage between funding requests and achieving Council priorities.**

Improving Morro Bay's Budget Document

The Government Finance Officers Association (GFOA) has established criteria for budget documents that reflect both the guidelines established by the National Advisory Council on State and Local Budgeting and the GFOA's best practices on budgeting. The GFOA offers a Distinguished Budget Presentation Awards Program to encourage and assist state and local governments to prepare budget documents of the very highest quality consistent with these guidelines.

The City of Morro Bay annual budget document lacks some of the GFOA's established criteria, and can improve in other areas. Table 5 summarizes the GFOA's budgeting guidelines and the extent to which they are currently being practiced by the City.

Table 5. Implementation of GFOA Best Practices on Budgeting in Morro Bay

Budget Best Practice	Status	Comment
Table of Contents, Introduction	Yes	Contents, Transmittal Letter, p. ii-iii, xiii-ix.
Description of priorities and issues, goals and strategies, factors influencing budget	Yes	Transmittal Letter lists goals from Council workshop, p. iv-viii.
Overview of Significant Budgetary Items and Trends	Yes	Transmittal Letter discussion p. iv-vii; each department/program page (summary of expenditures by type and total department revenue) contains notes of significant changes.
Organization Chart	Yes	Chart with name and title of employees by department, page xi.
Fund Descriptions and Fund Structure	Yes	List of funds on page xv, descriptions of funds included on page preceding statement of revenues, expenditures and change in fund balance for that fund.
Description of relationship between the entity's functional units and funds	Needs Improvement	There is no text explaining the mission and objectives of each program and its source of funding; this should be added to the budget summary pages for each department/program.
Basis of Budgeting	Needs Improvement	Glossary on page G-1 contains brief definitions but clarification is needed to describe the difference between budget basis (available cash) used by City in lieu of GAAP basis (modified accrual).
Financial Policies	Needs Improvement	Resolutions show policies for General Fund reserve, Risk Management Fund, investments, tourism, development fees, and other at end of document; not all areas recommended for policy adoption are addressed.

Budget Best Practice	Status	Comment
Budget Process	Needs Improvement	Budget contains adoption resolution, but document needs concise description of budget process, including explanation of relevant legal or policy requirements, internal process to prepare the budget, opportunities for public input, budget calendar, and process for amending the budget after adoption.
Consolidated Financial Schedule	Yes	Summary schedules of fund balance, revenue, and expenditures by type, p. 1-3, 6-8 for General Fund.
Fund Balance	Yes	Summary schedule on p. 1 and as part of statement of revenues, expenditures, and change in fund balance for five-year period for each individual fund.
Revenues	Needs Improvement	Revenue schedule by type by fund included, along with very brief discussion in transmittal letter, but requires section describing basis for each major revenue source, assumptions underlying projections, and future trends; graphs are helpful. General Fund is the primary focus but basis for revenues in other funds should be included.
Capital Expenditures	Needs Improvement	Budget contains a CIP schedule but projects are not described, and funding sources for non-enterprise projects are not identified.
Debt	Needs Improvement	Transmittal cites Water Fund's non-compliance with revenue coverage requirements, but debt service is not further identified. Budget needs to include financial data on current debt obligations, the relationship between current debt levels and legal debt limits, and effects of existing debt levels on current operations.
Position Summary Schedule	Yes	Positions listed in org chart (p. xi), FTE history (p. xii), position costs (p. xiii-xiv).
Department Descriptions	Not Addressed	Description of the assigned services, functions, and activities of organizational units.
Unit Goals and Objectives	Not Addressed	Program goals and objectives must be clearly identified along with their relationship to the overall City goals and anticipated timeframe for accomplishment.
Performance Measures	Not Addressed	Should include the outputs of individual programs and provide a meaningful way to assess the effectiveness and efficiency of those programs. The measures should relate to the mission, goals, and objectives of each program, and include information for prior, current and budget years.
Statistical and Supplemental Data	Not Addressed	Data should provide a context for understanding decisions incorporated into the budget, including factors that will affect current or future levels of service such as population growth, economic strength in the region, and population change. A "community profile" description is also helpful.

Morro Bay has fully implemented eight of these 19 best practice guidelines, while seven areas need improvement and four have not been addressed. Ideally, all of these budget principles need to be adopted and fully implemented to help elected and appointed officials maintain the financial discipline crucial to achieving fiscal sustainability. Given staffing constraints, it would be appropriate to phase in addressing these areas in FY 2016-17 and beyond. For example, budget policies and long-term forecasting should be undertaken first; program goals, CIP and narrative descriptions next; and performance measures last.

Recommendation 16. Improve the presentation, transparency, and utility of the City's adopted budget document by addressing guidelines established by the Government Finance Officers Association in budgets for FY 2016-17 and beyond.

Administrative Services Department

Finance

The Finance Division is very leanly staffed, yet few related functions are contracted. Because of the lean staffing, the department's ability to provide financial and budgeting information and assistance to operating departments is limited. In addition, the division has limited capacity for innovation and planning, and, for example, does not prepare a Comprehensive Annual Financial Report (CAFR), a Government Finance Officers Association best practice.

There is inadequate time and funding allowed for training and participation in professional organizations. Even getting routine work done is difficult when in the midst of audit or budget preparation. While this "belt tightening" can work for short periods of time, it is not sustainable over the long run.

If contracting or hiring temporary help during peak periods such as audit and budget preparation periods is not feasible, adding back at least one half-time staff person to assist all divisions in the Administrative Services Department with clerical duties should be considered. This observation also applies to the other divisions within the Administrative Services Department (human resources and information technology).

Recommendation 17. Evaluate opportunities to outsource work in finance, human resources, and information technology. Doing so will allow City staff to have more time for planning, training, and other functions essential to the long-term effectiveness of the department.

The same financial auditor has been used for many years. There were insufficient bids the last time the City prepared a request for proposals for auditor services. GFOA best practices do not require a change in auditor, recognizing there are sometimes insufficient qualified auditing firms available to bid. The current auditor has not prepared what is generally known as a "management letter," a letter that outlines issues of concern that are not material to the audit document itself. Instead, he has discussed these kinds of concerns with the finance director each year in an exit interview. It is a rare occurrence that an auditor does not provide a management letter. Regardless, the types of issues raised can be very helpful to management in correcting problems before they arise, especially regarding financial controls.

Recommendation 18. Develop a request for proposals for auditing services and actively seek audit firms to bid. If the current auditor is retained, request a different focus each year. If an exit interview substitutes for a management letter, both the city manager and the finance director, at minimum, should be present at the interview. However, the preference is to put such auditor findings in writing, which will also assist the Council in its oversight function

While not atypical of small cities, there is no formal purchasing system. Departments mostly handle their own purchasing. To maintain financial controls and assure purchasing regulations and policies are followed, departmental purchasing processes should be reviewed from time to time.

Recommendation 19. Review the purchasing function in departments every few years to ensure that purchasing policies and regulations are being followed.

The business license tax function was transferred to Public Services in 2010 when an account clerk position was eliminated. This creates a "one stop shop" for some customers. However, there is some concern that the function is handled too passively with little follow-through on delinquent licenses.

A recent audit found many businesses to be out of compliance. When letters were sent to individuals without licenses or with delinquent licenses, the result was extremely negative, resulting in poor public relations and embarrassment for the City. The finance director is responsible for collecting City taxes but has little control over how the function is handled given the current structure. However, the Finance Division does not have the staff capacity for routine collection of the tax. It has been suggested that once certain retirements occur, the City Clerk's Office might be an appropriate place to collect the business license tax. This would be physically closer to the finance director's office, which would facilitate supervision of the collection function.

> **Recommendation 20. Place the business license tax function back under the supervision of the finance director regardless of where the routine collection is physically handled.** Evaluate transfer of the physical function to the City Clerk's Office.

Information Technology

The information technology (IT) function has only one employee. When he is unavailable, vendors and some knowledgeable operations staff provide the only backup. Antiquated and inadequate IT services negatively impact every City department in terms of cost-effective service delivery. Financial software is only adequate and was last upgraded in FY 2009-10, which is just one example of out-of-date technology. (Others are mentioned later in this report.) Operating departments are aware of many IT applications that could help them deliver services more quickly and efficiently, and there are likely many of which they are unaware. Identifying specific functions to outsource will add capacity.

Unfortunately, the new automated payroll system is not detailed enough for the Recreation and Parks or Fire Departments, both of which keep their own separate records. Mistakes cannot be corrected in a timely fashion. What should have been timesaving technology has not turned out to be so.

There is practically no time for IT planning, system testing, or training. Helping operating departments keep their personal computers operational consumes a huge amount of time and still does not address the needs of departments who operate 24/7.

The City does not have an IT Strategic Plan or IT goals. An IT Strategic Plan should begin with an assessment of current IT infrastructure and examine future needs, emergency backup and security, web design, calendaring, and contracting opportunities. The plan should include prioritized goals and cost estimates for each element needed. This will be a significant expense (approximately $70,000 for an assessment and IT Strategic Plan), but is critically needed.

Another even more pressing issue is there is currently no backup generator for servers in City Hall although public safety departments are dependent on their operation. Implementation should be given high priority.

> **Recommendation 21. Hire an IT planning consultant to develop an IT Strategic Plan.**

> **Recommendation 22. Explore improvements to the new automated payroll system with the vendor to determine how to meet payroll needs in various departments.**

> **Recommendation 23. Investigate outsourcing some IT functions such as responding to individual PC problems throughout City departments.** Much outsourcing can be done remotely. This will be especially important while the IT Strategic Plan is developed (Recommendation 21), as supporting that process will consume staff time.

Human Resources

Human Resources (HR) is essentially one employee who has responsibility for typical HR functions such as recruiting, assisting with labor negotiations, processing personnel actions, and assisting departments with union and employee association issues. Several operating departments indicated they could use more HR help with recruitments, yet the individual is already at capacity.

The City does not have an employee handbook and personnel rules and regulations are in the process of being finalized. Lead labor negotiator services are already contracted.

> **Recommendation 24. Investigate joining CalOpps and/or similar online application services to widen recruitment range and save staff time handling job applications.**

Concern about compaction of wages between management and individuals they supervise was raised during interviews as well. In the past, there have been supervisors who made less than the employees they supervise, which creates morale issues. This is often an issue in small cities, but can be dealt with if there are resources to do so and the political will.

Recommendation 25. Analyze the effect of adopting a policy that supervisor classifications should make a minimum of 5% more than employees they supervise.

Police Department

The Police Department is leanly staffed with very limited clerical support. Officers must type their own reports and the police chief handles most of her own correspondence and related functions. Contracting dispatch services was a cost-effective decision; however, an unintended consequence is there are no dispatchers available as backup staff for police records and only one position is responsible for this work. Staff indicate a lack of time for planning and attention to supervision. During interviews it was clear there may be more opportunities to research and obtain grant funding, but there is very little time available to do so.

Recommendation 26. Investigate purchasing voice-recognition software that will assist officers in preparing their reports.

Recommendation 27. Add at least one half-time staff person to provide staff backup in Records and, as time permits, additional clerical support for the entire department.

In the recent past the department experienced high turnover with sworn officers, causing expense for recruitment and training. The recent strategy to hire officers who are interested in making a lateral move has been effective, but lateral hires are older and will retire sooner. It has been suggested that if the officers were paid more, they would stay, and the increased salary cost would be covered by reduced costs of training and recruitments. A salary study is not part of this review. However, in general, if salaries are significantly lower than those in nearby areas, there will be high turnover regardless of other job-related amenities.

Staffing currently is a minimum of two sworn officers per shift. Sworn officers are needed for minimum staffing and perform the non-sworn functions that might be performed by community service officers (CSOs) elsewhere. Occasionally the police chief and detectives are needed to reach this minimum due to injuries, vacations, etc. Thus, any reductions in sworn staff would cause a significant reduction in service level.

As noted in the 2008 study, we do not recommend decreasing police staff levels in any way. Based on an analysis by the Police Department, the only reasonable way to significantly decrease police costs would require contracting the entire service to the county sheriff with considerable reduction in service.

Recommendation 28. Prepare a Police Department staffing plan that addresses succession planning as well as the causes and costs of turnover.

Another result of the lean staffing is there is minimal effort for code enforcement due to lack of time. Other department directors are also concerned about the lack of code enforcement. A recommendation for adding a code enforcement position is included under the "citywide" section of this report.

The Police Department currently charges full cost recovery for police services at many special events, causing a hardship to the nonprofit organizations that run them. Continuation of the fees at these levels could cause the events to be discontinued, with possible economic development and other consequences. When implementing Recommendation 1 (city-wide cost-recovery review), it will be important to review the cost recovery levels for special events by nonprofit organizations requiring police services.

Finally, the 2008 report recommendation that the City consider contracting with the county sheriff for police service may still be a cost-effective choice. While such services will not provide the level of attention to individual residents currently provided by the Police Department, the City may decide that such a high level of service, while welcome, is not worth the cost.

We recommend a new discussion with the sheriff that starts without any presumed service levels and that base proposal be the level of service the sheriff would provide if the City were unincorporated. Additional services can then be added to the base proposal to bring it to the level that is most consistent with community expectations at a cost that can be afforded.

Several staffing models may be available from the sheriff and should be explored, even if they offer lesser service to the community than what is currently enjoyed.

Recommendation 29. Obtain formal proposals from the San Luis Obispo County sheriff on the cost of providing law enforcement service to the City based on two or three service levels. If this option is realistic, prepare to educate the public that service levels will change.

Harbor Department

Management Partners' 2008 study made several recommendations regarding the Harbor Department that were not implemented. The most significant of these was to investigate transferring all operations to a professional harbor management company. This recommendation was not implemented because it was believed that no private company could provide the level and scope of services provided by City employees. However, there was no investigation into contracting parts of the services currently being provided by City staff, nor were efforts made to determine whether a reduced service level might be acceptable.

Therefore, recommendations in this report again include considering contracting some entire functions as well as less drastic changes if extensive contracting does not prove viable. It is important that the idea of contracting not be rejected out of hand simply because a different level of service might result.

As described in the 2008 report, the Harbor Department Operating Fund is an enterprise fund established to conform to the Tidelands granting statutes of 1947 under which the City manages is waterfront lands and the Harbor. The Tidelands grant restricts the use of revenues to permitted uses related to the Harbor services in the Tidelands, and it should be noted that cost savings in the Harbor will not directly result in savings to the City General Fund.

One of the main issues relating to the level of service provided is the amount of service fees and rents the City is willing to charge. Measure D restricts certain areas to commercial fishing industry-related uses and grandfathered uses. This has limited the potential economic development in those areas for other industries such as tourism (recreational fishing and boating, restaurants, etc.) It appears there is significant community commitment to preserving the commercial fishing industry.

Also because of Measure D, the Harbor Department does not get full cost recovery on commercial fishing docks. Since this is an enterprise fund with no General Fund support, others using harbor services are subsidizing the commercial fishing uses. Another issue that is important to mention is that not enough resources are devoted to capital maintenance, such as replacing the antiquated and small department building. Again, as an enterprise fund, the cost of such replacement is a legitimate cost recovery component; fees need to be adjusted to ensure cost recovery takes capital maintenance needs into account.

Focus group participants believe many harbor users would be willing to pay more for better-equipped and better-maintained facilities. When Recommendation 1 in this report is implemented (identifying city-wide cost recovery policies and fees), it will be important to reevaluate subsidies to commercial fisherman to determine if they are still appropriate.

The Harbor Department is staffed with seven full-time equivalent (FTE) employees, which includes administrative staff, an operations manager, and harbor patrol officers. The department also has part-time employees for its lifeguard program, maintenance aides and harbor patrol reserve staff members. Together, the department budgets about $125,000 for these part-time staff positions (excluding benefits calculated at about 18%). For FY 2014-15, the harbor operating fund projects a balanced budget of about $1.7 million. This fund reimburses the General Fund for City overhead and other costs in the amount of $281,896. Revenue is derived from boat-related fees (slip fees, mooring fees, boat launch, etc.) and leases on certain shorefront properties.

Table 6 below compares estimated revenues for the Harbor Department at the time of the prior Management Partners report and estimates for FY 2014-15.

Table 6. Harbor Department Operating Revenues for FY 2008-09 compared with FY 2014-15

Estimated Harbor Revenue	FY 2008-09	FY 2014-15
Commercial leases (including percent of gross lease payments)	$1,430,000[1]	$1,433,425
Slip, moorings, and transient commercial pier rents	$150,000	$183,960
Transient recreational boat mooring and slip rents	$ 120,000	$132,860
Miscellaneous (shower fees, floating dock rental, live-aboard fees)	$ 33,500	$24,000
Launch ramp parking	-	$25,000
Total	$1,733,500	$1,799,345

Source: 2008 Management Partners Report and FY 2014-15 amended budget
[1]*Includes $250,000 of power plant outfall lease*

During focus groups and in survey responses, City staff had many ideas for increased revenues such as charging for recreational vehicle (RV) parking and installing parking meters on the Embarcadero. These ideas have merit and should be investigated and given full consideration to help support quality harbor services. One fee, charging a boater for repeated towing needs, is apparently already identified and simply needs to be enforced.

Recommendation 30. Establish a fee schedule and begin charging for RV/camping areas.

Recommendation 31. Evaluate the cost-effectiveness of installing paid parking along the Embarcadero. This evaluation could be extended to areas outside the harbor such as downtown.

Recommendation 32. Begin charging fees for multiple boater tows provided in the current fee schedule.

The department continues to have an issue with ongoing maintenance. Currently, harbor patrol officers (HPOs) provide maintenance in their "spare" time. This consumes what might otherwise be proactive patrol time. The 2008 study recommended the maintenance function be consolidated with other City maintenance programs, but this recommendation was rejected because of the special nature of slips, piers, and other harbor infrastructure. Now that overall City maintenance function has been transferred to the Public Works Department, it would be worthwhile to revisit this concept.

Operation of the harbor exposes the City to a number of liabilities, primarily in terms of the capital costs for facility replacement and regular maintenance. The current Harbor Department does not have the funding in place to address the immediate maintenance needs. The City should, therefore, consider alternatives including contracting harbor services and reducing staffing levels.

The City of Emeryville has successfully contracted the operation of its harbor to a commercial service provider, Marinas International. The transition started in 1998 and was completed in 2000. The deal included:

- City employees being transitioned out to new employment (not to the contractor).
- The contractor making capital improvements, including a complete reconstruction of all docks (complete), relocating fuel tanks (complete) and the construction of a restaurant (not yet built).
- Giving the City a percentage of operating fees, including a monthly rent amount, plus a percent of their revenue.

- A 25-year lease agreement.

According to Emeryville city leadership, the contract has been positive for the marina and the City. The contract agreement has resulted in increased revenues, decreased vacancies and uncared-for boats, and improvement in the overall facility appearance. An experienced contract harbor operator could engage in best practices to enhance the overall harbor functions and amenities in Morro Bay.

The following recommendations consider the possibility of contracting all services, as well as keeping them in house. Thus, some recommendations are mutually exclusive.

Recommendation 33. Determine what level and scope of service is desired from the Harbor Department with the understanding that the cost of providing the service will have to come from harbor fees and rents. It is true, for example, that the Coast Guard cannot provide the same level of public safety as can the Harbor Department with HPOs. However, the City needs to determine the level and cost of services it wants and is willing to pay for, and not just assume the status quo is the appropriate level. This recommendation might be easier to accomplish as part of the investigation of contract services as in the recommendations below.

Recommendation 34. (Repeat of Recommendation 7 from the 2008 report): Investigate contracting all daily operations of the Harbor Department to a professional harbor management company. By contracting most harbor operations, and moving harbor maintenance and eliminating the harbor patrol function (both recommended for consideration later in this report), the Harbor Department can become a small department focused purely on citywide economic development, with the understanding that the harbor and oceanfront is a core economic development opportunity for the City. By reducing labor costs in the Harbor Department, the City will have more money for needed maintenance and capital repairs.

To be viable and generate the most favorable terms for the City, the recommendation above may need to be combined with policy changes and economic development initiatives. For example, the City may need to consider some or all of the following steps:

- Change the current preference given to commercial fishing vessels and allow for potentially higher market revenues associated with alternative users for pier and slip space;
- Consider a major new commercial or slip development on City property to entice investment interest; and/or
- Allow for proposals that also incorporate contracting for property management services.

If the City does not contract all Harbor Department services, the department needs to be staffed appropriately. Staff members in the department have been stressed following the removal of a management position that has been frozen. This position should be designated for a business manager who would oversee harbor leasing. Without this position, responsibilities have been adjusted and the workload has been reassigned to existing staff. Transferring some functions elsewhere in the City, or contracting pieces of the work could also add capacity.

Recommendation 35. (Repeat of Recommendation 8 from the 2008 report): If the City chooses to retain harbor operations, investigate transferring harbor maintenance functions to the Public Works Department. This City-wide consolidated maintenance program will allow for more efficient and effective use of maintenance staff and contractors.

Recommendation 36. If harbor operations are retained, evaluate transferring the lease and property management function and other administrative duties to the Administrative Services Department. Doing so will help provide capacity and depth and allow the Harbor Department to focus on patrol and enforcement.

The Harbor Patrol Unit consists of three officers and a supervisor who are non-sworn staff with limited peace-office authority. The functions of the Harbor Patrol are to provide:

- Safety and enforcement of harbor regulations;
- Surf rescue;
- Oversight of the seasonal lifeguard program;
- Miscellaneous administrative and light maintenance functions, including slip mooring and boat maintenance; and
- Removal of derelict boats.

Operation of a Harbor Patrol Unit providing professional safety services such as surf rescue requires an effective training program. The City is exposed to significant liability if it offers professional services and does not properly prepare staff to provide those services and/or has not developed proper policies and procedures for safety activities. The City is not obligated to provide safety services, but if it does it must provide those services competently or be liable for significant legal risks.

The Coast Guard has a permanent local station in Morro Bay and is equipped for a wide range of rescues. Given the Coast Guard presence in town, the City's operation of a parallel rescue function is less important than it used to be. If the City is not willing to raise fees and other revenues to ensure that resources are available to provide training and other safety program elements, consideration should be given to whether the rescue program should be continued.

Fire Department

Fire suppression and emergency medical services are provided by a staffing model that uses a mix of career firefighters and part-time reserve firefighters. Per the most recent memorandum of understanding, a minimum of three full-time sworn staff are on duty daily at the City's single station, Fire Station 53. A fourth part-time reserve firefighter is used to augment daily staffing, allowing the department to staff its engine with four firefighters. At least two paramedic-certified firefighters are dispatched to emergency calls for service, allowing advanced life support care to begin immediately upon arrival. Ambulance transport services are provided by San Luis Ambulance, a private paramedic ambulance provider, which has one ambulance located in Morro Bay.

The 2008 Management Partners report offered two alternative recommendations related to the provision of fire suppression services in the City. The first alternative recommended adopting a paid on-call fire service model and the second recommended receiving a proposal from CAL FIRE. The existing City model relies significantly on part-time reserve firefighters to supplement daily staff. Due to the geographic and demographic constraints that limit Morro Bay's ability to recruit and train staff, the paid on-call fire service option was not deemed viable for the City.

The CAL FIRE contract option was explored during 2007 and 2008. After a series of community workshops and staff analysis, the CAL FIRE option was ultimately not pursued. Management Partners was asked to revisit this option as part of this report update, which was also suggested as a cost-saving measure raised by several respondents to the employee survey.

CAL FIRE is the service provider for the unincorporated areas of San Luis Obispo County and the communities of Pismo Beach, Avila Beach and Los Osos. The level and type of service CAL FIRE provides to the Los Osos Community Service District (CSD) is comparable to the services provided by the Morro Bay Fire Department. Although the call volume is greater in Morro Bay, analysis conducted by the Morro Bay fire chief suggests that the City's personnel costs for municipal employees and Los Osos CSD personnel costs for contract staff through CAL FIRE are approximately equivalent. Should the City wish to revisit contract fire service delivery, CAL FIRE could provide comparable levels of service to those offered by the existing municipal fire department.

Assuming similar contract costs as Los Osos CSD, the operational costs for CAL FIRE services are likely to be close to the City's existing expenditure levels. However, should the City pursue contract personnel through CAL FIRE, the City's unfunded pension liability obligation would likely change. CalPERS' projections for the City's unfunded liability assumes that the City's fire workforce would remain as municipal employees. If the City were to contract for fire protection services through CAL FIRE, the future years of CalPERS service accrual would be attributed to CAL FIRE, not the City. As a result, the projected amount of Morro Bay's unfunded liability for fire employees may decrease.

Determining if contracting for fire service generates cost savings remains an open issue that would require the City to check with CalPERS for modified estimates of future unfunded liability bills should the City pursue contracting. As discussed in Attachment B, the Fire side CalPERS fund will be paid off in FY 2021. At that time, the City will realize some offsetting savings despite planned CalPERS employer rate increases.

Because the City remains liable for the unfunded fire side fund liability regardless of whether it continues as the service provider, it may be advantageous to explore contracting closer to the side fund payoff date. Alternatively, additional cost savings may be realized if the City is willing to accept a reduced level of service. This would require policy direction from Council. If fire service level reductions are acceptable to the City Council and community, contracting for fire suppression and emergency medical services may generate General Fund savings.

Recommendation 37. (Repeat of 2008 Recommendation 12.) Request a proposal from CAL FIRE to provide the lowest possible level of service to Morro Bay and build up to a desirable service level from that point. Obtaining an estimate from CAL FIRE for reduced levels of service may allow for General Fund savings. However, pursuing a contract with CAL FIRE to match existing service levels is unlikely to generate cost savings until the Fire side CalPERS fund is paid off in FY 2021.

The Fire Department, like other City departments, does not have an equipment replacement plan for major equipment. However, in a resource-constrained environment, Fire Department staff members have been proactive and aggressive in pursuing community donations, in-kind donations, and grants. These funds have enabled the department to maintain a modern fleet using sources other than the General Fund. This is an exemplary practice that has provided critical funding for the department and should be continued in the future.

As noted earlier, the first recommendation in this report is to conduct a City-wide fee study. As part of this analysis, the Fire Department's fee schedule should be reviewed to determine if fees for mandatory fire inspections and fire prevention meet industry practices with respect to cost recovery.

Staff members reported a need for better code enforcement citywide. In the Fire Department, staff identified opportunities for improved enforcement of the fire code, specifically related to multiple false alarms. The creation of a City-wide code enforcement position could be shared among the Fire, Police, and Harbor Departments. While some revenue is anticipated from improved enforcement, this position should not be dependent on citation revenue. Recommendation 6 in the Citywide Recommendations Section of this report addresses this issue.

The department's fire prevention activities include plan checks, building inspection, fire code enforcement, hazard and weed abatement, and harbor lease site inspections. These duties are primarily managed by a part-time fire marshal who works a total of 12 hours each week. Some duties are outsourced to a fire protection engineering service.

The current fire marshal is a CalPERS retired annuitant whose work hours must not exceed 960 hours in a single fiscal year. According to staff, this individual regularly exceeds his weekly hourly cap due to the volume of outstanding work. Given the limited number of work hours and the many fire prevention tasks that need addressing, staff members report that the fire marshal's full duties are not being completed.

Neighboring cities have combined aspects of the fire marshal position with building inspector duties, allowing the building inspector to enforce fire code compliance. The overlapping nature of these two functions may provide increased efficiency. The building inspector position is currently vacant and the City is contracting for this function on an interim basis.

> **Recommendation 38. Analyze the feasibility of using the vacant building inspector position to enforce aspects of the fire code.** Doing so would allow the position to be shared by the Fire and Planning Departments.

Recreation and Parks Department

At the start of this study, responsibilities of the Recreation and Parks Department included consolidated maintenance functions for the City of Morro Bay as well as recreation programming. The recent reorganization moved maintenance functions into the Public Services Department (now renamed Public Works). Observations and recommendations for both functions are included in this section.

Consolidated Maintenance

The consolidated maintenance function included about nine full-time equivalent employees with responsibility for maintaining all of the City's public buildings, streets, parks and street trees, fleet and equipment. Based on interviews, the City is supplementing staff with contractors for large jobs and when in-house expertise is not available. Two years ago the City entered into a contract for maintenance of the Cloisters Assessment District. Contracting for this service is a good business model.

The consolidated maintenance function is also responsible for prepping and cleaning up all special events in the City, which according to staff are sizable in number, approximately 25 events annually. There is no work order system to help track time or resources used for any of the maintenance or special events functions. Such a system would be advantageous in identifying the true cost of services for all activities performed by the maintenance workers. (Note: During interviews we learned that the Wastewater Division is about to purchase the Citiworks work order system, which apparently could then be offered to all employees in the City.)

Recommendation 39. Invest in a work order system.

The Streetsaver program is used to track and assess pavement management. Although about $500,000 of Measure Q dollars are devoted to streets each year, based on interviews, the need is far greater than the funding. In addition, the City's pavement management plan does not address pedestrian improvements. The City has an approved sidewalk inspection program, yet there is still significant work to be done on sidewalks and pedestrian improvements. A plan is needed that sequences how streets, sidewalks, gutters, signs, striping, etc. will be accomplished.

Recommendation 40. Develop a five-year Street and Sidewalk Plan that identifies when sidewalks, gutters, signs, and striping will be accomplished.

Management Partners' 2008 report recommended requiring property owners to be responsible for maintenance of the public right of way in front of their property. The recommendation was not implemented and we believe it should be considered once again.

Recommendation 41. (Repeat of Recommendation 26 from 2008 Report) Implement use of Streets and Highways Code Section 5600-5630 to require property owners to fix sidewalks.

Trees are an important asset to any city. The residents of Morro Bay value their trees and often call the City to attend to residential trees. This places a burden on the already limited staff resources. If the City is doing work for private individuals, they should be charged for that work. When most jurisdictions do this type of work they bill the resident accordingly. Another option is to politely tell the resident they must engage a private contractor. (While much of the tree trimming is outsourced, customer complaints are responded to by City staff.)

Recommendation 42. Stop providing tree maintenance for trees owned by residents, including trees planted in the public right of way by someone other than the City.

The City's fleet maintenance includes vehicle and equipment maintenance and the fueling function. While some of the maintenance is outsourced, there is no fleet management system to manage the fleet and the mechanic must complete a myriad of paperwork as a result. Management Partners has a concern whenever an individual is working alone in a job that might be hazardous. During interviews we learned that the mechanic has applied for other jobs in the City. If he left this position, it is likely to be advantageous to outsource the entire fleet maintenance function.

Recommendation 43. Evaluate the costs and benefits of outsourcing the entire fleet maintenance function.

Management Partners' peer research revealed that in the Capitola, Pismo Beach, and Scotts Valley fleet maintenance is primarily carried out by city staff. Similar to Morro Bay, fleet maintenance is housed within the Public Works Department among the peers. As shown in Table 7, personnel staffing and expenditures are roughly equivalent among the peer cities. Morro Bay's personnel expenditures are about 10% below its peers.

Table 7. City Fleet Assets and Budgeted FY 2014-15 Resources for Fleet Maintenance

City	Number of Vehicles	Maintenance Provider	Staffing (FTE)	Personnel Expenditures
Morro Bay	44	City Staff and Contract	1.0	$89,524
Atascadero[1]	72	City Staff and Contract	N/A	N/A
Capitola	20	City Staff	1.5	$100,000
Pismo Beach	77	City Staff	1.5	$102,846
Scotts Valley	Not reported	City Staff	1.1	$109,329

[1]In Atascadero, fleet maintenance is not managed by a single individual or division. Each department is responsible for fleet maintenance.

An alternative would be to consider leasing the fleet. The decision to lease involves analysis of several factors, including the age of each vehicle in the fleet and various financing methods available to the City. Leasing would offer a pay-as-you-go financing approach, and may enable the City to replace the aging fleet more quickly than if vehicles were to be purchased.

According to fleet industry professionals, depending on how the lease is structured, the City may be able to generate revenue through a sale/leaseback agreement, such that the City sells its assets to a leasing company and leases them back. Alternatively, the use of a lease-purchase agreement could help reduce ongoing operational costs.[1] Either leasing option would require greater analysis to identify the potential impact on finances and operations. While an in-depth cost and life cycle analysis of the City's fleet is beyond the scope of this project, the decision to lease

[1] Christensen, Janis. "Leasing: Not Just for Private Sector Fleets," *Government Fleet*: May 2010.

would involve closer examination of the City's charge-back rates, maintenance and replacement costs, and overall fleet utilization.

Recommendation 44. Evaluate the costs and benefits of leasing instead of purchasing vehicles.

According to individuals who were interviewed, the vehicle replacement fund was depleted in 2009. The City lacks a systematic mechanism for vehicle replacement. It has no plan or written policies for vehicle replacement and does not collect annual internal service charges from departments to pay for such replacements. Vehicle replacement is postponed until one-time funding becomes available or departments have sufficient capacity in their annual operating budgets. Although Morro Bay is not alone in facing this problem, as vehicles and equipment age and are kept in service beyond their useful lives, the result can be safety risks and higher maintenance costs. (See Recommendation 4.)

In answer to the question of whether it would be more economical for the City to lease or to own its fleet, the recommendations below would need to be completed.

Recommendation 45. Develop vehicle replacement criteria and examine the age and condition of the City's existing fleet against those criteria, industry standards, and each vehicle's economic life cycle.

Recommendation 46. Determine vehicle/equipment replacement costs over a 15-year period to estimate the total costs required to fund replacements on an annual basis.

Recommendation 47. Use annual replacement cost estimates to evaluate the cost-efficiency of the various vehicle replacement funding mechanisms. Such mechanisms include allocating annual cash appropriations, establishing a reserve fund and chargeback system, and/or financing with loans or bonds, or leasing from a company or bank.

The City has made a decision to stop using the fueling system at the corporation yard which should save costs. While a small above-ground tank will be available for emergencies, the majority of fueling will no longer be done at the corporation yard. This is a best practice as it eliminates environmental risks to the City without significant additional costs.

Between Memorial Day and Labor Day, the City operates a seasonal trolley with routes between campsites and the City center. The City also contracts for a deviated fixed route bus system. Trolley operations are no longer supported by the General Fund (See Recommendation 17 of the 2008 report), and employees identified this as an area for cost savings as part of the survey. According to staff, the trolley is funded through the federal Transportation Development Act, which offers two sources of funding for public transportation: the Local Transportation Fund and the State Transit Assistance Fund. Depending on regional needs, these funds may be used for roads and street projects.

Recommendation 48. Evaluate the popularity of the trolley program among residents, tourists, and business owners.

Recommendation 49. Investigate the ability to use federal and state funds to fund road infrastructure instead of funding the trolley program. Implementation of this recommendation would be based on the results of Recommendation 48.

Recreation

As stated previously, at the start of this project recreation services had been combined with consolidated maintenance which had been a more sizeable department. Currently, the department consists of four recreation FTEs with supplemental support from a number of part-time employees. Included in these four FTEs is one director, one recreation supervisor for youth/adult sports, one recreation supervisor for youth/senior services, and one administrative technician.

Staffing is supplemented by volunteers from the senior community and a community-based organization called PathPoint. The department provides a wide range of year-round youth and adult recreation programming at the City's community center, senior center, and other public facilities. Staff also manage seasonal camps, athletic leagues, and special events.

Table 8 shows where recreation services are housed, the number of full-time recreation staff, and expenditures.

Table 8. Peer Comparison of Recreation Placement, Staffing Levels and Expenditures

City	Department Housing Recreation Services	Full-Time Staff	Total Recreation Expenditures
Morro Bay	Recreation	4.0	$1,502,716
Atascadero	Police	2.0	$497,900
Capitola	Recreation	3.25	$850,000
Pismo Beach	Community Development	1.0	$445,299
Scotts Valley	Public Works	5.0	$902,024[1]

[1]*Of Scotts Valley's total recreation expenditures, only $70,096 are General Fund. The remainder of funding is from other sources.*

Among the peer cities, Morro Bay is one of only two cities to have a standalone department. Atascadero, Pismo Beach, and Scotts Valley assign recreation services to other city departments. Given the current size and scope of the function, placement in another department should be considered. Part of the decision about the appropriate department will hinge on whether alternative service delivery methods are chosen and to what extent they are used.

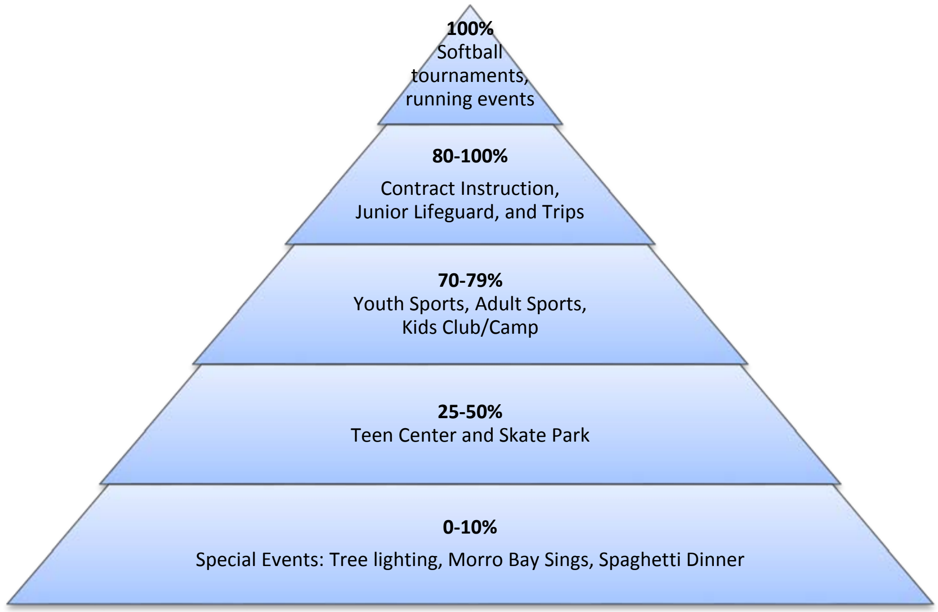
Recommendation 50. Identify which department should be responsible for recreation services.

Given the various models to provide recreation services, the staffing comparison provided in Table 8 shows one aspect of recreation operations. Further study is needed to more accurately understand and assess how these models compare to Morro Bay's Recreation Department in terms of service level and quality. Analyzing additional data, such as the types of program offerings, number of participants, revenue, and expenditure levels, is beyond the scope of this project but would inform the decision to use alternative service delivery models for recreation within Morro Bay.

In the 2008 Management Partners report, it was recommended that the City "restructure the recreation programs to be cost covering" either through city-managed recreation programs or through privatized recreation program offerings. Since 2008, recreation staff have developed a financial sustainability model for the department. A key component of this model is a cost-recovery policy that identifies target recovery levels based on program type, as shown in Figure 1. For example, cost recovery targets for tournaments and special events are 100% while the majority of other recreation programs aim for 70% to 79% recovery. Programs and events with zero percent cost recovery (annual Easter egg hunt, tree lighting ceremony, etc.) are either no longer offered or staff solicit donations or sponsors to continue these activities using non-City funds.

This model allows for close monitoring of revenues by program type, and the associated General Fund subsidy, and is a best practice.

Figure 1. Recreation Department Cost Recovery



The cost recovery model shown in Figure 1 reflects established targets according to the existing service delivery model of City-provided recreation services. Different models exist for running recreation programs, including the use of non-City service providers or the elimination of the recreation function, as recommended in the 2008 report. The use of external service providers that currently operate similar programs in other jurisdictions may be able to help Morro Bay realize greater operational and cost efficiencies.

For example, the City's Recreation and Parks Department operates its own junior lifeguard program. Seasonal, part-time staff are hired by the Recreation Department and receive some training from the Harbor Department. The County of San Luis Obispo Parks Department operates a similar junior lifeguard program at Cayucos Beach, just north of Morro Bay. In the City of San Luis Obispo, the YMCA coordinates contract class offerings for residents. Exploring the potential costs to partner or contract with the county or other service providers may improve overall quality of recreation programming, reduce staff time and resources, and boost overall recreation program cost recovery.

Recommendation 51. Evaluate partnerships and/or contracting opportunities to increase recreation programming cost-recovery through the use of external service providers.

The Recreation and Parks Department provides services to Morro Bay residents and also serves the neighboring unincorporated communities of Los Osos and Cayucos. City residents receive a discount (typically $5.00) over non-residents. While the difference between resident and non-resident fees varies by community, non-resident rates are typically 20% to 25% percent greater.

Recommendation 52. Increase non-resident recreation participation fees in alignment with industry practices.

The department has developed a robust partnership with the Morro Bay Community Foundation that provides partial, need-based scholarships to youth to offset participation costs. Staff report that nearly half of the children enrolled in Morro Bay schools qualify for the free or reduced lunch program. Eligibility for this program is used as an indicator for recreation staff to identify potential candidates for scholarships to participate in city programming. Through the use of proactive public-private partnerships, the Recreation and Parks Department has successfully sustained enrollment levels while aggressively working to keep programs financially accessible. This is an effective practice and should be continued.

Staff report there are additional opportunities to expand public-private partnerships by working to attract and engage private sponsors. These sponsors could advertise on City property (on trash cans near Morro Rock or the harbor, for example) or could receive naming rights for specific parks or amenities. Funds received by the City could restore zero percent cost recovery programs like the Easter Egg hunt, which is valued by the community but does not generate revenue.

According to staff, this idea was previously brought to Council but no action was taken. Many other cities have been successful in implementing robust public-private partnerships and/or sponsorships for recreation programs and have used transparent public processes to establish policies and procedures for pursuing public-private partnerships.

Recommendation 53. Evaluate implementing public-private partnerships and sponsorships for recreation programs.

Public Services Department

The Public Services Department, as configured when we began our study, included the following divisions: Administration, Engineering, Planning, Water, and Wastewater. Each is discussed below.

Administration

The Administration Division had four authorized FTE when we began this study and is responsible for managing the administrative functions of the department including budgeting, planning, purchasing and bid processes, overseeing contracts, and supervising permitting and business license activities. In addition, the department's website is managed by the management analyst in the division. Based on interviews, there is more work to be done than administrative staff to do it. Many deadlines coincide with each other (e.g., planning commission packet, Joint Powers Authority packet, time cards, and payroll), which is challenging for the current staff. Over the last several years administrative staffing has been reduced, yet the expectations have remained the same. This is not a sustainable situation.

The lack of current technology is one of the main concerns expressed during interviews. The current HdL business licensing system is old and not easy to use. As a result, a great deal of manual work must be done by staff. For example, all noticing and business renewal notices are done manually; folding and stuffing are manual and are extremely time consuming. In addition, all permit tracking is done by the permit technician via email; there is not electronic inputting of data by review staff.

Although the management analyst has initiated cross-training, individuals do not have time to provide back-up for each other. Consequently, the administrative work flow slows and in some cases completely stops when individuals are sick or on vacation. In addition, some administrative tasks cannot be completed or performed well because of the daily workload demands. These include proper records management, records retention, and filing.

In addition to wasting valuable staff resources, customers in most governments want to be able to access information online and expect to be able to pay for services that way (although some focus group participants indicated that many Morro Bay residents want to pay in person). Upgrading the current system will be a significant improvement in customer service and will alleviate some staff time that can be devoted to other activities.

Recommendation 54. Upgrade the permitting and business license systems to allow online renewals and payments.

Recommendation 55. Streamline the business license process to eliminate the manual spreadsheet system currently used.

Capital improvement planning is not always supported by prioritization nor are funding sources always identified. According to estimates prepared by City staff, deferred capital projects require estimated expenditures of about $41.1 million, as shown in Table 9.

Table 9. Morro Bay Deferred Capital Projects (as estimated by Engineering Staff)

Deferred Capital Projects/Programs	Primary Reason for Deferral	Projected Expenditure
Citywide Pavement Rehabilitation	Funding	$22,000,000
N. Main (Section 3) Sewer Replacement	Funding	$3,500,000
Police Department HQ Renovation[1]	Funding	$2,500,000
Harbor Department Office Replacement	Funding	$1,500,000
Facility Repair/Renovation	Funding	$1,200,000
Citywide ADA Improvements	Funding	$1,000,000
Harbor Parking Lots Rehab	Funding	$1,000,000
Kings Water Tank Expansion	Funding	$1,000,000
Harbor Repair/ Renovation	Funding/Staff	$2,400,000
Nutmeg Tank	Funding/Staff	$2,000,000
Embarcadero Sewer Replacement	Funding/Staff	$700,000
Desalination Upgrade Phase 2	Funding/Staff	$300,000
Section 13/14 Sewer Replacement	Funding/Staff	$250,000
Water, Sewer and Stormwater Master Plan Updates	Funding/Staff	$200,000
Section 12 Sewer Replacement	Funding/Staff	$100,000
Implement Asset Management /Work Order/ Material Tracking System[2]	Funding/Staff	$25,000
Chorro Valley Water Service Replacements	Staff	$300,000
State Park Water Line Replacement	Staff	$250,000
WWTP Flood Protection	Staff	$150,000
WWTP SCADA	Staff	$80,000

Deferred Capital Projects/Programs	Primary Reason for Deferral	Projected Expenditure
TMDL Wasteload Allocation plan	Staff	$45,000
GIS Implementation[2]	Staff	
Reorganize As-Built Plan Files	Staff	
Capital Facilities & Real Property Inventory	Staff	
Update Procurement Policy/ Ordinance	Staff	
Encroachment Ordinance	Staff	
Current Contracts List	Staff	
Laurel Easement Water/Sewer/Stormdrain Replacement[3]	Other	$500,000
Elena Water Tank Maintenance/Removal[4]	Other	$100,000
City Development Standards, Drawings & Specifications	Other	
Total		$41,100,000

[1]Staff recommend conducting a needs assessment to confirm budget.
[2]System would require additional estimated expenditure of $25,000 annually.
[3]Project to be completed with Nutmeg Tank.
[4]Project to follow after Nutmeg Tank completion.

Developing a more comprehensive Capital Improvement Plan (CIP) would better identify needed funding and help with the long term financial forecast**.** Capital improvement projects with annual operating and maintenance costs exceeding $100,000 should not proceed without City Council certification that funding will be made available in the applicable year of the cost impact.

> **Recommendation 56. Integrate goal-setting priorities with the next Capital Improvement Program (CIP) update.** Identify capital project needs over a minimum five-year period, together with the appropriate funding sources, and build those amounts into the long-term financial forecast.

Management Partners was asked to research how other jurisdictions have handled Americans with Disabilities Act (ADA) compliance audits. Peer benchmarking results showed that three cities (Atascadero, Capitola, and Pismo Beach) have completed ADA compliance audits within the past five years, and one city has not (Scotts Valley). Audits were completed by in-house staff in Atascadero and in Capitola, and by contract in Pismo Beach.

Planning

The planning manager is fairly new to Morro Bay and was dealing with some staffing changes (e.g., the building inspector had recently left the City). The building inspector position handled building inspections and plan checks. The City is now contracting with California Code Check (Atascadero-based). Because of non-competitive wages and technical requirements, there was a sense it will be difficult to recruit for the building inspector position.

At the time of our interviews, the reorganization to create a stand-alone planning department was anticipated. This created concerns about whether there would be adequate administrative staff assigned to the new department. Since the arrangement at the time was to have an administrative unit for the Public Services Department as a whole, it was unclear how staff would be allocated in the new configuration. Ideally, the planning manager indicated there would be one administrative supervisor and one permit technician to run the counter. Many senior level or technical staff members are doing administrative tasks that would best be done by an employee with administrative skills. In addition, some important tasks, such as code updates, are not getting accomplished.

> **Recommendation 57. Contract short-term assistance for special projects such as code updates and specific administrative functions.**

As previously mentioned in other departments, the current fees are out of date (the last fee study was conducted in 2004) and building fees do not cover costs. (See Recommendation 1.) Full cost recovery for planning and building is appropriate so that taxpayers are not subsidizing the cost of an individual or developer. Information from interviews also indicated that in addition to fees not covering costs, building impact fees are quite low in Morro Bay.

Similar to other departments, technology is not providing efficiencies. The HdL permit tracking system is not efficient or effective and only one person in the City is trained on the system. As a result, all tracking is paper-based. This is extremely time-consuming for staff and customers. In addition, there is no outward-facing system that allows residents to track the status of a permit. This is a best practice that is found in planning and building departments throughout the country.

Recommendation 58. Investigate whether upgrades to the HdL permit tracking system will allow the City to manage the permit process efficiently and provide a way for customers to track their applications electronically.

A General Plan update is currently in the planning stage. This will take additional resources from an already-stressed staff. Although the City has received $400,000 for certain aspects, such as the local coastal plan, the entire cost of the General Plan update is likely to be at least $600,000. Sources for additional funding will need to be identified.

Engineering

Based on interviews, resources devoted to the City's engineering function are stretched thin and much work has been deferred. This is especially true of General Fund and Water Fund projects. The City's budget lists capital projects together with vehicle and equipment needs. Capital projects should be identified separately, based on priority. A five-year CIP budget typically lists projects, anticipated by year and based on priority, separately from other needs. Prioritizing projects City-wide is a best practice, but is not being done in Morro Bay.

Thirty capital projects were identified as being deferred or delayed based primarily on lack of funding or staffing. Engineering staff members estimated the approximate value of these deferred or delayed projects to be over $40 million as shown in Table 9 above. Some, such as a supervisory control and data acquisition (SCADA) project at the wastewater treatment plant, will impact staff efficiency while others, such as the Citywide Pavement Rehabilitation, are infrastructure needs that must be attended to.

Recommendation 59. Initiate a Capital Improvement Program Committee consisting of representatives from affected departments to discuss each project and agree on priorities annually and over the next five-year period. Include all projects that have been deferred.

Water Division

The Water Division has made several changes since Management Partners' report in 2008. The first is the division was previously staffed with maintenance workers who were not licensed. The division now has operations staff, all of whom hold licenses for treatment and distribution and also do maintenance work. The change to more specialized skilled labor for water functions is valued by Water Division management.

The division is adequately staffed, partly because meter reading was recently contracted to an outside provider. This allowed additional time for regular maintenance. As a result, one part-time position was eliminated. The division has a preventive maintenance schedule and is able to accomplish the work as scheduled.

Water crews will assist with streets during storms, emergencies, etc. There is a good working relationship between the two functions, which has not always been the case, although requests for assistance with water-related street repairs are lesser priorities for the streets crew.

One area of improvement mentioned during interviews was to have water crews coordinate street patching with the streets crew so that asphalt work to repair water patching is done on a monthly basis. This would benefit the City in two ways: first, it would save money by not having to use contractors for small jobs and second, it would ensure that the patches were done in a timely manner.

> **Recommendation 60. Coordinate patching resulting from water projects with streets crews so that patches are done regularly on a monthly basis.**

Payments are currently made to the City via individual customer bank accounts (autodrafts), which require staff to manually enter account numbers. This is very labor intensive, particularly for water billing. The City's financial institution/bank should have ways to automate this function. Personal checks could also be processed in this manner by the city's bank.

> **Recommendation 61. Develop an agreement with the City's bank to have the bank process autodrafts and checks for the City, particularly for water billing.** Ensure that the agreement includes having the bank automatically record account numbers with payment amounts.

Another step toward even greater efficiency may be to contract the entire water billing function. Contracted meter reading has achieved positive results in the City by increasing staff capacity to address other activities. Many jurisdictions contract water billing. Staff report that significant time is spent addressing customer calls and complaints related to billing.

Contracting the billing function would improve the already limited administrative staff capacity dedicated to the Water Division.

Recommendation 62. Evaluate the costs and benefits of outsourcing water billing.

The Water Division provides 24/7 standby in case of emergency but often water crews are called for help with non-water functions (tree limbs, park bathrooms issues, etc.) because other employees in the City know that water crews are responsive and that enterprise funds have money to pay overtime and standby costs. However, when emergency work is done that is not attributable to the Water Division, the proper department or division should be charged; not the Water Division.

Recommendation 63. Ensure that the Water Division is not being charged for services it is rendering on behalf of other departments or divisions.

Wastewater Division

In late October of 2012, the Wastewater Division began managing collections, which works well. The biggest issue confronting the division is the treatment plant which was originally constructed in 1953. The last major upgrade was in 1984. A new wastewater treatment plant (WWTP) was originally planned for 2014, but site selection issues have postponed it. As a result, the new plant is not likely to be online until at least 2020. Although this is may be more than five years away, Council has not been willing to pay for repairs to maintain the existing facility as needed, which has proved very challenging and may continue for the next several years.

Current staff members are doing an excellent job trying to maintain what is there, even though the collection line is reportedly not in good shape, nor is the facility. Staff members have welding, pipe fitting, and other specialized mechanical skills that enable work to be performed in-house, thereby saving the City money. Two staffing issues were discussed during interviews. The first is the disparity in pay and the second was succession planning. Water and wastewater collections staff are paid for certifications but wastewater operators are not. There is a need to examine the pay scales and total compensation packages to be consistent.

Recommendation 64. Work with human resources to study the total compensation for workers in the Water and Wastewater Division to ensure consistency in regard to certification pay.

Of current staff, three retirements are likely to occur in the next five years and an additional two retirements are likely in five to seven years. (This means that five of the current eight wastewater FTEs will be retiring.) In addition, there is one anticipated retirement in collections in the next several years. This signifies a need for succession planning to enable current employees to train new employees until the new WWTP is online.

Recommendation 65. Ensure that operations manuals are up to date and reflect current processes and procedures to use as training tools with new employees.

As with other areas of the City, the most modern and efficient technology is not in use. There is no supervisory control and data acquisition (SCADA) system, which would allow staff to control equipment remotely. Once the new WWTP is in operation, it will likely require two fewer FTE to operate because of SCADA and other superior technology. Staffing levels will need to be reevaluated at that time.

The new WWTP project is complex and requires a great deal of staff energy and attention. As it is already in the planning stages, Management Partners will not make recommendations about the planning or financing of the new plant, or the level of wastewater user fees required to operate that plant.

Conclusion

The City of Morro Bay has been less affected by the economic recession than many cities. It is also in better financial shape than many cities because of its proactive approach to minimizing CalPERS liabilities. However, the City has not completely escaped the financial impacts of its environment. Without additional revenues or decreased expenses, projections show the City will eventually begin using up its reserves. In addition, more funding is needed for infrastructure and equipment maintenance, particularly for information technology.

The City already operates very leanly. Management Partners found no "easy" expense reductions that would not correspondingly decrease services. If it wishes to significantly reduce expenses, the City will likely have to make some change in service levels. Contracting some services may reduce the service impacts. On the revenue side, updating fees is a first step in providing additional income.

The 65 recommendations included in this report will assist the City in attaining a balanced budget with adequate reserves. Once the report is finalized, Management Partners will work with staff to develop an implementation plan for the recommendations. The financial forecast model also provides the City with a way to monitor its progress toward financial goals.

Attachment A – List of Recommendations

Recommendation 1. Conduct a City-wide review of cost recovery and fee policies and set fees accordingly.

Recommendation 2. Require all funds to pay a share of General Fund costs such as accounting, investment, legal, and general administration.

Recommendation 3. Prepare an OMB A-87 compliant Cost Allocation Plan on which to base contributions from all funds.

Recommendation 4. Reestablish capital maintenance and equipment replacement reserves and add to them on an annual basis.

Recommendation 5. Develop a proposal for integrating Tourism Bureau activities with City operations.

Recommendation 6. Hire a community service officer/code enforcement officer directly or via contract.

Recommendation 7. Fix the feedback loop for the "Let Us Know" function on the website.

Recommendation 8. Develop a succession planning framework and identify positions at high risk for turnover.

Recommendation 9. Adopt a comprehensive set of financial and budget policies to provide a meaningful and easily understood framework for maintaining financial discipline.

Recommendation 10. Move resources from the General Fund and/or Emergency Reserve as needed to avoid deficits in other funds in future budgets.

Recommendation 11. Update the financial model prepared by Management Partners annually with any changes in actual or projected revenues and expenditures.

Recommendation 12. Place one-time or limited-term revenues in the City's Emergency Reserve and/or Vehicle Replacement and Facility Maintenance funds, or designate them for capital outlay or other "one-time project expenses," rather than ongoing operating expenses.

Recommendation 13. Review the historical basis for the 27.5% reserve goal established in 2010 and update the current reserve policy as appropriate.

Recommendation 14. Determine the City's actuarial liability for future insurance claims to determine the appropriate level of reserve for the Risk Management Fund.

Recommendation 15. Incorporate objectives from the City Council goal setting session into the budget process to establish a linkage between funding requests and achieving Council priorities.

Recommendation 16. Improve the presentation, transparency, and utility of the City's adopted budget document by addressing guidelines established by the Government Finance Officers Association in budgets for FY 2016-17 and beyond.

Recommendation 17. Evaluate opportunities to outsource work in finance, human resources, and information technology.

Recommendation 18. **Develop a request for proposals for auditing services and actively seek audit firms to bid.**

Recommendation 19. **Review the purchasing function in departments every few years to ensure that purchasing policies and regulations are being followed.**

Recommendation 20. **Place the business license tax function back under the supervision of the finance director regardless of where the routine collection is physically handled.**

Recommendation 21. **Hire an IT planning consultant to develop an IT Strategic Plan.**

Recommendation 22. **Explore improvements to the new automated payroll system with the vendor to determine how to meet payroll needs in various departments.**

Recommendation 23. **Investigate outsourcing some IT functions such as responding to individual PC problems throughout City departments.**

Recommendation 24. **Investigate joining CalOpps and/or similar online application services to widen recruitment range and save staff time handling job applications.**

Recommendation 25. **Analyze the effect of adopting a policy that supervisor classifications should make a minimum of 5% more than employees they supervise.**

Recommendation 26. **Investigate purchasing voice-recognition software that will assist officers in preparing their reports.**

Recommendation 27. **Add at least one half-time staff person to provide staff backup in Records and, as time permits, additional clerical support for the entire department.**

Recommendation 28. **Prepare a Police Department staffing plan that addresses succession planning as well as the causes and costs of turnover.**

Recommendation 29. **Obtain formal proposals from the San Luis Obispo County sheriff on the cost of providing law enforcement service to the City based on two or three service levels.**

Recommendation 30. **Establish a fee schedule and begin charging for RV/camping areas.**

Recommendation 31. **Evaluate the cost-effectiveness of installing paid parking along the Embarcadero.**

Recommendation 32. **Begin charging fees for multiple boater tows provided in the current fee schedule.**

Recommendation 33. **Determine what level and scope of service is desired from the Harbor Department with the understanding that the cost of providing the service will have to come from harbor fees and rents.**

Recommendation 34. **(Repeat of Recommendation 7 from the 2008 report): Investigate contracting all daily operations of the Harbor Department to a professional harbor management company.**

Recommendation 36. **If harbor operations are retained, evaluate transferring the lease and property management function and other administrative duties to the Administrative Services Department.**

Recommendation 37. (Repeat of 2008 Recommendation 12.) Request a proposal from CAL FIRE to provide the lowest possible level of service to Morro Bay and build up to a desirable service level from that point.

Recommendation 38. Analyze the feasibility of using the vacant building inspector position to enforce aspects of the fire code.

Recommendation 39. Invest in a work order system.

Recommendation 40. Develop a five-year Street and Sidewalk Plan that identifies when sidewalks, gutters, signs, and striping will be accomplished.

Recommendation 41. (Repeat of Recommendation 26 from 2008 Report) Implement use of Streets and Highways Code Section 5600-5630 to require property owners to fix sidewalks.

Recommendation 42. Stop providing tree maintenance for trees owned by residents, including trees planted in the public right of way by someone other than the City.

Recommendation 43. Evaluate the costs and benefits of outsourcing the entire fleet maintenance function.

Recommendation 44. Evaluate the costs and benefits of leasing instead of purchasing vehicles.

Recommendation 45. Develop vehicle replacement criteria and examine the age and condition of the City's existing fleet against those criteria, industry standards, and each vehicle's economic life cycle.

Recommendation 46. Determine vehicle/equipment replacement costs over a 15-year period to estimate the total costs required to fund replacements on an annual basis.

Recommendation 47. Use annual replacement cost estimates to evaluate the cost-efficiency of the various vehicle replacement funding mechanisms.

Recommendation 48. Evaluate the popularity of the trolley program among residents, tourists, and business owners.

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Recommendation 65. Ensure that operations manuals are up to date and reflect current processes and procedures to use as training tools with new employees.

Attachment B – Financial Overview

Management Partners has prepared a financial model for the City of Morro Bay that generates a long-term financial forecast, identifies structural imbalances and determines the impact of addressing unfunded needs of the City. The model includes the General Fund (001), Emergency Reserve (051), and the Vehicle Replacement (050), Facility Maintenance (052), and Measure Q (003) funds.

The purpose of a long-term financial forecast is to project the cost impacts of current (baseline) levels of staffing and services, including reasonable estimates of cost increases both within and beyond the City's control. Similarly, a baseline forecast projects a reasonable rate of growth for each of the General Fund's revenue sources given past history and likely economic trends. Alternative assumptions for the major revenues and expenditures with the greatest financial significance can then be tested to show their impact on the forecast's bottom line.

The forecast builds on historical revenues and expenditures from FY 2005 through 2014, and the staffing level and adopted City budget for FY 2015, to come up with revised estimates for FY 2015 and projections through FY 2023. Together with the actual amounts for FY 2014, this constitutes a 10-year forecast. Detailed analyses have been prepared for the three largest tax sources: property tax, sales tax, and transient occupancy tax (TOT), and the potential impact of a modest recession in FY 2017-18 has been included.

Expenditure levels reflect inflationary impacts over time, and include pension costs based on a detailed analysis of projected CalPERS employer rates. Amounts identified in the City's five-year Capital Improvement Program (CIP) for vehicle replacement, information technology, fire equipment and facility maintenance, but not funded to date, are built into the forecast. It is assumed that 1) the General Fund will backfill funds 050 and 052 to the extent that the resources of those funds are insufficient to fund the identified project amounts, 2) Measure Q spending will be limited to a level that will sustain an adequate reserve without General Fund support, and 3) the Emergency Reserve will transfer funds as needed to avoid a deficit in the General Fund.

The result is an Emergency Reserve balance that declines rapidly though FY 2020, and thereafter declines at a much slower pace. A deficit is avoided, but by FY 2023 the balance is expected to be just under $800,000, or 6% of total General Fund expenditures, compared to the City's goal of 27.5%. To get the reserve balance up to the City's goal will require either additional resources or a reduction in the projected level of spending.

What keeps the City from plunging into deficit is the scheduled payoff of the "side funds" established by CalPERS for the payment of a large portion of the unfunded liability of the Police and Fire safety employee plans. The side fund for the Police safety plan accounts for 55% of the plan's unfunded liability and is paid off in three years, and the Fire plan accounts for 57% of that plan's unfunded liability and is paid off in five years. Thus, at a time when most cities will still be grappling with significant planned increases in CalPERS employer rates, Morro Bay will realize some offsetting of savings. The employer rate for the Police plan's tier 1 "classic" employees is projected to fall from 53% of payroll to 38% of payroll stating in FY 2019, while the rate for Fire tier 1 employees is projected to fall from 65% of payroll to 44% starting in FY 2021. Pension costs will be discussed later in greater detail.

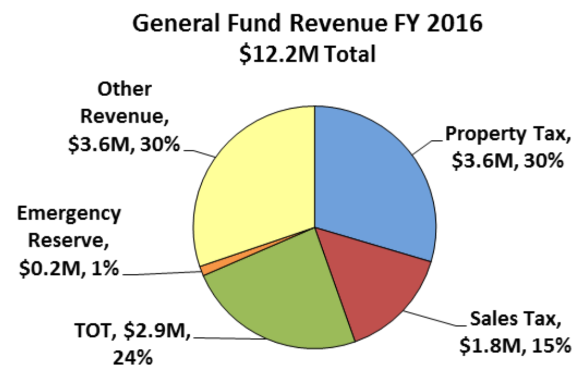
The City lacks the vehicle replacement and facility maintenance plans to fully identify its long-terms needs in these areas, which may well exceed what is currently identified in the CIP. Information technology is a special concern, and it is recommended that a full IT needs assessment be prepared as the amounts identified in the CIP appear inadequate. For these reasons there will likely be greater financial pressure over time on the General Fund and Emergency Reserve than this forecast currently reflects. Thus it is imperative that the City revisit the level of cost recovery being achieved from its fees, charges and permits. It should also implement an updated cost allocation plan applicable to all funds, not just enterprises, to ensure that all funds are fully reimbursing their fair shares of administrative overhead incurred by the General Fund. The report shows that the City's cost recovery is low, and that general taxpayers are supporting functions that should be paid for by developers and other users of fee-supported services. Greater cost recovery will assist the City in addressing additional replacement and maintenance costs.

Staff can update this financial model periodically and use it to guide the annual budget process, test the outcomes resulting from alternate economic outcomes and policy decisions, and measure the progress in meeting the City's financial goals.

General Fund Revenues

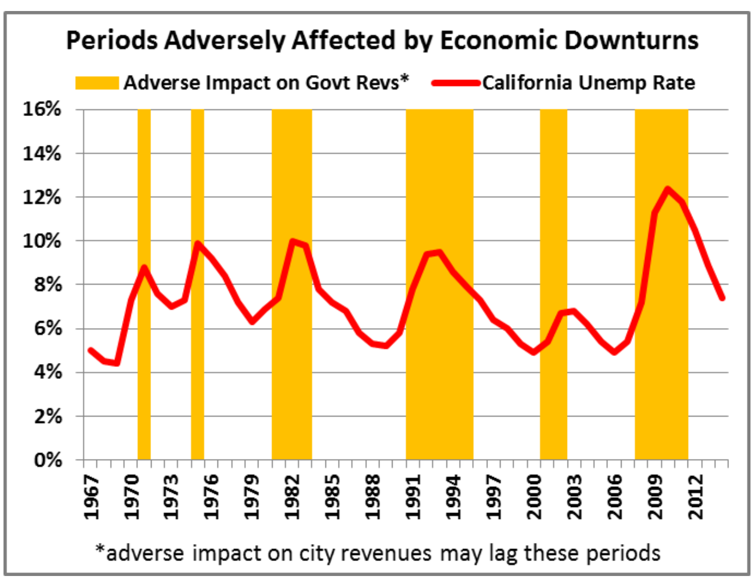
Figure 2 shows the major revenues for the General Fund. Of special note is that just three sources, property tax, sales tax and transient occupancy tax, comprise 68% of the total. As a small city reliant upon tourism, the TOT is the second largest revenue source and its vitality is a major determinant of the health of the overall General Fund. These top three revenue sources will be examined in more detail to provide a better understanding of the resources that comprise the foundation of the General Fund forecast.

Figure 2. Projected General Fund Revenues by Type for FY 2016



The probability of the next economic recession falling within the period of a ten year forecast cannot be ignored. Since 1928 an official recession has occurred on the average of every 6.5 years. This forecast assumes a modest recession starting in 2017. The term and intensity of a given future recession cannot be predicted, but it unlikely to be as intense as the recent "Great Recession." This recession, the largest since the Great Depression of the 1930s, started in December 2007 and officially ended in June 2009, although its adverse effects on public sector revenues lingered for a few years thereafter. Figure 3 shows the periods of adverse impact on local agency revenues from recessions since 1967, superimposed on the California unemployment rate.

Figure 3. Recession Impacts in California



Property Tax

Property taxes are governed by Propositions 8 and 13 of 1978. Proposition 13 is the better known of the two, with its fixed tax rate (1% shared by all agencies) and limitation on annual growth in property value from its 1975 level (the lesser of California CPI or 2%). Market-level price changes do not influence assessed value unless a property a) is newly constructed, or b) changes ownership, or c) has its "true" market value fall below the Prop 13-restricted value for the property. The last case is where Prop 8 comes in: after this initial reduction, assessed value is restored in future years as the true market prices of such properties rise, without respect to the 2% growth limitation, until it "catches up" with its future Prop 13-restricted value.

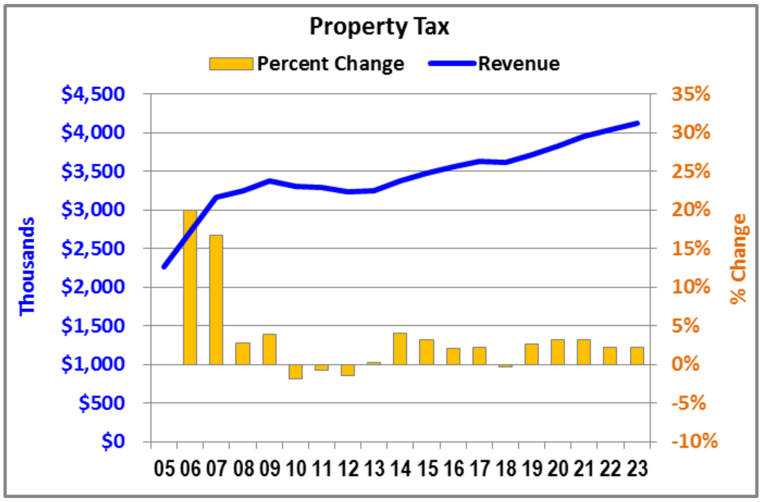
The property tax has a built-in one-year lag time due to its annual reassessment (valuation as of the January 1 "lien date" preceding the fiscal year for which that value is taxed), so property taxes are not always reflective of current economic conditions. Secured roll property taxes (those secured by a lien on the property) are allocated by the county, which generally comes half in December and half in April. Unsecured taxes are primarily levied on taxable personal property (such as business fixtures and equipment, boats, aircraft). Supplemental taxes are computed for new construction and transfers, and that value change is reflected in a prorated assessment (a supplemental bill) that covers the period from the first day of the month following the supplemental event to the end of the fiscal year.

Morro Bay receives 13.065% of the 1% property tax on assessed valuation with the City, compared to approximately 15% for cities statewide. These tax sharing ratios have their origins in the historical shares of property tax prior to the passage of Prop 13, which means there is a disparity of treatment among cities statewide, and this sharing ratio is not subject to change by the City. The property tax also includes the "property tax in lieu of Vehicle License Fees (VLF)," which is allocated by the county and increases in accordance with growth in the City's secured assessment roll. Also known as the Vehicle License Fee Adjustment Amount (VLFAA), this revenue is part of the VLF-Property Tax Swap of 2004: when the VLF was eliminated, the state met its constitutional obligation to hold cities and counties harmless by replacing the VLF with property tax from the schools, which the state then made up with higher state aid to schools.

Figure 4 shows the revenue from the property tax (line, left axis) and the annual percentage growth (vertical bar, right axis). The impact of the Great Recession on Morro Bay property tax revenues was quite moderate, with a peak (FY 2009) to trough (FY 2012) decline of 4%. (Some cities suffered a revenue loss of up to 30%.) The lien date lag-time and delays in reassessment of properties are what caused the revenue losses to not occur until FY 2009. FY 2015 reflects updated estimates from the county, resulting in a higher amount ($3.34 million) than budgeted ($3.55 million). The projected recession impact is assumed to start in FY 2018 if the recession starts in 2017, with recovery of value losses over the ensuing three fiscal years. The overall average annual growth rate from FY 2016-2023, including the recession, is 2.15%.

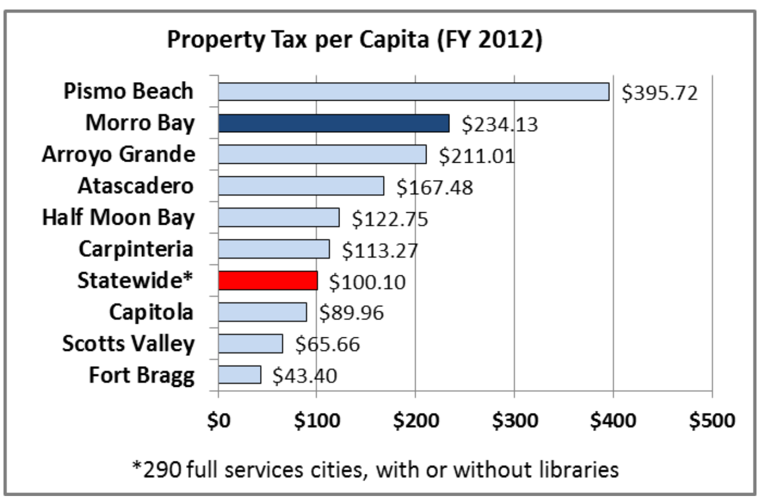
The former power plant has been decommissioned, but not totally demolished. There is much speculation as to what future uses the property may be put. The Dynegy property is currently on the tax rolls at $16.9 million, which is only 1% of the total assessed value of Morro Bay. While there is a wide range of potential future assessed value of the property (from zero as a tax-exempt parcel to perhaps tens of millions of dollars depending on the type of development and whether the smokestacks are removed), given the uncertainty involved the forecast strikes a "middle ground" by assuming a continuation of the current assessed value.

Figure 4. Property Tax Historical and Forecasted Revenue



As shown in Figure 5, the amount of revenue per capita is above that of all but one of its comparison cities, and over double the statewide median for full service cities.

Figure 5. Property Tax Revenue per Capita: Comparison Cities and Statewide



Source: CaliforniaCityFinance.com

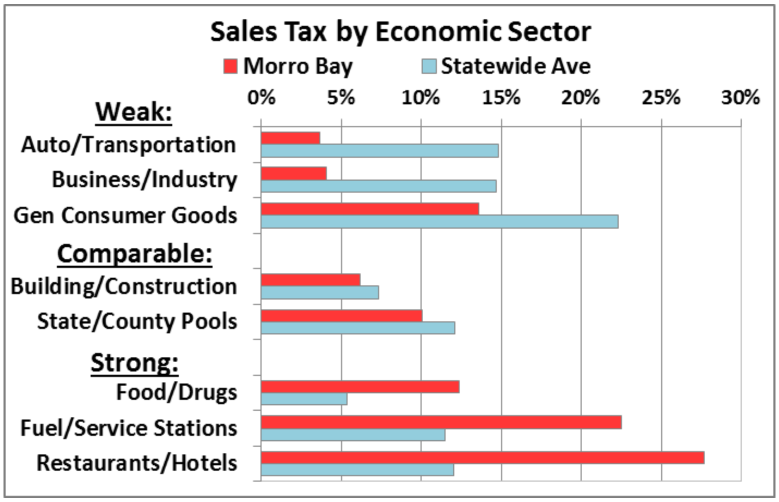
Sales Tax

The sales tax is collected by the state, with 0.75% of taxable sales being allocated to cities and counties on a situs basis (i.e., location of the sale), and 0.25% allocated through "additional property tax in lieu of sales tax"2 This so-called "triple flip" is scheduled to end effective January 1, 2016, at which point the 0.25% will be given back to cities and counties, thus restoring the full 1% Bradley-Burns local tax rate. The sales tax also includes an allocation of approximately $120,000 annually from the countywide Prop 172 Public Safety Sales Tax.

Figure 6 compares Morro Bay's sales tax revenues by economic sector to the statewide average. Areas in which the City is weak are auto sales, business/industry sales direct to other businesses, and general consumer goods. Areas in which the City is roughly comparable to (but still below) the statewide average are building/construction and the state/county pools. (The pools provide agencies a share of the revenue received from transactions, such as internet sales, that are not allocated on a situs basis to a specific agency). Areas in which the City is strong are food/drugs, and the tourist-influenced areas of fuel/service stations and restaurant/hotels. This serves as an indicator as to the type of sales tax generating development the City should seek in order to reduce its "leakage" of sales to surrounding jurisdictions (consumer goods) or gain sales that are not in competition with other local vendors (business/industry).

[2] "In March 2004, the voters of California approved Proposition 57, the California Economic Recovery Bond Act. The measure authorized the issuance of $15 billion in 'Economic Recovery Bonds' to close the state's operating budget deficit. Under Proposition 57, the bonds are repaid from a dedicated 0.25 percent increase in the state sales and use tax. The city/county portion of the sales and use tax rate imposed Bradley-Burns Uniform Sales Tax law is reduced by 0.25 percent, such that there is no net impact on the total rate. Cities and counties are reimbursed for the reduced sales and use tax revenue with transfers of local property tax revenues that would otherwise have gone to schools. Schools are made whole from the state general fund and experience no negative impact. This mechanism is known as the 'triple flip.'" Source: CaliforniaCityFinance.com (Feb 2015)

Figure 6. Morro Bay Sales Tax by Economic Sector Compared to Statewide Average



The sales tax is closely linked to trends of economic growth, unemployment, and inflation. Several factors that are or will be negatively influencing sales tax growth in general are:

- *Trends toward purchasing non-taxable services versus taxable commodities.* According to the State Board of Equalization (BOE), taxable sales as a percent of personal income have dropped from a high of 53% in 1979 to 32% in 2011, a trend exacerbated by an aging population. Taxable sales in California today, adjusted for inflation, are 28% lower than in 2000.
- *Taxable sales growth limited to top income earners.* From 2000 to 2010 household spending increased 27%, but all of the net gain is for the top 20% of household income earners. According to the U.S. Census Bureau, 2013 California real median household income level (adjusted for inflation) has fallen 10% from its 2006 peak, nearly back to its 1997 level.
- *Increasing levels of non-taxable sales*. Catalog and internet sales are rising, and projected to be 9% of all retail transactions by 2016. In addition, compliance with the self-reported use tax remains low. Future retail trends are for downsized "touch and feel" stores or even "virtual" stores. These factors are likely to result in a shift in the actual point of sale from local stores to fulfillment distribution centers located in other cities.
- *Technology and lifestyle changes may result in lower sales tax revenues*. One example of technology changes affecting sales tax is the availability of 3-D printers. These printers can fabricate products to order on-site, but under existing BOE regulations the sales tax applies only to the raw materials used instead of a finished product. This results in a lower tax being paid. Another example is the growing popularity of food trucks. Rather than the tax being generated by brick and mortar restaurants where the city reaps all of the local tax, the sales tax generated from food trucks is allocated by county or state pools resulting in the city receiving only a share of the total.

These factors will act to dampen the expected rate of sales tax growth over time, compared to historical levels.

In 2006 voters passed Measure Q, an additional half-cent sales tax, to support general City services. This results in a local sales tax rate of 8.0%, which places the City at the median (49th percentile) of city sales tax rates statewide. (Note that in San Luis Obispo County, five other cities also have an additional half-cent voter-approved sales tax rate: San Luis Obispo, Arroyo Grande, Pismo Beach, Grover Beach and Paso Robles.) Figure 7 shows the number of cities at each total sales tax rate levied in California.

Figure 7. Sales Tax Rates Among California Cities

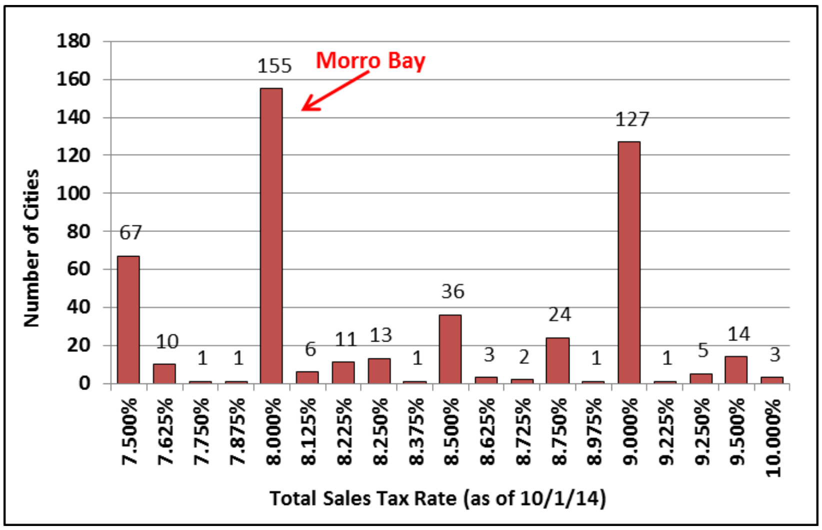
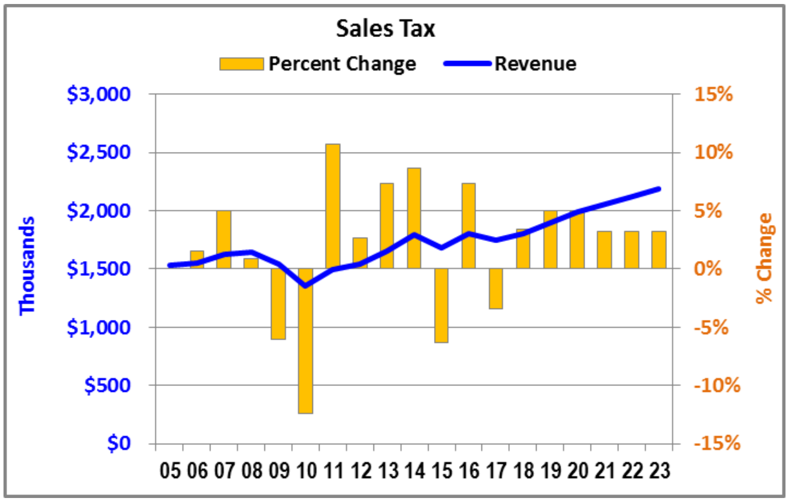


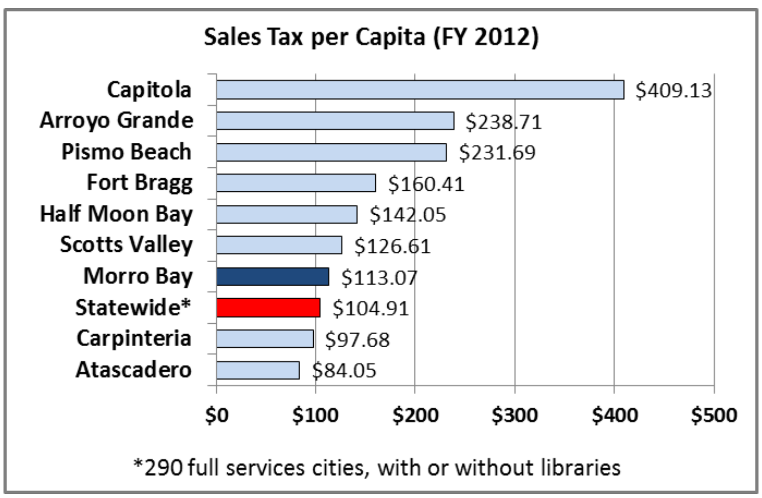
Figure 8 shows the revenue from the sales tax and the annual percentage growth. The impact of the Great Recession was more pronounced on the sales tax than on the property tax, with a peak (FY 2008) to trough (FY 2010) decline of 18%. Over the next few years expect to see a roller coaster trend in revenues. In FY 2015 sales tax revenues exclusive of Prop 172 are projected to decline around 4.7% due largely to the reduction in fuel prices over the past year. In FY 2016, the "triple flip" ends, with a resulting one-time cash flow gain that will boost overall non-Prop 172 revenues by 7.8%. However, in FY 2017, with the loss of the prior year's one-time gain of the "triple-flip" phase-out, and the projected effect of the next recession, non-172 revenues are projected to be down 3.4%. The three following years would expect to see greater than normal growth as most of the recession loss would be recovered. The "normal" (non-recession) annual growth rate projected by HdL, the sales tax auditing firm, is 3.3%.

Figure 8. Tax Historical and Forecasted Revenue



As shown in Figure 9, the amount of revenue per capita is slightly above the statewide median for full service cities, but ranks towards the bottom of the comparison cities.

Figure 9. Sales Tax Revenue per Capita: Comparison Cities and Statewide

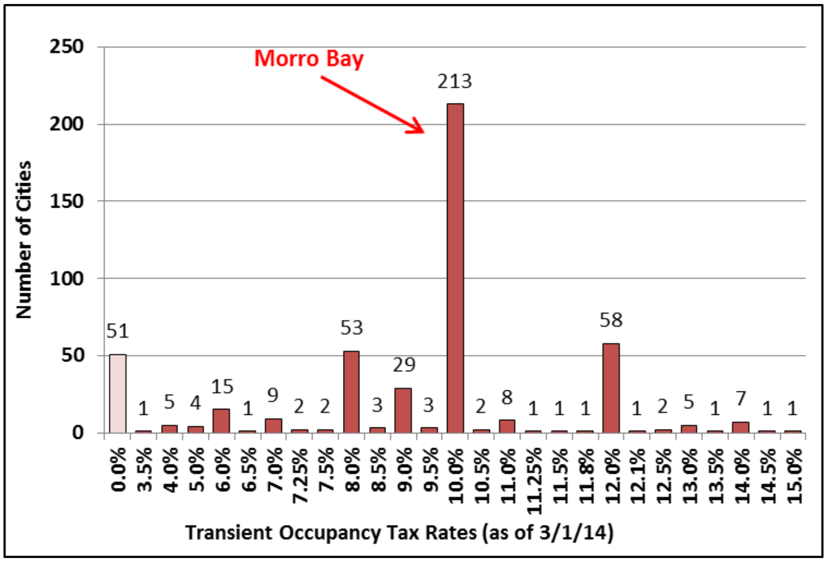


Source: CaliforniaCityFinance.com

Transient Occupancy Tax

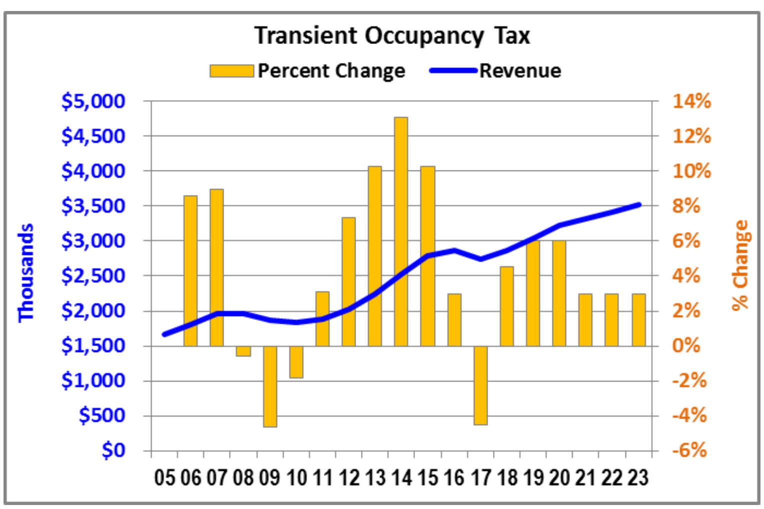
The TOT is a 10% tax rate on the price of transient lodging (less than 30 days). The 10% rate is equal to the statewide median rate for cities that levy this tax. Figure 10 shows the number of cities at each tax rate statewide. All cities in the county levy a 10% TOT rate. Most of the City's tax proceeds come from motels (85%), with the remainder from trailer parks (7%) and vacation rentals (8%).

Figure 10. Transient Occupancy Tax Rates Among California Cities



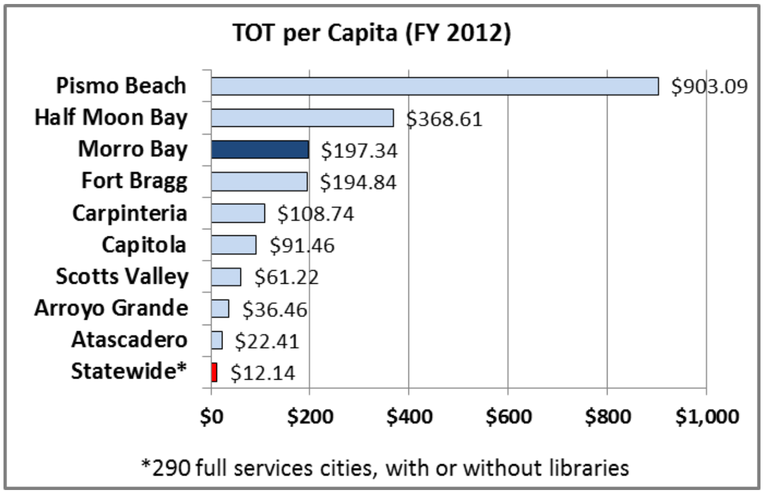
As goes the tourism trade, so goes the TOT. Figure 11 shows the pronounced TOT trends of recent years. The peak (FY 2007) to trough (FY 2010) recession decline was 7%. It might have been worse, except that Morro Bay's reputation of providing value accommodations may have resulted in less of a net loss than may have been experienced in other competing tourist destinations. Starting in FY 2011, the TOT started a period of robust growth, averaging 8.8% annually from FY 2011-15. However, it would not be prudent to assume continued increases in occupancy and room rates as seen in the past four years. The forecast assumes an ongoing annual growth rate of 3% (interrupted by the projected recession), which is well under recent growth, but in excess of the projected inflation rate of 2%.

Figure 11. Transient Occupancy Tax Historical and Forecasted Revenue



As shown in Figure 12, the amount of TOT revenue per capita is above the median of the comparison cities. The statewide median is far below, given that most cities are not oriented toward tourism.

Figure 12. Transient Occupancy Tax Revenue per Capita: Comparison Cities and Statewide



Source: CaliforniaCityFinance.com

Fees, Charges and Permits

User-supported activities generate fee, charge and permit revenue. However, there is a concern that these revenues are not recovering their costs to an appropriate level. Figure 13 shows the historical level of revenue for fees, charges and permits, compared to constant dollar amounts, which reflects a 23.3% drop in purchasing power due to inflation.

Figure 13. Fee, Charge and Permit Revenue

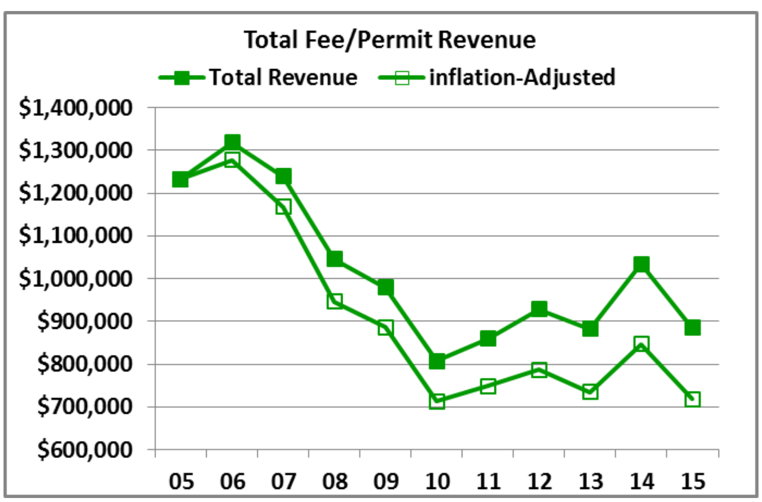
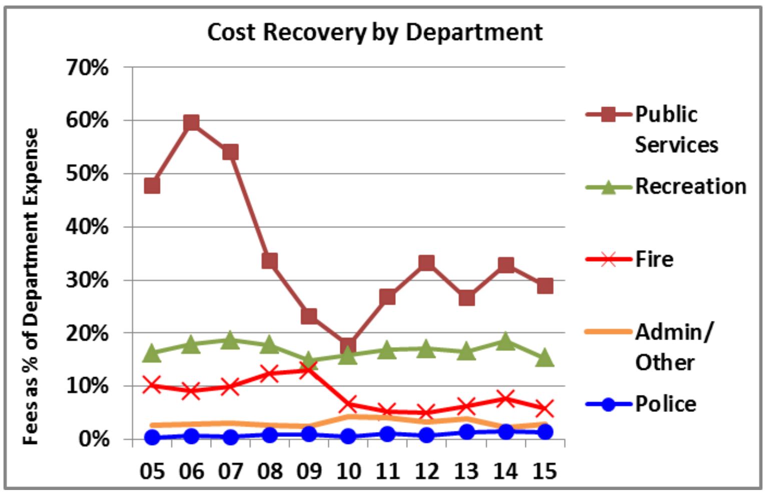


Figure 14 shows the cost recovery percentage by department in recent years. There has been a marked drop in cost recovery in the Public Service Department (now the Public Works Department), from a high of 60% to an average of 30% over the last five years. The fee levels for Recreation and Parks has remained relatively stable at 17%, but that is half the national average of 34% for similar recreation programs. A 2006 ICMA study found the per capita non-golf recreation fees for cities under 100,000 population to be $45.96; just increasing recreation fees to this standard would generate another $78,000 annually. The result is that developer and user-supported activities are being subsidized by the general taxpayer, rather than the beneficiaries of those services.

Figure 14. Cost Recovery by Department



Other Revenues

The total revenue from recurring sources like the Property Transfer Tax, Business License Tax, franchise payments, and fines, which comprises the bulk of other revenues, has remained virtually unchanged over the last 11 years at around $900,000 annually.

Revenues that have fallen include: interest income, which has dropped from $520,000 in FY 2005 to essentially zero over the last six years because of the General Fund's negative balance; grant revenue, which has dropped from an average of $235,000 a year during FY 2005-2008 to $62,000 annually over the past seven years; and other intergovernmental income, which has dropped from a high of $300,000 in FY 2006 to $10,000 annually over the past four years.

On the upside, rents have increased from $52,000 in FY 2005 to $357,000 in 2015, and recent improved collection efforts will boost annual Business Tax collections by around $100,000, promoting equity among businesses by ensuring that all are paying their fair share.

In a separate category are annual transfers to the General Fund from the Gas Tax Fund (supporting street maintenance staff) and Measure Q Funds (offsetting the cost of Fire Department overtime). These transfers have been relied upon by the General Fund for many years, and have averaged a total of $350,000 to $400,000 annually for several years. The forecast assumes the continuation of these transfers, but if the General Fund had sufficient resources, the Gas Tax money could instead go toward additional street repairs and the Measure Q money toward other improved services. As it is, the General Fund requires the continued support from these two funds.

Finally, there is $800,000 in transfers collectively from the Transit, Water, Sewer, and Harbor funds for reimbursement of general administration (overhead) costs incurred by the General Fund on behalf of all other City funds. This amount is unchanged from FY 2012 levels, except for a $30,000 decline in Transit contribution.

General Fund Emergency Reserve

As noted previously, the forecast assumes that the Emergency Reserve will be drawn upon as needed to avoid a deficit in the General Fund. In FY 2016 expenditures are projected to exceed revenues by $320,000, and thus a transfer would be made to hold the General Fund to a zero balance. It is inadvisable to allow funds to run negative balances because in reality that negative balance must be covered by other funds that are in the “pooled cash” of the City, meaning that funds that are restricted in their use are effectively being tapped to cover a portion of the shortfalls. By automatically transferring funds as needed, the budget model gives a clear picture of the net draw on the General Fund and Emergency Reserve, as these are the only funds that can be used for *any* valid municipal purpose. The Emergency Reserve and General Fund balance will be discussed further later in this attachment.

General Fund Expenditures

Figure 15 shows the major elements of the projected expenditures of the General Fund for FY 2016. Of special note is that personnel costs comprise 73% of total expenditures. This is relatively high, although the share spent on personnel among cities can vary depending on the extent of contracting out for services (which shifts spending from personnel to other operations and maintenance), or General Fund support of capital projects (which adds spending to capital outlay and transfers out which the General Fund would not otherwise incur).

Figure 15. Projected General Fund Expenditures by Type for FY 2016

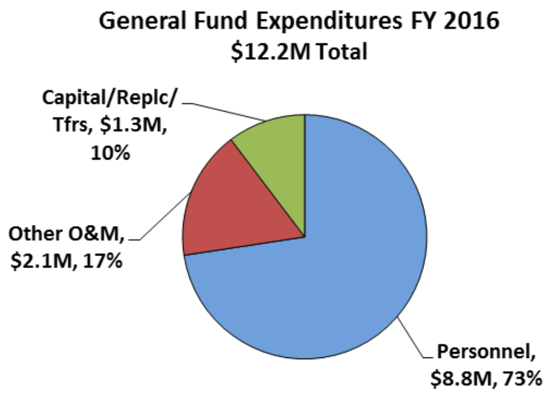


Figure 16 displays General Fund staffing from FY 2000 to 2015 compared to enterprise fund staffing. After increasing from 85.0 full-time equivalent (FTE) positions to a high of 92.25 FTE in FY 2004, General Fund staffing declined to 73.0 FTE in FY 2011 and has changed little since then. Thus, General Fund staffing has declined 21% from peak level staffing, while enterprise fund staffing increased by 30% as of FY 2007, and has stayed near that level. This is more a reflection of available resources, rather than workload demands in both areas.

Figure 16. Staffing Levels in Full-Time Equivalent Positions

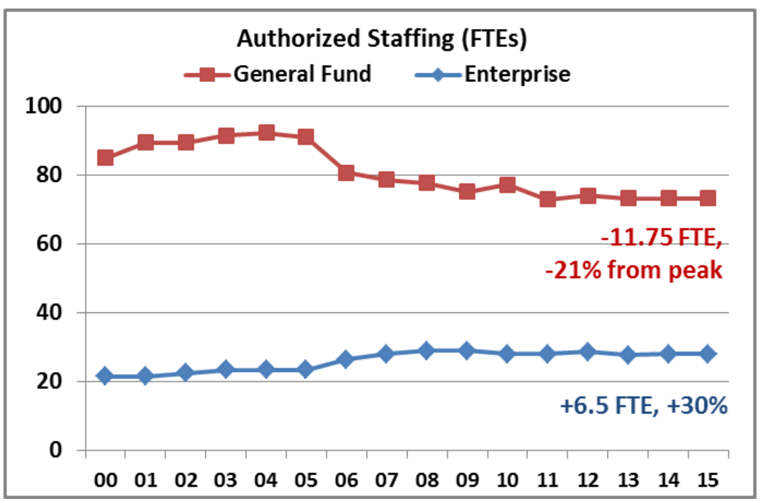
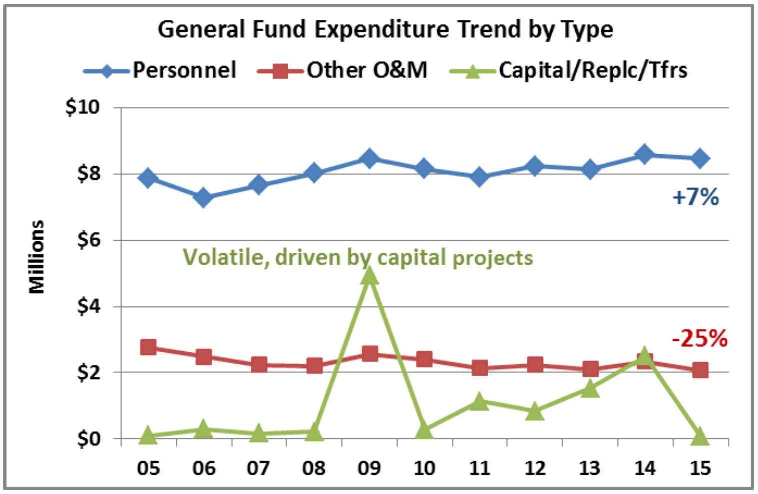


Figure 17 shows the trend of major General Fund expenditure types. Although staffing levels have decreased, increases in CalPERS pension rates and compensation have slowly driven up personnel costs by 7% since 2005. By comparison, other operations and maintenance (O&M) costs have steadily declined by 25% since 2005. This indicates that in addition to reducing positions, the City has cut back on the replacement of equipment and technology and deferred maintenance spending, in an effort to avoid further cuts in personnel. Capital projects dictate the timing of capital outlay and transfers to other funds, so the trend is not meaningful. The main concern is not committing future General Fund resources that aren't available to capital projects.

Figure 17. Morro Bay Staffing Levels in Full-Time Equivalent Positions



Personnel Cost Assumptions

The budget model makes a number of assumptions that influence the projected level of personnel expenditures. Major assumptions are as follows:

- No change in FY 2015 budgeted staffing levels, despite increasing workload demands over time. Assumes that short of securing additional ongoing resources, increasing workload must be met from productivity and efficiency gains, with any resulting savings dedicated to necessary staffing and service improvement cost increases.
- City payroll projections for FY 2015 are updated with the recent MOU changes that affect all employees in FY 2015, and sworn police and fire employees in FY 2016.
- Continuation of merit/step increases for all employees below top step of their current job classification, under the practice established in existing labor agreements and the City's job classification system (some get 5% increase, most get none). Since many employees are at top step already this amounts to an aggregate increase of 1.5%.
- Competition within the labor market will eventually drive up costs, so it is unrealistic to expect no change over time. The model increases compensation equal to the projected inflation rate of 2%, to reflect future fiscal pressure on personnel costs. (Any higher ongoing increases to compensate for past years of no pay raises would force budget cuts.) Any increase in compensation and health contributions is subject to subject to the meet and confer negotiating process. The forecast does not make judgments about *how* increased costs might be reflected among job classes or labor units; it only looks at costs in the lump sum by type.
- Vacancy savings is budgeted at 3% of personnel costs. The City doesn't currently budget such an offset, however, vacancies are inevitable, and while they may vary in magnitude

among departments, 3% is a reasonable General Fund-wide assumption. By budgeting the gross costs of all authorized positions, including vacancies, and then building in a credit for expected vacancy savings, the net budget will provide a more reasonable approximation of the ultimate expenditures realized for a given fiscal year. Better estimates increase the credibility of a city's budget numbers.

- CalPERS employer rates are projected using a detailed analysis of all plans and benefit tiers, taking into account CalPERS' own projections through FY 2021 and the ongoing transition over time of "classic" employees[3] being replaced by "new hires" (who will receive the lower PEPRA[4] benefits). A composite rate as a percent of payroll is produced that the model applies to police, fire and miscellaneous employee compensation. The forecast assumes 50% normal cost sharing by existing employees starting in FY 2018 (if achieved earlier then additional net savings may result depending on the outcome of the negotiations). Pension plan costs are discussed further below.

Pension Costs

CalPERS divides the cost for pension benefits into two parts: (1) the employee rate and (2) the employer rate. The employee rate for the City's plans5 is set by CalPERS at 9% of compensation for safety employees and 8% for miscellaneous (non-safety) employees. The past practice in many cities was that the city would pay part or all of the employee's share (Employer-Paid Member Contribution, or EPMC), although this is changing. Morro Bay employees pay all of their own employee contribution. Employer rates are divided between "normal costs" (the employer cost of projected benefits allocated to the current plan year, less employee contributions), and "unfunded liabilities" (the present value of benefits earned to date that are not covered by current plan assets). The unfunded liabilities are amortized over time in stages; new amortization bases are created annually depending on the deviation of reality from actuarial assumptions. Actuarial gains reduce future rates, and losses increase them.

CalPERS has implemented a revised method for rate smoothing and amortization of unfunded liability costs over a fixed time period. These costs, along with a reduction in the discount rate (the projected rate of return from investments) from 7.75% to 7.5%, were built into the June 30,

[3] These are existing tier 1 or tier 2 Morro Bay employees, or future hires who are currently receiving pre-PEPRA level benefits from another CalPERS agency.

[4] The Public Employee Pension Reform Act of 2013 increases minimum retirement ages and establishes reduced benefit formulas for Police, Fire and Miscellaneous employees hired on or after January 1, 2013, so cost savings will be phased in over time. PEPRA increases contributions for new employees to 50% of the actuarial normal cost of the plan. Caps on the annual pay used to calculate benefits of new hires are imposed. Starting in FY 2018, local governments will be able to impose higher contributions by existing employees than permitted under current labor MOUs if they are unable to reach agreement on such a change with their employee unions.

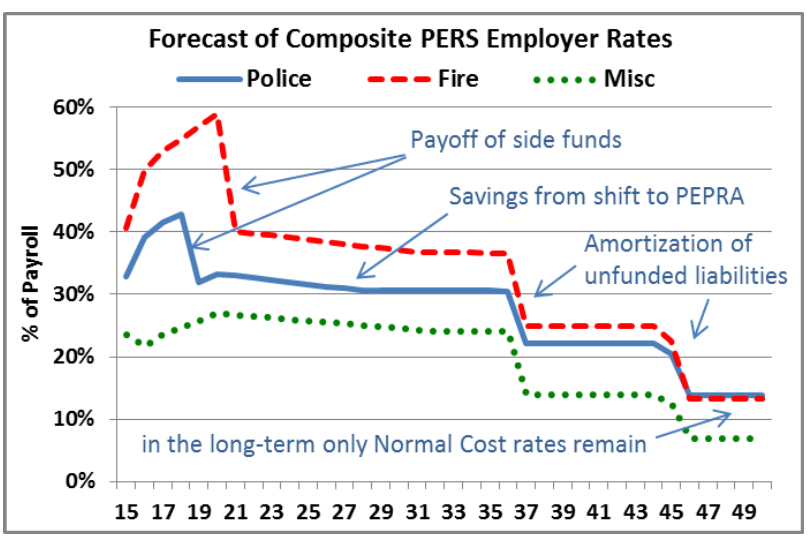
[5] Police and fire tier 1 is 3%@50, tier 2 is 3%@55, and PEPRA is 2.7%@57. Miscellaneous tier 1 is 2.7 @ 55, tier 2 is 2% @ 60, and PEPRA is 2% @ 62.

2012 valuation. CalPERS also adopted mortality improvement assumptions that were incorporated into the June 30, 2013 valuation (provided to member agencies in October 2014). The net impact of all of these changes will be a significant increase in employer rates, despite the increasing levels of savings resulting from PEPRA over time.

The Management Partners' forecast projects employer retirement costs through 2050. The model takes into account the pooled rates which apply to the City's police and fire safety plans, and the new dollar basis for unfunded liability payments by pool participants that replaces the old percent of payroll basis. As the amortization bases for unfunded liabilities applicable to each plan and tier of benefits is paid off, unfunded liability rates are reduced. An estimated transition of employees from "classic" to "new hire" status is reflected by shifts of employee compensation from the tier 1 and 2 levels to the less costly PEPRA tier 3 plans over the next 20 years, which results in lower normal costs charged to the City.

The resulting composite total employer rates of the police, fire, and miscellaneous plans are presented in Figure 18, which shows significant increases for both safety and miscellaneous plans over the next few years (from 15% to 45% in magnitude from FY 2015 to peak levels, depending on the plan). However, the payoff of the "side funds," established by CalPERS for the payment of a significant portion of the unfunded liability of the police and fire safety employee plans, will significantly reduce overall pension costs starting a few years from now. The side fund for the police safety plan accounts for 55% of the plan's unfunded liability and is paid off in three years, and the fire plan accounts for 57% of that plan's unfunded liability and is paid off in five years. Thus, at a time when most cities will still be grappling with significant planned increases in CalPERS employer rates, Morro Bay will realize some offsetting of savings. The rate for the police plan's tier 1 employees is projected to fall from 53% of payroll to 38% of payroll stating in FY 2019, while the rate for fire tier 1 employees is projected to fall from 65% of payroll to 44% starting in FY 2021.

Figure 18. Long-Term Forecast of CalPERS Employer Rates



Following the payoff of the side funds, the forecast projects a gradual decline in rates as the impact of PEPRA on the normal cost rates is fully realized. As additional amortization bases are paid off the rates drop further, in stair-step fashion, until (in theory) all unfunded liabilities are paid off and only normal costs remain. In reality, there will be years when net actuarial gains will temporarily compress this time frame, and years when actuarial losses will extend it, but this is the overall long-term profile of CalPERS rates, assuming no changes in benefits.

Unfunded Needs

Table 10 shows additional costs built into the forecast, some of which are identified in the City's five-year CIP, but which are not currently funded in the FY 2015 budget.

Table 10. Amounts Included in Financial Forecast That Are Currently Not Funded (in thousands)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	Total
Vehicle Replacement	$45[1]	$732[1]	$300[1]	$190[1]	$500[1]	$250	$250	$250	$250	$2,768
Facility Maintenance	$50[1]	$370[1]	$338[1]	$575[1]	$50[1]	$200	$204	$208	$212	$2,208
Information Technology	$18[1]	$33[1]	$20[1]	$25	$26	$26	$27	$27	$28	$228
Fire Equipment	$29[1]	$45[1]	$91[1]	$39[1]	$67[1]	$56[1]	$0[1]	$18[1]	$4[1]	$348
CIP Transfers	$51	$200	$200	$200	$200	$200	$200	$200	$200	$1,651
Added Service	$0	$100	$103	$106	$109	$113	$116	$119	$123	$889
Totals	**$193**	**$1,480**	**$1,052**	**$1,135**	**$952**	**$845**	**$796**	**$823**	**$817**	**$8,092**

[1]*Identified in CIP but not funded*

Vehicle replacement is handled through Fund 050, but the City does not have a fleet replacement charge imposed on departments, so there is no systematic means of financing the replacement of vehicles. Historically, vehicles have been replaced on a pay-as-you-go basis within department budgets, or one-time resources have been deposited in Fund 050 to pay for such costs. The forecast assumes that Fund 050 will pay the amounts identified for vehicles in the CIP for FY 2015-18, except where funding is linked specifically to development impact fees or Measure Q. These amounts total $1.76 million, an average of $353,000 per year. Beyond that, the forecast assumes an annual expenditure of $250,000. To the extent that Fund 050 resources are insufficient, the General Fund transfers the amount needed to cover the shortfall.

Facility maintenance is handled through Fund 052. The City does not impose annual building use charges on departments (usually done on the basis of square footage of building space occupied) to generate funds to be used for facility maintenance. The past practice has been to deposit one-time resources and the Salwasser loan repayments (currently around $99,000 annually) to Fund 052 to pay for projects. The forecast assumes that Fund 052 will pay the amounts identified for police, communications, and public services buildings in the CIP for FY

2015-18, which total $1.38 million, an average of $277,000 per year. Beyond that, the forecast assumes an annual expenditure of $200,000. To the extent that this exhausts Fund 052 resources, the General Fund transfers the amount needed to cover the shortfall.

Information technology amounts are identified in the CIP for fiscal years 2015 through 2017, but average only $23,500 per year. These amounts have been built into the forecast for Fund 052, and starting FY 2018 an annual expenditure of $25,000 is assumed.

Fire equipment amounts (non-vehicular) are identified in the CIP for fiscal years 2015 through 2023 (and beyond) and average about $40,000 per year. These amounts have also been built into the forecast for Fund 052.

Capital Transfers made by the General Fund from FY 2005-14 total $11.9 million, for an average of $1.2 million per year. The FY 2015 budget for transfers out is only $51,000. The CIP does not identify general capital improvements (non-enterprise) after FY 2015 that might require General Fund support, but it is likely that additional projects will be identified as part of the latest goal-setting process. As a placeholder, the forecast builds in $200,000 annually in transfers out to other funds that may be required by capital projects or other obligations.

Additional Service costs of $100,000 are built into the forecast as a placeholder for an increase in service levels above and beyond the FY 2015 budget funding levels that the City may identify for addressing a selected high priority. This may be in the form of either ongoing operating costs, or a series of one-time expenditures.

Table 11 shows the resulting impact on the General Fund, which absorbs $6.9 million of the total $8.1 million in additional investment in asset replacement, maintenance, and additional services.

Table 11. Impact of Unmet Needs on General Fund (dollars expressed as thousands)

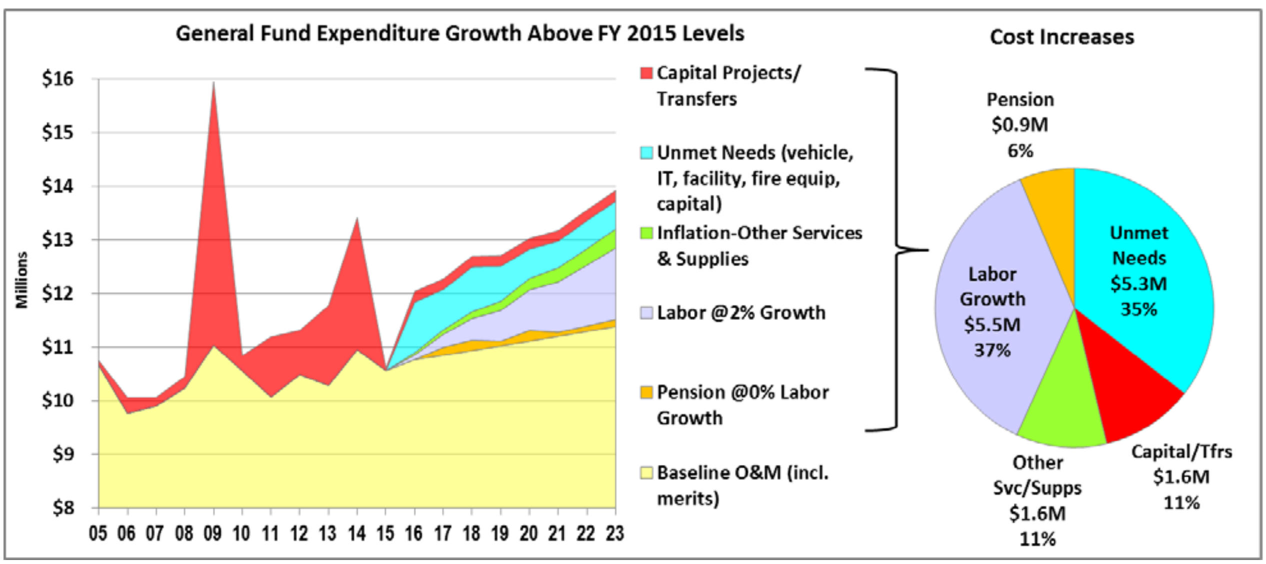
	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	Totals
Added Service*	$0	$100	$103	$106	$109	$113	$116	$119	$123	**$889**
Tfr Out-Capital	$51	$200	$200	$200	$200	$200	$200	$200	$200	**$1,651**
Tfr Out-Fund 050	$0	$579	$300	$190	$500	$250	$250	$250	$250	**$2,569**
Tfr Out-Fund 052	$0	$264	$349	$539	$43	$183	$131	$154	$144	**$1,807**
Totals	**$51**	**$1,143**	**$953**	**$1,035**	**$ 853**	**$745**	**$697**	**$724**	**$717**	**$6,919**

** Amounts in excess of current department budgets*

Whether or not the amounts identified above will be sufficient to make the organization and community sustainable over the long-term is an unanswered question at this time. The work products from the recommended studies and analysis will provide the information the City needs to ensure the forecast adequately addresses these funding needs. The assumptions in the financial model can be adjusted to reflect varying levels of ongoing commitment in the above areas.

To summarize, Figure 19 shows the major cost drivers for the General Fund. The peaks in prior year spending are due to capital projects to which the General Fund contributed. Future growth above projected FY 2015 levels for O&M spending are largely attributable to the various unmet needs and allowance for additional services ($5.3 million or 35%) and capital project transfers ($1.6 million or 11%); together these two sources account for nearly half, or 46% of future spending increases. The next largest category is labor costs at 37%, which at a 2% inflationary growth, accounts for a $5.5 million increase; these costs include the impact of compensation growth on salary-related costs such as Medicare, overtime, incentive pay, workers compensation, unemployment insurance, and pension costs. (The baseline O&M increase over FY 2015 levels is due to the cost impact of future step increases for eligible employees that are already provided for in labor contracts and built into the City's pay structure; this is shown as a baseline cost to differentiate it from the discretionary pay increases that may be approved in future labor agreements.) The pension cost category, $0.9 million or 6% of total cost increase, reflects the pension cost increase at 0% labor inflation, thus any pension cost increases attributable to a salary COLA is counted under the labor growth category. The remainder of cost increases total $1.6 million for inflation increases in other services and supplies, or 11% of the total.

Figure 19. Cost Drivers of Future Projected Spending Increases



General Fund Forecast Summary

Figure 20 shows that the forecasted revenues (solid line), are inadequate to support baseline expenditures. The projected expenditures would exceed revenues by the greatest amount from FY 2016-20, and by lesser mounts thereafter. A modest recession is projected for 2017, which leads to a stagnation of revenues in FY 2017-18. The shaded area surrounding the line indicates a potential range of revenue from plus or minus 0.5% in annual ongoing revenue growth. Since actual revenues will inevitably vary from the forecast from year to year, the range indicates the most likely range in which revenues are most likely to fall over time. Even at optimistic revenue levels, General Fund revenues do not always exceed expenditures, and at pessimistic levels they would always fall below expenditures. (It isn't prudent to count on optimistic revenues as a salvation for structural imbalances in the budget. There are many moving parts to a budget forecast; an improving economy usually brings with it inflationary pressures that drive up labor compensation levels and other costs, which acts to offset the effect of revenue gains.) Historically, revenues excluding transfers in (a better measure of recurring revenues) have grown at an average annual rate of 1.73% from FY 2005-14, which includes the Great Recession. Peak recurring revenue growth was 14.3% in FY 2006 and the biggest decline was 9.9% in FY 2010. The forecasted average revenue growth rate from FY 2015-23 is 2.37%.

Figure 20. Comparison of Revenue Range to Projected Expenditures

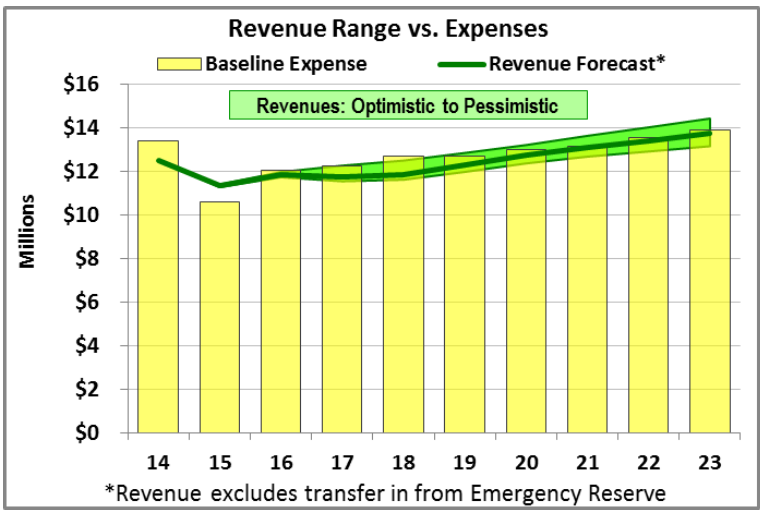


Figure 21 displays the resulting combined balance of the General Fund and Emergency Reserve which declines rapidly though FY 2020, and continues to decline thereafter but at a much slower pace. A deficit is avoided, but by FY 2023 the balance is projected to be $950,000, or 6.8% of total General Fund expenditures, compared to the City's goal of 27.5% (or $2,750,000, whichever is greater). To get the reserve balance up to the City's goal will require either additional resources, or a reduction in the projected level of spending.

Figure 21. Combined Balance of General Fund and Emergency Reserve Compared to 27.5% Reserve Goal

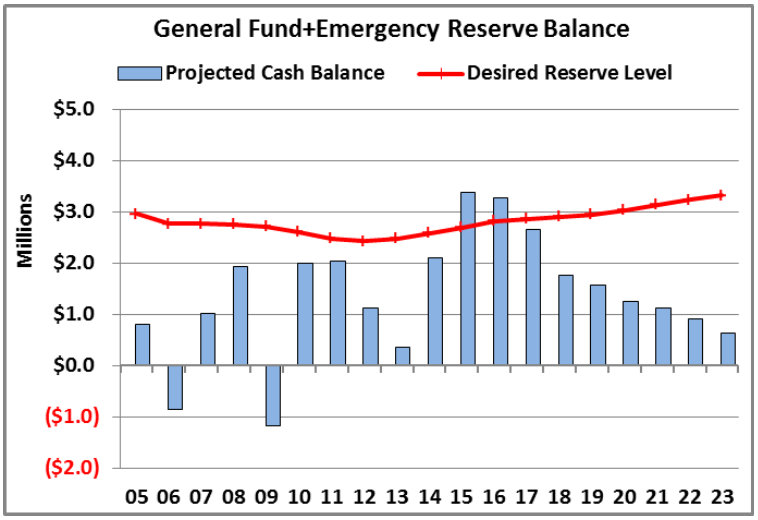
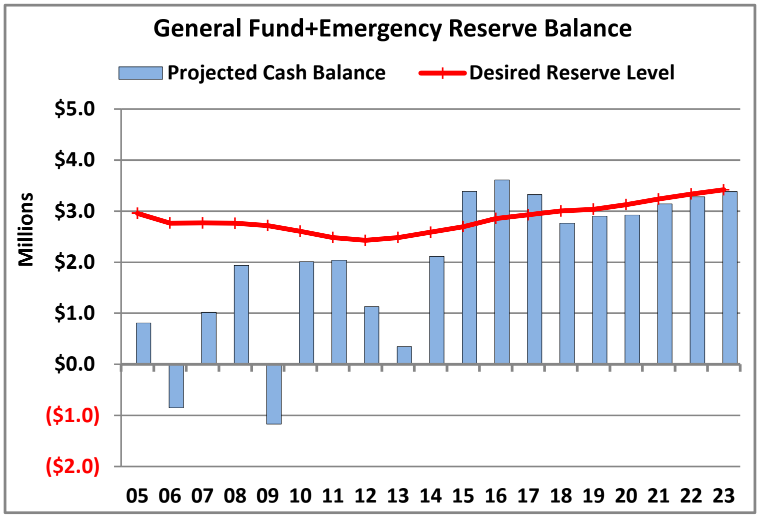


Figure 21 does not incorporate any corrective budgetary actions such as reducing expenditures or increasing revenues to restore reserve levels. The resulting balance, while taking into account a modest recession, leaves a thin margin for dealing with a recession of greater magnitude, or emergencies or other unforeseen spending needs. Once needs assessments are completed for technology, vehicle replacement and facility maintenance, increased spending demands will likely emerge. The goal setting process will likely also identify high priority services or projects that currently lack funding. The balance will also need to be built up to deal with the next economic downtown down the line.

Figure 22 shows that an ongoing improvement of $325,000 in net annual resources starting in FY 2016, with growth, would lead to the 27.5% reserve goal being attained by FY 2023. The additional resources could be in the form of either lower expenditures or higher revenues than contained in the forecast.

Figure 22. Impact of $325,000 Net Annual Forecast Improvement on Reserve Balance at 27.5% Goal



The City's current 27.5% reserve level compares to the Government Finance Officers Association (GFOA) recommended minimum balance of two months operating expenditures (or revenues), which equates to a 16.67% reserve level. A key passage from the GFOA policy reads as follows:

> *The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances. Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.*[6]

Using the lower 16.67% reserve level as a goal would require $165,000 of net ongoing improvement in the forecasted resources, as shown in Figure 23.

[6]Government Finance Officers Association, "Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund." http://www.gfoa.org/determining-appropriate-level-unrestricted-fund-balance-general-fund

Figure 23. Impact of $165,000 Net Annual Forecast Improvement on Reserve Balance at 16.67% Goal

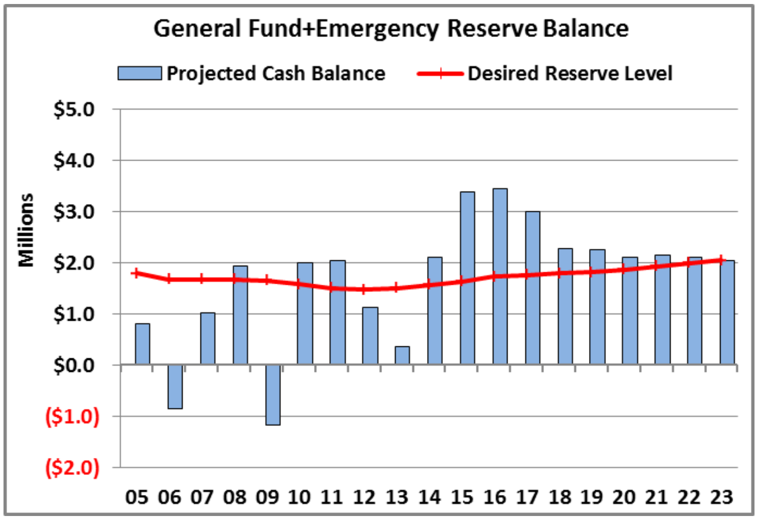


Table 12 provides a summary forecast for the General Fund, Emergency Reserve, Vehicle Replacement, Facility Maintenance and Measure Q funds. As previously discussed, the Emergency Reserve transfers in sufficient amounts to hold the General Fund to a zero balance, which avoids the past policy of allowing the General Fund to operate at a deficit. The bottom of Table 12 provides a summary of the major assumptions driving the forecast.

Measure Q is projected to slowly grow its balance to 20% by FY 2023; the average over the forecast period is 13.9%. The Measure Q sales tax is projected to continue raising 81.8% of the full 1% Bradley-Burns rate excluding state/county pools. (The transactions and use tax base is different from that of the sales and use tax, meaning that a 0.5% local voter-approved rate such as Measure Q may raise more or less than one-half of the 1% Bradley-Burns rate. While based on local sales, transactions and use taxes generally apply to merchandise that is delivered in a jurisdiction which imposes such a tax. For example, Morro Bay collects a Measure Q tax on autos purchased out of town by Morro Bay residents because the tax is charged and allocated based on the location in which the property will be registered.)

Existing staffing levels are assumed, with growth in costs equal to that for General Fund personnel. The Fire overtime cost transfer to the General Fund is assumed to continue and grows at 3.5%. Debt service for the 2011 Fire Station project is built in. Capital outlay grows at 3% from the $45,000 budgeted in FY 2015 (these amounts have varied from $0 to $485,000 in prior years) depending on the projects involved. After setting all of these parameters, including growing an adequate reserve, the amount that can be spent on a recurring basis for contracts is $450,000 and repairs/maintenance at $25,000, both with 3% growth. Contracts in prior years have ranged widely from $57,000 to $1.4 million and repairs/maintenance from $0 to $105,000.

Table 12. Summary of Long-Term Financial Forecast for General Fund and Emergency Reserve Before Any Increase in Fees or Other Budgetary Corrections

City of Morro Bay Summary Budget Forecast ($ in 000)

General Fund	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Property Tax	$3,377	$3,483	$3,556	$3,633	$3,620	$3,717	$3,834	$3,955	$4,041	$4,128
Sales Tax	1,794	1,681	1,805	1,744	1,804	1,894	1,988	2,053	2,120	2,189
TOT	2,527	2,788	2,871	2,742	2,865	3,037	3,220	3,316	3,416	3,518
Other Revenue	2,341	2,182	2,413	2,381	2,326	2,377	2,429	2,465	2,501	2,537
Transfers	2,451	1,272	1,339	1,870	2,166	1,481	1,627	1,459	1,555	1,622
Total Revenue	12,491	11,405	11,984	12,370	12,782	12,506	13,098	13,248	13,632	13,995
Personnel	8,574	8,454	8,747	9,133	9,427	9,579	9,959	10,111	10,422	10,743
Other O&M	2,370	2,102	2,144	2,186	2,229	2,273	2,318	2,363	2,410	2,457
Transfers/Svc Adds	2,467	51	1,093	1,052	1,125	653	821	774	801	795
Future Budget Cuts	0	0	0	0	0	0	0	0	0	0
Total Expenditures	13,411	10,608	11,984	12,370	12,782	12,506	13,098	13,248	13,632	13,995
Net Annual	(920)	797	0	0	0	0	0	0	0	0
Beginning Balance	(2,503)	(797)	0	0	0	0	0	0	0	0
Cash Adjustments	2,626	0	0	0	0	0	0	0	0	0
Ending Balance	(797)	0	0	0	0	0	0	0	0	0

Emergency Reserve	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenue	$56	$538	$17	$16	$13	$9	$8	$6	$6	$5
Transfers Out	1	62	119	632	909	205	332	143	219	265
Net Annual	56	476	(102)	(616)	(896)	(196)	(324)	(137)	(214)	(260)
Beginning Balance	2,853	2,909	3,385	3,283	2,668	1,772	1,575	1,252	1,115	901
Ending Balance	2,909	3,385	3,283	2,668	1,772	1,575	1,252	1,115	901	641
Total GF+ER Balance	$2,112	$3,385	$3,283	$2,668	$1,772	$1,575	$1,252	$1,115	$901	$641
% of GF Exp	15.7%	31.9%	27.4%	21.6%	13.9%	12.6%	9.6%	8.4%	6.6%	4.6%

Vehicle Replace	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenue	$20	$195	$204	$219	$155	$175	$200	$200	$200	$200
Expenditures	26	45	357	219	155	175	200	200	200	200
Net Annual	(6)	150	(153)	0	0	0	0	0	0	0
Beginning Balance	9	3	153	0	0	0	0	0	0	0
Ending Balance	3	153	0	0	0	0	0	0	0	0

Facility Maint	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenue	$1,312	$99	$688	$629	$764	$268	$408	$357	$381	$371
Expenditures	54	254	615	629	764	268	408	357	381	371
Net Annual	1,258	(154)	73	0	0	0	0	0	0	0
Cash Adjustments	(1,216)	0	0	0	0	0	0	0	0	0
Beginning Balance	40	81	(73)	0	0	0	0	0	0	0
Ending Balance	81	(73)	0	0	0	0	0	0	0	0

Measure Q	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenue	$924	$919	$924	$920	$916	$951	$997	$1,045	$1,078	$1,111
Expenditures	1,306	930	856	882	908	1,010	1,038	1,062	1,090	1,119
Net Annual	(383)	(11)	68	38	9	(59)	(40)	(17)	(12)	(8)
Beginning Balance	447	64	53	121	159	168	109	69	52	40
Ending Balance	64	53	121	159	168	109	69	52	40	32

Key Assumptions:

Revenue Scenario	Baseline	Budget Cuts	$0K	Health Contribution	2.00%	Facility Maint-2020	$200K
Recession	2017	Annual COLAs	2.00%	Inflation (CPI)	2.00%	Technology-2018	$25K
Recession Impact	**-5%**	Merits (composite)	1.50%	PERS Disc Rate Chng	0.00%	Service Increase-2016	$100K
FY 2015 Amounts	Adjusted	Vacancy Savings Rate	3.00%	Vehicle Replace-2020	$200K	Transfers Out-2017	$200K

Opportunities for Enhanced Revenues

The 2008 report included several recommendations for new or enhanced revenues, including some requiring voter approval. Listed below are those the City might still want to consider not otherwise recommended in this report:

1) Implement an Utility User Tax (UUT): Government Code Section 37100.5 authorizes cities to collect a utility user's tax on electric, gas, cable television, water, and telephone services. The tax is collected by the utility as part of its regular billing and is then remitted to the City. The tax rate is set by the City Council typically defined by the voter referendum used to authorize the tax.
2) Increase Existing Transient Occupancy Tax (TOT). TOTs of 11 or 12% are not uncommon in California.
3) Implement a general or special parcel tax.
4) Implement a Citywide Proposition 218 assessment for street lighting and street maintenance. This could occur through a Proposition 218 election requiring 50% approval of ballots from voters who would be assessed, weighted by value of assessment.