



# City of Hermosa Beach

Civic Center, 1315 Valley Drive, Hermosa Beach, CA 90254-3885

December 28, 2015

Honorable Mayor and Members of the City Council and Citizens of Hermosa Beach, California:

## Introduction

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Hermosa Beach for the fiscal year ended June 30, 2015. The report is intended to update readers on the status of the City's financial position and results of operations for the past fiscal year.

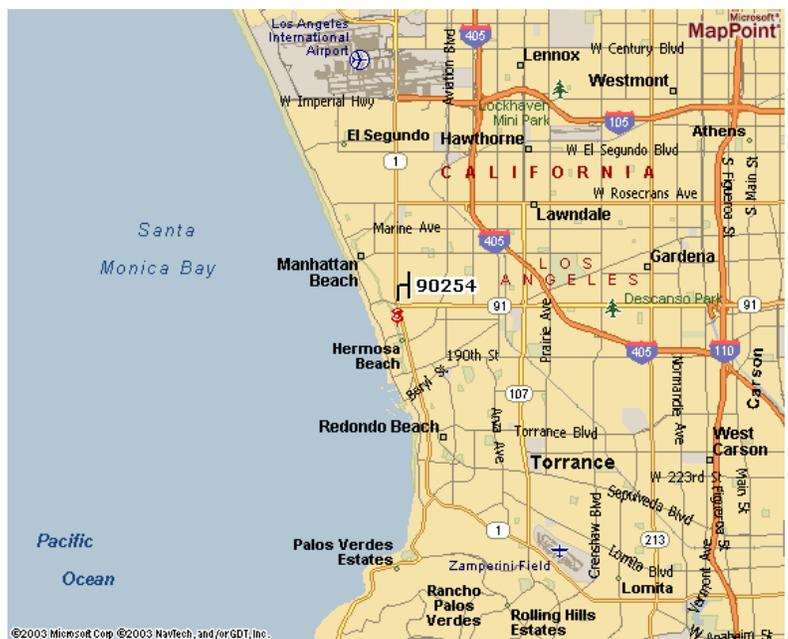
Management's representations concerning the finances of the City of Hermosa Beach are contained herein. Consequently, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of the City of Hermosa Beach has established an internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the City of Hermosa Beach's financial statements in conformity with generally accepted accounting principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the City of Hermosa Beach's framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

## Audit

The City of Hermosa Beach's financial statements have been audited by Pun & McGeedy, LLP, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City of Hermosa Beach for the fiscal year ended June 30, 2015, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unmodified opinion that the City of Hermosa Beach's financial statements for the fiscal year ended June 30, 2015, are fairly presented in conformity with GAAP. The independent auditors' report is presented as the first component of the financial section of this report.

## Profile of the Government

The City of Hermosa Beach is a beachfront, bedroom community with a stable population, located four miles south of Los Angeles International Airport. The City occupies 1.4 square miles and serves a population of 19,772, according to the State's latest population estimate. However as a beach city, the City experiences a high visitor population and the associated costs. Due to this high visitor population, the City operates in many ways like a larger city. During the 2014-15 fiscal year, beach attendance ranged from a low of 77,600 in December 2014 to a high of 1,596,605 in July 2014, according to the Los Angeles County Fire Department, Lifeguard Division.



The City of Hermosa Beach, incorporated on January 14, 1907 as a general law city, operates under the Council-Manager form of government. Policy-making and legislative authority are vested in a governing council consisting of five members of the City Council elected on a non-partisan basis at large for a four-year term. Council members serve four-year, staggered terms, with an election every two years. One member is chosen by fellow members to serve as Mayor for a period of nine months; one is chosen to serve as Mayor Pro Tem. The Council is responsible for, among other things, establishing policy, passing ordinances, adopting an annual budget; appointing members to various City Commissions and Boards and hiring the City Manager and City Attorney. The City Manager is responsible for carrying out the policies and ordinances of the City Council, for overseeing the day-to-day operations of the government, and for appointing the heads of the various departments.

The City offers a full range of municipal services, including police and fire protection, community development (planning and zoning), cultural, recreation and parks, maintenance and construction of public improvements, parking and animal control, and general administration. Financial information for the Lighting and Landscaping District, the Lower Pier Avenue Assessment District and the Myrtle Avenue, Loma Drive, Bayview Drive, and Beach Drive Utility Underground Districts are included in the City's financial statements as required by governmental accounting standards.

Summary information from the *May 2015 Profile of the City of Hermosa Beach*, produced in 2015 by the Southern California Association of Governments (SCAG), is shown below along with selected information from the U.S. Census. The SCAG report is produced every two years, with the next release in May 2017.

<b>SCAG PROFILE OF THE CITY OF HERMOSA BEACH</b>		
<b>Category</b>	<b>2014 STATISTICAL SUMMARY Hermosa Beach</b>	<b>2012 STATISTICAL SUMMARY Hermosa Beach</b>
Median Age	38.6	38
Non-Hispanic White	79.5%	80.3%
Hispanic	8.8%	8.5%
Non-Hispanic Asian	6.0%	5.9%
Non-Hispanic Black	1.2%	1.2%
Non-Hispanic American Indian	0.2%	0.1%
Non-Hispanic All Other	4.3%	4.1%
Homeownership Rate	44.7%	44.7%
Average Household Size	2.1	2
Median Household Income	\$95,050	\$93,017
Mean Travel Time to Work	33.3 minutes	32 minutes

U.S. CENSUS BUREAU QUICK FACTS					
Category	Hermosa Beach	California	Category	Hermosa Beach	California
Persons under 5 years, 2010	5.1%	6.8%	Per capita money income in the past 12 months (2011 dollars), 2009-2013	\$69,606	\$29,527
Persons under 18 years, 2010	15.9%	25.0%	Persons below poverty level, 2009-2013	3.4%	15.9%
Persons 65 years and over, 2010	9.0%	11.4%	Median value of owner-occupied housing units, 2009-2013	\$1,000,001	\$366,400
Female persons, 2010	47.3%	50.3%	Housing units in multi-unit structures, 2009-2013	48.4%	31.0%
Bachelor's Degree or higher, persons age 25+, 2009-2013	70.9%	30.7%	High School graduate or higher, persons age 25+, 2009-2013	99.0%	81.2%

The U.S. Census Bureau Quick Facts are as of October 2015. Further data regarding the City may be found in the Statistical Section.

The annual budget serves as the foundation for the City of Hermosa Beach's financial planning and control and is based on the Strategic Plan adopted by the City Council. All departments of the City of Hermosa Beach are required to submit requests for appropriation to the City Manager according to a budget calendar. The City Manager uses these requests as the starting point for developing a proposed budget, which is presented to the City Council for review by May 15. At least one public budget workshop is held prior to the required public hearing, with adoption required no later than June 30<sup>th</sup>. If the City Council fails to adopt a budget by that date, the budget submitted by the City Manager, as amended by the City Council, if applicable, is the appropriated budget except for capital improvement outlays. The appropriated budget is prepared by fund and department (e.g., Police Department). The City Manager may make transfers of appropriations between departments within each fund; transfers of appropriations between funds, however, require the approval of the City Council. The City Council receives monthly revenue and expenditure reports during the year and a midyear budget review is conducted after the first six months of the fiscal year to ensure estimates are on target. Budget-to-actual comparisons are provided in this CAFR for each individual governmental fund for which an appropriated annual budget has been adopted. For the General Fund and major governmental funds with appropriated annual budgets, this comparison is presented as Required Supplementary Information on pages 92-93. For non-major governmental funds with appropriated annual budgets, this comparison is presented as Supplementary Information, after the Notes to the Financial Statements.

### Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City of Hermosa Beach operates.

**Local economy.** Hermosa Beach is a “bedroom community” as evidenced by a household count of +10,000 and an in-city business count of under 1,000 (excluding apartments and home occupations) Hermosa Beach had growth of 6.2% in secured and unsecured assessed valuation, as compared to 5.6% for Los Angeles County. The 6.2% growth was the 12<sup>th</sup> highest of 88 cities in Los Angeles County. Median home prices in Hermosa Beach as of June 2015 were \$1,361,000, compared to \$525,000 for Los Angeles County. The Hermosa Beach median home price for June 2014 was \$1,246,000, compared to \$450,250 for Los Angeles County. The average median home price for Hermosa Beach for fiscal year 2014-15 was \$1,455,550 and \$1,159,125 for fiscal year 2013-14. Home values adjacent to the beach increased for the fifth year in a row after declining 2009-2011.

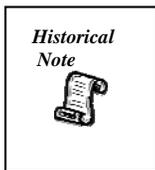
As a beach city, the three highest occupations are management, sales, and administrative support, however residents enjoy access to a much more diverse employment base with the close proximity of all of the other cities in Los Angeles County. The unemployment rate in Hermosa Beach is 3.1%, compared with 7.4% for Los Angeles County, and 6.2% for California as of June 2015.

General Fund Secured property taxes increased 7% in 2014-15, consistent with growth in assessed values. Property adjacent to the beach has held its value better and grown faster as compared to property in the inland areas.

Sales tax receipts for 2014-15 are up 4%.

Transient occupancy tax (the tax on hotel stays) grew 7% over 2013-14. Receipts of more than \$2.3 million are the highest level ever. Average occupancy for 2014-15 was 81% for Hermosa Beach compared to last year’s rate of 81.1%. Hermosa Beach has eight hotels and one youth hostel, with rooms capacity ranging from 17 rooms to 106 rooms.

Utility user tax (UUT) revenue remained the same as last year at \$2.4 million and is approximately 10% less than the highest year of 2006-07. Part of this decline is related to a change by AT&T in taxation of their cellular bundled services and loss of prepaid cellular tax revenue as well as a 3% decline in electricity tax revenue. The utility user tax is the third highest tax source of income for the City.



*Since the City was successful in obtaining voter approval (72%) for adoption of a modern UUT ordinance in November 2007, revenue is protected as technology changes occur. The ballot measure was intended to be revenue-neutral, in that the video and telecom rate was reduced from 6% to 5.5% to offset any new revenue received from new technology in those areas. The UUT as a source of revenue has been very reliable.*

**Accounting Changes.** The City implemented Government Accounting Standards Board (GASB) Statement No 68, Accounting and Financial Reporting for Pensions, effective July 1, 2014. Net pension liabilities of \$36,303,639 were recorded and the unrestricted net position was reduced accordingly. The change in accounting standards impacted the government-wide financial statement, notes, and required supplemental information only.

**National/State Economy.** The Legislative Analyst’s Office reports that the State budget is better prepared for an economic downturn than it has been at any point in decades, given that the main economic scenario shows 2016-17 ending with reserves of \$11.5 billion. That is compared to \$4.5 billion reported in last year’s CAFR as the ending estimate for 2015-16.

Beacon Economics reports several positive State trends including non-farm job growth outpacing the nation for 40 consecutive months and stronger home sales of 9.8% over the past year. Like Hermosa Beach however, the State is behind on investment in infrastructure, which is a challenge that must be addressed.

**California Public Employees Retirement System (CalPERS).** The preliminary CalPERS investment return as of June 2015 was 2.4%, however over the past three and five years, the Fund has earned returns of 10.9 and 10.7 percent respectively, performing better than the benchmarks for the first time since 2007. The 20 year investment return stands at 7.8%.

The CalPERS Board adopted a funding risk mitigation policy that will incrementally lower the discount rate (assumed rate of return) in years of good investment returns. This will be done gradually (by a minimum of .05 percentage points to a maximum of .25 percentage points when investment returns outperform the existing discount rate of 7.5% by at least four percentage points). This will work to offset increased employer contribution rates that would otherwise increase when the discount rate is lowered and help pay down CalPERS unfunded liability. This adjustment is in large part due to the aging workforce. A decade ago the ratio of active to retired workers was 2 to 1, it is now 1.6 to 1 and the trend downward will likely continue.

The City created a Retirement Stabilization Fund in 2003-04 to plan for anticipated rate increases. This amount now appears as part of the “assigned” balance in the General Fund in the amount of \$1,000,000.

**Long-term financial planning.** The City has adopted comprehensive financial policies addressing a range of items including accounting and reporting, internal controls, budget, revenue, debt service and investments. The policies are published in the budget and reviewed annually.

The City Council’s adopted financial policies relating to long-term financial planning for specific funds are as follows:

Insurance Fund—Goal of \$3,000,000 in net assets for aberrations in claims reserves and catastrophic losses.

Equipment Replacement Fund—Goal of net assets equal to the accumulated amount calculated for all equipment, based on replacement cost and useful life of equipment.

Contingency—Goal equal to 16% of the General Fund appropriations for economic uncertainties, unforeseen emergencies.

Compensated Absences—Goal equal to 25% funding for accrued liabilities for employee vacation, sick and compensatory time.

The City also has a financial policy of transferring funds unspent in the General Fund at year-end to the Insurance Fund, Equipment Replacement Fund, Capital Improvement Fund and to add to Contingency Funds. The transfer for 2014-15 was \$2,610,442, per Council direction at Midyear Budget Review, to the Capital Improvement Fund. The City Council makes changes as necessary to the year- end transfer, depending on the equity in the funds or based on other needs.

In 2012-13 the City Council set aside \$2.5 million of unrestricted net position in the Insurance Internal Service Fund, in addition to \$ 3.5 million recorded as a liability, for the costs of the MacPherson Oil lawsuit settlement and proposed new oil project which are discussed in detail in the Notes to the Basic Financial Statements (Note 14). After the March 3, 2015 election when residents voted not to lift the ban on oil drilling, the City used the previously set aside \$6 million to pay E & B Natural Resources a portion of the \$17.5 settlement agreement. The remaining \$11.5 million was recorded as a liability at year end in the Insurance Fund and immediately paid off in August 2015 after lease revenue bonds were issued.

The City’s long term financial planning focuses on the Five Year Financial Forecast and Capital Improvement Plan, which is produced as part of the annual budget. In May 2015, staff presented the Fiscal Health Model from the International City/County Management Association’s (ICMA) Center for Performance Based Budgeting. The model is a tool that may be used to evaluate various scenarios to assist in gauging the fiscal health of the City. Since the City is built out, the Capital Improvement Plan primarily addresses maintenance, repair and upgrading of facilities and infrastructure, particularly streets, storm drains and sewers.

Primary projects coming up, (other than street and sewer improvements, which occur every year) are design of improvements for the Pacific Coast Highway/Aviation corridor, South Park Playground improvements, municipal pier structural repairs, and citywide energy conservation upgrades.

**Cash management policies and practices.** Temporarily idle cash was invested during the year in obligations of the U.S. Treasury, corporate notes, certificates of deposit, the State Treasurer's investment pool and the Los Angeles County pool. The average maturity was 51 months, with an average weighted yield on investments of .85% Investment income includes changes in the fair value of investments. Changes in fair value during the current year, however, do not necessarily represent trends that will continue nor do such amounts necessarily become realized, since the City intends to hold the investments to maturity.

**Risk management.** The City is self-insured up to \$250,000 for liability claims. Excess coverage up to \$20 million is obtained through the Independent Cities Risk Management Authority (ICRMA), a joint powers authority consisting of medium-sized California municipalities. The cost of the insurance depends on both the loss experience of member cities and the loss experience of the City.

The City purchases workers' compensation coverage through a self-insured program available through ICRMA. The City maintains a \$500,000 self-insured retention limit and participates in a self-insured risk sharing pool through the ICRMA and the California State Association of Counties (CSAC). Together, these two joint powers authorities provide a shared limit of coverage up to a maximum of \$200 million.

Claims defense and settlement are coordinated by third party administrators for both liability and worker's compensation, with oversight by the City Manager (since the Human Resources Director/Risk Manager position was cut).

Additional information on the City's risk management activity can be found in Note 8 of the Notes to the Basic Financial Statements.

**Pension and other post-employment benefits.** The City provides pension benefits to safety and non-safety employees through the California Public Employees Retirement System (CalPERS). CalPERS provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. The City was successful in negotiating two tier rates for new employees in all bargaining units beginning in 2011-12. As of June 30, 2015, the City has twenty (20) Tier 2 employees. With the State's pension reform implemented 1/1/13, the City now has three tiers. As of 6/30/15 there are thirty-three (33) employees in Tier 3. The City has paid employee contributions as a negotiated benefit for many years however in 2012-13 the City negotiated for employees to begin paying the entire share of the employee contribution over three years with an offsetting increase in salaries, which will be achieved by 2014-15. All of these changes will reduce pension costs over time. City employer contributions are actuarially determined on an annual basis.

The City also provides post-employment health care benefits for certain retirees. As of the end of the current fiscal year, there were 59 retirees receiving these benefits.

The City established a trust with an outside party to administer these funds in July 2007. The City is contributing the annual required contribution for all employees as determined by an actuarial study in the manner as is done for retirement contributions to CalPERS.

Additional information on the City of Hermosa Beach's pension arrangements and other post-employment benefits can be found in Note 9 and 10 in the Notes to the Basic Financial Statements.

### **Awards and Acknowledgements**

The Government Finance Officers Association (GFOA) awarded a 2014 Certificate of Achievement for Excellence in Financial Reporting to the City of Hermosa Beach for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2014. This was the twenty-fifth consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, a report must be published that satisfies both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the efficient and dedicated services of the entire staff of the Finance Department. We would also like to express our appreciation to the City Manager and all of the departments, including the City Clerk and City Treasurer, and to our auditors, Pun & McGeady, LLP, for their assistance and support in preparation of the report. Credit also must be given to the Mayor and the City Council for their continuing support for maintaining the highest standards of professionalism in the management of the City of Hermosa Beach's finances.

Respectfully submitted,



Viki Copeland  
Finance Director