EL DORADO LAFCO

LOCAL AGENCY FORMATION COMMISSION

AGENDA OF FEBRUARY 22, 2017

REGULAR MEETING

TO:	**Shiva Frentzen, Chair, and Members of the El Dorado County Local Agency Formation Commission**
FROM:	**José C. Henríquez, Executive Officer**
AGENDA ITEM #8:	**PUBLIC HEARING TO CONSIDER AND ADOPT THE PROPOSED BUDGET FOR FISCAL YEAR 2017-18**

RECOMMENDATION

Staff recommends that the Commission:

1. Receive the information related to the draft Proposed Budget for Fiscal Year 2017-2018;
2. Consider the two options for the Proposed Budgets for Fiscal Year 2017-2018
3. Open the Public Hearing on this matter; and
4. Adopt Option 1 as the Proposed Budget for Fiscal Year 2017-2018 because it gives the Commission the most flexibility to react to the most possible outcomes in the coming fiscal year.

REASON FOR RECOMMENDED ACTION

The recommended LAFCO Budget provides adequate funding for the agency to meet the responsibilities under the Cortese-Knox-Hertzberg Act. El Dorado LAFCO adopts its own budget in a two-stage process with notice to all funding agencies.

BACKGROUND

Summary

Described in this memorandum is the first budget under the new carryover process that your Commission adopted last year. This means that from now on, the carryover/fund balance is a known amount and not an estimate. Applicant fees and interest revenues are still forecasted, however. Agency contributions as a whole are expected to be reduced by approximately 16-20%, depending on which option the Commission chooses.

Operating costs will be reduced by approximately 6% from the current year. Employee costs will increase between 5-10%, again depending on which options the Commission chooses. This is because the agency has to start preparing for a potential hire. Despite this, the size of the overall budget will only go up by 2-5%.

The Ad Hoc Committee composed of Chair Frentzen and Commissioner Humphreys met with your Executive Officer to discuss the draft budget in late January. The Committee reviewed the various scenarios about the upcoming changes to employees and their budget implications. Their recommendations were incorporated into the draft budget before you for consideration.

How to Read the Attached Budget:

Budgetary items will be referred to by its description and General Ledger (GL) Account. The GL number reflects the Fund Number in the Commission's accounting system. The Fund Number corresponds to the monthly Profit & Loss report the Commission receives as part of its meeting packet.

The attachments to this report mirror the narrative from this point forward:

- Attachment A contains the calculated carryover from FY2015-16. This number is inputted into next year's budget as a source of revenue under GL 4100, consistent with both your direction from last year as well as with your policies.
- Attachment B contains the estimated earned fee revenues from petitions and applications in the upcoming fiscal year. This number is inputted into the budget as a source of revenue under GL 4000.
- Attachment C contains the calculations for Operating Expenses.
- Attachment D contains the salary calculations and expenses. This attachment has been reformatted for simplicity and clarity.
- Attachment E contains the complete draft Proposed Budget for FY2017-18.

Overall Budget Highlights

The biggest budgetary highlight is that the two largest revenue sources in this budget are now known numbers. The carryover/fund balance is no longer a forecasted amount but a calculated number thanks to your Commission's policy change last year. The amount used for the carryover/fund balance ($119,975) is the carryover from FY2015-16 minus what was used for the current fiscal year ($27,070) per your amended budget.

The second biggest highlight is that there will be a reduction in the total agency contributions next year. A large carryover/fund balance amount is responsible for the decrease in agency contributions. The size of the reduction depends on which option is chosen out of the two available for your consideration.

The forecast project fee revenue is purposely kept low. Although staff is aware of several projects that will require LAFCO action, staff does not have a good read on when applications will come in.

Almost all expenses are expected to grow modestly or be reduced significantly. The largest increases will be in Funds 6020 (Accounting Services), 6040 (Cell and Telephone

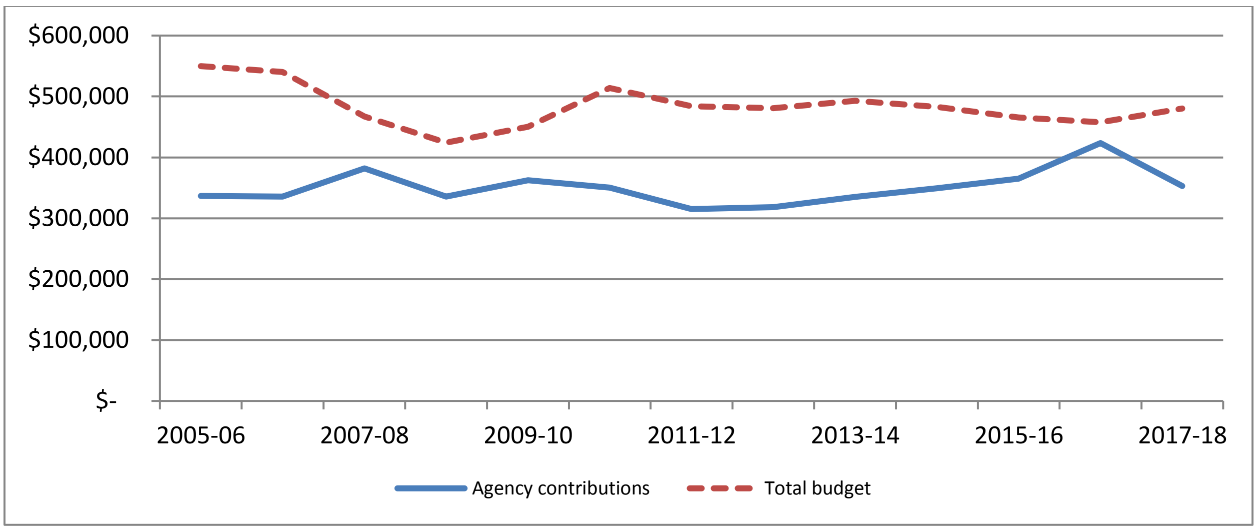
Services), 6750 [Staff Development (incl. Commissioner Development)] and 6770 (Transportation). All of these will be explained below.

The lump-sum payment to CalPERS for the unfunded liability in FY2017-18 will be a budget-busting $94.

Planning for Personnel Changes

The other budgetary highlight and that the Commission should discuss is the agency needs to start preparing for your Administrative Assistant's retirement. She has been with LAFCO for 11 years so far and has been a key member of staff. Her tenure has been marked with identifying improvements to LAFCO's administrative processes and keeping a watchful eye on office expenses. She is planning to retire in 2020. Given that a long lead time is necessary to train a LAFCO employee effectively, and given it is my recommendation that LAFCO allows as much time as possible for the new person to work alongside and learn from your Admin Assistant, it is never too early to plan.

LAFCO Budget History (Option 1 displayed)



Budget at a Glance

Budget		**FY2017-18**	
	FY2016-17	**Option 1**	**Option 2**
Employee Expense	$318,719	$351,421	$334,096
Operating Expense	$126,208	$118,667	$118,667
Operating Contingency	$12,621	$11,867	$11,867
Expense Total	**$457,548**	**$481,955**	**$464,630**
Non-Agency Revenues	$6,977	$6,977	$6,977
Agency Contributions	$423,501	$355,003	$337,678
Prior Year Fund Balance	$27,070	$119,975	$119,975
Revenue Total	**$457,548**	**$481,955**	**$464,630**

Expenditures

Operating Costs

Please note that the discussion on operating costs is the same across both options before you. As detailed in Attachment C, operating costs are budgeted as 6% lower than current year. Some expenditures that have been flat for a while (General Liability Insurance, Memberships and CALAFCO Membership) will tick upwards. As noted earlier, some increases are larger than usual:

- Fund 6020 (Accounting Services) – Monthly accounting costs have increased on average. This increase is more of a long-overdue correction, as opposed to a sudden increase in service cost. What this means is that there were steady increases in cost in more recent years; however, the lower costs from a decade ago were skewing the average downward. The correction was in in tweaking the formula to give more weight to more recent years.
- Fund 6040 (Cell and Telephone Services) – The California Supreme Court is expected to rule that all communications on public officials' and employees' private devices are related to the agency's "conduct of the public's business." As a result, these will be subject to disclosure under the state's Public Records Act. Some Commissioners have known that your Executive Officer is currently using his personal phone for business in order to save LAFCO money. In anticipation of this ruling, it is best to have a device specifically dedicated to LAFCO business from now on. This allows for the full public disclosure of any LAFCO-related materials on the LAFCO phone and respects your EO’s privacy on personal matters. In addition, the Commission knows that the LAFCO office will soon have broadband service from Comcast. These costs will now be reflected in the budget.
- Fund 6750 [Staff Development (incl. Commissioner Development)] and Fund 6770 (Transportation) – The CALAFCO Conference will be in San Diego this year. The 2018 CALAFCO Workshop for staff will be in Marin County. While the number of people budgeted to attend each event is the same as previous years (no more than 4 people), the lodging and transportation costs are expected to be higher at both venues.

There are a few expenditures that will see a significant reduction to offset these increases, for an overall lowering of costs.

Employee Expenses

As noted earlier, the Administrative Assistant plans on retiring in 2020. While it may sound as if it is too early to start planning for this, in actuality it is not. Unless there is prior experience with LAFCO Law, it takes about six months of training for someone to start to feel as if they are no longer underwater. It takes a few more months for the person to start independently contributing to the workload (as opposed to being in “training mode” where existing staff is training the new person as well as managing their own workload). And there should be a sufficient amount of overlap so that this person can learn as much as possible from the Admin Assistant before she retires.

Staff recommends that the next hire be a full-time Clerk-Analyst. This position has been vacant since 2008. While existing staff is able to cover some functions from the position, the reality is that the absence has been felt. In a small office as LAFCO, the loss of the clerk resulted in the loss of about 33% in workforce capacity. LAFCO is steadily falling behind on its MSR work. If the right person is hired, this person could both assist in this effort and with the processing of upcoming applications, those 4-5 large projects on the horizon that will inevitably become applicants to LAFCO.

The differences between the two options relate to the timing of the hiring. Option 1 assumes that a clerk-analyst will be onboard for 3 of the 4 quarters of FY2017-18. Option 2 assumes that this person is only at LAFCO for half a year. Staff recommends that the Commission adopt Option 1 as the superior option for the following reasons:

1. Because there is such a long training period, the timing of the hire is critical. It has to be long enough to accommodate the training so that the new person can assist existing staff cope with the increased workload. Otherwise the risk is that the new person becomes detrimental to the effort, requiring existing staff to spend time with training and with the regular workload. Option 1 gives your Executive Officer the most flexibility in when to hire the new person should the need arise.
2. This point will make more sense when it is coupled with points 3 and 4 below. Every and any month in which the Clerk-Analyst position is not filled means that LAFCO can capture those salary savings and turn it into carryover for FY2019-20. Larger carryovers help the agencies by making the contributions smaller. In addition, Option 1 gives you a clearer picture of what the budget will look like with this position filled over an entire fiscal year the more months you budget for it next year.
3. It provides a soft landing for the contributing agencies in future years. In the upcoming three years the budget has to accommodate the cost of 3.5 people, until the transition is complete with your Administrative Assistant’s retirement. The impact to the agency contributions will vary depending on the other three sources of revenue. However, the political fallout for you will be greater if you were to drop the agency contributions significantly this year and have to raise them significantly in near future (assuming an increase is necessary). The fallout might be less if the decrease this year is more gradual and any increase in the coming years is also more gradual.
4. Once you break the agency contributions down to what it means to each agency, the difference in cost between the options is not much. Option 1, from a total cost standpoint, is $17,000 more than Option 2; however this means that it will cost the County $5,600 more next fiscal year. The cities and the special districts will each split $5,600 among themselves. While there is a financial impact, and this is not meant to minimize the pain to each agency, as a proportion to their respective budgets the difference is minimal once you start breaking it down.

For existing staff, the budget is the same as in the current year’s budget. There are no raises for anyone except a potential increase in pay should the Policy Analyst be promoted. Having staff take three days of furlough has also been retained.

Future Considerations

<u>Personnel Costs</u>

While this budget contemplates a partial year of employee expense for FY2017-18 for the hire of the Clerk-Analyst, the budgets for FY2018-19 and 2019-20 will also bear the cost of the Clerk-Analyst plus the Admin Assistant. As a result, the Commission should keep in mind that the size of the budget will increase for the next three years. However, there will only be one budget where staffing is at 3.5 people for a full fiscal year, since there is partial year for the Clerk-Analyst in 2017-18 and a partial year for the Admin Assistant in 2019-20.

Employer Rate

Another factor in the upcoming budgets are the expected increase of the employer rate for CalPERS. The January 2017 letter is included under Item 10D3(a) of this Agenda, but in summary the employer rate is expected to increase as a result of CalPERS lowering the "discount rate assumption," which is the expected long-term rate of return on CalPERS investments. Basically, CalPERS' actuaries calculate the cost of an employers' total pension liability on the system, from the time of each employee's retirement until his/her death. This is the pension obligation. When CalPERS calculates how much to charge employers for this obligation, it assumes that the money employers pay into the system will gain some rate of return if invested. This expected rate of return is then "discounted" from the obligation, lowering the employer rate. CalPERS had assumed an average long-term rate of return of 7.5% on its investments. Prominent economists, actuaries and political leaders (most notably Governor Brown) have indicated that an average rate of return of 7.5% was too optimistic, especially in light that CalPERS has not recovered from the 2008 economic crash and last year's return on investments was very weak. They lobbied for the lowering of the discount rate and the CalPERS Board complied in late 2016.

Because it is a closed system, the lowering of the discount rate increases the employer rate. While LAFCO was forecast to have single-digit employer rates for the next six years, this may no longer be possible. CalPERS' letter makes it clear that LAFCO should estimate a 1-3% increase in its rate as a result of the discount rate being lowered to 7%. The change in employer rate is estimated below, per the 2017-19 Valuation Report and taking into account the January 2017 CalPERS letter:

	Calculated rate	**Projected future employer contributions**				
Fiscal Year	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**
Original Rate	8.921%	8.9%	8.9%	8.9%	8.9%	8.9%
Estimated Rate	9.171-9.671%	9.4%-10.4%	9.9-11.9%	9.9-11.9%	9.9-11.9%	9.9-11.9%

On this topic, please note the following three things.

- The January 2017 CalPERS letter indicates that there will also be impacts to the unfunded accrued pension liability (UAL). Unfortunately, lack of data prevent staff from being able to give facts to the Commission. While the Valuation Report included estimates for the lump-sum UAL payment, the numbers in this report were done before the Commission authorized the large UAL payment in Fall 2015. As a result, it is possible that there is little, if any, impacts to LAFCO as it relates to the UAL as a result of the change in the discount rate. Staff will provide an update in the summer once the new Valuation Report is issued.

- The Commission made several changes to its benefit policies in 2009. While the employer rate is what it is, the Commission will not have to budget for the employee rate for the new hire (barring any other changes). In other words, having a new person will not necessarily translate into large increases in benefits and salary costs. There will be some pension and other benefits savings that will be realized.
- As you may recall, the Center for California Studies asked your EO serve as the interim academic advisor for the California Executive Fellows Program in 2016. Sacramento State University has asked your EO to continue to serve in that capacity long term. That means there will be, roughly, 30 business days a year in which I will be out of the office to teach seminar and perform other duties associated with that role. So far, that time off has been absorbed by my vacation day balance. In this long term role, however, there will be two related impacts. First, as my vacation balance is reduced, it means that upcoming LAFCO budgets would have to budget less for Accrued Leave (Fund 6800). Second, as my vacation balance is reduced, it is possible that I will have to take a couple of unpaid days off beyond the budgeted furlough days, thus saving the agency some money.

While it may seem like there are many moving parts to this budget, it is actually pretty stable. The “LAFCO Budget History” chart on page 3 shows that this budget is actually lower than the FY2013-14 budget, with agency contributions at the same level as that fiscal year. Your management and oversight have ensured that the budget is kept at an appropriate level for this agency to do its job.

<u>Attachments</u>

Attachment A: Carryover/Fund Balance Calculations Fiscal Year 2014-2015

Attachment B: Fiscal Year 2017-2018 Estimated Project Revenue

Attachment C: Operating Budget Calculations

Attachment D: Option 1 - Employee Salary & Benefit Schedule

Attachment E: Option 1 - Draft Proposed Budget FY 2017-2018

Attachment F: Option 2 - Employee Salary & Benefit Schedule

Attachment G: Option 2 - Draft Proposed Budget FY 2017-2018