City of Twentynine Palms

General Fund
Five-Year Fiscal Forecast: 2017-22

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General Fund Five-Year Fiscal Forecast: 2017-22

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OVERVIEW

Background

This report is in response to the City of Twentynine Palm's interest in preparing a General Fund five-year fiscal forecast in helping assess its ability to sustain current service levels on an ongoing basis.

Like virtually all other local governments in California, the City has been faced with major fiscal challenges over the past several years in the wake of the worst recession since the Great Depression, compounded by the dissolution of redevelopment agencies (RDA's), which was a key funding source for community investments.

Making good resource decisions in the short term as part of the budget process requires considering their impact on the City's fiscal condition down the road. Developing good solutions requires knowing the size of the problem the City is trying to solve: in short, the City cannot fix a problem it hasn't defined. And in this economic and fiscal environment, looking only one year ahead has the strong potential to misstate the size and nature of the fiscal challenges – and opportunities – ahead of the City.

For those local agencies that have prepared long-term forecasts and follow-on financial plans, this did not magically make their fiscal problems disappear: they still had tough decisions to make. However, it allowed them to better assess their longer-term outlook, more closely define the size and duration of the fiscal challenges facing them, and then make better decisions accordingly for both the short and long run. This will be true for the City as well.

The City has contracted with William C. Statler to prepare the General Fund Five-Year Fiscal Forecast. (An overview of consultant qualifications is provided in the Appendix.)

Forecast Purpose and Approach

The purpose of the forecast is to identify the General Fund's ability over the next five years – on an "order of magnitude" basis – to continue current services in light of the worst recession since the Great Depression and the dissolution of RDA's, combined with other fiscal circumstances unique to the City; and if the forecast projects a negative gap between revenues and expenditures, to identify realistic options for the City's consideration in closing the gap.

The forecast does this by projecting ongoing revenues and subtracting from them likely operating, debt service and capital costs in continuing current service levels. If positive, the balance remaining is available to fund "new initiatives" such as implementing CIP goals, addressing unfunded liabilities or improving service levels. On the other hand, if negative, it shows the likely "forecast gap" if the City continues current service levels.

It is important to stress that this forecast is not the budget.

It doesn't make expenditure decisions; it doesn't make revenue decisions. As noted above, its sole purpose is to provide an "order of magnitude" feel for the General Fund's ability to continue current service levels on an ongoing basis**.**

> ***Can the City Afford New Initiatives?***
>
> **This is a basic question of priorities, not of financial capacity. But the forecast assesses how difficult answering this question will be.**

Ultimately, this forecast cannot answer the question: "Can the City afford new initiatives?" This is a basic question of priorities, not of financial capacity per se. However, making trade-offs is what the budget process is all about: determining the highest priority uses of the City's limited resources. And by identifying and analyzing key factors affecting the City's long-term fiscal heath, the forecast can help assess how difficult making these priority decisions will be.

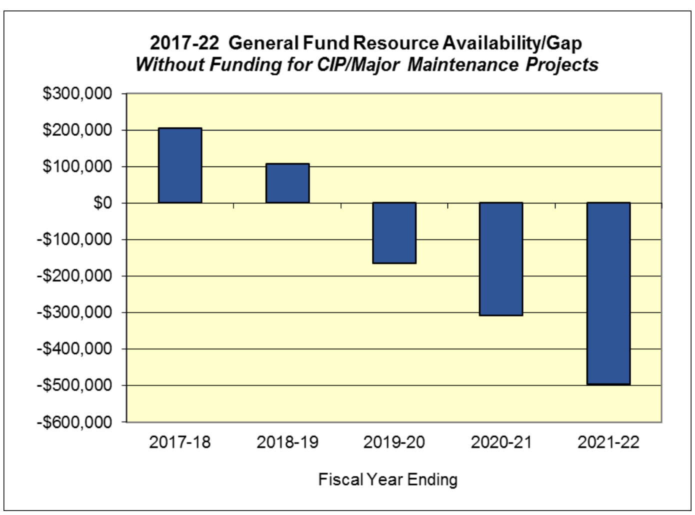
Stated simply, the forecast is not the budget. Rather, it sets forth the challenges – and opportunities – ahead of the City in adopting a balanced budget, next year and beyond.

FORECAST FINDINGS

The Short Story

- The General Fund is in relatively good shape in funding operating costs: for the first two years, there is a positive variance between revenues and expenditures. That said, a modest gap begins to grow between revenues and operating costs in the last three years of the forecast. As discussed below, there are strategic options available to the City in closing these out-year gaps.

- However, there are significant challenges ahead in funding CIP and major maintenance projects.



Funding Operating Costs. As shown in the sidebar chart, forecast revenues exceed operating costs in the first two years, with modest gaps growing the out-years.

Because the gaps are modest and partially offset by positive results in the the first two years, available reserves – which are very strong – will be about the same as they are today at the end of the five-year forecast: $7.3 million versus $7.9 million, after setting aside $3.2 million for RDA/successor agency wind-down ($2 million) and Fire Department obligations ($1.2 million).

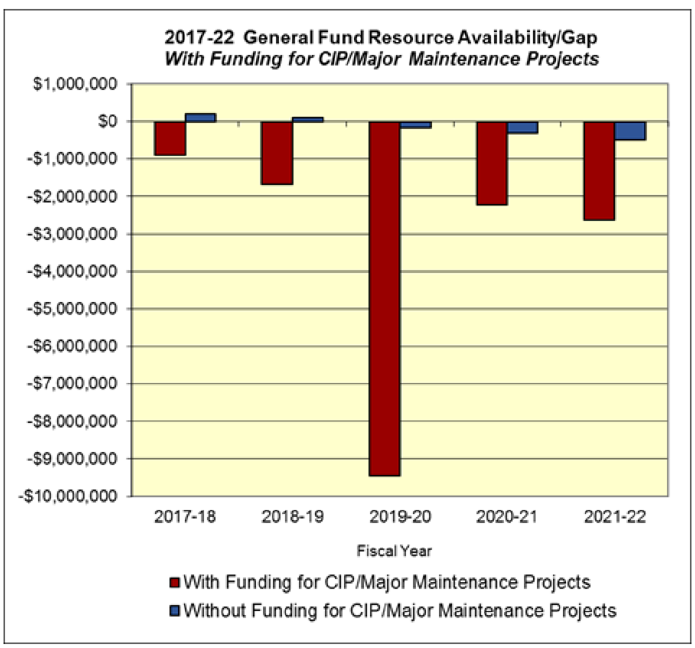
Even setting these funds aside, the City's reserves are very strong, reflecting a reserve-to-operating expenditire ratio of 94%.

There are three key factors driving the operating gap in the outyears, even though modest increases in revenues are projected and many costs are not expected to increase beyond the 2% assumption for inflation:

- ***Sheriff contract costs***. These are the largest portion of General Fund costs, accounting for 40% of total expenditures. Over the past five years, these costs have increased by 4.6% annually; and by 5.5% over the past two years. Based on past trends, these are projected to increase by 5% annually in the forecast.

- ***CalPERS costs.*** The City contracts with the California Public Employees Retirement System (CalPERS) in providing pension benefits to its regular employees. As discussed more fully in *Key Trends* section this report (Chapter 4), these costs are projected to increase significantly over the next five years (and for several years thereafter) due to changes in key actuarial assumptions, most notably the "discount rate" (expected investment yields). While these more conservative assumptions, along with other recent CalPERS reforms, will asssist in strengthing the system and stabilizing costs in the long-term, they will result in higher costs over the next eight years.

- ***Project Phoenix operating costs.*** This downtown redevelopment project is projected to be operational in 2019-20. The project consists of basic infrastructure in the downtown area (parking lots, underground utilities, and wastewater package treatment plant). In addition to the basic infrastructure, the City will add a multi-purpose facility to the downtown. This multi-purpose facility will have general fund operational costs associated with it including janitorial, maintenance, utilities and staffing. These costs are estimated at $100,000 in 2019-20, increasing by 2% annually thereafter.



Funding With CIP/Major Maintenance Projects. The sidebar chart compares the forecast results for operating costs with what happens if CIP/Major Maintenance Projects are included in the forecast. (The basis for the CIP/Major Maintenance Projects is discussed below.)

This chart shows two things:

- The out-year operating gaps are modest when contrasted with including CIP/Major Maintenance Projects.

- Rather than the relatively close match between revenues and operating costs, the forecast shows an annual average "gap" of about $3.4 million when CIP/Major Maintenance Projects are included. Without corrective action, available reserves at the end of the five-year forecast would be depleted.

➊ INTRODUCTION

The Path Forward. As discussed below, there are several options available in closing the modest operating gap in the out-years and funding CIP/Major Maintenance Projects (in full or part) that would result in a balanced budget, including:

- Using reserves for one-time costs.
- Debt financing suitable CIP projects.
- New revenues (which will likely require voter approval).
- Combination of these three.

Caveat: The Forecast Reflects Cautious Optimism. As discussed in more detail later in this report, the continued growth in the economy (and related growth in City revenues) is not a sure thing. At 92 months, the nation is now in its third longest period of economic expansion in over 80 years. And it is quickly closing in on the other two: 106 months of sustained economic growth (almost nine years) from 1961 to 1969; and 120 months (ten years) from 1991 to 2001. In short, avoiding a downturn over the next five years would mean setting a new post-Great Depression record for economic expansion.

Accordingly, with prospects of a favorable fiscal outlook for operations, the City should strongly consider using available resources in funding CIP/Major Maintenance Projects and/or addressing its unfunded pension and retiree health liabilities before expanding operating programs.

- Allocating funds for one-time CIP/major maintenance projects has the advantage of addressing infrastructure and facility needs, while positioning the City for the next downturn. Stated simply, it is much easier to reduce projects than it is to cut operating programs and staff.

- In the case of unfunded pension and retiree health liabilities, using funds for this purpose will reduce future year costs and reflects an implied 7.0% return on funds compared with current yields of 0.75% in the Local Agency Investment Fund (LAIF).

Key Forecast Drivers

Assumptions drive the forecast results, which are detailed in the *Assumptions* section (Chapter 2). Stated simply, if the assumptions change, the results will change. There are seven key drivers underlying the forecast results:

- General economic trends and outlook
- State budget situation
- Current financial condition
- Key revenues
- Operating cost drivers, including the Sheriff contract and CalPERS costs.
- Population growth and development
- Capital improvement plan and major maintenance projects

➊ INTRODUCTION

➊ *General Economic Trends and Outlook*

Where we are today. We have seen consistent growth nationally and in the State for more than seven years.

- National unemployment is 4.5%, down from its peak of 10.0%.
- California unemployment is 5.0%, down from its peak of 12.2%.
- The stock market has rebounded strongly: the Dow Jones Industrial Average has increased from a low in March 2009 of 6,500 to historic highs of about 21,000; and at over 2,300, the S&P 500 is also at historically high levels.
- Corporate earnings are up, with record highs nationally.
- The banking system is healthier.
- Interest rates continue to be low by historic standards (although access to credit is tougher).
- Housing prices have recovered (although this has resulted in affordability challenges).

Where we're headed. While there is uncertainty, many economists do not see significant economic storm clouds on horizon for the nation or the State.

- The Legislative Analyst's Office (LAO) – one of the most credible sources on State economic and fiscal issues – assumes modest growth nationally and strong economic performance in the State through 2018.
- Beacon Economics – also highly regarded for its State and regional economic forecasts – sees State unemployment staying below 5.5% though 2018, with continuing (albeit modest) growth in employment, personal income and taxable retail sales.

However, at 92 months, we are now in the third longest period of economic expansion in over 80 years; and closing in on the other two.

Stated simply, we're due for a downturn. Based on long-term trends, there is a reasonable likelihood that we will experience some level of economic downturn over the next five years. Avoiding this would mean setting a new post-Great Depression record for economic expansion.

What this means for the City. Property tax, sales tax and transient occupancy tax (TOT) revenues account for over 80% of General Fund revenues. These are driven by the performance of the local economy. This in turn is driven by the interrelated performance of the regional, state and national economies. While no significant economic downturns that will impact key General Fund revenues are projected in the forecast, this is not a sure thing.

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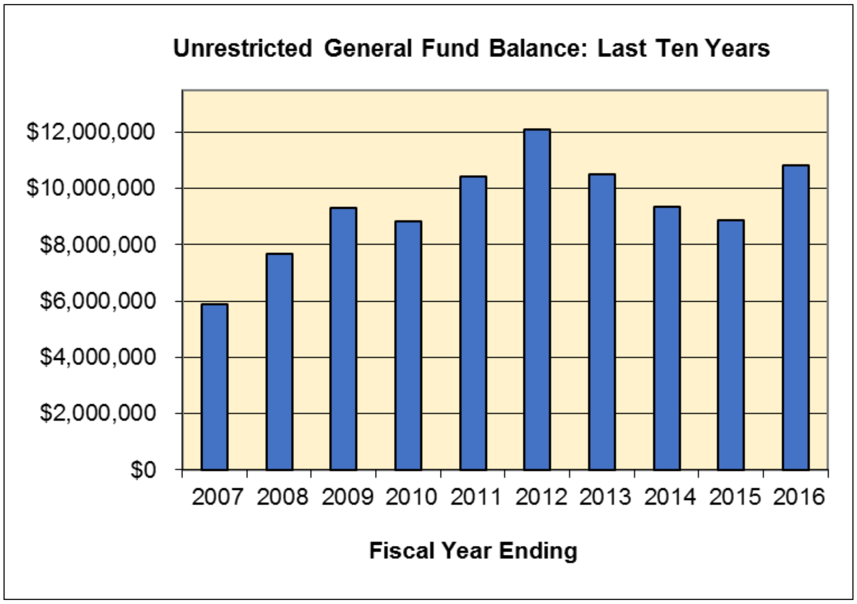
❷ *Current Strong Financial Condition*

The following chart shows the City's General Fund balance for the past ten years. As shown in this chart, the City has very strong reserves: 102% of expenditures at the end of 2015-16, after setting aside $3.2 million for RDA/successor agency wind-down and Fire Department obligations (and if these are included, the ratio rises to 144%). It also shows that reserves have remained relatively constant, which means that the City has been able to respond to tough fiscal times without relying on significant drawdowns on its reserves.



This was not the case for many cities in California. In short, while the City has not been immune from adverse economic forces resulting from the Great Recession and State takeaways, it has been more successful than many other communities in California in weathering these fiscal storms.

June 30, 2016 Ending General Fund Balance. As shown below, the City ended 2015-16 with a General Fund balance of $10.9 million, of which $7.6 million is available after setting aside funds for RDA/successor agency wind-down and Fire Department obligations. This will serve the General Fund well in meeting the challenges ahead.

General Fund Balance	Amount
Nonspendable	93,963
Unrestricted General Fund Balance	
Assigned	
RDA/Successor Agency Wind-Down	2,000,000
Fire Department Obigations	1,200,000
Unassigned	7,630,067
Total Unrestricted Fund Balance, June 30, 2016	**10,830,067**
Total Fund Balance, June 30, 2016	$10,924,030

2015-16 Audited Fund Balance

❸ *State Budget Outlook*

Over the past twenty-five years, the greatest fiscal threat to cities in California has not been economic downturns, dot.com meltdowns or corporate scandals, but rather, State takeaways. These included 20% reductions in property tax revenues in transferring revenues to schools via the Education Revenue Augmentation Fund (which in turn allowed the State to reduce its funding to schools by a commensurate amount), property tax administration fees, unfunded State mandates and most recently, dissolution of redevelopment agencies. These takeaways were on top of the fiscal challenges facing cities in light of their own revenue declines and cost pressures.

Fortunately, due to an improving economy combined with tax increases, constrained spending and more prudent fiscal policies (including required contributions to reserves), the State is in its best financial condition in many years. Accordingly, there are no further takeaways on the horizon – but neither are there any suggested restorations of past takeaways.

That said, while there are added constitutional protections in place since the last State raids on local finances, five years is a long time for the State to leave cities alone.

❹ *Key Revenues*

Based on trends for the past ten years (detailed in Chapter 4), it is clear the City has successfully navigated its way through the Great Recession. The forecast generally assumes modest growth in the City's top three revenues – property tax, property tax/VLF swap and sales tax – with continued strength in transient occupancy taxes. Together, these four sources account for over 80% of General Fund revenues.

❺ *Operating Costs*

There are four key operating cost assumptions reflected in the forecast, which are described in greater detail on in the *Assumptions* section (Chapter 2).

- **Operating cost "baseline."** The 2016-17 Budget, with revised estimates as presented at the Mid-Year Budget Review, is the "baseline" for the forecast. From this, operating costs are projected to increase by inflation (projected at 2% annually), excluding retirement and Sheriff contract costs.

- **CalPERS retirement costs**. Significant increases in retirement costs are assumed based on projections provided by CalPERS.

- **Sheriff contract costs.** These the General Fund's largest operating cost area and account for 40% of General Fund expenditures. As shown in the *Key Trends* section (Chapter 4), these costs have increased by 4.6% annually over the last five years; and by 5.5% over the past two years. Based on these trends, Sheriff contract costs are projected to increase by 5% annually in the forecast.

- **Project Phoenix operating costs.** The multi-purpose facility added by this project will have general fund operational costs associated with it including janitorial, maintenance, utilities and staffing. These costs are estimated at $100,000 in 2019-20, increasing by 2% annually thereafter.

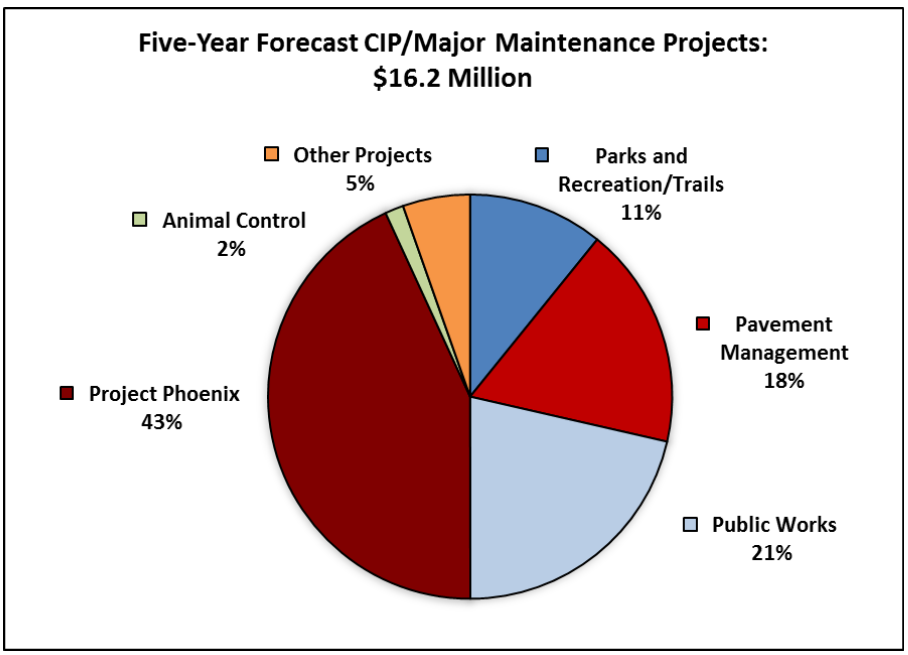
❻ *Population Growth and Development*

The City's population of about 26,000 has remained virtually unchanged over the past ten years; and there are no major residential or commercial projects on the horizon that are likely to be completed in the next five years. Accordingly, no new revenues or costs from new development are projected in the forecast.

❼ *Capital Improvements and Major Maintenance Projects*

Five-Year CIP/Major Maintenance Projects. For the purpose of assumptions in preparing the forecast, City staff has drafted an assessment of CIP/major maintenance project needs that will likely required General Fund resources to achieve over the next five years.

The resulting CIP/Major Maintenance Projects is presented the *Assumptions* section (Chapter 4). It totals $16.2 million over the next five years, about $3.2 million on an annual basis, summarized as follows by program:



Forecast Gap vs Budget Deficit

In those years where expenditures are greater than revenues, this forecast does not project a "budget deficit." Stated simply, a projected "forecast gap" is not the same as a "budget deficit." The City will have a budget deficit only if it does nothing to take corrective action. One of the key purposes of the Forecast is to create a roadmap in setting the City's course for journey ahead. By making tough but prudent choices – as it has in the past – in closing any potential future gaps, the City will avoid incurring real deficits.

❶ INTRODUCTION

FORECAST FRAMEWORK

Background

There are two basic approaches that can be used in preparing and presenting forecasts: developing the forecast based on one set of assumptions about what is believed to be the most likely outcome; or preparing various “scenarios” based on a combination of possible assumptions for revenues and expenditures. This forecast uses the “one set of assumptions” approach as being the most useful for policy-making purposes. However, it presents two “what ifs:”

- Operating Costs
- Operating Costs with CIP/Major Maintenance Projects. The assumptions in this case are the same as the “Operating Costs” forecast with the addition of CIP/Major Maintenance Projects.

That said, the financial model used in preparing this forecast can easily accommodate a broad range of other “what if” scenarios.

Demographic, Economic and Financial Trends

The past doesn’t determine the future. However, if the future won’t look like the past, we need to ask ourselves: why not? How will the future be different than the past, and how will that affect the City’s fiscal outlook? Accordingly, one of the first steps in preparing the forecast is to take a detailed look at key demographic, economic and fiscal trends over the past ten years.

A summary of key indicators is provided in the *Key Trends* section (Chapter 4), beginning on page 22. Areas of focus include:

- ***Demographic and Economic Trends.*** Economic, population, housing and inflation trends as measured by changes in the consumer price index (CPI).

- ***Revenues Trends.*** Focused on the City’s top five General Fund revenues – property taxes, property tax/VLF swap, sales tax, TOT and franchise fees – which together account for about 90% of total General Fund revenues.

- ***Expenditure Trends.*** Overall trends in key expenditure areas, including sheriff contract costs, insurance, pensions, retiree health care and full-time equivalent staffing.

Forecast Assumptions

As noted above, assumptions drive the forecast results. Sources used in developing forecast projections include:

- Long and short-term trends in key City revenues and expenditures.
- Economic trends as reported in the national media.
- Statewide and regional economic forecasts prepared by the University of California, Los Angeles, California Economic Forecast and Beacon Economics.
- Economic and fiscal information developed by the State Legislative Analyst (LAO), State Department of Finance and State Controller.
- Fiscal and legislative analysis by the League of California Cities.
- Five-year employer contribution rate projections prepared by CalPERS.

Ultimately, working closely with City staff, the forecast projections reflect our best judgment about performance of the local economy during the next five years, and how these will affect General Fund revenues and expenditures. A detailed discussion of the assumptions used in the forecast and the resulting projections are provided in the *Assumptions* section beginning on page 14. The supporting detail for the forecast is provided in Chapter 3, beginning on page 18.

What's Not in the Forecast

Grant Revenues. For operations, the forecast does not reflect the receipt of any "competitive" grant revenues over the next five years. However, based on past experience, it is likely that the City will be successful in obtaining grants for operating purposes. However, these are typically for restricted purposes that meet the priorities of the granting agency, which are not necessarily the same as the City's. Moreover, experience shows given federal and state budget challenges, the amount of available grant funding is more likely to decline over the next five years than increase.

Operating and CIP/Major Maintenance Needs Not Funded in the 2016-17 Budget. It is likely that there are City needs that are not reflected in the "baseline" 2016-17 Budget or in the assumptions for CIP/Major Maintenance Projects.

Transportation Funding Package Currently Under Consideration. It appears that the Governor and Legislature leadership have agreed on new transportation funding with substantial increases for state highways, public transportation and local streets and roads ("Road Repair and Accountability Act of 2017"). Based on analysis by the League of California Cities, this could result in added City revenues for street purposes of $150,000 in 2017-18 (partial year) and $449,000 annually thereafter if the package is approved as currently proposed.

What's Most Likely to Change?

By necessity, the forecast is based on a number of assumptions. The following summarizes key areas where changes from forecast assumptions are most likely over the next five years:

Top Revenue Projections. These are directly tied to the performance of the local economy, which in turn is driven by the interrelated performance of the regional, state and national economies. As noted above, no significant economic downturns that will impact key General Fund revenues are projected in the forecast. However, it bears repeating that this is not a sure thing.

Revenue Projections from New Development. While none are reflected in the forecast, it is possible that new revenue-producing projects (with minimal service needs and related costs) may surface. If that's the case, then revenues – at least in the forecast out-years – may be better than the forecast.

Insurance Costs. Consistent with the assumption of using the 2016-17 Budget as the "baseline," the forecast assumes that general liability and workers' compensation insurance costs will grow by inflation (2% annually). However, in the past this has been a volatile cost area for many cities in California (and the City's experience has shown the potential for wide swings as well). While loss experience plays a role, higher costs can also be incurred resulting from volatility in the financial markets. This can often have a far greater impact on insurance costs than actuarial loss experience.

Retirement Costs. The forecast uses CalPERS' rate projections for the next five years. While this is a reasonable assumption, experience has shown the potential for even steeper increases in employer contribution costs from CalPERS estimates.

THE PATH FORWARD

As discussed above, the City is in relatively good fiscal shape in funding operating costs – which has been the focus of past City budgets.

However, the forecast also shows an annual average "gap" of about $3.4 million when CIP/Major Maintenance Projects are included.

There are several options available in closing the modest operating gap and funding CIP/Major Maintenance Projects (in full or part) that would result in a balanced budget:

- Using reserves for one-time purposes.
- Debt financing.
- New revenues (which will likely require voter approval).
- Combination of these three.

Using Reserves for One-Time Purposes. The forecast shows that without CIP/Major Maintenance Projects, available General Fund balance will stay about the same as it today at the end of the five-year forecast: about $7.3 million.

On one hand, prudent reserves are necessary in meeting cash flow needs and responding to natural and human-made disasters, adverse fiscal circumstances and unforeseen expenditure needs. On the other hand, cities do not exist to accumulate reserves: their purpose is help make their communities good places to live, work and play. As such, it is appropriate, under the right circumstances, to use reserves – which are a one-time funding source – for one-time purposes. Accordingly, it may be appropriate to use some of the City's reserves in funding needed facility and infrastructure costs.

It may also make sense to use reserves in reducing unfunded retiree health care and pension liabilities, and thus reduce future year costs. (The City took this approach in 2014-15 when it made a pension prefunding payment of $1.0 million to CalPERS. This will result in a reduction in the City's unfunded accrued liability payment of $107,000 in 2017-18 (from $240,000 to $133,000): this is comparable to an 11% return on the City's investment.

However, before any significant use, the City should adopt a clearly articulated reserve policy that ensures a solid, policy-based foundation for decision-making. The policy should address three critical issues:

- Given the fiscal risks that the City is trying to mitigate with reserves, what's the right amount?
- When is it appropriate to use reserves below target policy levels? (Reserves are often referred to as "rainy day" funds, so it would make sense to use them when it rains – unexpectedly. There's a certain amount of "normal" rain that is likely to fall every year. This "normal" rain shouldn't be funded via reserves but through the operating Budget.)
- What's the strategy for restoring reserves to policy levels when they have been used?

Putting this framework in place ahead of time will make tough decision-making about using reserves easier.

Debt Financing. Completion of Project Phoenix is estimated to cost $7 million in 2019-20 ($8 million is available from previous RDA bond sales but the current estimate for total project costs is $15 million). While there may be others, this is a reasonable candidate for debt financing: it is a "lumpy" cost in the CIP; will serve the City for many years; and will result in very low debt service costs relative to General Fund revenues. For example, if financed for 30 years with an estimated interest rate of 3.75%, annual debt service payments would be about $390,000. This represents about 4% of estimated 2019-20 General Fund revenues (and the City currently has no General Fund debt obligations). This reflects a modest debt service ratio. For example, rating agencies typically become concerned when the debt ratio exceeds 10%.

New Revenues. As discussed in the *New Revenue Options* section (Chapter 5 beginning on page 37), there are a wide variety of new revenue sources available to the City. These include:

- Local option sales tax
- TOT
- Utility users tax
- Business license tax
- Parcel tax
- Higher user fee cost recovery

However, with few exceptions, they all require voter approval:

- Majority voter approval if for general purposes.
- Two-thirds voter approval if for special purposes or a parcel tax.

While discussed in greater detail in the *New Revenue Options* section, the most likely new revenue source that will help meet the City's CIP/Major Maintenance Projects goals is a local option sales tax of ½-percent, which will generate about $550,000 annually.

If this (or any other new revenue source) is proposed as a general-purpose tax, the soonest that a revenue measure could be placed before voters is November 2018, in conjunction with Council elections as required by the State Constitution. (Ballot measure elections for special purposes, or general purposes with unanimous Council declaration of a fiscal emergency, can be held at any time).

As discussed in Chapter 5, preparation for successful revenue ballot measure typically takes 12 to 18 months, so November 2018 is not that far away.

Combination of Options. Rather than relying on only one option, the City could use a combination of them.

CONCLUSION

Favorable Outlook in Funding Operating Costs. The General Fund is in relatively good shape in funding operating costs: for the first two years, there is a positive variance between revenues and expenditures. That said, a modest gap begins to grow between revenues and operating costs in the last three years.

Challenges Ahead in Funding CIP/Major Maintenance Projects. The forecast shows an annual average "gap" of about $3.4 million when CIP/Major Maintenance Projects are included.

The Path Ahead. This report identifies three basic options for closing the modest out-year operating gap and funding CIP/Major Maintenance Projects. Two of these – using reserves and debt financing – can be approved by the Council. However, any new revenue sources (except for higher user fee cost recovery and an increase in solid waste franchise fees) will require voter approval.

❷ ASSUMPTIONS

DEMOGRAPHIC TRENDS

Population. Based on recent trends, no change in population (either up or down) is projected to materially affect revenues or expenditures over the next five years.

Inflation. Based on long-term trends and projections in recent statewide and regional forecasts, inflation – as measured by the consumer price index (CPI) – grows by 2% annually throughout the forecast period.

ECONOMIC OUTLOOK

At 92 months, the nation is now in its third longest period of economic expansion in over 80 years. And it is quickly closing in on the other two: 106 months of sustained economic growth (almost nine years) from 1961 to 1969; and 120 months (ten years) from 1991 to 2001. In short, avoiding a downturn over the next five years would mean setting new post-Great Depression record for economic expansion. Nonetheless, many economists do not see significant economic storm clouds on horizon for the nation or the State. Accordingly, no significant economic downturns that will impact key General Fund revenues are projected in the forecast. However, this is far from a sure thing.

EXPENDITURES

Operating Costs. The adopted 2016-17 Budget is the "baseline" for the forecast operating expenditures, with modest estimate revisions as presented at the Mid-Year Budget Review. From this, operating costs are projected to increase by inflation (projected at 2% annually), with the notable exception of retirement, Sheriff contract costs and Project Phoenix operating costs starting in 2019-20.

CalPERS. Based on projections provided by the California Public Employees Retirement System (CalPERS), these costs are projected to rise significantly. Accordingly, detailed cost projections based on factors provided by CalPERS have been separately calculated.

The underlying factors driving the increases are described in the *Key Trends* section of this report beginning on page 31. Based on these factors, the detail calculations for projecting retirement costs are provided in Chapter 3 on page 20.

Sheriff Contract Costs. As discussed in the *Key Trends* section, increases in Sheriff contract costs have increased annually by 5.5% over the past two years; and by 4.6% annually over the past five years. Based on this, the forecast assumes a 5% annual increase in Sheriff contract costs.

Project Phoenix Operating Costs. The multi-purpose facility added by this project will have general fund operational costs associated with it including janitorial, maintenance, utilities and staffing. These costs are estimated at $100,000 in 2019-20, increasing by 2% annually thereafter.

Other Operating Costs. The forecast assumption of 2% for operating cost increases (aside from Sheriff and retirement costs) is lower than past trends. This is based on the following factors:

- In preparing and reviewing expenditure trends, special attention was separately focused on key "external" drivers like insurance, CalPERS retirement, retiree health care and Sheriff contract costs.

- Based on past trends for general liability and workers' compensation insurance costs (page 31), these expenditures appeared to have stabilized and are not expected to exceed the CPI assumption.

- As discussed in the *Trends* section (beginning on page 35), until the recent downward revision in the discount rate (investment yield) assumption from 7.06% to 4%, the City was fully funding this obligation on actuarial basis. Even with this revision, the City is setting aside funding annually that is more than its "pay-as-you-go" obligation. There may be opportunities to use reserves in reducing the unfunded liability (and thus reducing the actuarial "annual required contribution"). However, based on the City's current funding approach, this cost is projected to increase by CPI.

- In the case of retirement costs, as noted above, these were prepared separately based on rate and cost information provided by CalPERS.

- And separate assumptions have been made for Sheriff contract costs.

- After accounting for these key drivers, the remaining costs are largely within the control of the City. Staffing costs account for about 30% of operating expenditures. Setting aside the four costs that are accounted for separately, staffing costs rise (or fall) based on one of two factors: authorized staffing levels and compensation. Both are within the control of the City. Since this report is a forecast and not the Budget, CPI is a reasonable basis for projecting these other costs.

Accordingly, given the underlying assumptions of current service levels (and thus staffing), the forecast projects that core operating costs will increase from the 2016-17 baseline by projected increases in the CPI.

Capital Improvement Plan (CIP)/Major Maintenance Projects. Expenditures are based on cost, funding and phasing assessments prepared by City staff. These are presented in this Chapter on page 17.

INTERFUND TRANSFERS

Transfers in and out are based on the 2016-17 Budget and increase annually based on changes in the CPI (2% per year).

STATE BUDGET ACTIONS

The forecast assumes no added cuts nor restoration of past cuts to cities.

REVENUES

Sources used in developing revenue projections for the forecast include:

- Long and short-term trends in key City revenues and expenditures.
- Economic trends as reported in the national media.
- State and regional economic forecasts prepared by the University of California, Los Angeles; California Economic Forecast; and Beacon Economics.
- Economic and fiscal information developed by the State Legislative Analyst (LAO), State Department of Finance and State Controller.
- Fiscal and legislative analysis by the League of California Cities.

Ultimately, however, in close consultation with City staff, the forecast projections reflect our best judgment about the performance of the local economy during the next five years and how these will affect General Fund revenues.

Top Five Revenues

The following describes the assumptions for the "Top Five" revenues in the forecast, which account for about 90% of total projected General Fund revenues (excluding transfers).

Property Tax and Property Tax/VLF Swap. These two revenue sources are driven by changes in assessed value. Under Proposition 13, annual increases of 2% are allowed, as well as increases to market value when property changes ownership or is improved. The forecast takes a conservative approach in forecasting increases of 2% annually.

Sales Tax. The forecast assumes modest growth in sales tax revenues base on inflation of 2.0% annually.

Transient Occupancy Tax. Transient occupancy taxes (TOT), which are based on hotels and other short-term occupancies, increased significantly in 2014-15 and 2015-16, growing by 16% over this two-year period. Given the improving economy and Twentynine Palms' close proximity to Joshua Tree National Park, this trend is projected to continue, with some leveling off in the out-years:

2016-17	7.75%
2017-18	7.70%
2018-19	6.00%
2019-20	6.00%
2020-21	5.00%
2021-22	5.00%

Franchise Fees. The forecast assumes modest growth in franchise fees based on inflation of 2.0% annually

Other Revenues

These are projected to remain flat or grow modestly by inflation (2%) during the forecast period.

Five-Year Capital Improvement Plan/Major Maintenance Projects

Summary	2017-18	2018-19	2019-20	2020-21	2021-22
Parks and Recreation/Trails	130,000	722,000	480,000	125,000	300,000
Pavement Management	575,800	575,800	575,800	575,800	575,800
Public Works	-	202,500	1,090,000	1,060,000	1,120,000
Project Phoenix	-	-	7,000,000	-	-
Animal Control	100,000	140,000	-	-	-
Other Projects	298,500	144,000	144,000	144,000	144,000
Total	$1,104,300	$1,784,300	$9,289,800	$1,904,800	$2,139,800
Parks and Recreation					
Rubber Playground Surface Luckie		TBD			
Sun Shade		15,000			
Knotts Sky Park Improvements		450,000	335,000	TBD	300,000
Luckie Park Improvements	100,000	12,000	100,000	125,000	
Facilities	30,000	25,000			
Vehicle/Equipment		170,000	45,000		
Total	130,000	672,000	480,000	125,000	300,000
Trails					
Safe Route to School Master Plan		50,000			
Two Mile, Mesquite to Enclia		TBD			
Sunnyslope, Mesquite to Enclia		TBD			
Baselie, Utah Trail to Bedouin		TBD			
Total	-	50,000	-	-	-
Project Phoenix					
Project Phoenix			7,000,000		
Public Works					
Vehicle/Equipment		200,000	90,000	60,000	120,000
State Route 62 Improvements			1,000,000	1,000,000	1,000,000
Public Works Front Office		2,500			
Total	-	202,500	1,090,000	1,060,000	1,120,000
Pavement Management					
Pavement Management *	575,800	575,800	575,800	575,800	575,800
Animal Control					
Business Sign		15,000			
Shelter Reno		60,000			
Quarantine Building	100,000				
Shelter Awnings			TBD		
Vehicle		65,000			
Total	100,000	140,000	-	-	-
Other Projects					
Well Repair	15,000	15,000	15,000	15,000	15,000
Hardware and Software	15,000				
Contract SVC/Studies	176,500				
HVAC Repair	24,000	8,000	8,000	8,000	8,000
Vehicle Replacement	68,000	121,000	121,000	121,000	121,000
Total	298,500	144,000	144,000	144,000	144,000

** Net of $465,000 in funding annually from Measure I.*

Operating Costs

3. GENERAL FUND FIVE YEAR FISCAL FORECAST: 2017-2022

	2014-15	2015-16	2016-17		FORECAST				
	Actual	Actual	Budget	Revised	2017-18	2018-19	2019-20	2020-21	2021-22
REVENUES									
Taxes and Franchise Fees									
Property Tax	$2,046,200	$2,057,900	$2,135,400	$2,099,100	$2,141,100	$2,183,900	$2,227,600	$2,272,200	$2,317,600
Property Tax: VLF Swap	2,759,900	2,817,500	2,818,800	2,873,900	2,875,200	2,931,400	2,932,700	2,990,000	2,991,400
Sales Tax	1,125,200	1,106,500	1,151,000	1,128,600	1,151,200	1,174,200	1,197,700	1,221,700	1,246,100
Transient Occupancy Tax	878,200	943,700	884,800	1,016,800	1,095,600	1,172,300	1,242,600	1,317,200	1,383,100
Franchise Fees	622,500	615,800	535,000	628,100	640,700	653,500	666,600	679,900	693,500
Other Taxes	26,000	33,900	26,700	34,600	35,300	36,000	36,700	37,400	38,100
From Other Governments	100,000	126,400	128,000	128,000	128,000	128,000	128,000	128,000	128,000
Permits, Licenses and Service Charges	496,500	557,000	455,000	526,800	537,300	548,000	559,000	570,200	581,600
Investment Earnings	22,900	24,800	29,500	29,500	29,500	29,500	29,500	29,500	29,500
Other Revenues	148,600	137,900	100,800	100,800	100,800	100,800	100,800	100,800	100,800
Total Revenues	**8,226,000**	**8,421,400**	**8,265,000**	**8,566,200**	**8,734,700**	**8,957,600**	**9,121,200**	**9,346,900**	**9,509,700**
EXPENDITURES									
Operating Programs	7,565,900	7,584,200	8,299,100	8,442,000	8,625,200	8,947,500	9,384,900	9,754,900	10,107,500
Prepay CalPERS Unfunded Liability	1,000,000	-	.	-	-	-	-	-	-
Total Expenditures	**8,565,900**	**7,584,200**	**8,299,100**	**8,442,000**	**8,625,200**	**8,947,500**	**9,384,900**	**9,754,900**	**10,107,500**
CIP/Major Maintenance Projects									
OTHER SOURCES (USES)									
Transfers In	24,000	-	260,000	260,000	265,200	270,500	275,900	281,400	287,000
Transfers Out	(40,600)	(728,700)	(167,000)	(167,000)	(170,300)	(173,700)	(177,200)	(180,700)	(184,300)
Other Sources (Uses)	900	-	-	-	-	-	-	-	-
Total Other Sources (Uses)	**(15,700)**	**(728,700)**	**93,000**	**93,000**	**94,900**	**96,800**	**98,700**	**100,700**	**102,700**
Sources Over (Under) Uses	**(355,600)**	**108,500**	**58,900**	**217,200**	**204,400**	**106,900**	**(165,000)**	**(307,300)**	**(495,100)**
FUND BALANCE, BEGINNING OF YEAR	11,171,100	10,815,500	8,428,500	10,924,000	11,141,200	11,345,600	11,452,500	11,287,500	10,980,200
FUND BALANCE, END OF YEAR	**10,815,500**	**10,924,000**	**8,487,400**	**11,141,200**	**11,345,600**	**11,452,500**	**11,287,500**	**10,980,200**	**10,485,100**

GENERAL FUND BALANCE, END OF YEAR									
Assigned									
Redevelopment/Successor Agency Wind Down	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Fire Department	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Unassigned	7,615,500	7,724,000	5,287,400	7,941,200	8,145,600	8,252,500	8,087,500	7,780,200	7,285,100
Total	**10,815,500**	**10,924,000**	**8,487,400**	**11,141,200**	**11,345,600**	**11,452,500**	**11,287,500**	**10,980,200**	**10,485,100**

Operating Costs with CIP/Major Maintenance Projects

3. GENERAL FUND FIVE YEAR FISCAL FORECAST: 2017-2022

	2014-15	2015-16	2016-17		FORECAST				
	Actual	Actual	Budget	Revised	2017-18	2018-19	2019-20	2020-21	2021-22
REVENUES									
Taxes and Franchise Fees									
Property Tax	$2,046,200	$2,057,900	$2,135,400	$2,099,100	$2,141,100	$2,183,900	$2,227,600	$2,272,200	$2,317,600
Property Tax: VLF Swap	2,759,900	2,817,500	2,818,800	2,873,900	2,875,200	2,931,400	2,932,700	2,990,000	2,991,400
Sales Tax	1,125,200	1,106,500	1,151,000	1,128,600	1,151,200	1,174,200	1,197,700	1,221,700	1,246,100
Transient Occupancy Tax	878,200	943,700	884,800	1,016,800	1,095,600	1,172,300	1,242,600	1,317,200	1,383,100
Franchise Fees	622,500	615,800	535,000	628,100	640,700	653,500	666,600	679,900	693,500
Other Taxes	26,000	33,900	26,700	34,600	35,300	36,000	36,700	37,400	38,100
From Other Governments	100,000	126,400	128,000	128,000	128,000	128,000	128,000	128,000	128,000
Permits, Licenses and Service Charges	496,500	557,000	455,000	526,800	537,300	548,000	559,000	570,200	581,600
Investment Earnings	22,900	24,800	29,500	29,500	29,500	29,500	29,500	29,500	29,500
Other Revenues	148,600	137,900	100,800	100,800	100,800	100,800	100,800	100,800	100,800
Total Revenues	**8,226,000**	**8,421,400**	**8,265,000**	**8,566,200**	**8,734,700**	**8,957,600**	**9,121,200**	**9,346,900**	**9,509,700**
EXPENDITURES									
Operating Programs	7,565,900	7,584,200	8,299,100	8,442,000	8,625,200	8,947,500	9,384,900	9,754,900	10,107,500
Prepay CalPERS Unfunded Liability	1,000,000	-	.	-	-	-	-	-	-
Total Expenditures	**8,565,900**	**7,584,200**	**8,299,100**	**8,442,000**	**8,625,200**	**8,947,500**	**9,384,900**	**9,754,900**	**10,107,500**
CIP/Major Maintenance Projects					1,104,300	1,784,300	9,289,800	1,904,800	2,139,800
OTHER SOURCES (USES)									
Transfers In	24,000	-	260,000	260,000	265,200	270,500	275,900	281,400	287,000
Transfers Out	(40,600)	(728,700)	(167,000)	(167,000)	(170,300)	(173,700)	(177,200)	(180,700)	(184,300)
Other Sources (Uses)	900	-	-	-	-	-	-	-	-
Total Other Sources (Uses)	**(15,700)**	**(728,700)**	**93,000**	**93,000**	**94,900**	**96,800**	**98,700**	**100,700**	**102,700**
Sources Over (Under) Uses	**(355,600)**	**108,500**	**58,900**	**217,200**	**(899,900)**	**(1,677,400)**	**(9,454,800)**	**(2,212,100)**	**(2,634,900)**
FUND BALANCE, BEGINNING OF YEAR	11,171,100	10,815,500	8,428,500	10,924,000	11,141,200	10,241,300	8,563,900	(890,900)	(3,103,000)
FUND BALANCE, END OF YEAR	**10,815,500**	**10,924,000**	**8,487,400**	**11,141,200**	**10,241,300**	**8,563,900**	**(890,900)**	**(3,103,000)**	**(5,737,900)**

GENERAL FUND BALANCE, END OF YEAR									
Assigned									
Redevelopment/Successor Agency Wind Down	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Fire Department	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Unassigned	7,615,500	7,724,000	5,287,400	7,941,200	7,041,300	5,363,900	(4,090,900)	(6,303,000)	(8,937,900)
Total	**10,815,500**	**10,924,000**	**8,487,400**	**11,141,200**	**10,241,300**	**8,563,900**	**(890,900)**	**(3,103,000)**	**(5,737,900)**

3. ASSUMPTIONS SUMMARY

		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Population		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Inflation		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
REVENUES & OTHER SOURCES							
Property Tax		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Transient Occupancy Tax		7.75%	7.00%	6.00%	6.00%	5.00%	5.00%
Sales Tax		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Franchise Fees		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Other Taxes		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
From Other Governments		Budget	Flat	Flat	Flat	Flat	Flat
Service Charges: Average of Prior 2 Year Actual as Base		526,800	2.00%	2.00%	2.00%	2.00%	2.00%
Other Revenues		Budget	Flat	Flat	Flat	Flat	Flat
Transfers In		Budget	2.00%	2.00%	2.00%	2.00%	2.00%
EXPENDITURES & OTHER USES							
Operating Expenditures							
CalPERS							
Payroll Base: Grows by Inflation	Classic Employees	1,620,400	1,652,800	1,685,900	1,719,600	1,754,000	1,789,100
General Fund accounts for	PEPRA Employees	83,600	85,300	87,000	88,700	90,500	92,300
about 80% of total staffing costs	Total Payroll Base	1,704,000	1,738,100	1,772,900	1,808,300	1,844,500	1,881,400
Normal Contribution Rate	Classic Employees	10.069%	10.110%	10.100%	10.100%	10.100%	10.100%
	PEPRA Employees	6.555%	6.533%	6.500%	6.500%	6.500%	6.500%
Adjusted for Assumption Changes	Classic Employees	10.069%	10.110%	10.850%	11.600%	13.100%	13.100%
	PEPRA Employees	6.555%	6.533%	7.250%	8.000%	9.500%	9.500%
Normal Contribution Costs	Classic Employees	163,200	167,100	182,900	199,500	229,800	234,400
	PEPRA Employees	5,500	5,600	6,300	7,100	8,600	8,800
	Total Normal Contribution Costs	168,700	172,700	189,200	206,600	238,400	243,200
Unfunded Accrued Liability (UAL) Costs	Classic Employees	192,300	107,100	134,200	162,800	184,100	207,200
80% of Classic and PEPRA UAL	PEPRA Employees	100	100	100	100	200	200
	Total UAL Costs	192,400	107,200	134,300	162,900	184,300	207,400
UAL Adjusted for Assumption Changes	Classic Employees	192,300	107,100	138,200	172,600	211,700	248,600
	PEPRA Employees	100	100	100	100	200	200
	Total Adjusted UAL Costs	192,400	107,200	138,300	172,700	211,900	248,800
	Total CalPERS Costs	361,100	279,900	327,500	379,300	450,300	492,000

3. ASSUMPTIONS SUMMARY

EXPENDITURES & OTHER USES		2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Sheriff Contract Costs: Increase Annually By	5.0%	3,423,300	3,594,500	3,774,200	3,962,900	4,161,000	4,369,100
Increased Operating Costs for Project Phoenix					100,000	102,000	104,000
All Other Costs: Increase by Inflation		4,657,600	4,750,800	4,845,800	4,942,700	5,041,600	5,142,400
Total Operating Expenditures		8,442,000	8,625,200	8,947,500	9,384,900	9,754,900	10,107,500
Capital Improvement Plan (CIP)/Major Maintenance Projects			1,104,300	1,784,300	9,289,800	1,904,800	2,139,800
Transfers Out		Budget	2.0%	2.0%	2.0%	2.0%	2.0%

❹ KEY TRENDS

DEMOGRAPHIC AND ECONOMIC TRENDS

General Economic Outlook

Where We've Been. The worst recession since the Great Depression officially began in December 2007 and ended in June 2009, which makes it the longest recession since World War II. Beyond its duration, the Great Recession was notably severe in several respects. Real gross domestic product (GDP) fell 4.3% from its peak in in the fourth quarter of 2007 to its trough in the second quarter of 2009, the largest decline in the postwar era.

The following highlights the key impacts of the Great Recession in the United States and California:

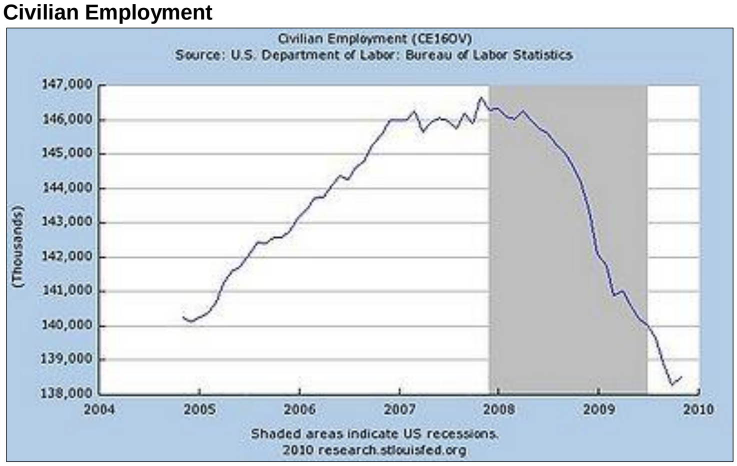
Employment

- The national civilian labor force plummeted: civilian employment dropped by 8.5 million jobs.
- The national unemployment rate doubled from 5.0%, where it was at or below this rate for 30 months before the start of the Great Recession, to 9.5% at its end (and peaking at 10.0% in October 2009).
- In California, the impact on unemployment was even worse. The unemployment rate increased from 5.0% at the start of the Great Recession and peaked at 12.2% in October 2010.

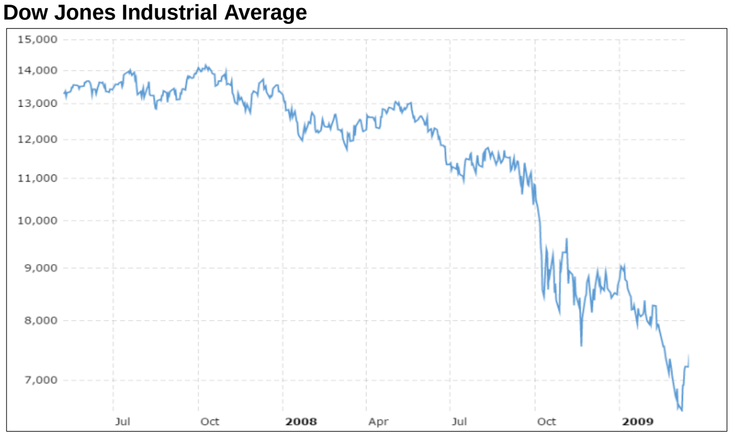
Stock Market

- The Dow Jones Industrial Average (DJIA) lost 46% of its value, falling from 14,100 in October 2007 to 6,500 in March 2009.
- The nation experienced its largest bank failure ever when Washington Mutual collapsed in September 2008.

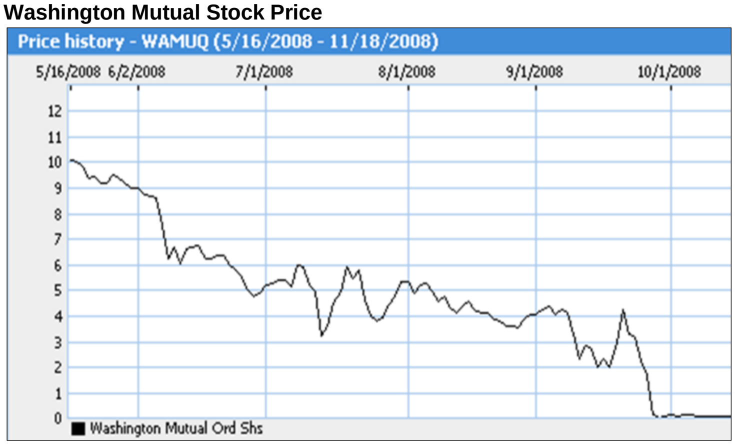
Civilian Employment



Dow Jones Industrial Average



Washington Mutual Stock Price



❹ KEY TRENDS

- The failure of Lehman Brothers in October 2008 was a major precursor to the subsequent meltdown in the nation's financial markets.

Lehman Brothers Stock Price

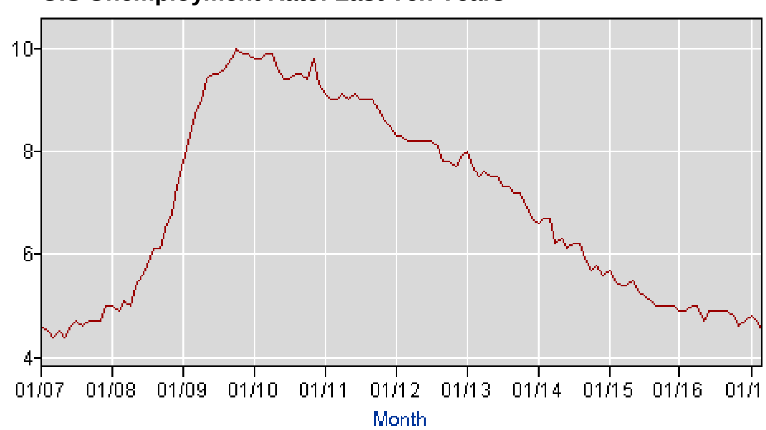
- The bankruptcy of AIG, the largest insurance company in the world, reflected financial markets spinning out of control as collateralized default swaps and other insured financial obligations failed.

AIG Stock Price

Where We Are Today. While the recovery has been tepid, the reality is that the national and state economies have been consistently growing for over seven years.

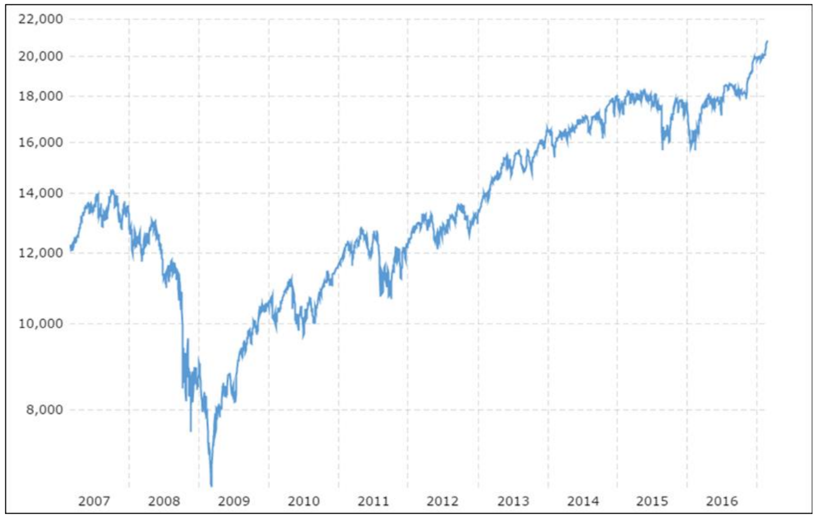
- Nationally, the unemployment rate is 4.5% compared with its peak of 10.0%.
- In California, the unemployment rate is 5.0%, down from its peak of 12.2%.
- The stock market has rebounded strongly, with the DJIA increasing from its low of 6,500 in March 2009 to historic highs of around 21,000 by April 2017.
- The banking system is healthier.
- Interest rates continue to be low by historic standards (although access to credit is tougher).
- And housing prices have recovered (although this has resulted in affordability challenges).

U.S Unemployment Rate: Last Ten Years



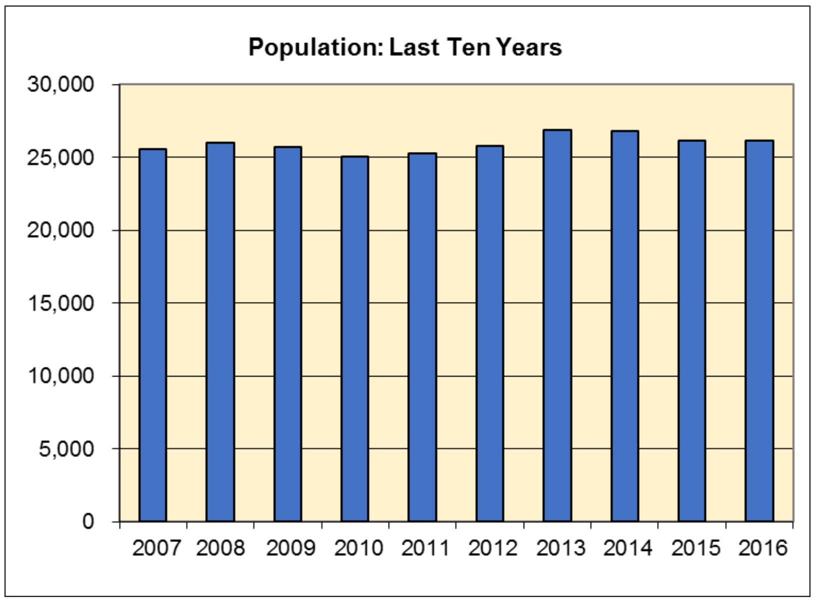
❹ KEY TRENDS

A good "snap shot" showing where we've been compared with where we are today is the DJIA over the last ten years: from deep declines to steady recovery.



Population, Inflation and Housing

Population		
January 1 of Each Year	Amount	% Change
2006	26,513	
2007	25,582	-3.5%
2008	25,996	1.6%
2009	25,745	-1.0%
2010	25,053	-2.7%
2011	25,287	0.9%
2012	25,823	2.1%
2013	26,924	4.3%
2014	26,849	-0.3%
2015	26,165	-2.5%
2016	26,138	-0.1%
Average Annual % Change		
Last 2 Years		-1.3%
Last 5 Years		0.7%
Last 10 Years		-0.1%



With minor ups and downs, the City's population has remained virtually unchanged for the past ten years.

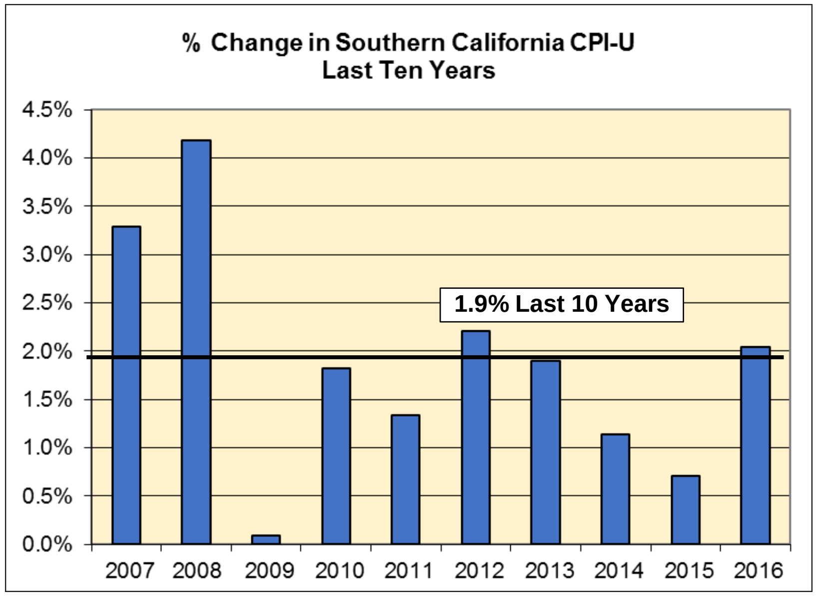
Source: State of California, Demographic Research Unit

❹ KEY TRENDS

Consumer Price Index: Southern California		
Fiscal Year Ending	Amount	% Change
2006	203.9	
2007	210.6	3.3%
2008	219.4	4.2%
2009	219.6	0.1%
2010	223.6	1.8%
2011	226.6	1.3%
2012	231.6	2.2%
2013	236.0	1.9%
2014	238.7	1.1%
2015	240.4	0.7%
2016	245.3	2.0%

Los Angeles-Riverside-Orange
All Urban Consumers, January 1 of Each Year

Average Annual % Change	
Last 2 Years	1.4%
Last 5 Years	1.6%
Last 10 Years	1.9%

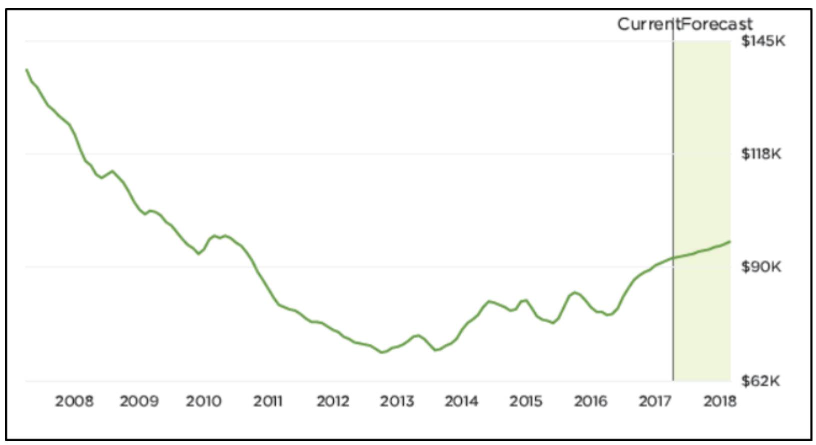


Consumer Price Index. Changes in the Consumer Price Index for All Urban Consumers (CPI-U) for the Southern California area increased by 2.0% in 2016; and by a similar amount over the past 10 years (1.9%).

Source: U.S. Bureau of Labor Statistics

Twentynine Palms Median Housing Prices. This chart shows the impact of the Great Recession, with a huge drop in median housing prices in Twentynine Palms from $139,000 in March 2007 to a low of $70,000 in September 2012 – a 50% decrease. However, while still below 2007 levels, recovery is underway, with median sales prices at $93,000 as of April 2017.

Source: Zillow.Com



❹ KEY TRENDS

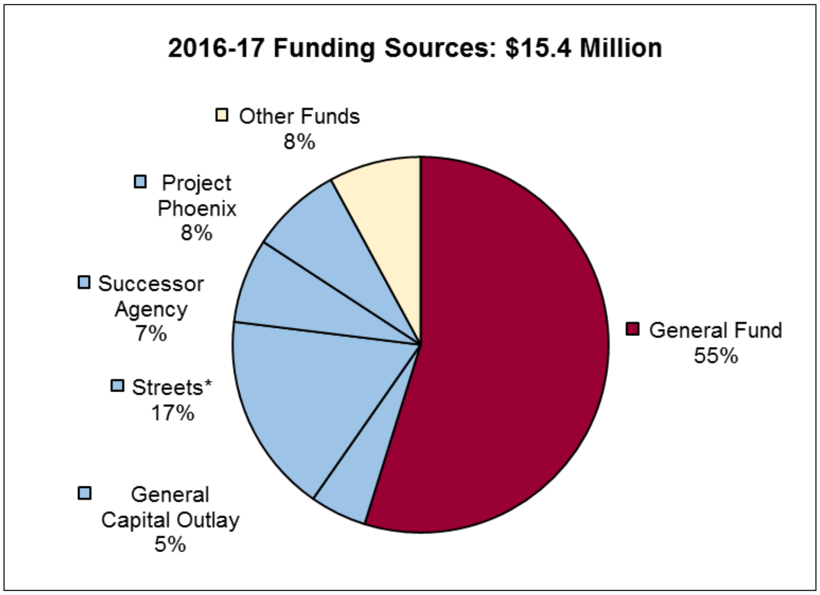
EXPENDITURE AND REVENUE SUMMARIES: 2016-17 BUDGET

Funding Sources: 2016-17 Budget		
Source	Amount	% Total
General Fund	8,466	55%
General Capital Outlay	753	5%
Streets*	2,665	17%
Successor Agency	1,123	7%
Project Phoenix	1,212	8%
Other Funds	1,224	8%
Total	**$15,443**	**100%**

In Thousands of Dollars

** Gas Tax, TDA, Major Local Highways, Measure I Funds*

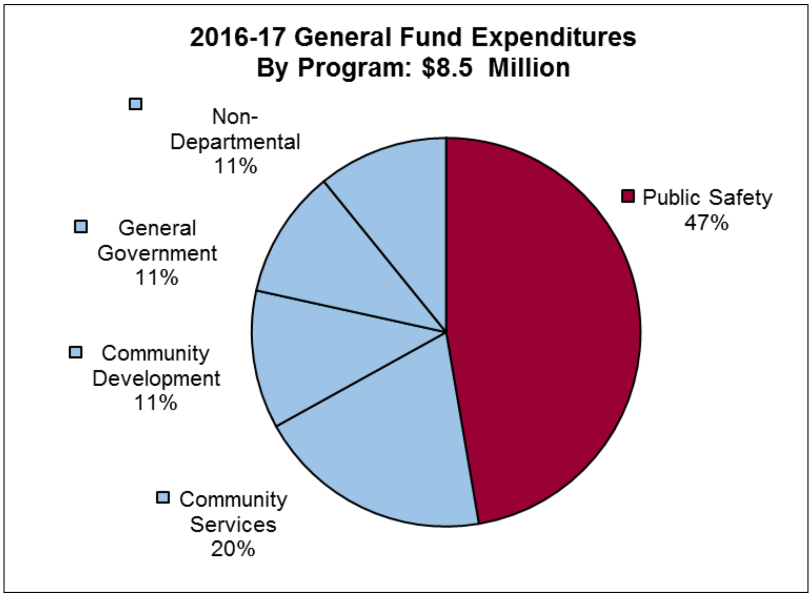
The General Fund – which is the focus of this forecast – accounts for over 50% of total City expenditures.



General Fund Expenditures & Uses: 2016-17		
Program	Amount	% Total
Public Safety	4,005	47%
Community Services	1,663	20%
Community Development	974	12%
General Government	907	11%
Non-Departmental	917	11%
Total	**$8,466**	**100%**

In Thousands of Dollars

The largest use of General Fund resources is public safety (Sheriff contract and animal control), which account for about half (47%) of total expenditures.

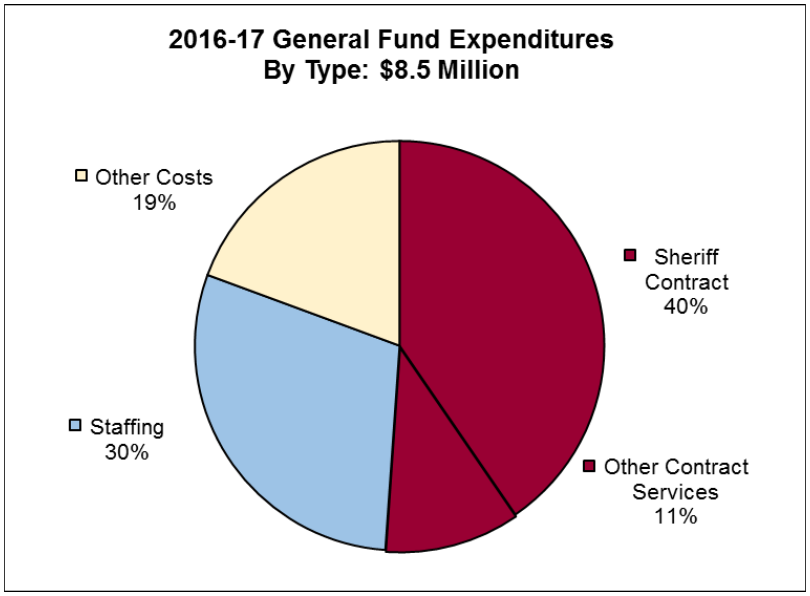


❹ KEY TRENDS

General Fund Expenditures & Uses: 2016-17		
Type	Amount	% Total
Sheriff Contract	3,423	40%
Other Contract Services	904	11%
Staffing	2,498	30%
Other Costs	1,641	19%
Total	**8,466**	**100%**

In Thousands of Dollars

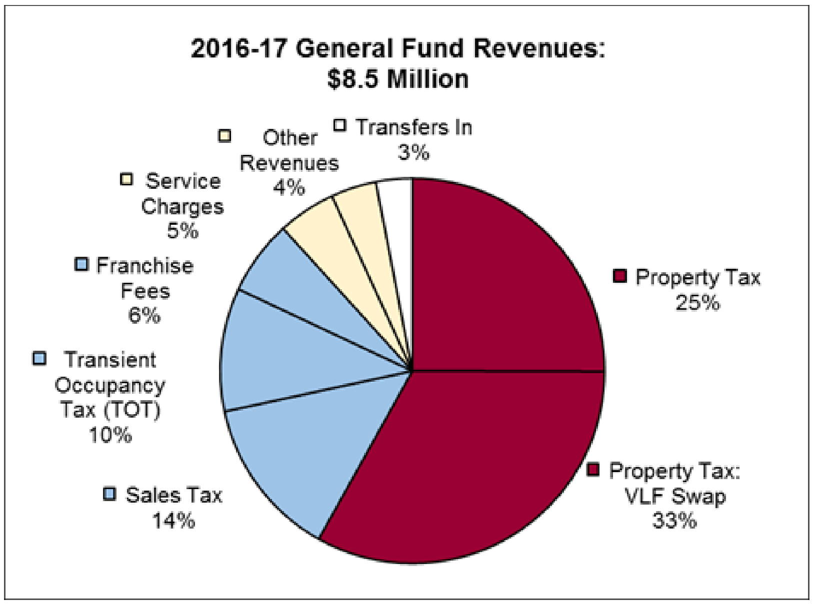
Contracts for Sheriff (35%) and other services (11%) account for slightly over 50% of General Fund uses. Staffing costs are the next highest cost, accounting for 30% of General Fund expenditures and uses.



General Fund Revenues & Sources: 2016-17		
Source	Amount	% Total
Property Tax	2,135	25%
Property Tax: VLF Swap	2,819	33%
Sales Tax	1,151	14%
Transient Occupancy Tax (TOT)	884	10%
Franchise Fees	535	6%
Service Charges	415	5%
Other Revenues	326	4%
Transfers In	260	3%
Total	**$8,525**	**100%**

In Thousands of Dollars

The "top five" revenue sources account for almost 90% of total General Fund sources. Assessed value-related revenues – property tax and property tax VLF swap – are the largest revenue source, accounting for almost 60% of total revenues and sources. These are followed by sales tax (14%), transient occupancy tax (10%) and franchise fees (6%).



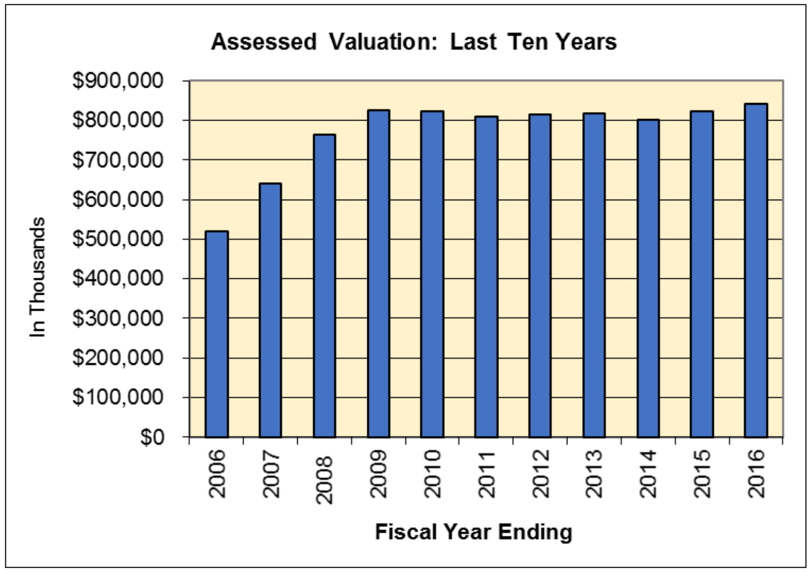
GENERAL FUND REVENUE TRENDS

The following tables and charts show long and short term trends in the General Fund for the "Top Five" revenue sources, which account for about 90% of total General Fund revenues and sources.

❹ KEY TRENDS

Assessed Valuation Trends		
Fiscal Year Ending	Amount	% Change
2006	$521,181	
2007	640,467	22.9%
2008	763,253	19.2%
2009	825,676	8.2%
2010	824,080	-0.2%
2011	808,742	-1.9%
2012	814,938	0.8%
2013	816,571	0.2%
2014	801,936	-1.8%
2015	823,448	2.7%
2016	841,518	2.2%
Average Annual % Change		
Last 2 Years		2.4%
Last 5 Years		0.8%
Last 10 Years		5.2%

In Thousands



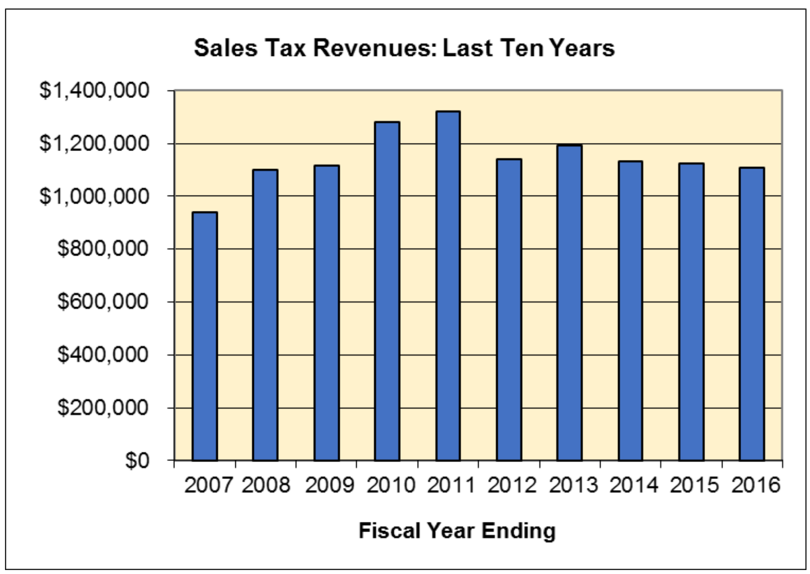
Property tax and Property tax/VLF Swap are the top two General Fund revenue sources, accounting for about 60% of total General Fund sources.

These are driven by changes in assessed value as determined by the San Bernardino County Assessor's office. (The apportionment of property taxes is determined by the State and subject to change; as such, assessed value is the underlying economic driver for property taxes.)

Unlike many other cities in California, which saw deep declines in assessed value during the Great Recession, this wasn't the case for Twentynine Palms: assessed value has remained stable since 2008-09.

Sales Tax Trends		
Fiscal Year Ending	Amount	% Change
2007	941,126	
2008	1,098,766	16.8%
2009	1,118,228	1.8%
2010	1,282,457	14.7%
2011	1,319,984	2.9%
2012	1,141,709	-13.5%
2013	1,194,404	4.6%
2014	1,130,834	-5.3%
2015	1,125,236	-0.5%
2016	1,106,489	-1.7%
Average Annual % Change		
Last 2 Years		-1.1%
Last 5 Years		-3.3%
Last 9 Years		2.2%

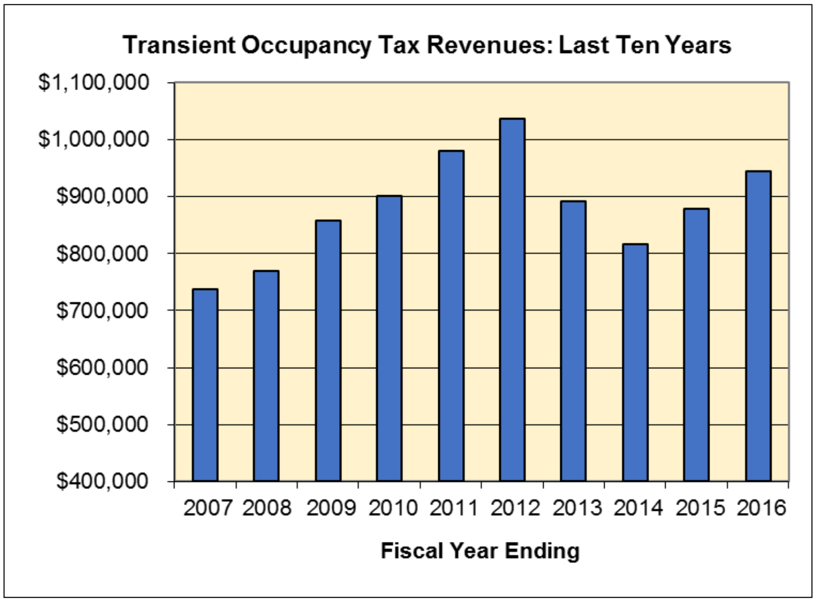
Based on the 1% rate: includes "triple flip" sales revenues from the State.



Sales tax revenues trends are mixed over the past ten years. As with transient occupancy taxes (see below), the counter-intuitive increases during the Great Recession in 2010-2012 are believed to be due to construction activity at the Marine Base. However, ups and downs in the State's "triple flip" backfill of ¼% of the City's sales tax rate may also be a factor (this ends in 2016-17). From 2013-14 onward, these have remained flat.

❹ KEY TRENDS

Transient Occupancy Tax Revenues		
Fiscal Year Ending	Amount	% Change
2007	$737,584	
2008	770,206	4.4%
2009	857,457	11.3%
2010	901,878	5.2%
2011	979,480	8.6%
2012	1,036,116	5.8%
2013	892,550	-13.9%
2014	816,017	-8.6%
2015	878,195	7.6%
2016	943,747	7.5%
Average Annual % Change		
Last 2 Years		7.5%
Last 5 Years		-0.3%
Last 9 Years		3.1%



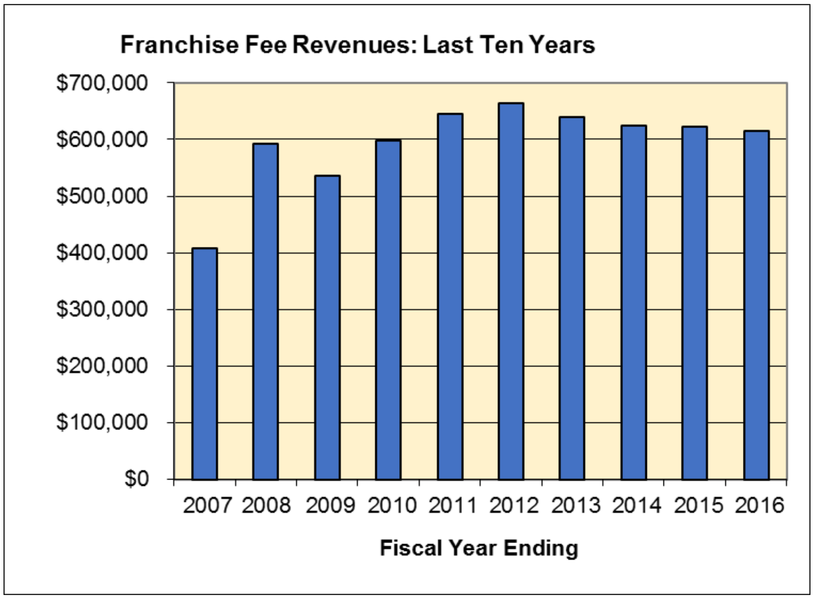
As with sales taxes, the counter-intuitive increases during the Great Recession are believed to be due to two factors:

- Construction activity at the Marine Base, resulting in a short-term increase in occupancy demand.

- Two strong additions to the TOT revenue base with the opening of the Fairfield Inn in 2010 and Holiday Inn Express in 2011. The City's top five hotels now account for 75% of total TOT revenues.

This growth period was followed by steep decreases in 2012-13 and 2013-14 (by 20% over the two years). However, revenues strongly recovered, growing by 16% over the next two years.

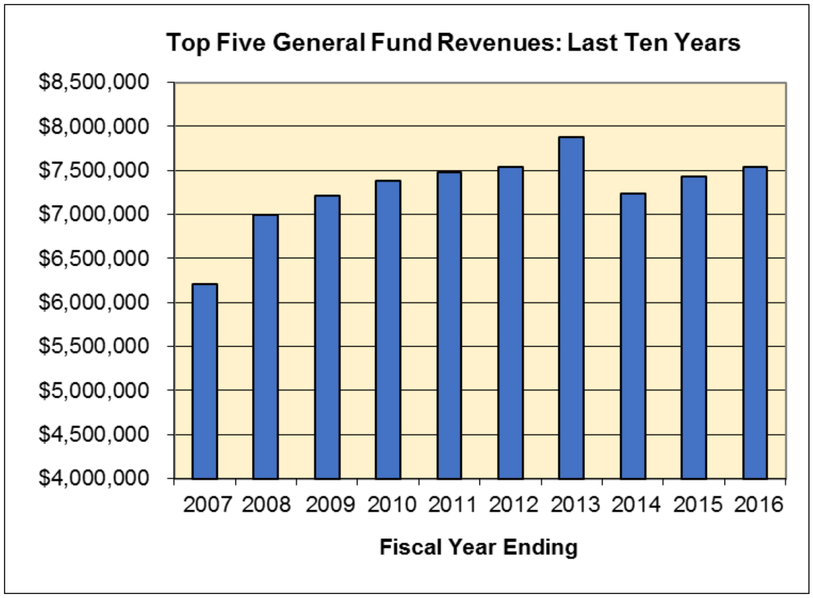
Franchise Fee Revenues		
Fiscal Year Ending	Amount	% Change
2007	$407,737	
2008	592,060	45.2%
2009	535,866	-9.5%
2010	597,645	11.5%
2011	644,710	7.9%
2012	663,805	3.0%
2013	638,808	-3.8%
2014	624,084	-2.3%
2015	622,531	-0.2%
2016	615,767	-1.1%
Average Annual % Change		
Last 2 Years		-0.7%
Last 5 Years		-0.9%
Last 9 Years		5.6%



Accounting for 6% of General Fund sources, franchise fees have remained relatively stable over the past ten years.

❹ KEY TRENDS

Top Five General Fund Revenues		
Fiscal Year Ending	Amount	% Change
2007	$6,212,347	
2008	6,998,709	12.7%
2009	7,208,125	3.0%
2010	7,377,794	2.4%
2011	7,481,392	1.4%
2012	7,537,847	0.8%
2013	7,874,763	4.5%
2014	7,236,233	-8.1%
2015	7,432,073	2.7%
2016	7,541,409	1.5%
Average Annual % Change		
Last 2 Years		2.1%
Last 5 Years		0.3%
Last 9 Years		2.3%



This chart shows trends for the "Top Five" revenues combined for the last ten years, which account for about 90% of total General Fund sources.

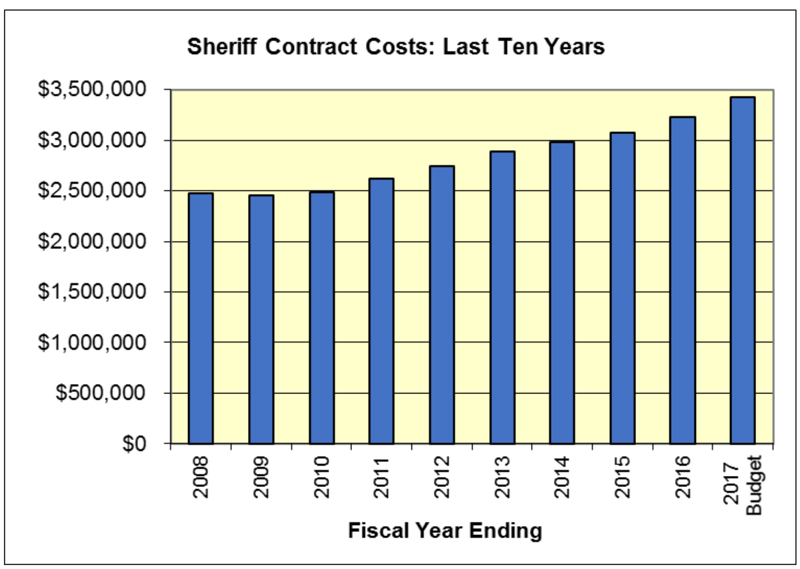
With some modest ups and downs, these top revenues have remained stable over the past ten years, even during the Great Recession. In short, the City has weathered the Great Recession better than many other cities in California.

GENERAL FUND EXPENDITURE TRENDS

The following tables and charts show long term trends for five key expenditure factors:

- Sheriff contract costs.
- Insurance: general liability and workers' compensation.
- Employer retirement contribution rates to the California Public Employees Retirement System (CalPERS) as well as projected rates for the next five years.
- Retiree health care.
- Full-time equivalent staffing.

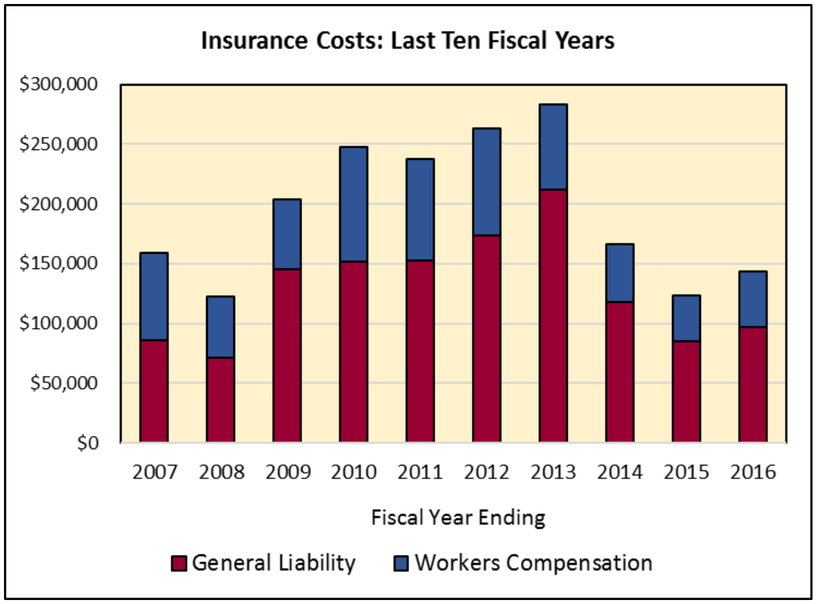
Sheriff Contract Costs		
Fiscal Year Ending	Amount	% Change
2008	$2,479,500	
2009	2,456,200	-0.9%
2010	2,487,000	1.3%
2011	2,618,400	5.3%
2012	2,739,200	4.6%
2013	2,887,600	5.4%
2014	2,983,500	3.3%
2015	3,078,000	3.2%
2016	3,225,000	4.8%
2017 Budget	3,423,300	6.1%
Average Annual % Change		
Last 2 Years		5.5%
Last 5 Years		4.6%
Last 9 Years		3.7%



At 40% of the total, the Sheriff contract cost is the largest General Fund expenditure area. These have grown about 5% annually over the past five years.

Insurance Costs. Insurance costs have been a major concern for many local agencies throughout the State. As reflected in the following chart for general liability and workers' compensation costs, the City has been on a roller coaster ride over the last ten years. However, insurance costs appear to have stabilized and are not projected to be a significant factor in the forecast. (Insurance costs are city-wide for all funds).

Insurance Costs		
Fiscal Year Ending	General Liability	Workers Comp
2007	$86,091	$72,639
2008	71,233	50,768
2009	145,000	58,633
2010	151,859	95,439
2011	152,561	84,537
2012	173,791	89,658
2013	211,899	71,652
2014	117,920	48,390
2015	84,536	38,713
2016	96,416	47,377



CalPERS Pension Costs

The City currently provides defined pension benefits to its regular employees through its contract with the California Public Employees Retirement System (CalPERS).

About CalPERS. While cities, counties, and special districts are free to create their own retirement systems, 460 of California's 482 cities are members of CalPERS. Dating back eighty years, CalPERS is now the largest pension fund in the United States, serving over 1.8 million members and managing $300 billion in assets. Members include state, city, county and special district employees.

Funding Pension Benefits. There are many actuarial factors that determine contribution rates, including inflation, employee earnings and life expectancy assumptions. However, the assumption for the "discount rate" – the projected long-term yield on investments – is one of the most important. For example, only about one-third of CalPERS retirement benefits are funded by employee and employer contributions: the other two-thirds are funded from investment yields.

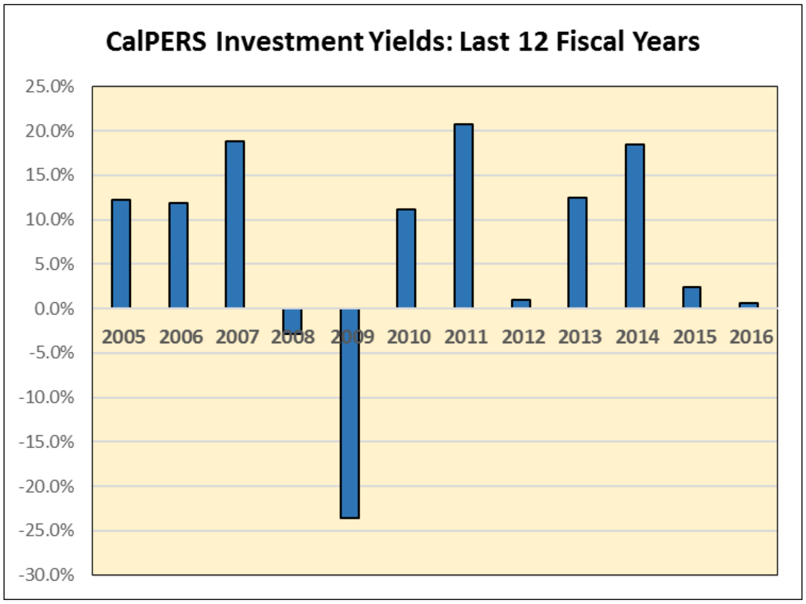
❹ KEY TRENDS

CalPERS current discount rate is 7.5%. Even small changes in this rate – up or down – can significantly affect funding. By comparison, over the past 20 years (through June 30, 2015), CalPERS net yield on returns has averaged 7.8%. However, there have been significant swings from year-to-year, with net returns averaging 6.2% for the ten years ending June 30, 2015.

In December 2016, the CalPERS Board approved reducing the discount rate to 7.0% by 2020-21, phased as follows by fiscal year:

- 2018-19: 7.375%
- 2019-20: 7.250%
- 2020-21: 7.000%

The impact of the reduced discount rates will be phased-in over five years.



City Pension Plans

The City currently has two separate retirement plans with CalPERS:

- ***Classic Miscellaneous Employees.*** For Classic employees, the City has a "2.5% at 55" plan for its miscellaneous employees: under this plan, non-sworn employees retiring at age 55 will receive 2.5% of their single highest year of "regular" pay for each year of service. (Regular pay does not include special earnings like overtime.) For example, a Maintenance Worker III with 25 years and "base" earnings of $59,200 (top of the salary range) retiring at age 55 would receive a pension of $37,000 annually.

- ***PEPRA Miscellaneous Employees.*** For PEPRA ("new") employees, the City has a "2% at 62" plan: under this plan, miscellaneous employees retiring at age 62 will receive 2.0% of the average of their three highest years of regular pay for each year of service.

Public Employees' Pension Reform Act

Effective January 1, 2013, the Public Employees' Pension Reform Act (PEPRA) created a "two-tier" retirement system under which benefits for "new" employees hired on or after January 1, 2013 are lower than those employees who were in the system before then.

"PEPRA" Employees. With the goal of reducing costs and future liabilities for state and local agency system members, major changes for "new" system (PEPRA) members include lower-cost pension formulas, increased retirement age requirements, use of "three years of highest average compensation" (rather than single highest year) in calculating pensionable pay and caps on maximum annual benefits.

"Classic" Employees. Retirement benefits for local agency employees hired before January 1, 2013 (Classic employees) are not affected by these "rollbacks:" they only affect PEPRA employees hired after this date. "Classic employees" also include those who established CalPERS membership before January 1, 2013 and were hired by a different CalPERS agency with a break in service of six months or less. These employees will be eligible for the new agency's benefit level that was in place as of December 31, 2012.

Funding CalPERS Benefits

Along with investment earnings, CalPERS pension benefits are funded by contributions from both employees and employers. The most significant of these is the employer share, which is determined actuarially and can vary significantly – both up and down – based on changes in actuarial assets and liabilities.

The employer share has two components

- ***Normal cost*:** The rate needed to meet current actuarial obligations.

- ***Unfunded liability*:** Funding needed to amortize any outstanding unfunded accrued liabilities (UAL), typically over 30 years.

❹ KEY TRENDS

Because it is the employer contribution that is subject to variation, it is the best indicator of retirement cost drivers. The following chart on page 34 shows past employer rates for "classic employees" as well as projected rates for the next five years.

Projected Rates. The projected rates below are based on two factors:

- Projections provided by CalPERS in their most recent actuarial report (August 2016), which were developed before the discount rate reduction. Note the significant reduction in the UAL that is scheduled for 2017-18 (reduction of $85,200, reflecting a 44% decrease). This is due to the City's pension liability reduction payment of $1.0 million in 2014-15.

- Adjustment factors provided by CalPERS to account for the discount rate decreases. Stated simply, these adjustments for lower investment yields increase projected pension costs beyond the estimates provided in the August 2016 actuarial report.

August 2016 Rate and UAL Projections

Classic Miscellaneous Employees	Normal Rate	UAL Cost*
2016-17 (Current Rate)	10.069%	$192,298
2017-18	10.110%	$107,134
2018-19	10.100%	$134,209
2019-20	10.100%	$162,811
2020-21	10.100%	$184,136
2021-22	10.100%	$207,238

PEPRA Employees	Normal Rate	UAL Cost*
2016-17 (Current Rate)	6.550%	$74
2017-18	6.533%	$93
2018-19	6.500%	$138
2019-20	6.500%	$186
2020-21	6.500%	$236
2021-22	6.500%	$204

** General Fund Share at 80% of total staffing costs*

Adjustments to these Rates and UAL Contributions Due to Discount Rate Reduction

		Normal Cost		UAL Payments	
Valuation Date	Fiscal Year Impact	Misc. Plans	Safety Plans	Misc. Plans	Safety Plans
6/30/2016	2018-19	0.25% - 0.75%	0.5% - 1.25%	2% - 3%	2% - 3%
6/30/2017	2019-20	0.5% - 1.5%	1.0% - 2.5%	4% - 6%	4% - 6%
6/30/2018	2020-21	1.0% - 3.0%	2.0% - 5.0%	10% - 15%	10% - 15%
6/30/2019	2021-22	1.0% - 3.0%	2.0% - 5.0%	15% - 20%	15% - 20%
6/30/2020	2022-23	1.0% - 3.0%	2.0% - 5.0%	20% - 25%	20% - 25%
6/30/2021	2023-24	1.0% - 3.0%	2.0% - 5.0%	25% - 30%	25% - 30%
6/30/2022	2024-25	1.0% - 3.0%	2.0% - 5.0%	30% - 40%	30% - 40%

As reflected above, increases will continue for three more years beyond the five-year forecast period.

❹ KEY TRENDS

Classic Miscellaneous Employees

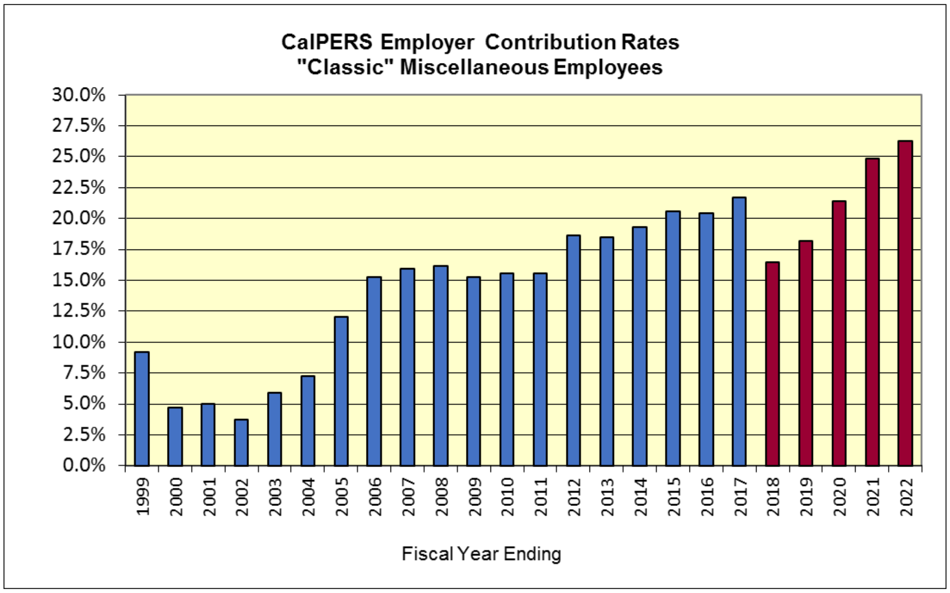
Employer contributions averaged about 6% of payroll from 1998-99 through 2003-04. This was below the "normal" rate that was otherwise required due to excess assets at the time.

However, with the impacts (and related investment losses) from 9/11, the dot.com meltdown and corporate scandals, employer contribution rates rose to about 15% of payroll by 2005-06. (Due to CalPERS' smoothing methodology at the time, the impact of reduced investment earnings was delayed by several years.)

Rates stabilized for the next six years through 2010-11. However, significant increases again took place due to the impact of the Great Recession on investment yields, rising to about 22% of payroll by 2016-17.

For most cities, rates will take another sharp increase from 2017-18 to 2021-22 based on a combination of factors, including the phased-in reduction in the "discount rate" from 7.5% to 7.0%.

The City also see this increase, but not until 2018-19. As discussed above, this because the City significantly reduced its UAL in 2014-15 by $1.0 million, with reduced rates following in 2017-18. However, after this reduction the City will see significant increases in its annual contributions to CalPERS.

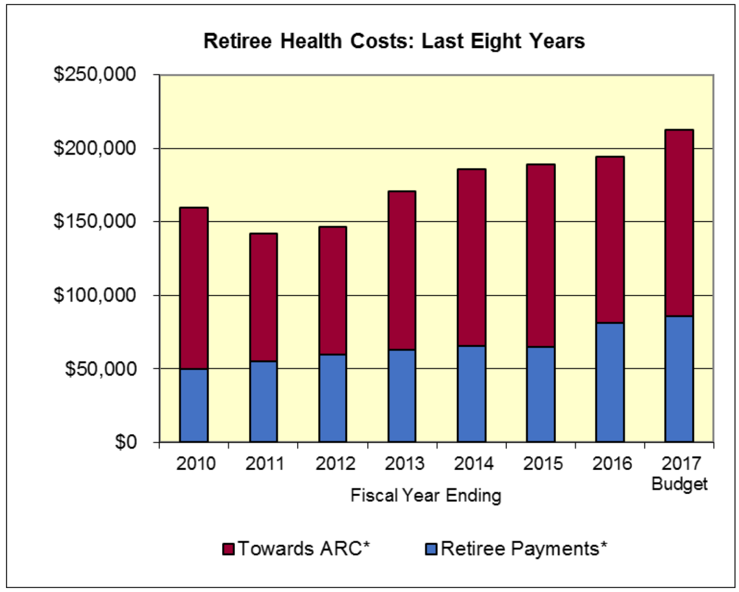


Note: Beginning in 2015-16, CalPERS discontinued including the amortization of unfunded actuarial liabilities (UAL) as part of the employer contribution rate: only the "normal" contribution rate is stated this way, with the UAL stated separately as a fixed amount. For comparison purposes, the fixed UAL amount is converted to a percent based on projected payrolls.

❹ KEY TRENDS

Retiree Health Care Costs	Retiree Payments*	Towards ARC*	Total
2010	$50,000	$109,598	$159,598
2011	55,000	86,828	141,828
2012	60,000	86,545	146,545
2013	63,000	107,906	170,906
2014	65,621	119,950	185,571
2015	64,749	124,004	188,753
2016	81,000	113,053	194,053
2017 Budget	86,100	126,500	212,600

** Allocation between ARC and retiree payments estimated for 2009-10 to 2012-13*



** Allocation between ARC and retiree payments estimated for 2009-10 to 2012-13*

Until the recent downward revision in the discount rate (investment yield) assumption from 7.06% to 4%, the City was fully funding its annual obligation (beginning in 2010) on actuarial basis. As shown in the sidebar, the City has consistently made payments towards its "annual required contribution" (ARC) in addition to its cash payments to retirees. These amounts have remained relatively stable for the last eight years.

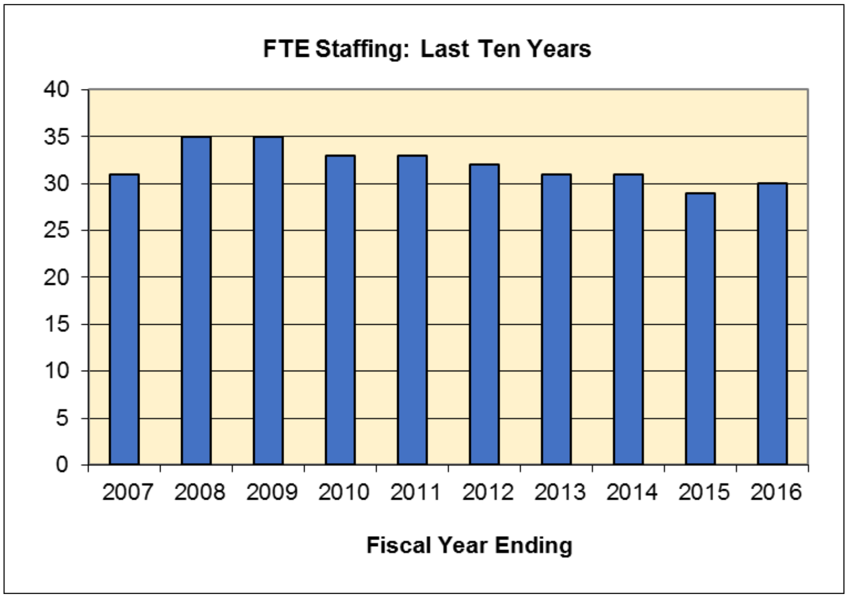
However, with the reduction in the discount rate in 2015-16, along with other assumptions in the March 2016 actuarial analysis prepared by Demsey, Filliger & Associates, the City's ARC went from about $195,000 to $589,000 in 2016-17.

City Retiree Benefits. The City participates in this State Health Insurance Pool administered by CalPERS. Member agencies participating in the State Pool are subject to regulations of the Public Employees Medical and Hospital Care Act (PEMHCA), which requires that member agencies provide a minimum employer contribution for retired employees. The minimum employer contribution is currently $128 monthly. The City currently contributes $500 monthly towards retiree health care premiums. As of June 30, 2016, there were fourteen retirees receiving this benefit.

City Funding Policy. Unlike defined pension plans such as CalPERS, where agencies are required to pay actuarially determined amounts each year, local government agencies are not required to do so for retiree health care benefits. Instead of paying an actuarially determined amount (the ARC), they can fund this on a "pay-as-you go basis." The City's current policy is to make contributions that are more than its annual "pay-as-you-go" cash payments, with added contributions that reduce its unfunded liabilities.

❹ KEY TRENDS

Full-Time Equivalent (FTE) Staffiing	
Fiscal Year Ending	
2007	31.0
2008	35.0
2009	35.0
2010	33.0
2011	33.0
2012	32.0
2013	31.0
2014	31.0
2015	29.0
2016	30.0



Staffing costs account for 30% of General Fund expenditures. Along with compensation a key factor in determining these costs is the level of authorized full-time equivalent (FTE) staffing. As shown in the ten-year FTE trends chart, the City has done an excellent job of containing staffing levels.

❺ NEW REVENUE OPTIONS

OVERVIEW

This section of the report presents new revenue options available to the City closing the modest operating gap in the out-years and funding CIP/Major Maintenance Projects.

The Short Story: There is a broad range of reasonable revenue options available to the City. However, virtually all of them would require either majority or two-thirds voter approval.

Based on the experience of many cities in California, it is possible to successfully pass a revenue measure. However, doing so requires effective preparation by the City before placing the measure on the ballot; and an effective community-based group that will campaign for its passage afterwards.

SUCCESSFUL REVENUE MEASURES

Voter Approval Required for Most New or Increased Revenues

Under Proposition 218, a State constitutional amendment approved by the voters in November 1996, most new revenue measures will require voter approval at some level:

Taxes. New and increased taxes require voter approval as follows:

- **General purpose.** If the revenues will be used for general purposes, majority voter approval is required. This must occur at the same time as regular Council elections, unless the Council declares an emergency by unanimous vote (in that case, the election may be held at any time).

- **Special purpose**. If the revenues will be "earmarked" for a specific purpose, two-thirds voter approval is required. This election can be held at any time.

Special Assessments. Whether for capital improvements or ongoing maintenance services, special assessments require majority approval by those being assessed (who are property owners), with each property owner's vote "weighted" by the amount of their assessment. For example, an owner with a property with an assessment of $1,000 would have ten votes for that parcel compared with one vote for an owner with a parcel assessment of $100. Additionally, Proposition 218 sets specific rules for how the benefit of special assessments must be apportioned.

Property-Related Fees. For fees that are levied as "an incidence of property ownership" (just because you own property), majority approval by those who will have to pay the fee is required; or at the agency's option, by a two-thirds vote of the electorate residing in the affected area. There are several specific exemptions under Proposition 218, including development review and impact fees under "AB 1600" (Section 65000 of the Government). Additionally, there is consensus that many fees charged by cities – such as recreation fees and police reports – are not subject to Proposition 218, since they are usually based on use, not property ownership.

This means that service charges unrelated to property ownership or enterprise operations (like water and sewer) are one of the few funding sources subject to Council decision-making: virtually all others require some form of voter or property owner approval.

Preparing for Successful Revenue Measures

One of the major "mega-trends" affecting governance today at all levels is a fundamental change in the way decisions are made. Over the past forty years, there has been a significant shift in voter preference from "representative democracy" to "direct democracy," especially in local government finance.

Proposition 13 did not start this trend, but it certainly resulted from it. Since its passage almost forty years ago in 1978, there have been an increasing number of citizen-approved limits on the ability of elected officials at the local level to make resource decisions on behalf of the community since then.

While there a number of possible explanations for this change, the fact remains that there is a decided shift to direct citizen decision-making in a broad range of issues previously thought to be too "technical" for this. While this has occurred in many areas such as insurance and campaign financing, it is especially prevalent in "ballot box budgeting." Citizens are no longer willing to give their proxy on financial issues to elected officials or to their interest group representatives on "blue ribbon" committees. City finance is an issue they want to decide directly for themselves.

***How does this shift affect the City's long-term fiscal health*?** Cities now need broad-based community support—in evidence on Election Day—to implement new revenue sources. In this new model of direct democracy, creating support among elected officials and community leaders—even if it broadly crosses a number of interest groups—is no longer enough. With these profound changes in voter approval requirements, cities must communicate a compelling vision for new revenues at a grass roots level among likely voters.

Local Revenue Measures Since 2001
Through November 2016

	Total	Pass	Passing%
City Majority Vote	832	612	74%
County Majority Vote	94	53	56%
SpecialDistr Fee MajVote	3	2	67%
City 2/3 Vote	373	191	51%
County 2/3 Vote	138	60	43%
Special District (2/3)	424	196	46%
School ParcelTax2/3	351	228	65%
SchoolBond 2/3Vote	50	17	34%
School Bond 55%	1213	1026	85%
Total	3478	2385	69%

Source: California Local Government Finance Almanac

While this may seem a high-hurdle, many local agencies throughout the State have been successful in gaining voter approval for revenue measures, even at the two-thirds level.

As shown in the sidebar chart, since 2001 (when school districts were first allowed to pass general obligation bond issues with 55% voter approval, versus the prior two-thirds requirement), almost 2,400 local revenue measures – about 70% of those presented to voters – have been passed through November 2016.

- For cities, over 600 general-purpose, majority approval measures have passed statewide: almost 75% of those presented to voters for consideration.

- And almost 200 two-thirds voter approval measures have passed in cities, although with a much lower success rate: slightly more than half of those measures were approved. In short, while two-thirds measures can be successful, the track record shows that they are more difficult to pass than general purpose measures.

In summary, if the need is compelling—either to maintain current services or to improve them—and it is effectively communicated, experience throughout the State shows that voter-approved revenue measures can be successful.

However, this experience also shows that doing so requires a significant commitment of time and resources in preparing for the measure. More importantly, it typically requires a strong community-based advocacy group that will aggressively raise funds and campaign for the measure once it is on the ballot.

This last issue cannot be stressed enough. Under State law, cities have broad discretion in using their funds for staff and professional assistance in analyzing issues, researching public opinion, conducting public education programs and developing voter support strategies. However, once an issue becomes a formal ballot measure, cities cannot participate as an advocate in any way. For this reason, unless there is a strong community-based group that is willing to aggressively raise funds and campaign for the measure, it is not likely to pass, no matter how much preparation was undertaken by the City before placing the measure on the ballot.

The first pre-condition—effective preparation—is within the control of the City; the second one—an effective community-based group—is not.

In summary, new revenues require community support—in evidence on Election Day. Gaining this support requires more than a compelling need: it also requires communicating that need in a compelling way. And this requires effective preparation by the City before placing the measure on the ballot; and an effective community-based group that will campaign for its passage afterwards. For this reason, for many cities, effective preparation was a 12 to 18-month process before placing a measure on the ballot.

Elements of a Successful Revenue Measure

There are three major steps that have been used successfully by local agencies throughout the State in preparing for successful revenue measures:

- ***Feasibility Assessment.*** Conduct public opinion research and assess the likelihood of a successful revenue measure.

- ***Education Program***. If the public opinion research is favorable, develop and implement an educational campaign on why new revenues are needed.

- ***Ballot Measure.*** Place the measure on the ballot if there is a community-based group that will aggressively campaign for its passage.

NEW REVENUE OPTIONS SUMMARY

The following is a "high level" summary of revenue options (further descriptions of the revenue source and basis for the estimate follow this chart).

	Revenue Source		Required Approval			
				Voter		
	Increase in Existing	New	Council	Majority	Two-Thirds	Annual Revenues
Local Option Sales Tax: ½%		x		If general purpose	If special purpose	$550,000
Transient Occupancy Tax: 1% increase to 10%: $111,000 3% increase to 12%: $333,000	x			If general purpose	If special purpose	$111,000 to $333,000
Property Transfer Tax	x			If general purpose	If special purpose	Not allowed for General Law cities
Business License Tax: Move from a regulatory, flat rate to ordinance to one whose purpose is revenue-raising based on gross receipts.	x			If general purpose	If special purpose	$125,000
General Obligation Bond (For capital improvements only)		x			x	Varies
Parcel Tax: Typically per "Equivalent Dwelling Unit" (EDU)		x			x	Varies depending on EDU
Utility Users Tax: Estimate of $25 per capita		x		If general purpose	If special purpose	$650,000
Admissions Tax		x		If general purpose	If special purpose	Not Viable
Parking Tax		x		If general purpose	If special purpose	Not Viable
Maintenance Assessments		x		x		Varies
Mello-Roos: Existing Development		x			x	Varies
Mello-Roos: New Development			*			Varies
Higher Cost Recovery	x	x	x			Depends on study results and current cost recovery versus cost recovery policy goals
Franchise Fees: Solid Waste Renegotiate fee	x		x			Depends on fee

As reflected in this summary chart, only three of these revenue options can be implemented by the Council:

- For Mello-Roos special taxes for new development, the revenues would only be available in new development areas: they could not be used to fund citywide improvements (such as public safety or storm drainage); and developer concurrence would also be required.

- Higher cost recovery may be possible; but while fees can be set lower than costs, they cannot be set higher. Accordingly, higher cost recovery efforts need to be preceded by a comprehensive cost of services study. (This could be prepared in-house with city staff, but most agencies contract with an independent professional for this work.) The cost study then needs to be followed by an analysis of current cost recovery versus cost recovery goals. (While some services lend themselves to full cost recovery, many do not.)

- The revenue potential from renegotiating the current solid waste franchise agreement is likely to be relatively small compared with the other options.

This underscores the findings of this report that any new significant revenues will likely require voter approval.

NEW REVENUE OPTION DESCRIPTIONS

The following provides brief descriptions of the possible revenue sources and the basis for the estimate, organized by whether voter or Council approval is required to implement it.

Requires Voter Approval

Two-Thirds Voter Approval

Parcel Taxes. With two-thirds voter approval, parcel taxes are allowed in any amount as long as they are not based on property value. They may set based on either a flat rate per parcel or a variable rate depending on the size, use or number of units on the parcel. As a "special" tax, they must be levied for a specific service—such as police, fire, emergency medical service, libraries or storm drainage. The amount of revenue generated is solely determined by the City's revenue goal and the resulting apportionment methodology. Accordingly, further analysis would be required to provide estimates for this revenue source.

Mello-Roos Special Taxes: Operating or Capital. Mello-Roos "Community Facilities Districts" (CFD's) are typically formed to provide services or capital improvements to new developments (when there is usually just one "voter"—the developer/land owner), but they can be formed on a citywide basis in already-developed areas as well. Depending how they are structured when approved, Mello-Roos special taxes can pay for operations and maintenance as well as capital improvements.

If there are twelve or more registered voters in the district, approval by two-thirds of the registered voters is required. However, if there are fewer than twelve registered voters, the district vote is by the property owners in the district. In this case, property owners have one vote for each acre of land they own in the District. For this reason, Mello-Roos CFD's are typically used in financing improvements and services for new development. It is rarely used for developed areas: given the similar two-thirds voter approval requirements, most cities use the more straightforward parcel tax approach instead.

Property Tax Increase as Part of General Obligation Debt. Adopted almost forty years ago in 1978, Proposition 13 does not allow an increase in general purpose property taxes above the "1% of market value" limit under any circumstances. However, subsequent amendments to this constitutional limit allow for increases in property taxes for voter-approved bonded indebtedness. General Law cities may incur general obligation debt up to 3.75% of assessed value, which for the City would be about $32 million. Under current market circumstances, this translates into an annual revenue-raising capacity to meet annual debt service requirements of about $2.0 million. The proceeds are restricted to specified capital improvements.

Majority (General Purpose) or Two-Thirds (Special Purpose) Voter Approval

The following revenue sources can be adopted by either majority or two-thirds voter approval, depending on their purpose. Revenue measures where the proceeds may be used for "general purposes" only require majority voter approval. However, revenue measures where the proceeds are "earmarked" and designated for specific purposes require two-thirds voter approval. In both cases, depending on how the revenue measure is structured, the proceeds could be used for operations or capital improvements (including debt service payments on capital projects financed by bonds).

Local Option Sales Tax. Cities are allowed to set their own "local option" sales taxes, and 176 have done so. The most common city rate is ½%. At this level, a local option sales tax would raise about $550,000 annually.

Transient Occupancy Tax (TOT). The City's TOT rate is 9%, which is projected to raise about $1.0 million in 2016-17. Each increase of 1% would raise about $111,000 annually. Of the 432 cities that have adopted TOT rates, the most common is 10%. Only 90 have set rates that are more than 10%.

Property Transfer Tax. Statewide, there is a property transfer tax of $1.10 per $1,000 of value when property is sold (or $220 on a property worth $200,000). For sales in a city, the proceeds are evenly divided between the city and the county, for an effective city rate of $0.55 per $1,000 of value. (For sales in unincorporated areas, the county retains all of the tax.)

Prior to the adoption of Proposition 62 by voters in 1986, all cities were allowed to set their own rate, but they had to give up their share of the $1.10 rate to do so. With the passage of Proposition 62, general law cities lost the ability to do this, since among its many revenue-raising limitations is a prohibition on real property transfer taxes.

However, because Proposition 62 was a "statutory initiative," its provisions only apply to General Law cities. As such, Charter cities are allowed to adopt this revenue source. Moreover, from 1986 until 1995, several appellate court rulings declared the provisions of

Proposition 62 to be unconstitutional. For this reason, during this interim period, many General Law cities—along with Charter cities—implemented their own property transfer tax at rates ranging from $1.10 to $15.00 per $1,000 of value. For cities that have adopted their own rate, the most common is $4.40 per $1,000. At this level, the City's own property transfer tax (which has averaged about $25,000 annually over the last four years) would raise about $197,000 annually, for a "net" increase of $172,000. However, in order to adopt this tax, the City would first have to become a Charter city. For this reason, while an option, it is not as viable as many of the other new revenue sources analyzed in this study.

Business License Fee. Most cities levy a business license *tax*, which is levied solely for general revenue purposes. In the City's case, while anyone doing business in the City is required to obtain a business license, it is for regulatory purposes, not revenue generation.

Most cities with modern business tax ordinances use gross receipts as the tax base to better reflect ability to pay. There are many ways of structuring the business taxes; and as such, more detailed analysis is required in estimating revenues from a business tax ordinance. However, based on a review of ratios between business tax and sales tax revenues in other California cities, a conservative estimate of 15% of sales tax revenues generates about $165,000 in revenues. Business license fees generate about $40,000 annually, resulting in net increase of $125,000.

Utility Users Tax. Half of the State's residents and a majority of businesses in California pay utility users taxes (UUT) at rates ranging from 1% to 11%. It is a tax on the consumption of utility services (such as natural gas, electricity, water, sewer, telephone and cable), similar in concept to the retail sales tax on commodities. For this reason, most cities set their rates based on the sales tax rate in effect at the time they adopted their UUT ordinance, which accounts for some of the variability in rates.

Statewide, for those 157 cities that levy UUT, the average rate is 5.4%, with per capita revenues ranging $4 in Pleasant Hill to $493 in El Segundo (and even higher in the largely industrial cities of Irwindale and Vernon). Stated simply, the cities with significant non-residential uses have higher per capita revenues. As such, a more detailed analysis is required in estimating revenues from a UUT. However, in a scan of similar cities, $25 per capita provides a ballpark estimate of $650,000.

Admissions Tax. This tax is levied on the consumer for the privilege of attending theaters, concerts, movies, sporting events, museums and other performances. The tax can be a flat rate, a percentage of the ticket value or a sliding rate depending on the cost of the ticket.

Although generally determined to be lawful, courts have struck down admissions taxes that are borne solely or primarily by activities protected by the First Amendment. These cases suggest that to implement this tax, a city must have substantial businesses or events that would be subject to it, which do not involve First Amendment rights and would bear a significant portion of the tax burden. For this reason, most cities that have this tax have professional sports teams, amusement parks, performing arts centers or similar major event venues in their cities. As such, no revenues have been projected from this source. Given the lack of any major venues in the City like those where this tax has been successfully implemented, it is unlikely that it would be legal to do so.

Parking Tax. This tax is imposed on occupants of off-street parking spaces for the privilege of renting the space within the City. It is typically levied when there are a large number of *privately-owned* and operated parking lots and garages, and there is a high demand for these spaces. Since this is not the case in Twentynine Palms, no revenues have been projected from this source.

Majority Property Owner Approval

Under Proposition 218, the approval process to establish or increase property-related fees and special assessments is very similar: they both require:

- A clear relationship between the costs and benefits per parcel.
- Mailed notice and public hearings.
- Majority approval by those responsible for paying the fee or special assessments, weighted by each property owner's fee or assessment benefit obligation.

Property related fees: operating or capital. Under Proposition 218, property-related fees are allowed with majority property owner approval, with votes weighted by the proportionate amount that each property owner would pay (or at the agency's option, by a two-thirds vote of the electorate residing in the affected area). Additionally, there must be a "nexus" between costs and benefits. Lastly, property related fees for services generally provided to the public, such as police, fire, ambulance or library services, where the service is available to the public at large in substantially the same manner as it is to property owners, are not allowed.

Special assessments: operating or capital. Special assessments for either one-time improvements or ongoing maintenance are also allowed under Proposition 218; however, majority approval by those responsible for paying the special assessments, weighted by each property owner's benefit obligation, is required. Detailed assessment reports prepared by a registered civil engineer justifying the apportionments among properties are required. Under similar ground rules, special assessment districts can be formed for one-time capital improvements.

Could Be Approved by the Council

The following revenue sources could be set or increased by the Council.

Mello-Roos Districts for New Development. Many cities require that new development pay not only for the facilities needed to service them, but for day-to-day services as well. This could include park and landscape maintenance, street lighting, street sweeping, libraries and fire protection. While this sets up two classes of city residents—those who receive what may be perceived as general city services based on the general-purpose tax revenues they pay, and those who must pay an additional premium for those same services—many cities have moved to this out of fiscal necessity. The revenue impact of this is difficult to assess, since it would depend on what services were subject to the special Mello-Roos tax.

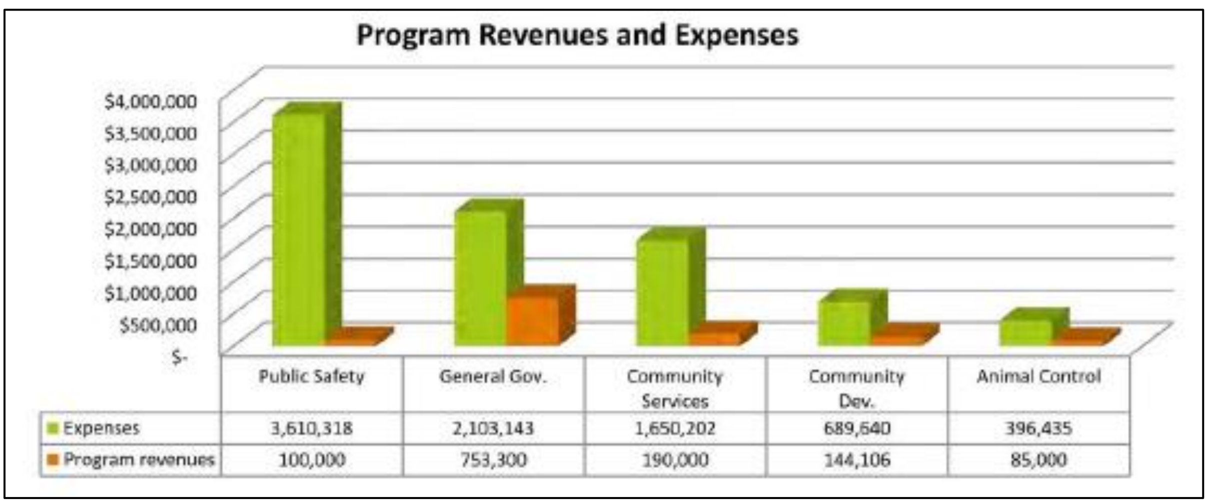
However, as discussed above, this would require the concurrence of the property owner in establishing this special tax district (assuming there are less than twelve registered voters in the District) before the start of construction.

Development Impact Fees. The City can set impact fees at any level that will fully offset (but not exceed) the cost of constructing capital improvements needed to service new development. This can cover a broad range of public facilities, including water, sewer, transportation, parks, cultural facilities, community centers, civic center improvements and public safety facilities. Detailed procedures for developing and collecting impact fees are set forth in Government Code Section 66000 (commonly referred to as "AB 1600").

The City has already adopted a wide range of development impact fees.

Higher Cost Recovery. This is one of the few remaining areas where the Council has discretion in balancing funding for the cost of services between general purpose revenues and fees. As noted above, while fees can be set lower than costs, they cannot be set higher. Accordingly, higher cost recovery efforts need to be preceded by a comprehensive cost of services study, followed by an analysis of current cost recovery versus cost recovery goals. (While some services lend themselves to full cost recovery, many do not.)

Pending this type of analysis, it is not possible to estimate the potential for higher cost recovery from services like animal control, development review and recreation. However, the following high-level assessment of service costs versus revenues from the 2016-17 Budget indicates that this may be an area the City should consider exploring further.



Franchise Fees. These fees are charged to public utilities – such as natural gas, electricity, refuse collection, water, sewer and cable television – for the use of City's right-of-way and their adverse impact on City streets in conducting their operations. However, the State prohibits franchise fees on telecommunications; and sets franchise fees for natural gas and electricity. Similarly, the Federal government limits franchise fees on cable television. As such the only area where the Council has some discretion is the solid waste franchise fee.

❺ NEW REVENUE OPTIONS

The current franchise agreement, which requires mandatory collection, is with Burrtec Waste Industries. In many communities throughout the State, the franchisee is indifferent to the rate, as long as the city is willing to set rates that will fully recover the fee. That said, the revenue potential from renegotiating the current solid waste franchise agreement is likely to be relatively small compared with the other options.

CONSULTANT QUALIFICATIONS

SENIOR FINANCIAL MANAGEMENT

Bill Statler has over 30 years of senior municipal financial management experience, which included serving as the Director of Finance & Information Technology/City Treasurer for the City of San Luis Obispo for 22 years and as the Finance Officer for the City of Simi Valley for 10 years before that.

Under his leadership, the City of San Luis Obispo received national recognition for its financial planning and reporting systems, including:

- Award for Distinguished Budget Presentation from the Government Finance Officers Association of the United States and Canada (GFOA), with special recognition as an outstanding policy document, financial plan and communications device. ***San Luis Obispo is one of only a handful of cities in the nation to receive this special recognition.***
- Awards for excellence in budgeting from the California Society of Municipal Finance Officers (CSMFO) in all four of its award budget categories: innovation, public communications, operating budgeting and capital budgeting. Again, ***San Luis Obispo is among a handful of cities in the State to earn recognition in all four of these categories.***
- Awards for excellence in financial reporting from both the GFOA and CSMFO for the City's comprehensive annual financial reports.
- Recognition of the City's financial management policies as "best practices" by the National Advisory Council on State and Local Budgeting.

The financial strategies, policies and programs he developed and implemented resulted in strengthened community services and an aggressive program of infrastructure and facility improvements, while at the same time preserving the City's long-term fiscal health.

CONSULTING

Fiscal Forecasts and Long-Term Financial Plans

- City of Bell
- City of Salinas
- City of Camarillo
- City of Grover Beach
- City of Pismo Beach
- Bear Valley Community Services District

Strategic Plans and Council Goal-Setting
In collaboration with HSM Team

- Strategic Planning: City of Monrovia
- Strategic Planning: City of Sanger
- Council Goal-Setting: City of Pismo Beach
- Council Goal-Setting: City of Willits

Organizational Analysis and Policy Advice

- Pro Bono Financial Management Transition Team and Policy Advice: City of Bell
- Preparation for Possible Revenue Ballot Measure: City of Monterey
- Fund Accounting Review: State Bar of California
- Financial Assessment: City of Guadalupe

- Financial Condition Assessment: City of Grover Beach
- General Fund Reserve Policy: City of Lompoc
- General Fund Reserve Policy: City of Willits
- Reserve Policy: State Bar of California
- Budget and Fiscal Policies: City of Santa Fe Springs
- Benchmark Analysis: City of Capitola
- Financial Management Improvements: City of Capitola
- Finance Organizational Review: Ventura Regional Sanitation District
- Organizational Review: City of Willits (in collaboration with the HSM Team)
- Finance Organizational Review: Sacramento Metropolitan Fire District
- Finance Department Organizational Review: City of Ceres (in collaboration with national consulting firm)

Other Financial Management Services

- Revenue Options Study: City of Greenfield
- Revenue Options Study: City of Pismo Beach
- Cost Allocation Plan: City of Greenfield
- Cost Allocation Plan: City of Guadalupe
- Cost Allocation Plan: City of Port Hueneme
- Cost Allocation Plan: City of Grover Beach
- Cost Allocation Plan Review: State Bar of California
- Cost Allocation Plan Review: City of Ukiah
- Disciplinary Proceedings Cost Recovery Review: State Bar of California
- Water and Sewer Rate Reviews: Avila Beach Community Services District
- Water and Sewer Rate Reviews: City of Grover Beach
- Solid Waste Rate Review: County of San Luis Obispo, Los Osos Area
- Solid Waste Rate Review: County of San Luis Obispo, North County Area
- Joint Solid Waste Rate Review: Cities of Arroyo Grande, Grover Beach, Pismo Beach and Oceano Community Services District

INTERIM FINANCE DIRECTOR

- City of Monterey
- San Diego County Water Authority
- City of Capitola

PROFESSIONAL LEADERSHIP

- Board of Directors, League of California Cities (League): 2008 to 2010
- Member, California Committee on Municipal Accounting: 2007 to 2010
- President, League Fiscal Officers Department: 2002 and 2003
- President, CSMFO: 2001
- Board of Directors, CSMFO: 1997 to 2001
- Member, GFOA Budget and Fiscal Policy Committee: 2004 to 2009
- Chair, CSMFO Task Force on "GASB 34" Implementation
- Fiscal Officers Representative on League Policy Committees: Community Services, Administrative Services and Environmental Quality: 1992 to 1998
- Chair, Vice-Chair and Senior Advisor for CSMFO Committees: Technology, Debt, Career Development, Professional and Technical Standards and Annual Seminar Committees: 1995 to 2010
- Member, League Proposition 218 Implementation Guide Task Force
- Chair, CSMFO Central Coast Chapter Chair: 1994 to 1996

CONSULTANT QUALIFICATIONS

TRAINER

Provided training for the following organizations:

- League of California Cities
- Institute for Local Government
- California Debt and Investment Advisory Commission
- Government Finance Officers Association of the United States and Canada
- California Society of Municipal Finance Officers
- Municipal Management Assistants of Southern California and Northern California
- National Federation of Municipal Analysts
- Probation Business Manager's Association
- California Association of Local Agency Formation Commissions
- Humboldt County

Topics included:

- Long-Term Financial Planning
- The Power of Fiscal Policies
- Fiscal Health Contingency Planning
- Financial Analysis and Reporting
- Effective Project Management
- Providing Great Customer Service in Internal Service Organizations: The Strategic Edge
- Strategies for Downsizing Finance Departments in Tough Fiscal Times
- Top-Ten Skills for Finance Officers
- Telling Your Fiscal Story: Tips on Making Effective Presentations
- Transparency in Financial Management: Meaningful Community Engagement in the Budget Process
- What Happened in the City of Bell and What We Can Learn from It
- Debt Management
- Preparing for Successful Revenue Ballot Measures
- Multi-Year Budgeting
- Integrating Goal-Setting and the Budget Process
- 12-Step Program for Recovery from Fiscal Distress
- Strategies for Strengthening Organizational Effectiveness
- Financial Management for Elected Officials
- Top Challenges Facing Local Government Finance Officers
- Budgeting for Success Among Uncertainty: Preparing for the Next Downturn

PUBLICATIONS

- *Presenting the Budget to Your Constituents*, CSMFO Magazine, July 2016
- *Planning for Fiscal Recovery*, Government Finance Review, February 2014
- *Guide to Local Government Finance in California*, Solano Press, July 2012 (Co-Author)
- *Managing Debt Capacity: Taking a Policy-Based Approach to Protecting Long-Term Fiscal Health*, Government Finance Review, August 2011
- *Fees in a Post-Proposition 218 World, League of California Cites, City Attorney's Department Spring Conference, May 2010*

- *Municipal Fiscal Health Contingency Planning,* Western City Magazine, November 2009
- *Understanding the Basics of County and City Revenue*, Institute for Local Government, 2008 (Contributor)
- *Financial Management for Elected Officials*, Institute for Local Government, 2007 (Contributor)
- *Getting the Most Out of Your City's Current Revenues: Sound Fiscal Policies Ensure Higher Cost Recovery for Citie*s, Western City Magazine, November 2003
- *Local Government Revenue Diversification, Fiscal Balance/Fiscal Share and Sustainability*, Institute for Local Government, November 2002 (Co-Author)
- *Why Is GASB 34 Such a Big Deal?,* Western City Magazine, November 2000
- *Understanding Sales Tax Issues,* Western City Magazine, June 1997
- *Proposition 218 Implementation Guide*, League of California Cities, 1997 (Contributor)

HONORS AND AWARDS

- Cal-ICMA Ethical Hero Award (for service to the City of Bell)
- CSMFO Distinguished Service Award for Dedicated Service and Outstanding Contribution to the Municipal Finance Profession
- National Advisory Council on State and Local Government Budgeting: Recommended Best Practice (Fiscal Polices: User Fee Cost Recovery)
- GFOA Award for Distinguished Budget Presentation: Special Recognition as an Outstanding Policy Document, Financial Plan and Communications Device
- CSMFO Awards for Excellence in Operating Budget, Capital Improvement Plan, Budget Communication and Innovation in Budgeting
- GFOA Award of Achievement for Excellence in Financial Reporting
- CSMFO Certificate of Award for Outstanding Financial Reporting
- National Management Association Silver Knight Award for Leadership and Management Excellence
- American Institute of Planners Award for Innovation in Planning
- Graduated with Honors: University of California, Santa Barbara