



PRELIMINARY BUDGET PREPARATION MEMORANDUM

June 29, 2016

BUDGET OVERVIEW

PURPOSE

We are pleased to present to the Board of Directors the proposed 2016/17 Fiscal Year Budget, supported by this supporting Budget Preparation Memorandum. The following assumptions, criteria and descriptions are used by staff in developing the actual budget numbers and should be very helpful in understanding the budget and its implications.

The development of the small public agency budget is as much an exercise in public outreach and education as it is in finance and fiscal accountability. Effective special district budgets tie directly to strategic plans and management goals and objectives, are simply presented and easily understood by the average District service customer. The District has seen much confusion over its financial performance, and we are determined to implement the financial structure and process to make local budgets and financial statements understandable, and in conformance with all laws and standards. Through these budget processes we also attempt to inform the general public of the good work we do at the LOCSO.

The primary purpose of the annual budget is to match available funding with meeting the service objectives of the Board of Directors, as well as agreements and permit conditions. In budget development, management allocates specified amounts of money to all necessary expenditures of the District based on Board policy, established priorities and the operating needs of the District as determined by its professional staff. It is normal for Boards and/or the public to question or challenge certain expenditures, and staff should be expected to support and even defend recommended expenditure levels with additional information, requirements from permits, studies, evaluations, comparisons or benchmarks to explain the relationship between the expenditure and meeting the Board's service objectives.

With this proposed as the preliminary budget, we expect significant Board direction at this June 29 meeting as we continue to refine our projections and resolve any outstanding budget issues, as well as produce a final budget that is balanced and the resulting progress and financial condition of the District clearly known. We expect to adopt the final 2016-17 budget in August 2016 following Board Committee review and input.

TRANSPARENCY

To provide a basis of budget understanding, the assumptions, criteria and procedure of budget development is articulated in this memorandum to offer the reader with the background necessary to comprehend the methodology used and the information necessary to identify trends, financial red flags, budget influences and other factors. The budget must identify where

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the public's money will be spent in the upcoming year; what vehicles, equipment and capital projects will be purchased, how much is spent on personnel, etc. The budgeting exercise is therefore used as a vehicle to increase financial transparency and accountability.

ACCOUNTABILITY

Budgeting is also a management tool used to continuously refine financial accounting methods to evaluate the impact of delivering various levels of public services. For example, we need to be able to not only quickly recognize when we have underestimated cost for materials and supplies; we should also have the ability to know whether the added expenses could have been avoided by replacing something sooner; such as a pump. We also need to carefully understand the cost for full water system maintenance according to an industry standard, versus the cost to allow equipment to deteriorate without much maintenance, ultimately replacing it sooner than typically required. Throughout the upcoming year, we will be refining our accounting practices to allow for this level of expense tracking so that in future budgets, we can easily understand the value and cost of our efforts, in each of the major areas of the services we provide.

SERVICE LEVELS

The District provides public, domestic water supply in accordance with various permits issued by the state. These permits are an example of a service in which our actions and service levels are for the most part fixed by others. We have a fiduciary responsibility under the permits to employ the certified staff and work them around the clock if necessary, purchase the monitoring equipment, replace and upgrade infrastructure to standards, perform sampling, purchase materials and supplies and apply the methods necessary to meet the specific operational conditions detailed in these complex permits. Noncompliance with permits results in serious fines issued by the state on a daily basis. Budgetary limitations are not an excuse for noncompliance with permit conditions.

Property or vehicle maintenance is an example of activities where we have the discretion to set service levels. Other than for fire protection and potential liability reduction, there are no state or federal mandates that require us to perform ongoing property maintenance to a specific level; however lack of maintenance on properties makes for ugly property, and lack of vehicle maintenance is not only ugly, but can shorten the life of a vehicle. Conducting our work in a manner that leaves a "known" *Dangerous and Defective Condition of Public Property* is one of the few instances where a public agency can be held liable for damages determined to be caused by such defects. In either case, the Board has the discretion to allow funding for more or less emphasis on these types of activities based on its priorities.

Although not mandatory, performing property and vehicle maintenance to an established standard will reduce liability to a minimum and maximize the useful life of the property and equipment itself; thereby reducing long term costs.

Maintenance to the full industry standard can be extremely expensive for a small community, especially when we perform the services and receive NO form of revenue other than fees and low property taxes. This high cost often leads the special district Board to under-fund necessary maintenance work, thus making a conscious decision to perform a lower level of service than required for optimal equipment life. For the most part, this budget proposes a level of maintenance adequate to keep systems functioning, with the understanding that many replacements will be needed at some point in the future.

When it comes to our fire services; by contracting with CalFire, we have selected a level of service commensurate with the standard of care and response expected of Calfire employees and stations statewide. In order to maintain this level of service, equipment must be in working order and meeting standards.

2016/17 BUDGET DISCUSSION

The District's budget is developed for the ensuing calendar year by the Accountant with assistance from department heads or other assigned budget preparers; under the review and guidance of the General Manager. Expenses and revenue spent and received this fiscal year were not able to be accurately calculated in preparation for this budget, due to the accounting problems of the past two years, and disarray for many changed account numbers established for unclear purposes. Staff used the 2015/16 fiscal year budget, and audited figures from past years to estimate expenses for 2016/17. Further, budget criteria are established and assumptions about known changes in expenses and revenue for the next year are forecasted and further guide budget development.

The purpose of the following budget assumptions and criteria is to provide the Board a better understanding of what makes up the budget, and why the numbers look the way they do. Explaining what drives the number can be a significant help in relating to the actual numbers shown in the various fund budgets. This budget proposal is very simply constructed and presented, due to the relatively stable and very limiting nature of our funding and limited expense fluctuations; therefore, this narrative is very important in understanding the financial condition of the District and where we will be spending the same, more or less money next year. Following are some basic assumptions and criteria used in our budget development:

REVENUE FORECASTS

- There will be no changes in the type of revenue received; ie no new assessments adopted or fees charged
- Both water base rate and sales (consumption) revenue will be consistent with the projected fiscal year end 2016. We are not planning financially on selling more water, or gaining more customers this fiscal year.
- The second of four water rate increases goes into effect July 1, 2016
- Fire special taxes will be increased by the 2.6% recommended
- No specific grant funds have been budgeted for the water fund.
- Revenue for the Wastewater fund is derived from administrative fees charged on the existing wastewater assessment bonds charged on the tax rolls
- Revenue for the Park and Recreation fund is derived from a transfer of revenue from the existing Park and Recreation reserve fund
- Property taxes will increase over last year's rate as estimated by the County

EXPENSE ASSUMPTIONS AND CRITERIA

The 2016/17 fiscal year budget is being prepared using the following assumptions regarding expenses:

***FUND 200 – Bayridge Estates**

- This fund provides street lighting, septic services, and open space management.
- There are 147 parcels that are assessed \$373.00 per parcel.
- This fund also receives property tax revenue from one County tax rate area
- Assessments will remain on the properties until the fund is balanced.
- There are 12 septic tanks that need to be pumped out completely so this fund will be charged, and this expense has caused this fund to be approximately \$40,000 in the negative this year.
- Some legal and engineering services will still be required.

FUND 301 – Fire

- Property tax revenue estimated by county tax collector's office, increased due to increasing property sales and taxed valuation

- Special tax revenue estimated by Wallace Group based on tax rolls as prepared for billing and collection
- Expenses include an approximate 5% increase in the cost of the Schedule A contract with Calfire; a \$100,000 increase
- An approximate \$46,000 increase in property taxes and assessments from 2015-16, far below the amount required to cover the Schedule A cost increase
- To balance the revenue and expenses, the vehicle replacement fund allocation was reduced in this budget proposal

***FUND 400 – Vista de Oro**

- Collection systems will be legally transferred to the County of San Luis Obispo in the 2016-2017 fiscal year.
- This fund provides street lighting and septic services.
- There are 73 parcels that are assessed \$216.00 per parcel.
- This fund receives NO property tax revenue.
- Assessments will remain on the properties until the fund is balanced.
- Some legal and engineering services will still be required this year, which is reflected in the contract services line.

***FUND 200 Bayridge Estates**

- Collection systems will be legally transferred to the County of San Luis Obispo in the 2016-2017 fiscal year.
- Major cost increase due to the one time septic system pumping costs

FUND 500 – Water

- This is an enterprise fund for water service in the Baywood Park/Los Osos Community.
- There are roughly 2750 connections that service a population of 7086.
- This fund receives property taxes from five County tax rate areas.
- Revenue estimate of \$1.8M based on FY 15/16 water sales with anticipated rate increase.
- Capital Improvements budgeted for this year will include
 - 8th & El Moro Upper Aquifer Well - \$90K for Phase I (drilling & testing)
 - Bids will be opened on July 21, 2016 in the LOCSD office @ 2:00 pm
 - Additional \$110K for the 8th & El Moro Upper Aquifer Well after Board approval to continue with equipping whether we blend or have to install an ion exchange unit.
 - Golden State Water Company & LOCSD Intertie project at 11th Street & Los Olivos –\$50K. Agreement has been signed.
 - Vehicle replacement - \$50K, Unit A needs to be replaced. It is a 2000 Ford F250 4x4 pickup
- Engineering and Professional Services will continue to be large items as we move forward with projects in the Los Osos Basin Plan.
- Shared Costs for Basin Management Committee items. An estimate for this calendar year is being used as an estimate to budget for next fiscal year. \$120K is the LOCSD share.
- There is a large line item for training and education \$18,500 budgeted. Our crews work with electrical equipment and will receive training this year. This budget item also includes OSHA compliance and other trainings.

FUND 800 – Drainage

- This fund provides drainage within the community and this budget includes increased level of repair and maintenance on facilities.
- The total revenue in this department barely covers the cost of personnel salaries for the department.
- The LOCSD maintains four pump stations (Don & Mitchell, 6th & El Moro, 8th & El Moro, and 16th & Paso Robles) and five drainage basins throughout the community.

- We will need some repairs and maintenance on the submersible pump stations to upgrade two control panels - \$5K budgeted.
- If pump or control panels need to be replaced there is \$40K budgeted for capital outlay.