



STAFF REPORT TO THE CITY COUNCIL

DATE: Regular Meeting of March 24, 2020

SUBMITTED BY: David Biggs, City Manager
Edwin Gato, Finance Director

SUBJECT: Municipal Financial Health Diagnostic Tool

RECOMMENDED ACTION: Receive a report and discuss the League of California Cities Municipal Financial Health Diagnostic Tool.

COMMISSION/SUBCOMMITTEE ACTION AND RECOMMENDATION: The report was presented to the Finance Commission at their special meeting on Thursday, March 18, 2020, and any comments from the Commission will be shared with the Council at its meeting.

DISCUSSION: The League of California Cities has developed a Municipal Financial Health Diagnostic tool for Cities to measure their financial health. Government financial health may be viewed in four related fiscal contexts:

1. Cash Solvency – the ability to meet immediate financial obligations;
2. Budgetary Solvency – the ability to meet all financial obligations during a budget year;
3. Long Run Solvency – the ability to meet all financial obligations in the future;
4. Service Level Solvency – the ability to provide the desired level of services for the general health and welfare of a community.

The League of Cities Financial Health Diagnostic tool is concerned with the ability of Cities to meet its financial commitments now and into the future (Cash, Budgetary, and Long Run Solvency).

In 2015, staff utilized the tool for the first time and the City Council received a presentation on the results on October 27, 2015. At that time, the City Council indicated that the tool should be updated each year after the annual audit is completed.

This tool focuses on the General Fund and looks at recent past and near future (FY 2017-18 through FY 2022-23) financial measures and indicators to provide an assessment of the City's financial distress and tendency towards financial crisis.

The California Municipal Financial Health Diagnostic tool consists of:

1. **The Financial Distress Checklist.** A 14 point list of key indicators to assess the near term financial health of the City's General Fund and other operations.
2. **The Financial Health Indicators.** This is linked to the 14 point Financial Distress Checklist. The Financial Health Indicators provide more detailed formulas and methods for determining financial condition. Of the 14 financial health indicators, there were 4 "Caution" indicators and 10 "Healthy" indicators for the City of Hercules.

The color code is Red = Warning; Orange/Rust = Caution; Green = Healthy

The City of Hercules staff has completed the Municipal Financial Health Diagnostic tool for the period of FY 2017-18 through FY 2022-23 using the following data: Audited Financial Statements for FY 2017-18 and FY 2018-19; and the Forecast for FY 2019-20 and FY 2022-23.

The results of the completion of the Municipal Financial Health Diagnostic tool for the Financial Distress Checklist are:

1. Net Operating deficit / surplus. There are no recurring general fund operating deficits. General revenues are sufficient to meet the net general revenue demand of programs.	<i>Caution</i>
2. Fund balance. Reserves are sufficient over multiple consecutive years and in compliance with adopted policy.	<i>Caution</i>
3. Capital Asset Condition. The city is keeping pace with the aging of its capital assets.	<i>Healthy</i>
4. Liquidity. Cash and short-term investments are sufficient to cover current liabilities (including short-term debt and accounts payable within 60 days).	<i>Healthy</i>
5. Fixed costs & labor costs. Fixed costs (including debt service and other contractual obligations), salaries and benefits are stable or decreasing over multiple years relative to reasonably expected revenue growth.	<i>Healthy</i>
6. General fund subsidies of other funds. Any general fund subsidies other enterprises or special funds are sustainable and in compliance with adopted policy.	<i>Healthy</i>
7. Constraints on budgetary discretion. The city council's authority to make budget changes is not excessively constrained by charter, contract, or law.	<i>Healthy</i>
8. Balancing the budget with temporary funds. The use of reserves, selling assets, deferring asset maintenance to balance the general fund has been limited, prudent and in compliance with adopted policy.	<i>Caution</i>
9. Balancing the budget with borrowing. The use of short-term borrowing, internal borrowing or transfers from special funds to balance the general fund has been limited, prudent and in compliance with adopted policy.	<i>Healthy</i>

10. Balancing the budget by deferring employee compensation costs. Pension liabilities and other non-salary benefits have been determined, disclosed and actuarially funded in compliance with adopted policy.	<i>Healthy</i>
11. Balancing the budget with backloaded debt service payments. Debt service payments have not been “backloaded” into future years.	<i>Healthy</i>
12. Funding operating costs with non-recurring revenues. Ongoing operating costs are being funded with ongoing rather than temporary revenues (e.g., from development, etc.)	<i>Healthy</i>
13. Timeliness and accuracy of financial reports. Financial Reports are being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)	<i>Healthy</i>
14. Service level solvency. Public service levels meet the standards and needs in this community.	<i>Caution</i>

The cautionary results was an increase from 2 to 4 compared to the prior year and are due mainly to Hercules’ Due Diligence Review (DDR) installment payment on the former Redevelopment Agency. The City proposed the following payments to the Department of Finance (DOF) as follows based upon a recent Settlement Agreement regarding litigation on the matter:

FY 2019-20	\$1,812,075
FY 2020-21	604,025
FY 2021-22	604,025
FY 2022-23	604,025

Because of this settlement payments, the City will have to draw money from the reserve to meet this obligation. The City has a policy to retain at least two months of reserves from economic uncertainties. Currently, the City has \$4 million in reserves and enough to cover three months of expenditures. The settlement payments to DOF is projected to decrease the General Fund reserves to \$1.6 million after the FY 2022-23 payment, or less than one month of reserve. However, there has been a significant improvement since the first use of the Diagnostic Tool in 2015, and this reflects the City’s continued progress on the path to financial sustainability.

ATTACHMENTS:

Attachment 1 – Municipal Financial Health Diagnostic tool

Financial Impact

Description:

Funding Source:

Budget Recap:

Total Estimated cost:	\$	New Revenue:	\$
Amount Budgeted:	\$	Lost Revenue:	\$
New funding required:	\$	New Personnel:	\$
Council Policy Change:	Yes <input type="checkbox"/> No <input type="checkbox"/>		