



May 2, 2023

**TO THE HONORABLE CITY COUNCIL:**

The Measure HH – Essential City Services Oversight Advisory Committee would like to offer an addendum to our original report to council approved at our meeting on April 17<sup>th</sup>. Specifically, we want to update our report to reflect action taken by City Council on April 18<sup>th</sup> related to Measure HH.

First, we want to acknowledge that City Council has approved the creation of the Measure HH Reserve including the transfer of \$23 million dollars from our Capital Reserves. This step will ensure that residents are able to track expenditures paid for by Measure HH and is a positive step in the right direction. It is our belief that this step addresses the first concern and recommendation we outlined in our original letter.

Second, the Committee believes that the \$23 million should not be spent on capital projects. We believe that the Spending Pledge did not prioritize capital projects. Instead, the Spending Pledge prioritized paying down our debt and addressing our pension liabilities. The only way to ensure that when Measure HH expires our debt is eliminated and our pension liabilities have been managed is to dedicate all “extra” Measure HH funds to debt and pension liabilities, not new capital projects.

Third, we believe that the purchase of land for the construction of a new fire house is not consistent with the priorities established in the Spending Pledge as originally conceived. We are also concerned that the repayment of the \$6 million dollars being borrowed from Measure HH Reserve to purchase new land for fire station 1 is not codified. We recommend that City Council formally commit to repaying the money to the Measure HH Reserve. We also do not believe that Measure HH funds should be funding source for the construction of the new fire house. If Measure HH money is used, the Committee would recommend that the Measure HH Reserve be repaid using income generated from or on the property housing the new fire station.

We respectfully request that the remaining \$17 million in the Measure HH reserves be earmarked and/or used to address our debt and pension liabilities. We would also request that as the \$6 million being borrowed from the Measure HH Reserve be earmarked for debt and pension liabilities when it is repaid.

Respectfully submitted,

**Randy Takayama, Chair**  
February 2021 – Present

**CITY OF FOUNTAIN VALLEY  
MEASURE HH ADVISORY OVERSIGHT COMMITTEE**

**Matt Taylor**  
April 2017 – Present

**Stephen Schwarz**  
January 2021 – Present

**Charles Hoyt, Vice Chair**  
February 2022 – Present

**Al Schwerin**  
Alternate  
March 2023-Present

**Jeffrey Stone**  
February 2022 – Present



May 2, 2023

## **TO THE HONORABLE CITY COUNCIL:**

The Measure HH – Essential City Services Oversight Advisory Committee was established by the City Council on April 4, 2017 after passage of Measure HH on the November 8, 2016 ballot. One of the provisions of Measure HH was the creation of an Oversight Committee to review and make recommendations to the City Council to ensure that revenues from the tax are utilized in accordance with the City’s Responsible Spending Pledge. The Responsible Spending Pledge sets forth the City’s priorities on the use of Measure HH funds, which states that the majority of this money should be used to maintain:

- Essential city services such as public safety/911 emergency response
- Keep Fire Station 2 open and maintain firefighter/paramedics
- Senior and youth programs
- Streets, sidewalks, roadways, parks and repair storm water systems
- Parks and play equipment
- Provide other essential City Services

The Pledge also states that whenever additional revenue gains are realized, City leadership should seek opportunities to:

- Pay off, pay down, consolidate, or refinance outstanding debt
- Pay down unfunded liabilities; and
- Rebuild and maintain the City’s established reserve levels

The purpose of this letter is to communicate that the Measure HH Oversight Committee has several concerns about the way in which Measure HH funds are being managed. We also believe it is important to be transparent with residents and admit that inaccurate financial data in 2022 exacerbated the city’s structural deficit.

This letter is divided into three sections. First, we will provide a quick summary of our concerns. Second, we will offer more detailed support for each of our concerns. Finally, we will conclude with a list of recommended action for City Council and City Staff.

## **A Summary of Our Concerns**

1. We believe that the City has transferred almost \$15 million dollars more than is justified to maintain and rebuild our reserves. Our Capital reserve account exceeds its council establish target. As a result, transferring Measure HH funds to this account is inconsistent with the spending pledge.

2. We believe that the City may be overcharging Measure HH for essential services, keeping fire station 2 open, and for senior and youth programs as represented on the annual report card. These increases are inconsistent with the methodology our committee has used since its inception. More importantly, the Measure HH Oversight Committee was not consulted or included in the conversation that led to these changes.
3. The City does not have a mechanism to ensure that when budget surpluses are identified, Measure HH is the first fund made whole. This allows Measure HH funds to be spent outside of the spending pledge.
4. The Measure HH Oversight Committee and City Council were given inaccurate financial forecasts on two different projections in 2022 exacerbating the City's structural deficit.

### **\$15 Million in Reserve Transfers**

To assure voters that they could trust the City to spend this new tax revenue on its intended purpose, residents were promised that if Measure HH funds exceeded the amount of our annual structural deficit they would be used for very specific projects. The City of Fountain Valley Spending Pledge states:

We also believe, that whenever **additional revenue gains are realized**, City leadership should seek opportunities to:

- Pay off, pay down, consolidate or refinance the City's outstanding debt;
- Pay down unfunded liabilities; and
- Rebuild and maintain the City's established reserves levels.

The City used Measure HH funds to rebuild and maintain its established reserves. Unfortunately, once those reserves were rebuilt, instead of using additional revenues to pay down debt and pension obligations, the City transferred Measure HH funds into capital reserves in excess of its council approved target.

This is not the first time this has happened. In fact, FY 2021-22 represents the third year our Oversight Committee has commented on this problem. Worse yet, the City is currently budgeting to do it again in FY 2022-23 where they project to transfer almost \$1.5 million additional Measure HH funds into Capital Reserves.

### **Changes to the Report Card Done Without Collaboration**

Our Committee is aware that for the purposes of the city's accounting and budget systems, Measure HH funds are general funds and unrestricted. We also recognized early on in 2017 that the City could easily say it was using Measure HH funds on Measure HH projects by charging the entire FVPD or FVFD budget to Measure HH.

As a result, the Committee in collaboration with the Fountain Valley Finance Department created a metric for assessing how much of the FVPD or FVFD budget should be charged to HH. As you can see in the attached chart of expenses, it is clear that the methodology for identifying Measure HH expenses related to Public Safety have changed since FY 2020-2021. Our concern is that we were not consulted when this change took place. We are not able to determine whether the changes made to the report card are good or bad because we have not been included in the conversation.

### **Ensuring all Measure HH funds are used for Measure HH**

The assumptions applied to our economic models and budgeting encourage conservative estimates on both our revenue and expenses. We budget to receive less revenue than we typically get and assume more expenses than we typically realize.

While we agree that this is a sound budgeting strategy, we are concerned that our processes allow more Measure HH money to be used from the general fund than is warranted. For example, when the City budgeted FY 2022-2023 we estimated that we would have an \$11.8 million-dollar deficit. As a result, 11.8 million dollars was allocated from Measure HH to cover essential city services.

What happens, however, when we realize at mid- or end of year that the City's actual structural deficit was \$8.8 million? We don't have a mechanism that "returns" the \$3 million dollars of Measure HH money that the City no longer needs to cover the deficit. As a result, \$3 million dollars of Measure HH can be spent outside of the restrictions connected with the spending pledge.

### **Bad Financial Data**

Both the Measure HH Oversight Committee and City Council were given inaccurate 20-year economic forecasts that overstated our economic position by almost \$100 million dollars in January of 2022. Second, City Council, when negotiating new contracts with our employee groups, was given incomplete/inaccurate information about the long-term cost of the contract negotiations in the spring of 2022. As a result, the City faced a perfect storm of overstating revenue and understating expenses. This inaccurate information exacerbated our structural deficit. This means that we have less Measure HH money to spend on debt and pension obligations than we should have had.

### **Recommended Action**

1. The Measure HH Oversight Committee recommends reallocating the overcapitalized fund balance in our Capital Reserves to the City's pension trust account. At a minimum, these funds should be identified as Measure HH funds to ensure that they are used consistent with the spending pledge.

2. The Measure HH Oversight Committee recommends that the Finance Department and the Measure HH Committee meet to collaborate on the appropriate metrics for building the Measure HH report card.
3. The Measure HH Oversight Committee recommends that the City adopt an accounting process that ensures that Measure HH allocations are fully captured.
4. The Measure HH Oversight Committee recommends that City Council make a public commitment to the spending pledge. We also recommend that this action be taken each time there is a change in the membership of City Council.
5. The Measure HH Oversight Committee recommends that staff provide a public report to City Council, at a regularly agenzized meeting, about the financial irregularities that occurred in early 2022 including an assessment of their impact on our structural deficit.

We are thankful for the opportunity to serve and we look forward to continuing to serve the City Council and the residents of this great city.

Respectfully submitted,

**Randy Takayama, Chair**  
February 2021 – Present

**CITY OF FOUNTAIN VALLEY  
MEASURE HH ADVISORY OVERSIGHT COMMITTEE**

**Matt Taylor**  
April 2017 – Present

**Stephen Schwarz**  
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February 2022 – Present

**Al Schwerin**  
Alternate  
March 2023-Present

**Jeffrey Stone**  
February 2022 – Present

**CITY OF FOUNTAIN VALLEY**  
**Schedule of Measure HH Revenues and Expenditures**  
**With Independent Accountant's Report Thereon**  
**For the Year Ended June 30, 2022**

## **INDEPENDENT ACCOUNTANT'S REPORT**

To the Honorable Mayor  
and Members of City Council  
of the City of Fountain Valley  
Fountain Valley, California

We have examined management of the City of Fountain Valley's (City) assertion that the City complied with Measure HH included in the accompanying Schedule of Measure HH Revenues and Expenditures (schedule) during the fiscal year ended June 30, 2022. The City's management is responsible for its assertion. Our responsibility is to express an opinion on management's assertion about the City's compliance with the specified requirements based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Our examination does not provide a legal determination on the City's compliance with the specified requirements.

In our opinion, management's assertion that the City complied with Measure HH reporting requirements included in the accompanying schedule is fairly stated, in all material respects.

This report is intended solely for the information and use of the City Council and management of the City of Fountain Valley, California and is not suitable for any other purpose.



Irvine, California  
March 1, 2023

CITY OF FOUNTAIN VALLEY  
SCHEDULE OF MEASURE HH REVENUES AND EXPENDITURES  
Fiscal Year Ended June 30, 2022

|   |               |
|---|---------------|
| <b>Measure HH Revenues</b>                                      | \$ 17,162,175 |
| <b>Measure HH Expenditures:</b>                                 |               |
| <b>Reoccurring Expenses Incurred on Essential City Services</b> | 5,424,000     |
| <b>One-Time Expenses (Additional Pension Paydown)</b>           | 3,000,000     |
| <b>Financial Stewardship: Reserves Set-Aside in 21-22</b>       | \$ 8,738,175  |

Measure HH provided necessary funding in Fiscal Year 2021/22 that was used for the following in accordance with the **Responsible Spending Pledge**:

| <b>Reoccurring Expenses Incurred on Essential City Services:</b>   |                  |
|--|------------------|
| <b>Public Safety</b>   |                  |
| Maintain 911 Emergency Response Times & Keep Fire Station No. 2 open <sup>1</sup>  | 1,579,000        |
| Police and Fire Pension Costs that are Legally Required to be Paid to CalPERS and Principal and Interest on the Safety Pension Obligation Bonds <sup>2</sup> | 2,108,000        |
| <b>Total Public Safety</b>   | <b>3,687,000</b> |
| <b>Senior &amp; Youth Programs</b>   |                  |
| Amount associated with the cost to keep the Recreation Center, Community Center & Senior Center open <sup>3</sup>  | 1,362,000        |
| <b>Employee Retention</b>  |                  |
| Salary and benefit increases <sup>4</sup>  | -                |
| <b>Capital Improvements</b>  |                  |
| Includes \$375,000 for residential road rehab.   | 375,000          |
| <b>Total Reoccurring Expenses<sup>5</sup></b>  | <b>5,424,000</b> |

| <b>One-Time Expenses:</b>   |                  |
|---|------------------|
| <b>Additional Payment to CalPERS towards unfunded pension liabilities</b> | <b>3,000,000</b> |

| <b>Reserves Set-Aside in 21-22:</b>  |                  |
|--|------------------|
| <b>Pension Reserves</b>  |                  |
| 2021-22 Contribution to Pension Trust Fund                                   | -                |
| <b>Increase in Capital Reserves</b>  |                  |
|  | 8,373,175        |
| <b>Capital Reserves - Transfer to Fleet Management Internal Service Fund</b> |                  |
| Set-aside for Fire Apparatus   | 365,000          |
| <b>Total Reserves Set-Aside in 21-22</b>                                     | <b>8,738,175</b> |

See accompanying notes to Schedule of Measure HH Revenues and Expenditures.

- <sup>1</sup> - Without Measure HH, staff would have faced the challenge of closing Fire Station No. 2, which would have been a gradual process spanning multiple years. The total cost attributable to 14-full-time equivalents (FTEs) within various classifications assigned to Fire Station No. 2 is \$2,174,551. Approximately 72.6% of the staffing cost attributable to Fire Station No. 2 has been identified as being funded from Measure HH, which equates to \$1,579,000.
- <sup>2</sup> - Historically, pensions were funded over a rolling 30 year period in accordance with CalPERS funding policy. In 2013 CalPERS approved a change to pension funding, which resulted in shorter amortizations and significant increases in amounts required to be paid to CalPERS beginning in Fiscal Year 2015-16. The City's annual pension expense was approximately \$5 million through Fiscal Year 2015-16, which included \$1,606,319 paid for police and fire pension costs for services rendered in prior years (excluding "normal cost" related to the accrual of benefits earned in the current year). In 2020-21, the projected expense for police and fire pension costs for services rendered in prior years is \$4,509,770, which includes principal and interest expense paid on Pension Obligation Bonds attributable to police and fire. Approximately 72.6% of the increase (\$2,903,451) in pension expense over the base year equates to \$2,108,000, which has been attributed to Measure HH.
- <sup>3</sup> - The Recreation and Community Services Department generally provides services that benefit the community as whole. Therefore, user fees and revenues generated by the Recreation and Community Services Department generally do not cover the full cost of programs. Therefore, the General Fund subsidizes the difference. The General Fund subsidy is estimated at approximately \$1,876,609 in Fiscal Year 2021-22. Approximately 72.6% of the General Fund subsidy has been identified as being funded from Measure HH, which equates to approximately \$1,362,000.
- <sup>4</sup> - Measure HH was approved by the community to allow for continuous operating and improvement of essential City services. In response to the community needs, the City Council approved negotiated adjustments to salaries and benefits for various classifications.
- <sup>5</sup> - General Fund operating revenues are \$75,714,737 and operating expenditures are \$63,601,239. The net operating surplus is \$12,113,498. Without Measure HH, the General Fund would have had an operating deficit of \$5,048,677. Therefore, this amount has been identified as being funded from Measure HH, which has been used for reoccurring essential City services.

## **CITY OF FOUNTAIN VALLEY**

### **Notes to the Schedule of Measure HH Revenues and Expenditures**

**Year Ended June 30, 2022**

#### **1. BASIS OF ACCOUNTING AND MEASUREMENT FOCUS**

The Measure HH Revenues and Expenditures Schedule (Schedule) is presented using the modified-accrual basis of accounting. Under the modified-accrual basis of accounting, revenues are recognized when they become both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

#### **2. REVENUES AND EXPENDITURES**

Measure HH revenues consist of the 1% transactions and use (i.e. "sales") tax approved by the voters of Fountain Valley on November 8, 2016. Measure HH became effective April 1, 2017, which provided twelve months of revenue in Fiscal Year 2021/22 in the amount of approximately \$17.2 million.

Measure HH is a general-purpose tax, which means the revenues received from the tax go into the City's General Fund to maintain or enhance any lawful City program, improvement or service such as police and fire services, senior and youth programs, etc. Without Measure HH, the General Fund's operating deficit for Fiscal Year 2021/22 would have been \$5,048,677. Measure HH expenditures include the utilization of funds to maintain existing services for public safety and senior and youth programs in an amount totaling \$5,424,000. In addition, Measure HH expenditures include a one-time expenditure of \$3,000,000 for funding of the pension liabilities.

The remaining balance of Measure HH funds represent amounts set-aside in reserves. The reserves set-aside in Fiscal Year 2021/22 include an increase in capital reserves of \$8,738,175.

The General Fund reserves set-asides have been \$1,747,320 in Fiscal Year 2016/17, \$6,914,942 in FY 2017/18, \$9,369,018 in FY 2018/2019, \$5,655,333 in FY 2019/20, \$9,669,419 in FY 2020/21, and \$8,738,175 in FY 2021/22. During FY 2019/20 a prepayment was made for the purchase of a fire apparatus in which the reserves set-aside was reduced by \$1,199,307. Since the original contributions in FY 2017/18, the OPEB and Pension set-aside reserves have accumulated \$1,103,964 in investment earnings. As of June 30, 2022 the total reserve balance was \$41,998,864.

**CITY OF FOUNTAIN VALLEY**

**Notes to the Schedule of Measure HH Revenues and Expenditures**

**Year Ended June 30, 2022**

Total reserves and targets are as follows as of June 30, 2022:

|                                | <b>Measure HH<br/>Reserves</b> | <b>Reserves<br/>at 6/30/22*</b> | <b>Short-Term/<br/>Long-Term<br/>Targeted<br/>Reserve</b> | <b>% Funded by<br/>Measure HH</b> |
|--------------------------------|--------------------------------|---------------------------------|---|-----------------------------------|
| OPEB Trust Reserves            | \$ 1,983,263                   | 12,376,076                      | \$10-30 Million   | 16%                               |
| Pension Trust Reserves         | 11,120,701                     | 11,120,701                      | \$10-30 Million   | 100%                              |
| Emergency Reserves             | 4,903,421                      | 18,426,000                      | \$14.2 Million  | 27%                               |
| Capital Reserves               | 18,145,228                     | 30,476,135                      | \$10-15 Million   | 60%                               |
| Capital Rsrve-Set-aside HH CIP | 5,116,251                      | 5,116,251                       | Shared by above   | 100%                              |
| Fire Apparatus Reserves        | <u>730,000</u>                 | <u>730,000</u>                  | \$2 Million   | 0%                                |
|                                | <u>\$ 41,998,864</u>           | <u>78,245,163</u>               |   |                                   |

\* Including Measure HH and non-HH reserves set-aside and related investment income.