



September 8, 2020

To the Honorable Mayor, City Council, and Citizens of Hesperia,

I am pleased to present the City of Hesperia's Fiscal Year (FY) 2020/21 Adopted Budget for the City of Hesperia, Hesperia Community Development Commission, Hesperia Housing Authority, Hesperia Fire Protection District, and Hesperia Water District. Preparing a municipal budget can be challenging in the best of circumstances. Like cities across the nation, Hesperia was especially challenged in preparing the FY 2020/21 Budget in the midst of a pandemic unlike anything experienced in nearly a century.

One of the most challenging aspects of the creation of the FY 2020/21 Budget is the uncertainty in understanding the full financial impact of the shut-down of California's economy, which began in mid-March and has continued at varying levels since then. The FY 2020/21 Budget of \$90.8 million is an 8% reduction from the FY 2019/20 Budget. Overall, the largest reductions are with the Capital Improvement Program (CIP) projects, as projects were either completed during FY 2019/20 or placed on hold due to funding impacts of the pandemic. The City's operating budget, which includes staffing and providing services to residents, is expected to remain flat.

## **Economic Downturn**

Pandemic-related closures and restrictions of business operations across multiple sectors have changed the economic outlook for municipalities across the nation. Food and drug stores have remained operational during stay-at-home orders which have resulted in improved revenues in this sector during the first quarter of 2020. This translates to only a small increase to related revenue to the City, as many purchases at these businesses are non-taxable.

Building activity had been stable during FY 2019/20 and continues to be stable, with no identifiable increases or declines evident during the creation of the FY 2020/21 Budget. The City's staff anticipates that growth will flatten during FY 2020/21 in response to the lower permit issuance across the state. During the great recession over a decade ago, the City experienced a 100% reduction in single family residential (SFR) permits, which has slowly increased in the years since to 291 permits issued in FY 2017/18 before reducing to 205 in FY 2018/19. During FY 2019/20, 234 single-family residential (SFR) permits were issued, which is a 41% increase over the number projected in the budget.

The City uses consultant-provided estimates for Sales and Gas Tax revenues (approximately \$10.4 million) with other government agencies providing revenue estimates for Local Transportation Funds, Gas Tax Road Maintenance and Rehabilitation Account (RMRA) Funds (approximately \$2.2 million). The remainder of the revenues are estimated by staff using trend analysis, examining development activity, property tax collection rates, water consumption by customer class, franchise fee statements, and hotel occupancy levels, which are then compared to amounts of prior years.

Prior to the pandemic, the City had seen an increase in sales tax revenue, however without second quarter data upon which to rely during the creation of the FY 2020/21 Budget, the City

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adopted a conservative approach during the budget process, anticipating a likely decrease in sales tax revenue related to the closure of the economy.

The unemployment rate in California has reached a record high, with April 2020 unemployment the worst rate in more than 80 years. As stay-at-home orders are adjusted, unemployment numbers fluctuate. As the workforce stabilizes, the City will likely begin to see an increase in consumer activity related to the needs of the commuting population. The City anticipates that increases will be modest and sectors slowly open and as more organizations implement work from home or other alternate work schedules.

### **Budgetary trends**

At the beginning of the calendar year, Hesperia's mid-year budget presentation identified revenues exceeding projects and reflected a generally positive financial outlook, which aligned with the careful planning that had been done in the preparation for the FY 2019/20 spending plan. In fact, sales tax revenue was trending as expected with projections pointing to a modest increase.

The FY 2020/21 Budget includes budgetary and service-level reductions across all funds in response to the dramatic impact of COVID-19 and the subsequent recession. These service-level reductions include a 10% furlough of all non-represented employees with, a reduced 32-hour work-week, a suspension of salary merit-step increases, the suspension of cost of living adjustments (COLA) for non-represented employees and the elimination of 12 vacant positions. Also included is a utilization of fund balance (reserves) to cover the known and anticipated revenue shortfalls.

The pandemic began in earnest in our region after the mid-year budget review in February 2020, at the start of the preparation process for the FY 2020/21 Operating Budget. Both staff and the City's sales tax consultant analyzed market response to government mandated closures of businesses as well as how the loss of gas-tax would impact the City's budget. As the financial outlook continued to deteriorate and closures and stay-at-home orders were extended, City staff was asked to reduce their departmental budget proposals in anticipation of a loss of revenue estimated at \$3.0 million. With the fiscal uncertainty of the stay-at-home orders, staff understood that revenues could continue to deteriorate as the year progressed.

Absent sales tax data from second quarter 2020, the FY 2020/21 Budget was created with significant unknowns, resulting in an unprecedented proposed budget that did not benefit from crucial data that had not been compiled or analyzed. As a result, during the first quarter budget review in the fall, staff will amend financial projections and expenditure plans based on available data.

While there continues to be significant unknowns with respect to loss in revenue, the City is aware that its budget is directly and significantly impacted by the loss of travel along Interstate 15 as well as the reduction in commuter travel, both of which result in a severe and damaging reduction to gasoline sales and the resulting gas tax. In addition, the stay-at-home order has created unprecedented vacancy rates at Hesperia hotels and motels, which account for \$1.0 million annually versus the \$0.8 million budgeted for FY 2020/21. These revenues will not be restored until both stay-at-home orders are lifted and consumer confidence and wiliness to travel is restored to pre-pandemic conditions.



## City Council Priorities

On February 11, 2014, the City Council hosted an agendaized Goal Setting Workshop where a consultant facilitated the integration of multiple goals into a list of the top six City Council Priorities. The goals, which were formally adopted by the Council on February 18, 2014, are as follows:

1. Public Safety – Ensure adequate public safety resources are available for our citizens, families, children, businesses, and visitors.
2. Financial Health – Hesperia will assure its financial health by continuing to provide structurally balanced budgets for its operating funds.
3. Future Development – Actively manage growth to ensure cohesive development including Industrial, Commercial, Residential, Freeway, Main Street and Ranchero Corridors.
4. Future Vision – Agree on a ‘vision’ of what Hesperia should be in 5, 15, and 25 years (revisit the ‘vision’ no sooner than once every 5 years).
5. Organizational Health – Establish and maintain a healthy and efficient organization to provide City services.
6. Capital Improvement – Create Capital Improvement Funding after Redevelopment’s elimination.

Each year the City Council works with staff to establish planning goals within the framework of these six City Council Priorities which then, based upon funding availability, are incorporated into the annual budget process. For FY 2020/21 the specific projects noted below received funding in advancement of the City Council’s Priorities:

- To advance the City Council’s Financial Health Priority, the City’s Reserve Policy was updated to require a minimum of two (2) months of the annual expenditures be held in cash, as recommended by the Government Finance Officers’ Association (GFOA). The specific purpose of the reserves is to provide funding to meet operational appropriation requirements in the event of shortfalls in the level of anticipated revenues or unanticipated expenses. Due to COVID-19, the City expended \$0.9 million of cash reserves to balance the budget, resulting in a balance of 2.2 months of cash reserve, consistent with the City Council’s Reserve Policy.

More information about the specific priorities for each division, as well as significant changes and expenditure information can be found in the F. Department & Program Expenditures section of this budget document.

## Issues on the Horizon

Leveraging limited resources to derive the greatest benefit for the good of the entire community is at the heart of the City Council’s commitment to conservative fiscal management. This prudent management philosophy made it possible for the City to maintain General Fund cash reserves with minimal impacts to the operating budget and to the level of service provided to the community. As the local, regional and national economy is suffering the impacts of the COVID-19 pandemic, Hesperia continues to maintain a conservative approach to the creation of the operating budget. Determined to live within its means, the City is cautiously analyzing revenue deficits while looking to sales tax data from the second quarter of 2020 to provide some clarity as



to the real impact to the local economy. While proactive measures have been taken to successfully maintain the City's fiscal health, remaining challenges include:

Employee Retirement Costs – The City is a member of the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee defined benefit pension plan for its personnel.

In anticipation of increased rates, based upon actions by the CalPERS Board to change its amortization and smoothing policies, the City Council gradually but purposefully moved away from the City bearing the cost of the full 8% employee contribution, to placing that cost reasonably with employees. Initiated well before the California Public Employees' Pension Reform Act of 2013, this funding shift began in FY 2007/08 and by FY 2012/13, employees were paying the full 8% employee contribution.

While this step was important, the City negotiated with employees to go even farther. To further advance the City Council's Financial Health Priority, in addition to paying the full CalPERS member contribution, employees also began paying 1% of reportable earnings as cost sharing of the City's normal costs starting in July 2015.

Despite these steps, last year CalPERS announced additional policy changes which will increase the City's pension costs, in an effort to improve the plans' funded status, including reducing the amortization period from 30 to 20 years for future unfunded liabilities and reducing the discount rate from 7.25% for FY 2018/19 to 7.00% for FY 2019/20. CalPERS is attempting to find solutions to reduce its \$146 billion unfunded liability, of which the Hesperia unfunded liability, including the Hesperia Water District and the former Hesperia Fire Protection District, is approximately \$22.4 million. As CalPERS continues to implement these changes, the annual funding requirements of the member agencies will increase over the next several years. Based upon 2019 CalPERS estimates, just the unfunded accrued liability (UAL) portion of the City's annual payment to CalPERS for the City, Water District and Fire's plans could reach as high as \$2.4 million by FY 2024/25, a 100% increase over the FY 2018/19 required contribution of \$1.2 million. For FY 2025/26, this amount is estimated to decrease to \$2.1 million, reflecting the complete phasing-in of the reduced amortization period.

With respect to the CalPERS plans for the Hesperia Fire Protection District (HFPD), on November 1, 2018 the Local Agency Formation Commission (LAFCO) annexation process for the transfer of Fire District operations to San Bernardino County Fire (County Fire) was complete. As a result, County Fire assumed the responsibility for providing fire protection and ambulance services and the HFPD transferred all assets and liabilities to County Fire, with the exception of the HFPD's former personnel obligations. Hesperia will continue to satisfy the outstanding CalPERS obligations of the HFPD and the City will receive a new source of property taxes. For plans without active employees, such as the HFPD plans, CalPERS reduced the amortization period to 15 years. As such, recent CalPERS projections estimate that the HFPD UAL will level-off at \$1.0 million beginning FY 2020-21, which is an increase of approximately \$200,000 over the FY 2018-19 required contribution of \$797,783.

In making the annual required contribution, CalPERS offers each agency the option of making monthly installment payments for the full required contribution amount, or an opportunity to make one lump sum payment at the beginning of each fiscal year for a discounted amount, enabling CalPERS to invest the full amount for nearly the entire fiscal year. By making the lump sum payment at the beginning of the fiscal year, for FY 2019/20 the City achieved a savings of approximately \$82,749 for the combined City and Water District plans, which is greater than what



the City would have earned through its normal investing practices by making the full required contribution through monthly installment payments to CalPERS.

Currently, the CalPERS pension payments are a relatively small portion of the City's overall budget; however, with pension reform, changes to CalPERS' actuarial methodologies, and general effects of the economy, it is one of the more volatile expenditures that will have the potential to drastically increase in the future.

Other Postemployment Benefits (OPEB) – Governmental Accounting Standards Board (GASB) Statement No. 45 and its successor No. 75 require public-sector employers to recognize the cost of postemployment benefits, such as postemployment healthcare, over the active service life of their employees rather than on a pay-as-you-go basis and identify the methods and assumptions that are required to be used to project benefit payments. The resulting unfunded liability is reported in the Comprehensive Annual Financial Report (CAFR).

Hesperia Golf Course & Country Club – The Hesperia Golf Course & Country Club (Golf Course) is a 211 acre, 18-hole course that first opened in 1957 and was a tour stop for the PGA (Professional Golfers' Association). The Golf Course was privately owned until April 2010 when the City purchased it, in part to avoid the potential for blight due to the owner's desire to sell with an unknown outcome, but more importantly for the water rights associated with the property. At the time of the purchase, the City was aware of deferred maintenance of the course and clubhouse from the previous owners. Much of the infrastructure was the same as it was when it was originally constructed in 1957.

At the time of purchase, the City conducted an extensive public outreach program in order for the community to submit input regarding the long-term use of the property. The results of the outreach program indicated overwhelming support to continue to operate the regulated 18-hole golf course and the City entered into an agreement with the Hesperia Recreation and Park District (Park District) to operate and maintain the Golf Course.

The Park District operated the Golf Course, from 2010-2019 and during that time annual losses were incurred, as expenditures for its operation exceeded the revenue generated. While substantive improvements were needed to improve course infrastructure, the City was working through the effects of the Great Recession which had a significant impact upon City revenues and took many years to recover from. As such, some repairs were made, but funds were not available for investment in the course to make improvements. Recently, due to water conservation efforts in California, the Hesperia Water District (Water District) received partial grant funds to construct infrastructure and begin a recycled water distribution program. The Water District is coordinating with Victor Valley Wastewater Reclamation Authority on a timeline for delivery of recycled water; delivery date is estimated for fall 2020.

In 2019, a Request for Proposal (RFP) was issued for the operation of the Golf Course when the agreement with the Park District ended. One respondent with extensive experience in golf course management was identified; however, start-up costs, needed repairs, projected operating losses, and fees to manage the course are projected to be \$1.2 million for FY 2019/20, with total costs to the City estimated at \$3.7 million over a 5-year period.

On August 20, 2019, the City Council provided direction to staff to move forward with a contract with the golf course operator to avoid a disruption of service. Due to the financial impact of golf course operations, staff was also directed to conduct a feasibility study for a community facilities district (CFD) to explore the potential of providing a funding mechanism for Golf Course operation and enhancements by the citizens who receive a direct benefit of living near the Golf Course.



Outreach to residents near the golf course about the proposed CFD began in April 2020 and included web-hosted community meeting facilitated by the City's CFD consultant and supported by City staff. Approximately 60 residents participated in the information session and had the ability to ask questions and propose suggestions for the future operations of the golf course. A Public Hearing on the proposed CFD will be held January 19, 2021 with the election scheduled for April 20, 2021. The CFD will only be formed if it is approved by two-thirds of residents who cast a vote; only residents in the CFD boundaries will be eligible to vote.

### **Significant Events of FY 2019/20**

- In response to the pandemic, Hesperia activated its Emergency Operation Center and declared a local emergency. The City will continue to lead its residents and businesses through this difficult time, coordinating with the County of San Bernardino and State of California to ensure that Hesperia is well-positioned to reopen the community in a safe and timely manner.
- In June 2020, the Hesperia City Council approved the FY 2020/21 Budget which provides an additional \$1.6 million of funding for its annual Road Improvement Program. These funds are used to enhance streets throughout the City and are in addition to the ongoing Street Maintenance Program. As part of this program, a culvert is being installed on Main Street at Pyrite to convey storm-water from the south to the north, alleviating flooding in the area. Rehabilitation and reconstruction work is planned for east Main Street while slurry seal is planned for Rancho Road between Seventh Avenue and Danbury.
- The City is proud to have been awarded more than \$5.0 million as a result of State and Federal grant programs. This funding will supplement City funds for much needed infrastructure improvements:
  - The City was awarded \$3.9 million as part of the California Transportation Commission's SB1 Local Partnership Program for the Rancho Widening Project, which will widen five miles of Rancho Road from two to four lanes and include features such as construction of a new bridge over the aqueduct, installation of signals and construction of a rail crossing.
  - The City received a federal Highway Safety Improvement Program grant for a traffic signal at the intersection of Main Street at Timberlane Avenue. The project will install a traffic signal, widen the roadway to accommodate left turn pockets, install sidewalks, crosswalks, and lighting. This intersection was identified as a safety priority by the City, with the cost of the project at \$1.2 million, supplemented with \$0.9 million of grant funding. This project is underway and is anticipated to be completed in 2021.
- The City Council implemented a new program to assist non-profits in the City of Hesperia. The new Community Assistance Program (CAP) replaced the Housing and Urban Development (HUD) funded Community Development Block Grant (CDBG) sub-recipient program that the City previously used. The CAP, funded by the General Fund, was created to enable non-profits to spend more time helping Hesperia residents and less time on administrative paperwork. With the implementation of this program, CDBG funds are now being allocated for street improvement projects within the approved CDBG target areas.
- Water conservation continues to be an important issue for California cities. In order to best use the community's water resources, the Hesperia Water District (Water District) is working with the Victor Valley Wastewater Reclamation Authority (VWRA) to bring a sub-regional



recycled water facility to the community, which will deliver tertiary treated water to recycled water customers in Hesperia. The Water District secured a \$2.0 million Proposition 84 Drought Relief Grant, as well as a \$4.7 million Proposition 1 Grant and a low interest loan through the California State Revolving Fund (SRF) Loan program to construct a storage reservoir, pump station, and approximately 8 miles of pipeline that will be used to transport recycled water to purple pipe locations such as the golf course, local schools, and parks. This will serve two important purposes; 1) reduce the flow of wastewater to the treatment plant and 2) lessen the demand on potable water for landscape irrigation purposes, thereby saving financial resources as well as precious water resources. Construction on the reservoir was completed in 2020 with water delivery anticipated by the end of the calendar year, pending readiness of VVWRA.

- Due in large part to a Mobile Source Emission Reduction Grant via the Mojave Desert Air Quality Management District, real-time adaptive traffic signal controllers are being installed at intersections along the Main Street corridor. These signal controllers utilize the latest technology to adjust signal timing based upon existing traffic at and approaching the intersection. Communication equipment was also installed, allowing the controllers to communicate with each other along the corridor, resulting in the efficient movement of traffic through the corridor. Phase I of this project installed real-time adaptive signal controller technology at eight intersections along the Main Street corridor from "I" Avenue to Eleventh Avenue, improving east/west travel. Completed in spring 2020, Phase II of the project installed the same type of system at an additional eight intersections from Escondido Avenue to Mesa Linda Avenue.

### Looking Ahead

Across the nation and the globe, every community has been touched by the Coronavirus pandemic. We have been witness to heart-breaking struggles and loss as well as resiliency of communities like ours that support their friends and neighbors during the most difficult of times. Knowing that the months ahead are filled with economic uncertainties, the City stands committed to ensuring continuity of services in support of Hesperia residents, businesses and stakeholders while maintaining a conservative fiscal approach to budgeting for organizational operations. I am confident that through partnering with our neighbors, City Council and dedicated staff, Hesperia will overcome challenges and explore opportunities that will strengthen our community, preparing us for future successes.

Nils Bentsen  
City Manager