Hot Topics ‘n Burning Issues
A City Finance Update

CSMFO Monterey Bay Chapter
May 22, 2014 Capitola, CA

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The California Local Government Finance Almanac

Over-reliance on land development revenue
Risky financing schemes
Unsustainable and Intractable employee compensation, especially public safety pension and retiree health care
Ceding of management and policy choices to others

Unsustainable and Intractable Decline in Core Revenues
Fear & Denial
Toxic relationships

Bad Brew in Troubled Cities
Revenues are up $2.4 billion (one time – not ongoing…)
- PIT withholdings, partnerships, dividends
- re annual bonus payments & 2012 federal tax policy changes

... but higher costs already eat it up
- MediCal enrollment in FY15 to 11.5 million up from 7.9 million
  - 46% increase – now 30% of population in MediCal
  - $2.4billion higher costs – but federal gov’t pays half
- Drought $800+ million
- Prop98 $659 million (net)
- CalPERS mortality assumptions, etc. - $1b phased in over 3 yrs
- Courts +$60million to $160 million increase
### 2014-15 Governor’s Budget
#### General Fund Budget Summary

($ in millions) Governor’s May Revision 2014

<table>
<thead>
<tr>
<th></th>
<th>2013-14</th>
<th>2014-15</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Resources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior Year Balance</td>
<td>$2,429</td>
<td>$3,903</td>
</tr>
<tr>
<td>Revenues and Transfers</td>
<td>$102,185</td>
<td>$105,346</td>
</tr>
<tr>
<td><strong>Total Resources Available</strong></td>
<td>$104,614</td>
<td>$109,249</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$57,980</td>
<td>$63,304</td>
</tr>
<tr>
<td>Proposition 98 Expenditures</td>
<td>$42,731</td>
<td>$44,462</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>$100,711</td>
<td>$107,766</td>
</tr>
<tr>
<td><strong>Fund Balance</strong></td>
<td>$3,903</td>
<td>$1,483</td>
</tr>
<tr>
<td>Economic Recovery bonds – early repayment (triple flip)</td>
<td>$1,604</td>
<td></td>
</tr>
</tbody>
</table>

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### California State Budget Outlook

#### Voter Approved Revenues

- Personal Income Tax (Prop30)
- Sales and Use Tax (Prop30)
- Corporate Tax simplification (Prop39)
California’s Fiscal Outlook

Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges**
  - 2 year delay in prison population cap OK
  - Avoided debt ceiling problems
- **Health Care Costs.** Medi-Cal is budget’s 2nd largest program.
- **Natural Disasters:** draught, fires, flood, earthquake.
- **Debts and Liabilities.** In addition to budgetary debt:
  - $218 billion state retirement-related unfunded liabilities
  - $65 billion deferred maintenance
  - $9 billion unemployment insurance
- **Capital Gains** (10% of General Fund tax revenues) volatile, affected by stock market behavior.

Reserves, Rainy-Day Funds

- 2014-15 would end w/ $2.3 billion reserve (incl $1.6 bil in Prop58 resv)
- Proposes new rainy–day fund mechanism

Education

- K–12 schools  +$4.5 billion
- Community Colleges  +$355 million
- UC and CSU  + $142 million each
- Higher Ed Innovation grants +50 million

Also...

- Judiciary and Criminal Justice  + $105 million ongoing
- State employees  +2% pay $173 million (all funds)

Governor’s Proposed Budget 2014-15

Pay Down “Wall of Debt”

- Accelerate pay down of economic recovery bonds $1.6 billion
- Pay off school and community college deferrals +$6.2 billion
- Repay $1.6 bil in special fund loans
- Address CalSTRS retirement liabilities

Infrastructure, etc

- Deferred maintenance projects  +$815 million (one-time)
- Water Plan  +$618 million plan incl groundwater basin protection, local water supplies, flood protection.
- Cap–and–Trade  +$850 million incl: high–speed rail system +$250 million, low–emission veh progr +$200 million
Governor’s Proposal for Rainy Day Reserves

Proposition 58 (2004)
- Requires 3% of estimated General Fund revenues deposited to Budget Stabilization Account (BSA)
- Deposits continue until BSA reaches $8 billion or 5%.
- Half of BSA deposit repays Economic Recovery Bonds (ERBs) until repaid.
  - Used ’06-07 & ’07-08, then emptied.
  - Suspended each year since then.

New Consensus Proposal
- Annual required deposit - size based on capital gains income tax revenues over 8.0% of annual General Fund revenues plus 1.5% of General Fund Revenues.
- Fill to 10% of General Fund.
- Proposition 98 component: amt counts for current year guarantee - to be used when guarantee drops.
- May use half to pay down debt.

Managing California’s Debts
LAO: “California’s Key Liabilities”

3 Kinds of Debt
- Retirement: providing for employee pensions, healthcare
- Infrastructure: borrowing to fund major public facilities
- Budgetary Debt: borrowing to fund current services

State’s Key Liabilities (debts) total over $340 billion
- But state is addressing $140+ billion of that

Unpaid debts (liabilities) grow at different rates
- State should put retirement debt at top of priority list
### Managing California’s Debts

**LAO: “California’s Key Liabilities”**

#### Examples of Growth Rates for Key Liabilities

<table>
<thead>
<tr>
<th>Liability</th>
<th>Growth Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>7.5%</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>4.3%</td>
<td>64.6</td>
</tr>
<tr>
<td>Special Fund loans to the General Fund</td>
<td>0.7%</td>
<td>4.5</td>
</tr>
<tr>
<td>Mandate reimbursements to local govt</td>
<td>0.3%</td>
<td>1.9</td>
</tr>
<tr>
<td>Proposition 98 settle-up</td>
<td>0.0%</td>
<td>1.5</td>
</tr>
</tbody>
</table>

#### Unfunded Retirement Obligations

<table>
<thead>
<tr>
<th>Liability</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>64.6</td>
</tr>
<tr>
<td>UC pension &amp; retiree healthcare</td>
<td>26.3</td>
</tr>
<tr>
<td>Judges’ Retirement System I pension program</td>
<td>3.3</td>
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<tr>
<td>Subtotal</td>
<td>($167.9)</td>
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#### Budgetary Debt

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>End of</th>
<th>End of</th>
<th>End of</th>
<th>End of</th>
<th>End of</th>
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</thead>
<tbody>
<tr>
<td>Deferred payments to schools and community colleges</td>
<td>$10.4</td>
<td>$6.4</td>
<td>$6.1</td>
<td>$0.0</td>
<td>$0.0</td>
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<tr>
<td>Economic Recovery Bonds</td>
<td>7.1</td>
<td>5.2</td>
<td>3.9</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Loans from Special Funds</td>
<td>5.1</td>
<td>4.9</td>
<td>3.9</td>
<td>2.9</td>
<td>0.0</td>
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<tr>
<td>Unpaid mandated costs to local govt, schools, colleges</td>
<td>4.3</td>
<td>4.9</td>
<td>5.4</td>
<td>5.4</td>
<td>0.0</td>
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<tr>
<td>Underfunding of Proposition 98</td>
<td>3.0</td>
<td>2.4</td>
<td>2.4</td>
<td>1.8</td>
<td></td>
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<tr>
<td>Borrowing from local governments (Proposition 1A)</td>
<td>1.9</td>
<td>1.1</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Deferred Medi-Cal Costs</td>
<td>1.2</td>
<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
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<tr>
<td>Deferral of state payroll costs from June to July</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
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<td>Deferred payments to CalPERS</td>
<td>0.5</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
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<tr>
<td>Borrowing from transportation funds (Proposition 42)</td>
<td>0.4</td>
<td>0.4</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
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<tr>
<td>Total</td>
<td>$34.7</td>
<td>$28.2</td>
<td>$24.9</td>
<td>$13.1</td>
<td>$0.0</td>
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</table>

*Source: Governor’s Proposed Budget May Revision*
Governor’s Proposed 2014-15 Budget
Local Government Issues

- Supplemental Frontline Law Enforcement funding increased to $40 million** from $27.5 million (began in 2012 with Prop30)
- State law enforcement grant program continued.
  (since 2011 funded from VLF shifted from cities)
  - COPS Frontline Law Enforcement program at same level (SLESA)
  - Jail Detention Facility Grants (in lieu of booking fees)
- Insufficient ERAF compensation for cities/counties in Alpine, Amador, San Mateo. (re triple flip, VLF swap)
- State-County Assessors' Partnership Agreement Program.
  - Three year program, $7.5 million/yr for nine chosen counties with matching funds to catch-up on property assessment.
- $3.3 million for public libraries for equipment to access high-speed internet networks.

Infrastructure Financing District Proposal

“Given that current compliance with the RDA dissolution statutes is improving, the Budget proposes expanding the IFD tax increment financing tool.”

- **Expand IFD use** to military base reuse, urban infill, transit priority projects, affordable housing, related consumer services.
  Goal: “Maintain focus on projects with benefits for residents of the IFD project area.”
- Create IFD, issue related debt subject to 55% voter approval.
- City or county may access its PropTaxInLieuVLF for IFD**
- Allow new IFD project areas to overlap with the project areas of the former RDAs.
- No tax revenues from K-14 schools, no state impact.
- **Any participating** county, cities, and special district that would contribute their revenue, must approve.
- **Must have RDA Finding of Completion**, compliance with SCO audit findings, conclusion of any outstanding legal issues.
A brief history of the Car Tax (VLF)

- 1935 – State Vehicle License Fee (a tax) established
  - motor vehicles eliminated from the local property tax
  - revenue subvened to cities and counties
- 1981-84 – State budget trouble. Legislature diverts hundreds of millions of city & county VLF $
- 1986 – Prop47: VLF must go to cities and counties
  - but Legislature still decides the rate, the tax base and the allocation
- 1998 - Legislature & Gov Wilson pass VLF cut
  - with backfill for cities and counties
- 2003 – Gray Davis admin pulls trigger, raises VLF
- 2004 – Davis Recalled, Schwarzenegger elected
  - On his first day in office, Schwarzenegger cuts VLF - restoring backfill and punching a $4 billion ongoing hole in the state budget without any way to pay for it
A Little History...
VLF Revenues and Allocations

- VLF Backfill
- Revenue at 0.65% rate

Special Allocations
- Counties Per Capita
- Cities Per Capita
- Admin Charges
- H&W Realignment

Property Tax in-lieu of VLF (2004 on)

The VLF-Property Tax Swap of 2004

- VLF Backfill
- Property Tax in Lieu of VLF
- Cities & Counties
- Schools

State General Fund

$4.4 b* in FY2004-05

* in FY2004-05
The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

- Property Tax
- Sales Tax
- Licenses/Permits
- Franchise Fees
- Other VLF
- AB1602 Special

- VLF "Bump" to zero over 5 yrs w/AB1602 VLF patch (assumed in incorp process)
- Actual (after SB89 shift)

Millions

- If incorporated before 2004 swap
- After Swap
- w/AB1602 VLF patch (assumed in incorp process)

If incorporated before 2004 swap swapped for PropTax in 2004

The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

Annexation of Inhabited Area example

- VLF
- Sales Tax
- Property Tax
- AB1602 Special

- VLF "Bump" to zero over 5 yrs w/AB1602 VLF patch (assumed in annex process)
- Actual (after SB89 shift)
Ending the Triple Flip
Can we stick it?

The Triple Flip
property tax for sales tax

- Increase State Sales Tax Rate +0.25%
- Decrease Local Sales Tax Rate -0.25%

Cities & Counties

Property Tax in Lieu of Sales Tax

$1.4 b

State Fiscal Recovery Fund

$1.4 b

State General Fund

$1.4 b

Schools
Triple Flip Timing
City/County Sales Tax Compensation

Fiscal Year
May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | May

SUTCF Estimates

Property Tax Allocation

Property Tax Allocation

Actuals Determined

SUTCF Estimates

Property Tax Allocation

True-Up

Property Tax Allocation

True-Up

Expected to end in 2015-16
- From debt service from ¼% state sales tax
- Likely residual wind-down into 2016-17

Governor proposing addt’l $1.6 billion payment from general fund in FY2014-15
- Would end the Triple Flip in 2014-15 with residual effects into 2015-16.

Prop1A (2004) prevents any mischief

One time boost of revenue for cities & counties at end
- Equivalent to 1.5 months of your sales tax
Motor Vehicle Fuel Taxes
*before 2010*

state portion

- **State Sales Tax**
  - 5% of sale

- **State Fuel Excise Tax**
  - 18¢

---

Motor Vehicle Fuel Taxes
*before 2010*

**Revenues**

- **State Sales Tax**
  - 5% of sale

- **Base Fuel Excise Tax**
  - 18¢

**Allocation**

- **Public Transit Acct**
- **Prop42 Transit Acct**
- **Prop42 State Hwy Acct**
- **Prop42 City&Co**
- **State Highway Acct**
- **City&Co HUTA**
Motor Vehicle Fuel Taxes
Fuel Tax Swap of 2010

Revenues

$0
$1
$2
$3
$4
$5
$6

Allocation

Public Transit
State Transportation
Debt Service
State Highway Acct
City&Co State Hwy Acct
City&Co HUTA

Base Fuel Excise Tax
18¢

Swap Excise Tax
21.5¢ (variable)

Transportation
Debt Service
State General Fund Relief

Highway User Tax Revenues
Allocation

18¢
39.5¢ Per Gal Gasoline
21.5¢ Swap rate (varies)

State Highway Account
Counties
Cities

Remainder

State
Highway
Account

Weight Fees
~$900 million

Weight Fee Offset
~$900 mil

Str&Hwys
§§2104-2108

Str&Hwys
§2103

~$900 million

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Base HUTA (§§2104-2107) revenue growth is flat, will decline in future.

§2103 revenue is complex and volatile.

3.5¢/gal gas excise tax increase by BOE next week will NOT change these revenue projections (the increase is assumed)

FY2014-15 proposed budget includes $100 million loan repayment to HUTA for cities & counties (Sec 2104-2107)

Not in projections. Don’t count on it yet.

Estimates will be updates in May.
Solvency

1. cash solvency - ability to meet immediate financial obligations; i.e. over next 30 or 60 days (accts payable, payroll).

2. budgetary solvency - ability to meet all financial obligations during a budget year.

3. long-run solvency – ability to meet all financial obligations into the future.

4. service-level solvency – ability to provide the desired level of services for the general health and welfare of the community.
Difficulties in Assessing Municipal Financial Health

- Published data are not complete or timely.
- Do we know how to assess those facts?
- Comparisons are often false and tell us nothing about solvency.
- Requires analysis, forecasting, context, legal... it’s not just an accounting or statistical exercise.
- Looking forward to sustainability
  - *history doesn’t tell you enough about the future*

Other Financial Health Analysis Tools

ICMA Financial Trends Monitoring System (FTMS)

*12 Factors, 42 indicators*
**Other Financial Health Analysis Tools**

**Financial Trends Monitoring System (FTMS)**

12 Factors, 42 indicators

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**California Municipal Financial Health Diagnostic:**

- Get to the primary indicators - useful & essential
- Leave out extraneous / secondary
- Add in overlooked & underappreciated factors
- Drill down to the real numbers
- Allow for nuance / clarification / differences
- Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach

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**The California Municipal Financial Health Diagnostic beta**

**Excel & PDF versions: Getting around**

- Content is identical: Excel & PDF
  - PDF is laid out in pages, easy to print/see
  - Excel file contains sections in sheets
- Excel File is intra-active
  - “Cover/Contents” sheet hotlinks to sections
  - Data entered in beige fields populates/calculates into others
- PDF file has form fields - limited intra-active

Get the files:

- [http://californiacityfinance.com/Diagnostic1308.xlsx](http://californiacityfinance.com/Diagnostic1308.xlsx)
# The California Municipal Financial Health Diagnostic beta

## Checklist & Summary

- **Indicators**
  - ✔ Scoring based on data

- **Data Gathering**
  - ✔ data input

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## The California Municipal Fiscal Health Diagnostic

### Financial Distress Checklist

<table>
<thead>
<tr>
<th>City of</th>
<th><strong>Fund:</strong></th>
</tr>
</thead>
</table>

| **1.** The city has recurring general fund operating deficits. |
| **2.** General fund reserves are decreasing over multiple consecutive years. |
| **3.** General fund current liabilities (including short-term debt and accounts payable within 90 days) are increasing. Cash and short-term investments are decreasing. |
| **4.** General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than recurring revenue growth. |
| **5.** The general fund is subsidizing other enterprises or special funds. |
| **6.** The city council's authority to make changes is constrained by charter, contract, or law (e.g. binding arbitration, minimum spending, minimum staffing or compensation formulas, etc.) |
| **7.** The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance. |
| **8.** The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds. |
| **9.** General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded. |
| **10.** General fund debt service payments have been "backloaded" into future years. |
| **11.** Ongoing general fund operating costs are being funded with temporary development revenues. |
| **12.** Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report) |
| **13.** Public service levels are far below standards needed in this community. |

For detailed indicators related to these points see the Financial Health Indicators.
1. Recurring Deficits?  
Are the government’s activities sustainable over time within the revenues available?

### 1a) Gross Annual Deficit/Surplus - unadjusted, using all general fund revenues and expenditures

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>-8.39%</td>
<td>1.37%</td>
<td>-1.17%</td>
<td>0.50%</td>
<td>-2.83%</td>
<td>-2.96%</td>
</tr>
</tbody>
</table>

**Formula**
\[
\text{gross annual deficit/surplus as a percent of revenues} = \frac{\text{gross current revenues} - \text{gross current expenditures}}{\text{gross current revenues}}
\]

### 1b) Net Operating Deficit/Surplus – sustainable, omitting non-recurring revenues

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>-9.83%</td>
<td>-5.04%</td>
<td>-2.03%</td>
<td>-2.62%</td>
<td>-3.67%</td>
<td>-3.80%</td>
</tr>
</tbody>
</table>

**Formula**
\[
\text{net operating deficit/surplus as a percent of revenues} = \frac{\text{net operating revenues} - \text{net operating expenditures}}{\text{net operating revenues}}
\]

### 1c) Net True Operating Deficit/Surplus - complete, adding unbudgeted general fund liabilities

<table>
<thead>
<tr>
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<th></th>
<th></th>
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</tr>
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<td>-6.54%</td>
<td>-2.03%</td>
<td>-2.62%</td>
<td>-3.67%</td>
<td>-3.80%</td>
</tr>
</tbody>
</table>

**Formula**
\[
\text{net true operating deficit/surplus as a percent of revenues} = \frac{\text{net operating revenues} - \text{net operating expenditures} + \text{unbudgeted current liabilities}}{\text{net operating revenues}}
\]

**Score:**
- **Warning-Red:** Persistent & increasing deficits over consecutive years.
- **Caution-Yellow:** Deficits are infrequent or relatively marginal compared to fund balance (see #2 below) and/or there is a reasonable plan for bringing revenues and spending into balance.
- **Good-Green:** Not an issue of concern.