The Economy is Recovering
But Municipal Budgets Remain in Peril

California was hit especially hard
- Housing: construction / real estate
- Exports: goods / tourism / licenses
- Business Spending – especially IT

California is leading in recovery
- Homebuilding subdued but improved
- Employment growing (but weaker lately)
- Business investment, exports, etc.

Local Budgets
- Taxable sales up but regional variation
- Property tax growth is flat – still declining in some areas
- Short term band-aids are gone
- Pension/OPEB problems are huge and cannot be ignored
  - 2012 reform package is very helpful ... but more is needed
- Redevelopment dissolution could not have come at a worse time.
  Not just the revenue loss ... uncertainty & workload.

What will the State Legislature do? Fix? Shift?
- Staff & councils are overwhelmed
- Some key players believe the recovery will solve it (wrong!)
Local revenue risk and uncertainty
- state actions  - local conditions

Tax structures out of step with changing society:
- sales tax, hotel tax, gas tax,
- utility user tax

Fragmentation of local finance and governance among overlapping governments

Disconnect betw service costs & revenues in urban development. “Fiscalization of Land Use”

Over-reliance on land development revenue
Over-reliance on redevelopment revenues
Risky financing schemes

Unsustainable and Intractable employee compensation especially public safety pension and retiree health care

Unsustainable Decline in Core Revenues

Fear & Denial
Toxic relationships
Ceding of management and policy choices to others
Are Incorporations and Annexations Extinct?

Pernicious Effects of the VLF-Property Tax Swap of 2004

The VLF-Property Tax Swap of 2004

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

$4.4 b^*$ in FY2004-05
The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

- VLF “Bump” Declines to zero over 5 yrs
- AB1602 to zero over 5 yrs
- VLF AB1602 Special
- Franchise Fees
- Licenses/Permits
- Sales Tax
- Property Tax
- Other

If incorporated before 2004 swap
- Actual (after SB89 shift)
- After Swap
- W/AB1602 VLF patch

The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

Annexation of Inhabited Area example

- VLF
- VLF AB1602 Special
- Sales Tax
- Property Tax

If incorporated before 2004 swap
- Actual (after SB89 shift)
- W/AB1602 VLF patch (assumed in annex process)
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.
The California Municipal Financial Health Diagnostic

- Initiated by the League at the urging of numerous mayors, councilmembers, city managers.
- In development; not final; not being publicly distributed
- Current: testing fine tuning preparing staff before public release
- Stats and charts alone don’t explain things. A wrap around narrative report is essential.

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
- What is our purpose and responsibility?
Other Financial Health Analysis Tools

ICMA Financial Trends Monitoring System (FTMS)

12 Factors, 42 indicators

Early warning trends
Factors affecting financial condition

ENVIROMENTAL FACTORS

1. Population
   - Population density
   - Age distribution
   - Natural and/or local disaster risk
   - Disaster risk
   - Political culture

2. Economic conditions
   - Economic growth
   - Employment levels
   - Income distribution
   - Unemployment rate

3. Organizational factors
   - Organizational structure
   - Management positions
   - Management policies

4. Financial factors
   - Financial stability
   - Financial performance
   - Financial risk

Legend:
- Increasing
- Decreasing

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
- Supportive, constructive approach
- Rather than punitive, condemning, driven by other agendas:
  - Prone to misunderstanding
  - Counterproductive, not collaborative
  - Ad hominem, accusatory
The Team

- Budget Analysis
  - revenue estimating,
  - expenditure projections,
  - debt schedules
  - review of revenue and expenditure components.
- Accounting
- Legal – MOUs, charter, etc.

Indicators of Impending Financial Crisis

- Failure to pay an undisputed claim from a creditor within 90 days past claim date.
- Failure to forward income taxes withheld or Social Security contributions for over 30 days past due date.
- Failure to make required pension fund contributions on time.
- Missing a payroll for 7 days.
- General fund available unrestricted balance for the end of the current fiscal year will be negative.
The California Municipal Financial Health Diagnostic

Financial Distress Checklist

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.

Municipal Service Reviews

1. Growth and population projections for the affected area.
2. The location and characteristics of any disadvantaged unincorporated communities within or contiguous to the sphere of influence.
3. Present and planned capacity of public facilities, adequacy of public services, and infrastructure needs or deficiencies including needs or deficiencies related to sewers, municipal and industrial water, and structural fire protection in any disadvantaged, unincorporated communities within or contiguous to the sphere of influence.
4. Financial ability of agencies to provide services.
5. Status of, and opportunities for, shared facilities.
6. Accountability for community service needs, including governmental structure and operational efficiencies.
7. Any other matter related to effective or efficient service delivery, as required by commission policy.