Hot Topics ‘n Burning Issues
A City Finance Update

California Municipal Treasurer’s Association
April 18, 2014  Burlingame, CA

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The California Local Government Finance Almanac

Bad Brew in Troubled Cities

- 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
- Ceding of management and policy choices to others
- Fear & Denial
- Toxic relationships

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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

Defining Municipal Financial Health

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.
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

### California Municipal Financial Health Diagnostic

**City of Fund:**

- The city has recurring general fund operating deficits.
- General fund reserves are decreasing over multiple consecutive years.
- General fund current liabilities (including short-term debt and accounts payable within 60 days) are increasing. Cash and short-term investments are decreasing.
- General fund fixed costs, salaries, and benefits are increasing over multiple years at a rate faster than recurring revenue growth.
- The general fund is subsidizing other enterprises or special funds.
- 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.)
- The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.
- The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.
- 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.
- General fund debt service payments have been “backloaded” into future years.
- Ongoing general fund operating costs are being funded with temporary development revenues.
- Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)
- Public service levels are far below standards needed in this community.

For detailed indicators related to these points see the **Financial Health Indicators**.
# The State of the State: Governor’s Proposed Budget 2014-15

## Governor’s Proposed Budget

### 2014-15 Governor’s Budget General Fund Budget Summary

<table>
<thead>
<tr>
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<th>2013-14</th>
<th>2014-15</th>
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<tbody>
<tr>
<td><strong>Resources</strong></td>
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<tr>
<td>Prior Year Balance</td>
<td>$2,528</td>
<td>$4,212</td>
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<td>Revenues and Transfers</td>
<td>$100,147</td>
<td>$104,503</td>
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<td>Total Resources Available</td>
<td>$102,675</td>
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<td><strong>Expenditures</strong></td>
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<td>Non-Proposition 98 Expenditures</td>
<td>$57,515</td>
<td>$61,731</td>
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<td>Proposition 98 Expenditures</td>
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<td>Total Expenditures</td>
<td>$95,463</td>
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<td><strong>Fund Balance</strong></td>
<td>$4,212</td>
<td>$1,922</td>
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<td>Budget Stabilization Account / &quot;Rainy Day Fund&quot;</td>
<td>$1,591</td>
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Governor’s Proposed Budget
State General Fund and Realignment Fund Revenue

Personal Income Tax
$69,764, 59%

Corporation Tax, $9,682, 8%

Sales & Use Tax, $24,071, 20%

Insurance Tax, $2,297, 2%

Vehicle License Fee, $2,071 2%

Other/Transfers, $1,281, 1%

Realignment Sales Tax, $9,569, 8%

State General Fund and Realignment Fund Revenue

Legisl Judicial Exec, $2,844, 2%

BusnConsSvcsHsg, $745, 1%

Transporation, $212, 0%

Resources & Environment, $2,229, 2%

MentalHealth, SupportSvcs, $9,330, 8%

Law Enforcement, Trial Court, $2,296, 2%

K-12 Education, $45,251, 38%

Higher Education, $12,377, 11%

Health & HumanSvcs, $28,793, 24%

Corrections, $9,560, 8%

“Local Revenue Fund”

General Govt, $3,191, 3%

ERB Payment, $1,591, 1%
Governor’s Proposed Budget 2014-15

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

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

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)

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

For FY2014-15, the Governor proposes to ...
- Pay down remainder of school deferrals $6.2 billion
- Pay off Economic Recovery Bonds early $1.6 billion
- Repay special funds $1.6 billion

Eliminating the “Wall of Debt”

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<td>Deferred payments to schools and community colleges</td>
<td>$10.4</td>
<td>$6.4</td>
<td>$6.1</td>
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<td>Economic Recovery Bonds</td>
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<td>Loans from Special Funds</td>
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<td>$3.9</td>
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<td>Unpaid mandated costs to local govs, schools, colleges</td>
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<td>$4.9</td>
<td>$5.4</td>
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<td>Underfunding of Proposition 98</td>
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<td>$2.4</td>
<td>$1.8</td>
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<td>Borrowing from local governments (Proposition 1A)</td>
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<td>$1.1</td>
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<td>Deferred Medi-Cal Costs</td>
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<td>Deferral of state payroll costs from June to July</td>
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<td>Deferred payments to CalPERS</td>
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<td>Borrowing from transportation funds (Proposition 42)</td>
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<td>$0.4</td>
<td>$0.2</td>
<td>$0.1</td>
<td>$0.0</td>
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City/County mandate cost repayment:
- 2015-16 $748m
- 2016-17 $152m
California’s Fiscal Outlook

Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges** – action/inaction.
- **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.

Capital Gains are Extremely Volatile

Year over year percentage change

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<td>-80%</td>
<td>-40%</td>
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<td>0%</td>
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<td>60%</td>
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California’s Fiscal Outlook

LAO’s Hypothetical Recession

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.

Governor: replace Prop58
- Annual required deposit - size based on capital gains income tax revenues over 6.5% of annual General Fund revenues.
- Increase size to 10% of estimated General Fund.
- Proposition 98 component: amt counts for current year guarantee - to be used when guarantee drops.
- May pay down budgetary debt instead of depositing to reserve.

Governor’s Proposal for Rainy Day Reserves

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Governor’s Proposed 2014-15 Budget
Local Government Issues

- Supplemental Frontline Law Enforcement funding continued at $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.

Are Incorporations and Annexations Extinct?
Pernicious Effects of the VLF-Property Tax Swap of 2004
The VLF-Property Tax Swap of 2004

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

State General Fund

$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

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

VLF Backfill $4.4 b

Cities & Counties $4.4 b

Property Tax in Lieu of VLF

Schools

$0.0 $5.0 $10.0 $15.0 $20.0 $25.0 $30.0

Millions

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The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

Annexation of Inhabited Area example

- VLF
- VLF AB1602 Special
- SalesTax
- Property Tax
- Other

Millions

If incorporated before 2004 swap

VLF AB1602 Special

Swapped for PropTax in 2004

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

State General Fund

$1.4 b

Schools

SUTCF Estimates

Property Tax Allocation

Actuals Determined

True-Up

Fiscal Year

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

Triple Flip Timing
City/County Sales Tax Compensation
The Triple Flip

- 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

H.U.T.A. Headaches

The Fuel Tax Swap of 2010
Motor Vehicle Fuel Taxes

**before 2010**

- **Revenues**
  - State Sales Tax: 5% of sale
  - Base Fuel Excise Tax: 18¢/gal

- **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**
  - Base Fuel Excise Tax: 18¢/gal
  - Swap Excise Tax: 21.5¢/gal (variable)

- **Allocation**
  - Public Transit
  - State Transportation Debt Service
  - State Highway Acct
  - City&Co $2103
  - State Highway Acct
  - City&Co HUTA
Transportation Debt Service
State General Fund Relief
Weight Fees ~$900 million

Highway User Tax Revenues Allocation

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

- State Highway Account
  - Str&Hwys §§2104-2108
  - 44%

- Counties
  - 22%

- Cities
  - 22%

- Remainder
  - Str&Hwys §2103
  - 22%

Highway User Tax Revenues

- FY10-11
- FY11-12
- FY12-13
- FY13-14 estimated
- FY14-15 projected

- §2103 swap HUTA cities & counties
- §2104 counties
- §2105 cities & counties
- §2106 cities & counties
- §2107 cities

Highway User Tax Revenues
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.