FINANCE DEPARTMENT

276 Fourth Avenue, Chula Vista, California 91910

Council Information Item

October 27, 2006

To: Honorable Mayor and City Council

Via: Jim Thomson, City Manager

From: Maria Kachadoorian, Director of Finance/Treasurer
Ed Van Eenoo, Director of Budget and Analysis

Subject: TaxpayersAdvocate.org Report "A Fiscal Analysis of the City of Chula Vista"

This is in response to report released by TaxpayersAdvocate.org on October 25, 2006. Due to several misrepresentations on the City's finances and its fiscal outlook, we have provided in this report additional information, which we hope will provide some clarification. As we have communicated to the City Council during the budget briefings in June 2006, we are working closely with the Departments to monitor the budget. We are also in the process of developing contingency plans as directed by Council.

General Fund Reserves

TaxpayersAdvocate.org Statement: The City has run a deficit for the past four years despite robust increases in revenue. City cut Emergency Reserves $21 million to balance budget.

City Response: The City has consistently adopted a balanced budget without the use of General Fund reserves. The reduction in reserves is not due to deficit spending, which occurs when there is a structural imbalance in the budget. As discussed in the City's Five Year Financial Forecast released in May 2006, the reduction in reserves, $16.1 million over a three-year period, occurred due to a combination of significant State revenue takeaways and mid-year appropriations by Council action as summarized below:

- State Revenue Take Aways ($3.5 million Vehicle License Fee Gap and $1.8 ERAF III) - $5.3 million
- Fire Department Staffing, Fire Station and Equipment enhancements - $3.8 million
- Purchase of Oxford Property for development of Harbor Side Park - $2.3 million
- Unanticipated Litigation and Workers Compensation Costs - $2.1 million
- Fire Department Computer Aided Dispatch Center - $1.8 million
- Municipal Utility Study/Franchise Negotiations - $1.4 million
- University Study - $1.0 million

The Council's General Fund minimum reserve level policy of 8%, which was adopted in 1996, was established to prudently protect the fiscal solvency of the City. Reserves are important to mitigate the negative impact on revenues from economic fluctuations, to withstand State budget grabs and to fund unforeseen expenditure requirements. Based on the most current projections we anticipate the available fund balance to be 8.8% ($14.9 million) at the end of the 2006 fiscal year, which is above the Council reserve policy of 8%.

Some charts included in the TaxpayersAdvocate.org report misrepresented the City's overall financial standing. For example, the "All Revenues/Expenditures" chart on page 6 indicates expenditures of $233.0 million in revenues and $256.4 in expenditures but fails to include other financing sources of $38.8 million, which also offset expenditures. When other financing sources are included the total revenues/financing sources would be greater than the expenditures.

City-Wide Debt

TaxpayersAdvocate.org Statement: This year, the General Fund, which pays for basic city services, will have an estimated debt service payment of $12 million, growing to $14 million annually in four years. The city stipulates that this would be approximately 7.3% of the General Fund, which is close to hitting the generally accepted debt ceiling of 8% to 10%.

Total annual City-wide debt service is budgeted at $24.8 million this year, or 8% of the total $308 million budget.

City Response: Over the past five years the City has issued $143 million in debt used to fund several major capital projects such as the new public works yard, police facility and the expansion of the Civic Center to be funded over three phases. The financing for several of these major projects have been planned for since the 1980's.

The debt service payments are being funded out of various sources such as the General Fund, Residential Construction Tax Fund, Development Impact Fee funds and others. At the time the debt was issued, staff did not assume that development would continue at the rapid pace it has over the past five years. Reserves separate from the General Fund are maintained within the Development Impact Fee fund, Residential Construction Tax Fund to mitigate fluctuations in the building market.

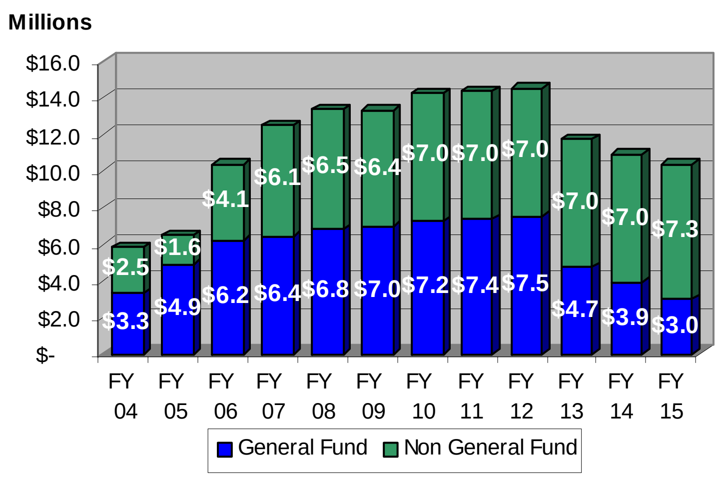
Outstanding Debt as of October 2006:
General Fund Debt - $64 million
Public Facility Development Impact Fee Debt - $76.9 million
Other Funds such as Residential Construction Tax - $11.5 million
Redevelopment Agency Debt – $42.4 million

The General Fund's annual debt service "commitment" is projected to be approximately $14.3 million, or approximately 7.3% of the projected General Fund operating budget by fiscal year 2011. However, it must be noted that although this amount is a General Fund commitment, only <u>$7.4 million is actually projected to be paid out of the General Fund, with the remaining $6.9 million paid from other sources such as development fees and residential construction taxes</u>. This $7.4 million represents approximately 3.8% of the projected General Fund operating budget, which would be considered more of an average debt burden for a local governmental entity. This continues to be within the City Council's debt service limit policy of 10% of the General Fund budget.

It is important to note that the final debt service payment of $2.8 million related to the 1994 Pension Obligation Bonds will occur in fiscal year 2012 reducing the General Fund obligation.

The "General Fund Debt Payments" chart on page 13 of the TaxpayersAdvocate.org report identifies the outstanding debt payments from the General Fund through FY 11 without noting that half of the payments actually are paid from non-general fund sources, which maintain separate reserves. The following chart provides a clearer perspective of the overall debt in the City.

Annual General Fund and Non General Fund Debt Payments
FY 04 to FY 15



<u>TaxpayersAdvocate.org Statement</u>: The City has stated that ½ of these payments will be paid from development fees and construction taxes. However, relying on building and related fees to fund half the City's General Fund debt service should raise a red flag, given the slowdown of construction/building activity.

City Response: Staff has developed a "worst-case scenario" cash flow model for the purpose of monitoring the minimum residential development activity required for the PFDIF to meet its ongoing debt service obligation. To be conservative, this analysis only looks at residential development; no new commercial or industrial development is assumed in this analysis.

As of June 30, 2006, the PFDIF has sufficient fund balance to meet all anticipated debt service payments through 2010 even if no new development were to occur during this timeframe. After 2010, the City would only have to issue an average of 545 residential permits per year in order for the PFDIF to meet its ongoing debt service payments. Over the previous 10 years, the City has issued an average of 2,365 residential units annually, and at no time during this period has residential development fallen below 1,100 units. These historic trends suggest that residential development in the City will not fall below the levels necessary to meet the PFDIF's debt service obligation.

TaxpayersAdvocate.org Statement: In FY 2005, building permits decreased 33%, and last year the City was $3 million short in anticipated revenues in its Development Services department.

In preparation for the fiscal year 2007 budget, staff from the Department of Planning and Building worked closely with members of the development community to project building permit activity for the coming year. Based upon this analysis staff recommended, and Council adopted as part of the fiscal year 2007 budget, a reduction in development processing revenues of $2 million. Furthermore, at the direction of City Council, staff has prepared a contingency plan for the current fiscal year that could be enacted if future revenues fall below projections.

Redevelopment/Bayfront Project

TaxpayersAdvocate.org Statement: Given the commitments of existing tax-increment funds and given the wide-ranging fiscal problems facing the City of Chula Vista, future redevelopment and bayfront projects are an increasingly risky enterprise.

City Response: The existing redevelopment revenues are committed to outstanding bond obligations and administrative costs. The Bayfront project will be financed using new net revenues generated by the project (Tax Increment, TOT and Port of San Diego Lease Revenues as defined in the Letter of Intent) and will not be dependent on existing funds.

CalPERS/Pension Obligation Bond

TaxpayersAdvocate.org Chart: “Outstanding Pension Debt” chart on page 15

City Response: The “Outstanding Pension Debt” chart on page 15 of the TaxpayersAdvocate.org report is misleading. It represents the unfunded liability as outstanding bonded debt, which is not the case. The unfunded liability is the difference between the accrued liability and actuarial value of the assets in the City’s retirement account with CalPERS. The unfunded liability is used to determine the employer contribution or the amount we have to pay each year to CalPERS to fund retirement benefits.

As a member of the State CalPERS system, the City's annual required pension obligations are calculated by CalPERS actuaries and are paid by the City in full every year. The contributions are actuarially calculated to meet the long-term viability of the City's CalPERS pension fund.

TaxpayersAdvocate.org Statement: The Chula Vista is paying 8.15% to earn 7.75% on its Pension Obligation Bonds.

City Response: CalPERS recently changed its assumed rate of return from 8.25% to 7.75%. The bonds were issued in 1994 when the assumed or projected rate of return was 8.25%. The actual rate of return for the past 15 years at CalPERS have ranged from –7.2% to 20.1% while the 15 year compounded return has been 9.7%. Therefore, based on the actuals to date, the City is earning more than it is paying via the Pension Obligation Bonds.

Growth of Employees and Salaries

TaxpayersAdvocate.org Statement: 257 employees added. City Council staff doubled. Management salaries average $131,400 plus benefits.

City Response: During the last six years, the number of authorized permanent positions in the City has increased from 1007 at the beginning of fiscal year 2001 to 1264 today -- a 26% increase. This increase in staffing is consistent with a commensurate increase in the City's population of 49,000 (from 174,000 to 223,000) over the same time period -- a 28% increase. The ratio of City staff per 1,000 residents remained remarkably stable over this time frame; falling slightly from 5.8 staff per 1,000 residents in 2001 to 5.7 staff per 1,000 residents today.

Support staff budgeted in the Office of the Mayor and Council has increased from 6 to 15 authorized positions since 2001. It is important to note that 4 of these positions were Council Aides that had previously been budgeted as hourly non-benefited employees. The City does not include hourly non-benefited employees in its authorized position lists. Therefore, when the Council Aide positions were converted to benefited employees, 4 positions were added to the City's authorized position count list but no additional personnel were actually added to the Mayor and Council's staff. Furthermore, one of the positions was a transfer of the Intergovernmental Affairs Coordinator from the Administration Department to the Office of the Mayor and Council and resulted in no additional cost to the City. Therefore, the true number of additional staff that has been added to support the Office of the Mayor and Council has been 4 positions since 2001.

The average salary of all executive and senior management positions in the City is currently $131,400. To put this number in context, an analysis of the California Public Agencies Compensation Survey was conducted. This survey compares the compensation for 15 executive and senior management classifications from 15 comparable agencies in the Southern California area. Of the 15 classifications surveyed, Chula Vista ranked in the upper quartile salary range for 1 position, the second quartile salary range for 10 positions, and the third quartile salary range for 4 positions. Of the 8 executive management classifications surveyed, average Chula Vista salaries were slightly above (1.1%) the mean of other jurisdictions in the survey. Of the 7 senior management classifications surveyed, average Chula Vista salaries were slightly above (1.5%) the mean of other jurisdictions in the survey. These results are consistent with City Council's compensation policy which calls for non-safety employees to be compensated at rates above the middle of the labor market for similar jurisdictions.

Sewer Funds

TaxpayersAdvocate.org Statement: A detailed review of Enterprise Funds (Sewer/Water) should occur to ensure that only appropriate transfers to the General Fund have occurred and not being used to mitigate General Fund over-spending, as occurred in the City of San Diego.

City Response: Transfers from the Sewer Fund are reviewed as part of the year-end independent financial statement audit. No audit concerns have been identified.

If you have any questions or concerns with regards to the issues raised in the report please contact Maria Kachadoorian at 691-5051 x4040 or Ed Van Eenoo at 691-5475.

cc:

Department Heads