



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Updated Report on Options for Increasing the City's General Fund Reserve

OVERVIEW

IBA Report 15-41 discussed options for increasing the City's General Fund Reserve and was presented to the Budget and Government Efficiency Committee (B&GE) on November 9, 2015. That report responded to a request of B&GE members for our Office to develop a potential alternative to the Mayor's Pension Payment Stabilization proposal by increasing the City's existing General Fund Stability Reserve. Attachment 1 to that report included a comparison of those two options, as well as changes to the City's Reserve Policy based upon Standard & Poor's assessment guidelines and the Government Finance Officers Association (GFOA) suggested best practices for reserves.

This updated report reviews both of the original proposals for creating a Pension Reserve and increasing the General Fund Stability Reserve. Also presented is a new third option which would accomplish both proposals by splitting available funds between them. Finally, this report includes the most up-to-date estimate for Excess Equity which would be the funding source for these proposals.

FISCAL/POLICY DISCUSSION

Two options for increasing the City's General Fund Reserve have been presented at B&GE: the creation of a Pension Payment Stabilization Reserve presented by the City's Chief Financial Officer (CFO) in October 2015, and a 2% increase to the General Fund Stability Reserve presented by our Office in November 2015. A brief overview of each of these options is detailed below, as well as a third option to increase the General Fund Reserve through a combination of both proposals.

General Fund Reserve Option 1: Mayor's Pension Reserve Proposal

The Mayor's May Revision to the FY 2016 Proposed Budget included a proposal for an irrevocable Pension Payment Stabilization Reserve Trust that would serve as a source of funds for any unexpected increases to the City's pension payment. This proposal was subsequently modified after conversations with our Office, and was presented to B&GE in October 2015 as a proposed Pension Payment Stabilization Reserve with the following components:

- The amount of the Reserve was proposed to be \$21.2 million: \$16.3 million from the General Fund (Excess Equity) and \$4.9 million from Enterprise Funds
- The amount in the Reserve would be calculated as 8% of the average of the last three years' Actuarially Determined Contribution (ADC) pension payments
- The Reserve could be used to pay for unexpected pension ADC increases as defined in the City's Reserve Policy

The Pension Reserve would be separate from the General Fund Reserve, and therefore would not be calculated into the General Fund Reserve 14% requirement. However, for comparison purposes, the \$16.3 million General Fund contribution to this new Reserve would be the equivalent of a 1.4% increase to the current policy of 14%.

Our Office supported the creation of this Reserve, noting that it was prudent to identify a source of funds for unanticipated changes to the ADC pension payment, although a majority of the B&GE members raised concerns about the narrow use of the Reserve.

General Fund Reserve Option 2: Increase the General Fund Stability Reserve

IBA Report 15-41 was presented to B&GE in November 2015, and included a discussion of the option to increase the General Fund Stability Reserve from 6% to 8% in lieu of the proposed Pension Reserve. As noted in that report and in our presentation to B&GE, the option to increase the existing Stability Reserve included the following components:

- There would be an increase to the existing Stability Reserve from 6% to 8%, for a total General Fund Reserve of 16% of General Fund operating revenues
- The 2% increase to the Stability Reserve would equal \$22.7 million paid for from the General Fund (Excess Equity), and the total General Fund Reserve would be calculated at 16% of the most recent three years' average of annual audited General Fund revenues (includes 8% Emergency Reserve and the increased 8% Stability Reserve)
- The Reserve could be used to pay for unexpected pension ADC increases as defined in the City's Reserve Policy, to mitigate financial risk due to revenue shortfalls or unanticipated critical expenditures, or for critical capital or operating needs

Like Option 1 described above, our report noted that this option was prudent and would move the City closer to meeting GFOA best practices for General Fund reserves as displayed in the following table:

| <i>(\$ in millions)</i> | % of General Fund Operating Revenues | Total General Fund Reserve Amount (FY 2016) | Increase Over Current General Fund Reserve Amount |
|---|--------------------------------------|---|---|
| Current General Fund Reserve Policy | 14% | \$158.7 | N/A |
| Option 2: Increase Stability Reserve | 16% | \$181.4 | \$22.7 |
| GFOA Guidelines¹ | 16.7% | \$189.3 | \$30.6 |

¹GFOA recommends a minimum of two months of operating revenues or expenditures, which is approximately 16.7%.

General Fund Reserve Option 3: Approve Both Reserve Proposals to Achieve Each Purpose

A third option combines the specificity of the Mayor’s initial proposal with the desire for flexibility expressed by some B&GE members, by taking \$22.7 million in Excess Equity discussed in Option 2 and splitting the funds to increase the Stability Reserve *and* create a new Pension Payment Stabilization Reserve.

- General Fund Stability Reserve
 - Increased from 6% to 7%, or \$11.3 million, and the total General Fund Reserve would increase from 14% to 15% (rather than the original 16%) of General Fund operating revenues
 - Calculated at 15% of the most recent three years’ average of annual audited General Fund revenues (includes 8% Emergency Reserve and the increased 7% Stability Reserve)
 - Reserve could be used for broader purposes as outlined in Option 2 above
- Pension Payment Stabilization Reserve
 - Total of \$14.7 million: \$11.3 million or 77.1% from the General Fund and \$3.4 million from Enterprise Funds (rather than the original \$21.2 million)
 - The amount in the Reserve would be calculated at 5.5% of the average of the last three years’ ADC pension payments
 - Reserve could be used for unexpected increases to the ADC
 - Funding could be increased through the budget process as determined necessary

The following table compares the funding amount of each of the three options:

| <i>(\$ in millions)</i> | Option 1: | Option 2: Increased | Option 3: Approve Modified Proposal | |
|---|------------------------------|--|-------------------------------------|--|
| | Pension Reserve | Stability Reserve | Pension | Stability |
| General Fund Contribution¹ | \$16.3 | \$22.7 | \$11.3 | \$11.3 |
| Enterprise Funds' Contribution | \$4.9 | - | \$3.4 | - |
| Total Funding Increase Over Current Reserve Amount | \$21.2 | \$22.7 | \$14.7 | \$11.3 |
| Mechanism | Create new, separate reserve | Increase existing Stability Reserve from 6% to 8%, for a total General Fund Reserve of 16% | Create new, separate reserve | Increase existing Stability Reserve from 6% to 7%, for a total General Fund Reserve of 15% |

¹The General Fund contribution of each reserve increase would come from Excess Equity, which was projected to be \$31.7 million in the Mayor’s FY 2016 First Quarter Budget Monitoring Report.

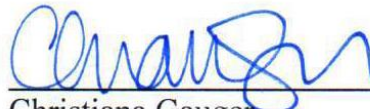
CONCLUSION

This report includes a review of the two options for increasing the General Fund Reserve that were discussed separately at B&GE in October and November, 2015. These options are scheduled to be presented to Council on January 25, 2016, and are discussed in greater detail in IBA Report 15-41 available in the docket back-up material.

Also included in this report is a third option that splits the amount between a 1% increase to the General Fund Stability Reserve and the creation of a Pension Payment Stabilization Reserve. Our Office views all three options as prudent.



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