

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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City Council Agenda Date: March 28, 2006

Item Number: 333, 334, & 335

Item: Authorization of Increased Legal Fees for Current and Former Elected Officials and City Employees

OVERVIEW

Definition

- **Unappropriated Reserve:** A component of the City's General Reserves that is not appropriated or used to balance the budget; also known as the General Fund Reserve, Unallocated Reserve or the Deep Reserve. In Fiscal Year 2006, the Unappropriated Reserve was scheduled to reach \$36,000,917, or approximately 4.16% of the General Fund Budget.

The three docket items discussed in this report, while heard by the Council as separate items, are virtually identical in the actions that are being requested. Broadly speaking, each item is requesting an increase in authorization to pay for the legal representation of current and former elected officials and city employees.

Item 333 is requesting authorization of an additional \$500,000 to pay for legal representation of current and former City officials and staff related to the case *SDPOA v. Michael Aguirre, et. al.* The retention agreement was previously authorized for an amount not to exceed \$200,000. The current request would bring the total not-to-exceed authorization to \$700,000.

Item 334 is requesting authorization of an additional \$927,312.80 to pay for legal representation of current and former elected City officials related to the ongoing financial investigations. The previous authorization for this purpose was \$851,000. The current request would bring the total authorization to \$1,778,312.80.

Item 335 is requesting authorization of an additional \$450,000 to pay for the legal representation of current and former City employees related to the ongoing financial investigation. Previous authorizations for this purpose total \$1,525,000. The current request would bring the total authorization to \$1,975,000.

For each of these actions, the Mayor is recommending to transfer funds from the City's Unappropriated Reserve to the Public Liability Fund to cover the General Fund portion of the increased authorizations. The costs associated with Items 334 and 335 will be allocated between the General Fund (71%) and Enterprise Funds (29%) on a Full-Time Equivalent basis, pursuant to the City's cost allocation policy approved by the City Council on March 20, 2006. The costs associated with Item 333 would be allocated entirely to the General Fund.

FISCAL/POLICY DISCUSSION

The most significant aspect of these actions is that, together, they mark the first time in recent history that the Council has been asked to authorize the use of the Unappropriated Reserve to pay for over-budget expenditures.

While this use of the Reserve represents a significant shift from existing policy and past practices, other cities do employ their reserves in such a manner, and doing so may be a more transparent mechanism for the funding and accounting of certain over-budget expenditures. The IBA believes that revisions to the City's current reserve policy may be appropriate, and recommends that the reserve policy issue be docketed for an upcoming Budget and Finance Committee meeting.

Currently, the level and use of the Unappropriated Reserve is governed by Council Policy 100-20. This policy states:

It is the intent of the City Council that the City of San Diego establish and maintain a General Fund Reserve level that is sufficient to address unforeseen contingencies such as natural disasters, catastrophic occurrences, or excessive liabilities or judgments against the City.

It is debatable whether the proposed use of the Unappropriated Reserve for these actions is consistent with the spirit of Council Policy 100-20. In addition, it is unclear why the Unappropriated Reserve is being recommended as a funding source for over-budget expenditures at this time without a more formal discussion on the appropriate use of reserves, and an amendment to the current policy.

QUESTIONS/COMMENTS

Does the proposed use of the Unappropriated Reserve adhere to Council Policy 100-20? It may be argued that the legal costs requested by these actions constitute an excessive liability for the City, and therefore fall under Policy. However, previous over-budget expenditures that were significantly greater in magnitude did not use the Unappropriated Reserve as a funding source.

How will this impact the City's bond rating? The City's commitment to building and maintaining its reserves has long been a strong point in the eyes of rating agencies and, more recently, has been one of the few positives for the City in terms of its credit rating.

What if there are insufficient revenues at the end of the fiscal year to fully replenish the Unappropriated Reserve? It is unknown whether sufficient excess revenues will be available at the end of the Fiscal Year 2006 to fully replenish the Unappropriated Reserve. If the Reserve is unable to be fully replenished at the end of the current fiscal year, then it should be made a top priority in the Fiscal Year 2007 budget. Note that this does not include any additional contributions to the Unappropriated Reserve that will be necessary to increase or even maintain the current level of reserves in Fiscal Year 2007.

CONCLUSION

The Mayor's recommendation in docket items 333, 334 and 335 to use the Unappropriated Reserve to fund over-budget expenditures represents a significant shift from existing policy and past practices. Since this practice may be a more desirable mechanism for the funding and accounting of certain unbudgeted expenditures, the IBA is interested in working with City staff to examine possible revisions to the current reserve policy to allow for more flexible usage of the Unappropriated Reserve within certain parameters.

The IBA recommends approval of these items utilizing the Unappropriated Reserve as a funding source with the following conditions:

- The City Council either waive Council Policy 100-20 or make a determination that these expenditures fall within the scope of the Policy;
- The Unappropriated Reserve be fully replenished at the end of Fiscal Year 2006, or if sufficient funds are not available, be made a top priority in the Fiscal Year 2007 budget;
- Council Policy 100-20 be placed on the Budget and Finance Committee's agenda in the near future to explore amendments to the City's reserve policy.

[SIGNED]

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