THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Deferred Capital Funding Options

OVERVIEW

Our office presented our review of the Mayor's Five-Year Financial Outlook for FY 2013-2017 to the Budget and Finance Committee on November 16, 2011 and to the full City Council on December 5, 2011. The most significant issue raised in our review related to the funding assumptions included in the Mayor's Outlook for addressing deferred capital expenditures. Our office has no disagreement with the magnitude of the problem, which is estimated now to be $898 million based on updated assessments (for streets, facilities and storm drains) or with the need for deferred capital to be a top funding priority over the next five years and beyond. Rather, we questioned the size and timing of the proposed multiple bond issuances which totaled $500 million (five $100 million bond issuances each year). We were also concerned that there were no increases proposed for cash funding for operations and maintenance projects over the five years. Our concerns focused on the following issues:

-Sufficient staffing capacity to expend this significant funding level annually based on our experience with the FY 2009 deferred capital bonds.

-The timing and uncertainty of the impacts of pending streamlining proposals.

-The long term impact on the General Fund of the debt service payments associated with $600 million in bond funding.

-The importance of ramping up cash funding over the five year period for ongoing non-capital needs that do not meet the criteria for long term bond funding.

-The desire to reduce reliance on bond funding for ongoing capital needs.

Following extensive discussion, the Budget and Finance Committee requested Chairman Todd Gloria to form a working group composed of the IBA's Office and the Mayor's Office to address their differences and develop a consensus five year funding approach for recommendation to the

Committee and subsequently City Council. The Committee requested that this matter be resolved prior to the Mayor requesting Council authorization to move forward with what is now planned to be a $75 million bond issuance in Spring 2012.

As a result of the working group, the Mayor's Office has issued a report for Budget and Finance Committee consideration on February 8, 2012 which presents funding options A and B as alternatives to the funding proposal in the original Five-Year Outlook. Both A and B provide the same total Capital/Maintenance program of $713 million for deferred capital over the five year period. This compares to $729 million in the original Outlook. However, this is still much more aggressive than the IBA scenario which provided total funding of $490 million as shown in the chart below.

Deferred Capital & Maintenance Spending Scenario (*$ in millions)*	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Mayor's Original 5Yr Outlook	$ 145.8	$ 145.8	$ 145.8	$ 145.8	$ 145.8	**$ 729.0**
Mayor's Revised Options "A" & "B"	$ 120.8	$ 130.0	$ 143.0	$ 156.0	$ 163.2	**$ 713.0**
IBA 5Yr Review	$ 158.0	$ 58.0	$ 58.0	$ 158.0	$ 58.0	**$ 490.0**

While both Options A and B provide the same total funding level, there are three fundamental differences: 1) the funding levels differ for operations and maintenance (O&M) projects; 2) the mix differs between cash and bonds; and 3) the percentage of bond eligible projects funded with bonds differs. As shown below, Option A includes $263 million for O&M/cash and $450 million for new bonds. Option B increases the O&M/cash to $298 million while decreasing the amount of bond issuances to $415 million over the five years with a corresponding decrease in debt service costs.

For years FY2013 and 2014, O&M/cash funding, new bond issuances and related debt service are the same. The differences in Options A and B appear in the outer years, FY2015-2017. Over the five year period the mix of bonds to cash is 63%/37% for option A and 58%/42% for Option B.

DEFERRED CAPITAL PROJECT AND MAINTENANCE SPENDING COMPARISON*

$ in millions

Mayor's Original 5Yr Outlook	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Debt Issuance Proceed Spending	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 100.0	$ 500.0
Operations & Maintenance Spending	$ 45.8	$ 45.8	$ 45.8	$ 45.8	$ 45.8	$ 229.0
TOTAL	$ 145.8	$ 145.8	$ 145.8	$ 145.8	$ 145.8	$ 729.0

Mayor's Revised Option "A"	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Debt Issuance Proceed Spending	$ 75.0	$ 80.0	$ 90.0	$ 100.0	$ 105.2	$ 450.2
Operations & Maintenance Spending	$ 45.8	$ 50.0	$ 53.0	$ 56.0	$ 58.0	$ 262.8
TOTAL	$ 120.8	$ 130.0	$ 143.0	$ 156.0	$ 163.2	$ 713.0

Mayor's Revised Option "B"	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Debt Issuance Proceed Spending	$ 75.0	$ 80.0	$ 81.0	$ 90.0	$ 89.4	$ 415.4
Operations & Maintenance Spending	$ 45.8	$ 50.0	$ 62.0	$ 66.0	$ 73.8	$ 297.6
TOTAL	$ 120.8	$ 130.0	$ 143.0	$ 156.0	$ 163.2	$ 713.0

** Figures shown for debt issuance proceed spending are from prior fiscal year bond issuance and do not include debt service*

Since options A and B are the same for the first two years, the Mayor is not recommending an option. Either option results in a $1.6 million reduction to the projected deficit for FY 2013-from the revised $12.2 to $10.6 million- as result of less debt service. For FY2014 both options result in a $1.1 million increase to the revised FY 2014 projected deficit-from $5.9 to $7.0 million. This increase in the FY 2014 deficit is the result of increased O&M costs, which are offset by reduced debt service costs, tied to a smaller bond issuance than originally planned.

The Mayor's Office makes no recommendation regarding the approach for FY 2015- 2017. The IBA recommends approval of Option B over Option A as it begins to address several of our concerns. It increases total cash funding for deferred capital projects from $229 million in the Outlook to $298 million over the five years; decreases total spending of bond funds from $500 million in the Outlook to $415 million; and increases O & M funding by 30%. In Option B the mix of bonds to cash is more appropriate and represents a substantial change from the Outlook.

Additionally, we would note that accomplishment of the proposed deferred capital expenditure levels even in the first two years is contingent upon effective, stable management of the capital projects area; success with implementing the proposed streamlining package; and adequate staffing levels. The streamlining proposals were recently reviewed by the Budget and Finance Committee and staff will be returning to the Committee to answer a number of Committee and IBA questions before proceeding to full Council.

There were preliminary discussions in our working group that 6-8 additional staff may be necessary to accomplish the proposed spending goals. However, this is not mentioned in the staff memo.

Finally, staff notes in their report that "since last November, they reconsidered their earlier recommendation and developed a more affordable and practical "status quo" alternative." While we support Option B as being more realistic, achievable, and appropriate, it is not clear what the impact will be on the deferred capital problem of expending $713 million and what level of service will be achieved. It is important to move forward with this program but a clearer picture is needed as to where the City will end up after this investment. This will help policy makers determine whether additional resources, such as a voter-approved bond program, may be necessary in the future.

While the Mayor's Office makes no recommendation regarding a five year approach, we recommend that Council approve one of the two funding plans in order to clearly communicate a preferred multi-year deferred capital funding program to the public and to the next administration. This would not preclude the Council from reassessing the approach in the future based on changing financial conditions or priorities. This schedule would also need to be reconsidered if projects are not being completed, and, therefore, bond funds are not being spent as expeditiously as planned.

Andrea Tevlin

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Independent Budget Analyst