THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 1

Deferred Capital

OVERVIEW

On July 11, 2011 the Audit Committee heard a Performance Audit of the City's Capital Improvement Program. At that meeting the Committee accepted the report and forwarded to the City Council with a request to the Independent Budget Analyst (IBA) to review the Structural Budget Deficit Elimination Guiding Principle 11, which requires the following:

> "Develop a plan to fund deferred capital infrastructure and maintenance needs to reduce the current backlog, identify the level of funding necessary to prevent the problem from growing larger, and to reduce the potential of increasing costs to identify the level of funding. Discuss at Budget and Finance Committee a policy to calculate and identify the level of funding for deferred maintenance budget needs."

In addition, the Audit Committee requested the IBA to develop recommendations for a five-year infrastructure budget and finance program that shows the City's current service level, the funding needed to maintain that service level, a service level improvement objective for Council consideration, and additional funding needed over a five-year period for achieving that objective.

This report responds to the Audit Committee's request by:

- Updating information previously provided by the IBA regarding deferred capital funding as detailed in our office's review of the Mayor's Proposed Fiscal Year 2012 Budget (Report #11-25);
- Reviewing the Mayor's Deferred Capital Plan as detailed in the recently released FY 2013-2017 Five-Year Financial Outlook;
- Providing an overview of alternative revenue sources that are already or could be consider for funding Deferred Capital projects;
- Providing an overview of other Deferred Capital items to be considered such as the City's capacity to handle a large volume of projects;
- And providing recommendations for Council consideration.

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The IBA is bringing this report to the Budget and Finance Committee (B&FC) due to the B&FC historically hearing items related to Deferred Capital.

FISCAL/POLICY DISCUSSION

At the B&FC meetings on March 16 and 30, 2011, the City's COO and Public Works staff presented information related to the funding required to address the City's "Catch-up" and "On-Going" expenses for Deferred Capital. Staff delineated "Catch-Up" as funding required to reach a designated service level and "On-Going" funding as the annual, recurring funding required after "Catch-Up" to maintain the desired service level.

"Catch-Up" Funding Required

Based on information provided by staff at the March 2011 B&FC meetings, staff has identified the following total backlog of deferred projects required to "Catch-Up" for the City's three main asset classes (Facilities, Streets, and Storm Drains). This information was based on condition assessments completed over the last five years.

"Catch-Up" Funding Required for High Service Level	
Asset Class	Funding Amounts (Millions)
Facilities	$216.0
Streets	$378.0
Storm Drains	$246.0
Total:	*$840.0*

As noted in staff's March 8, 2011 report to the B&FC Committee, the $840 million reflects the ***total backlog*** for the three main asset classes. Although the complete elimination of the deferred capital backlog would be the ideal goal, even if funding were available this is not realistic due to the City's existing capacity to manage and monitor projects at this level of funding. As a result of the challenges associated with funding and capacity, staff identified condition levels and funding alternatives for each of the main asset classes in their March 8, 2011 report. These alternatives (I & II) were based on future funding availability in the context of the City's total budget and also projected staffing capacity. It should be noted that in March 2011, the Mayor was proposing Alternative I as the appropriate funding level based on funding and staffing capacity. ***However, the City Council has not taken a formal action on the Mayor's alternatives and this is an area that the Council will need to address in the future. As discussed below, identifying the service level will drive the funding required in the future and the capacity required to handle project management and monitoring.*** The following sections review the existing funding levels for each of the three main asset classes as well as the proposed alternatives.

Facilities

The City of San Diego currently has over 1,600 facilities totaling over 10 million square feet. These buildings include a large range of facilities including high rise office buildings, police and fire stations, libraries, community centers, museums, senior centers, storage sheds, concession stands, picnic pavilions, and comfort stations. A large number of the City's 1,600 buildings are small, minor facilities that serve as storage and recreation purposes.

In Fiscal Year 2007, the City undertook a condition assessment of 31 public safety buildings. In 2009, the City completed an assessment of an additional 443 major City Facilities. In addition, in 2009, the City completed a separate Facilities Condition Assessment of the Civic Center Facilities (five facilities). The Facilities Condition Assessments looked at the facilities' current plant value and overall condition based on age and maintenance history. Based on the three Facilities Condition Assessments, the following total "Catch-Up" funding needs were identified for facilities:

Facilities "Catch-Up" Funding by Facility Type	
Facility Type	**Total Needs in Dollars**
Civic Center Plaza Bldgs	$99.7
Park & Recreation	$59.0
Library	$16.4
Fire	$12.7
Police	$12.2
General Services	$11.5
Engineering	$2.5
Life Guard	$2.0
Total:	**$216.0**

In addition, a Facility Condition Index (FCI) for each of the facilities was also developed. The FCI is a formula that divides "Total Cost of Required Repairs" by the "Current Replacement Value" of the facility. The FCI categories are as follows:

Good – FCI of 5.00% or less
Fair - FCI of 5.01% to 10.00%
Poor – FCI of 10.01% or more

In their March 8, 2011 report to the Budget & Finance Committee, staff identified two Alternatives (I & II) based on the FCI scores derived from the 443 facilities assessed in 2009 and also funding required for the Civic Center facilities ($21 million for Alternative I and $32 million for Alternative II). The following table details the necessary funding required to "Catch-Up" to the FCI levels proposed for Alternatives I & II and the number of facilities that would fall into each level:

Facilities Service Levels Alternatives						
	Existing		Alternative I		Alternative II	
Service Level (FCI)	% Facilities	# of Facilities	% Facilities	# of Facilities	% Facilities	# of Facilities
Good	45%	202	45%	202	60%	269
Fair	22%	99	40%	179	30%	134
Poor	33%	147	15%	67	10%	45
Funding Required for Alternatives (Millions)	N/A		$47.0		$70.0	

Streets
The City of San Diego has a street network that consists of 2,574 miles of asphalt streets and 111 miles of concrete streets. In 2007 the City undertook a condition assessment of the asphalt streets and in 2009 an assessment was completed of the concrete streets. After the 2007 condition assessment, each street section was assigned an Overall Condition Index (OCI) that was based on the street's ride quality and surface condition, including the amount of cracks, spalling, alligatoring, and potholes. The following details the three OCI classifications:

Good – OCI of 70 or greater
Fair – OCI of 40 to 69
Poor – OCI of less than 40

In their March 8, 2011 report to the B&FC, staff identified two Alternatives (I & II) based on the OCI scores derived from the 2,574 miles of asphalt streets assessed in 2007. The following table details the necessary funding required to "Catch-Up" to the OCI levels proposed for Alternatives I & II and the number of miles that would fall into each level:

Asphalt Streets Service Levels Alternatives						
	Existing		Alternative I		Alternative II	
Service Level	% Streets	Street Miles	% Streets	Street Miles	% Street	Street Miles
Good	38%	978	45%	1,158	60%	1,544
Fair	45%	1,158	40%	1,030	30%	772
Poor	17%	438	15%	386	10%	258
Funding Required for Alternatives (Millions)	N/A		$57.0		$157.0	

It should be noted that the table above is based on the Condition Assessment completed in 2007 and does not include the concrete streets. In addition, the 2007 Condition Assessment is based on street "sections" which generally are street blocks. For this table the IBA has reflected street miles for discussion purposes. The Transportation & Storm Water department has recently completed a Condition Assessment of all asphalt, concrete, and alleys. The updated OCI could significantly alter the numbers presented above due to impacts associated with the City's Street Resurfacing program and City Streets degrading since the last condition assessment. ***The IBA recommends that once the new OCI's have been calculated that these numbers, including the impacts on funding, should be reported to the City Council.***

Storm Drains

The City's storm drain system includes 24,078 storm drain structures, 754 miles of drainage pipes, and 84 miles of drainage channels and ditches. In addition, approximately 38 miles of pipeline is Corrugated Metal Pipe (CMP). Staff notes that the CMP portion of the system has the shortest expected service life and is the most problematic part of the system. In their March 8, 2011 report to the B&FC, staff did not provide a rating similar to what was provided for Facilities and Streets. Staff has stated that due to the nature of the asset and mixture of the Storm Drain assets (Concrete pipes and CMP) it is difficult to identify a specific Condition Assessment.

However, staff did identify two alternative pipeline rehabilitation programs and the funding required to reach each of the targets identified. The following table outlines the "Catch-Up" service levels and the funding required for Alternatives I and II:

"Catch-Up" Storm Drain Service Levels		
Service Levels	**Alternative I**	**Alternative II**
Pipelines Rehabilitated		
Years:	45	35
Pipelines Replaced		
Years:	90	75
Pump Station Rehabilitation		
Years:	30	15
Structure Replacement		
Years:	90	75
Funding Required for Alternatives (Millions)	**$88.0**	**$165.0**

Assets not included in the $840 Million "Catch-Up" funding requirement

It should be noted that the following assets have not been included in the $840 million "Catch-Up" funding identified in the March 8, 2011 report to the B&FC. There are a number of reasons that these assets have not been included in the $840 million and more details are provided below under each section.

- Sidewalks
- Water and Sewer Infrastructure
- Convention Center
- Qualcomm Stadium
- Petco Park
- Alleys
- Bridges

· Drainage channels
· Piers, seawalls and related Park & Recreation managed structures
· Right of Way features (signs, signals, and guardrails)

Sidewalks
For sidewalks, the City has not commissioned a formal condition assessment but addresses damaged sidewalks when notified. It should be noted that in a January 28, 2011 Memorandum of Law, the City Attorney's Office opined that under state law, every property owner is responsible for maintaining and repairing the portion of the public sidewalk fronting his or her property. However, the City has shifted much of the responsibility onto itself through Council Policy 200-12 which outlines the conditions where the City will replace sidewalks. In addition, generally the City is liable for injuries to the public if the adjacent property owner's failure to maintain or repair the sidewalk creates a dangerous condition, and fails to make the sidewalk safe within a reasonable time.

Water and Sewer Infrastructure
Funding for Water and Sewer Capital infrastructure projects are funded through the City's Water and Sewer funds. Funding for the Water and Sewer projects comes from rates charged to citizens and businesses receiving services from these departments. Annually, the Public Utilities Long-Range Planning Group and the City Engineering design team develops a CIP Master Plan (15 year outlook for Water/Sewer Capital Improvement Program). The Master Plan includes all known projects including addressing any deferred capital and/or new projects. Based on the CIP Master Plan and the Budgetary Five-Year Outlook, the Public Utilities Department is able to project the need for additional rate increases if necessary.

Convention Center, Qualcomm Stadium, Petco Park
For the Convention Center, Qualcomm Stadium, and Petco Park, each of these facilities are funded through sources other than the City's General Fund. However, it should be noted that facilities such as Qualcomm Stadium and Petco Park share common funding sources with the City's General Fund. An example is the Transient Occupancy Tax. If one of these facilities were to experience a failure due to the lack of deferred maintenance, the General Fund could be impacted.

Remaining assets (Alleys, Bridges, Drainage Channels, etc.)
For the remaining assets such as alleys, bridges, and drainage Channels, funding for deferred capital comes from local, state, and federal sources. Funding for Piers, Seawalls, and related Park and Recreation managed structures (Ball Field lighting, irrigation, Tot Lots, walkways, sports fields and Courts) could have a General Fund impact. Mayoral staff has stated that they will be looking at performing condition assessments of these assets in the future but note that a Condition Assessment can cost over $500,000 and identifying funding is a challenge.

"On-Going" Funding Required
Once the City has achieved a required service level it is equally important that the "On-Going" expenditures are funded at a level to ensure that the City does not fall behind on maintenance. If the City does not meet the minimum annual required "On-Going" funding level, the "Catch-Up" funding requirement will grow. Simply put, without adequate "On-Going" funding, the City

could find itself in a situation similar to today - a large “Catch-Up” funding requirement with limited resources to address the problem. Or even worse, the City could find itself in a situation where it has incurred large annual debt service payments related to bonds previously issued for deferred capital projects while still maintaining a substantial “Catch-up” requirement.

In addition, identifying funding for “On-Going” maintenance can be a challenge due to the restrictions that are placed on funding sources. Some “On-Going” maintenance is considered capital in nature and can be funded through bonds. Examples include a two inch overlay of asphalt on streets or a new roof and electrical system for a facility. Other items such as Slurry Sealing of streets, minor repairs of facilities (Painting, patching walls, minor plumbing), and minor repairs to storm drains (Cleaning, removal of debris) are considered maintenance (Non-Capital) in nature and do not qualify for bond funding. For these items, identifying funding sources can be a challenge. Some of the significant Deferred Capital funding sources such as TransNet are used for both capital and maintenance purposes. However, with a funding source such as TransNet, the City is capped (30% of annual funding) on what can be used for non-capital maintenance. Generally, the City looks to maximize the allowable maintenance funding from each of the state or local sources related to infrastructure but these collective funding sources generally fall short of what is needed annually for “On-Going” non-capital maintenance. As a result, the General Fund, when funds are available, is a primary source used for “On-Going” non-capital maintenance funding.

In their March 8, 2011 report to the B&FC, Public Works staff presented two alternative funding scenarios for “On-Going“ maintenance for the main asset classes. It should be noted that in March 2011, the Mayor was proposing Alternative I as the appropriate funding level for “On-Going” funding. The following table outlines the alternative “On-Going” funding scenarios for the three significant asset classes and the required amount to keep the City at the current “Status Quo” level compared to the funding levels included in the Fiscal Year 2012 Budget. It should be noted that for Fiscal Year 2012 all capital “On-Going” maintenance expenses were classified as “Catch-Up” funding.

Required "On-Going" Maintenance Funding (Millions)				
Asset Class	Status Quo	Alternative I	Alternative II	FY 2012 Budget
Facilities - Total	**$16.0**	**$32.0**	**$48.0**	**$10.0**
Facilities - Capital/Non-Capital (1)	$16.0	$32.0	$48.0	$10.0
Streets - Total	**$32.0**	**$70.0**	**$89.0**	**$26.4**
Streets - Capital	$0.0	$56.0	$79.0	$0.0
Streets - Non-Capital	$32.0	$14.0	$10.0	$26.4
Storm Drains - Total	**$10.0**	**$45.0**	**$45.0**	**$9.0**
Storm Drains - Capital	$0.0	$26.0	$26.0	$0.0
Storm Drains - Non-Capital	$10.0	$19.0	$19.0	$9.0
Total: (2)	*$58.0*	*$147.0*	*$182.0*	*$45.4*

(1) The split between Capital and Non-Capital was not available at the time this report was released.
(2) Reflects the total (Capital & Non-Capital) for the combined main asset classes.

In addition, the following table provides a breakdown of the funding sources included in the Fiscal Year 2012 budget for "On-Going" maintenance. It is important to note that a funding source such as Proposition 42 is contingent upon the State and could fluctuate from year to year.

"On-Going" Funding Sources		
	Funding Source	FY 2012 (Millions)
Facilities		
	General Fund	$9.1
	TOT	$0.7
	Other	$0.2
	Sub-Total:	*$10.0*
Streets		
	Prop 42	$15.2
	TransNet	$11.2
	Sub-Total:	*$26.4*
Storm Drains		
	Storm Drain Fund	$6.0
	General Fund	$3.0
	Sub-Total:	*$9.0*
	Total:	*$45.4*

Mayor's Plan to Fund "Catch-Up" and "On-Going" Expenses

As discussed in the sections above, funding of a Deferred Capital program is a balance between the desired service level, available funding, and project management capacity. The following sections discuss the Mayor's plans to address the "Catch-Up" and "On-going" funding in the context of the Mayor's recently released Fiscal Year 2013 – 2017 Five – Year Financial Outlook (Outlook).

"Catch-Up" Funding

On October 19, 2011 staff presented the Outlook to the B&FC. In the Outlook, the Mayor outlines his plan to address the "Catch-Up" funding for the next five fiscal years. As detailed in the Outlook, the Mayor is recommending that the City bond for $100 million per year for the next five years for a total of $500 million. This would be in addition to the $103 million in bonds issued in 2009. The following table details the impacts to the $840 million "Catch-Up" backlog from funding expended since Fiscal Year 2010 to date, and the impacts of the $500 million in future bond issuances and projected TransNet funding expected in Fiscal Years 2013 – 2015. It is important to note that this chart does not take into consideration additional expenses associated with the cost of construction increases or the impacts of not adequately funding "On-Going" expenses as discussed above. These factors could add additional annual expenditures.

Mayor's "Catch-Up" Funding Plan (Millions)

Asset	Funding Required FY 2011	Funding Expended/Planned (1)	Funding Required FY 2012(2)	Projected Additional Bond/TransNet Funding FY 2013 - 2017(3)	Remaining Backlog after 2017
Facilities	$216.0	$10.5	**$205.5**	$108.0	**$97.5**
Streets	$378.0	$82.5	**$295.5**	$228.0	**$67.5**
Storm Drains	$246.0	$10.0	**$236.0**	$103.0	**$133.0**
Total:	*$840.0*	*$103.0*	*$737.0*	*$439.0*	*$298.0*

(1) Includes funding expended/planned from Fiscal Year 2010 to date. Funding sources include the 2009 Bond Issuance, TransNet, and Proposition 1B. It should noted that Facilities are not eligible for TransNet or Proposition 1B funding. In addition, a portion of the 2009 bond funding has been used for asset classes other than Facilities, Streets, Storm Drains.

(2) Reflects the difference between the Funding Required FY 2011 and Funding Expended/Planned Columns.

(3) A portion of the future bond fundings will be used for asset classes other than Facilities, Streets, Storm Drains.

It should be noted that the Deferred Capital funding proposal in the Outlook is substantially more than what is required for the "Catch-Up" funding in Alternatives I ($192 million) & II ($392 million) as proposed by the Mayor in their March 8, 2011 Report to the B&FC. In fact, the anticipated bond funding in the Outlook exceeds the Mayor's „Catch-Up" funding requirements by $308 million for Alternative Service Level I and $108 million for Alternative Service Level II. Given the significant increase in bonds funds in the Outlook when compared to the Alternative Services Level recommendations, it is unclear what service level is now being recommended by the Mayor's Office given the significant bond funding increases in the most recent Outlook.

The IBA discussed with staff why the anticipated bond funding is more that what is required for the "Catch-Up" funding alternatives originally proposed. Staff indicated that the deferred capital needs are continuously in flux and the "Catch-Up" estimate was a point in time that will decrease or increase as infrastructure conditions are reassessed or newly assessed. In addition, some of the bond proceeds will be used to address assets other than Facilities, Streets, and Storm Drains. Furthermore, some of the bond funding may be used to replace end-of-service life infrastructure with new infrastructure, instead of repairing it, which would decrease the amount of on-going funding necessary to maintain aging capital but increase the cost to "Catch-Up" funding.

Factors to consider with future Bond Issuances

When evaluating future bond issuances, it is important to consider the impacts of the annual debt service payments on the City's General Fund. For each $100 million in bond debt issuance, staff is estimating an annual debt service payment of $7.2 – 7.5 million. If the City were to follow through with the five additional bond issuances then staff is projecting an annual debt service payment of $44.5 million in Fiscal Year 2017. For comparison purposes, the Library Department's Fiscal Year 2012 operating budget is $37.2 million.

In addition to the impacts to the General Fund from the annual debt service payments, Long-Term Bonds also have other factors that must be considered. These factors include:

- Negative Arbitrage: Negative arbitrage is the difference between interest paid and interest earned on idle bond proceeds. It is typically encountered because the City borrows at long-term rates and invests bond proceeds at short-term rates so that proceeds will be available for the financed project when needed. The City currently pays approximately 4.5% more than it earns on idle bond proceeds for the 2010 bonds (due to market conditions, this is significantly higher than usual). The best way to minimize negative arbitrage is to quickly spend bond proceeds to meet project funding needs.

- Bond Expenditure Requirements: Federal tax laws generally require that proceeds of long-term bonds be expended on designated projects within three years. Project capacity limitations can influence the City's ability to comply with these regulations.

The significant impacts to the General Fund through debt service payments and other considerations associated with the use of Long-Term Bonds illustrates the importance of the City Council weighing in on the level of service that should be attained. As stated before in this report, the City Council has not taken a formal action on the Mayor's service level alternatives and it is the service levels that will drive the required "Catch-Up" and "On-Going" funding in the future and the capacity required to handle project management and monitoring. Also, it is uncertain what service level is now being proposed by the Mayor.

"On-Going" Funding

In March 2011, the Mayor recommended Alternative Service Level I for "On-Going" maintenance which would require annual funding of $147 million. The Fiscal Year 2012 Annual Budget includes $45 million for "On-Going" maintenance for the three main asset classes. Of the $45.4 million budgeted in the Fiscal Year 2012 Budget, $12.1 million is from the General Fund. It should be noted that the Outlook does not include any increases in General Fund Support for "On-Going" maintenance funding for Fiscal Years 2013- 2017. In addition, staff notes in the Outlook that State restructuring of gasoline taxes allows Proposition 42 revenue to be redirected back to the State's General Fund at any time by a majority vote of the State's Legislature. If this were to occur, a significant "On-Going" maintenance funding source for streets ($15.2 million in Fiscal Year 2012) would be lost.

For discussion purposes our office has developed the following tables to reflect the impacts to the General Fund if the full funding for the "On-Going" maintenance for the "Status Quo" and the Alternatives were included in the Mayor's Outlook. A caveat is that at the time of the release of this report our office had not completed our review of the Outlook. As a result, the deficit reflected in our final Outlook report could be different that what is reflected in the following table. In addition, these tables assume that any growth in "On-Going" maintenance expenses would come from the General Fund. Funding for "On-Going" maintenance would come from multiple areas including state and local sources if available. Finally, the funding for "On-Going" maintenance is one of the most critical needs facing the City in the future but must be balanced against other unmet needs.

"On-Going" Funding for "Status-Quo" Compared to Outlook Projected Deficits

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Outlook Projected Deficit	($31.8)	($36.6)	($28.1)	($5.6)	$22.7
Status Quo[1]	($12.6)	($12.6)	($12.6)	($12.6)	($12.6)
Total:	*($44.4)*	*($49.2)*	*($40.7)*	*($18.2)*	*$10.1*

[1] Total is net of the $45.4 million in "On-Going" maintenance expenses included in the FY 2012 Budget and assumed through Fiscal Year 2017

"On-Going" Funding for Alternative I Compared to Outlook Projected Deficits

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Outlook Projected Deficit	($31.8)	($36.6)	($28.1)	($5.6)	$22.7
Alternative I[1]	($101.6)	($101.6)	($101.6)	($101.6)	($101.6)
Total:	*($133.4)*	*($138.2)*	*($129.7)*	*($107.2)*	*($78.9)*

[1] Total is net of the $45.4 million in "On-Going" maintenance expenses included in the FY 2012 Budget and assumed through Fiscal Year 2017

"On-Going" Funding for Alternative II Compared to Outlook Projected Deficits

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Outlook Projected Deficit	($31.8)	($36.6)	($28.1)	($5.6)	$22.7
Alternative II[1]	($136.6)	($136.6)	($136.6)	($136.6)	($136.6)
Total:	*($168.4)*	*($173.2)*	*($164.7)*	*($142.2)*	*($113.9)*

[1] Total is net of the $45.4 million in "On-Going" maintenance expenses included in the FY 2012 Budget and assumed through Fiscal Year 2017

As detailed in the tables above, the service level selected could have a significant impact on the City's operating budget. Realistically, even assuming funding to meet the "Status Quo" or achieve the Alternative I service level could require significant service level reductions to balance each fiscal year's General Fund budget if other funding sources are not identified. However, these tables illustrate the importance of discussing the required "On-Going" maintenance funding in the context of the City's annual budget process to ensure that an adequate funding level is included in the budget and is balanced against other service priorities and that the Council is also informed of the impacts to the "Catch-Up" backlog.

Other Current Funding Sources to be considered for Deferred Capital Expenses

Historically, when the City has discussed funding for Deferred Capital Expenses at Council meetings, budget hearings, or Council Committees, the focus has been on the significant funding sources such as Bond Funds, TransNet, Proposition 42, and the Capital Outlay Fund (Proceeds from land sales). In the foreseeable future these sources will continue to make up the core funding for Deferred Capital.

However, it should be noted that the City has other funding sources that could be considered in the future to either directly assist with funding for deferred capital related expenses or leveraging for future bond issuances. It is important to note that any funding source that could be used to offset the impacts to the City's General Fund could be used for or augment other service priorities including increasing funding for "On-Going" maintenance expenses. At the request of the IBA, the City Attorney's Office completed a cursory review of the following funds that could be considered for Deferred Capital expenses or leveraging for future bond issuances. Based on this review, there could be opportunities to use these funds for Deferred Capital. However, it should be noted that many of these funds have specific charter requirements on where and how the funds can be used and some of these funds are already obligated to other projects or services. Moreover, some of these sources might not be appropriate for a pledge as a repayment of bonds. If the Council were to elect to explore these funding sources for future Deferred Capital expenses, the City Attorney would need to complete a more in depth review.

Park & Recreation Related Facilities & Infrastructure

Mission Bay Improvement

Purpose: The Mission Bay Improvements Fund is used for permanent public capital improvements and deferred maintenance of existing facilities within the Mission Bay Park Improvement Zone consistent with the Mission Bay Park Master Plan. Funding is directly related to the City of San Diego Charter, Article V, Section 55.2 that requires that three-quarters of all lease revenues collected from Mission Bay in excess of $23.0 million (or the remainder of those revenues if less than 75 percent is available after the allocation to the San Diego Regional Parks Improvement Fund has been made) be allocated to the Mission Bay Improvements Fund to solely Benefit the Mission Bay Improvements Zone. Park improvements are prioritized in the Charter section, although other projects may proceed once the priorities have been budgeted, approved by council, and have a funding plan put in place.

Revenue Source: Transfer from the General Fund – Mission Bay Park's Rents

Projects/Services Currently Funding: The Fiscal Year 2012 Budget reflects $983,000 in continuing appropriations for Capital Improvement Projects (CIP). Examples of projects funded from the Mission Bay Improvement Fund include the North Crown Point Gazebo Replacement and Fiesta Island Infrastructure Improvements.

It should be noted that Outlook projects the Mission Bay Improvement Fund and the San Diego Regional Parks Improvement fund will start to receive additional revenue as a result of a decrease to the minimum threshold of $23.0 million to $20.0 million and the anticipated growth in Mission Bay Lease Revenues. In Fiscal Year 2017 the fund is projected to receive an additional $7.9 million.

San Diego Regional Parks Improvement Funds
Purpose: The San Diego Regional Parks Improvements Fund is to be used only for non-commercial public capital improvements for San Diego Regional Parks and park uses. The eligible City of San Diego's Regional Parks include Balboa Park, Chollas Lake Park, Mission Trails Regional Park, Otay River Valley Park, Presidio Park, San Diego River Park, open space parks, coastal beaches, and contiguous coastal parks. Funding is directly related to the City of San Diego Charter, Article V, Section 55.2 that requires that one-quarter of all lease revenues collected from Mission Bay Park in excess of $23.0 million, or $2.5 million (whichever is greater), be allocated to the Regional Parks Improvements Fund to solely benefit San Diego Regional Parks. Park improvements are prioritized in this Charter section, although other projects may proceed once the priorities have been budgeted, approved by Council, and have a funding plan in place.

Revenue Source: Transfer from the General Fund – Mission Bay Park's Rents

Current Funding: The Fiscal Year 2012 Budget reflects $2.3 million in continuing appropriations for Capital Improvement Projects (CIP) and $8.5 million in reserves. Examples of projects funded from the Regional Improvement Fund include reconstruction of the Balboa Park Arcade and the construction of the Mission Trails Regional Park Equestrian Comfort Station.

Mission Bay/Balboa Park Improvement Fund
Purpose: The Mission Bay/Balboa Park Improvement allocation provides the City with the ability to finance capital improvements in Mission Bay Park and Balboa Park.

Revenue Source: Transfer from the Transient Occupancy Tax (TOT) Fund

Current Funding: The Fiscal Year 2012 Budget reflects $350,000 for the Balboa Park Tram and $1.1 million for bond debt service payments for bonds issued in 1996. Examples of projects funded through these bonds include Balboa Park facility improvements and shoreline restoration for Mission Bay.

Environmental Growth Funds (1/3 & 2/3)
Purpose: The Environmental Growth Fund was established for the exclusive purpose of preserving and enhancing the environment of the City of San Diego, provided that two-thirds is to be used for debt service for bonds for the acquisition, improvement and maintenance of open space to be used for park or recreational purposes. If there are no such bonds outstanding or if two-thirds of the EGF exceed the amount necessary to service outstanding bonds then those moneys shall be used for the purpose of preserving and enhancing the environment of the City of San Diego.

Revenue Source: Franchise Fees (Fees resulting from agreements with private utility companies in exchange for use of the City's rights-of-way).

Current Funding: The Fiscal Year 2012 Budget for the 1/3rds fund reflects $306,000 for the City's Maintenance Assessment District Reimbursements, $3.7 million for Regional Park/Open Space Maintenance, and $55,000 transfer to the Los Penasquitos Canyon Preserve fund. The Fiscal Year 2012 Budget for the 2/3rds fund includes $8.1 million for park and open space maintenance.

Public Safety Related Funds

Public Safety Needs & Debt Service

Purpose: The Public Safety Needs and Debt Service Fund was established as a special revenue fund with the purpose of tracking expenditures for public safety needs.

Revenue Source: Funding for the Public Safety Needs and Debt Service Fund is safety Sales Tax Revenue, a half-cent sales tax resulting from the enactment of Proposition 172 in 1994.

Current Funding: The Fiscal Year 2012 Budget includes a $2.5 million transfer to the Fire-Rescue Department and a $2.5 million transfer to the Police Department for operating expenses. In addition, $1.6 million is transferred to the Fire and Lifeguard Facilities fund.

Fire and Lifeguard Facilities Fund

Purpose: The Fire and Lifeguard Facilities Fund is appropriated for the purpose of the accumulation and expenditure of funds for lease payments and project/debt management costs related to lease revenue bonds issued for the construction or improvement of fire and lifeguard stations throughout the City.

Revenue Source: Funding for the Fire and Lifeguard Facilities Fund is a transfer of safety Sales Tax Revenue from the Public Safety & Debt Service Fund.

Current Funding: The Fiscal Year 2012 Budget includes $1.6 million in debt service payments for lease revenue bonds issued in Fiscal Year 2002 for Fire and Life Safety facilities. Example of projects that the Fire and Life Safety Facilities bonds have funded include the construction of Fire Station 45 in East Mission Valley and the construction of the La Jolla Shores Lifeguard Station.

Bond Financing Options to fund Deferred CIP

Long-term bond financing is an appropriate means of financing capital improvement projects. Deferred capital improvement projects involving the replacement of major systems or building components can be financed with either general obligation or lease revenue bonds (which the City is already using for Deferred Capital Expenses). However, it should be noted that ongoing maintenance of public facilities that is not capital in nature cannot be financed with these bonds. The following section provides an overview of the general obligation bonds.

General Obligation Bonds
General Obligation Bonds are typically issued to finance government improvements benefiting the community as a whole. These bonds are secured by the full faith, credit and taxing power of an issuer. The issuer pledges to levy the necessary taxes (typically ad valorem property taxes) on all assessable property within its jurisdiction to provide the timely repayment of debt. Buyers of general obligation bonds know that voters have approved a new ad valorem tax dedicated to pay all debt service on the bonds. Due to the strength of this security pledge, general obligation bonds receive the highest ratings. General obligation bonds typically provide issuers with the lowest borrowing costs, do not require funding a reserve fund, and are readily accepted by investors in the municipal marketplace.

General obligation bonds require two-thirds voter approval which can be difficult to achieve. Because of this, cities in California have historically chosen to look at other financing methods to fund their needs. A December 31, 2008 Los Angeles Times article on municipal debt pointed out that "of the more than 10,000 bonds and other debt vehicles issued between 1998 and 2007, fewer than 700 went to a public vote, according to the state treasurer's office." However, the article also pointed out that "nontraditional debt vehicles cost more over the long run because they are considered riskier than general-obligation bonds, which governments stand fully behind. Investors therefore demand higher interest rates."

Project Management and Oversight Capacity
In their June 2011 audit of the City's Capital Improvements program, the Office of the City Auditor noted that the contract bid and award process for projects can take six to nine months to complete. Unless bond financing can be timed to coincide with the need for project funding, a lengthy contract bid and award process further idles bond proceeds. As discussed above, this results in additional negative arbitrage costs and puts pressure on the City's bond expenditure requirements (Federal tax laws generally require that proceeds of long-term bonds be expended on designated projects within three years). The best way to minimize negative arbitrage is to quickly spend bond proceeds to meet project funding needs. As part of a successful deferred capital plan, adequate project management and oversight capacity is essential. The following sections review the City's staffing resources and also examples of project delivery methods.

City Staff Resources
In 2006 the Engineer and Capital Projects Department underwent an extensive Business Process Re-engineering (BPR) study. Prior to the study, many of the engineering services were split among various departments throughout the City. As a result of the study, most of the engineering services, including project management, were consolidated into the Engineering and Capital Projects department. At that time, staff stated that centralizing operations would provide the oversight that was needed to prioritize projects and ensure effective allocation of available resources. As a result of the BPR, 89.50 positions, many of them engineers, were reduced from the budget. During our review of the Fiscal Year 2008 Proposed Budget (Report 07-46), our office wrote:

> "There are practical limits on how much work can be handled in any given fiscal year. The City should carefully evaluate and determine how many projects can be logistically

accomplished each year. Furthermore, staffing requirements for carrying out projects needs to be considered, particularly in the Engineering and Capital Projects department."

Since the implementation of the E&CP BPR in Fiscal Years 2008 & 2009, the number of E&CP staff has remained relatively static. However, as noted in the Fiscal Year 2012 Budget, the total value of all Capital Improvement Projects awarded for construction (total project cost) has grown from $117.0 million in 2010 to an estimated $498.0 million in Fiscal Year 2011 and the number of projects has increased from 75 in Fiscal Year 2010 to an estimated 118 in Fiscal Year 2011. As we noted in our review of the Fiscal Year 2012 Proposed Budget (Report #11-25), E&CP department management had previously stated that they would not be able to handle the increased capacity associated with additional deferred capital funding. Due to this, ***the IBA recommends that prior to any additional bond issuances, the E&CP department provide an overview to a Council Committee on staffing requirements needed to handle the increased project capacity, and an update on the impacts of the department's BPR detailing what has been successful and any challenges resulting from the changes. Additionally, future Five Year Outlooks should include the required staffing funding to match approved Deferred Capital service level assumptions.***

Project Delivery Methods

In our review of the Fiscal Year 2012 Proposed Budget, we noted that to address the lack of project capacity, department management was looking at different service delivery methods to the City's procurement systems and also process changes. Some examples include:

> *Multiple Award Construction Contracts (MACC):* With a MACC program at the City, the City Council would award contracts to multiple design-build contract entities (typically four or five) and these firms would compete on individual project task orders on a best value basis. The advantage of this approach is that these multiple contractors are awarded in response to a single RFP that would be advertised by contracting staff.
>
> *Reduce the number of projects required to proceed to Council Committee prior to being placed on a Council Docket:* Staff estimates that under that current process which requires most contracts to proceed to committee prior to moving to the full Council delays projects approval by one to three months. Staff is suggesting a review of the Council approval process for contracts to streamline the time necessary to award a contract.

It should be noted that staff is working to reduce the time required to implement CIP Projects. At the November 2, 2011 B&FC meeting, staff is expected to provide suggestions to streamline project delivery. In addition, in June 2011, the City's Chief Operating Officer announced that the Public Works Construction and Professional Architect/Engineering responsibilities would be moving from the Purchasing and Contracting Department to the Public Works Department. The COO stated that the change would streamline the public works contacting process resulting in improved capital project delivery. Management has also announced recently that the City's CIP project delivery system is scheduled to undergo the Managed Completion process.

Finally, in their June 2011 audit of the City's Capital Improvements program, the Office of the City Auditor included 24 recommendations to improve planning and oversight of the City's CIP program. Of the 24 City Auditor recommendations, staff agreed with 17. With the implementation of the City Auditor's recommendations; a review of the City Staff Resources by a Council Committee; and the review and possible implementation of project delivery systems and process changes, the City should have an good understanding of what is required to successfully provide project management and oversight capacity prior to the issuance of additional bonds.

Transparency/Availability of Project Information

In researching this report, our office worked with staff from the Mayor's Office and the Engineering and Capital Projects Department. Staff was helpful in providing all requested information for this report and was also available to answer any follow-up questions that our office had. However, without access to staff to provide the requested information, it would have been very difficult to locate the critical information regarding the City's Deferred Capital program. With the Mayor proposing additional bond issuances in the future, it is essential that critical information such as the current backlog of projects, timelines, and funding are included in a central location such as the City's website so that the public can review the status of the program. Below are two examples of how other organizations utilize their websites to inform the public of the projects included in their Capital and Deferred Capital/Maintenance programs. It should be noted that the City has recently started to provide a list of streets that have been repaved on the City's website.

City of San Antonio

The City of San Antonio has a Infrastructure Management Program (IMP) that is a five-year rolling plan that identifies projects and establishes schedules for their significant assets. Included on their website is the Five-Year Maintenance Program by asset type (See Attachment 1) that lists the project, the Fiscal Year that the project will be addressed, and the type of maintenance that will be provided. As follow-up the Department of Public Works provides annual reports on the status of the projects.

In addition to the IMP, The City of San Antonio's Capital Improvements Management Services Department maintains a "Dash Board" for projects included in their $550 million bond program approved in 2007. The "Dash Board" includes information on project phases (Design, construction, and Completed), Cash flow, and percent of project on time. However, Capital Improvements Management Services staff stated that the cost for implementation of the "Dash Board" was $400,000 which could be cost prohibitive for the City of San Diego.

San Diego Unified School District (SDUSD)

On November 4, 2008 the San Diego voters approved a $2.1 billion general obligation bond measure, Proposition S. Proposition S extended the previously voter approved Proposition MM tax rate of $66.70 per $100,000 assessed value of taxable property from 2029 to 2044. The Scope of work under Proposition S includes updating classrooms to "21st Century" technology levels, replacing portable classrooms with permanent buildings, and providing other updates to facilities.

To track the status of bond funded projects the SDUSD includes a Proposition S Bond Program page on their web-site that enables the public to track projects status by school or start date (See Attachment 2).

In addition to information being provided on projects and status, it is important that the public is able to understand the multiple funding sources that are used to address the City's Deferred Capital Program. Similar to the funding source table included in this report for "On-Going" maintenance (Page 8), the IBA recommends that a table be developed for the City's website that details the funding required for "Catch-Up" and "On-Going" maintenance expenditures and the amount and funding source included in the annual budget.

Finally, once the City Council has identifies services level goals and funding has been identified, it is essential that staff report to a Council Committee semi-annually on the status of the *overall* Deferred Capital program, not just the projects associated with bond issuances. The updates should include the following:

- Projects Status Reports - Once reviewed by a Council Committee this information should be posted on the City's web-site.
- Update on recently completed condition assessment reports and how they impact "Catch-Up" and "On-Going" funding.
- Update on funding changes including the status of bond expenditures.
- Review of project capacity and the impacts of new service delivery methods.

CONCLUSION

In July 2011, the City's Audit Committee requested the office of the IBA review the Structural Budget Deficit Elimination Guiding Principle 11 and also develop recommendations for a five-year infrastructure budget and finance program. It was requested that the program should consider the City's current service levels; the funding needed to maintain service levels; a service level improvement objective for Council consideration; and additional funding needed over a five-year period for achieving that objective. This report responds to the Committee's request and also consolidates information released over the last year by staff and the IBA, regarding the City's Deferred Capital Program, into a comprehensive document. In addition, our office has provided a number of recommendations (Attachment 3) to better address the City's Deferred Capital needs in the future. The IBA is bringing this report to the Budget and Finance Committee (B&FC) due to the B&FC historically hearing items related to Deferred Capital

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Attachments:

1. City of San Antonio Adopted Infrastructure Management Program (IMP) FY 2012-2016
2. San Diego City School District Proposition-S Bond Program
3. IBA Recommendations for the City's Deferred Capital Program