



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 15, 2015

IBA Report Number: 15-12

City Council Docket Date: April 21, 2015

Item Number: 337

IBA Review of the Mayor's Capital Improvements Program (CIP) Cash Management Process Improvements

OVERVIEW

On March 11, 2015 the Infrastructure Committee considered three separate proposals from the Mayor related to infrastructure process enhancements which addressed five-year funding for street repairs; changes to cash management processes to expedite project delivery; and the streamlining of project delivery processes to make them more efficient. The Infrastructure Committee unanimously accepted and approved forwarding all three items to the full City Council. On March 18, 2015, the Budget and Government Efficiency Committee also reviewed the cash management component of the proposals.

On Tuesday, April 21, the Council is being asked to consider and accept the following reports:

ITEM 336 Report No. 15-026 Street Pavement Repair Program

ITEM 337 Report No. 15-024 Capital Improvement Program (CIP) Cash Management Process Improvements

ITEM 338 Report No. 15-020 Process Improvement and Streamlining for CIP Delivery

This report addresses the proposed improvements for the CIP cash management process with an analysis of the information previously presented to Committee, as well as some recommendations for Council to consider when reviewing the item.

FISCAL/POLICY DISCUSSION

CIP projects are allocated funding each year through the City's annual budget process; details of the projects funded each year can be found in Volume 3 of the City's Proposed and Adopted Budgets. Additionally, funding and project prioritization decisions occur throughout the year at the Capital Improvements Program Review and Advisory Committee (CIPRAC), as well as via resolution when departments route actions to Council. CIP projects are not included as part of the City's quarterly budget monitoring as that process only includes a review of funds with budgeted personnel expenditures and has not been a vehicle for reviewing CIP project expenditures or funding sources.

As of March 12, 2015, the City's CIP had \$737.4 million in unencumbered funds¹ and the Financial Management Department (FM) is proposing to initiate a centralized process under their review that would include ongoing budget monitoring and reporting, as well as other cash management efficiencies:

- Regular internal monitoring of CIP project budgets with asset-owning departments
- Once- or twice-a-year requests to the City Council to transfer available CIP project funds to priority projects
- Reallocation of funds from technically complete (teco) projects
- Pooled CIP project contingencies
- Deappropriation of annual allocations at the end of the fiscal year
- Encumbering funds as-needed
- Authorizing a commercial paper program for the City

These proposals are intended to remove impediments to the City's ability to spend CIP funds in the fiscal year in which they are budgeted, and to focus those funds on the most highly prioritized projects.

Proposed Changes to CIP Fiscal Oversight, Management, and Reporting

Financial Management is proposing to expand the internal CIP monitoring process that they have established with E&CP and the Transportation & Storm Water Department (TSW), to all of the City's asset-owning departments. The expansion and formalization of a quarterly monitoring program will mean more consistent oversight of project schedules and funding needs, and allow for a more accurate picture of cash requirements and funding prioritizations. FM is proposing that their internal monitoring process will result in one or two reports to the City Council each year that will identify any available excess budgets and request authority from the City Council on behalf of departments to reallocate those excess budgets to priority projects. Our office notes that the requests for reallocation of project budgets will *not* be accompanied by a report synthesizing the results of the internal monitoring process. While Council will be presented with requests to approve the transfer of funds from one project to another, they will not be told what percentage of CIP funding sources (i.e., TransNet) is projected to be spent by the end of the

¹ As reported in FM's presentation to the Budget and Government Efficiency Committee on March 18, 2015.

fiscal year. Our office recommends that Council request a mid-year or year-end update on CIP spending by funding source, in order to review year-end CIP fund projections and receive updates from departments as appropriate.

FM’s proposed changes to CIP cash management processes will not provide any ‘new’ revenues for CIP projects, but they will work to identify any funds that are currently allocated but unspent due to stalled projects or projects that have not started because they are only partially funded. FM noted that there is \$737.4 million in unencumbered CIP funds as of March 12, 2015, and they plan to identify those funds that are not likely to be spent in their current allocation in order to reallocate them to eligible high priority projects listed on the Council-approved Waterfall list. While the majority of the \$737.4 million in unencumbered funds are restricted for specific purposes, some unencumbered funds were identified in less restrictive funding sources that could be reallocated to higher priority transportation or General Fund projects, including: \$60.0 million in TransNet funds, \$33.0 million in General Fund dollars, \$15.0 million in Prop 42 (Transportation Assets) funds, and \$10.0 million in Capital Outlay Fund projects—for a total of approximately \$118.0 million.

The IBA also requested a list of CIP projects that had budget in FY 2015 but no expenditure activity as of March 12, 2015. FM provided the list of projects by asset-owning department that totaled approximately \$57.4 million in unspent funds from a variety of funding sources, as displayed in the table below.

CIP Projects with Zero Expenditures in Fiscal Year 2015 as of March 12, 2015		
Asset-Owning Department	Number of Projects	Total Available Budget
Environmental Services	2	\$ 430,517.21
Fire-Rescue	8	\$ 1,295,211.27
Library	9	\$ 1,074,754.81
Park & Recreation	32	\$ 6,918,309.71
Police	5	\$ 2,983,359.81
Public Utilities	74	\$ 22,918,144.14
Public Works-General Services	3	\$ 102,560.80
QUALCOMM Stadium	1	\$ 203,031.29
Transportation & Storm Water	98	\$ 21,508,511.41
Total	232	\$ 57,434,400.45

There are a variety of reasons why a project may not have incurred any expenses in a fiscal year; the table above includes those projects that are newly created and without expenditures, as well as older projects in various states of development where spending has stalled in FY 2015. FM’s analysis of unencumbered funds will identify those areas where funds are not being appropriately utilized. Their additional recommendations for process improvements also call for granting them the authority to transfer these funds to priority projects that will allow them to be spent more expeditiously, as discussed in the following section.

Proposed Changes Requiring Council Action and Additional Financial Analysis

In addition to the changes in CIP project monitoring and reporting, FM will be asking for Council approval to transfer funds from some technically complete projects to other priority projects, for the authority to pool budgeted project contingencies into one fund, for the authority to transfer unspent annual allocation funds into priority projects at the end of the fiscal year, and a request to initiate a commercial paper program. FM will continue their monitoring and analysis of CIP cash management in support of all of these requests for authority as well as in the implementation of a new encumbrance process that will see CIP project costs encumbered in the year that they will be spent, as opposed to the current practice of encumbering the full cost of a multi-year contract in the first fiscal year of that contract. Additional information on changes in CIP project encumbrances as well as all requests for additional authority is outlined in the paragraphs below.

Reallocation of funds from technically complete (teco) projects. A project is considered to be technically complete when the asset has been put into service but is still in the warranty phase and therefore is not ready to be considered completely closed. However some teco projects have cash balances that could be transferred to other priority projects; FM has indicated that as of March 2, 2015, \$23.0 million from different funding sources have been identified in teco projects. The Department will be conducting an analysis to determine the amount of funds that may be appropriately transferred out of a teco project and will request the authority to de-appropriate and reallocate these funds as part of the FY 2016 Appropriations Ordinance (AO).

As an example, the approximately \$57.4 million in CIP projects with zero expenditures in FY 2015 displayed in the table in the previous section includes some teco projects as highlighted in the following table.

CIP Projects with Zero Expenditures in Fiscal Year 2015 as of March 12, 2015		
Asset-Owning Department	Number of Teco Projects	Total Available Budget
Library	3	\$ 528,669.04
Park & Recreation	4	\$ 7,399.42
Police	1	\$ 46,664.65
Public Utilities	2	\$ 72,043.62
Transportation & Storm Water	4	\$ 167,150.86
Total	14	\$ 821,927.59

The authority that will be requested by FM in the AO would give the Chief Financial Officer (CFO) or her designee the ability to transfer funds from these teco projects to other identified priority projects on the Waterfall list.

Pooled CIP Project Contingencies. CIP projects include a budget for contingency that is set at 5% of construction contract bid costs. Since not all contingency budgets are fully expended, FM is proposing to pool all budgeted project contingencies into one Fund per funding source in order to lower the percent of contingency needed, which in turn will reduce the amount of funds that need to be budgeted per project. FM is estimating that pooling contingencies could lower the

contingency cost per project by 1-2%, and they will work with E&CP to determine the appropriate contingency percentage to use for each asset type. FM is proposing to pilot this strategy in FY 2016 with Water and Sewer projects, and will request the authority to pool these funds as part of the FY 2016 AO.

Year-end Review of Annual Allocations. Annual allocations are used to fund specific CIP projects (i.e., sidewalks). FM has noted that allocated, unspent annual allocations typically ‘roll over’ from one fiscal year to the next, but as part of their cash management process improvements they are proposing to produce a year-end CIP report reviewing annual allocations and requesting the deappropriation of any unspent funds that can then be re-appropriated into priority projects. As of March 2, 2015, there was approximately \$146.0 million of available budget in annual allocations.

CIP Project Encumbrances. In the course of completing a CIP project, the City will normally enter into one or more contracts with outside vendors. Current practice is to encumber project funds to support the entirety of the contract even if it spans multiple years. As part of the cash management streamlining, FM is proposing to encumber funds for a multi-year contract on an annual basis, as is done with multi-year contracts paid for with departments’ operations and maintenance budgets. This proposal will only apply to CIP projects expending funds from predictable funding sources (i.e., TransNet), and only after FM provides an estimate of future year revenues from the identified funding source. FM will pilot this approach in FY 2016 using TransNet-funded projects.

Commercial Paper Program. The use of commercial paper as a short-term borrowing tool is proposed to reduce negative arbitrage costs and improve the process for timely execution of large contracts. For example, the CFO indicates the reliability of commercial paper borrowing will allow large construction contracts to be issued sooner than would otherwise be possible. On March 23, 2015, the Council approved amendments to the City’s Debt Policy that included the potential use of commercial paper borrowing. In order to initiate a Commercial Paper Borrowing Program, staff plans to return to Council in the fall of 2015 for approval of an authorizing resolution.

CONCLUSION

FM’s focus on centralizing CIP monitoring, reporting, and cash reallocation efforts is being done with the intent to allow departments to focus on completing projects—whether they are projects currently underway or other priority projects that are waiting for additional funds to be allocated to them. Our office supports these measures as they provide greater transparency for the public and the Council into how CIP project funds are spent and allocated. We also note that the Mayor’s FY 2016 Proposed Budget includes requests from the FM, E&CP, and TSW departments for additional positions to support the proposed changes to the CIP cash management process.

Our office supports the proposed CIP cash management efficiencies and suggests that these changes be reviewed and monitored to ensure they result in a greater number of budgeted CIP

dollars spent each year. To track the progress of these efficiency measures, our office recommends that Council consider the following:

1. Reporting on the status of funds: FM is proposing to formalize and expand their internal CIP project budget monitoring process to all asset-owning departments. They anticipate that as a result of this process they will be coming to Council once or twice a year to seek Council approval to reallocate excess budgets to priority projects. However, they will not be using that time at Council to provide an update of how CIP funds are projected to be expended by the end of the fiscal year.

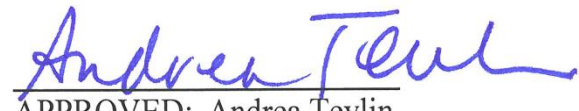
Our office is recommending that Council request a CIP budget monitoring report be presented at mid-year or as part of the proposed Year-End CIP Report in order to be able to review projected year-end CIP fund balances.

2. Reporting on the status of proposed efficiencies: This report has reviewed a large number of process efficiencies that FM and Debt Management are implementing, or are asking Council for the authority to implement, in order to remove impediments to the City's ability to spend CIP funds in the fiscal year in which they are budgeted and to focus those funds on the most highly prioritized projects.

Our office is recommending that Council request these efficiencies be tracked and reported back on how the measures are working. Some suggestions for tracking could include working with the Performance & Analytics Department to develop performance measures—either for the finance departments, the asset-owning departments, or for display in Volume 3 of the Adopted Budget—that track the number of projects completed on time and the percent of CIP budget dollars spent in the year that they were budgeted.



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