



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2018 CIP Year-End Budget Monitoring Report

OVERVIEW

The Fiscal Year 2018 Capital Improvements Program (CIP) Year-End Budget Monitoring Report (Year-End CIP Report) was issued on May 17, 2018, and was presented to the Infrastructure Committee on May 23, 2018. The report heard at the Infrastructure Committee included a request for the City Council to approve a net increase to the CIP of \$88.7 million. However, the 101 Ash Street allocations included in the Year-End CIP Report will be considered by Council separately on June 18, along with other items related to 101 Ash Street. Excluding these allocations, the budget request would increase the CIP by a net of \$75.5 million. Most of this funding is in Developer Fees and Enterprise Funds.

The report also asks for approval to transfer \$21.3 million between CIP projects. Generally, funds that are not currently needed for projects are being recommended for transfer to other projects. Transferred funds are needed to support higher costs due to design, construction, and unforeseen conditions, as well as to close out projects. Our Office does not raise concerns with the requested budget adjustments in this report.

The Year-End CIP Report also includes updates on process improvements and several major CIP fund sources, including TransNet. In the Budget Review Committee on May 3, 2018, Councilmember Gomez asked our Office to look into the TransNet fund balance. Since the Year-End CIP Report provides updated projections for FY 2018, this report focuses on TransNet funds in response to this request. Finally, we provide a brief discussion on the status of other significant funds within the CIP.

BACKGROUND

TransNet revenue is derived from a half-cent sales tax. This initiative was approved by voters in 1988 and again in 2004, which authorized the tax through 2048. TransNet revenue supports

countywide improvements to transit systems, highways, and streets. The City receives funding for the Local Street and Road Program, which is one of the subprograms funded by TransNet.

TransNet sales tax revenue flows to the San Diego Association of Governments (SANDAG). The City's current practice is to request funding from SANDAG to be drawn down each month to replenish funds spent in the previous month. At least 70% of this funding should be spent on capital projects to relieve traffic congestion and up to 30% can be used to fund maintenance of transportation infrastructure. SANDAG's Board Policy No. 31 limits the amount of funding that can reside at the City to 30% of its annual allocation. If the City exceeds this threshold, SANDAG will defer payments until the balance has fallen below the 30% limit.

The Transnet Extension Ordinance requires local agencies to develop a five-year project list for TransNet funding every two years. SANDAG approves the project list and a "program of projects" to be funded during the next two fiscal years. Projects not included in the approved program of projects cannot be funded with TransNet. The program of projects is included in the Regional Transportation Improvement Plan (RTIP)¹, and the RTIP is submitted to the state and federal governments for approval.

If a local agency wants to add or remove a project, or change funds programmed for projects, an amendment to the approved program of projects in the RTIP must be made. This can be seen in the Year-End CIP Report which requests one TransNet appropriation increase and several transfers between projects, with a corresponding request to update the 2016 program of projects. The City's proposed program of projects for the 2018 RTIP, which covers FY 2019 through FY 2023, was approved by the Infrastructure Committee on May 23, 2018, and is planned to go to the City Council for approval on June 19, 2018. The FY 2019 projects and allocations are included in the FY 2019 Proposed CIP Budget.

FISCAL/POLICY DISCUSSION

TransNet Fund Balance is Budgeted in Existing Projects

As a follow-up to the May 3 Budget Review Committee, the Transportation and Storm Water Department (TSW) provided Council with a breakdown of all active operating and maintenance and capital improvement projects that have TransNet funds, in a referral response memorandum dated May 11, 2018. The purpose of the list was to show where the remaining fund balance is budgeted within projects.

The list contains about 200 projects, many of which are subprojects within CIP annual allocations. The projects fit into three categories:

- 1) They have been appropriated TransNet funds in prior fiscal years and have unspent allocations that have carried over into FY 2018;
- 2) They were appropriated TransNet funds as part of the FY 2018 Adopted Budget or through other budget requests; or
- 3) The projects fit into both of the categories above.

¹ This is a five-year plan updated every two years, with additional options to amend.

Cumulatively, the projects in these categories have a total of \$66.3 million budgeted in TransNet funds. According to TSW as of May 29, \$30.1 million has been drawn down from cash held at SANDAG and expects one more draw down of \$3.2 million to occur before the end of the fiscal year. This aligns with the \$33.3 million in projected disbursements reflected in the Year-End CIP Report, leaving a projected fund balance of \$32.5 million held at SANDAG at the end of FY 2018.

Though these TransNet funds have already been approved for projects, Council has the authority to approve, deny, or reallocate funds through the budget process, Council items requesting appropriations, or Council items requesting updates to the RTIP. If Council wishes to fund a new or different project not already included in RTIP, funds would need to be diverted from existing projects and eventually paid back with future revenue. Corresponding Council resolutions would also be required to update the program of projects included in the RTIP.

Efforts to Reduce TransNet Fund Balance

The TransNet fund balance has been reduced from \$55.5 million at the end of FY 2015 to \$32.5 million projected at the end of FY 2018. TransNet expenditures are expected to increase since at the May 23, 2018 Infrastructure Committee meeting Financial Management stated that their goal is to reduce the fund balance of \$32.5 million to be equivalent to about half of the City's annual allocation. With an anticipated FY 2019 allocation of \$33.4 million, half of this amount would be about \$16.7 million. Our office believes this is a reasonable goal. It is unclear when this goal is intended to be reached, which would determine how fast funding would be drawn down from SANDAG. In the previous two fiscal years, fund balances have been closer to about one year's worth of the City's annual allocation.

The Year-End CIP Report states that the current TransNet fund balance is anticipated to continue its downward trend through FY 2019. According to TSW staff, contributing to this is the almost complete spend down of old TransNet funds residing at the City and the requested \$2.6 million appropriation in TransNet funds included in the Year-End CIP Report. This appropriation is to repay SANDAG for overpayment related to the State Route 56/Black Mountain Road project, which is complete. The depletion of these persistent pots of funding residing at the City allows the City to draw down additional funds while staying under the threshold of 30% of the City's annual allocation.

Staff also indicate that they are continuing to explore ways to make spending TransNet funds more efficient. One such way is encumbrance of future revenue which, as explained in the Year-End CIP Report, is being used for two CIP projects. Instead of encumbering the entire amount of a construction contract, only the amount needed for the current fiscal year is encumbered, allowing the rest to be available for more immediate project needs. This avoids reserving funds for projects that will not be spent for multiple years, and uses future revenue to fund these costs when needed.

Status Update of Other Key CIP Funds

The Year-End CIP Report also provides a status update on the expenditure of lease revenue bond proceeds to finance General Fund deferred capital improvements (DC bonds), gas tax revenues², General Fund Contributions to the CIP, Capital Outlay, and the Infrastructure Fund. DC bonds are

² Gas tax, Prop 42, and the Road Maintenance and Rehabilitation Account supported by SB 1 gas tax increases.

anticipated to be fully expended by the end of FY 2019, and gas tax funds and the Infrastructure Fund show significant expenditure activity. The Capital Outlay fund balance is discussed in our Office's final budget report, "Recommended City Council Modifications to the Mayor's Proposed FY 2019 Budget and May Revision" released May 31, 2018.

Providing updates on these key funds within the CIP is important to see the effects of improved cash management strategies that have been undertaken in recent years, such as prioritizing the expenditure of certain fund sources over others. The most restrictive fund sources are used first, and the least restrictive sources are used last, so that funding can be spread to as many projects as possible. In addition, flexible cash on hand enables the City to be nimble and respond to urgent needs that may arise. However, having too large of a fund balance risks underutilizing valuable resources that could be used for services in other areas of the City's budget.

Because lease revenue bonds issued by the City are required to be spent within a certain amount of time, those funds have been prioritized for expenditure over other more flexible resources. General Fund contributions to the CIP, are typically the last to be spent since they are completely unrestricted.

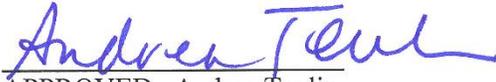
The Year-End CIP Report cites \$31.2 million in General Funds within the CIP that have not been spent. Like the TransNet fund balance, this is funding that has previously been appropriated and is currently budgeted within existing projects. However, these funds are often reallocated between projects, as seen in the Year-End CIP Budget Report with a request to transfer about \$800,000 in General Funds between projects. The balance of General Funds within the CIP has gone down by \$9.3 million since the FY 2017 CIP Year-End Report. The ideal amount to have in fund balance is difficult to identify, but our Office will continue to monitor this important resource.

CONCLUSION

The Year-End CIP Report includes a request for Council to approve a net increase to the CIP of \$75.5 million, excluding the 101 Ash Street allocations. Our Office does not raise concerns with the requested budget adjustments.

Since the Year-End CIP Report provides an update on key CIP funds, including TransNet, this report provides additional information on the TransNet fund balance held at SANDAG in response to Councilmember Gomez's request in the May 3, 2018 Budget Review Committee. Significant progress has been made in spending down this fund balance and staff anticipates this trend will continue. Monitoring TransNet and other significant funds within the CIP through semi-annual budget monitoring reports is critical in efficiently managing the program's vast resources.


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