SECTION 4.0

HOW HEALTHY ARE THE ESD OPERATING FUNDS?

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4.1 INTRODUCTION

BAS Consultant Team member HF&H evaluated the most recent audited financial information for the ESD funds (June 30, 2006) that were available. This includes an analysis of the three major operating funds for ESD: General Fund, Refuse Disposal Fund, and Recycling Fund. The Energy Conservation Program Fund (Energy Fund) is reported within the General Fund information; however, in this analysis the Energy Fund was not reviewed because it does not significantly impact ESD finances. A description of the work performed for Phase I and the results of the analyses are provided in this section.

4.2 HOW THE FINANCIAL ANALYSIS WAS PERFORMED

The purpose of analyzing the ESD's historical and projected revenues and expenditures, and reserves was to determine:

- The current financial condition of the funds,
- Reasonableness of the landfill closure/post-closure reserves, and
- The trends in revenues and expenditures.

The terms used in the financial analysis and their definitions are as follows:

Term	How Determined	What Does It Mean?
Operating Margin	(Total Operating Revenue less Total Operating Expenses) divided by Total Operating Revenue	Measures operating efficiency. Measures what portion of the operating revenue is left to pay for non-operating costs such as interest on debt. A higher operating margin is better than a lower operating margin.
Current Ratio	Current Assets divided by Current Liabilities	Measures the entity's ability to meet short-term obligations with available funds. A higher current ratio is better than a lower current ratio.
Debt Service Coverage	Revenue less Operating Expenses plus Depreciation and Interest) divided by Current Portion of Long-term Debt plus Interest Expense	Provides an estimate of an entity's ability to cover debt obligations from cash generated from operations. A higher value is better than a lower value.
Unrestricted Net Assets	Assets less Liabilities less Restricted Assets	Assets available for general operating purposes. A higher value is better than a lower value.

4.2.1 FINANCIAL CONDITION OF THE FUNDS

To review the financial condition of the funds, HF&H:

1. Obtained balance sheet information for fiscal years (FY) 2001 through 2006 for each of the funds from the City's Comprehensive Annual Financial Report (CAFR). Balance sheet information for Collection Services Division and other ESD divisions is not readily available from the CAFR because it is combined with much larger amounts related to general governmental services of the City. Note: Because the City did not publish a CAFR for FY 2002, balance sheet information for this year was not available.
2. Calculated the Operating Margin to determine the fiscal soundness of the disposal operations.
3. Calculated the Current Ratio to determine the City's ability to fund its current liabilities with current assets.
4. Calculated the Debt Service Coverage to determine the City's ability to pay its debts with available free cash.

4.2.2 ADEQUACY OF CLOSURE/POST-CLOSURE AND CAPITAL REPLACEMENT RESERVES

To review the adequacy of the closure/post-closure and capital replacement reserves, HF&H:

1. Obtained the City's calculations and supporting documentation for the closure/post-closure reserve.
2. Reviewed the procedures used by the City for capital replacement.

4.2.3 TRENDS

To review any trends in revenues and expenditures, HF&H:

1. Obtained un-audited actual revenues and expenses for FY 2001 through FY 2008 and budget data for FY 2009. It was noted that there were significant changes in accounting for administration and depreciation expenses between FY 2001 and FY 2003. It was also noted that there were changes in the department's allocations between FY 2006 and FY 2007.
2. Calculated the year-to-year variances in revenues and expenses.

a. Expenses were disaggregated into the following categories and annual variances were calculated: salaries; benefits; supplies, services, data processing, and energy resources; transfers; and capital outlay; and
b. Annual gross and net revenues were identified and annual variances calculated.

4.2.4 LIMITATIONS

The HF&H analysis is based on public documents and information. Revenues and expenditures for the period from FY 2001 and FY 2003 to FY 2006 are based on the independently-audited financial statements and disclosures contained in the CAFR.

The adequacy of debt service reserves was based on comparison of the fund's Debt Service Coverage ratios to public waste sector industry averages which are between 1.5 and 2.1. Debt Service Coverage ratio compares the net revenue (revenue after expenses, depreciation, and interest) to the current (12-month) debt service requirements.

The adequacy of the closure/post-closure reserves was based on the review of the City's supporting documentation submitted to the California Integrated Waste Management Board (CIWMB).

It was not within the scope of this task to project the financial effect of recent actions (e.g., economy, recycling and C&D ordinances, zero waste programs, etc.) on the financial impacts to operations, future trends, or the adequacy of reserves.

4.3 RESULTS OF FINANCIAL ANALYSIS

4.3.1 GENERAL FUND

For FY 2009, the annual budgeted expenditures in the General Fund are $40.5 million. The General Fund portion of the ESD funding provides for weekly residential refuse collection, refuse container management, underground tank management, asbestos and lead management, hazardous materials, and other related services.

4.3.1.1 TRENDS

Overall the General Fund has been trending upward in line with the consumer Price Index (CPI).

The increase in expenditures from FY 2001 to FY 2008 was $0.6 million or 25 percent (an average annual increase of 3.2 percent). *This is consistent with the change in the CPI for the San Diego area, which had an average annual increase of 3.85 percent for the period FY 2001 to FY 2008.*

4.3.1.2 ADEQUACY OF RESERVES

The General Fund maintains a reserve for capital replacement costs for solid waste vehicles based on anticipated needs and estimated costs of replacing vehicles.

4.3.2 REFUSE DISPOSAL FUND

For FY 2009, the annual budgeted expenditures are $33.6 million for the Refuse Disposal Fund portion of the ESD funding. This provides for the operation of a full-service landfill for the diversion and disposal of waste collected by the City, franchised haulers, and the public. Some of the other services provided by the Refuse Disposal Fund include solid waste code enforcement, litter and illegal dump abatement program, closed landfill monitoring and maintenance, and community clean-ups.

4.3.2.1 TRENDS

The average monthly costs in the Refuse Disposal Fund increased from $2.2 million in FY 2001 to $2.5 million in FY 2008 and to a projected average monthly cost of $2.8 million in FY 2009. This is an increase of $0.3 million or 14.5 percent (an average annual increase of 2 percent) from FY 2001 to FY 2008. From FY 2001 to FY 2009, this is an increase of $0.6 million or 27 percent (an average annual increase of 3.1 percent). This is comparable to the CPI for the San Diego area which had an average annual increase of 3.85 percent for the period FY 2001 to FY 2008 (Table 4-3). *The annual cost increases in the Refuse Disposal Fund have been less than the CPI from FY 2001 to FY 2008.*

The net revenues from FY 2001 to FY 2008 have remained consistent. FY 2008 year end revenues are projected to exceed expenditures by approximately $2.4 million.

4.3.2.2 ADEQUACY OF RESERVES

The Refuse Disposal Fund maintains the reserve for the closure and post-closure maintenance of the West Miramar Landfill. As of June 30, 2006, the fund had $32.1 million in net assets restricted for closure and post-closure maintenance. It was noted that the last review by the CIWMB on February 20, 2008, stated that the financial assurance funding status for the closure and post-closure maintenance plans were adequate.

Reserves for capital (vehicles/equipment) replacement costs are kept as part of an Internal Service Fund. As part of the City's budget process, an annual equipment rental/usage fee is determined and each fund is charged a monthly fee. The fee includes the cost of the vehicle/equipment fleet maintenance, as well as funds for future replacements. The replacement funds are kept within the Refuse Disposal Fund and ESD will request replacement/new equipment as part of the annual budget process. The capital replacement (for vehicles/mobile equipment) process is consistent with industry standards for governmental entities.

4.3.3 RECYCLING FUND

With FY 2009 final budgeted expenditures of $23 million, the Recycling Fund portion of the ESD funds provide for curbside recycling and greenery collection for the residents of the City. Other services include recycling and greenery container management; waste reduction and diversion programs for City offices, residential, businesses, and the military; community clean-ups; and household hazardous waste programs. Between FY 2001 and FY 2007, the ESD implemented a Citywide Curbside Recycling Program and incurred related expenses in staff, equipment, and other operating costs.

4.3.3.1 TRENDS

The following trends were observed:

1. The average monthly cost for the Recycling Fund increased from $1.2 million in FY 2001 to $1.8 million in FY 2008 and to a budgeted average monthly cost of $1.9 million in FY 2009. This is an increase of $.6 million or 53.5 percent (an average annual increase of 6.3 percent) from FY 2001 to FY 2008 and an increase of $.7 million or 60 percent (an average annual increase of 6.1 percent) from FY 2001 to FY 2009.
2. The Recycling Fund had 25 employees added between FY 2001 and FY 2007, incurred a significant increase in the equipment usage charges and had additional containers purchased in FY 2007. The overall increase is reasonable when compared to the CPI for the San Diego area which had an average annual increase of 3.85 percent for the period FY 2001 to FY 2008 and the specific increases incurred as the recycling programs were developed.
3. Historically, expenditures have tracked closely with the fund revenues. The un-audited revenues for FY 2008 exceeded expenditures by $2.4 million, primarily resulting from higher than expected revenues from recycling commodity sales. The budgeted expenditures for FY 2009 exceed budgeted revenues by $2.8 million.

4.3.3.2 ADEQUACY OF RESERVES

Reserves for capital (vehicles/equipment) replacements are kept in an Internal Service Fund. As part of the City's budget process, an annual equipment rental/usage fee is determined and each fund is charged a monthly fee. The fee includes the cost of the vehicle/equipment fleet maintenance, as well as funds for future replacements. ESD typically requests replacement or new equipment as part of the annual budget process. The capital replacement process is consistent with industry standards for governmental entities.

4.4 CONCLUSIONS

4.4.1 GENERAL FUND

No significant adverse trend was identified regarding total General Fund operating expenditures, which increased at a rate less than inflation (CPI). However, the average full-time equivalent salary and benefit cost generally increases at a rate twice the rate of inflation (as measured by the Bureau of Labor Statistics CPI-U for the San Diego Region). The General Fund has no solid waste related debt in its financial statements. Funds from the Refuse Disposal Fund are "borrowed" for the General Fund and annual payments are being made (Miramar Place Operations Yard). The amount is not shown as a receivable on the financial statements for the Refuse Disposal Fund and the payments are included in annual revenue.

4.4.2 REFUSE DISPOSAL FUND

While the financial analysis performed for the Phase I Report does not identify a problem, the Refuse Disposal Fund is experiencing a reduction in its Operating Margin and Total Margin. Additionally, the impact of the recently adopted Construction and Demolition and Recycling Ordinances is not fully known. At the January 16, 2008, RMAC meeting, ESD staff presented the expected financial impacts of increased waste diversion at Miramar Landfill on ESD funding. As more waste is diverted from the Miramar Landfill through recycling and other diversion efforts, the Refuse Disposal Fund and Recycling Fund receive less revenue.

Additionally, the fund is experiencing a reduction in its operating margin due to the fact that the standard and the franchise disposal fees have not been increased during the period of 2001 to 2008 while a 25 percent CPI increase occurred. The costs are the primary cause of the reduced margins and it may be worse in the future.

4.4.3 RECYCLING FUND

The Recycling Fund is expecting a significant reduction in its operating and total margins and it has budgeted an operating loss of $2.8 million in FY 2009. There is an anticipated beginning reserve balance of $9.9 million to absorb the operating loss.

Based on the budgeted FY 2009 revenues and expenditures, the Recycling Fund does not appear to have adequate liquidity and debt service coverage. More current financial statements and projections would need to be analyzed to determine if the Recycling Fund debt service is adequate to meet regulatory requirements.

4.4.4 OVERALL FINANCIAL PICTURE

The ESD has implemented cost cutting measures and increased efficiencies to extend the lives of the funds. However, given the overall trends of the funds, the success of recently implemented waste reduction and diversion efforts, and the impacts of the economic crisis, the Recycling Fund is currently projected to be in a deficit in Fiscal Year 2010 and the Refuse Disposal Fund is currently projected to be in a deficit in future years.

In the long term, though, the City may have to implement measures such as increased revenue or reductions in services. The impacts to the funds will be a significant consideration for Phase II.