



# **Response to Grand Jury Report Titled “San Diego City’s Financial Crisis–The Past, Present, and Future**

Meeting of the City Council

November 8, 2010

Item 151

# City Council Response to Grand Jury Report



- The Grand Jury filed this report on June 8, 2010.
- Assesses the financial issues facing the City and also determines what brought the City to its current financial condition.
- Also proposes strategies to mitigate the City's budgetary deficits.

# City Council Response to Grand Jury Report



- Includes 27 findings and 16 recommendations-of these the City Council is required to respond to all findings and nine of the recommendations.
- Superior Court granted an extension to December 1 due to demands of the legislative calendar

# City Council Response to Grand Jury Report



- For each finding:
  - Agree
  - Disagree wholly or partially
- For each recommendation:
  - Has not been implemented
  - Has not yet been implemented, but will be in the future
  - Requires further analysis
  - Will not be implemented

# City Council Response to Grand Jury Report



- IBA reviewed a draft copy of the Mayor's responses
- For each item, Council may:
  - Join the Mayor's response
  - Modify the Mayor's response
  - Respond independently of the Mayor
- IBA has prepared recommended responses on behalf of the Council.
- Only the findings that "modify the Mayor's response" or that "respond independently of the Mayor" are discussed in the presentation.

# City Council Response to Grand Jury Report



Recommendations:	10-128, 10-132, 10-137	<i>Join the Mayor's and/or Audit Committee &amp; City Auditor Response</i>
Findings:	01, 02, 05, 06, 08, 09, 11, 13, 14, 15, 16, 17, 20, 21, 23	
Recommendations:	10-125, 10-127, 10-129, 10-131, 10-138, 10-139	<i>Respond with a Modification to the Mayor's Response</i>
Findings:	03, 04, 07, 12, 18, 19, 24	
Recommendations:	10-130, 10-140	<i>Respond Independently of Mayor</i>
Findings:	10, 22, 25, 26, 27	

# City Council Response to Grand Jury Report



- This report was presented to the Rules Committee on October 20, 2010. It was voted 5-0 to accept the IBA's recommendations with amendments to Recommendations 10-129 and 10-131.
- The IBA's recommended responses have been updated to reflect the Rules Committee action.

# Finding #03



**Finding #03:** *Absent an increase in General Fund revenue, the projected increases in the required annual pension contribution in future fiscal years will necessitate even more service cuts in General Fund Departments.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

Partially Disagree. Balancing the budget can be accomplished through additional revenues, savings from reforms such as Managed Competition, or additional reductions. Reductions do not necessarily have to come solely from service cuts. Over the past couple of years, the City's labor unions have made many concessions which have reduced costs without a reduction in service. In addition, through business process reengineering and other efficiency studies, the City has reduced its costs without cutting services. However, at some point, as we saw in fiscal year 2011, services will be impacted.

# Finding #04



**Finding #04:** *Switching to the Teeter method of receiving property tax allocation from the County may stabilize that source of revenue and may result in an increase of about \$2 million per year for the City's General Fund.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

Partially Disagree. While the Teeter method may result in a more stabilized revenue stream, it could also mean that the City receives less revenue in the long run. It should be noted that the City is currently conducting a study that will examine this alternative. The study is expected to be completed by the end of the year.

# Finding #07



**Finding #07:** *These pay-down projections are based partially on the assumption by SDCERS that its pension fund portfolio will earn at least 7.75% each and every year. Earnings over the past three years have been a negative 1.84%.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

Partially Disagree. The 7.75% ~~assumed~~ rate of return is an the assumed average investment return over time. It is recognized that there will be years where SDCERS will earn in excess of the 7.75% assumed rate and years in which SDCERS will earn less.

# Finding #10



**Finding #10:** *For every year SDCERS does not reach an investment return of 7.75%, the City is required to increase its contribution to the retirement fund.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

Partially Disagree. Investment returns below 7.75% would produce investment experience losses to the pension system, increasing subsequent contribution amounts. However, returns above 7.75% would reduce future contributions.

# Finding #12



**Finding #12:** *SDCERS reduced the guaranteed interest rate for DROP employees from 7.75% to 3.54% effective July 2009; there was a further reduction to 2.91% effective January 1, 2010. In order to maximize their benefits, some seventy to eighty veteran fire fighters and a like number of senior police officers locked in the then existing 7.75% interest rate on their DROP accounts by leaving the work force on or before June 30, 2009, rather than accepting the reduced interest rate. This negated some of the expressed effect of keeping experienced personnel on staff.*

# Finding #12



**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

Partially Disagree. ~~This statement may or may not be true. The City cannot contradict or affirm this statement without additional information.~~ There was also a change in the DROP annuity rate, which was reduced from 7.75% to 5% for DROP participants retiring after June 30, 2009. There were 421 City employees who retired from DROP during June 2009. DROP interest rates were likely among a number of factors considered by affected employees prior to making this major life decision.

# Finding #18



**Finding #18:** *Proposed methods of enhancing revenue fall far short of satisfying these obligations, debts and liabilities; revenue enhancements may be insufficient to address budget shortfalls resulting from the projected increases in the City's ARC payments over the next five years.*

IBA Recommendation: Respond with the following modification of the Mayor's Response:

Partially Disagree. The actual future ARC payments over the next five years are unknown. The current proposed revenue enhancement and savings from reforms ~~would~~ may be sufficient to cover modest growth in the City's ARC payment.

# Finding #19



**Finding #19:** *The implementation of a hybrid pension system for employees hired on or after July 1, 2009 will do little to reduce the burden on the taxpayers for decades, at which time these employees will reach retirement age.*

IBA Recommendation: Respond with the following modification of the Mayor's Response:

Disagree. The new second tier pension system saves the City approximately \$500,000 ~~\$1 million~~ in the first year of implementation, \$1 ~~\$2~~ million the second year, \$1.7 ~~\$3~~ million the third year and so on until it reaches approximately climbing to an estimated \$28 ~~\$20~~ million annually in the thirtieth year of implementation. The total estimated savings over 30 years is projected at \$394 million.

# Finding #22



**Finding #22:** *By charging minimal fees for each book, DVD, or other service provided, hours of operation could be increased to generate more revenue; library hours may not have to be reduced from forty-one to thirty-six hours per week, as they have in recent budget cuts.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Finding #22



- Disagree. Any new or increased General Fund revenue option implemented in future budget processes could be considered as a potential funding source for increased hours for library operations.
- The creation of a new library fee is not likely to generate sufficient revenue to fully reinstate recent reductions.
- Any proposed fee increase would require a legal analysis of any applicable laws and grant conditions that might impact the ability of the City to impose a fee for library services.
- Finally, instituting a fee for basic library services could have a harmful effect on ensuring access to important resources to all citizens, especially those who are least able to pay and may have the greatest needs.

# Finding #24



**Finding #24:** *Cost savings could be achieved by consolidation of various functions performed by both the City and the County.*

IBA Recommendation: Respond with the following modification of the Mayor's Response:

Agree. However, additional study of what services could be performed by both the City and the County, the legal ramifications, and the actual savings would need to occur prior to any consolidation being considered.

# Finding # 25



**Finding #25:** *City Hall acted improvidently in cutting the public safety workforce for FY 2010 and FY 2011.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Finding #25



- Disagree. One of the key duties of the City Council is to adopt an annual budget that is balanced and fiscally responsible.
- The budget must be balanced using very limited resources while addressing numerous critical needs and financial obligations
- The Budget process includes a number of checks and balances, which brings transparency and objectivity to the process.
- Given the significant reductions in non-public safety staffing and services made by the City over the past several years, and the fact that public safety represents over 50% of the City's General Fund budget, the City was limited in options to close the significant budget deficits for Fiscal Years 2010 and 2011.
- Once the City has the financial resources to do so, public safety will be the number one priority for restorations.

# Finding #26



**Finding #26:** *A proactive dialogue as to the efficacy of a Chapter 9 reorganization cannot be removed from any discourse as to the City's financial health.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Finding #26



- Strongly Disagree. The Mayor and City Attorney have both publicly advised the City Council and citizenry that municipal bankruptcy is not an effective option for the City for a variety of reasons, both financial and legal.
- Moreover, in a public financial training to the City Council on October 11, 2010, a representative of Fitch Ratings, one of the three major rating agencies, indicated that discussion of bankruptcy raises concerns for both rating agencies and investors regarding the ability and willingness of an issuer, such as the City, to repay its obligations.
- Premature discussion of Chapter 9 could adversely impact the City's near and medium term financial position.

# Finding #27



***Finding #27:*** *A Chapter 9 filing would result in a federal determination of which fringe benefits and collective bargaining agreements could be restructured. The fringe benefit total is \$423.7 million, according to the FY 2011 Proposed Budget.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Finding #27



- Disagree. While the cited fringe benefit total is correct, as noted in the response to Finding 26 the Mayor and City Attorney have both publicly advised the City Council and citizenry that municipal bankruptcy is not an effective option for the City of San Diego for a variety of reasons, both financial and legal.
- A Chapter 9 filing is likely to take several years to wind its way through the courts before the City would have a final answer regarding the restricting of agreements and most, if not all, of the current collective bargaining agreements may have expired.
- There can be no certainty that a Chapter 9 filing would result in a determination that fringe benefits could be restructured.

# Recommendation 10-125



**10-125:** *Analyze the impact of the City's opting in to the Teeter Plan for receiving its allocation of property tax revenue and switch to that method for FY 2012 if the analysis reveals financial benefits for the City.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

This recommendation has not yet been implemented. This approach is currently under study and the results will be reported to the City Council ~~this fall~~ by the end of the year.

# Recommendation 10-127



**10-127:** *Investigate alternate retirement systems to determine whether the San Diego City Employees' Retirement System (SDCERS) should be dissolved in favor of another system, a purely outsourced operation, or retention of the current system.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

# Recommendation 10-127



- Disagree. This recommendation will not be implemented because it is not warranted or reasonable. At this time, the City Charter essentially provides for two alternatives for the administration of the City's retirement plan. These are either SDCERS or CalPERS. To move the administration of the plan to CalPERS would require a majority approval of all active members of SDCERS. In addition, the City's retirement factors and system requirements would have to conform to one of the options currently offered by CalPERS. This may not be possible because vested rights of active and retired members would have to be protected.

# Recommendation 10-129



**10-129:** *Approve and fund an actuarial analysis of DROP which would confirm or refute the fact that it is cost neutral.*

## Rules Committee Changed IBA Recommendation:

~~Join the Mayor's Response~~ Respond with the following modification to the Mayor's response:

- ~~• This recommendation has not yet been implemented. This recommendation has been implemented. The City has approved and funded the study, which is in the process of completing this study currently underway and it anticipated to will be published by the end of the year.~~

# Recommendation 10-130



**10-130:** *Consider taking the steps necessary to declare an immediate moratorium on all new DROP entrants pending the completion of the cost neutrality analysis.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Recommendation 10-130



- This recommendation requires further analysis. This recommendation involves legal issues related to labor negotiations and application of San Diego Charter section 143.1.
- The City has taken initial steps to amend the Municipal Code to eliminate eligibility for new DROP entrants who are unrepresented unclassified and unrepresented classified General Members who have not yet entered the program (except Council Assistants or Council Representatives).
- Actions for elimination of DROP eligibility for unrepresented unclassified Lifeguards and Police are also underway.
- The City Council has not adopted the ordinance because SDCERS has stated that the ordinance requires a Charter section 143.1 vote of City employees, who are members of the retirement system. The vote is pending, and anticipated after the completion of the DROP cost neutrality study, which is expected to be completed by the end of the year.

# Recommendation 10-131



**Recommendation 10-131:** *Consider taking the steps necessary to discontinue DROP for all new entrants should the actuarial analysis demonstrate that it is not cost neutral.*

Rules Committee Changed IBA Recommendation: Join the Mayor's Response Respond with the following modification to the Mayor's response:

- This recommendation requires further analysis. San Diego Municipal Code §24.1401 states that “DROP is intended to be cost neutral.” The City will examine several alternatives to the DROP program should the pending cost neutrality actuarial analysis study demonstrate that it is not cost neutral. If a further analysis is necessary, it will be conducted after the finding that the program is not cost neutral.

# Recommendation 10-138



**10-138:** *Eliminate redundant positions and extraneous levels of management and supervision as middle managers leave City service through attrition.*

**IBA Recommendation:** Respond with the following modification of the Mayor's Response:

This recommendation has been implemented and will continue to be a part of every reduction process. The City has eliminated over 1,400 full-time equivalent positions over the past four years. This has included the elimination of many positions through consolidation and through the flattening of the organization.

# Recommendation 10-139



**10-139:** *Restore the cut to public safety personnel as a priority.*

**IBA Recommendation: Respond with the following modification of the Mayor's Response:**

This recommendation has not yet been implemented. Once the City has the financial resources to do so, public safety will be the number one priority. ~~Until then, so long as the City faces future projected deficits, restoring any service that has been previously reduced is not financially responsible.~~

# Recommendation 10-140



**10-140:** *Convene a panel of bankruptcy experts to discuss the legal and financial ramifications of a Chapter 9 declaration of bankruptcy, in the context of a publicly noticed City Council or Council Committee meeting.*

**IBA Recommendation:** Do not join the Mayor's Response and respond independently with the following:

# Recommendation 10-140



- Recommendation will not be Implemented. The Mayor and City Attorney have both publicly advised the City Council and citizenry that municipal bankruptcy is not an effective option for the City of San Diego for a variety of reasons, both financial and legal.
- Moreover, in a public financial training to the City Council on October 11, 2010, a representative of Fitch Ratings, one of the three major rating agencies, indicated that discussion of bankruptcy raises concerns for both rating agencies and investors regarding the ability and willingness of an issuer, such as the City, to repay its obligations.
- Premature discussion of Chapter 9 reorganization could adversely impact the City's near and medium term financial position due to negative rating agency action, such as a ratings downgrade, and the related market responses.
- The City believes there are options available for reducing its liabilities that are both less costly and more certain than bankruptcy and that any formal action by the City to investigate the efficacy of municipal bankruptcy, even as an academic exercise, is not in the best interests of the City.

# City Council Response to Grand Jury Report



Questions?