

**OFFICE OF INDEPENDENT BUDGET ANALYST  
CITY OF SAN DIEGO  
M E M O R A N D U M**

No. 06-21

DATE: September 18, 2006

TO: Council President and Members of the City Council

FROM: Andrea Tevlin, Independent Budget Analyst

SUBJECT: Lease Purchase Financing to Replace Needed Equipment

---

The City Council docket of September 19, 2006 has two items (Items 331 and 332) requesting approval of lease-purchase financing to replace needed equipment. Item 331 involves a request to use lease purchase financing to replace three 100 foot service aerial ladder trucks in the Fire-Rescue Department. Item 332 similarly involves a request to use lease purchase financing to replace 32 refuse packers and 7 pieces of beach equipment. This memorandum is offered in response to questions that the IBA has received related to these items.

The IBA supports the use of the City's lease-purchasing program, Equipment and Vehicle Financing Program (EVFP), for the replacement of the equipment in the aforementioned items. Our support is based on our understanding that EVFP: 1) provides a cost-effective alternative to cash financing, 2) generally matches the financing term to the useful life of the financed equipment and 3) offers a financing rate that is approximately 1.5% to 3% better than available vendor financing. As noted in the staff report, the financing rate for each of the aforementioned items is set at 65% of the U.S. Treasury securities index at 5-year maturity plus 160 basis points which is currently just under 5%. This rate is commensurate with the City's applicable credit rating and has been negotiated to move should there be an improvement or deterioration of the City's rating. If more favorable financing is negotiated before payment is due for this equipment, the proposed ordinances will allow staff to alternatively use the better financing terms.

The IBA does, however, have a budgeting concern with respect to the utilization of lease-purchase financing for the replacement of fire equipment. With the exception of lifeguard trucks and certain leased fire equipment, there currently is no budgetary practice that systematically provides funds for the replacement of Fire-Rescue equipment that must be taken out of service. This differs from the budgeting practice used to replace General Fund motive equipment whereby appropriately determined assignment charges, applied to customer/user departments, go into a special purpose Replacement Fund to cover the expense of replacing equipment that is at or beyond its expected life cycle.

Authorizing lease-purchase financing for three Fire-Rescue ladder trucks (utilizing Item 331 as an example) results in an unplanned, unanticipated General Fund commitment of approximately \$437,000 a year for the next eight fiscal years (FY 08 through FY 15). Without singling out Item 331 (as we

Page 2

Council President and

Members of the City Council

September 18, 2006

understand these ladder trucks are well beyond their expected useful life), this is an example of budgeting outside of the regular budget process that, in the aggregate, can significantly reduce General Fund budget flexibility and discretion in future years. The IBA recommends that the Fire-Rescue and Police departments, where appropriate, consider developing a comprehensive schedule for equipment replacement based on expected useful life. Used with estimated equipment replacement costs, this schedule would then be used to determine an appropriate amount of funds to annually budget within each department for the future replacement of needed public safety equipment.

The IBA recommends this approach as a more thoughtful means of planning for the significant expense of equipment replacement. If implemented, annual budget allocations for equipment replacement could be incorporated into the City's multi-year budget planning process. As noted above, the City is already effectively using a similar assignment charge system to fund the replacement of General Fund motive equipment. Given the certainty of significant fiscal constraints in the coming years, the City must have a more systematic means of planning for expenditures of this magnitude.