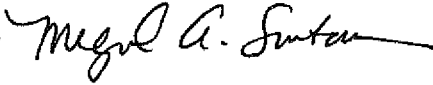


REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: February 9, 2010
CAO File No. 0116-00001-0000
Council File No. 09-0600-S159
Council District: All

To: Antonio R. Villaraigosa, Mayor
Eric Garcetti, Council President
Bernard C. Parks, Chair, Budget and Finance Committee

From: Miguel A. Santana, City Administrative Officer 

Reference: Mid-Year (Third) Financial Status Report

Subject: **COUNCIL MOTION NO. 10BB – SHORT TERM PLAN FOR FISCAL SOLVENCY**

SUMMARY

On February 3, 2010, this Office presented the Mid-Year (Third) Financial Status Report (FSR) to the Council (C.F. No. 09-0600-S159) at which time the Council directed this Office to provide a Short-Term Plan for Fiscal Solvency (Motion No. 10BB). The Plan would include options that would increase revenue or reduce costs within six months.

DISCUSSION

Based on Council's actions regarding the Mid-Year FSR on February 3, 2010, the current budget deficit is now estimated at \$212 million. Below is a table of measures that may be implemented to reduce the current year deficit by as much as \$72.6 million. These savings measures were previously presented in the Mid-Year FSR and Addendum, but were not acted upon by Council.

Fiscal Year 2009-10 and 2010-11 Budget Deficits and Savings Measures
(millions)

	2009-10	2010-11
<i>Budget Deficit</i>	-\$ 211.7	-\$ 483.8
Elimination of General Fund Positions Includes the elimination of Disability, Environmental Affairs and Human Services Departments. 2009-10 amount reflects the elimination/special funding of 500 General Fund positions. 2010-11 amount reflects the elimination/special funding of an additional 500 General Fund Positions.	\$ 7.9	\$ 76.9
Elimination of the Cultural Affairs Grant Program	0.5	4.0
Suspension and modification of the Neighborhood Council Grant Program	1.6	4.1
Modification to the Solid Resources Lifeline Rate Program Bureau of Sanitation is working on solution to address the 2009-10 deficit. 2010-11 amount reflects savings from phasing in Lifeline fee structure similar to DWP program.	0.0	8.2
Unappropriated Balance, AB1290 funds (also presented in Addendum)	10.0	10.0
Total savings measures, as presented in Mid-Year FSR	\$ 20.0	\$ 103.2

Mayor – 5 percent salary, Gang Reduction and Youth Development reduction	\$ 1.3	\$ 1.3
Council – 5 percent salary reduction	1.1	1.1
General City Purposes Fund – Unencumbered funds	3.4	4.9
Council Funds – Unencumbered funds (without recent activity)	26.5	0.0
Estimate only – some may require ordinance changes		
Police Department – No new hiring, layoff probationary Police Officer I positions	15.2	69.4
Fire Department – Elimination and reassignment of 57 Firefighter III positions	<u>5.1</u>	<u>22.1</u>
Total savings measures, as presented in Mid-Year FSR Addendum	\$ 52.6	\$ 98.8
Total identified savings measures	<u>\$ 72.6</u>	<u>\$ 202.0</u>
Remaining Budget Deficit	<u>-\$ 139.1</u>	<u>-\$ 281.8</u>

If all measures were to be implemented, the resulting current year deficit would be \$139.1 million. The projected 2010-11 deficit of \$483.8 million would be reduced by \$202 million to \$281.8 million.

The Reserve Fund balance, as reported in the Mid-Year FSR, was \$170.9 million with expected transfers projected to increase the fund to \$232.0 million by year-end. It should be noted that to date the fund has provided interim funding for approximately \$32.3 million in liability claims, and this amount will increase by end of the fiscal year. The City intends to borrow through a Judgment Obligation Bond (JOB) issuance to repay the Reserve Fund. There is a risk that a decline in the City's debt rating will increase borrowing costs.

This Office continues to work towards increasing the Reserve Fund balance through the reversion of prior-year encumbrances, up to an additional \$10 million. Recommendations to revert these funds will be provided in a forthcoming report from this Office. Further, it is recommended that any new one-time revenues, such as surplus property sales not anticipated in the budget, be used to augment the Reserve Fund.

Without the identification of additional savings measures, a transfer from the Reserve Fund in the range from \$139.1 to \$211.7 will be required to cover expenditures through the close of the fiscal year. The result would be a Reserve Fund balance ranging from a high of \$102.9 million down to \$30.3 million. The worst-case scenario would result in a Reserve Fund balance equivalent to 0.7 percent of General Fund revenue, dangerously below the 5 percent threshold mandated by the City's Financial Policies.

2009-10 Status of the Reserve Fund
(\$ millions)

Status of Reserve Fund – As of January 15, 2010		\$ 170.9
Transfer from the Fire Hydrant and Main Installation Fund		28.8
Repayment of loans from Judgment Obligation Bond proceeds		32.3
Reversion of prior-year encumbrances (estimated)		10.0
Revenue from surplus property sales*		<u>0.0</u>
Adjusted Status of Reserve Fund		\$ 242.0
Remaining 2009-10 Budget Deficit (with and without additional savings measures)		
	<u>-139.1</u>	<u>-211.7</u>
Year-end Reserve Fund Balance	\$ 102.9	\$ 30.3

*Currently, revenue from surplus property sales is not expected to exceed budget.

While the Reserve Fund may be utilized as a *short-term solution to provide cash flow* for the City's expenditures, the deficits projected for the current fiscal year and fiscal year 2010-11 will require further action to reduce costs or increase revenue.

It should be noted that borrowing to cover expenditures would not likely be an option available to the City, at least without significant borrowing costs. Per Fitch Ratings' December 1, 2009 report concerning the Municipal Improvement Corporation of Los Angeles, the City's deteriorating financial situation could trigger the downgrade of its debt rating. Specified concerns included:

- *The worsening General Fund structural imbalances in an environment of declining tax revenues, a softening property market, and rising personnel-related costs;*
- *The failure to achieve long-term personnel cost reductions, particularly through reduction in work force size and modified benefits entitlements; and*
- *The ongoing erosion of reserves.*

Even with the adoption of the measures outlined here, which includes the depletion of the Reserve Fund, significant work remains to be done to address the remaining deficit of \$281.8 million in 2010-11. This deficit *equates to the full-year salaries plus pension contribution costs of 3,665 civilian employees*. Delays in implementing any savings measures will only cause this deficit to grow.

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