REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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		Council District:	All

To: The Mayor
The City Council

From: Miguel A. Santana, City Administrative Officer

Reference: Discussion in the Budget and Finance Committee on December 5, 2016.

Subject: **PROPOSED ACTIONS TO ADDRESS THE 2016-17 DEFICIT AND RESTORE THE RESERVE FUND LEVEL, INCLUDING CURTAILING EXPENDITURES, STRENGTHENING REVENUES, AND THE ISSUANCE OF A JUDGMENT OBLIGATION BOND**

RECOMMENDATIONS

That the Council:

1. In order to curtail expenditures, instruct departments to:

   a. Withdraw any new and unbudgeted spending proposals to be resubmitted, only if warranted, as part of the 2017-18 Budget process;

   b. Make any necessary adjustments to mitigate their own shortfalls within existing department resources, inclusive of adjusting their hiring plans for the year; and,

   c. For civilian vacancies, prioritize and expedite the hiring of fully special-funded positions and/or positions required to implement mandated programs resulting from settlements while holding other positions vacant until the Mid-Year Financial Status Report is considered;

2. In order to strengthen General Fund revenues:

   a. Instruct the Office of Finance, with the assistance of the Offices of the City Administrative Officer (CAO) and the City Attorney, to negotiate Transient Occupancy Tax collection agreements with short-term and vacation rental websites similar to that recently formed with Airbnb (C.F. 16-0600);

   b. Adopt the series of recommendations proposed by the CAO regarding the regulation of billboards (C.F. 11-1705) including those related to issuing a request for information and a request for qualifications to assess the opportunities and potential costs and benefits from siting billboards on public parcels in conjunction with the development of a comprehensive policy; and,

c. Instruct the CAO to work with major event venues in the City to ensure that the City is fully reimbursed when events at those venues require special services; and,

d. Hold in abeyance or disapprove any new policies under consideration that could further reduce current year General Fund receipts; and,

3. In order to restore the Reserve Fund:

   a. Instruct the CAO, with the assistance of the City Attorney, to proceed with a Judgment Obligation Bond issuance of between $50 and $70 million to reimburse the Reserve Fund for extraordinary liability payouts made resulting from settlements and judgments; and,

   b. Set as a priority for Fiscal Year 2017-18, the appropriation of adequate funding to address liabilities based on a comprehensive review of existing cases by the City Attorney and risk mitigation efforts by departments, in particular those experiencing high levels of litigation; and,

   c. Instruct the CAO to report back with recommendations to expedite the repayment of outstanding Reserve Fund loans and the release of prior-year encumbrances.

BACKGROUND

On December 5, 2016, the Budget and Finance Committee considered a motion (Krekorian – O'Farrell) requesting the City Attorney to present an amendment to the Los Angeles Administrative Code (Section 11.27) to clarify and expand on the types of settlements that are eligible to be paid with Judgment Obligation Bonds in a manner more consistent with current legal practice, and to provide more procedural flexibility with respect to the timing of certain portions of the issuance process. Also at that meeting, the Committee heard this Office's Second Financial Status Report (FSR), which among other matters noted that this Office was exploring the use of Judgment Obligation Bonds to address anticipated higher-than-budgeted liability payouts. At that meeting, this Office committed to report back prior to the issuance of any such bonds with a justification for doing so, if indeed that was our recommendation.

SUMMARY

<u>Current Fiscal Concerns</u>

The Second Financial Status Report (FSR) reported a potential $52 million expenditure deficit and highlighted risks to revenues totaling $138 million. Since that report, additional information has increased the reported expenditure deficit to up to $80 million, while a new identified shortfall increases the combined revenue risk to $165 million. Therefore, the combined potential deficit currently stands at $245 million.

The options to resolve this deficit are extremely limited. As stated in the Second Financial Status Report, as of November 21, 2016, the Reserve Fund Balance stood at $295.1 million, or 5.29 percent of the Adopted General Fund budget. Further, in that Report this Office expressed concern that, due to expenditure and revenue challenges, the Reserve Fund was unlikely to be available to offset the deficit and remain above the 5 percent policy threshold.

Since the Reserve Fund will not be available to fully offset this deficit, this report provides recommendation to address the current year fiscal challenges by curtailing expenditures, strengthening revenues, and proceeding with the issuance of Judgment Obligation Bonds.

Expenditure Concerns and Recommendations

The gross expenditure deficit reported in the FSR was approximately $82 million mostly driven by the liability claims account, human resource benefits account, and recent labor agreements reached with firefighters. The FSR also proposed solutions of approximately $30 million, bringing the deficit down to $52 million.

Subsequent to the FSR's release, however, this Office has identified additional unbudgeted expenditures that will increase the projected expenditure deficit from $52 million to between $70 and $80 million. One significant source of expenditures includes pending resolutions to additional cases being handled by the City Attorney and Conflict Counsel. These payouts are above the $135.5 million identified in the FSR, which already exceeded the Adopted Budget by $67 million. As this Office stated at the time of the adoption of the 2016-17 Budget, potential liabilities above budgeted amounts posed a major risk in 2016-17 that had the potential to exceed the available reserves set aside in the Unappropriated Balance. The City must strive to increase the funding available for liabilities in the upcoming budget process.

Additional expenditures totaling $10.5 million have also resulted from recent changes to labor agreements, including an additional $8 million shortfall in the Human Resource Benefits Account. There are also new spending requests from departments that, if funded, would exacerbate the expenditure deficit.

In order to curtail expenditures, it is first recommended that no requests for new and unbudgeted funding be approved for the remainder of 2016-17. While we understand that legitimate needs arise during the fiscal year, consistent with the City's Financial Policies, those needs should be assessed in the context of the 2017-18 Budget taking into consideration all of the other increased demands next year.

Further, departments should be instructed to take steps to generate sufficient savings to, at the very least, address any deficits they are facing in 2016-17. Steps should be inclusive of adjusting hiring plans as salaries tend to be the most significant portion of departmental spending. Departmental savings are likely to also be used to address shortfalls elsewhere in the City.

Finally, civilian hiring should be prioritized to focus on filling special-funded and mandated positions. Other than these positions, civilians hiring should be limited until after the Mid-Year Financial Status Report is considered, at which point this Office will recommend a more comprehensive solution for addressing the 2016-17 deficit.

Revenue Concerns and Recommendations
In addition to this projected expenditure deficit, the FSR also identified $36 million in 2016-17 revenues below plan to date, primarily due to a portion of 2016-17 property tax being received in 2015-16. This shortfall combined with other risks to year-end revenue in departmental receipts, sales taxes, electric users' taxes, parking fines, and franchise fees (see table below), results in potential deficits totaling $138 million. The risk to departmental receipts of $71 million is based on forecasts of lower related cost reimbursements due to unfilled proprietary and special-funded positions. In circumstances where departments have used as-needed or part-time staffing to fill vacancies, the City has not typically assessed related costs. Therefore, this Office is in the process of seeking related cost reimbursements to those positions in an effort to mitigate this identified risk. Since the release of the FSR, the Board of the Department of Water and Power approved a Power Revenue Transfer that is $27 million lower than what was assumed in the budget. This reduction in the Power Revenue Transfer increases the potential revenue shortfall in 2016-17 to $165 million.

Summary of 2016-17 Revenues Below Plan and at Risk

Item	*Amount (Millions)*
Property Tax	$36
Departmental Receipts	$71
Sales Tax	$13
Electric Users' Tax	$12
Power Revenue Transfer	$27
Parking Fines	$5
Taxicab Franchise	$1
Total	*$165*

This Office anticipates that some of this shortfall may be offset by additional receipts from other revenue sources such as transient occupancy taxes and the possibility that an early property tax receipt from 2017-18 will occur in 2016-17. Nonetheless, given the size of the expenditure deficit, a sizeable transfer from the Reserve Fund will be required to fully fund expenditures through year-end. Furthermore, if an early receipt of property tax occurs, the revenue budget for 2017-18 will be lower by that same amount.

Therefore, this Office first recommends that the Office of Finance, with assistance from the CAO and City Attorney, seek to negotiate collection agreements with short-term and vacation rental websites similar to the one recently entered into with Airbnb. Through the Airbnb agreement, the City has begun to capture Transient Occupancy Tax (TOT) revenue that guests are required to pay by law, but that had not been previously collected. The additional revenue from Airbnb will ensure that TOT budget projections are met and exceeded in 2016-17. This will provide some relief, but only if those revenues are allowed to be recognized as General Fund receipts, and not dedicated for other purposes.

In addition, this Office has presented a series of recommendations related to the regulation and siting of billboards in the City. There may be opportunities for enhanced revenues for permitting billboards to be sited on some City parcels, consistent with an adopted framework of regulations. This Office's reports on this matter are currently pending in the Planning and Land Use Management Committee, and adopting those recommendations could provide a new source of revenue (C.F. 11-1705).

It is also recommended that the CAO be instructed to seek reimbursement for special services provided to major event venues around the City. Examples of these venues include the Coliseum, Dodger Stadium, and Staples Center. Over the past several months, the City has been in discussions with these venues to present our costs caused by supporting these events and discussing options for recovering those costs. At this time, the City should seek agreements to establish service levels and ensure reimbursement.

Finally, it is recommended that any efforts to earmark General Fund revenues for dedicated purposes should be held in abeyance or disapproved. This includes policies that would change the parking citation program, earmark revenue from the Airbnb TOT collections for special purposes, or divert natural gas franchise revenue to dedicated accounts.

Judgment Obligation Bonds

Our final set of recommendations are focused on restoring Reserve Fund levels, the first of which is that the City should move forward with issuing a Judgment Obligation Bond, with the proceeds being used to reimburse the Reserve Fund for payments made to address liability claims above the budgeted amount.

In brief, the decision to issue Judgment Obligation Bonds (JO Bonds) should balance on two competing principles. On the one hand, the City should strive to use cash rather than debt to handle current-year obligations, such as this year's high level of liability payouts. Debt is best used to pay for items that offer long-term benefits, thus sharing the payment burden with those who benefit with those investments in the future. At the same time, the City should strive to retain a Reserve Fund of at least 5 percent both to be consistent with City policy and to address truly unanticipated crises or emergencies.

Were the Reserve Fund flush, this Office would recommend its use to pay for this year's high liability payouts especially since the increases have not resulted from a single, unprecedented payout, but are the result of what appears to be a new trend of increased liability payouts. The Reserve Fund, however, is currently only precariously above the minimum policy threshold amount of 5 percent of the Adopted General Fund budget. This puts the City at risk of not being able to address unforeseen emergencies.

Due to the high number of cases and the amounts exceeding the Liability Claims budget, the Debt Policy allows for the issuing of JO Bonds for "unusual and non-recurring court" judgments and settlements. Since there are not sufficient budgeted funds to pay for these, the issuance of JO Bonds are allowed under these circumstances. In addition, State law allows for the issuance of debt for this type of working capital as it is an "obligation imposed by law," whereas other types of expenditures if there is an emergency in the City would not be available. Issuing debt to replace the funds in the Reserve Fund to pay these liabilities will not only assist the City in keeping its rating but also ensure that cash would be available for other working capital needs.

The City's issuance of JO Bonds falls under the City's 6 percent non-voter approved debt limit. Currently, that debt ratio is a 4.12 percent, which is considered on the low to medium scale of the debt criteria used by the rating agencies. A strong Reserve Fund is another criteria used by the rating agencies. Falling below the 5 percent Reserve Fund policy would be a credit negative for the rating agencies. We believe that issuing these JO Bonds for unbudgeted settlements is not a credit negative.

For these reasons, it is recommended that the City continue with the process of issuing Judgment Obligation Bonds that can be used to reimburse the Reserve Fund so that it can return to an adequate level to mitigate this risk. However, this recommendation should not dilute the fact that the issuance of JO Bonds is an extraordinary budget tool that should be used sparingly. Thus, this action should only be taken if it is accompanied by a commitment to more adequately fund the Liability Account for 2017-18 based on a comprehensive review of existing cases by the City Attorney. This review will provide the Council and Mayor with a better understanding of the risks and potential monetary liability the City faces in 2017-18 so that it can set aside a level of funding that avoids the use of the Reserve Fund.

Attached is a timeline identifying the steps needed to issue the bonds this fiscal year. Once the cases are settled and approved by the Mayor and Council, this Office will present a report requesting authority to validate these cases in court as "obligations imposed by law." There is no obligation to issue bonds with the adoption of that report. When the court validation process in completed that is when this Office will return to the Mayor and Council for the authority to issue the bonds.

FISCAL IMPACT STATEMENT

If the expenditure and revenue recommendations in this report are adopted, they will support efforts to address the 2016-17 deficit by reducing departmental deficits, generating savings that can be used for Citywide deficits, and protecting and increasing revenues in the current year. While the issuance of Judgment Obligation Bonds would increase the balance in the Reserve Fund, the recommendation to proceed with the Judgment Obligation Bond does not yet authorize the issuance of debt and therefore has no impact at this time.

MAS:BC:NRB,MCK,JWW:01170034c
Attachment

Judgment Obligation Bond 2017 Tentative Schedule

Week of January 23, 2017	Deadline for City Council and Mayor approval for cases to be included in JOB issuance
Week of January 30, 2017	CAO releases report including validation documents for pursuing JOB issuance
Week of February 6, 2017	Budget and Finance, City Council, and Mayor approval of CAO report
Week of February 27, 2017	City Attorney provides final stipulated judgments and settlements to be financed
Week of March 6, 2017	Court Validation Process begins (Estimated time: between 85 and 95 days, including 30 to 45 days for validation judgment, a 15+ day process for order for publication of summons and default judgment, and a 30 day appeal period. After the 30 day appeal period passes, the City can sell bonds.)
Weeks of March 13, 20, and 27, 2017	-Receive order of publication -Post summons in public places and mail summons to interested parties -Publication of summons in each of the two subsequent weeks in Daily Journal
Week of April 3, 2017	Final publication in newspaper
Weeks of April 17 and 24, 2017	-Deadline for interested parties to respond (10 days or more after final publication) -Court Clerk enters default judgments and schedules hearing -Hearing in Superior Court and default judgment rendered -CAO releases report authorizing the issuance of Judgment Obligation Bonds
Week of May 8, 2017	Budget and Finance Committee approval of CAO report
Week of May 15, 2017	City Council and Mayor approve CAO report
Week of June 5, 2017	Sell Judgment Obligation Bonds (must be 15 calendar days apart from TRAN sale)
Week of June 19, 2017	-Period to appeal judgment validation ends, no less than 30 days from date of default judgment was rendered -Close bonds and receive funds, but not before appeal period ends