

CITY OF LOS ANGELES  
INTER-DEPARTMENTAL CORRESPONDENCE

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C.F. No. 13-0455  
Deputy: E. Pulst

Date: June 3, 2013

To: The Honorable City Council

From: Miguel A. Santana, City Administrative Officer *Miguel A. Santana*  
Gerry F. Miller, Chief Legislative Analyst *Gerry F. Miller*

Subject: **TECHINICAL CORRECTIONS TO PROPOSED BUDGET  
STABILIZATION FUND POLICY**

**SUMMARY**

On April 15, 2013 our offices issued a joint report and proposed policy for the Budget Stabilization Fund (BSF). The following technical corrections to the report and policy are being submitted for consideration.

- 1) Correction and update to the Deposit Rule and simulation

Deposits

Based on the review of these methodologies, historical City General Fund revenue receipts, and consistency with the intent of the fund, our offices pursued an option that would result in required annual deposits based on economic conditions being met. Specifically, our offices examined the combined average growth of the following seven general fund tax revenue sources over the last 24 years (3.4 percent) as the index for the deposit/withdrawal rules of the BSF.

- 1. Property Tax
- 2. Utility Users' Tax
- 3. Business Tax
- 4. Sales Tax
- 5. Transient Occupancy Tax
- 6. Documentary Transfer Tax
- 7. Parking Users' Tax

Applying this index, a deposit to the BSF will **be appropriated as part of the budget development process** when the anticipated combined revenue growth of the seven general fund tax revenue sources listed above **for the budget being developed** is

greater than 3.4 percent growth. **The growth will be calculated from the current year's adopted budget.** When this condition is met, the amount of the deposit will be the difference between the anticipated growth **for the budget being developed** and the growth at 3.4 percent.

The following simulation illustrates the budget appropriations to the BSF that would have been required as part of the development of the budgets from 2006-07 **to 2013-14** had this policy been in place.

Simulation of Potential Transfers to the Budget Stabilization Fund under the Proposed Policy  
2005-06 to 2013-14\* (Dollars in Millions) **Changes in Bold**

Fiscal Year	Adopted Budget	Revenue at 3.4% growth	Upcoming Fiscal Year	Adopted Budget	Surplus (Shortfall)	To BSF
2005-06	<b>2,764.8</b>	<b>2,858.8</b>	2006-07	3,080.1	<b>221.3</b>	<b>221.3</b>
2006-07	<b>3,080.1</b>	<b>3,184.8</b>	2007-08	3,240.2	<b>55.4</b>	<b>55.4</b>
2007-08	<b>3,240.2</b>	<b>3,350.3</b>	2008-09	3,277.9	<b>(72.4)</b>	<b>0.0</b>
2008-09	<b>3,277.9</b>	<b>3,389.4</b>	2009-10	3,129.6	<b>(259.7)</b>	<b>0.0</b>
2009-10	<b>3,129.6</b>	<b>3,236.1</b>	2010-11	3,084.2	<b>(151.9)</b>	<b>0.0</b>
2010-11	<b>3,084.2</b>	<b>3,189.0</b>	2011-12	3,141.1	<b>(48.0)</b>	<b>0.0</b>
2011-12	<b>3,141.1</b>	<b>3,247.8</b>	2012-13	3,219.6	<b>(28.2)</b>	<b>0.0</b>
<b>2012-13</b>	<b>3,219.6</b>	<b>3,329.1</b>	<b>2013-14*</b>	<b>3,444.1</b>	<b>115.0</b>	<b>115.0</b>

\*Pending Mayor's Approval

Based on the policy guidelines, an appropriation to the BSF would have been required as part of the 2006-07 **and 2007-08** budgets. **An appropriation to the BSF as part of the 2013-14 budget has been included though at a lower amount and what the policy would have required.**

2) Correction and update to the Withdrawal simulation

Withdrawals

The following simulation illustrates the budget transfers from the BSF that would have been possible as part of the development of the budgets from 2006-07 **to 2013-14** had this policy been in place.

Simulation of Potential Transfers from the Budget Stabilization Fund under the Proposed Policy  
2005-06 to 2013-14\* (Dollars in Millions) **Changes in Bold**

Fiscal Year	Adopted Budget	Revenue at 3.4% growth	Upcoming Fiscal Year	Adopted Budget	Surplus (Shortfall)	To BSF	BSF Balance	25% Cap	Transfer from BSF (Limit 25% of Balance)	BSF Balance After Transfer
2005-06	2,764.8	2,858.8	2006-07	3,080.1	221.3	221.3	221.3	55.3	0	221.3
2006-07	3,080.1	3,184.8	2007-08	3,240.2	55.4	55.4	276.7	69.2	0	221.3
2007-08	3,240.2	3,350.3	2008-09	3,277.9	(72.4)	0.0	221.3	55.3	55.3	166.0
2008-09	3,277.9	3,389.4	2009-10	3,129.6	(259.7)	0.0	166.0	41.5	41.5	124.5
2009-10	3,129.6	3,236.1	2010-11	3,084.2	(151.9)	0.0	124.5	31.1	31.1	93.4
2010-11	3,084.2	3,189.0	2011-12	3,141.1	(48.0)	0.0	93.4	23.3	23.3	70.0
2011-12	3,141.1	3,247.8	2012-13	3,219.6	(28.2)	0.0	70.0	17.5	17.5	52.5
2012-13	3,219.6	3,329.1	2013-14*	3,444.1	115.0	115.0	167.5	41.9	0.0	167.5

\*Pending Mayor's Approval

**RECOMMENDATIONS:**

That the Council, subject to the approval of the Mayor:

1. Adopt the revised Proposed Financial Policy for the Budget Stabilization Fund for the City of Los Angeles, effective upon Mayor and Council action;
2. Request the City Attorney, with the assistance of the City Administrative Officer, to begin drafting the necessary ordinance language to codify the Proposed Financial Policy for the Budget Stabilization Fund, and any other necessary ordinance changes.

**FISCAL IMPACT**

Adoption of all of the above recommendations will complete the implementation of Charter Amendment P which codified the establishment of the Contingency Reserve Account and Emergency Account within the Reserve Fund, and also established the BSF in the City Treasury. If adopted, the recommendations would potentially increase the City's Reserve Fund and BSF above their current amounts. The amount would be determined by subsequent Council and Mayor actions on the budget as well as the performance of the City's economically sensitive revenues. Adoption of these recommendations would also assist in addressing revenue shortfalls in times of economic distress similar to those projected by the City Administrative Officer in the Four-Year Budget Outlook.

MAS:BC:01130095

Attachment

## **Revised Attachment 1 Financial Policy for the Budget Stabilization Fund**

### **Purpose**

The City's general tax revenues are sensitive to economic conditions as well as actions taken by outside entities including the state and federal governments. Unanticipated revenue shortfalls during a fiscal year are usually addressed through reductions in critical services and operations. Given this revenue uncertainty, as part of the 2009-10 budget process, the Mayor and City Council established a Budget Stabilization Fund (BSF). Subsequent to this action, in March 2011, City of Los Angeles voters amended the City Charter to include the Budget Stabilization Fund as a charter-required fund.

A stabilization fund, is created with money set aside during periods of robust economic growth or when revenue projections are exceeded to help smooth out years when revenue is stagnant or is in decline. Furthermore, it provides the following protections and benefits to the City's financial health and stability:

- Sets aside revenue during years of strong revenue growth and would prevent using above average revenue growth to finance ongoing expenses such as increased employee salaries and benefits, as well as new services and programs.
- Enforces spending discipline by setting aside money collected from revenues received during good economic conditions for use during years with lower growth or declining revenue;
- Protects against reducing services during a recession;
- Addresses temporary cash flow shortages, revenue shortfalls or unpredictable one-time expenditures;
- Mitigates long-term imbalances by curbing the use of unusual surpluses for ongoing expenditures;
- May reduce City's borrowing costs due to stronger bond ratings; and,
- Stabilizes finances during significant downturns.

### **Legal Basis of the Reserve Fund and Budget Stabilization Fund**

#### City Charter

The City Charter established the Reserve Fund which holds unrestricted cash set aside outside the budget for unforeseen expenditures, emergencies or natural disasters. Charter Section 344 requires the Controller to transfer surplus general revenues and other unspent appropriations from the General Fund to the Reserve Fund at the end of the fiscal year. In March 2011, voters passed Charter Amendment P which codified the establishment of the Contingency Reserve Account and Emergency Account within the Reserve Fund. Charter Amendment P also established the BSF in the City Treasury and authorized the requirements for transfers or expenditures from the BSF to be established by ordinance.

## Funding Policy

### Minimum Balance

Unlike the Reserve Fund, the BSF does not have a minimum balance threshold amount that it must maintain. The deposit and withdrawal rules established herein will ultimately dictate the available balance in the BSF.

### Maximum Balance

The BSF does not have a maximum balance amount level.

In the event the combined balance in the Reserve Fund and the BSF will exceed 15 percent of the adopted General Fund budget, the City Council and Mayor may consider appropriating the “excess” funds to other funding priorities that are considered to be “one-time” expenditures such as:

- One-time expenses such as capital spending to meet the **Capital Improvement and Expenditure Program Policy (CIEP)**;
- Prepayment of General Fund debt or other obligations.

Any balance within the BSF will not be counted toward meeting the five percent Reserve Fund policy level.

### Deposit Rules

#### **Required Budget Appropriation to the Budget Stabilization Fund**

**In accordance with the budget development process established by the City Charter, beginning with the development of the 2014-15 budget, a new budget appropriation to the BSF shall be included as part of the adopted budget for the following fiscal year when the combined growth of the following seven General Fund tax revenue sources is anticipated to exceed 3.4 percent. The growth calculation will be based on the comparison between the adopted budget for the current year and the budget for the following fiscal year.**

1. Property Tax
2. Utility Users' Tax
3. Business Tax
4. Sales Tax
5. Transient Occupancy Tax
6. Documentary Transfer Tax
7. Parking Users' Tax

The amount of the new budget appropriation to the BSF shall be the difference between the anticipated combined revenue growth of the seven general fund tax

revenue sources listed above and the combined value of these sources with an assumed 3.4 percent growth.

In the event an affirmative action is taken by the City, voters, or another government entity that increases or decreases the tax rates of any of the seven revenue sources used to set the index for the deposit/withdrawal rules of the BSF, a recalculation of the index by the City Administrative Officer and Chief Legislative Analyst will be automatically triggered. Any changes to the index require an amendment to this policy and related ordinances.

### **Adjustments to the Required Budget Appropriation**

The required budget appropriation to the BSF may be adjusted up or down based on the following:

- Upward adjustments may be made at the discretion of the City Council and Mayor (See other deposits to the BSF).
- Downward adjustments may only be made to maintain the Reserve Fund at five percent of the General Fund, **to comply with the CIEP policy**, in the event a fiscal emergency is declared by the City Council and Mayor, or if the BSF funding policy is suspended by the City Council and Mayor based on findings that it is in the best interest of the City to suspend the policy.

### **Other Deposits to the Budget Stabilization Fund**

Mid-year deposits to the BSF or deposits above the required amount may be authorized by the City Council, subject to the approval of the Mayor at any time during the year from various sources including but not limited to:

- One-time receipts from the sale or lease of the City's assets or securitization of future revenue streams.
- Any unanticipated revenue recognized during the year that has not already been programmed.
- Funds made available from the release of prior year encumbrances.
- Year-end surpluses.

Pursuant to the City Charter, prior year funds and surpluses will revert to their original funding sources. Those reverting to the General Fund will first revert to the Reserve Fund to ensure the funding level of the Reserve Fund is at 5 percent of the General Fund and to ensure sufficient funds are available in the Reserve Fund for year-end closing transfers. The balance of funds may be deposited into the BSF.

## **Withdrawals from the Budget Stabilization Fund and Priority Uses of the Fund**

Savings in the BSF will primarily be used to mitigate revenue shortfalls due to economic recessions and address the resulting short-term budgetary shortfall. It should not be used to pay for increased or enhanced services. While the BSF does not provide long-term relief from the implementation of structural reductions or solutions, it will provide a "soft landing" and transition for difficult and painful reductions to discretionary programs. Withdrawals from the BSF must be made as follows:

During the development of the budget for the upcoming fiscal year, a transfer from the BSF to the General Fund may be incorporated as part of the adopted budget when the combined growth of the following seven general fund tax revenue sources is anticipated to fall short of 3.4 percent for the upcoming fiscal year. **The growth calculation will be based on the comparison between the adopted budget for the current year and the budget for the following fiscal year.**

1. Property Tax
2. Utility Users' Tax
3. Business Tax
4. Sales Tax
5. Transient Occupancy Tax
6. Documentary Transfer Tax
7. Parking Users' Tax

The amount of the transfer from the BSF in any year shall be limited to 25 percent of the available balance in the BSF unless a fiscal emergency for the City has been declared or if the BSF funding policy is suspended by the City Council and Mayor based on findings that it is in the best interest of the City to suspend the policy.

The primary use of the BSF must be to mitigate revenue shortfalls due to economic recessions or revenue reductions and to address the resulting short-term budgetary shortfall. It shall not be used to provide increased or enhanced services or employee salaries and benefits.

In the event the combined Reserve Fund and BSF exceed 15 percent of the General Fund budget, the City may elect to use the surplus for one-time uses that include, but are not limited to capital projects, infrastructure repairs, debt repayment, settlements, and equipment purchases.