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City of Long Beach
Working Together to Serve

Memorandum

Date: June 23, 2015

To: Patrick H. West, City Manager PWest

From: John Gross, Director of Financial Management

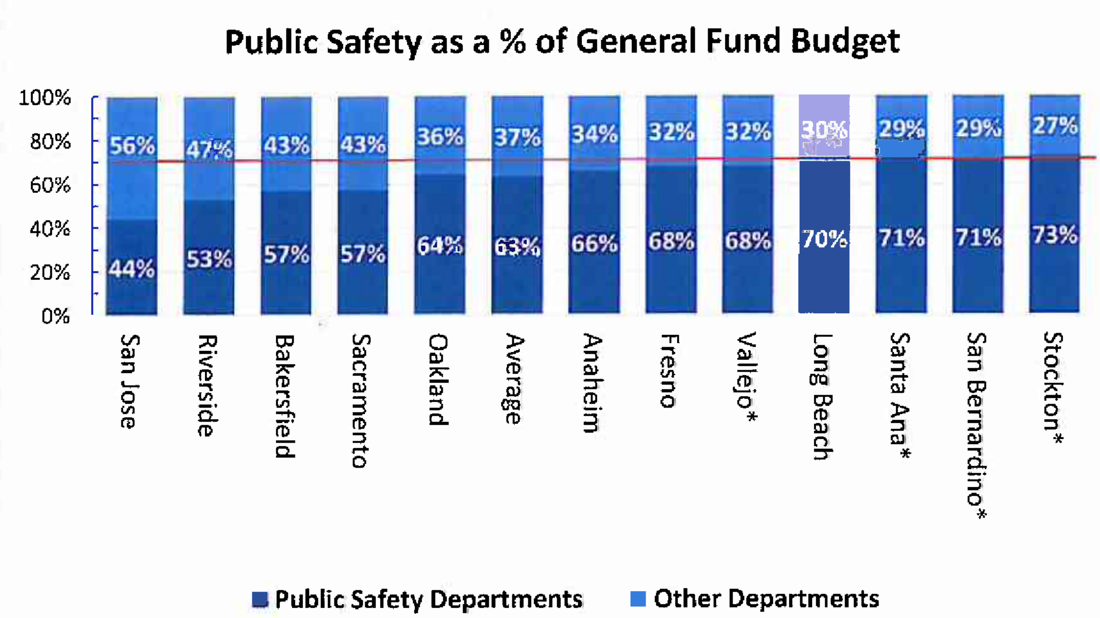
For: Mayor and Members of the City Council

Subject: **Budget Study Session Follow-Up**

During the March 3, 2015 Budget Study Session on the Fiscal Year (FY) 16 through FY18 Financial Outlook presentation, the City Council requested that staff review and benchmark public safety services as a percent of the total General Fund costs in both distressed and non-distressed cities. The City Council also requested that staff review CalPERS information for distressed cities. In addition to the requested information, staff has reviewed the General Fund revenue of each benchmark city to determine if overreliance on a particular revenue source contributed negatively to a city's fiscal outlook. This memo addresses these items.

Public Safety as a Percent of General Fund Budget

Staff analyzed the current fiscal year (FY 15) budget documents of 11 California cities. Staff selected cities based upon their population sizes in relation to Long Beach and/or their inclusion in previous benchmarking exercises. The following graph shows each city's General Fund percent allocation to public safety and all other departments.



* Cities in fiscal distress

The red line on the graph represents the 70 percent public safety General Fund allocation threshold that the City adopted beginning in FY 11 as a part of the concept of "Proportionate Share." As described during the March 3, 2015 Budget Study Session, Proportionate Share is a budget development tool that allocates budget in a manner that keeps each general City service at the same relative level of the budget as the previous fiscal year; preserving public safety as a top priority while maintaining the budgetary support needed for Long Beach to remain a full-service city. Further, we noted that cities in fiscal distress tend to allocate more than 70 percent of their General Fund budgets to public safety.

Of the 11 cities reviewed, three – San Bernardino, Santa Ana and Stockton - allocate more than 70 percent of their General Fund budgets to public safety. Each of these cities have faced fiscal distress in recent times, with San Bernardino and Stockton being two of three California cities to declare bankruptcy since 2008. Vallejo, the third California city to declare bankruptcy, currently allocates 68 percent of its General Fund budget to public safety; a drop from 74 percent during the fiscal year in which it entered bankruptcy. None of the non-distressed cities reviewed allocate more than 70 percent of General Fund budget to public safety. The average General Fund allocation to public safety for all cities reviewed is 63 percent.

Based on this review, a correlation appears to exist between a city's fiscal health and an unchecked General Fund percentage allocation to public safety. As indicated, the City currently allocates 70 percent of its General Fund budget to public safety and manages this percentage not to exceed 70 percent.

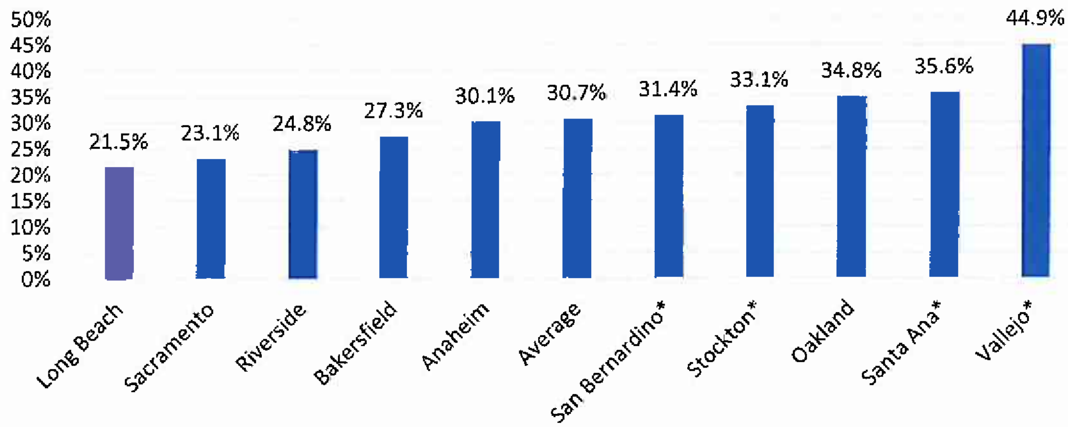
<u>CalPERS Information</u>

Staff reviewed the most recent CalPERS actuarial reports available for nine of the 11 benchmark cities above. Fresno and San Jose are not CalPERS cities and were, therefore, excluded from the review. The data is current as of October 2014.

Employer Contribution Rates - Employer contributions to CalPERS represent a significant commitment of General Fund expenditure budget each fiscal year. As demonstrated in the next graph, the average combined employer contribution rate of all cities reviewed is 30.9 percent. At 21.5 percent, Long Beach has the lowest combined average employer contribution rate among benchmark cities. In comparison, the distressed cities have combined employer contribution rates ranging from 31.4 percent to 44.9 percent. While several factors impact the employer contribution rate, including payroll, mortality rates and unfunded liabilities, having a comparatively low employer contribution rate is a positive for the City.

Additionally, from FY12 – FY14, the City negotiated with employee groups for employees to pay the full portion of their required employee pension contributions. Prior to this action, the City paid a percentage of the employee contributions to CalPERS, known as Employer Paid Member Contributions (EPMC). While CalPERS actuarial reports do not distinguish between required employee contributions and EPMC, cities that continue to pay their employee contributions have a functionally higher contribution rate than the rate indicated in the next graph. Had the City and employee groups not reached an agreement for pension reform, the City's functional employer contribution would be 6-7 percent higher than it is today.

FY 15-16 Employer Contribution Rate
All Employee Groups

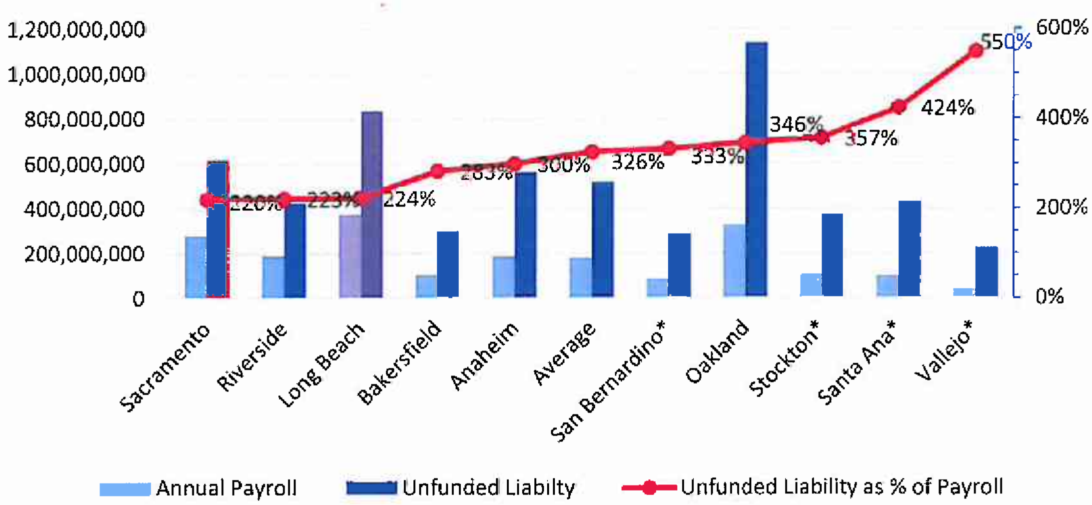


* Cities in fiscal distress

Unfunded Liability - The primary driver of increasing pension costs in recent years is unfunded liability. Unfunded liability is the difference between a pension fund's assets and its accrued liabilities. Unfunded liability expressed as a percentage of annual payroll is used as a measure of pension fund health. The following graph shows unfunded liability as a percent of payroll, combined for both miscellaneous and public safety employee groups for each benchmark city.

As demonstrated below, unfunded liability as a percentage of payroll for the four distressed cities is above the average 326 percent. By comparison, Long Beach has a combined unfunded liability of 224 percent of payroll. This is among the lowest of the cities reviewed.

Unfunded Liability as a Percent of Payroll
Combined All Employee Groups



* Cities in fiscal distress

Revenue Sources

Staff reviewed the largest General Fund revenue sources for each of the cities above to determine if there was a correlation between revenue sources and fiscal health. These included property tax, sales tax, utility users tax (UUT), transient occupancy tax (TOT), and business license tax. As expected, property and sales taxes accounted for the largest proportion of General Fund revenue in the majority of the cities reviewed, representing an average of 29 percent and 25 percent, respectively. The proportion of General Fund revenue from other revenue sources varied widely from city to city. No clear correlation could be established between revenue sources and fiscal health. However, three of the four fiscally distressed cities – Stockton, San Bernardino and Vallejo – rely more heavily on sales tax revenue than they do on revenue from property taxes. This may account for some of the financial distress experienced by these cities as sales tax revenue tends to be more elastic and sensitive to swings in the larger economy than other large revenue sources like property tax and UUT.

Staff will continue to monitor trends in General Fund budget allocations, pension liabilities, revenue sources and other possible indicators of municipal fiscal health to help inform budget allocation recommendations.

If you have any questions, please contact Budget Manager Lea Eriksen at extension 8-6533.

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