



OFFICE OF THE CITY AUDITOR
Long Beach, California

R-13

LAURA L. DOUD, CPA
City Auditor

September 2, 2014

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file the Summary Report on Proposition H (FY's 2007-2013).

DISCUSSION:

The citizens of Long Beach approved Proposition H, the Police and Fire Public Safety Oil Production Tax, on May 1, 2007. Prop H amended the City's Municipal Code to assess an additional 25 cents per barrel special tax on oil producers operating in Long Beach. Effective on June 1, 2007, this special tax is in addition to the existing tax of 15 cents per barrel produced. Prop H funds can only be used for police officers, firefighters, and related costs, including but not limited to equipment, facilities, and training, in order to ensure timely responses for public safety needs.

As of September 30, 2013, oil operators in Long Beach reported a total of 82,330,175 barrels of oil produced. Based on this cumulative oil production, the City collected a total of \$22,048,174 of Prop H oil tax revenue, including penalties and interest.

Prop H revenues have been primarily used to fund police officer and firefighter staff positions. Each year, Prop H has been able to support on average 12 police officers and 11 firefighters. Over the years, the remaining Prop H funds were used for non-personnel related expenses, including fleet services charges, fire truck acquisition and retrofit, technology, safety equipment, uniforms, and other supplies and materials.

The City Auditor is mandated by the Municipal Code to prepare an independent annual financial audit of Prop H revenues and expenditures for each fiscal year. The annual financial audit contains information regarding the amount of special tax revenue collected

and expended on purposes defined in the code, the status of any projects and programs funded by the tax revenue, and the amount of unspent monies on deposit that were carried over into the current fiscal year.

This informational report summarizes the cumulative benefit of Proposition H funds since 2007.

TIMING CONSIDERATIONS:

Action by the City Council is not time sensitive.

FISCAL IMPACT:

Approving this action would have no fiscal impact.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

A handwritten signature in cursive script that reads "Laura L. Doud".

LAURA L. DOUD, CPA
CITY AUDITOR

Attachment



City of Long Beach Office of the City Auditor



Police and Fire Public Safety Oil Production Tax Act:

Providing vital funds for public safety since 2007

August 1, 2014

A Summary Report on Proposition H FYs 2007-2013

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Executive Summary

The citizens of Long Beach (City) approved Proposition H (Prop H), the Police and Fire Public Safety Oil Production Tax, on May 1, 2007. Prop H amended the City's Municipal Code to assess an additional 25 cents per barrel special tax on oil producers operating in Long Beach. Effective on June 1, 2007, this special tax is in addition to the existing tax of 15 cents per barrel produced. Prop H funds can only be used for police officers, firefighters, and related costs, including but not limited to equipment, facilities, and training, in order to ensure timely responses for public safety needs.

As of September 30, 2013, oil operators in Long Beach reported a total of 82,330,175 barrels of oil produced. Based on this cumulative oil production, the City collected a total of \$22,048,174 of Prop H oil tax revenue, including penalties and interest. The FY 2013 oil production volume in Long Beach represented an 11.1% decline from the total volume in FY 2008. Compared to oil production, total Prop H revenues collected have declined at a slower rate. FY 2013 revenues were only 1.5% less than total proceeds in FY 2008.

A total of \$21,901,103 in Prop H funds have been spent on approved public safety-related uses as set forth in the City's Municipal Code, as of September 30, 2013. Prop H revenues have been primarily used to fund police officer and firefighter staff positions. Each year, Prop H has supported on average 12 police officers and 11 firefighters. Remaining Prop H funds have been used for non-personnel related expenses, including fleet services charges, fire truck acquisition and retrofit, technology, safety equipment, uniforms, and other supplies and materials.

The City Auditor plays an important oversight role with respect to Prop H revenues. The Municipal Code mandates the City Auditor to prepare an independent annual financial audit of Prop H revenues and expenditures for each fiscal year. The annual financial audit contains information regarding the amount of special tax revenue collected and expended on purposes defined in the code, the status of any projects and programs funded by the tax revenue, and the amount of unspent monies on deposit that were carried over into the current fiscal year.

Background

What is Prop H?

The Long Beach Oil Production Tax (OPT) was first created by City Ordinance and codified in the Municipal Code in 1990, levying a set fee of \$0.15 per barrel on oil companies “conducting, managing or carrying on the business of oil production from any well located in the City.” This OPT remained unchanged for 17 years with no adjustment to the rate based on the Consumer Price Index (CPI), until in 2006, City Auditor Laura Doud and her staff began to conduct further investigation of the OPT.

In 2006, the newly elected City Auditor found that Long Beach had one of the lowest OPT rates among surrounding communities. The City’s OPT was fixed, even though the market price of oil had nearly doubled during the 17-year period. As a result, the City Auditor recommended that the OPT be increased to bring Long Beach in line with surrounding jurisdictions and to capture more revenue with a fair OPT rate.

The City Auditor worked closely with City officials, the Long Beach Firefighters and Police Officers Associations, and many other local influential organizations to garner public support for Proposition H, called the Police and Fire Public Safety Oil Production Tax.

On May 1, 2007, the citizens of Long Beach overwhelmingly approved Prop H with 70.2% of the vote, which is unprecedented support for a Long Beach tax issue. Prop H levied a special tax in addition to the OPT, effectively increasing the oil tax fees from \$0.15 to a total of \$0.40 per barrel.

This Prop H special tax, codified in Municipal Code Section 3.80.222, is a legally distinct tax used specifically to fund public safety. These proceeds may be used only for police officers,

firefighters, and related costs, including but not limited to equipment, facilities, and training in order to ensure timely responses for public safety needs. The Prop H tax portion is annually adjusted every June 1st by the CPI, as shown in Table 1 below.

Table 1.
Prop H Tax Rates
FY 2007-2013

Effective Date	CPI Adjustment	Prop H Special Tax	Total OPT & Prop H Tax
June 1, 2007	-	\$0.25	\$0.40
June 1, 2008	\$0.01	\$0.26	\$0.41
June 1, 2009	\$0.01	\$0.27	\$0.42
June 1, 2010	\$0.00	\$0.27	\$0.42
June 1, 2011	\$0.00	\$0.27	\$0.42
June 1, 2012	\$0.01	\$0.28	\$0.43
June 1, 2013	\$0.00	\$0.28	\$0.43

The oil taxes are due to the City on or before the last day of each calendar quarter. The payments are based on a production quarter, which ends one month earlier than the calendar quarter. For example, the tax payments for the production quarter ending June 30, 2014 were due to the City on or before July 31, 2014.

Failure to pay the tax results in a penalty of 25% of the total amount of the total tax on the first day of the month following the close of the calendar quarter. If the tax remains unpaid for each month thereafter, an additional 10% penalty is assessed, up to a maximum of 100% of the tax amount.

What is the ongoing fiduciary role of the City Auditor?

Under Municipal Code Section 3.80.227, the City Auditor is required to prepare an independent annual financial audit of Prop H revenues and expenditures by January 31st for the prior fiscal year. The financial audit must contain information regarding the amount of special tax revenue collected and expended on purposes defined in the code, the status of any projects and programs funded by the tax revenue, and the amount of unspent

monies on deposit that were carried over into the current fiscal year.

The City Auditor's annual financial audit has four primary objectives:

- Identify Prop H revenues received the prior fiscal year and determine if funds remitted by the oil producers were properly calculated based on oil producers' reports remitted to the City;
- Identify prior FY's expenditures of Prop H funds and analyze whether such expenditures complied with the approved uses set forth in the Long Beach Municipal Code;
- Determine the amount of unspent Prop H monies on deposit at the end of the prior fiscal year that were carried over into the current fiscal year; and
- Determine the status of any projects and programs funded by Prop H revenue.

The audit is conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

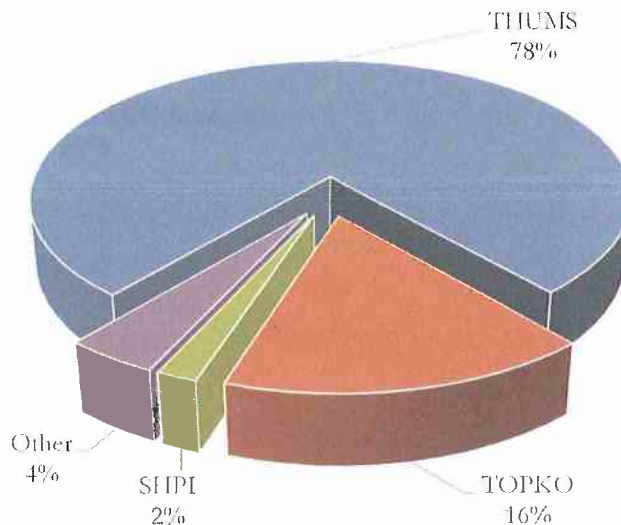
Oil Production

Over 82.3 million barrels of oil was produced in the City from FY 2007 through FY 2013.

Since initiation of the Prop H tax, oil operators in Long Beach reported extracting a total of 82,330,175 barrels of crude oil. The average yearly output was more than 13.1 million barrels of oil.

THUMS Long Beach Company (THUMS), Tidelands Oil Production Company (TOPKO) and Signal Hill Petroleum, Inc. (SHPI) have been the City's top oil producers. As illustrated in Chart 1, these three oil operators accounted for 96% of oil produced since the implementation of Prop H.

**Chart 1.
Percentage of Total Barrels Produced by Oil Producer
FYs 2007-2013**



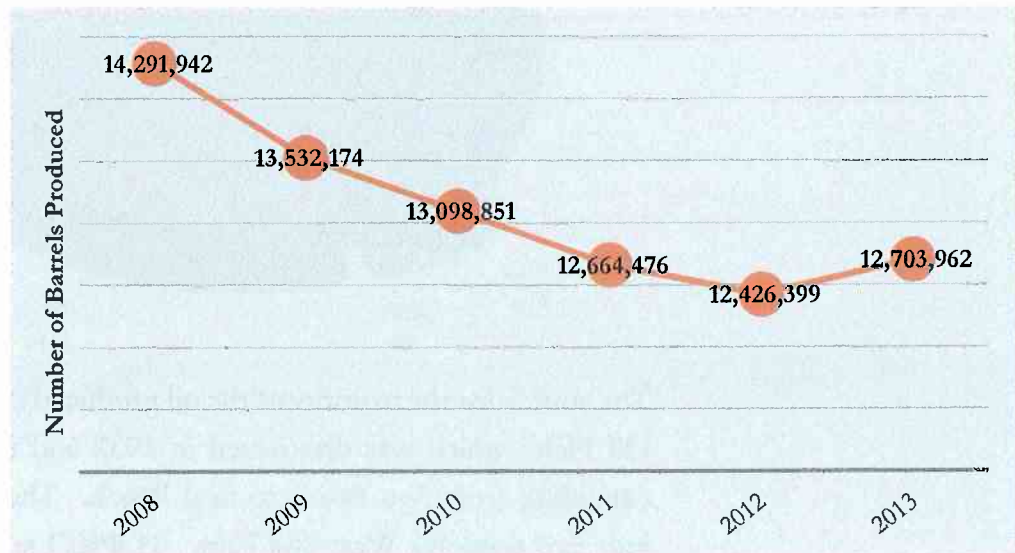
The source for the majority of the oil produced is the Wilmington Oil Field, which was discovered in 1932 and is 13 miles long, extending from San Pedro to Seal Beach. The field is divided into two sections: West and East. TOPKO serves as the field contractor for the western section of the oil field, and THUMS serves as the field contractor for the eastern section. Since inception of Prop H, THUMS has produced 63,887,665 barrels of oil, while TOPKO produced 13,484,552 barrels of oil.

SHPI, the third largest oil producer in Long Beach, is the operator for the Signal Hill West Unit, Signal Hill East Unit, Signal Hill Bryant Lease, Signal Hill H&L Lease, and Signal Hill LBA-1 Lease Oil Fields. The oil fields are located in both Long Beach and Signal Hill. SHPI has produced a total of 1,509,218 barrels of oil in Long Beach.

Oil production has been trending downward, with FY 2013 output that was 11% less than the output in FY 2008.

Since the inception of Prop H, annual oil production in Long Beach has decreased, thereby reducing the amount of special oil tax revenues to the City. As shown in Chart 2 below, in FY 2013, 12,703,962 barrels of oil were reported, equating to an 11.1% reduction from the FY 2008 production volume of 14,291,942 barrels. Between FY 2008 and FY 2012, the oil production level declined at an average of 2.6% per year, but production increased by 2.2% in FY 2013 from the prior year.

Chart 2.
Annual Oil Production in Long Beach
FYs 2008-2013



Note: Excludes oil production in FY 2007, as Prop H was enacted on June 1, 2007.

Since it was first discovered, the Wilmington Oil Field has produced nearly three billion barrels of oil, making it at one of the largest oil fields in the U.S. in terms of cumulative production. However, after more than 80 years of extraction, the Wilmington

Oil Field – like the other major oil fields in the Los Angeles Basin – is viewed as nearly depleted, given competing land uses.¹ According to the U.S. Geological Survey, the most likely estimate of the remaining proved reserves² of recoverable oil for the combined Wilmington-Belmont fields is 200 million barrels.³ Note that total oil production in Long Beach declined 39% within the past 20 years (between FY 1993 and FY 2013).

There was a steep drop beginning in June 2008; however, the market price for crude oil has been trending upward since February 2009.

When the special oil tax became effective in June 2007, the monthly average price of oil based on the WTI (West Texas Intermediate) crude index was steadily rising. In June 2008, the monthly WTI average reached a high of \$133.93 per barrel.

**Chart 3.
Price of Crude Oil, WTI Index
June 2007 – September 2013**



However, the oil price declined significantly shortly thereafter, with the average monthly WTI index falling to \$39.16 per barrel

¹ U.S. Geological Survey, *Forgone Oil in the Los Angeles Basin: Assessment of Remaining Petroleum in Giant Fields of Southern California* (Tulsa, OK: American Association of Petroleum Geologists, August 2012).

² Proved reserves are quantities of crude oil estimated with reasonable certainty, from the analysis of geologic and engineering data, to be recoverable from well-established or known reservoirs with existing equipment and under existing operating conditions (Society of Petroleum Engineers and World Petroleum Council).

³ U.S. Geological Survey, *Remaining Recoverable Petroleum in Ten Giant Oil Fields of the Los Angeles Basin, Southern California* (Reston, VA: USGS, 2012).

in February 2009. However, as shown in Chart 3 above, the crude oil price rose steadily thereafter.

Note that a decline in the price of oil could impact the City in two ways:

- Prop H revenue is suspended by Municipal Code for any months in which the WTI average falls below \$20 per barrel; and
- A decision by oil producers to decrease production in line with a decrease in oil prices, thereby reducing Prop H revenue.

Revenues

Over \$22 million in Prop H funds had been collected for public safety by the end of FY 2013.

Since Prop H was enacted on June 1, 2007, the City has collected a total of \$22,048,174 in Prop H oil tax revenues, including penalties and interest, as depicted in Table 2 below. The oil tax revenue received was based on production reports totaling 82,330,175 barrels of crude oil.

Table 2.
Total Prop H Revenues Received
FYs 2007-2013

Fiscal Year*	Oil Tax Revenue	Penalties	Interest	Total
2007	\$903,093	-	-	\$903,093
2008	\$3,609,806	\$8,132	\$59,513	\$3,677,451
2009	\$3,511,007	\$2,991	\$20,808	\$3,534,806
2010	\$3,540,929	\$7,953	(\$368)	\$3,548,514
2011	\$3,419,409	\$7,243	\$1,356	\$3,428,008
2012	\$3,386,472	\$5,411	\$3,017	\$3,394,899
2013	\$3,557,052	\$5,437	(\$1,086)	\$3,561,403
Total	\$21,927,768	\$37,167	\$83,240	\$22,048,174

*Note: FY 2007 is a partial year as Prop H was initiated on June 1, 2007.

As part of the OCA's annual financial audit of Prop H proceeds, 95% of the special tax revenues received each year were confirmed with the oil producers. It was determined that annual funds remitted by oil producers were properly calculated based on the reports presented to the City, the revenues were recorded into the City's financial system, and penalties were assessed appropriately on late payments.

The special tax revenues and penalties received have been deposited into Fund 121, the Police and Fire Public Safety Oil Production Act Special Revenue Fund, as required by Section 3.80.225 of the Municipal Code. The revenues were divided equally between two sub-funds, one for the Police Department and one for the Fire Department.

More than \$3.5 million in Prop H revenues are collected each fiscal year.

Prop H revenues to the City have averaged more than \$3.5 million per year, ranging from \$3.4 million to nearly \$3.7 million, as shown in Chart 4 below. While annual oil production in Long Beach has declined gradually at an average of 2.2% per year, total Prop H revenues collected have declined at a slower 0.3% average rate per year. This is primarily due to upward adjustments in the Prop H tax rate based on changes to the CPI.

**Chart 4.
Prop H Annual Revenues
FYs 2008-2013**



Note: Excludes FY 2007 tax revenues, which does not represent a full year.

Expenditures

Prop H taxes are payable on a quarterly basis, contingent upon reported oil production levels from the prior three months. Yearly expenditure amounts and uses budgeted in the Prop H fund for the Police and Fire Departments are determined by the Department of Financial Management’s Budget Office (Finance) during the preparation of the annual budget, based on projected available Prop H funds plus any excess funds available. For these reasons, Prop H-related expenditures in a particular year are not equivalent to that year’s actual Prop H tax proceeds.

By the end of FY 2013, nearly \$22 million in Prop H funds had been spent on public safety operations.

Since the Prop H tax was enacted, a total of \$21,901,103 has been spent on approved public safety uses as set forth in the City’s Municipal Code, as shown in Chart 5 below. On average, nearly \$3.7 million of Prop H funds are utilized each year for police and fire services.

Chart 5.
Total Prop H Expenditures
FYs 2008-2013



Note: There were no expenditures during FY 2007.

87% of Prop H expenditures had been used to fund police officer and firefighter positions.

As shown in Table 3 below, 87.1% of expenditures were spent on the salaries, wages and benefits of existing police officers and firefighters. The remaining 12.9% of expenditures is for non-personnel related expenses, including fleet services charges, fire truck acquisition and retrofit, technology, safety equipment, uniforms, and other supplies and materials.

**Table 3.
Total Prop H Expenditures
FYs 2008-2013**

Fiscal Year	Salaries, Wages and Benefits	Materials, Supplies and Services	Internal Support	Capital Purchases	Total
2008	\$2,927,000	\$296,190	\$161,524	\$16,423	\$3,401,137
2009	\$3,479,737	\$36,157	\$1,077,474	\$0	\$4,593,368
2010	\$3,571,158	\$8,588	\$303,825	\$0	\$3,883,571
2011	\$2,778,615	\$17,860	\$191,881	\$0	\$2,988,357
2012	\$2,905,281	\$39	\$167,620	\$0	\$3,072,940
2013	\$3,413,635	\$23	\$548,073	\$0	\$3,961,731
Total	\$19,075,426	\$358,857	\$2,450,397	\$16,423	\$21,901,103
% of Total	87.1%	1.6%	11.2%	0.1%	100.0%

Each year, Prop H has helped fund on average 12 police officers and 11 firefighters.

During the recent recession, Prop H helped support critical services, such as traffic safety, crime prevention, fire suppression, and emergency medical response. Each year, Prop H has been able to support on average 12 police officers and 11 firefighters, as shown in Table 4 below. The funds also supported 10 and 12 police officer recruits in the Police Academy during FYs 2008 and 2013, respectively.

Other significant uses include support for 22 police academy recruits, fire truck acquisition and retrofit, facility modification, equipment and technology.

**Table 4.
Positions Funded by Prop H
FYs 2008-2013**

Fiscal Year	Police	Fire
2008	14 motorcycle officers	12 firefighters
2009	14 motorcycle officers	12 firefighters
2010	14 motorcycle officers	12 firefighters
2011	12 motorcycle officers	6 firefighters and 3 captains
2012	9.5 motorcycle officers	6 firefighters and 3 captains
2013	9.5 motorcycle officers	6 firefighters and 3 engineers
Yearly Avg.	12.2 FTEs	10.5 FTEs

Unspent Funds

The Prop H fund started FY 2014 with \$560,000 in unspent monies.

In order to not overspend available Prop H fund balances, some funds are reserved for carry-over for the next fiscal year.

**Table 5.
Prop H Carry-Over Fund Balance
FY 2009-2013**

Fiscal Year	Prop H Carry-Over at FY End
2009	\$150,280
2010	\$198,137
2011	\$637,789
2012	\$959,749
2013	\$559,421

In FY 2012, the excess or carry-over fund balance grew to nearly \$1 million, as shown in Table 5 above. Based on an audit recommendation in the OCA's FY 2012 report, Financial Management developed a reserve policy to address the growing fund balance and to reduce the risk of unexpected revenue drops. The new policy establishes a goal to maintain a fund balance in the range of \$150,000 and \$400,000 to provide a cushion should Prop H revenues decline or to fund large one-time expenditures.

Although the policy was written during FY 2013, it was not completed prior to the finalization of the FY 2014 budget. This, combined with an unexpected spike in oil production, resulted in the fund balance exceeding the policy cap of \$400,000 at the end of FY 2013. However, management has stated that it plans to use a portion of the \$559,421 carry-over fund balance when budgeting for FY 2015. Since this carry-over balance was not considered during the FY 2014 budget process, we expect the Prop H fund balance to grow through September 30, 2014.