James Johnson
City of Long Beach
Councilmember, Seventh District

R-2

Date: January 11, 2011

To: Honorable Mayor and Members of the City Council

From: Councilmember Gary DeLong, Third District
Councilmember James Johnson, Seventh District

Subject: Establishment of a "Revenue Smoothing Fund"

RECOMMENDATION:

Request the Council refer consideration of the attached "Revenue Smoothing Fund" proposal to the Budget Oversight Committee.

DISCUSSION

In recent years, actual city revenues have declined as a result of the economic crisis, causing major reductions in expenditures. While such belt-tightening is a necessary part of an organization facing falling revenues, the detriment to city services and the painful effect these reductions have had on employees could be mitigated in the future by establishing a "Revenue Smoothing Fund" (also known as a "Rainy Day Fund") in our City Charter.

Revenue smoothing funds are common public finance tools to smooth volatile revenues and 47 of 50 states currently have such funds (See National Conference of State Legislatures). Some local government jurisdictions have also adopted such funds. Examples of such cities include San Francisco and Tulsa, Oklahoma.

A proper Revenue Smoothing Fund helps to lessen the harm to an organization in years in which revenues are falling while requiring savings when revenues are relatively high. Such a smoothing of revenues, while not addressing structural deficiencies that may exist in an organization, nonetheless help to stabilize finances over time and thus allow for better long-term financial planning in addition to helping provide some cushion in difficult financial years for the city. Such revenue smoothing over fiscal years is qualitatively different than the need to save funds for extreme emergencies, and thus a Revenue Smoothing Fund would be complimentary to reserve funds intended for use in such emergencies.

A Revenue Smoothing Fund has been previously discussed for Long Beach, and the previous version is currently before the Budget Oversight Committee for discussion along with a discussion of reserve funds generally. The mechanics of a Revenue Smoothing Fund are vital to ensure that it serves its intended purpose, and thus the attached proposal is attached for the Committee's consideration.

FISCAL IMPACT

The proposed Revenue Smoothing Fund would have a net neutral effect on City finances over the long run, while helping to smooth out swings in revenue caused by economic recessions and other forces. Thus, the General Fund may have more or less resources available to it depending on whether revenue performance is stronger or weaker than the average of the last ten years. Such smoothing allows the City to mitigate the harmful reductions caused in downturns while requiring savings during positive revenue years.

Attachments: (1) Revenue Smoothing Fund Formula, (2) Hypothetical Example of Revenue Smoothing Fund, and (3) Revenue Smoothing Fund FY 1998-2009 Hypothetical Performance

REVENUE SMOOTHING FUND FORMULA

Establish the median increase in General Fund Revenues, adjusted by inflation (the annual increase in the Consumer Price Index for all goods, the L.A. metropolitan area) and the increase in population over the previous ten years. Categorize future financial years in either "good" years (where the projected percentage increase exceeds the median) or "bad" years (those where the projected percentage increase was less than the median).

In "good" years, require that either:

1. Half (50%) of the increased revenues greater than the median be placed in the Revenue Smoothing Fund, or
2. 3% of the total General Fund revenues, whichever is less.

In "bad" years, allow the City to either:

1. Withdraw from the Revenue Smoothing Fund half of the fallen revenues below the median, or
2. 3% of the total General Fund revenues, whichever is less.

Proposed Legal Mechanism

In order to ensure that the Revenue Smoothing Fund operates properly in good times as well as bad, it is proposed that the Fund would be established by amending the city charter. However, in order to allow amendment in case of some unforeseen and unintended consequence, it is proposed that amendment by allowed by a unanimous vote of the City Council.

HYPOTHETICAL EXAMPLE OF REVENUE SMOOTHING FUND

Below is a hypothetical example for year X. Round numbers are used for ease of explanation.

Assumptions

General Fund (GF) = $100 million
GF Median Increase (adjusted for pop. Growth & inflation) for previous 10 yrs = 2%
GF increase for year X = 1%

Calculation

Revenue Smoothing Adjustment = (present growth – median growth) * GF * 50%
Revenue Smoothing Adjustment = (1% - 2%) * $100,000,000 * 50% = -$500,000

The negative number shows that this is a “bad” year, and thus money should be taken from the Revenue Smoothing Fund and transferred to the General Fund.

The transfer of $500,000 is less than 3% of the General Fund, so the full transfer is made.

Result

$500,000 is transferred from the Revenue Smoothing Fund to the General Fund for Year X.

Revenue Smoothing Fund FY 1998-2009 Hypothetical Performance (based on comparing GF to median of last ten years, transferring 50% of GF swings) 1/3/2011

Fiscal Year	General Fund	Population	Rev Per Capita	CPI (base yr 1989)	Inflation v. base year	Rev Per Capita Adj for CPI change	Increase In Per Capita Rev Adj for CPI	% Change adjusted for CPI/Pop	Median % Change adjusted for CPI/Pop for last 10 yrs	GOOD or BAD year?	Change to Fund (negative number means you transfer money to GF; positive number means you transfer money to RSF)
FY 88	$229,919,194										
FY 89	$238,156,687			128.30	1.0000						
FY 90	$252,320,093	429,321	$587.72	135.90	1.0592	554.85					
FY 91	$268,465,169	436,904	$614.47	141.40	1.1021	557.54	2.69	0.4852%			
FY 92	$286,544,697	441,527	$648.99	146.50	1.1419	568.36	10.82	1.9401%			
FY 93	$291,689,242	439,451	$663.76	150.30	1.1715	566.60	-1.76	-0.3096%			
FY 94	$290,812,455	438,132	$663.76	152.30	1.1871	559.16	-7.44	-1.3136%			
FY 95	$288,445,736	436,566	$660.72	154.60	1.2050	548.32	-10.84	-1.9389%			
FY 96*	$365,911,047	437,446	$836.47	157.50	1.2276	681.39	133.08	24.2699%			
FY 97	$303,827,877	439,945	$690.60	160.00	1.2471	553.78	-127.61	-18.7284%			
FY 98	$315,416,346	444,966	$708.85	162.30	1.2650	560.36	6.58	1.1881%			
FY 99	$334,268,359	451,399	$740.52	166.10	1.2946	571.99	11.64	2.0766%			
FY 00	$326,744,462	461,522	$707.97	171.60	1.3375	529.33	-42.67	-7.4591%			
FY 01	$341,788,075	467,058	$731.79	177.30	1.3819	529.55	0.22	0.0412%	0.0878%	BAD	-$79,732
FY 02	$368,054,363	472,717	$778.59	182.20	1.4201	548.26	18.72	3.5345%	-0.1342%	GOOD	$6,751,360
FY 03	$366,850,248	480,019	$764.24	187.00	1.4575	524.34	-23.92	-4.3629%	-0.1342%	BAD	-$7,756,510
FY 04	$366,955,924	485,633	$755.62	193.20	1.5058	501.79	-22.55	-4.3005%	-0.6362%	BAD	-$6,723,077
FY 05	$372,847,121	488,131	$763.83	201.80	1.5729	485.62	-16.17	-3.2224%	-0.9489%	BAD	-$4,238,462
FY 06	$368,175,489	488,335	$753.94	210.40	1.6399	459.75	-25.88	-5.3288%	-1.5906%	BAD	-$6,881,447
FY 07	$385,703,804	488,242	$789.98	217.34	1.6940	466.35	6.60	1.4359%	-3.7615%	GOOD	$10,023,268
FY 08	$401,015,177	489,090	$819.92	225.01	1.7538	467.52	1.17	0.2515%	-1.5906%	GOOD	$3,693,644
FY 09		490,882		223.22	1.7398						
Total	$6,763,911,565										

[1] Fiscal Years 1988-1997 from Resource Allocation Plans ; Fiscal Years 1998 - 2008 from Famis.

[2] Includes 15 months as a transition period that moves the beginning of the fiscal year from July 1 to

Note: Chart revised from FM chart for previous proposal