# City of Garden Grove
# Financial Sustainability Project

**Presentation to City Council**

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Management Partners

July 10, 2018

Management Partners

GARDEN GROVE

# Management Partners Serves Only Local Government Clients Nationwide, Including California's Largest Cities

**20+** years of service exclusively to local governments

Over **1,500** projects successfully completed in 42 states

**80+** associates including generalists and subject-matter experts

**3** national offices in Costa Mesa and San Jose, CA and Cincinnati, OH

Served **80%** of California cities with more than 100,000 people

**Services**

- Operations Improvement
- Strategic Planning
- Service Sharing
- Financial Planning/Budgeting
- Organization Analysis
- Organization Development
- Performance Management
- Process Improvement
- Facilitation and Training
- Executive Recruitment
- Executive Coaching

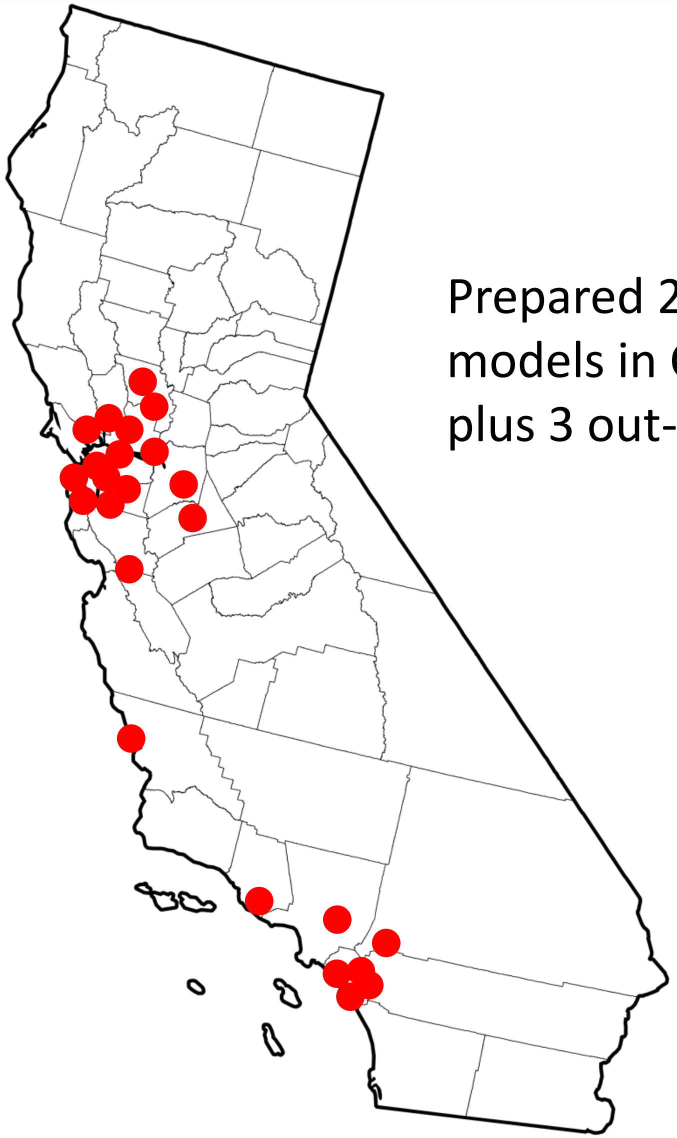
Experienced helping many California cities facing fiscal challenges including: Fremont, Hayward, Long Beach, Oxnard, Sacramento, San Jose, Stockton, San Bernardino, Santa Ana and Tracy

# Budget Goals & Purpose of Presentation

- Maintain core city services Garden Grove residents expect and deserve for their quality of life, including:
  - Maintaining 9-1-1 emergency response times
  - Police and fire protection by maintaining staffing levels
  - Protecting local infrastructure, including streets and drinking water supplies
- Properly prepare for the City's long-term financial viability, including exploring options for locally-controlled funding
- Provide careful and transparent models for the City Council's long-term budgeting

# Over Two Dozen Financial Forecasts Prepared in California During Past Four Years

- Management Partners provides outside third party perspective; a "second opinion"
- Extensive experience with budget modeling and forecasting
  - 27 local agencies, 2 bankruptcies
- Prepare 20-year budget forecast model to serve as basis for future budget strategies
  - Focus on General Purpose Fund
- Capability to run alternative forecast assumptions, cost out labor proposals
- City owns the model



Prepared 24 budget models in California, plus 3 out-of-state

# Last Eight Budgets Have Projected a Structural Shortfall

- Deficit avoided to date due to:
  - High employee vacancy rates
  - $14.5M shifted from ISFs from FY09-10 through FY16-17
  - Faster recovery from recession than expected, stronger hotel tax
- City is rightfully concerned about sustainability of lost funding due to state takeaways, unmet infrastructure needs, lower revenue growth rates, and higher PERS costs

PROJECTED SOURCES & USES OF
BASIC FUNDS
FISCAL YEAR 2017-18 THROUGH 2021-22
(In Thousands of Dollars)

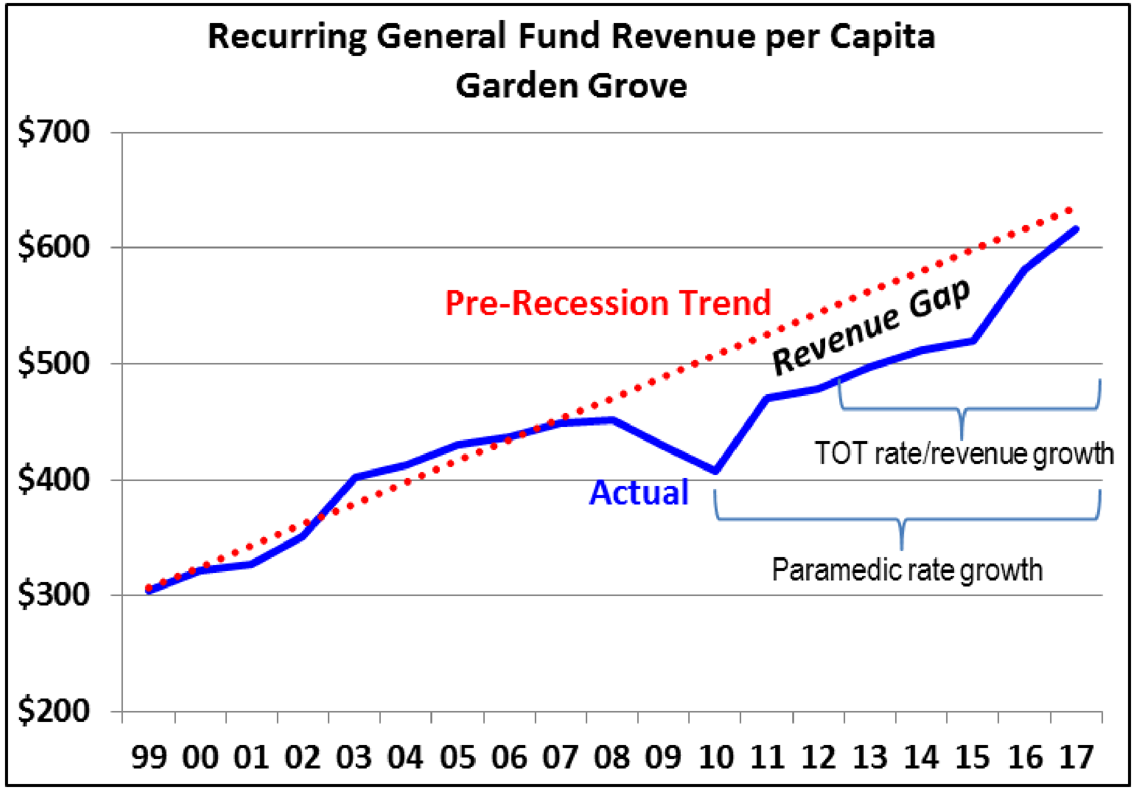
| | 2017-18 (Budget) | 2018-19 (Budget) | 2019-20 (Projected) | 2020-21 (Projected) | 2021-22 (Projected) |
|---|---|---|---|---|---|
| Sources | | | | | |
| Reserve | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Transfers/Carryovers | 5,484 ① | 3,094 | 1,037 | 558 | 584 |
| Beginning Balance | 12,229 | 12,171 | 12,969 | 11,969 | 10,969 |
| Estimated Revenue | 118,591 | 122,198 | 124,694 | 127,555 | 127,266 |
| Total Sources of Funds | 136,304 | 137,463 | 138,700 | 140,082 | 138,819 |
| Uses | | | | | |
| Operations | 118,054 ② | 122,104 | 128,576 | 132,047 | 134,688 |
| Capital Improvements | 5,531 | 5,100 | 5,654 ④ | 5,939 ④ | 5,480 |
| Contingency Reserve | 0 | 0 | 0 | 0 | 0 |
| Total Uses of Funds | 123,585 | 127,204 | 134,230 | 137,986 | 140,168 |
| EST. BALANCE (Deficit) | 12,719 | 10,259 | 4,470 | 2,096 | (1,349) |
| Less: Restricted Balance | (12,285) | (12,969) | (11,969) | (10,969) | (9,969) |
| Less: Assigned Fund Bal. (Excess Para. Tax Rev.) | (285) | (504) | 0 | 0 | 0 |
| Balancing Measures | 0 | 3,300 ③ | 7,499 ③ | 8,873 ③ | 11,318 |
| NET BALANCE | 49 | 86 | 0 | 0 | 0 |

# Budget Challenges Typically Facing Cities

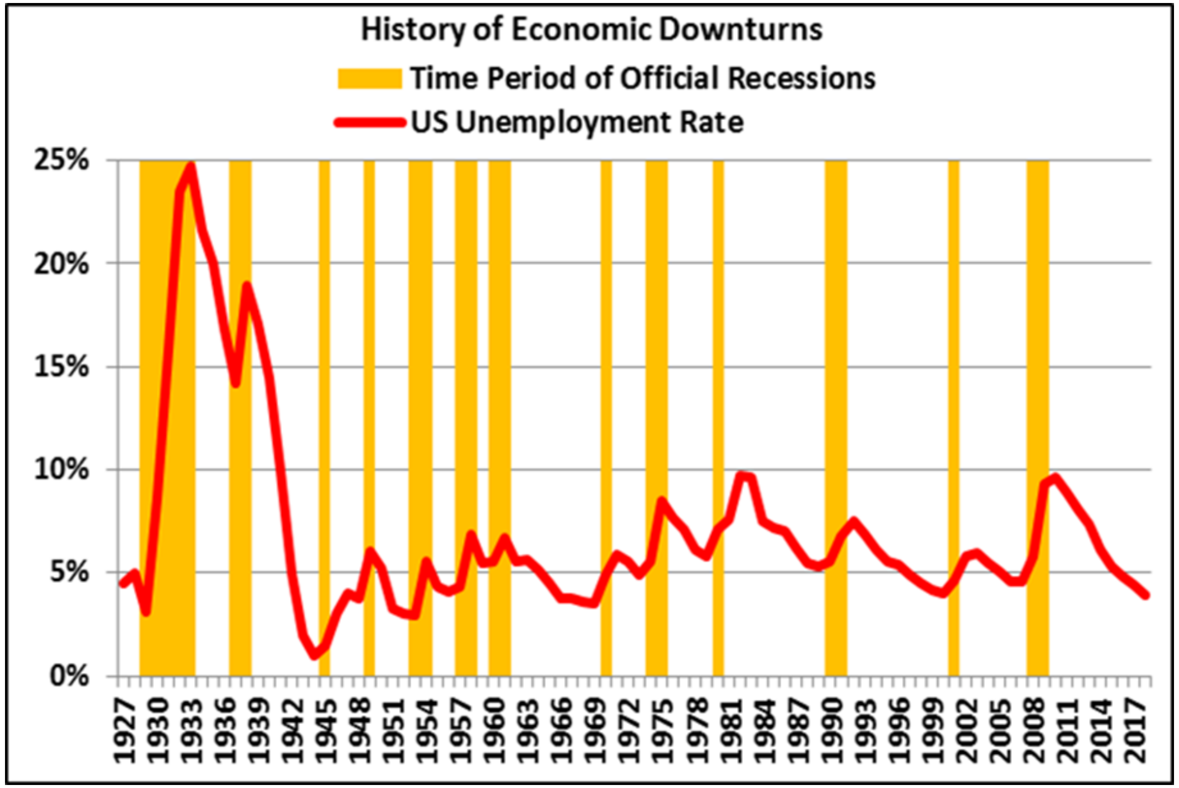
- Persistent revenue gap
- Future recessions
- Significant staffing reduction
- State's early prison release policies
- Labor market pressures
- Inadequate infrastructure maintenance
- Internal service needs
- Restore/maintain reserve levels
- Large pension cost increases

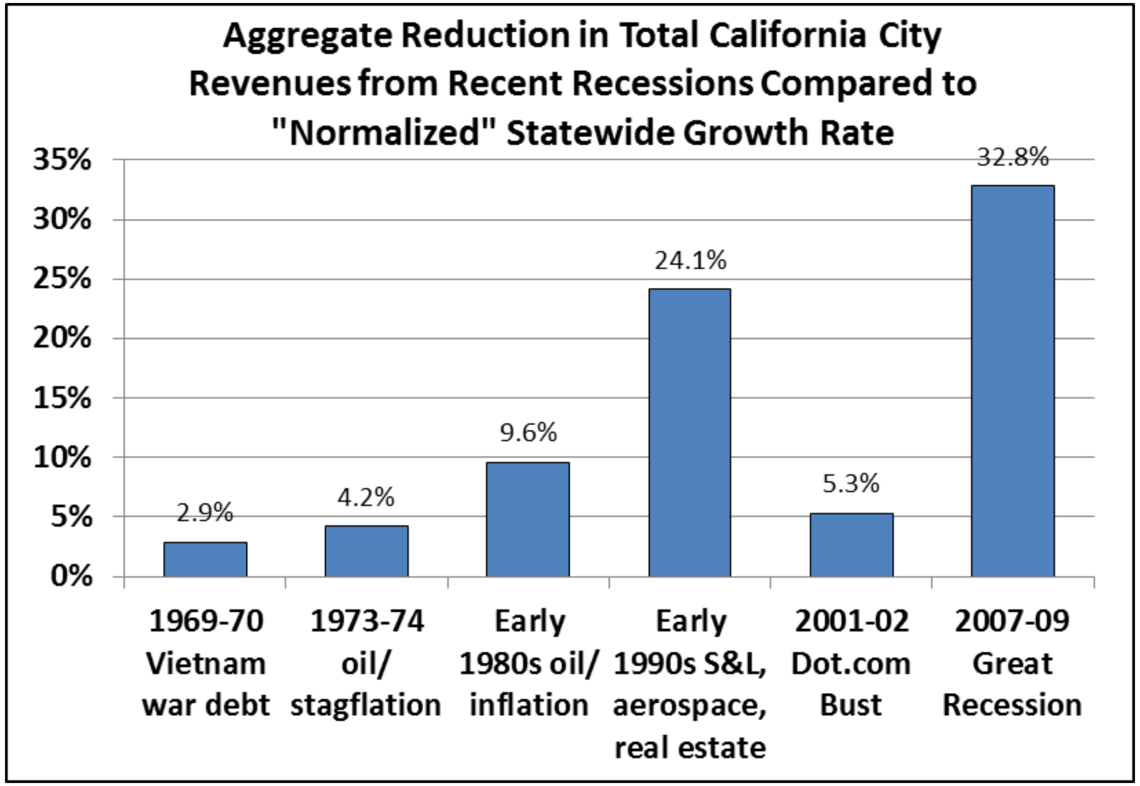
# Revenue Gap Closing

- In general, cities have not recovered from Great Recession revenue losses
- Large gap typically exists between past expectations and current reality
- Without cuts, spending was on track to continue on pre-recession trend line
  - Garden Grove is closing this revenue gap (but expenditures still growing faster than revenues)



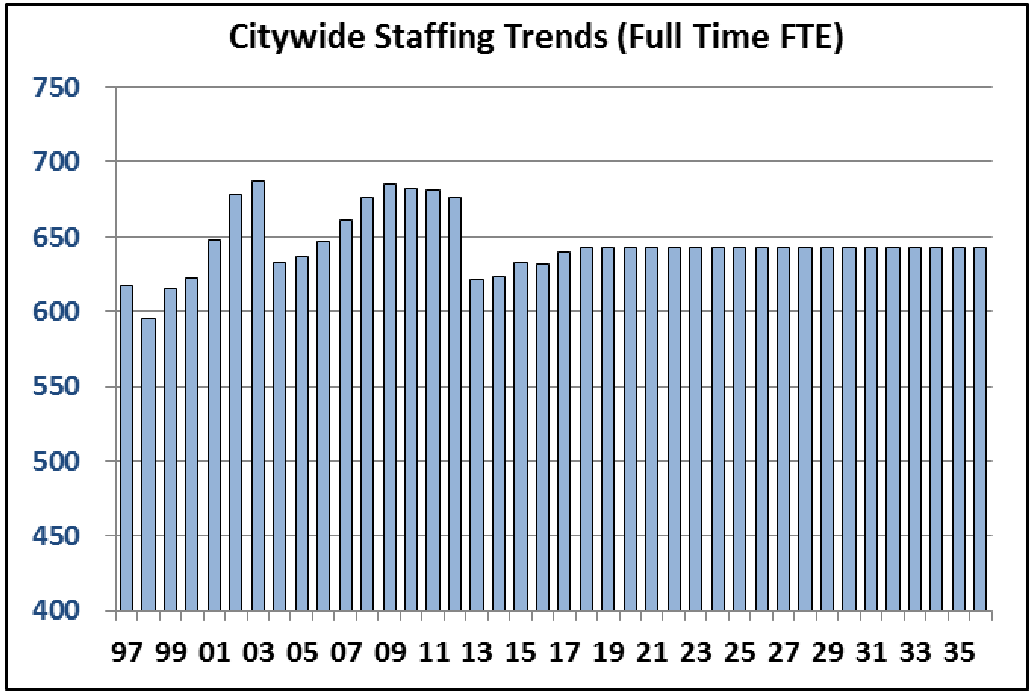
# The Next Recession



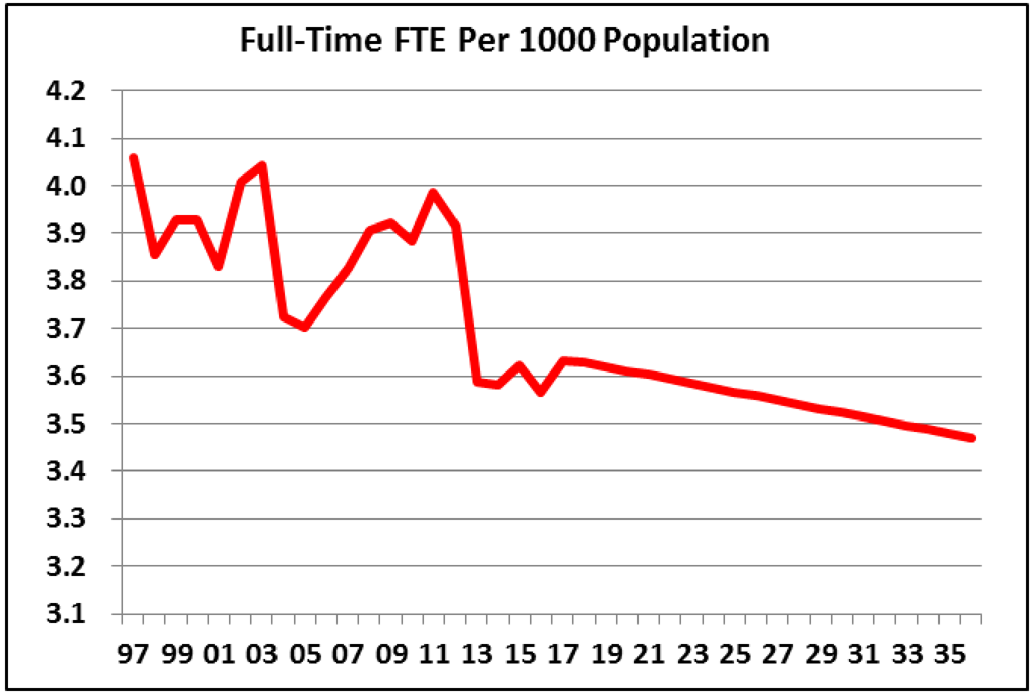




- Recessions have occurred an average of every 6.8 years since 1927; city budget impacts often lag official recessions
- Causes vary but key issues are timing and magnitude
- Model assumes modest recessions every seven years starting FY 2020-21

# Staffing Levels Lower Post-Recession

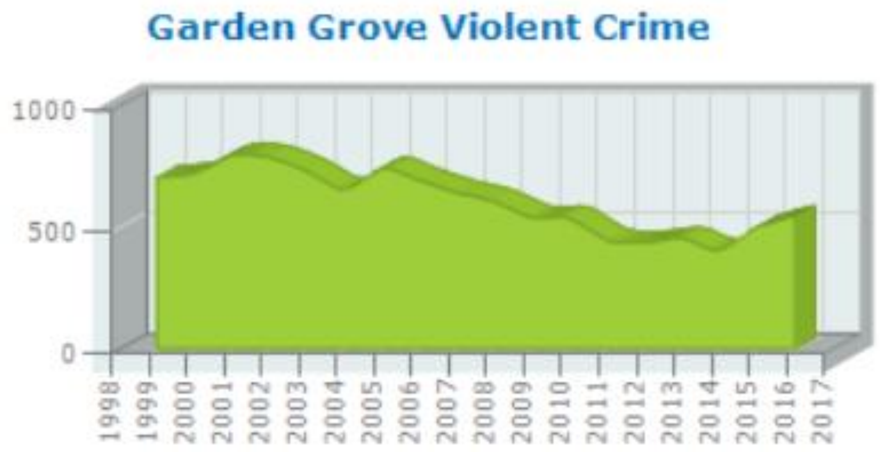



- 64 FTE cut from pre-recession peak (9% cut)
- 19 FTE added back since then (30% of loss restored)

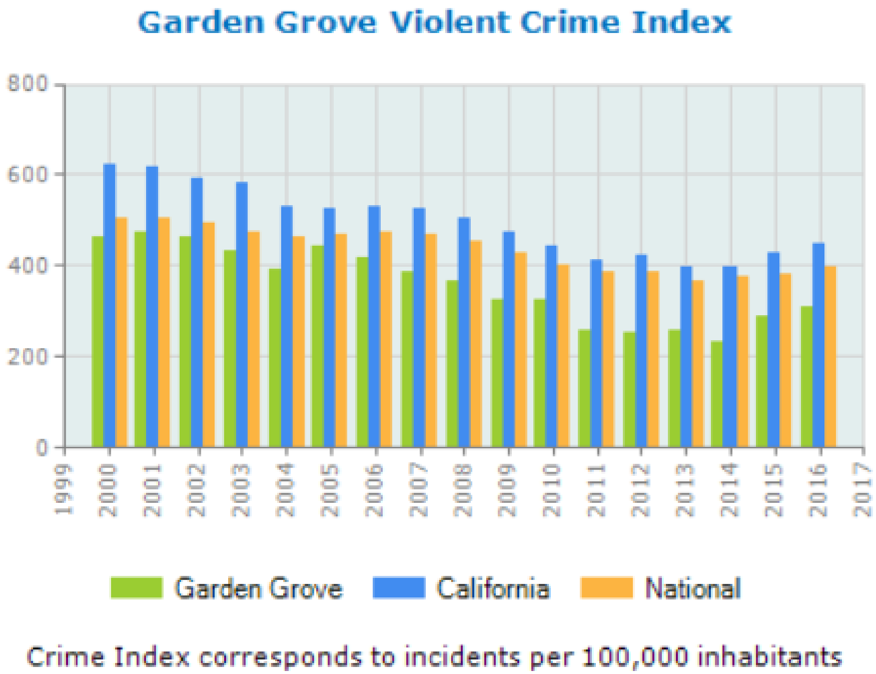


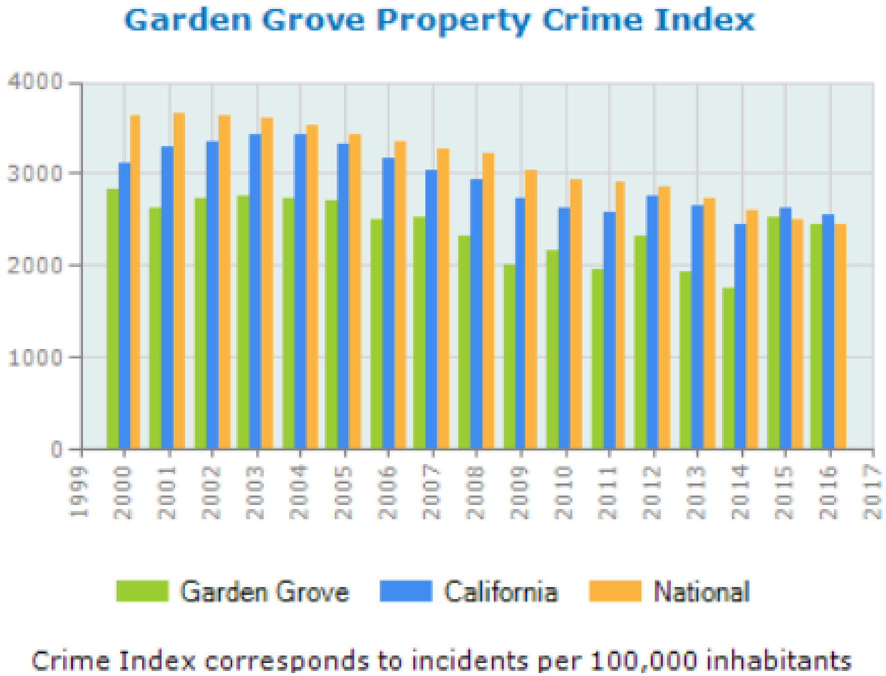

- Long-term decline in staffing per capita will continue if staffing is held constant
- Implications for handling population and workload growth

# Garden Grove Crime Statistics

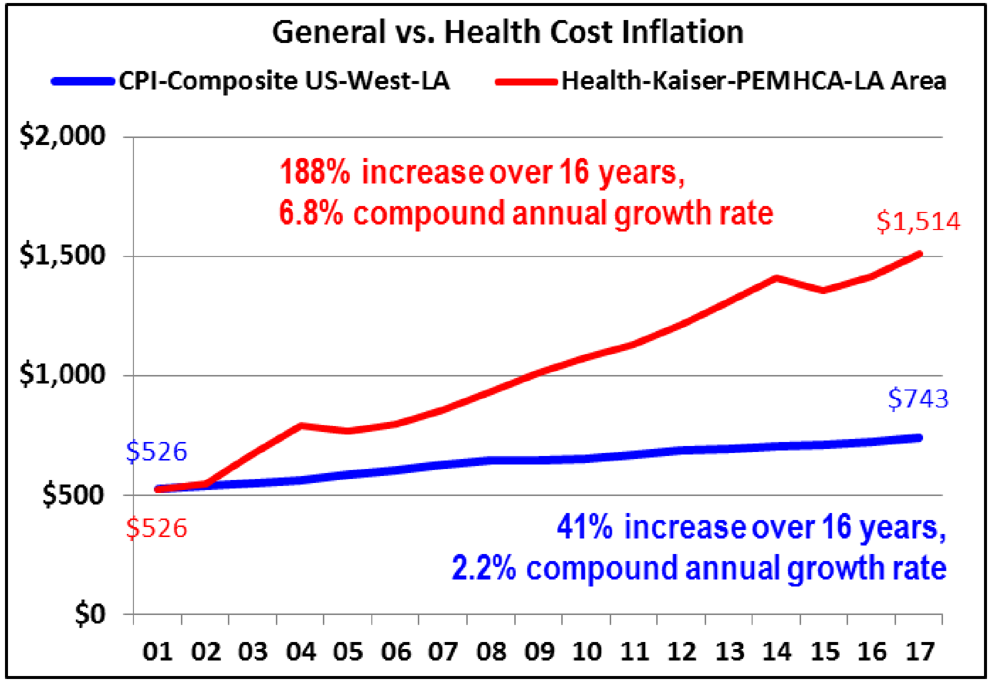






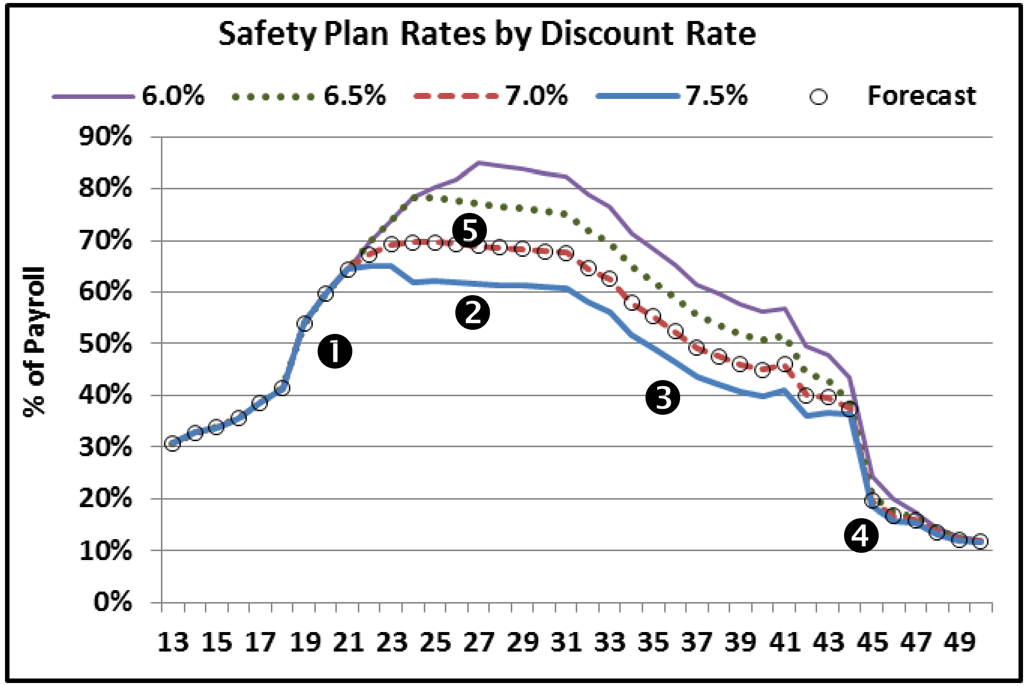
# Wage and Health Cost Pressures

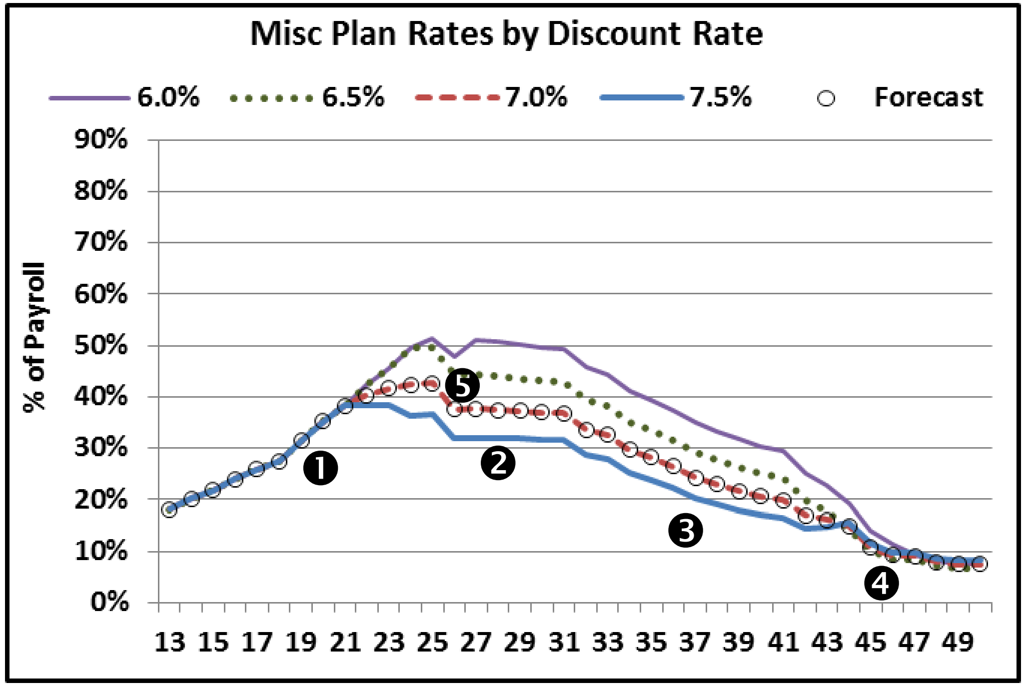




- Wage gap since end of Great Recession
- Lower PEPRA benefits add pressure to boost wages to compensate (Public Employees' Pension Reform Act in 2013 lowered benefit levels for new hires)

- Health premium costs grew at 6.8% annual rate in region over last 16 years
- General inflation annual growth rate of 2.2% (composite rate)

# Garden Grove Pension Rate Life Cycle




1. Planned rate increases through 2023 due to phase-in of CalPERS rate structure changes
2. PEPRA savings as new employees receive lower benefits (2013 to 2043)
3. Amortization of unfunded liability (most evident in 2030s and 2040s)
4. Normal costs are all that remain after unfunded liability is paid off
5. Discount rate recently reduced to 7%, total impact phased in over 7 years; forecast assumes discount rate stays at 7%; risk is that discount rate will drop further

# Model is Valuable Tool in Budget Process

- **Long-Range Forecast**
  - Identifies demand on available resources over long-term (10-20 years), under given set of assumptions
    - Different assumptions = different forecast
    - Current draft model may change!
    - Facilitates development of budget parameters
    - Not a replacement for budget, which sets detailed spending priorities

- **Budget Model**
  - Valuable tool for preparing the forecast – spreadsheet on steroids
    - Can produce many alternate forecasts and “what-if” scenarios
    - Helps cost out labor negotiating proposals
    - Use in public meetings to show impacts on long-term fiscal sustainability

# Key Budget Model Features-I

- **General**
  - Account level detail of revenues, expenditures and fund balance from prior years
  - Adjustable growth rates for each revenue and expenditure category
  - Control panel allows easy revision of key variables
  - Visual dashboard of over 40 charts change as variables are revised
- **Revenues**
  - Detailed basis for property and sales taxes
  - Adjust timing and magnitude of recessions
  - Impact of adding new revenues, or expiration of current sources
  - Adjust levels of projected new housing, hotels or other economic development

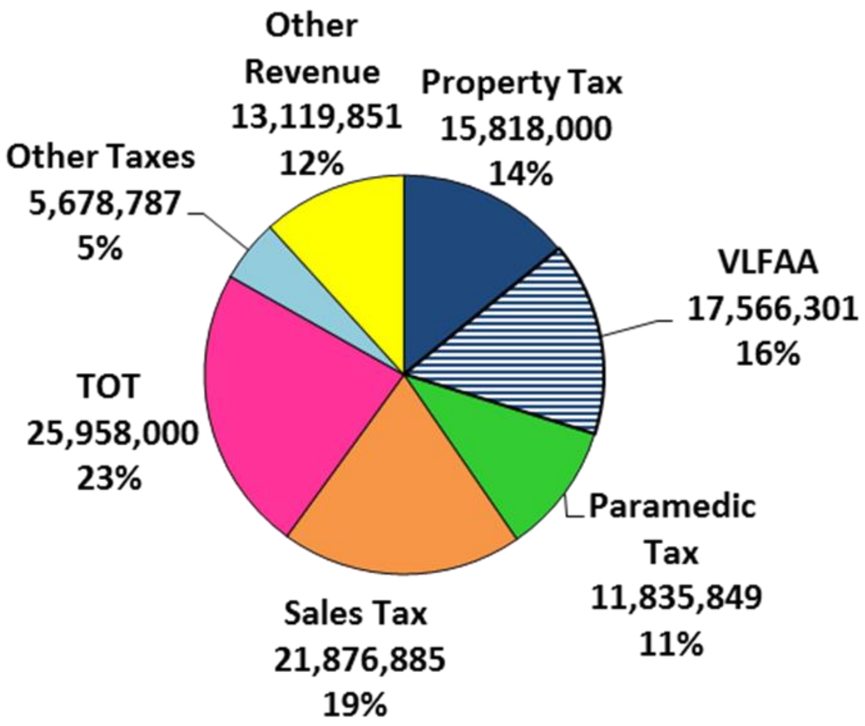
# Key Budget Model Features-II

- **Payroll Model**
  - Details costs for all current employees/authorized positions
  - Make changes by labor unit (COLAs, health, PERS cost-sharing)
  - Includes merit increases, and projected savings based on historical turnover rates
  - Can model impacts of cuts through attrition
- **Pension Model**
  - Long-range projections of normal costs and each UAL amortization base for all plans and tiers, based on latest CalPERS valuation
  - Shows impact of lower discount rates
- **Service Levels**
  - Add/reduce FTE or spending levels to show impact of unmet needs or budget cuts

# Key Revenue Assumptions

- **Recessions**: modest economic downturn every seven years starting FY 2020-21
- **Property Tax**: HdL data on transfers/Prop 8, city projection of new construction, 2% inflator; 3.1% compound annual growth rate (CAGR)
- **Paramedic**: Rate remains at $0.08 per $100 AV
- **Sales Tax**: HdL forecast by business sector through FY 2019-20; 1.7% CAGR
- **TOT**: 3.0% CAGR; includes site C and BN group projects (893 new hotel rooms by 2023)
- **All Other**: 1.1% CAGR

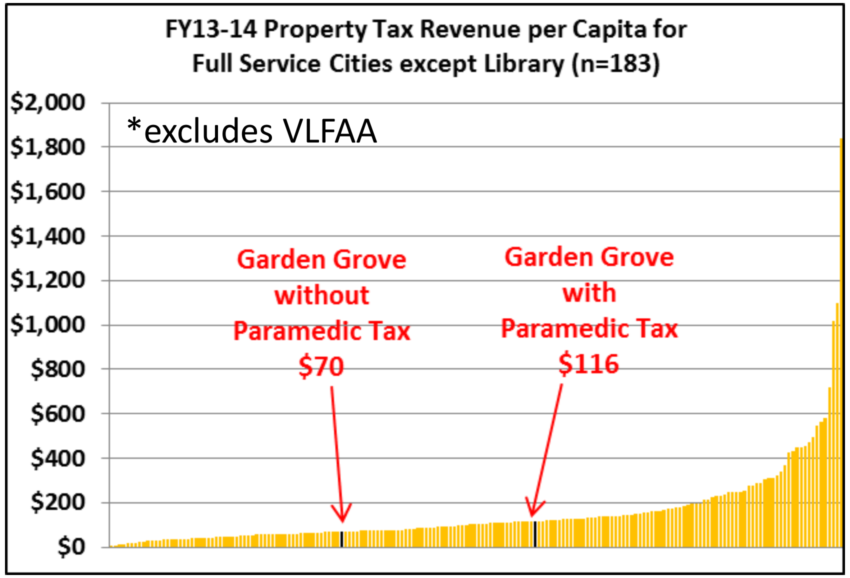
FY 18-19 Total Revenue
Fund 111-General Purpose



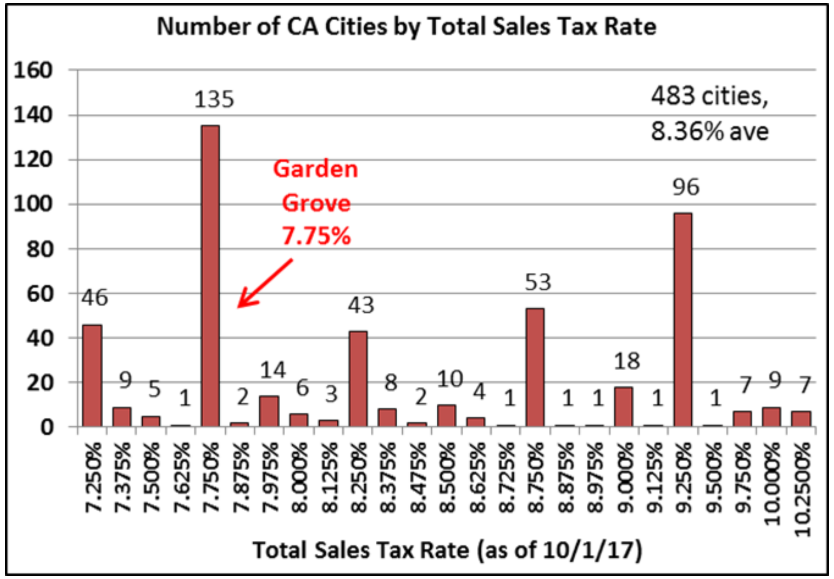

**Total: $111,853,673**

# City Tax Levels

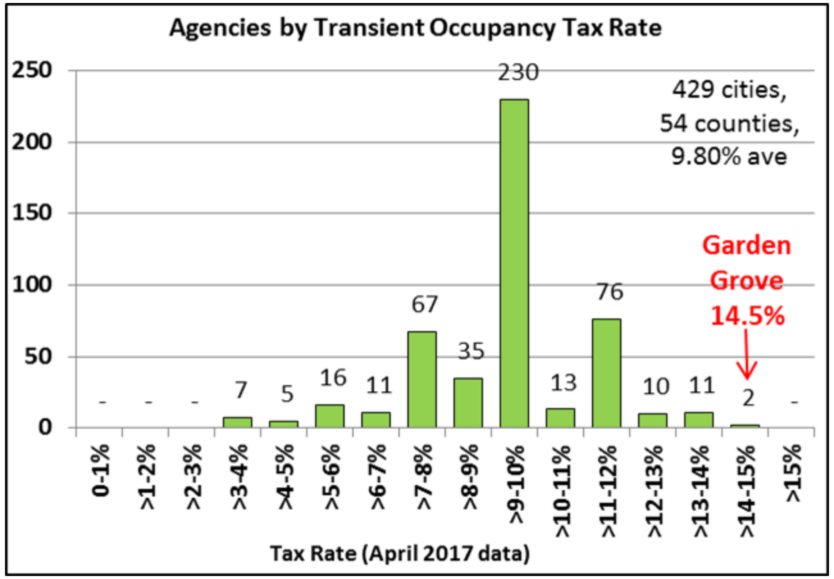
## PROPERTY TAX*




## SALES TAX



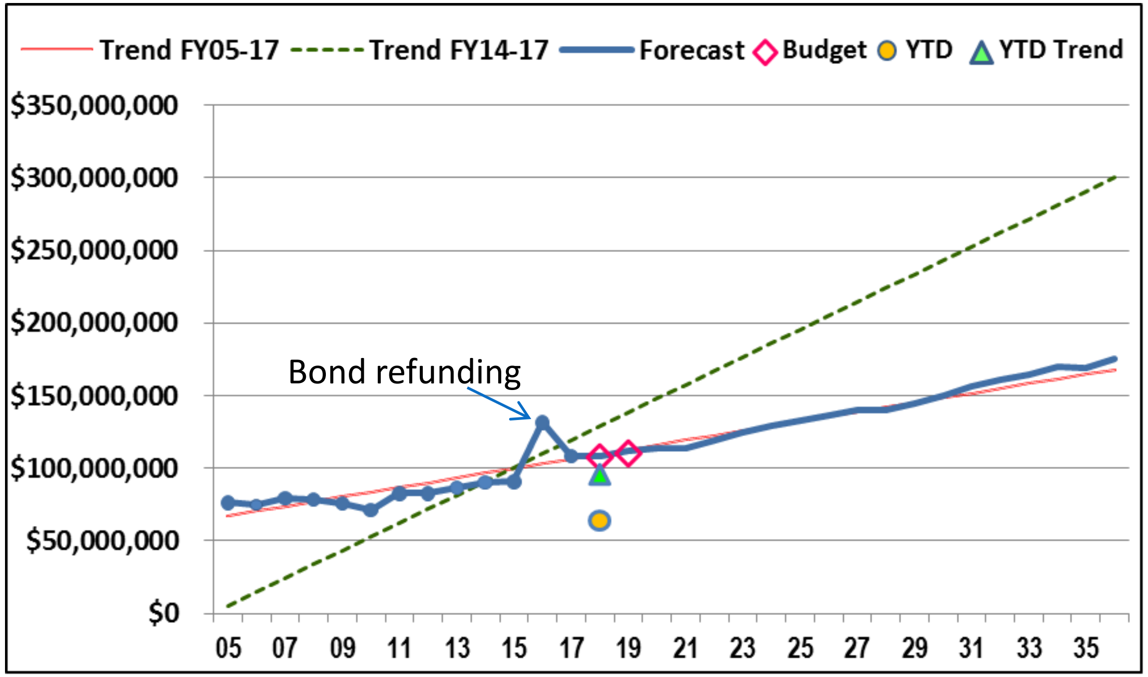

## HOTEL TAX

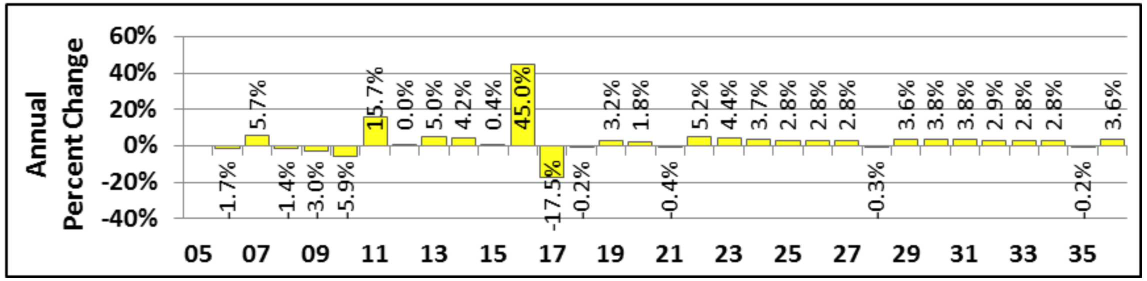



- Statewide tax rate is 1% but city shares vary based on services offered and other factors; City is low without Paramedic Tax
- Numerous voter-approved local sales taxes have created wide range of rates statewide; most of Orange County is at 7.75%
- Hotel tax typically paid by visitors; City's rate is high but market allows it

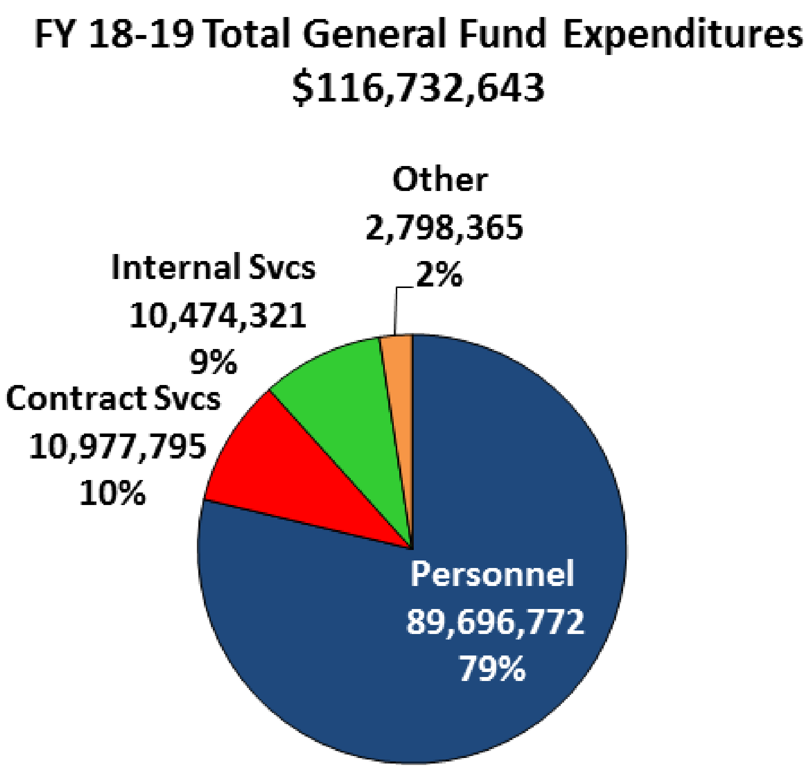
# Total Revenue Growth

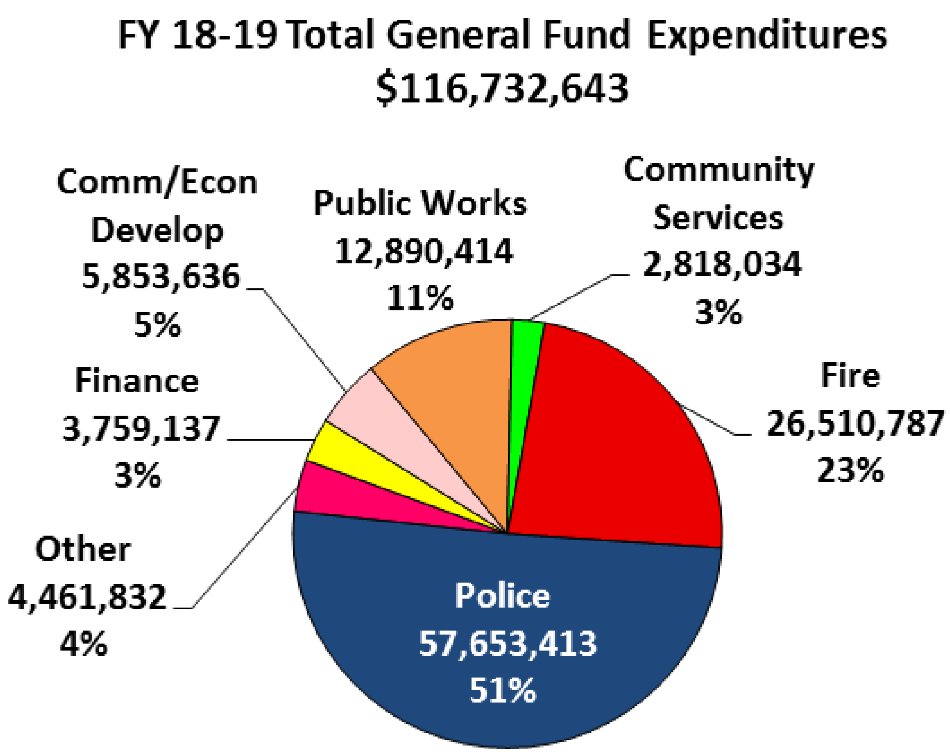
- Recent trend (green) reflects post-recession recovery period; this growth rate won't continue
- Long-term trend (red) includes past economic downturns
- Past: revenue growth was a compound annual growth rate (CAGR) of 2.97%, including higher TOT and paramedic rates enacted during that period
- Future: CAGR from FY 2016-17 to FY 2035-36 is 2.56%; includes new hotels; consistent with long-term trend
- Basic message: it is wishful thinking that revenue growth alone can solve the structural shortfall



# Expenditures by Type and Department
## (Before Proposed 5% Cuts)



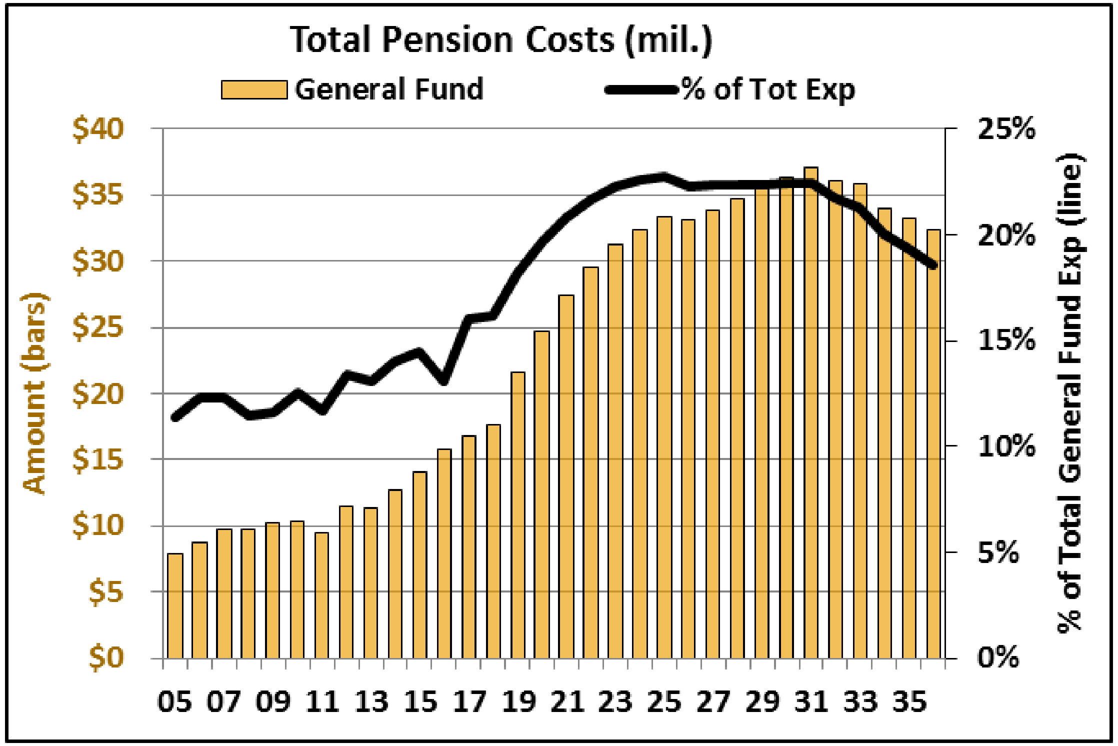



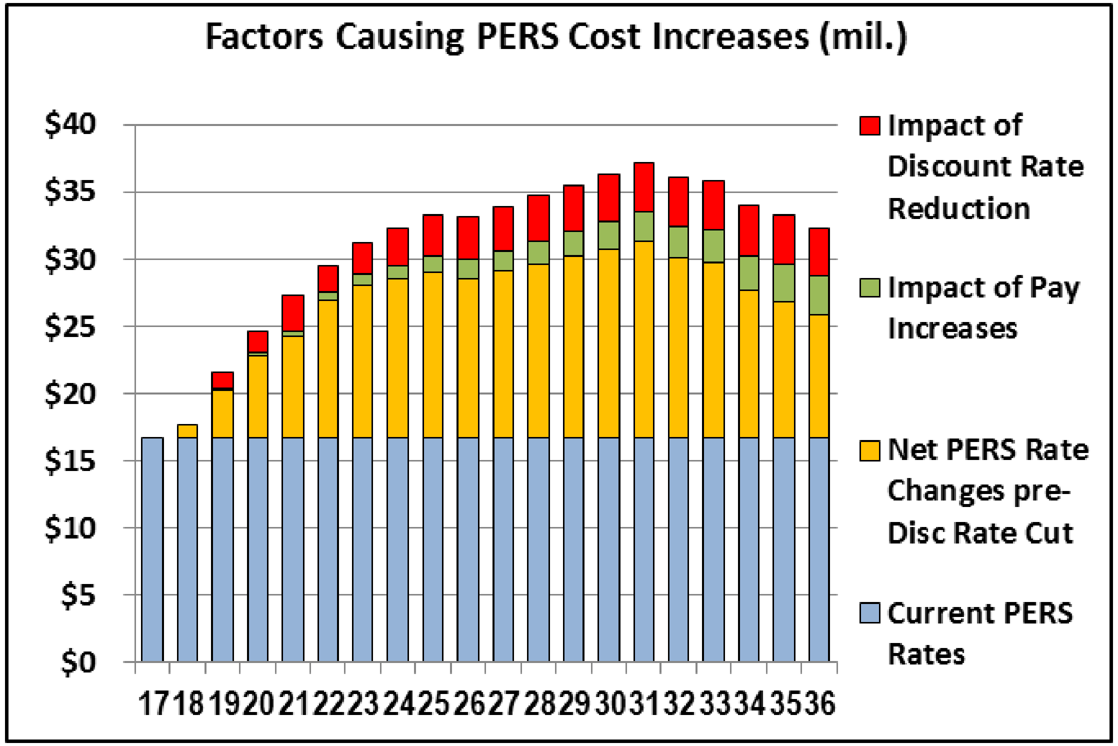

- Over three-quarters of costs involve personnel (79%)
- Almost three-quarters of costs are for public safety (74%)

# Key Expenditure Assumptions

- **Staffing levels**: no change from current FTE
- **Wage Adjustments**: current MOUs through FY 2017-18, assumes 2% growth but this will depend on future MOUs; combination of merit increases and turnover savings adds net 0.25% per year (5% turnover rate is low); vacancy savings rate drops from current 7% to 3% over 3 years; forecast is lower that the CalPERS assumption of 3% growth in payroll
- **Pensions**: based on six-year CalPERS forecast (2016 valuation) with continued transition of employees from Classic to PEPRA benefit levels; assumes discount rate remains at 7%
- **Health**: assumes 3% growth but will depend on future MOUs
- **Other Services and Supplies**: averages 2% annual growth
- **5% Cut**: assumes this is one-time in FY2018-19
- **Debt Service**: per debt schedules of current obligations
- **Capital**: pays for Community Services and Facility Maintenance Plan from CIP; assumes street costs covered by Gas Tax under SB 1 and Measure M
- **Subsidy of Other Funds**: as required to maintain zero balances

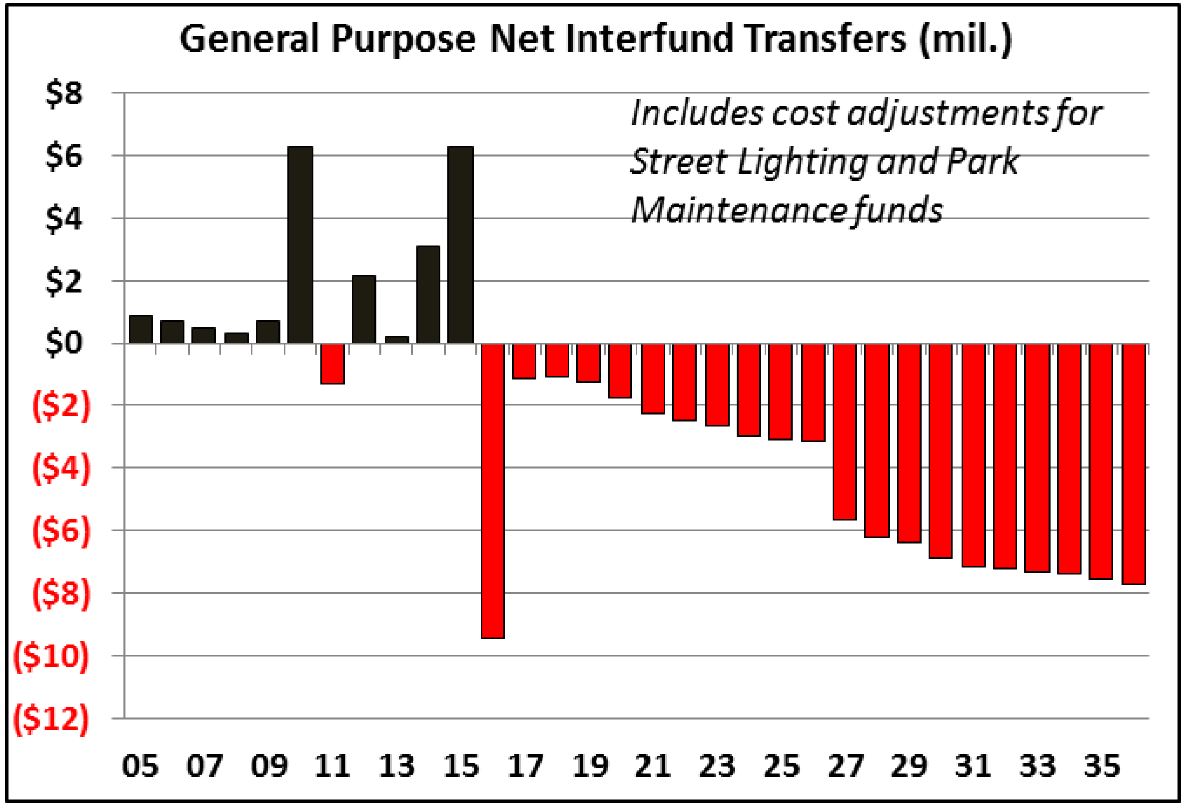
# Evolution of Pension Costs



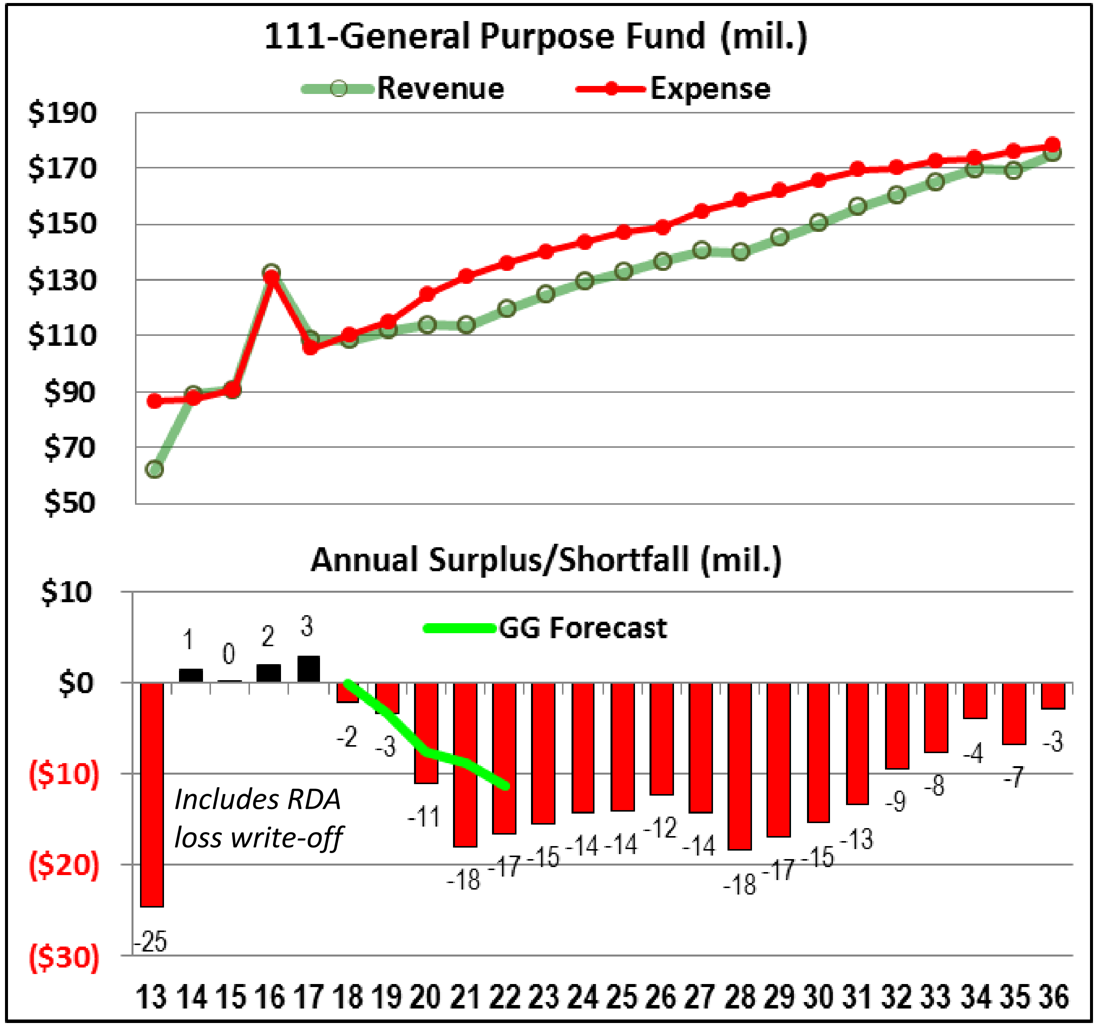

- Costs double in 10 years; pensions peak at 23% of GF expense; costs continue to rise until FY 2030-31; assumes discount rate remains at 7%
- Shows portion of increase attributable to planned increases, COLAs, and impact of discount rate reduction from 7.5% to 7%

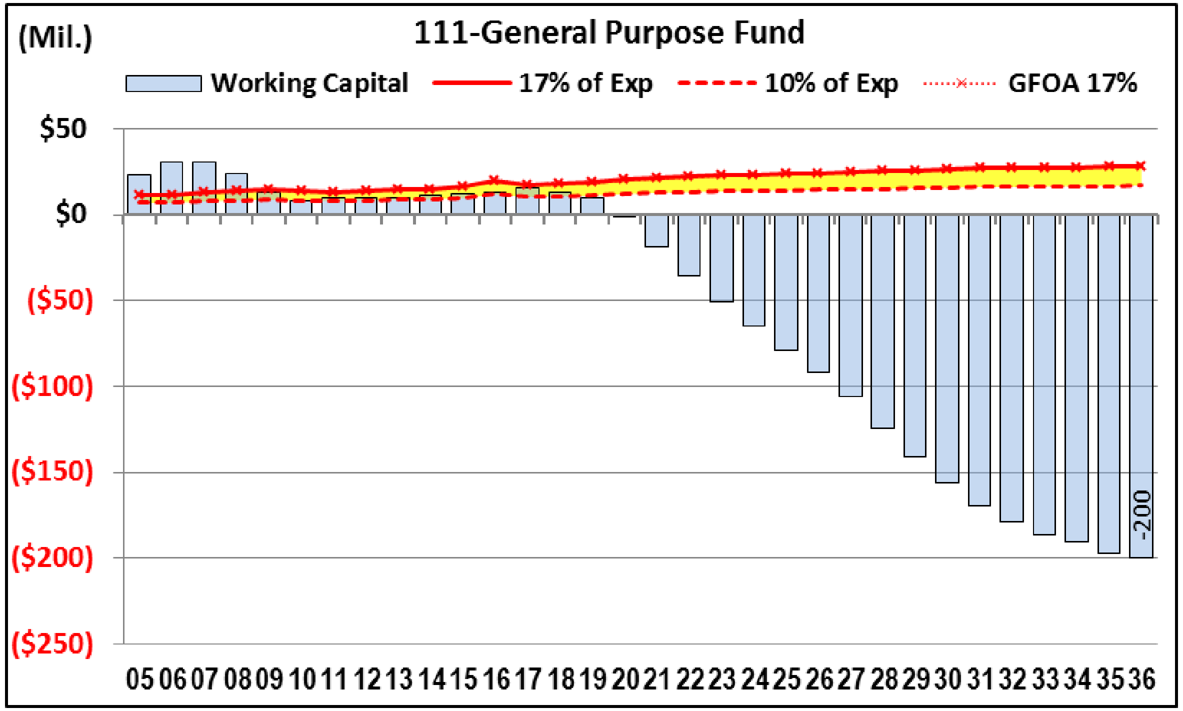
# In Future, Transfers Out Will Exceed Transfers In




- **Past**: Net Gain, especially post-recession
  - Transfers In from Golf, RDA, Fleet, Risk Mgmt, Workers Comp, Employee Benefits, Partnerships, Development Agreement; these will not be continued
  - GF paid part of utility/other costs of Street Lighting and Park Maintenance ($340K average over past 10 years)
  - $178K average paid to "self-supporting revenue" fund (20% of costs)
  - One-time $8M to Public Safety fund (bond refinancing savings)
- **Future**: Net Draw on General Fund
  - Street Lighting, Park Maintenance, Cable TV, Self-Supporting Revenue, Gas Tax (staff costs will exceed revenues), Risk Mgmt, Info Systems, Econ Development, TID Transit

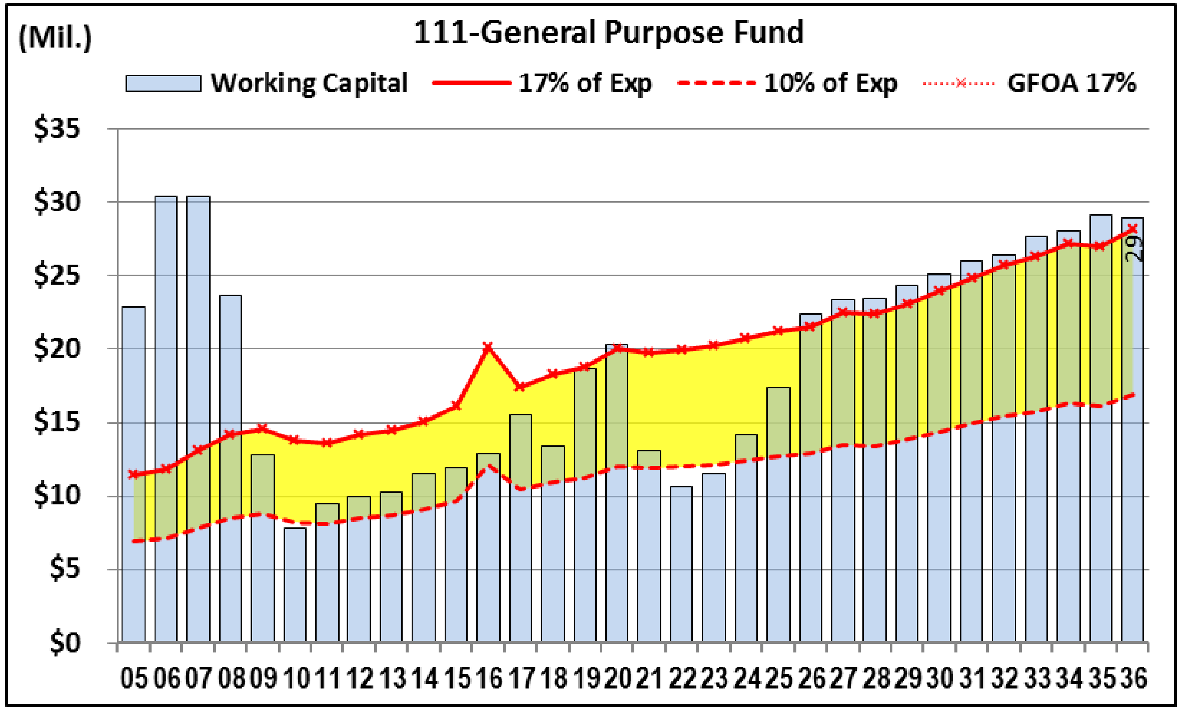
# General Purpose Shortfall Before Budget Corrections

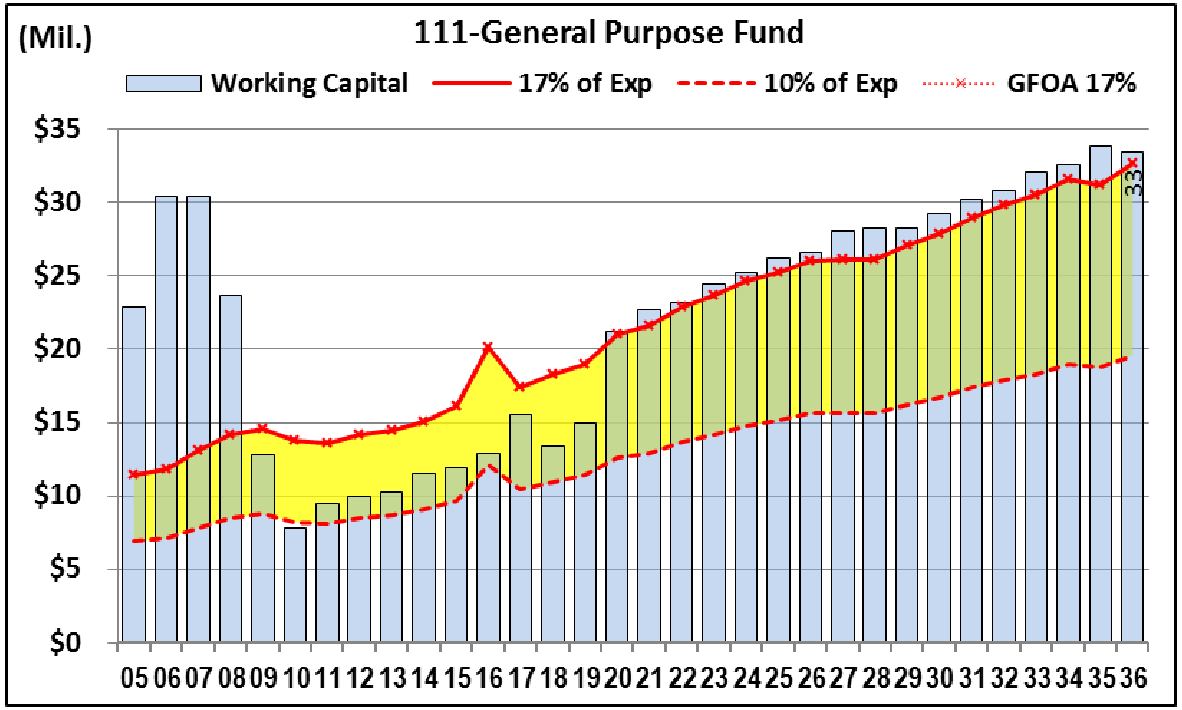



- Shortfall similar to City forecast through FY 2019-20, higher thereafter due to recessions, higher PERS cost, projected transfers; deficit reached in FY 2019-20 at projected use of reserves; rate of decline slows in 2030s

# Alternative Scenarios Can Achieve Sustainable Budget




- Cut 60% of positions vacated through attrition starting FY2019-20 for three years; $5M added cuts starting FY 2020-21; no COLAs until FY 2022-23; partial service restoration starting FY 2029-30

- Voters approve a 1-cent local funding measure; no budget cuts required; added funding allows for service improvements and improved maintenance of infrastructure starting FY2019-20

# Status of Other Key Funds

| Fund | Status | Trend Summary |
|---|---|---|
| 060-Gas Tax 2106-07 | Warning | Annual deficits will need $400K/year by mid-2020s as staff cost exceeds Gas Tax |
| 108-Land Sale Proceeds | Favorable | Balance of $9M held for specific projects |
| 117-Golf Course | Warning | Course losing money; balance can be used for maintenance/rehab |
| 118-Self-Support Rev | Unfavorable | Requires $300K ongoing subsidy (31% of annual cost) |
| 150-Cable TV | Unfavorable | Requires $400K ongoing subsidy (82% of annual cost) |
| 530-Street Lighting | Unfavorable | Requires $300K ongoing subsidy (17% of annual cost) |
| 535-Park Maintenance | Unfavorable | Requires $320K ongoing subsidy (32% of annual cost) |
| 783-Info Systems | Warning | Running annual deficits, will need $300K annual subsidy by late 2020s |
| 784-Workers' Comp | Warning | Running annual deficits, will deplete reserve post-2036 |
| 785-Fleet Management | Favorable | Balance of $27M working capital, $19M of which belongs to General Purpose Fund |
| 788-Telecommunication | Favorable | Balance of $1.8M; may require more for future capital needs |
| 789-Risk Management | Warning | Balance depleted by mid-2020s, requires $2.8M annual subsidy |
| 790-Communications | Warning | Balance insufficient to replace assets over time |

# Alternative Forecast Outcomes

## Potential Outcomes that Would Improve Forecast

- Higher employee vacancy rates (more vacant positions or vacancies for longer periods of time)
- Delayed or weaker recessions
- PERS investment gains
- Voters approve a local funding measure
- Stronger economic development than already included in forecast

## Potential Outcomes that Would Worsen Forecast

- PERS investment losses
  (or additional discount rate cuts)
- Weaker revenue growth, fewer new hotel rooms, or more severe recession losses
- Higher annual COLAs approved than the 2% in forecast
- Staffing levels increased beyond current levels
- Extreme events

# Conclusions

- As with many cities, Garden Grove faces significant long-term budget challenges
- These challenges will begin to threaten the City's ability to continue providing services at current levels
- Current budget challenges require either significant cuts to key services, such as public safety, or additional locally-controlled revenues that are not subject to state takeaways
- Developing reliable budget models and strategies will help to preserve the City's flexibility and ability to provide services
- Strategies need to be developed in light of the City's community engagement efforts and the prioritization of key services it identifies

# For More Information

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