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A Fiscal Analysis of the City of Solana Beach

Solana Beach — Financial Storm Clouds Ahead

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By

TaxpayersAdvocate.org

www.taxpayersadvocate.org

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“...small cities such as Solana Beach are considered today on the “endangered list.” There is a real and rational concern throughout the county, among city management and civic leaders, as to whether or not small cities will be able to survive the competition for finances, resources, and the lure of the “large pockets” found among large cities and counties.”

Mayor David Powell, State of the City Address, June 21, 2006

Key Findings

- **In general, the City is currently in average to good financial condition**
- **However, the City is facing projected revenue shortfalls by 2010**
- **In the future, the City must increase revenue sources or make cuts in services**
- **The City faces two significant legal issues which could have significant financial impacts on future budgets: the settlement requiring the replacement of 13 low/moderate income housing units and the City’s Clean Water fee litigation filed by the Howard Jarvis Taxpayers Association, which could impact approximately \$190,000 in annual funds. A mail vote to determine the fate of this fee will be held in September.**
- **General Fund debt is low.**
- **Existing Redevelopment Agency Revenues are already allocated, so additional development projects are needed to generate new revenues.**
- **Future capital needs are significant, and for the most part have identified funding sources. However, a shortfall of approximately \$2.5 million can be adequately handled only with new general and redevelopment funds. In addition, construction funding for the Highway 101 Street Scaping/Traffic Calming project, estimated at \$10 to \$12 million has not yet been identified.**
- **The City of Solana Beach has historically been remarkably successful at generating outside grant funding for large capital projects, primarily in the rail corridor/rail station. Given current state and federal funding constraints, it is apparent that Solana Beach must use mostly local funding sources for future needs.**

Executive Summary

Like many municipalities in California, the City of Solana Beach is facing potential service cuts in the near future. These tough decisions facing the City are in spite of generally excellent economic conditions with significant growth in most revenue categories. While Solana Beach is in much better financial condition than two recent cities studied by TaxpayersAdvocate.org (Del Mar and Chula Vista, which are facing severe, self-inflicted financial crises) there are looming fiscal storm clouds which Solana Beach must address.

To address these issues, Solana Beach will be faced with the following options:

- Make cuts in programs, staff or both
- Raise taxes
- Generate additional revenues through private development

Actions

The city should focus on the following:

Slow down rapidly increasing costs for public safety services. Consider creation of a municipal police department in collaboration with other coastal municipalities, and expand cross jurisdictional management (and possibly merging) fire and lifeguard services with other coastal municipalities.

Enhance revenues by approving planned Highway 101 area developments inside and outside the redevelopment area and focusing on ways to increase business (especially retail/restaurant and hotel product).

Note: This report is an overview of Solana Beach's financial history and condition, not a detailed department-by-department review of spending practices or revenue categories.

Solana Beach-- Financial Storm Clouds Ahead

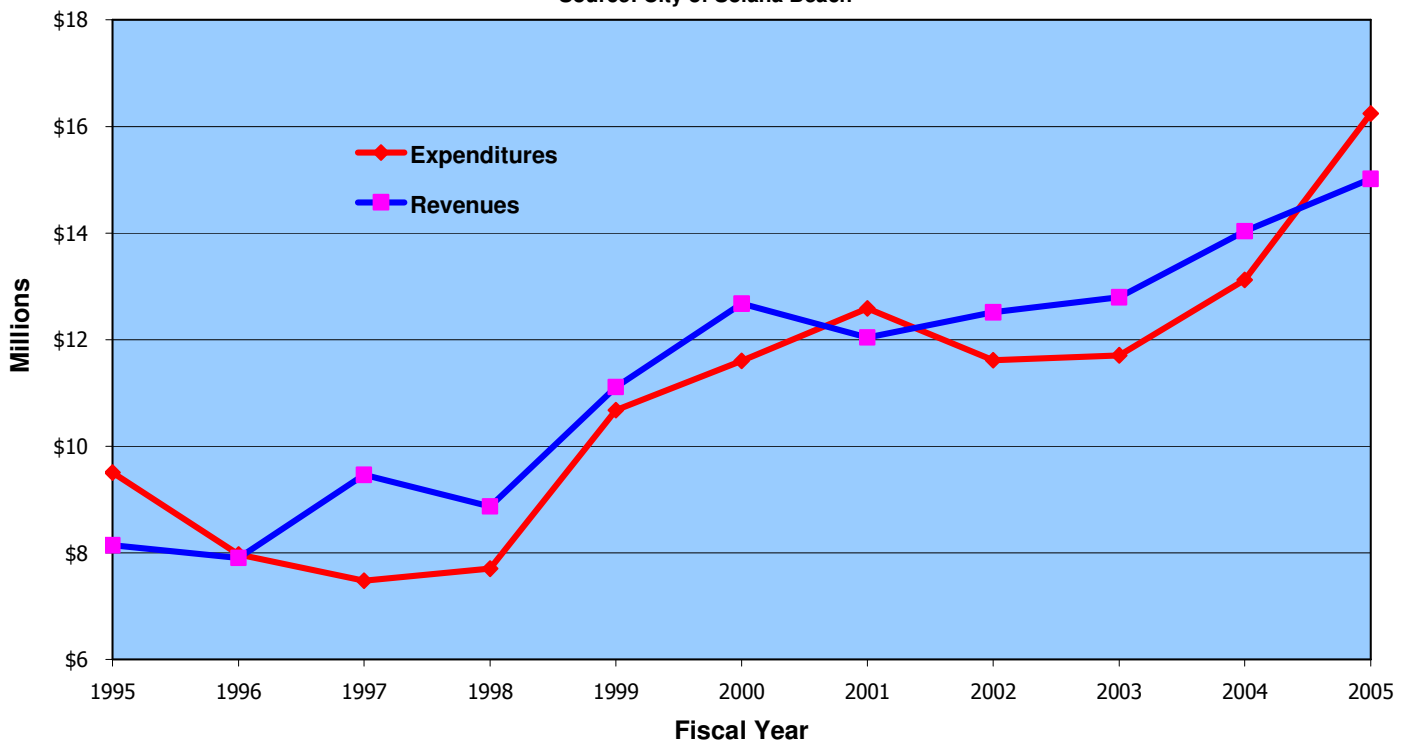
Revenue Growth vs. Expenditures

According to the City of Solana Beach's Comprehensive Annual Financial Reports (CAFR), since Fiscal Year (FY) 1995 through FY 2005, the City of Solana Beach's General Government revenues have increased from \$8.1 million to \$15 million. Over the same period, 1995 through 2005, General Government spending went from \$9.5 million to \$16.2 million, including capital improvement projects.

These historical trends demonstrate that in spite of strong revenue growth, spending has essentially equaled and occasionally exceeded revenues. This history and future projections indicate the possibility that the city will face on-going structural deficits, unless policy changes are implemented.

In the current FY 2007 budget message, city management anticipates General Fund Expenditures to *exceed* Revenues by \$223,789 in FY 2010. New labor contracts for Fire, Marine Safety (lifeguard) and General employees are due to expire June 30, 2007, which could result in greater shortfalls.

**City of Solana Beach
General Governmental Revenues vs. Expenditures**
Source: City of Solana Beach



Source: City of Solana Beach FY 2004 & FY 2005 CAFR

(See Attachment A for detailed review of annual revenues and expenditures from FY 1995 through FY 2005)

Unless otherwise noted, the primary source of data for this analysis is the FY 2004 and FY 2005 CAFRs prepared by independent Auditors and City Financial Management staff. The FY 2005 CAFR is the most current audited financial statements available at the time this study was prepared.

Detailed Spending Increases -- FY 1995 through FY 2005

General Government:	\$960,000 to \$2.59 million
Public Safety:	\$3.88 to \$5.90 million
Public Works:	\$1.27 to \$2.15 million
Community Development	\$427,442 to \$792,434
Community Services	\$182,156 to \$263,705
Tax Increment Distribution*	\$117,857 to \$178,247 (last in FY 2000)
Capital Outlay	\$2.2 to \$4.1 million
Debt Service	\$444,573 to \$363,706
Total	\$9.5 to \$16.2 million

Spending has increased 71% since FY 1995 and 40% in the last five years.

Source: City of Solana Beach Comprehensive Annual Financial Reports (CAFR) June 30, 2004 & June 30, 2005

In this year's adopted budget (2006/2007), total General Fund revenues are \$13.28 million with expenditures at just under \$13 million.

*Revenues from previous Redevelopment entity. New Redevelopment entity will generate approximately \$407,000 in FY 2007.

The City of Solana Beach also has six special assessment and lighting/landscaping districts, most of which predate incorporation. Total funds generated are estimated at \$832,000 in FY 2007.

These districts are essentially self-supporting. However, city staff indicates that the MID 33 Fund—which maintains Highway 101 medians--will have to be subsidized by over \$125,000 for five years by the General Fund, starting FY 2009.

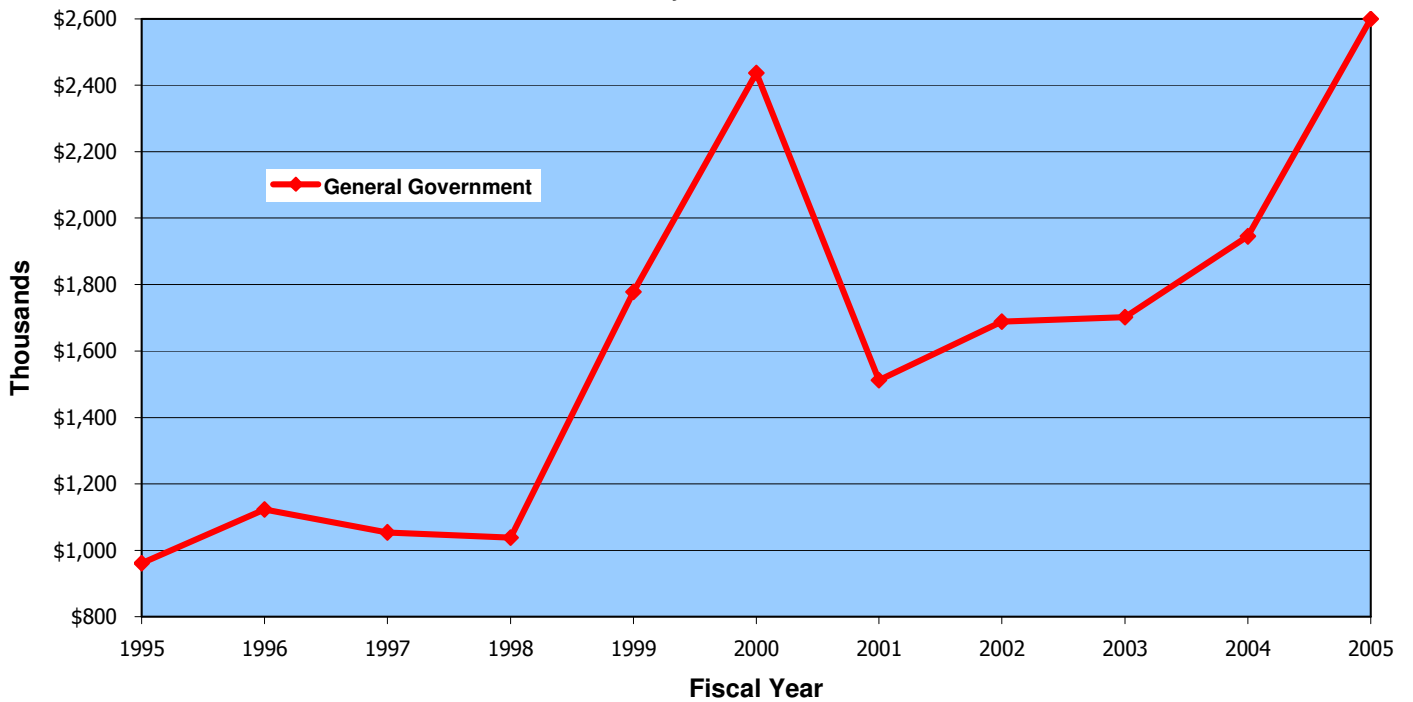
Wastewater: The Solana Beach Sanitation Department administers and inspects the city's sanitation system. Solana Beach contracts with the City of Encinitas to maintain sewer lines. The San Elijo Treatment Plant is administered by a Joint Powers Authority (JPA). The fee based Enterprise Fund has an annual budget of \$5.6 million. This year, an \$11 million CIP project is funded by ratepayers. FY 2007 debt service is \$847,400.

Growth of General Government Expenditures

After significant reductions at the beginning of the decade, General Government expenditures have steadily grown. These include:

City Council, Clerk, Attorney, Manager, Finance, Non-Departmental, Human Resources and Information Services.

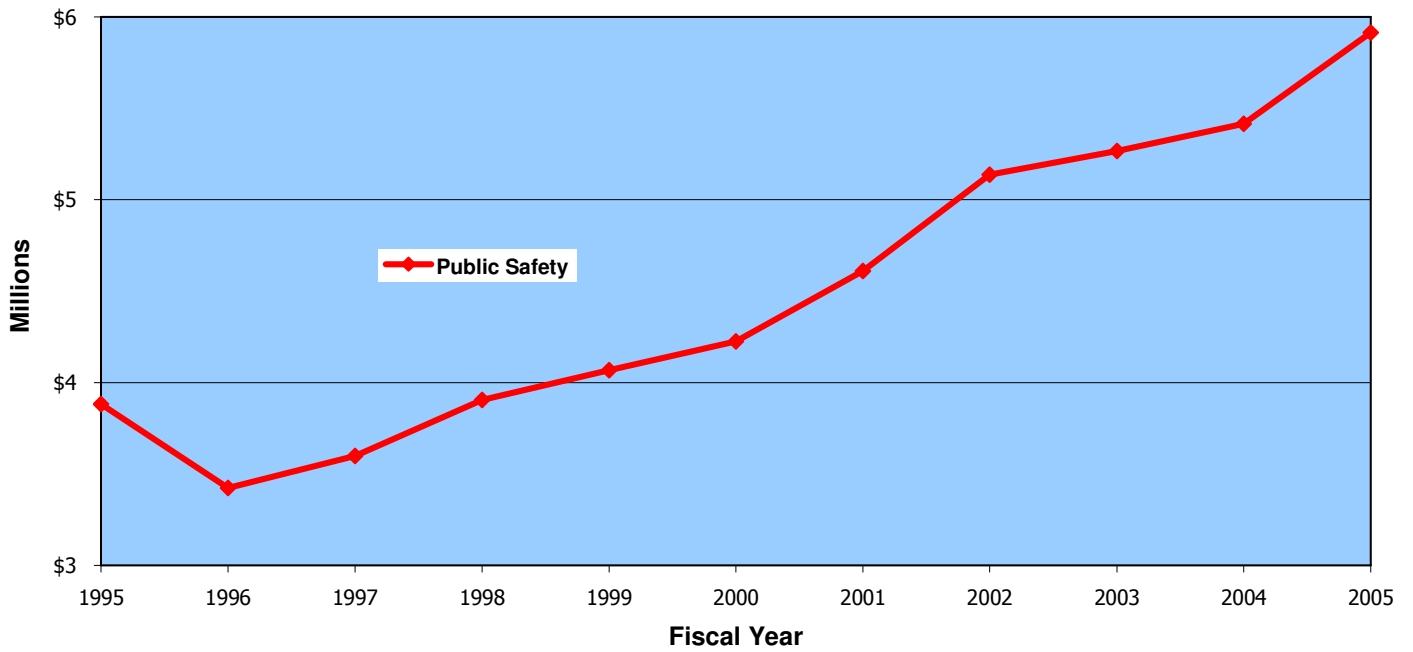
**City of Solana Beach
General Governmental Expenditures
Function: General Government**
Source: City of Solana Beach



Public Safety

Over half of the General Fund expenditures are consistently spent on public safety (Sheriff, Fire and Marine Safety/Lifeguard).

**City of Solana Beach
General Governmental Expenditures
Function: Public Safety**
Source: City of Solana Beach

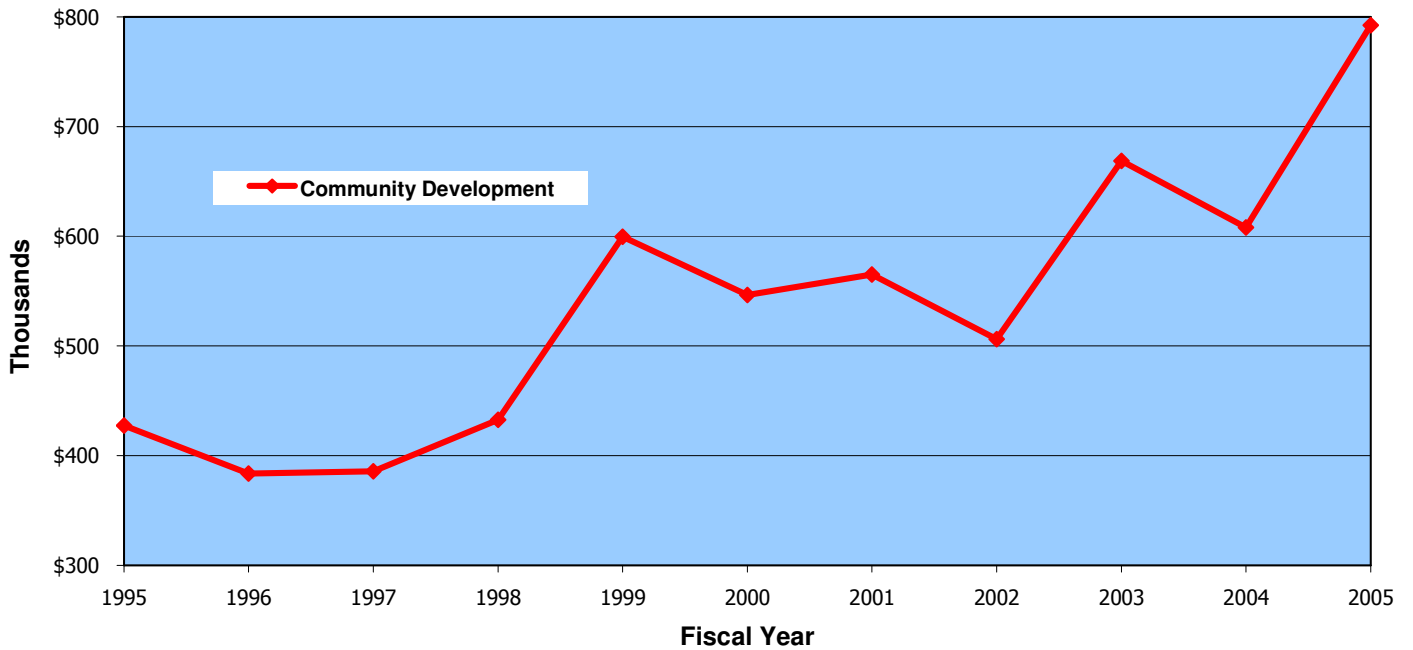


Solana Beach budget documents indicate that Sheriffs' contract cost increases are 6.9% in FY 2007 and 10% in the next budget year.

Community Development

Planning and Building services have grown significantly in the last few years. Apparently, these cost increases are not related to significant increases in the amount of development, but as a result of increased restrictions on the building process.

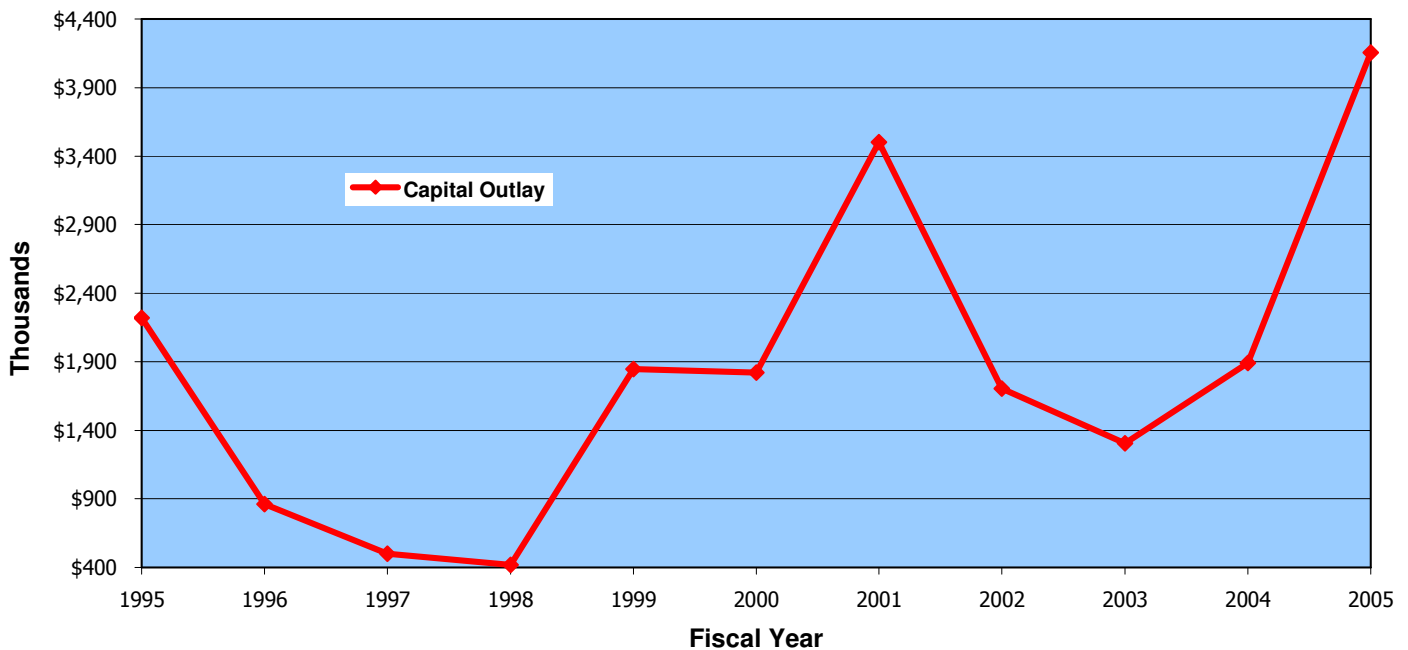
**City of Solana Beach
General Governmental Expenditures
Function: Community Development**
Source: City of Solana Beach



Capital Improvement Program (CIP)

From FY 1995 through FY 2005, the City allocated \$20.2 million to CIP Projects.

**City of Solana Beach
General Governmental Expenditures
Function: Capital Outlay**
Source: City of Solana Beach



The City Council approved a Five Year, \$33 million CIP Plan for FY 2007 through FY 2011, which includes approximately \$4 million of existing projects. Of the additional \$29 million, the city has identified realistic funding sources for all but \$2.5 million.

Additional general fund and redevelopment agency revenues will be needed to complete the projects and address ongoing maintenance needs.

In addition, construction funding for the Highway 101 Street Scaping/Traffic Calming project, estimated at \$10 to \$12 million has not yet been identified.

The City of Solana Beach has historically been unusually successful at generating outside grant funding for large capital projects, primarily in the rail corridor/rail station. Given current state and federal funding constraints, it is apparent that Solana Beach must use mostly local funding sources for future needs.

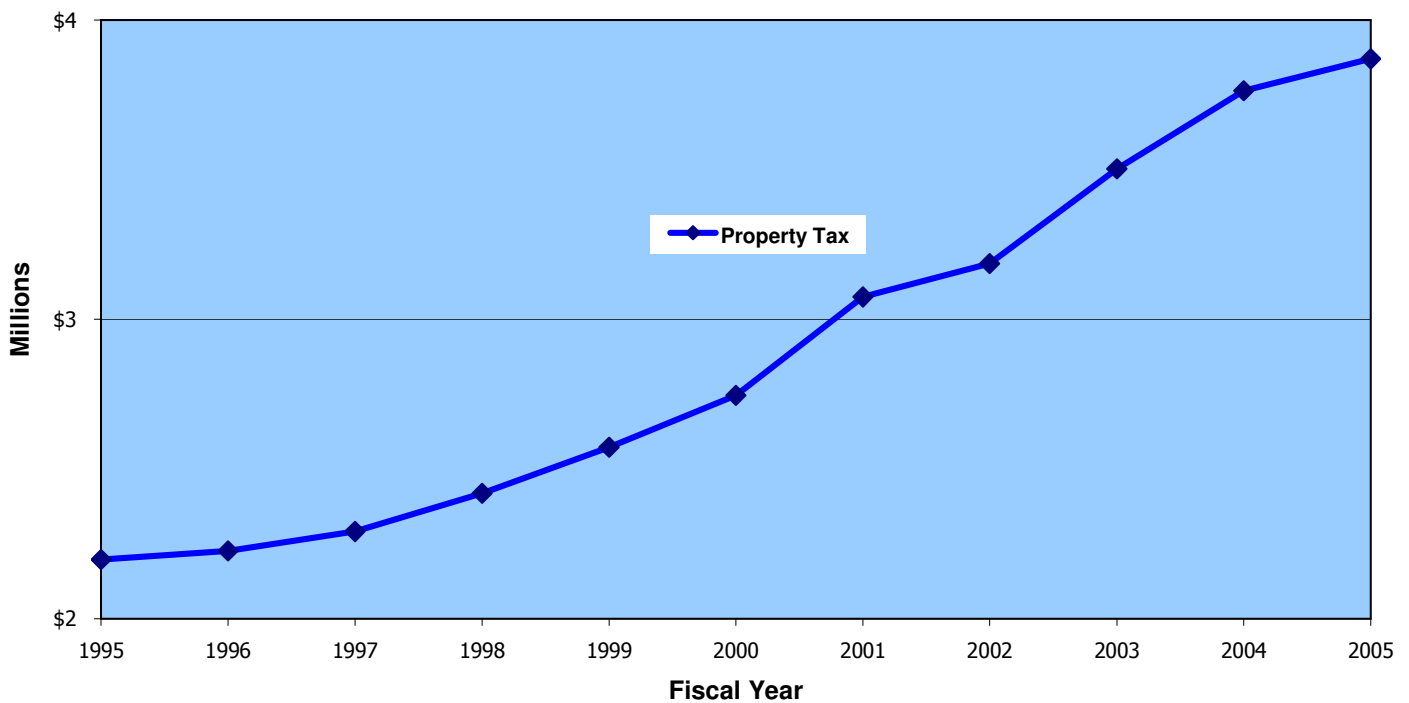
Strong Revenue Growth

Revenue Growth has been fairly and consistently strong across the board.

A slow-down in property appreciation is likely in the near future due to overall economic trends, and possible impacts of recent voter restrictions on housing scale (Proposition A).

Property Tax

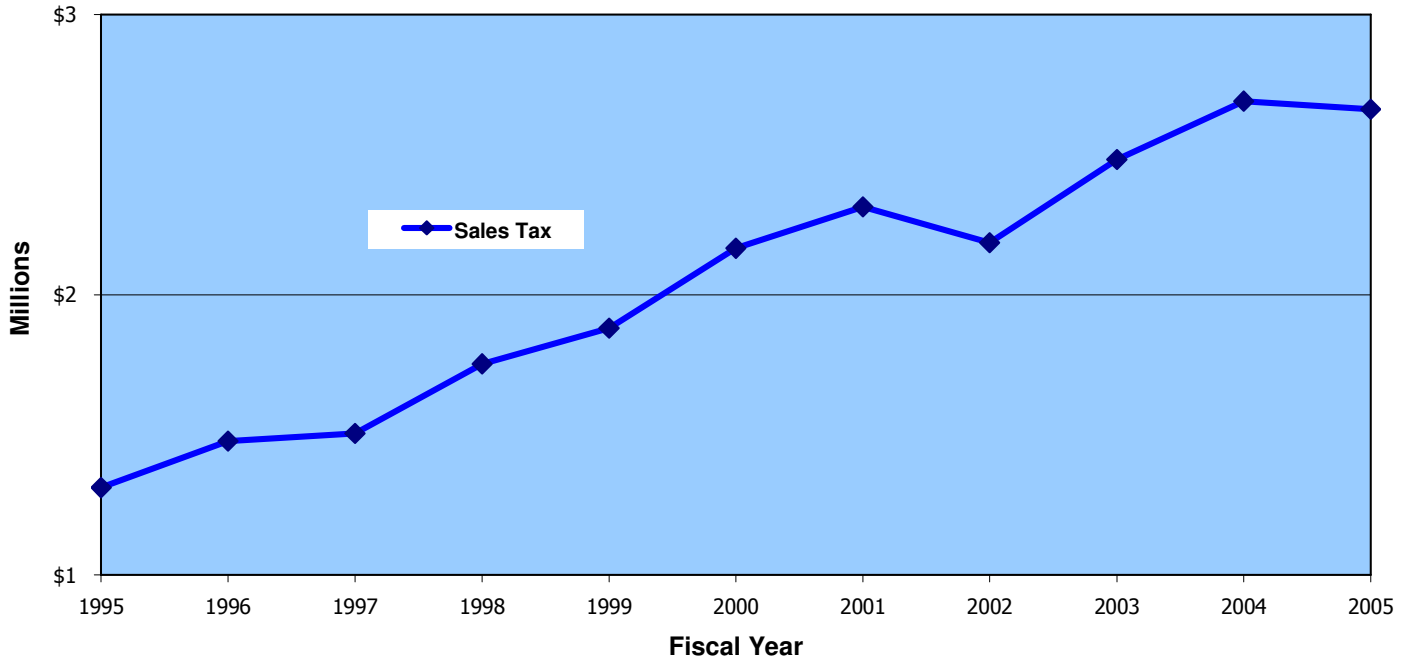
City of Solana Beach General Governmental Revenues
General Fund Tax Revenue Source: Property tax
Source: City of Solana Beach



Sales Tax

Sales tax growth has also been robust. However a flattening of growth is likely unless additional retail is added.

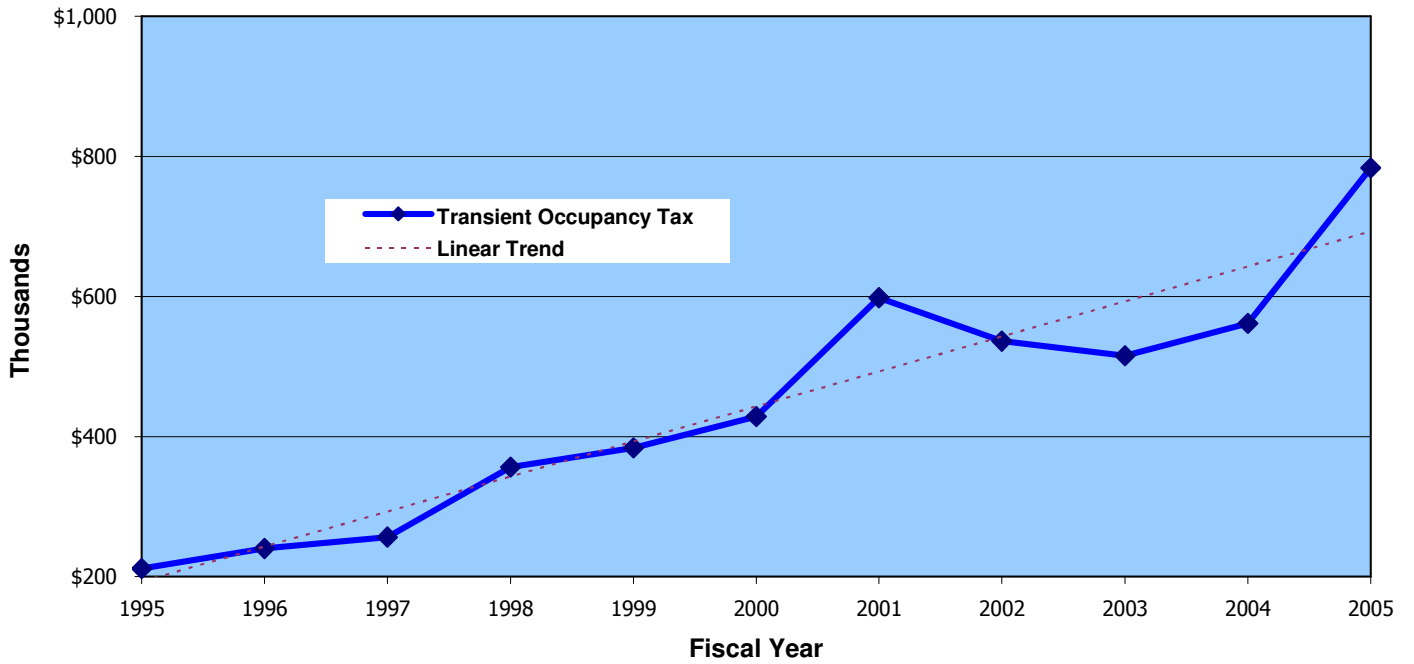
City of Solana Beach General Governmental Revenues
General Fund Tax Revenue Source: Sales tax
Source: City of Solana Beach



Transient Occupancy Tax (TOT) Hotel Tax 10%

The spike in TOT revenues from 2004 to 2005 represents the first year of TOT collection on short-term vacation rentals.

City of Solana Beach General Governmental Revenues
General Fund Tax Revenue Source: Transient Occupancy tax
Source: City of Solana Beach



Redevelopment

The redevelopment agency received its first Tax Increment (TI) funds of \$380,000 in FY 2006. In the current FY 2007 budget, the agency is anticipated to generate \$407,000 in Tax Increment (TI). Expenditures are budgeted at \$397,700.

In 2006, the city issued \$3.55 million in bonds to be paid off through revenues generated from existing properties within the redevelopment area. \$132,700 will be spent on debt service for redevelopment bonds (increasing to \$165,900 in FY 2008).

General Fund Subsidy

FY 2006 was the first year that redevelopment funds were utilized to reimburse General Fund staff (City Manager and Finance Director) for their time spent on redevelopment issues. Allocations:

FY 2006	\$45,500
FY 2007	\$61,600
FY 2008	\$64,700 (proposed)

While these allocations are appropriate, it demonstrates the additional need the city has to boost redevelopment funds.

Although TI funds should grow as values increase, between debt service and overhead, limited funds are available for additional redevelopment related functions. To this end, city staff writes (in the current budget) of the proposed public/private project north of the train station (Cedros Crossing) project:

“Upon successful development, the project will generate significant revenue growth in sales and RDA tax increment revenues due to new construction proposed in the City’s new RDA project area.”

Documents supplied by the developer to the City estimate that Cedros Crossing is expected to generate over \$375,000 in additional revenues (in 2005 dollars) annually for Solana Beach’s taxpayers. Approximately \$270,000 is estimated to be tax increment funds, the rest would be general tax revenues.

General Fund Debt

In addition to Redevelopment and Sanitation District debt, the City issued \$3.465 million in lease-revenue bonds in 2001/2002 in order to refinance existing debt. A \$328,000 debt service payment will be made in FY 2007 from general revenue sources.

General Fund Unrestricted (Emergency) Reserves

General Fund Unrestricted (Emergency) Reserves are currently \$1.33 million (after the city transferred \$884,000 from general fund reserves for capital projects) or 10.3% of the FY 2007 General Fund. City staff estimates this percentage will drop to 9.5% in FY 2008. While still an acceptable percentage, the downward trend should be watched.

City staff anticipates that that there will be a revenue shortfall of over \$200,000 in FY 2010, possibly requiring an additional depletion of emergency reserves.

Employees and Salaries

See exhibit A for full salary data

“Two significant cost drivers brought to the City Council’s attention last year contributed to cost increases again this year. These are PERS (Public Employees Retirement System) costs for all employees and the increase in contract costs with San Diego County for law enforcement services.” **Excerpt from FY 2006/2007 City Manager’s Budget Message**

The majority of city expenditures are spent on city employee salaries and benefits. Solana Beach is not immune to the significant growth in negotiated retirement (and other benefits) cost increases facing state and local government.

The City of Solana Beach supplied payroll and benefit data for all city employees for FY2006.

Total city payroll was \$4.39 million for approximately 1,113 full time and part time/seasonal employees.

The city calculates the FY 2006 Full Time Equivalent (FTE) employees at 64.27. The average city employee salary in FY 2006 was \$68,421, excluding benefits.

In addition, each employee received \$610 per month -- \$7,320 per year -- in pre-tax dollars (apportioned for part-time employees) to be used to purchase health, dental and vision insurance.

This increased to \$660 per month -- \$7,920 annually -- this fiscal year.

Therefore, the average salary, including \$7,320 health stipend, for all city employees in FY 2006 was: \$75,741.

Benefits/Retirement

Individual benefits range from 25% to 44% of salary, with public safety employees being at the higher end.

Total benefits in FY 2006 were \$1.5 million according to city budget documents.

Total salary and retirement benefits cost the city approximately \$5.89 million in FY 2006.

The City of Solana Beach contracts with the San Diego County Sheriff’s department for law enforcement services. While the city agrees to the specific level of service each year, salary and benefits for these employees are approved by the Board of Supervisors. Solana Beach budget documents indicate that Sheriffs’ contract cost increases are 6.9% this year and 10% in the next budget year.

Executive & Senior Management Salaries and Benefits

The City categorizes its 17 management employees as “Executive, Senior Management and Mid Management.”

The FY 2006 management salaries supplied by the city, show management employees with total salaries (excluding benefits) of \$1.4 million or 32% of all budgeted salaries.

The average management salary in FY 2006 was \$82,352 plus \$7,320 in health stipend or an average of \$89,672 per management employee. The FY 2006 management salaries shown are artificially low due to a number of personnel and classification changes made in mid 2006.

Potential Threats

The City of Solana Beach faces two significant legal issues which could have significant financial impacts on future budgets: the 1993 settlement (amended in 1999) requiring the replacement of 13 low/moderate income housing units and the city's Clean Water fee litigation filed by the Howard Jarvis Taxpayers Association, which could impact over \$400,000 in funds.

1993 Low/Moderate Housing Settlement:

The city has indicated it hopes to develop an affordable housing plan to address our needs this calendar year. Where and how it will be funded is not currently known. The city currently does not have a state certified Housing Element as required by law.

Howard Jarvis Taxpayers Association (HJTA)—Clean Water Fee Litigation.

Federal Clean Water Act requirements, as well as state enforcement actions have led many municipalities to institute a clean water fee to pay for this "unfunded mandate." The city has collected approximately \$249,000 since the inception of the National Pollutant Discharge Elimination System (NPDES) or "Clean Water" fees, and projects about \$188,000 in revenues in the current fiscal year. HJTA maintains that the clean water fee charged by the City of Solana Beach is illegal unless approved by a public vote. TaxpayersAdvocate.org agrees with this assessment. The city has reported it has achieved the following settlement:

The city has entered in to a Stipulation for Entry of Judgment with the Howard Jarvis Taxpayers Association (HJTA) regarding the city's National Pollutant Discharge Elimination System Fee (NPDES).

1. The city will conduct a mail ballot no later then September 30, 2007.
2. The city may treat the fee as a valid fee and not a tax.
3. HJTA shall not take a position for or against the fee and will neither contribute money nor draft or sign ballot arguments or campaign literature relating to measure but reserves the right to redress for the dissemination of false or misleading information by the city, or the expenditure of public funds for campaigning.
4. Plaintiffs waive Government Code section 53728 dollar-for-dollar property tax withholding.
5. The city shall reimburse Plaintiffs the total of \$42,000 as full and final satisfaction for their attorney's time and costs in this matter.

A NO vote by the electorate would result in the city needing to halt future collections. In addition, the city would need to find other funding sources to fulfill the NPDES requirements. This \$190,000 impact would be a significant annual loss to the general fund.

TaxpayersAdvocate.org

Formed in 2003, TaxpayersAdvocate.org is a private, non-partisan fiscal watchdog organization based in San Diego and Sacramento. In addition to analyzing fiscal policy, ballot measures and legislation, TaxpayersAdvocate.org endorses candidates for public office in California.

Report Author

The principal author of this report was Scott Barnett, President, TaxpayersAdvocate.org. Scott Barnett has over 25 years of experience in public policy and budgeting. Mr. Barnett served on the Del Mar City Council from 1984 to 1988, was executive director of the San Diego County Taxpayers Association from 1994 through 2001 and formed TaxpayersAdvocate.org in 2003.

Charts and Graphs and Source Documents

The attached graphs and charts were prepared by TaxpayersAdvocate.org and are all based on data derived from official City of Solana Beach budgets and documents and pension documents from the California Public Employees Retirement System (CalPERS).

These documents include:

- FY 2003/2004 Comprehensive Annual Financial Report (CAFR)
- FY 2004/2005 Comprehensive Annual Financial Report (CAFR)
- FY 2006/2007 Adopted Budget
- FY 2006/2007 Management Salary Schedule
- FY 2005/2006 Actual Wages and benefits detail for each City employee
- 2006 Final Official Statement (FOS) Solana Beach Redevelopment Agency \$3.555 Bond Issuance Report
- City of Solana Beach Retiree Health Plan, Actuarial Valuation June 5, 2006
- City of Solana Beach/California Public Employees Retirement System (CalPers) Misc. Employees, June 30, 2005
- City of Solana Beach/California Public Employees Retirement System (CalPers) Safety Lifeguard Plan, June 30, 2005
- City of Solana Beach/California Public Employees Retirement System (CalPers) Safety Fire Plan, June 30, 2005
- Fiscal Revenue Analysis, Cedros Crossing, Alfred Gobar Associates, August 4, 2005
- Mayor David Powell, State of the City Address, June 21, 2006
- City of Solana Beach and Solana Beach Redevelopment Agency Workplan Fiscal Year 2006-2007 (Draft), April 27, 2006
- Settlement Agreement between City of Solana Beach and Howard Jarvis Taxpayers Association—Clean Water Fees
- Email communications with City of Solana Beach Management staff

All of the above except actual employee wage data and emails with city staff can be viewed at: www.taxpayersadvocate.org.

Thank you to the City of Solana Beach for their prompt and thorough response to document requests.