You Need the Financial Health Diagnostic

- **Validate** areas in which your city is *fiscally healthy*
- **Identify problems**, areas to *improve*
- **Act to remedy** problems *before* they get worse or unmanageable
- **Avoid being blind-sided** by problems
- **Add credibility** to your fiscal evaluation
- **Help others** (labor associations, taxpayers and other interested parties) **understand** your financial position
Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Risky financing schemes
- Ceding of management and policy choices to others
- Toxic relationships
- Fear & Denial
- Unsustainable and Intractable employee compensation, especially public safety pension and retiree health care
- Unsustainable Decline in Core Revenues

Defining Municipal Financial Health

**Solvency**

1. **Cash solvency** - ability to meet immediate financial obligations; i.e. over next 30 or 60 days (accts payable, payroll).
2. **Budgetary solvency** - ability to meet all financial obligations during a budget year.
3. **Long-run solvency** – ability to meet all financial obligations into the future.
4. **Service-level solvency** – ability to provide the desired level of services for the general health and welfare of the community.
Difficulties in Assessing Municipal Financial Health

- Published data are not complete or timely.
- Comparisons are often false.
- Do we know what the numbers mean? Are they enough to draw conclusions?
- Requires analysis, forecasting, context, legal
  - it’s not just an accounting or statistical exercise
  - history doesn’t tell you enough about the future

Our Approach

California Municipal Financial Health Diagnostic:

- Get to the primary indicators - useful & essential
  - Leave out extraneous / secondary
  - Add in overlooked & underappreciated factors
- Drill down to the real numbers
- Allow for nuance / clarification / differences
  - Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach
1. Recurring Deficits?

**Gross Annual Deficit/Surplus (unadjusted)**

\[
gross \text{ annual deficit/surplus as a percent of revenues} = \frac{\text{gross current revenues}}{\text{gross current revenues}} \times \left( \frac{\text{gross current revenues}}{\text{gross current revenues}} \right) - \frac{\text{gross current expenditures}}{\text{gross current revenues}}
\]

**Net Operating Deficit/Surplus**

- sustainable, omits non-recurring

*Take out revenues and expenditures:*

- restricted to non-operating (e.g., capital improvements),
- legally restricted revenues,
- temporary revenues and spending

\[
net \text{ operating deficit/surplus as a percent of revenues} = \frac{\text{net operating revenues}}{\text{net operating revenues}} - \frac{\text{temporary revenues}}{\text{net operating revenues}} - \frac{\text{net operating expenditures}}{\text{net operating revenues}}
\]
1. Recurring Deficits?

Unbudgeted current liabilities. Amortized costs of...
- unbudgeted actuarially required contributions (ARC) to Other Post-Employment Benefits (OPEB) or pension systems;
- unbudgeted earned leave cash-out liabilities;
- maintenance and replacement costs of vehicles, technology, buildings, streets, and other properties and infrastructure.

Net True Operating Deficit/Surplus

\[
\text{Net True Operating Deficit/Surplus} = \frac{\left(\text{net operating revenues} - \text{temporary revenues} - \text{net operating expenditures} - \text{unbudgeted current liabilities}\right)}{\text{net operating revenues}}
\]

1c) Net True Operating Deficit/Surplus - complete, adding unbudgeted general fund liabilities

<table>
<thead>
<tr>
<th>Year</th>
<th>2015-16 projected</th>
<th>2016-17 projected</th>
</tr>
</thead>
<tbody>
<tr>
<td>-9.83%</td>
<td>-6.54%</td>
<td>-2.03%</td>
</tr>
<tr>
<td>-2.62%</td>
<td>-3.67%</td>
<td>-3.80%</td>
</tr>
</tbody>
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Score:
- Warning-Red: Persistent & increasing deficits over consecutive years.
- Caution-Yellow: Deficits are infrequent or relatively marginal compared to fund balance (see 2d below) and/or there is a reasonable plan for bringing revenues and spending into balance.
- Good-Green: Not an issue of concern.

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## The California Municipal Financial Health Diagnostic

### Financial Distress Checklist

<table>
<thead>
<tr>
<th>Measures</th>
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<tbody>
<tr>
<td>1. The city has recurring general fund operating deficits.</td>
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<tr>
<td>2. General fund reserves are decreasing over multiple consecutive years.</td>
<td></td>
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<tr>
<td>3. General fund current liabilities (including short-term debt and accounts payable within 60 days) are increasing. Cash and short-term investments are decreasing.</td>
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</tr>
<tr>
<td>4. General fund fixed costs, salaries, and benefits are increasing over multiple years at a rate faster than recurring revenue growth.</td>
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<tr>
<td>5. The general fund is subsidizing other enterprises or special funds.</td>
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### Practices and Conditions

<table>
<thead>
<tr>
<th>Practices and Conditions</th>
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<tbody>
<tr>
<td>6. The city council’s authority to make changes is constrained by charter, contract, or law (e.g. binding arbitration, minimum spending, minimum staffing or compensation formulas, etc.)</td>
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</tr>
<tr>
<td>7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.</td>
<td></td>
</tr>
<tr>
<td>8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.</td>
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<tr>
<td>9. General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded.</td>
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<tr>
<td>10. General fund debt service payments have been “backloaded” into future years.</td>
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<tr>
<td>11. Ongoing general fund operating costs are being funded with temporary development revenues.</td>
<td></td>
</tr>
<tr>
<td>12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)</td>
<td></td>
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<tr>
<td>13. Public service levels are far below standards needed in this community.</td>
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