



CITY OF LOS ANGELES

Staying the Course

SUBMITTED BY:

A handwritten signature in black ink, reading "Miguel A. Santana". The signature is fluid and cursive, with a long horizontal stroke at the end.

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STAYING THE COURSE: EXECUTIVE SUMMARY

INTRODUCTION

Earlier this year the Los Angeles 2020 Commission released a report entitled *A Time for Truth* in which it asserts that the City risks becoming “a City in decline.”¹ A major focus of the report is the City’s budgetary challenges due to ongoing deficits that are driven by rising retirement, health and compensation costs exceeding revenue growth. The report states that the City’s budget woes have resulted in diminished services to the public and infrastructure, instability, and have been a detriment to the overall economic recovery.

Many of the issues identified in the 2020 Commission report were disclosed in a series of reports prepared by this office at the direction of then Council President Eric Garcetti, the Council leadership and then Mayor Antonio Villaraigosa in response to the City’s fiscal crisis. The first report was issued in 2010 entitled, *Three-Year Plan to Fiscal Sustainability*. This report projected that given the level of spending and anticipated growth in revenues forecasted at that time, the deficit for fiscal year 2013 would reach approximately \$1 billion (C.F. 09-0600-S159). The report called for a series of difficult short and long-term solutions guided by the following principles:

1. Responsible Fiscal Management
2. Focus on Core Services
3. Alternative Service Delivery Models
4. Sustainable Workforce
5. Strengthening Revenues²

These five principles and supporting recommendations established a road map for policymakers to reduce the projected deficit by over 80 percent.³ The actions of the City’s elected leadership over the last five years have resulted in the Standard and Poor’s reaffirmation of the City’s solid AA- bond rating and conclusion that the City exhibits strong principles of fiscal management and financial policies.⁴

Four years later, the City’s fiscal outlook is stronger. The combined reserve and budget stabilization funds are at an unprecedented level of nearly 8 percent of the City’s General Fund budget; the City’s workforce has been maintained at about 14 percent below its highest point in 2007; Public Private Partnerships are in full operation, including the Convention Center and the Northeast Valley

¹ Report is available at www.la2020reports.org

² Subsequent reports added a fifth principle in support of Maintaining, Enhancing and Protecting Revenues

³ C.F. 10-0600-S61; C.F. 11-0600-S157; C.F. 12-0600-S171

⁴ Standard and Poor’s Rating Services; “Ratings Direct. Summary: Los Angeles California; Appropriations; General Obligation.” December 20, 2013.

Animal Shelter; and major reforms have been adopted to mitigate increasing costs in pensions, health care and compensation. The City has also made progress in closing out major legal liabilities to the General Fund on cases related to furloughs, retiree health care, pension reciprocity with the Department of Water Power and other matters.⁵

Moreover, the City's economy is experiencing a period of steady expansion, as unemployment continues to decline and property values reach toward pre-recession prices.⁶ Crime is at levels not seen in over 60 years and has created the foundation of expanded tourism, which hit an all-time high at 42 million visitors in 2013,⁷ and new investments in Downtown, Hollywood and Universal City. There is a renewed excitement about Los Angeles as THE place to live, work and play.⁸ As a recent report by the Loyola Marymount University's Center for the Study of Los Angeles captured, Angelenos are optimistic about our City, and with reason.⁹

Still, while we may celebrate how far we have come and look forward to the Los Angeles we are becoming, as a City government, we continue to encounter significant challenges. While City revenues this year are anticipated to grow 4.4 percent, a rate above the national Gross Domestic Product,¹⁰ expenditures are still growing at a faster rate resulting in a projected deficit for fiscal year 2014-15 of \$242 million. Furthermore, the following three years continue to show deficits, albeit diminishing in size. This is predicated on the City implementing ongoing solutions to reduce the deficit.

Demands for reinvestment in basic services after years of reductions have placed greater pressure on already strained City resources. The City's aging information technology systems, infrastructure, buildings and fleet are reaching critical levels following years of patchwork solutions to simply keep them from failing. Additionally, while the City has resolved some major lawsuits, other looming legal liabilities still persist, particularly related to the City's utility user tax and sidewalks.

⁵ Examples of cases settled include *The Association of Los Angeles City Attorneys v. City of Los Angeles* and *Romero v. City of Los Angeles*.

⁶ Beacon Economics; *Forecast LA*; Volume 4, Number 4; February 2014.

⁷ Beacon Economics; *Forecast LA*; Volume 4, Number 4; February 2014.

⁸ Silver Lake was rated the "best hipster neighborhood" by Forbes: Morgan Brennan; "America's Hippest Hipster Neighborhoods"; forbes.com; September 20, 2012. GQ called Downtown "the coolest new downtown in America": Brett Martin; "America's Next Great City is Inside LA;" GQ.com; January 2014. *Bon Appetit* called Los Angeles restaurant Alma the best new restaurant in America in 2013: Andrew Knowlton; "Alma: Best New Restaurant in America 2013;" bonappetit.com; August 12, 2013.

⁹ Loyola Marymount University; *Forecast LA: From Those Who Know it Best – Residents and Leaders*; 2014.

¹⁰ City revenue growth reflects revised 2012-13 actual revenues to revised 2013-14 estimated revenues; The U.S. Bureau of Economic Analysis reports that the gross domestic product growth in 2013 in the U.S. was 1.9 percent.

Attempts to strengthen the City's revenue have been unsuccessful with the defeat of Measure A, which would have eliminated the structural deficit and better positioned the City to reinvest in our aging infrastructure, maintain and eventually restore basic services.

In short, we are not done yet. As Mayor Garcetti and Budget and Finance Chair Paul Krekorian have emphasized, there is still much work to do to fully reinforce the City's fiscal foundation. In some ways, the next three years may be harder than the last three inasmuch as the "easy" solutions are no longer viable. Also, while we now have the benefit of knowing what works, we are also mindful of those options that did not work. Moreover, some of the solutions that helped bring the City back from the brink are still being challenged, such as the new civilian pension tier. Unwinding these successes will only worsen the City's outlook. As the City enters into labor negotiations with the majority of the bargaining units, any raises or increases in benefits, without offsets through ongoing labor concessions, will also increase the structural deficit.

For the last decade, the City's structural deficit has been an albatross around the neck of the City; impeding critical investments in services, infrastructure, and technology. Simply put, the structural deficit makes it impossible to adequately invest in the City services demanded by Angelenos and sought by the Mayor and City Council. So long as the structural deficit exists, the City will continue to rely on governmental inefficiencies including the managed hiring process and using one-time revenues for ongoing programs, to balance each year.

It is for this reason that, no matter how daunting the challenge, this Office recommends that the City's policymakers set a goal to eliminate the structural deficit by fiscal year 2018. The goal to eliminate the structural deficit will provide a framework to inform current and future budget decisions, labor negotiations and policy initiatives.

Eliminating the structural deficit by 2018 will not be easy. It is as true today as it was in the height of the fiscal crisis; there are only two ways of eliminating the structural deficit: reduce expenditures and increase revenues. Reaching this objective will require a multi-year process, thoughtful planning, and discipline. Also challenging is maintaining a balance between the desire to strengthen services and the need to stay on a course to maintain solvency.

The City is in a strong position to meet this goal:

- The hard work and resolve of Mayor Garcetti, Council President Wesson, Budget and Finance Chair Paul Krekorian, and the entire Council to strengthen the City's fiscal standing has resulted in a solid foundation to build upon.

- Revenues are anticipated to undergo a prolonged period of steady growth due to the current trajectory of the economy.
- As a result of all the efforts to curtail retirement costs, including the adoption of a new civilian pension tier, the City's pension obligations are projected to peak in fiscal year 2016-17 and finally begin to descend in fiscal year 2017-18.
- The City has an opportunity to partner with labor to further reign in health care, compensation, worker compensation and pension costs- the primary drivers of the structural deficit- with the majority of the labor contracts opening up for renegotiation.
- Managed responsibly, the City's healthy Reserve Fund and Budget Stabilization Fund provide a reasonable cushion to allow for reforms to be adopted in the next few years that will take time to take hold before generating on-going savings and efficiencies. Moreover, the City has a strong track record of resolving shortfalls within each fiscal year as they surface, without relying on the Reserve Fund for solutions.
- As the City pursues a new economic development model in a post-Community Redevelopment Agency (CRA) context, opportunities and strategies can be pursued to expand the tax base with new developments on underutilized City properties.
- Mayor Garcetti, Council and Controller Ron Galperin's focus on Performance-Based Budgeting establishes a new framework to invest, in a smarter way, services with measurable outcomes based on the Mayor's "back-to-basics" goals:
 1. Promote good jobs for Angelenos all across Los Angeles.
 2. Restore the City services that make our neighborhoods livable and attractive.
 3. Make our communities the safest in the nation.
 4. Create a more sustainable and livable city.
 5. Live within our financial means.
 6. Provide outstanding customer service to our residents and businesses.
 7. Deploy innovation and technology to modernize city government.
 8. Restore pride and excellence in public service.
 9. Partner with citizens and civic groups to build a greater city.
- The City can address the major liabilities drawing concern from the bond rating agencies, with the City Attorney Mike Feuer's commitment to reduce liability costs and resolving cases.

THE ROADMAP: SUMMARY OF RECOMMENDATIONS

The title of this report is, *Staying the Course*, and like the previous four, seeks to answer three basic questions:

1. What have we accomplished?
2. Where are we now?
3. Where are we going?

Understanding that City leaders will face tension between the desire to add services and the need to stay on a course to maintain solvency, the report's purpose is also to inform decision making on policy and budgetary questions to strengthen our fiscal footing. As such, this report proposes several concrete policy recommendations that if implemented over the next three years will help the City towards its goal of eliminating the structural deficit by balancing growth and solvency, addressing our liabilities, and focusing expenditures on outcomes rather than restoration. The recommendations build on principles of solid fiscal management that the City adopted and worked to adhere to in order to confront the fiscal crisis. Together, they provide a roadmap for action and will help the City to build a fiscal future in which we can improve the quality and cost effectiveness of the services we provide, while better preparing us for future fiscal challenges.

RESPONSIBLE FISCAL MANAGEMENT:

1. Adopt as a policy objective, the elimination of the structural deficit by fiscal year 2018.
2. In the event that the Reserve Fund and/or Budget Stabilization Fund are used to close deficits, restore the Funds by depositing unanticipated one-time revenues, and set as a goal to increase their combined balances to 10 percent of budgeted General Fund revenues.
3. Maintain as a practice closing shortfalls that surface within each fiscal year without relying on the City's Reserve Fund.
4. Create a plan to address major legal liabilities, through solutions that provide a risk management framework of corrective action plans to prevent the recurrence of similar liabilities.
5. Limit the reliance of the General Fund to offset federal cuts to grants, and prioritize City funding for services supported by these sources against all other City services.
6. Revise the Capital Investment Policy to incorporate a five-year investment plan inclusive of special funded and bond-funded investments in capital assets, and that takes into account outcomes related to the desired quality

of our infrastructure as opposed to a standard resource allocation of one percent of General Fund revenues per year.

FOCUS ON CORE SERVICES:

7. Adopt and implement the recommendations in the recent Fire Department deployment study over the next several fiscal years insofar as they will enable the Fire Department to focus on achieving positive outcomes in its core services. (Council File)
8. Initiate a Police Workforce Capacity study with recommendations for achieving desired public safety outcomes through a balanced approach among overtime, police hiring and greater civilianization.
9. Adopt a short and long-term plan for the City's investments in technology infrastructure to reduce risk, improve reliability and quality through a cost-effective and modern system.
10. Continue support for the development and implementation of the Customer Relationship Management System, and maintain as a long-term goal the ongoing consolidation of City call centers.

ALTERNATIVE SERVICE DELIVERY MODELS:

11. Develop a strategic plan for the use of City real estate assets, and continue to build toward the use of underutilized properties to enhance economic development efforts through a partnership with the Department of Economic and Workforce Development and a Non-Profit Economic Development Corporation.

SUSTAINABLE WORKFORCE:

12. Maintain the civilian pension reforms adopted and partner with Labor to ensure sustainability of long-term costs by controlling labor, health care and pension costs through the following solutions:
 - a. Ensure that all employees pay 10 percent toward the cost of health care premiums;
 - b. Seek salary step reforms and entry level salary reductions;
 - c. Control pension and compensation costs by not providing cost of living adjustments for a minimum of three years;
 - d. Implement the Controller's recommendation to modify injury on duty payments so they are comparable with other government agencies

STRENGTHEN REVENUES:

13. Establish dedicated and ongoing revenue streams, including through voter-approved tax increases, for the reconstruction of the City's failed streets and sidewalks.

WHAT HAVE WE ACCOMPLISHED? LESSONS LEARNED

For many years, the City of Los Angeles has been building and implementing budgets in crisis mode. The precipitating events were the Great Recession, the most severe recession since the Great Depression, the associated bursting of the local housing bubble, and the decline of financial markets. However, while the origins of the wide economic crises were largely beyond the control of City leaders, in the years leading up to the economic collapse the City, like so many other jurisdictions, acted as though the boom years would last forever. Buoyed by high revenues, including property tax, documentary transfer tax, and permit fees and confident in the diversity and strength of the City's economic base, the budget continued to grow and salaries continued to rise. There were warnings and evidence of a structural deficit driven by this growing payroll and associated benefit costs, but the City did not act aggressively to bring the budget into long-term balance.

At the onset of the Great Recession, the only way that the City could remain afloat was to make a series of painful decisions. Often, City leaders had to choose between bad options such as furloughs and layoffs.

In the midst of these short-term responses to the immediate fiscal crisis of 2009-10, this Office prepared, and the Mayor and Council adopted, a *Three-Year Plan to Fiscal Sustainability*. This report, and three subsequent reports updating the plan, provided a strategy for the City as it faced looming budget deficits for the foreseeable future. At the core of these reports were five guiding principles discussed below.

FIVE GUIDING PRINCIPLES

RESPONSIBLE FISCAL MANAGEMENT

Adhere to responsible management and fiscal practices by maintaining a healthy Reserve Fund, pursuing ongoing solutions to our deficit instead of one-time fixes, and preparing for unpredictable liabilities.

Central to achieving this principle is increasing our Reserve Fund to its current level of 6.97 percent. In addition, the City recently established a Budget Stabilization Fund which dedicates revenues from economy-sensitive taxes that come in above standard growth levels to a reserve that can be used at a later time to address unexpected needs. The combined reserve and budget stabilization funds are at an unprecedented level of nearly 8 percent of the City's General Fund budget.

Governmental reserve funds are often viewed by outside entities as one indicator of the fiscal health of the organization. High reserves show that the jurisdiction

has the capacity to deal with unforeseen emergencies without negatively impacting ongoing spending and provides a safety net if revenues do not meet expectations or turn downward for a period of time. Rating agencies evaluate a jurisdiction's reserve fund as part of its rating determination, and higher ratings attract investors to debt offerings driving the cost of debt down. Thus, healthy reserves not only prepare a government for crisis, but also reduce ongoing operating costs.

The City has a policy of maintaining its Reserve Fund at the level of at least 5 percent of the City's budget. One of the major accomplishments of City leaders in the face of the recent fiscal crisis is that the Reserve Fund continually grew and for the first time since adoption of the policy actually exceeded the 5 percent target.

In addition to demonstrating our commitment to fiscal responsibility, increasing and maintaining our Reserve Fund has brought our reserve balance to a level that is consistent with other big cities across the Country. Thus, we can be seen as a good risk with fiscal behavior that meets national norms and best practices.

FOCUS ON CORE SERVICES

Focus on core services by prioritizing, implementing efficiencies, and eliminating redundancies.

In order to achieve this principle, City leaders considered and implemented numerous proposals to seek efficiencies and reduce administrative costs by consolidating and restructuring services. Examples include restructuring and consolidating the City's human resources work, and consolidating the Office of Public Safety into the Police Department.

Other accomplishments under this principle include:

- ✓ Funded 800 miles of street repairs for fiscal year 2013-14.
- ✓ Reduced crime to historic levels.
- ✓ Restored Library services pursuant to Measure L.
- ✓ Consolidated administrative and duplicative functions such as human resources and public safety.
- ✓ Enhanced 311 technology to increase accessibility and responsiveness.
- ✓ Expanded the Green Retrofit and Workforce Program using \$12 million in Qualified Energy Conservation Bonds (QECCB) to retrofit 52 City buildings, resulting in the creation of the Green Retrofit Program Fund

PURSUE ALTERNATIVE SERVICE DELIVERY MODELS

Pursue alternative service delivery models that reduce the cost of providing quality services while maintaining or even enhancing services.

At the core of this principle is the idea that outcomes are more important than process. More specifically, City residents care more about whether their service request is addressed and less about who does the work. Under this principle, we have sought and entered into partnerships with non-governmental organizations that can expand the range of City services at a lower cost. For example, the City transferred the management and operation of the Northeast Valley Animal Shelter to Best Friends, a non-profit organization, at their cost. In addition, the City contracted with Anschutz Entertainment Group to manage and operate the Los Angeles Convention Center with a goal of ensuring that the Convention Center becomes a leading and primary destination of top tier national and international conventions, trade shows, and events. The agreement will also help to leverage the Convention Center to maximize hotel room occupancy, attract new customers and provide superior service to guarantee customer satisfaction.

As a result of the dissolution of the Community Redevelopment Agency, the City's policymakers adopted the creation of a new Department of Economic and Workforce Development and is pursuing a partnership with an Economic Development Non-Profit to develop an economic development strategic plan and convert underutilized City's assets into opportunities for development and job creation.

MAINTAIN A SUSTAINABLE WORKFORCE

Maintain a sustainable workforce through a fair and equitable compensation system, managed healthcare costs, and controlled pension obligations.

Employee costs comprised of salaries and benefits continue to be the main driver of City expenditures. The ongoing pension obligation is in many respects beyond the control any one City official – payment amounts have been determined, and payments are required for all eligible retirees for the remainder of their lives. Similarly, healthcare costs have been rising at a rate that exceeds inflation due to factors beyond the immediate control of the City. Nonetheless, over the past several years, City leaders have worked with labor partners to negotiate ways to share these cost obligations between the City and the employees.

The City has made many strides in recent years to achieve this principle. In regard to pension costs, the City has increased employee pension and retiree health contributions and established new pension tiers for future civilian, sworn, and Department of Water and Power (DWP) employees. The savings for the

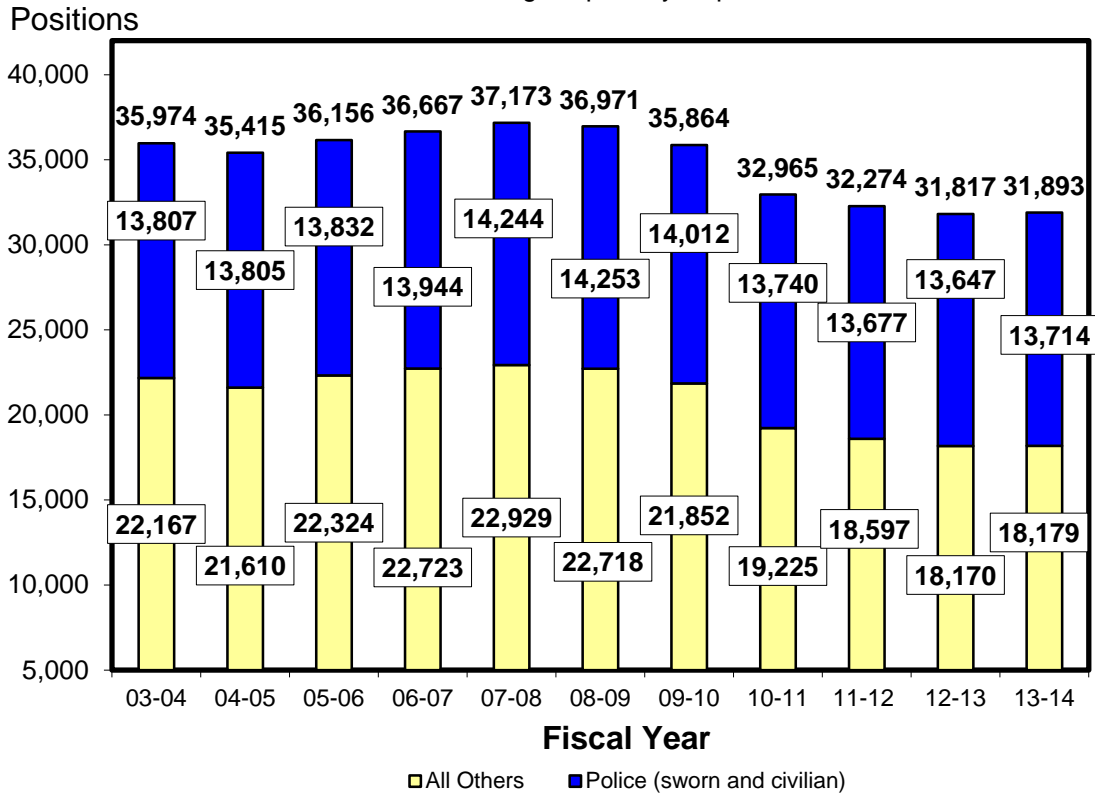
new civilian pension are expected to be approximately \$4 billion over the next 30 years in present value (C.F. 10-1250).

This fiscal crisis has demonstrated the central role that salaries and benefits have in driving City costs. While at first, we only had the blunt force tools of layoffs, furloughs, and early retirement, it is clear that the best way to manage these costs in the long term is to control the number of City employees and their salaries. To reduce salary costs, the City has reduced the starting salary for several classes, and reduced the size of the City's workforce by 14 percent, or 4,750 employees since 2007-08.

Chart 1

AUTHORIZED CITY STAFFING

Not including Proprietary Departments



In partnership with the City workers and union leaders, the City was also able to mitigate the growth in health care costs by implementing 5 percent employee contributions to health care premiums for active non-represented employees, and negotiated 5 percent to 10 percent employee contributions for several represented employee groups to reduce the City's health care costs; adopting plan design changes to the City's benefit plans, including increasing co-pays, implementing a narrow network, and changing one of the City's health care providers.

Resolution of Major Labor-Related Lawsuits

During the fiscal crisis, the City worked with many of its labor partners to identify and agree to ways to reduce employee costs. Among the tools used to generate cost savings were increasing pension and retiree health care contributions, and implementing furloughs and unpaid holidays. The City Attorneys Association did not agree to these approaches and brought lawsuits against the City.

As a result, the City imposed cost cutting mechanisms, including imposing furloughs and freezing the retiree healthcare subsidy level. In turn, the City Attorneys Association sued the City claiming that the City did not have the right to take these actions unilaterally in two separate cases. Recently, as a result of successful global mediation efforts between the City and the City Attorney bargaining units, the City was able to settle the lawsuits and enter into a new labor contracts with a bargaining units. Items in the MOU's resulting in long-term savings include:

- 3 years of no cost of living adjustments
- 4 percent contribution to retiree health care
- 10 percent contribution toward health care premium for active employees
- Reduction of starting salary for future city attorneys
- An elongated salary step structure

In addition, the City also resolved a major lawsuit regarding reciprocity with the DWP. In this case, *Romero v. the City of Los Angeles*, members of the DWP pension board sued the City for refusing to end the practice reciprocity between City and DWP employees. After months of settlement discussions, the City agreed to end reciprocity on the condition that a new pension tier be implemented for future DWP employees. In addition, like the global settlement with the City Attorneys, the City also adopted a multi-year agreement with the International Brotherhood of Electrical Workers (IBEW) which resulted in pushing out a contractually obligated cost-of living adjustment three years, three years of no cost-of-living adjustments and a reduction in the starting salary of over 30 DWP classifications. The savings to DWP ratepayers over 30 years of both the settlement and MOU are projected to be over \$415 million during the term of the contract (C.F. 13-1004).

STRENGTHEN REVENUES

Raise new revenues through the support of voters and through efforts that grow the economy and stimulate job creation, while protecting and maximizing existing revenue sources through a responsive collection system and full cost recovery of services rendered.

To ensure improved collections, the City established a feasible target for the collection of aged receivables and presented a plan of action to improve the City's ability to collect on these accounts. We have also sought to ensure that programs that are appropriately fee-supported are effectively covering their costs by reducing the General Fund subsidy for special funded programs, and moving El Pueblo and golf operations toward self-sufficiency. These practices will help to ensure that we can continue to provide vital services even as their costs inevitably rises.

Other efforts that have strengthened revenues include:

- ✓ Improving the monitoring and coordination of collection efforts by establishing the Office of the Inspector General for Revenue and Collections.
- ✓ Improving transportation grant accounting resulting in an additional \$42 million in one-time revenue.
- ✓ Absorbing over \$81 million in former CRA revenue within the General Fund.
- ✓ Conducting Proposition K program reconciliation to identify \$18 million in one-time General Fund reimbursements.
- ✓ Identifying \$140 million in earnings and savings from voter-approved General Obligation bond projects to invest in police, fire and animal shelter projects and ensure the completion of projects promised to voters.
- ✓ Partnering with labor to identify \$10 million of funds to disencumber and reprogram.
- ✓ Establishing a part-time traffic officer program to increase traffic enforcement resulting in increased revenues and enforcement.

Other efforts to strengthen revenues were unsuccessful. In 2013, the City's voters were asked to consider increasing sales tax by 0.5 percent to bring an end to the City's fiscal crisis and begin a process of restoring the services that were cut or eliminated or protecting services in jeopardy of being impacted, like public

safety. This initiative would have generated over \$200 million a year of new revenue on an annual basis. This new revenue would have provided the City fiscal stability, and an opportunity to reinvest one-time revenues used to address each deficit and to reinvest in the City's aging infrastructure. The voters decisively voted no on the proposal and sent a message that we still had work to do to instill confidence and trust.

LESSON LEARNED: MOVE FORWARD BY STAYING THE COURSE

Working under the five guiding principles, significant steps have been taken to create a more sustainable workforce and to control salary and benefit costs. Non-core services have been curtailed, eliminated, or folded into other core functions. City departments have been restructured in order to take advantage of synergies or efficiencies. There is a renewed focus on generating and collecting revenues.

In addition to the positive steps taken by the City to address our fiscal crisis, we are also beginning to experience a steady economic recovery. While encouraging, the economic recovery will not give the City the means to immediately, or at any point, reconstruct itself in its prior image. Nor should that be our goal. Instead, the improving economy provides us with the opportunity to learn from our mistakes and build on our accomplishments to stay on our course toward being better prepared to address the next significant fiscal challenge.

Although the worst of the economic crisis is behind us and our revenues are recovering, the City should continue to stay the course by adhering to the guiding principles that ushered us through the crisis. We also need to recognize that some of the necessary and difficult decisions made under those principles to address the fiscal crisis of the past several years might be considered counter to good management practices. For example:

- As a result of the Early Retirement Incentive Program, the City's most experienced workers left City service without any succession planning or even time for a proxy exit memo.
- In an effort to protect public safety and direct community service departments like Street Services, internal support service departments including the Information Technology Agency and General Services received disproportionately higher reductions without reconciling the impact.
- The uncertainty and disequilibrium created by reducing labor costs through concessions and staff reductions severely impacted morale and created a culture of "surviving another day" and "doing more with less" instead of innovation, creativity, and ingenuity.

- Departments' flexibility to invest, hire, and adjust staffing levels with changes in demand and priorities was significantly curtailed as the City struggled to control costs, curtailing General Managers' authority and accountability to outcomes and performance.

As the economy grows and the City's projected deficit shrinks, the City now has an opportunity to heed the voters' message and continue on its path of reform. What is needed is a new comprehensive plan, based on the same guiding principles and with the same urgency, specificity, and focus as the plans that kept the City solvent in the face of its extreme fiscal challenges.

WHERE WE ARE NOW? STILL RECOVERING, NOT RESTORING

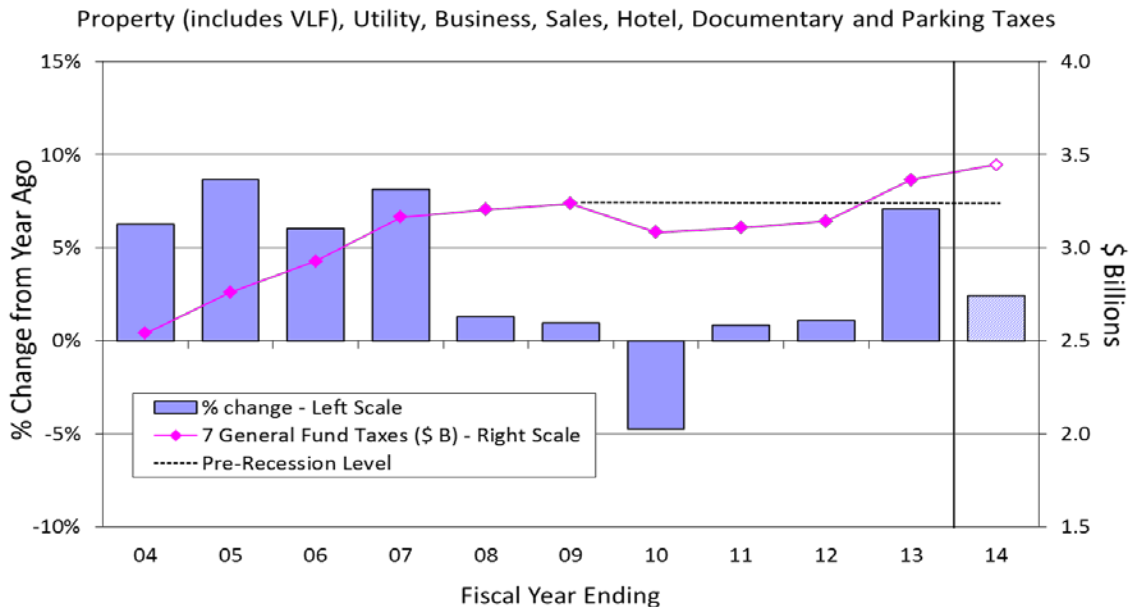
The City continues on the path to economic recovery. The unemployment rate in Los Angeles County is down from a high of 13.3 percent in July 2010 to 8.8 percent in December 2013; although this is still well above the low of 4.3 percent in December 2006. Real estate market indicators are also positive. The Department of Building and Safety estimates that construction permits for residential units will increase 15 percent from the previous fiscal year. The median price of single family homes in the City has increased by 10.75 percent in December 2013 from the previous year.

However, this growth may be tempered by the declining volume in home sales, decreasing 2.5 percent from the previous calendar year, which may be attributed to increasing home prices and mortgage rates as well as low inventory. Taxable sales and hotel occupancy and rates continue to increase, translating to increased sales tax and transient occupancy tax revenues of 3.5 percent and 12.8 percent, respectively for the calendar year.

Connected to these initial signs of recovery, revenues have exceeded pre-recession levels, with a 6.3 percent increase in 2012-13 from the prior year, and a projected 4.3 percent increase in 2013-14. These revenue increases are largely due to increases in real estate and economically driven taxes, such as property, documentary transfer, sales and hotel taxes, supporting confidence that the local economy is on the mend.

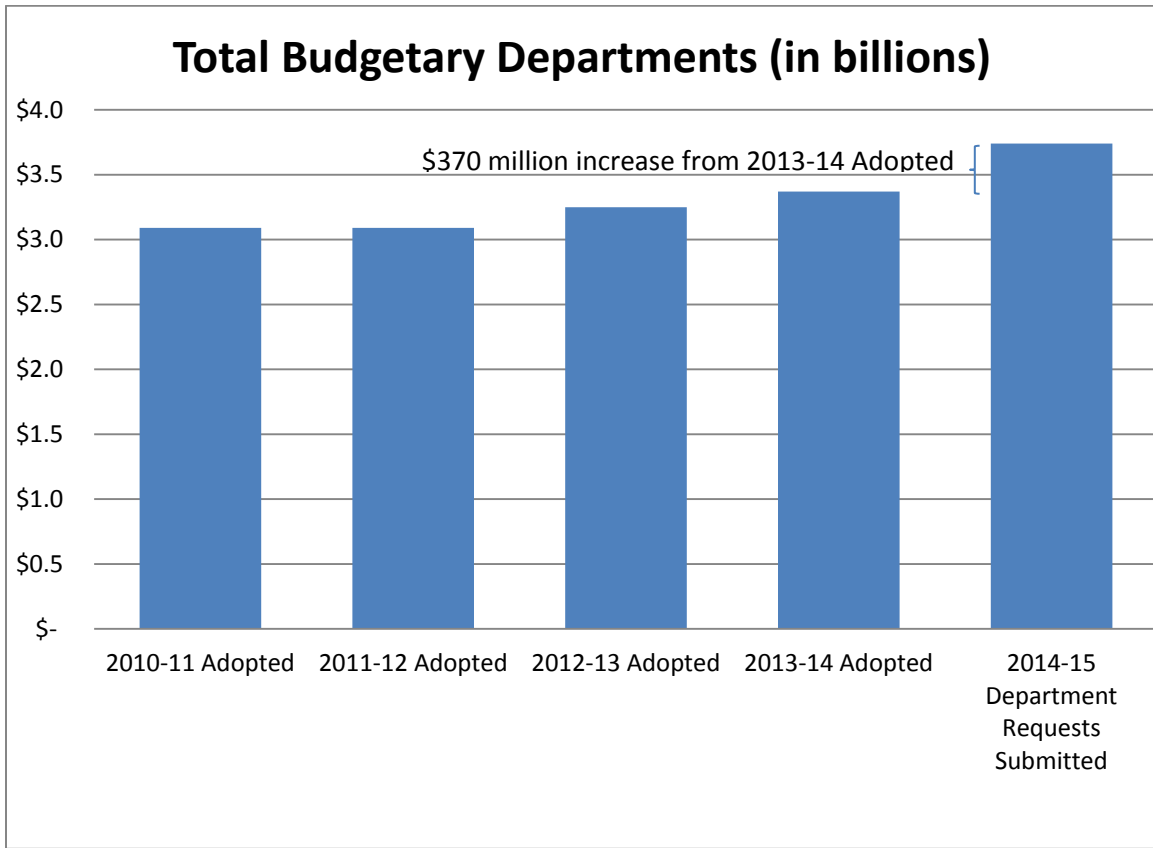
Chart 2

7 General Fund Taxes



With this encouraging news, there is the growing sense in the City that our fiscal condition has improved, generating pressure to restore services that have been cut, or to expand and add new services that are needed. The vision of a City that can improve the quality of life for our residents is compelling. Therefore, it is understandable that many in the City are identifying new ways to use City resources. For example, the recent departmental budget submissions, if all approved, would increase the City's expenditures by \$370 million. This is irrefutable evidence of the pressure to rebuild the City.

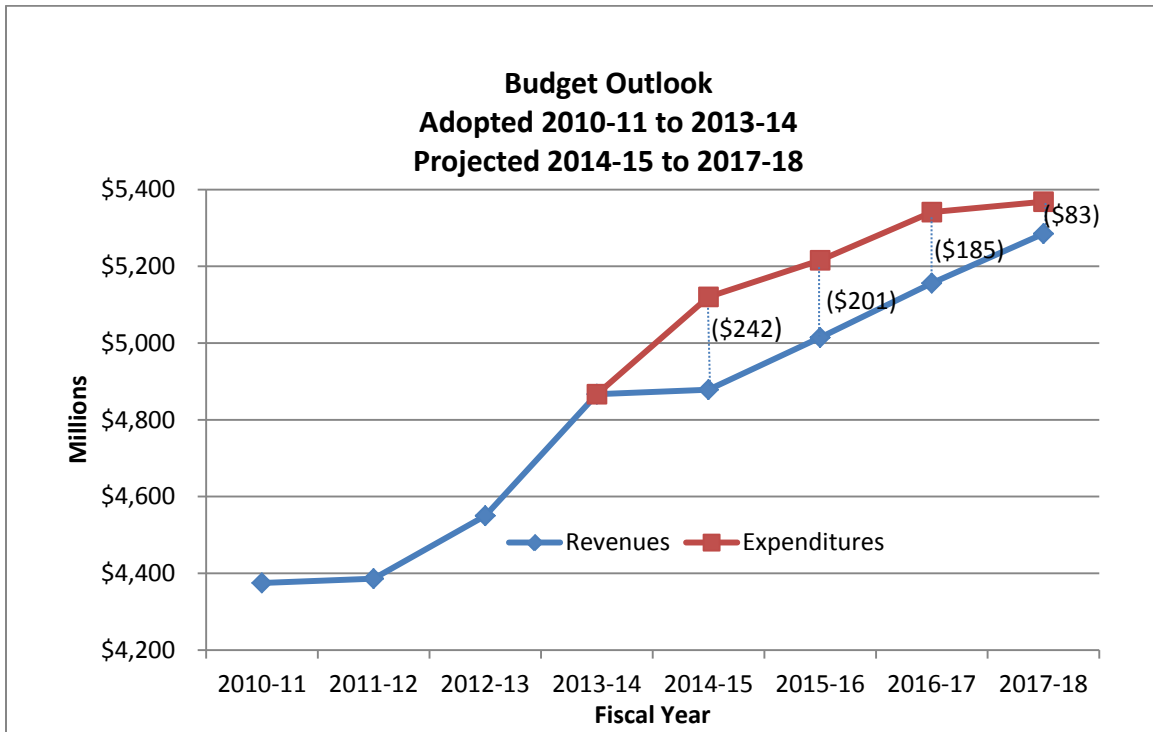
Chart 3



Unfortunately, the economic recovery will not give the City the means to immediately, or at any point, reconstruct itself in its prior image let alone to dramatically add new services. In fact, the City is facing continued deficits for the next five years.

The Revised Four-Year Outlook included in the Second Financial Status report projected a \$242 million deficit in 2014-15. This is a daunting challenge for the current budget development process. The deficit is projected to decrease in future years to a low of \$83 million in 2017-18.

Chart 4



This decrease, however, could be compromised by a number of costs or reductions in revenue not currently included in these projections such as the continuation of the Fire Department's unfunded Ambulance Augmentation Plan and issues related to the Fire Dispatch Center staffing, which could increase the 2014-15 deficit by approximately \$14 million.

These increases will be partially offset by \$10 million in savings due to slightly lower than anticipated pension contribution rate. However, these savings will be eliminated and the deficit could increase if labor negotiations result in significant changes to employee compensation.

In summary, while our economy is recovering, we are not in a position to restore old services or add new services. Instead, we need to stay the course. The following sections provide concrete recommendation that will set the appropriate balance between growth and solvency, acknowledge and plan for significant pending liabilities, and base expenditure decisions on desired outcomes.

WHERE WE ARE GOING? ELIMINATE THE STRUCTURAL DEFICIT

RESPONSIBLE FISCAL MANAGEMENT

- 1. Recommendation on balancing growth and solvency: Adopt as a policy objective, the elimination of the structural deficit by Fiscal Year 2018.**

Faced with the tension between restoring and adding new services, and staying on a course of sustained fiscal solvency, we must choose the latter. There are three key components to staying on this course: Strengthening our Reserve Fund, containing labor costs, and seeking to back any new expenditures with new revenues.

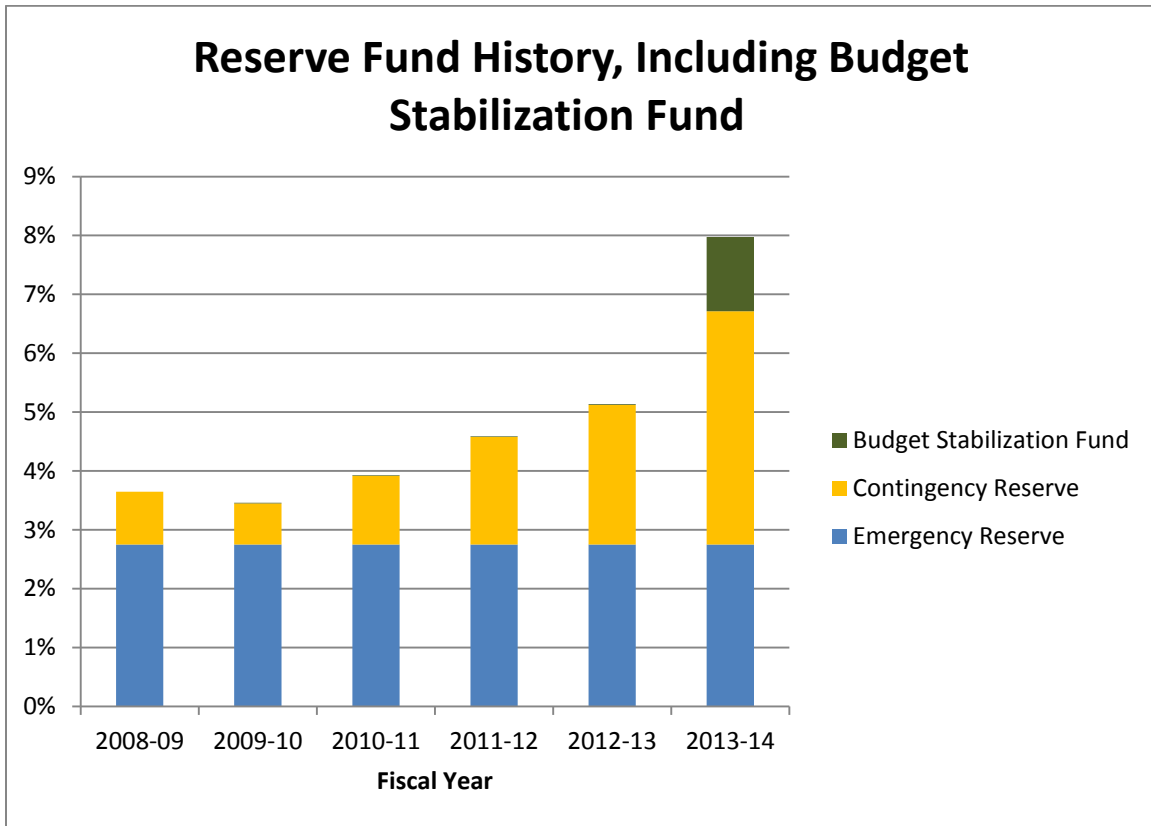
- 2. Recommendation on strengthening the City's reserves: In the event that the Reserve Fund and/or Budget Stabilization Fund are used as a resource to ease the lingering impacts brought on by the economic crisis, restore the Reserve Fund and Budget Stabilization Fund over the course of the next three fiscal years, and increase their combined balances to ten percent of budgeted General Fund revenues.**

Pursuant to the City Charter, the Reserve Fund is comprised of two components. The Emergency Reserve equals the first 2.75 percent of all General Fund receipts and is to be used only in the case of a significant economic downturn, a natural disaster, or some other significant unanticipated event. The remainder of the Reserve Fund is the Contingency Reserve.

Not technically part of the Reserve Fund but also an economic reserve for the City is the Budget Stabilization Fund. This Fund is comprised of excess revenue from seven economy-sensitive taxes, Property tax, Utilities Users' Tax, Business Tax, Sales Tax, Transient Occupancy Tax, Documentary Transfer Tax, and Parking Users' Tax. If cumulative receipts from these taxes are 3.4 percent above the prior year's level, those excess receipts are directed to the Fund. The Fund will primarily be used to offset shortfalls that occur due to lower than usual (3.4 percent) growth in these taxes, or for one-time uses if the amount in the Fund exceeds 15 percent of the General Fund budget.

At the start of 2013-14, the Emergency Reserve held \$133.8 million, the Contingency Reserve held \$192.8 million, and the Budget Stabilization Fund held \$69.5 million. Even with \$8 million from the Budget Stabilization Fund programmed for transfer to the General Fund as part of the Approved 2013-14 Budget, these three reserves together were equal to 7.98 percent of the City's 2013-14 General Fund budget.

Chart 5



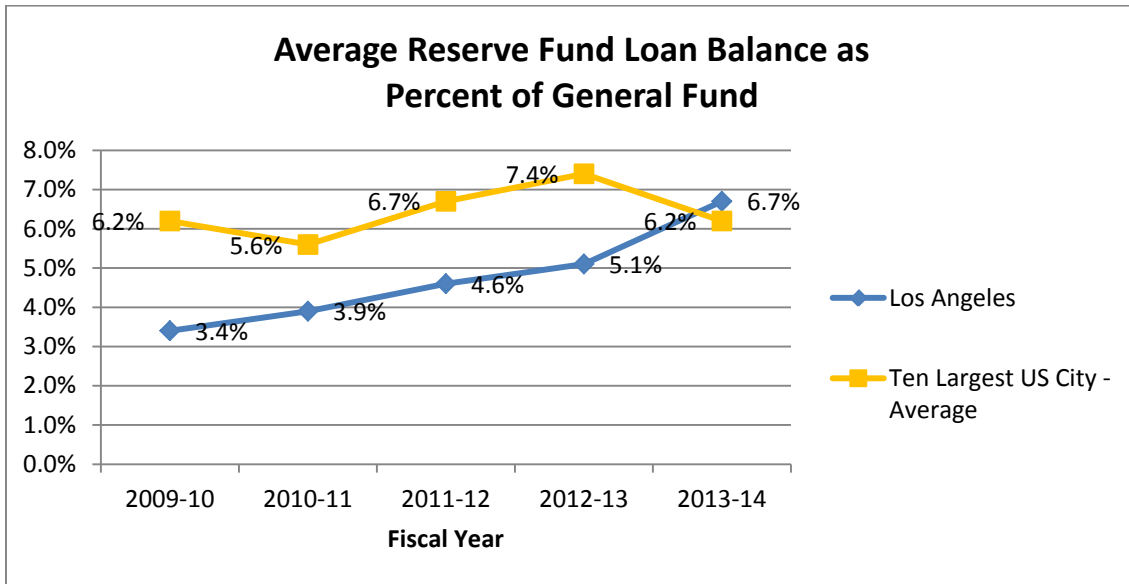
The increase of the City's reserves in the face of the fiscal crisis is a significant accomplishment. As illustrated in the table above, the 2013-14 Budget saw the most dramatic increase. This increase was buoyed by the receipt of a series of one-time revenues. Adhering to City policy, many of those revenues were directed to the Reserve Fund, protecting the City from an even greater structural deficit. As the City faces the final years of the fiscal crisis, the larger Reserve Fund provides the opportunity for one-time solutions as we wait for revenues to catch up with expenditures. Using the Reserve Fund in this way is only appropriate if the excess funds are used for current level expenditures rather than for ongoing, expanded services. Further, this Office only supports borrowing from the Reserve Fund in this way in the short term, in the context of a the three-year goal to increase the City's total reserves to ten percent of General Fund revenue and to eliminate the structural deficit.

Although higher reserves tend to be a sign of greater fiscal health, there is no best practices standard that would apply to all jurisdictions. The Governmental Finance Officers Association recommends that governments should maintain a reserve level equal to two months expenditures, or 16.7 percent of annual expenditures. This level, however, is not considered to be required for larger

jurisdictions that are better able to predict contingencies and have more diversified revenue streams.¹¹

This Office recently released a study comparing the reserve fund levels for the ten largest cities in the Country, and found that the City of Los Angeles' current Reserve Fund level is close to the median level in these jurisdictions. Thus, our current practice is consistent with national standards. Nonetheless, increasing the Reserve Fund would both help the City to successfully address unanticipated fiscal contingencies, and demonstrate our fiscal responsibility to investors and taxpayers.

Chart 6



3. Recommendation on addressing mid-year budget challenges: Maintain as a practice closing shortfalls that surface within each fiscal year without relying on the City's Reserve Funds.

The City is recognized by the bond rating agencies and investors for not waiting until the budget process to address shortfalls. At least four times a year, this Office submits Financial Status Reports (FSRs) that provide a snap shot of revenues and expenditures. Any discrepancies are dealt with as they surface. This practice has allowed the City to build up the Reserve Fund, control unplanned spending and closely monitor revenues. Maintaining this practice will be critical in eliminating the structural deficit by 2018.

¹¹ Government Finance Officers Association, *Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2001 and 2009) (BUDGET and CAAFR)*, page 2, footnote #5.

4. Recommendation on addressing liabilities: Create a plan to address prolonged major legal liabilities within three years, through solutions that provide a risk management framework of corrective action plans to prevent the recurrence of similar liabilities.

In Standard and Poor's recent summary of its rating of the City's debt, the most significant weakness it identified was in the City's debt and liability profile. A key component to that assessment was that "large contingent liabilities related to pending litigation, if successful, could significantly increase future liabilities for Los Angeles." In this assessment, it specifically referred to the ongoing *Ardon* case related to the City's Utilities Users' Tax. Standard and Poor's further stated that one factor that could impact their decision to raise their rating would be an improvement of the City's "liability profile."¹²

Even though we firmly believe that the ultimate exposure from the *Ardon* case is lower than the potential worst case scenario of \$750 million, it is only one of a number of cases that are currently being litigated against the City that cumulatively impose significant potential liability. There are also cases related to accusations of wrongdoing against LAPD employees, for example, fabrication of evidence in *Lisker v. City of Los Angeles*. There are cases brought against the City by billboard companies including Clear Channel Outdoor, Regency Outdoor, and CBS Outdoor. Other cases relate to the City's compliance with federal accessibility laws, including *Independent Living Center of Southern California et al v. City of Los Angeles*.

The potential liability in these and other cases has a demonstrated negative impact on the City's cost of issuing debt. In many of these examples, the City hopes to prevail on the merits of the case, but where it may not this Office intends to work with the City Attorney to develop and implement specific strategies to mitigate major known liabilities. In this way, liabilities can be an opportunity to drive policy changes and funding decisions that can ultimately reduce the City's exposure.

Moreover, there are hundreds of cases involving employee discrimination and other issues that do not receive the same attention as the high profile litigation. Each case offers an opportunity for management to identify the underlying causes and adopt corrective action plans to ensure that the same mistakes are not occurring again and again. It is recommended that working with the City Attorney and the Controller, the implementation of these plans be audited to ensure that the corrective action plans are actually implemented and maintained throughout the City.

¹² Standard and Poor's Rating Services; "Ratings Direct. Summary: Los Angeles California; Appropriations; General Obligation." December 20, 2013.

Sidewalk Program

State law stipulates that the fronting property owner is responsible for maintaining the sidewalk in good condition. In 1973, however, in part because of the availability of Federal funding, the City enacted a limited exception to the State law and assumed the responsibility for repairs to curbs, driveways, and sidewalks damaged as the result of street tree root growth. The City's sidewalk network is extensive, measuring over 11,000 miles and we would incur significant costs to address all damage caused by trees, and do incur significant liability costs due to cases against the City by people that trip and fall on damaged sidewalks. Our average payouts to people that trip and fall over tree root or otherwise damaged sidewalks over the last three years have been approximately \$1.9 million annually. Further, the City is currently being sued in the case *Willits, et al. v. City of Los Angeles* under the claim that there are sidewalks that are not accessible in accordance to the standards set by the American with Disabilities Act. This also represents a significant potential liability.

The 2013-14 Budget includes \$10 million in the Unappropriated Balance for the City to begin a sidewalk program, under the management of the Bureau of Street Services. On January 14, 2014, the Bureaus of Street Services, Engineering, and Contract Administration, and this Office released a joint report that proposes a plan for the use of these funds. Among the issues discussed in the report is whether it is more cost effective to repair damaged sidewalks with City staff or with contractors. Ongoing funding to fix sidewalks should be included in the 2014-15 Budget and in future budgets. By adequately funding sidewalk repairs, we can not only make strides in a fair settlement in the *Willits* case, but can also reduce the number of future trip-and-fall claims against the City, thereby reducing a significant future liability.

- 5. Recommendation on the use of the General Fund as a backstop: Limit the reliance of the General Fund to offset federal cuts to the Community Development Block Grant Program and other grants, and prioritize City funding for services supported by these sources against all other City services.**

Notwithstanding the City's own fiscal challenges, actions by the federal government to impose across the board reductions through sequestration, compliance reviews, and other budget actions have created more demand for the City's limited General Fund resources. Simply relying on the General Fund to offset reductions from the federal government is an unsustainable proposition. Moreover, fully offsetting reductions from the federal government signals to departments and the public that these services are a higher priority than others. This is the current dilemma the City faces with the Community Development Block Grant (CDBG).

City leaders will be faced with a difficult policy decision – should the City eliminate or reduce the services impacted by Federal reductions, or should the

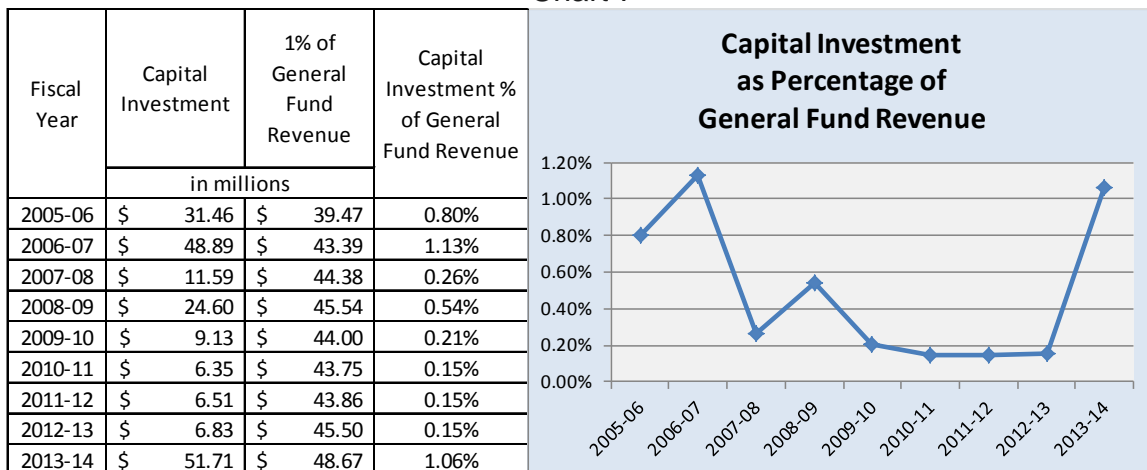
City find another funding source, with a likely ongoing impact on the General Fund, in order to maintain the services. The services themselves are important. The community-based organizations performing such activities as educational and vocational training, employment placement and retention services, extended hours and programs at parks throughout the City, litter and graffiti abatement, fixed hiring sites for the City's Day Laborer Program, and revitalization efforts for the L.A. River. Funding these services with the General Fund, however, would ultimately reduce the City's ability to perform other vital services.

6. Recommendation on capital programs and investments: Revise the Capital Investment Policy to incorporate a five-year investment plan inclusive of special funded and bond-funded investments in capital assets, and that takes into account outcomes related to the desired quality of our infrastructure as opposed to a standard resource allocation of one percent of General Fund revenues per year.

The City has invested billions of dollars in assets, including roads, buildings, and parks. It is of the utmost importance that these assets be protected through regular maintenance, albeit at a significant cost. Therefore, in 2005 the City established a policy through which one percent of all General Fund expenditures would be appropriated for investing in and maintaining our capital assets annually. The policy reflects the important goal of investing in capital. In some instances, the City has bond or special funding that can be used to protect these assets but in many cases the maintenance is a General Fund obligation.

During the recent fiscal crisis, the City was forced to take extraordinary measures to manage the economic turmoil. The City chose to suspend this policy. Wherever possible, the City provided capital investment funding but it was below the one percent level. The following table shows the level of capital investment since the adoption of the policy in 2005.

Chart 7



For the current FY 2013-14, the City was able to fully restore and exceed capital funding beyond the one percent level. Despite this, however, it is duly noted that the policy requiring one percent of General Fund expenditures each year is not the most strategic way to ensure an adequate level of capital investment. For one thing, it does not take into account special or bond-funded investments in capital assets. Nor does it take into account the actual need for maintenance based on an inventory of assets, maintenance standards, and a prioritized, planned schedule. Therefore, while we must invest in our capital assets, we must also revisit our current policy to ensure that all investments are captured and that the City makes a consistent practice of performing maintenance and protecting our assets on an ongoing basis. Revising this policy in this way would reflect a shift from a focus on resources to a focus on outcomes.

FOCUS ON CORE SERVICES

As a result of the defeat of Measure A, the proposed initiative to increase the City's share of the sales tax, the City continues to endure an ongoing struggle with a structural deficit and liabilities and is not in the position to restore service cuts or initiate significant new programs. Nonetheless, the City will need to find a way to respond to the service demands in our communities. Where new services cannot be funded by additional revenues, savings will need to be identified to offset the costs of the new services, or existing resources will need to be reprioritized.

An important lesson learned is that it's easier to implement a service strategically the first time than to restructure it once it is already being offered. In light of this, there needs to be a fundamental shift in the way the City thinks about implementing services – a shift toward expecting and measuring outcomes rather than a focus on resources or staffing. Mayor Garcetti has already taken an important first step toward a focus on outcomes through the initial implementation of a performance based budget process for 2014-15. There are several other recommendations discussed below where the City can refocus service delivery toward this outcome-driven approach in the years to come.

Performance Budgeting

In order to focus on core services we must have the ability to prioritize among the many important services provided by the City and to assess the effectiveness of programs using well thought out and accurate metrics. Using this assessment, we should make decisions to fund higher priority and more effective programs at a higher level, and reduce or eliminate funding for low priority or ineffective programs. When applied in a comprehensive manner to budgetary decisions, this type of analysis is known as Performance Budgeting (PB). For many years, the City Council has requested that the budget process incorporate more elements of PB to facilitate this broader, comparative analysis.

Many of the difficult decisions made in recent years have been based on a limited prioritization analysis but the approach has not been comprehensively applied. In preparation for the 2014-15 Budget at the direction of the Mayor, the City has taken significant first steps toward a comprehensive PB approach. Among the key elements of the Mayor's PB approach are:

- The establishment of nine priority outcomes. City departments are expected to focus their services and efforts toward achieving elements within these priority outcomes:
 1. Promote good jobs for Angelenos all across Los Angeles.
 2. Restore the City services that make our neighborhoods livable and attractive.
 3. Make our communities the safest in the nation.
 4. Create a more sustainable and livable city.
 5. Live within our financial means.
 6. Provide outstanding customer service to our residents and businesses.
 7. Deploy innovation and technology to modernize city government.
 8. Restore pride and excellence in public service.
 9. Partner with citizens and civic groups to build a greater city.
- Budget requests must align with these outcomes. The 2014-15 Budget process required departments to illustrate how their existing services and proposed new services fall within the Mayor's priority outcomes.
- Results teams comprised of the Mayor's Office, Council Offices, the Controller's Office, departments, and this Office that evaluated budget requests within each priority outcome, and ranked them based on both how closely they align with the outcome, and how effectively they achieve the goals within it.

When presented to the City Council in April, the Proposed 2014-15 Budget will take the first step in identifying resource appropriations by priority outcome, and will offer specific metrics by which the effectiveness of programs can be measured. Over time, this new way of budgeting will enable the City Council to better determine whether the programs proposed for funding will support the achievement of their goals for the City, and the effectiveness of the those programs. In this way, PB is intended to shift the City budget discussions away from what resources should be added or cut, and toward the outcomes that we expect to achieve. Performance Budgeting will take several years to fully implement, but will be critical in aligning resources to specific outcomes.

7. Recommendation on Fire Deployment: Adopt and implement the recommendations in the recent Fire Department deployment study over the next several fiscal years insofar as they will enable the Fire Department to focus on achieving positive outcomes in its core services and reinvest savings back to the Fire Department.

Personnel costs are a major driver in the cost of Fire Department services, and are driven by deployment strategies which are complex and must carefully balance costs against the need for high quality protection of public safety, and the safety of department staff. Due to the complexity and sensitivity of deployment decisions, it has been difficult to effectively balance public safety, firefighter safety, and cost effectiveness.

Therefore, the 2013-14 Budget included funding for an independent analysis of all Los Angeles Fire Department operations. The recently released study includes analyses of deployment, potential civilianization of certain functions, dispatch strategy, and response times, and benchmarks these operations against best practices and other jurisdictions. The final report is currently under consideration by the Mayor and Council.¹³

The goal of the study is to enhance the amount of service that firefighters can provide in their core roles in fire suppression and emergency response. One area of focus is the opportunity to civilianize roles that are currently performed by firefighters. Increasing the use of civilians where appropriate, allows firefighters better focus on their core outcomes of firefighting and EMS; increases resources and personnel availability; and reduces the reliance of overtime.

For example, this Office also supports considering the role of ambulance transport currently provided by Firefighters who are responding to medical calls. The vast majority of calls requiring Fire Department response (80 to 85 percent) are for emergency medical services (EMS). Firefighters respond to the call, and attempt to stabilize the patient at the scene. In some cases, patients must then be transported to an area hospital in a Fire Department ambulance, and the firefighter must remain at the hospital until the patient is formally admitted for care. This process can take a significant amount of time, during which time the ambulance and firefighters are not available to respond to other calls. Further, all this occurs after the firefighter has already performed the core service of emergency response and stabilization of the patient.

¹³ C.F. 12-0600-S28

8. Recommendation on Police Workforce Capacity Study: Initiate the development of a Police workforce capacity study with recommendations for achieving desired public safety outcomes through a balanced approach among overtime, police hiring and greater civilianization of the workforce.

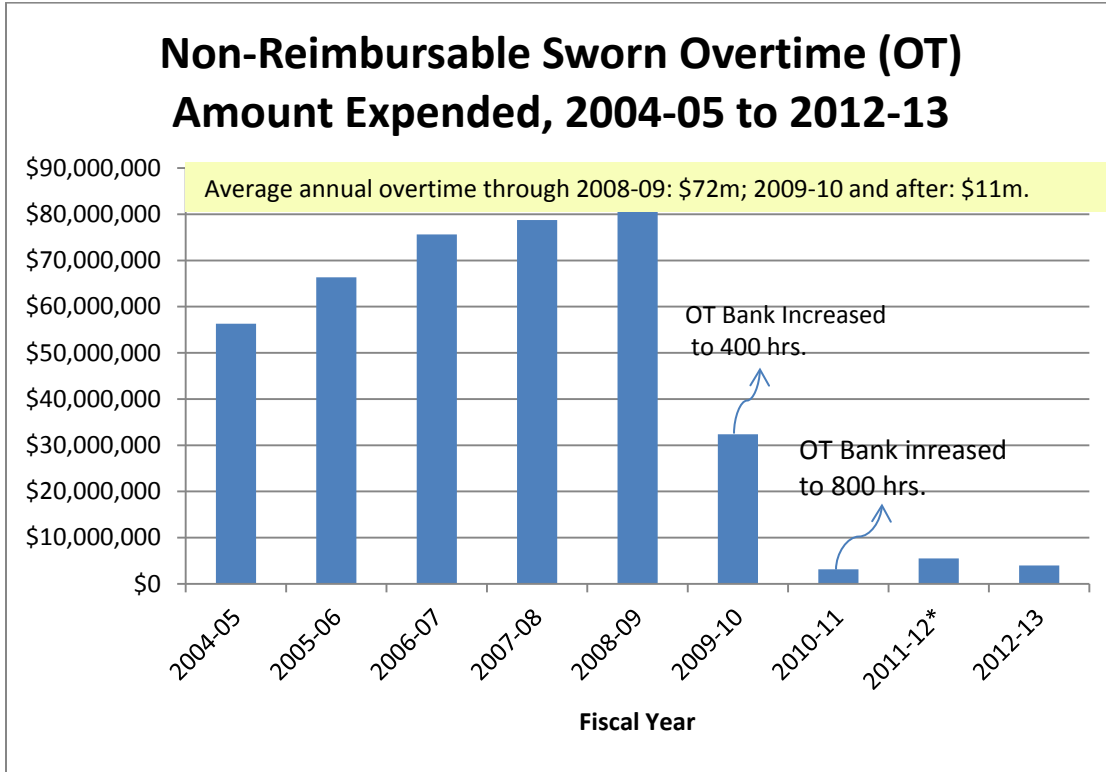
Over the past decade, the City has made a firm commitment to increasing, and now maintaining 10,000 Police Officers in the Police Department. No priority has been higher, and City leaders have had to make many difficult decisions related to other City services to stick to this commitment. Concurrent to these efforts, the City has experienced a consistent decline in crime rates to historically low levels. This accomplishment and the positive impacts on Angelenos cannot be understated.

The Police Department has expressed a clear relationship between the increased size of the police force and the ongoing decline in crime. Consistent with our renewed focus on outcomes and performance budgeting, it is the continued decline in crime and the associated improvement in the quality of life that should be the City's goal.

It is recommended that the City appropriate resources that will enable police officers to spend more time doing the important work of policing, which is indeed the central activity required for crime suppression. How to best appropriate these resources and whether our current practice meets that standard would be best determined through an in-depth, independent staffing capacity study. This study would include analysis of current deployment practices, civilianization of jobs within the Police Department, and the use of overtime. One important and pressing issue to illustrate this point is police overtime.

For the five years prior to 2009-10, the City had paid out an average of \$71.6 million in overtime payments to the Police Department's sworn employees. In an effort to reduce this payout in the short-term and overall use of overtime, the City and police officers union agreed to increase the amount of time individual police officers can bank from 150 hours to 800 hours. Combined with Chief Charlie Beck's efforts to reduce the overall use of overtime, this program effectively reduced overtime payouts on an annual basis to an average of \$11.3 million over the past four years.

Chart 8



This strategy did not come without its challenges. In order to manage this plan, the Police Department required police officers with high banks to take time off prior to getting to the 800-hour level. From a performance standpoint this has reduced the number of officers available for crime suppression.

In addition, the cumulative size of the bank has grown significantly. The remaining overtime bank also represents a large deferred liability that will continue to be a fiscal burden on the City for years to come. The cost to payout the bank today would be more than \$110 million. Fortunately, while the City is not held to a single one-time payout, the cost of the bank grows each year as officer receive cost of living adjustments and promotions. Payouts are done either when an officer promotes or when they leave city service.

The higher bank allowance of 800 hours will expire on June 30, 2014 with the termination of the current labor contract. Establishing a new, lower bank level would require the City to begin substantial payouts to police officers working overtime once again, or the loss of even more officer-hours if they continue to be required to take time off in-lieu of cash payments. This issue has been identified as an issue of concern by the City's bond rating agencies.

9. Recommendation on IT innovation and strategic planning: Adopt a smart and long-term plan for the City's investments in technology infrastructure to reduce risk, improve reliability, and improve quality through a cost-effective and modern system.

In the context of a fiscal crisis it can be difficult to change to more efficient processes when their implementation requires an initial investment and only offers a future payoff. While departments have made proposals in recent years for new and innovative programs, in order to address pressing budget shortfalls preference has gone to changes that show an immediate reduction in cost.

City leaders need to be given the ability to make more strategic decisions. In the absence of dedicated funding, however, it will always be difficult to invest current funds in a project with a future payoff. Information technology investments fall clearly in this category, with high implementation costs, and long-term benefits.

In recent decades, innovation and productivity have been driven by advances in information technology. While the increased use of technology has reshaped the look of government and public services, inherent risk aversion and tight oversight of finances have kept most governments from being on the cutting edge of technology innovation. While the City should not look to break new ground, it should be more nimble and better positioned to implement new approaches once they are developed and tested in the private sector and proven to be advantageous to our constituents.

The City has developed a relatively decentralized information technology model. While the Information Technology Agency (ITA) provides some central services, such as network and data services that clearly benefit from economies of scale, many department have maintained control over the applications that they use on a daily basis to perform core services. Departments with resources have supported this model as it provides them with the ability to take advantage of technological advances to improve their services, but many others have lagged behind.

In 2010 the City Council established the Information Technology Oversight Committee (ITOC) comprised of the Mayor's Office, the Office of the Chief Legislative Analyst (CLA), and this Office. The ITOC has enabled City leaders to provide a more consistent and strategic approach to the use of technology throughout the City. Under the direction of the ITOC, the City entered into a contract with a consultant to evaluate all elements of the City's information technology provision and to develop a comprehensive strategic plan going forward.

Avasant, the selected consultant, has recently released its study and we anticipate that it will be presented to the City Council in the near future. The study

will provide a framework for the discussion of how to best improve our use of information technology in the City to enhance our services, improve productivity, and reduce costs.

10. Recommendation on 3-1-1: Continue support for the development and implementation of the Customer Relationship Management System, and maintain as a long-term goal the ongoing consolidation of City call centers.

Several years ago the City initiated efforts to create one centralized call center reached by calling 3-1-1. The intent was to both make all City services more accessible through a single easy-to-remember number and to take advantage of economies of scale to have a more efficient call center operation. This effort was an important first step which resulted in the reduction in the number of lines required to contact the City and the establishment of a 3-1-1 call center that can handle all initial calls into the City. There are still at least four other sizable call centers operating in the City, and for the most part, 3-1-1 operators receive calls and then transfer the calls to either the appropriate call center or department if an actual service is required.

The next level of call center efficiency is to enable operators at City call centers to accept service requests and trigger a response. Callers should then be able to track their requests and the data collected should be used to measure program effectiveness. This information can also help inform budget priorities and allocation of resources. This program is known as a Customer Relationship Management (CRM) System. Due to budget reductions, earlier efforts to implement a broad CRM System were curtailed before it could be completed. Currently, however, the City is working to develop a new CRM system that will provide the comprehensive request and tracking functionality that the current system lacks. The first phase of the project is scheduled for completion in May 2015 and will include Bureau of Sanitation services, as well as requests for street services and graffiti removal.

While focused on public works in its initial roll out, the adoption of a common CRM platform will again enable the City to consider further call center consolidation. Once the CRM system is operational and proven effective, City leaders should again consider and discuss a broader call center consolidation. Issues to consider are the costs and benefits of consolidation and which department should be responsible for managing a consolidated call center.

Further, upon implementation, the CRM will enable the City to aggregate service delivery response data and support the focus on metrics that is central to developing a performance budgeting approach. This tool will be an important resource to help the City focus on outcomes and performance as the data will reflect actual responses and services provided.

ALTERNATIVE SERVICE DELIVERY MODELS

11. Recommendation on economic development and asset management: Develop a strategic plan for the use of City real estate assets, and continue to build toward the use of underutilized assets to enhance economic development efforts through a partnership between the Department of Economic and Workforce Development and a Non- Profit Economic Development Corporation.

The City's land and buildings are valuable assets that we should manage, maintain, and use on behalf of the City's residents. Through strategic management, these assets are a potential source of public benefit, but the City needs to do a better job of planning for their use through the development of a strategic plan for asset management. As an important first step, the City has recognized the importance of evaluating the use of our real estate assets to enhance our economic development efforts.

In the 2013-14 Budget the Mayor and City Council established a new economic development model for creating new jobs, attracting new businesses, and maximizing City assets. Through this model, a new Economic and Workforce Development Department (EWDD) was established to perform the primary economic development functions of the City. One key role of the Department is to administer workforce development and training functions which are primarily funded by federal grants. A second function includes two interrelated components that will allow the City to identify opportunities to leverage its real estate assets for economic development: 1) Enhanced management of the City's property assets to ensure that they are being used in the most economically advantageous manner; and, 2) the recruitment and support of new businesses to establish themselves in the City and drive economic growth.

The continued development of this new model will set the City on a path of enhanced and better coordinated economic development. While the job training component of the new department is established and functioning, in the coming year City leaders will have to consider and decide on the best path for economic development activities such as asset management and business recruitment. The CLA and this Office will report to the Economic Development Committee and Council within the next several weeks about options relative to partnering with a non-profit organization focused entirely on this type of work. This model has proven effective in other jurisdictions, including New York City. The degree to which the model is implemented and the role that EWDD plays relative to asset management and other aspects of economic development needs to be determined in the coming months.

SUSTAINABLE WORKFORCE

- 12. Recommendation to mitigate labor costs: Maintain the civilian pension reforms adopted and partner with Labor to ensure sustainability of long-term costs by controlling labor, health care and pension costs.**

It is recommended that City leaders support efforts to:

- a. Ensure that all employees pay 10 percent toward the cost of health care premiums;**
- b. Seek salary step reforms and entry level salary reductions;**
- c. Control pension and compensation costs by not providing cost of living adjustments for a minimum of three years;**
- d. Implement the Controller's recommendation to modify injury on duty payments so they are comparable with other government agencies**

This Office is optimistic new collective bargaining agreements can be reached that are beneficial for both the employees and the City and that allow for ongoing stability and partnership between management and labor.

Employee Healthcare

Currently, the City offers a generous healthcare subsidy to its employees. For civilian employees, that subsidy is tied to the premium for the Kaiser family plan, which is currently \$1,408 per month. More than half of civilian employees are in the Kaiser plan. For sworn employees, the current subsidy is \$1,169 per month, which can be applied to the premium cost of a variety of plans. In most cases, the employee is only responsible to pay for the difference between the premium amount and the City-provided subsidy. There is always, however, at least one plan available to meet the employees' health care needs without their paying for any portion of the premium.

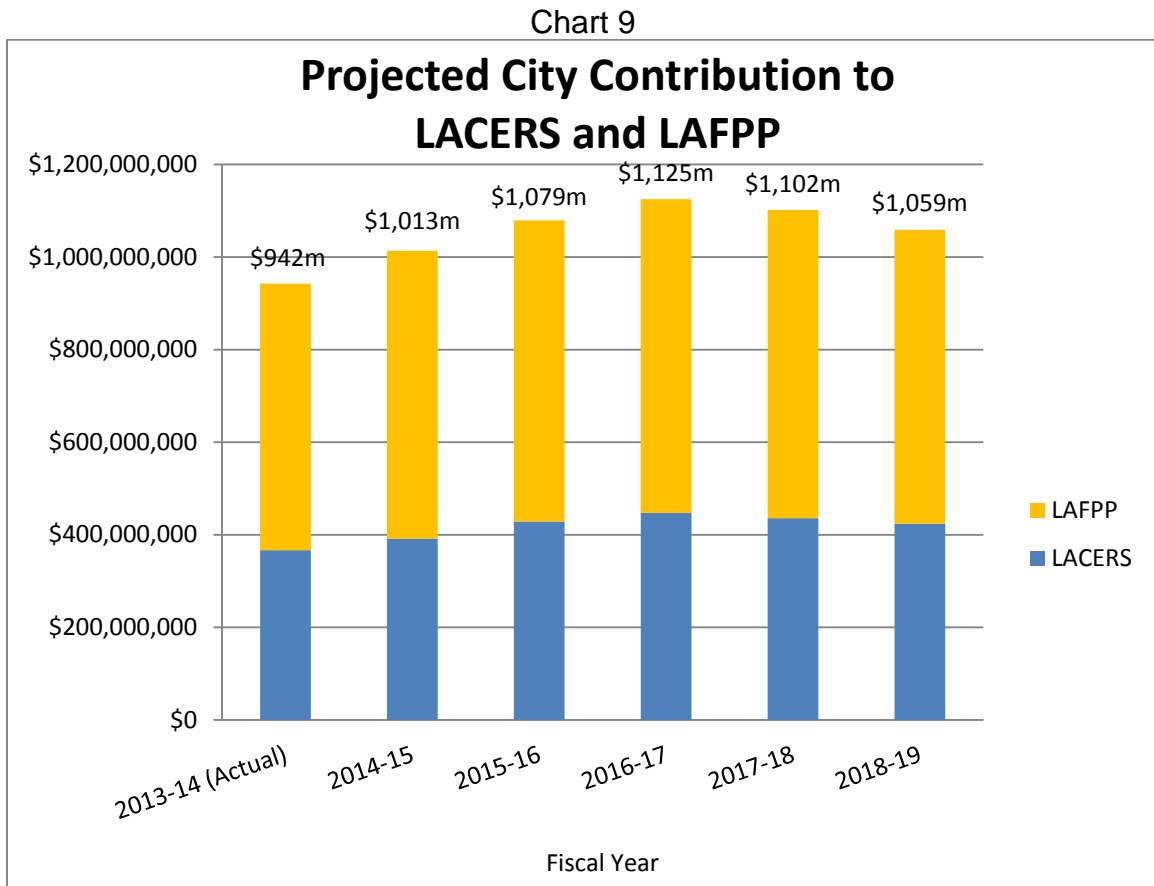
At the same time, healthcare costs continue to rise nationwide. Since the City has historically guaranteed a subsidy tied to a designated service level, a majority of the cost increases have been borne by the City rather than by the employees. Since these increases in healthcare costs are driven by the industry, the City has little control over the increases beyond attempting to negotiate favorable rates with the carriers in partnership with labor.

A stated goal for negotiations between the City and the employee organizations that represent City employees is to require employees to pay at least 10 percent of the cost of their individual healthcare premium. To date, several employee

organizations have agreed to pay five percent of the premium and several more have agreed to contribute ten percent of the premium beginning in 2014 or 2015. Extending this requirement to all City employees would be a positive step in reining in the City's costs in the area of employee healthcare. It is estimated that if all employees paid 10 percent of the premium, it would result in annual savings to the General Fund of over \$35 million.

Pensions

The General Fund is responsible to make a large contribution each year to support pension payments for LACERS as well as the Fire and Police Pension System. As discussed above, the City has made strides to control this annual contribution by increasing employee pension and retiree health contributions and establishing new tiers for future employees. Even with recent reforms the annual contribution is large, growing, and variable, as demonstrated on the table below.



Source: Illustrations of future City contributions prepared by Segal (actuary) as commissioned by the CAO.

Many of the drivers of our pension costs, such as the stock market, the obligations to existing retirees and to current employees when they retire, and the amount of time that retirees remain under the system, are beyond the control

of City leaders. It is recommended that the City instead focus on the cost drivers of the pension system that it can control, including the obligations to future employees that have not yet entered the system, employee salaries, and the number of City employees.

In addition, it is anticipated that the volatility of these payments will become even more pronounced in the coming years. As demonstrated in the above table, the contribution amount in 2013-14 to both systems is approximately \$942 million. We project that the City's pension costs will peak at \$1,125 million by 2016-17, before falling to \$1,059 million by 2018-19. This is due in part to volatility in the stock market over the past several years and the new pension tiers adopted. While spread over several years, these dramatic annual shifts have still resulted in highly variable contribution requirements in the coming years.

This volatility along with high contribution amounts will pose serious challenges when preparing annual budgets. These obligatory one-time shifts reduce the ability to plan for and fund ongoing costs which require steady and consistent funding. Further, a lower payment in a certain year may give an exaggerated sense of the City's fiscal health and impact spending decisions in an unsustainable manner. Both pension systems' boards are considering leveling the recognition of deferred losses, which would, among other things, lead to a more consistent contribution payment by the City. However, both boards have also signaled a review of the rate of return which could result in higher contribution rates. Moreover, the Coalition of Unions have filed a challenge against the new civilian pension. The City's pension contribution will increase should the new pension tier be withdrawn or halted.

STRENGTHENING REVENUES

- 13. Recommendation on backing new expenditures with new revenues: In its ongoing efforts to focus on core services, the City must establish dedicated and ongoing revenue streams, including through voter-approved tax increases, for the reconstruction of the City's failed streets and sidewalks.**

Given the significant obligations from salaries and benefits, potential liabilities, and deferred expenditures, the City is not in a position to initiate new services or restore services that were reduced during the fiscal crisis. Therefore, we need to continue to seek dedicated funding for new programs where possible, and to enhance our General Fund receipts to pay for other expenditures that cannot generate a dedicated funding stream. Voter-approved funding for comprehensive street improvements are discussed below, as well as opportunities to increase our unrestricted General Fund revenues.

Save Our Streets Program

The City is responsible for the maintenance of 6,500 center line miles of streets and 11,000 miles of sidewalks. Due to the extensive network of streets, and the high number of streets that are classified as “failed,” improving and even maintaining them is an uphill battle. Recently the Pavement Preservation Program overseen by the Bureau of Street Services has focused on keeping the working streets working through slurry seal, pothole and crack repair, resurfacing, and some limited street reconstruction. With only enough resources to fix 10 to 15 miles of failed streets each year the City is facing an ever increasing number of miles of failed streets without the resources to fix them. If funds from the Pavement Preservation Program were focused on reconstruction of failed streets instead of resurfacing, we would lose the ability to maintain the current condition of streets, and even more would fall into the “failed” category.

Chart 10

2011 Street Infrastructure Condition Assessment			
Percent	Grade	Condition	Characteristics
21	"A"	Good	Maintenance Required: None Physical Condition: no cracking, no oxidation, and no base failure
23	"B"	Satisfactory	Maintenance Required: Slurry Seal Physical Condition: minimal cracking, no oxidation, and no base failure
18	"C"	Fair	Maintenance Required: Maintenance Overlay (1.5 to 2.0 inches of Asphalt Concrete) Physical Condition: minimal cracking, no base failure to 5% base failure
13	"D"	Poor	Maintenance Required: Maintenance Overlay (2.0 to 2.5 inches of Asphalt Concrete) Physical Condition: some cracking, 6% base failure to 35% base failure
25	"F"	Failed	Maintenance Required: Resurfacing and/or reconstruction (6.0 to 12.0 inches of Asphalt Concrete) Physical Condition: major or unsafe cracking, 36% base failure to over 50% base failure

Source: Chart compiled from Bureau of Street Services 2011 State of the Streets Report

The 2013-14 Budget included \$132.77 million for the Pavement Preservation Program. The available resources that fund these current efforts, including Proposition C, Measure R, the Traffic Safety Fund, the General Fund, and the Gas Tax, are diminishing in relation to the need and cost of repair, and will not

even allow the City to maintain the current level of street repair which is budgeted at 800 miles in fiscal year 2013-14. If additional funding is not identified to offset the gap between revenue and expenditure growth, we can expect that an increasing number of streets will begin to be classified as “failed.” New funding will have to be identified for the repair of “failed streets” if the City is to actually see improvement in the overall quality of our street system, and to be able to maintain that improvement for the foreseeable future.

Similarly and as previously discussed in the context of liabilities, there are sidewalks throughout the City’s 11,000 mile network that are in a state of disrepair. The cost of improving the entire sidewalk system is beyond the City’s budgetary capacity without a new revenue stream or another form of shared-cost with the public.

CONCLUSION

The City is not alone in having confronted some significant challenges during the last several years. Other major cities like Chicago and San Jose have encountered similar structural issues caused by the growing cost of labor. In Los Angeles, City leaders have taken these challenges head-on, making difficult and at times unpopular decisions to ensure the City’s solvency. This Office is confident that the City will manage the next four years with the same resolve. We look forward to working with the Mayor, Council, labor and the City’s stakeholders to eliminate the structural deficit by 2018.