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CITY OF SAN BERNARDINO
CITY MANAGER'S OFFICE

TO: Mayor and Common Council

FROM: Allen Parker, City Manager

SUBJECT: Proposed Recovery Plan in Support of the Plan of Adjustment for Submittal to Bankruptcy Court

DATE: May 18, 2015

Recommendation

Adopt this Recovery Plan for the City and the attached Resolution approving the bankruptcy Plan of Adjustment and disclosure statement and authorizing the City Attorney and City Manager to file both with the court along with any amendments.

Executive Summary

This report describes the City's bankruptcy Recovery Plan (Plan) as well as other information underlying the City's approach and basis for the City's Plan of Adjustment and disclosure statement. It explains the City's overall fiscal planning which provides the foundation for the Plan of Adjustment, including the treatment of obligations in the Plan of Adjustment.

This report also describes the past practices and history of the City prior to the adoption of the Operating Practices for Good Government (OPGG), an interim operating agreement signed by the Mayor, City Council, City Attorney and City Manager on April 6, 2015. The adoption of the OPGG is a significant step forward for the City. This was done based upon the recommendation of the Strategic Planning Core Team (Core Team), a group of distinguished community residents, asked by the Mayor and Common Council to help the City chart a plan for the future. The Core Team, along with municipal government experts hired by the City to assist in preparation of this plan, believe that until fundamental government and management issues fully explained in this report are resolved, it will be difficult for the City to operate in a modern and efficient manner.

The City will prepare a draft of a new Charter for consideration by the voters and this draft will be presented to the voters on the first available date on which such vote can be held. Nothing in this Plan or the report is intended by the City to solicit support or campaign for or against this proposed initiative for Charter repeal, reform or amendment. The City takes no position advocating or campaigning as to whether such Charter repeal, reform or amendment initiative described in this report and the Plan should or should not be approved by the voters. This document is intended to illuminate the unique governance issues the City does face. This report and the Plan notes in several places that the Core Team has identified a need for changes which lead to Charter reform, recommended Charter reform, and indicated that individual Core Team members intend to support a Charter reform initiative.

In compliance with the Bankruptcy Court's direction by order entered November 24, 2014, the Plan of Adjustment and associated disclosure statement must be submitted to the court by May 30, 2015.

The Plan provides for the treatment of various classes of creditors' claims against San Bernardino. The associated disclosure statement is an explanatory document that provides supplementary information on the treatment of creditors under the Plan of Adjustment. The Bankruptcy Code specifically prohibits the solicitation of the acceptance or rejection of a Plan of Adjustment prior to the court approving a disclosure statement. The Bankruptcy Court is not obligated to approve a Plan of Adjustment. It may dismiss the Chapter 9 case, which would mean that the City would no longer be under the protections provided by Chapter 9. It is quite possible, and indeed probable, that the Plan of Adjustment may change through negotiations after it is filed. The Plan of Adjustment must be one that is in the best interests of the creditors, which has been interpreted to mean that it needs to be better than other alternatives or a dismissal of the Chapter 9 case. Chapter 9 does not allow the creditors or other parties in interest to file a Plan of Adjustment.

The Insolvency

There are a number of measures of solvency for municipal corporations. The most commonly accepted metrics of fiscal health for municipal organizations are: 1) service delivery solvency, 2) budget solvency and 3) cash solvency. Each is defined below.

- *"**Service delivery solvency**" is defined as a municipality's ability to pay for all the costs of providing services at the level and quality that are required for the health, safety and welfare of the community.*
- *"**Budget solvency**" refers to the ability of an agency to create a balanced budget that provides sufficient revenues to pay for its expenses that occur within the budgeted period.*
- *"**Cash solvency**" is defined as an organization's ability to generate and maintain cash balances to pay all its expenditures as they come due.*

One can think of these measures as a pyramid which builds a fiscal foundation for a city. At the bottom is cash solvency, which is absolutely essential for day-to-day operations. Above this comes budget solvency, a necessary condition for sustainable operations. Finally at the top of the pyramid is service solvency, which denotes the ability to provide for the municipal operations at a level consistent with community needs and expectations. While a municipality can operate in a condition of service insolvency or even budget insolvency for some period of time, cash solvency must always be maintained. Currently San Bernardino is both service and budget insolvent, and cash solvent only due to the protection of Chapter 9 bankruptcy.

San Bernardino sought bankruptcy protection on August 1, 2012. The filing was made because of acute cash insolvency. The City had depleted all General Fund resources and could not keep current with normal operational expenditures. The City filed under an emergency section of California law instead of going through the AB 506 "neutral evaluation process" otherwise required before a local government can file for bankruptcy. This process can take 6 months, and San Bernardino had less than 60 days of operational cash on hand.

To conserve cash for operational requirements, the City suspended payments due to the California Public Employees Retirement System (CalPERS), and certain debt payment obligations. It also obtained stay protection from a number of other liabilities and obligations. A pendency plan budget was passed in November 2012 as set forth in Resolution No. 2012-278 which cut $26 million in expenditures and deferred another $35 million in payments.

The City's eligibility for bankruptcy protection was challenged by CalPERS and an employee bargaining organization in 2012. Ultimately, the City was ruled eligible for bankruptcy in August 2013, but CalPERS appealed the court's order. The appeal did not move forward as a result of an agreement reached with CalPERS, as found in the Mediator's Order approved on June 9, 2014 under which the City agreed to repay CalPERS for missed payments and resume making monthly payments. A variety of other litigation arose from the bankruptcy including motions filed by the police and fire unions and the owners of the certain pension obligation bonds the City had not been paying.

In 2013 and early 2014, the City engaged in a recall and a special election which resulted in a new Mayor, City Attorney and several new Common Council members. The City also had a 24% annual turnover rate in the executive leadership of the City (City Manager and department directors) over the last ten years and 50% in years 2009 and 2013. In late October 2014, the bankruptcy court ordered the City to file a Plan by May 30, 2015.

A Return to Solvency

To address budget shortfalls in thirteen of the past eighteen years, the City has already cut staffing and benefit levels, added new revenue sources, expended reserves, and eliminated services and programs. Nevertheless, it was forced to seek bankruptcy protection in 2012. Without substantial and immediate restructuring of the organization, both operationally and financially, the City will not be able to provide basic services.

While a number of factors have contributed to this crisis, by far the most significant and difficult to control has been increasing operating costs occurring at a time when the City's revenues have yet to fully recover from the Great Recession. Since the City's peak General Fund revenue of $133 million in 2008, the City has experienced severe losses in key areas such as sales tax, franchise fees, utility users tax (UUT), permits, and funds transferred from the Economic Development Agency (EDA). Today, several years after the end of the Great Recession, General Fund revenues remain $7 million below peak levels at $126 million.

As a growing full service city with a population exceeding 200,000, the City has historically provided services through a workforce exceeding 1,200 employees. Maintaining a large workforce has exposed the City to rising operational and capital costs as well as long term benefit liabilities outside of the City's control. Despite recent reductions of approximately 250 employees, numerous other cost-reduction strategies implemented by the City, continued deferral of $200 million of essential capital maintenance and the replacement of fleet vehicles, a structural deficit upwards of $20 million in the General Fund continues.

Unfortunately, there is no “silver bullet” for significantly increasing revenues, stabilizing operational costs or funding significant capital maintenance for a City incorporated over 100 years ago. Unlike a private employer, a public agency cannot simply decide to go “out of business” or otherwise stop providing certain essential services to the public.

The City has made reasonable efforts over the last several years to address its fiscal situation and continues to do so. Municipal services are generally labor-intensive, with City employees such as police officers and firefighters providing essential services. Nonetheless, the City has implemented $26 million in annual cost control measures in an effort to maintain essential service levels, including the following:

- Workforce and service reductions
- Implementation of tiered pension plans
- Benefit concessions
- Pension cost sharing
- Elimination of the Employer Paid Member Contribution (EPMC) for safety employees
- Standardization of Other Post-Employment Benefits (OPEB) and elimination of an OPEB Implied Subsidy

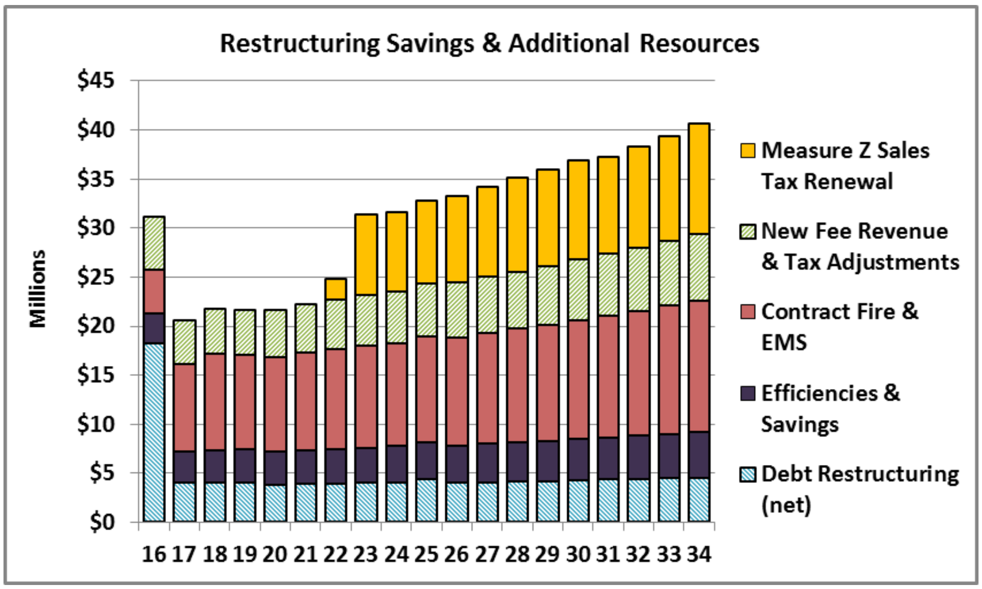
The budget pressures faced by the San Bernardino municipal government reflect the broader economic problems faced by San Bernardino’s residents. By almost any measure, the Great Recession continues to have a devastating effect on San Bernardino’s residents and their economic resources. In turn, as further detailed in the analysis to follow, these economic factors have weakened the City’s tax base and revenue streams while adding to community service demands. While there is much evidence to conclude service impairments to date have risen to the level of an emergency, a critical consideration is whether economic conditions and rising operational costs will further weaken the City’s ability to provide public services into the foreseeable future. Unfortunately, the answer is a resounding yes. Because of this situation, through a comprehensive operational and financial restructuring the City must place a priority on fiscal and service stabilization starting with the delivery of essential services, sufficient working capital equal to 15% of operating expenses, capital investments in infrastructure, information technology, public facilities and fleet vehicles, as well as deficit recovery for essential internal service funds (i.e., workers compensation and general liability) equal to approximately $200 million.

In addition to fiscal and service stabilization, strategic plan investments are necessary to ensure the City can flourish as a solvent organization into the future with the support of its residents and business community. Information gleaned from strategic plan workshops provide the City with valuable input into the services and programs most needed and wanted throughout the community. Through the strategic plan process, the City received feedback on service delivery options as well as revenue generating options for inclusion into the Plan of Adjustment.

While it might be tempting to conclude that the City can survive with a Plan of Adjustment, which does not address fiscal and service stabilization issues or strategic planning initiatives, it would leave the City in a continuing position of service and budget insolvency, which is not consistent with a fundamentally sound municipal corporation. Based on our strategic planning and analysis of the City's overall fiscal position, returning the City to service and budget solvency is essential for a successful San Bernardino. Unfortunately making the investments necessary to return the City to satisfactory operations makes the proposed treatment imposed by the Plan of Adjustment difficult for all stakeholders in the bankruptcy.

Figure 1 summarizes the financial components that this Plan proposes to meet the City's financial gap. These restructuring savings and additional resources are sufficient to meet the City's fiscal and service stabilization goals while maintaining a working capital reserve equal to approximately 15% on an ongoing basis.

Figure 1. Financial Components of the Return to Fiscal Solvency



An Organization without an Accountable Governance System

As this Plan document will demonstrate, the seeds of San Bernardino's decline and eventual bankruptcy were sown and have matured over decades. The Chapter 9 filing of San Bernardino is not due to any one financial calamity or setback, but rather a series of events cascading into bankruptcy. The Great Recession was the triggering event, but it was also merely the last event in a long chain leading to this result.

The Core Team and other constituencies, including outside experts, have concluded that decades of questionable management and inefficiency are very much the result of a convoluted City Charter that complicates daily management and generally neutralizes executive authority. The City's governance structure is highly complex and unique compared with any other city in California. Overlapping authority and ambiguities in the City's Charter create operational uncertainty and ineffectiveness because the role, responsibility and authority of the Common Council, City Manager, City Attorney and Mayor are unclear and at times, contradict each other. No other city in California has followed this peculiar governmental approach. The Charter itself has grown and progressively become more unwieldy as a result of City initiated amendments in 1992, 1995 (twice), 1996, 2001, 2004 and 2014. With a system of diluted authority, many previous City employees with named responsibility have sought employment elsewhere, creating an untenable 24% annual turnover rate in executive management positions over the last ten years. The outcome was best summarized in a recent Atlantic article, by the well-known writer and journalist James Fallows:

> "San Bernardino has a uniquely dysfunctional city-governance system, sort of a metropolitan parallel to the current zero-sum gridlock of national politics. Some cities we've seen run on the "strong mayor" principle; others, "strong city manager." Because of San Bernardino's unique and flawed charter, it has in theory a "strong mayor" but in reality a "strong nobody" system of government, and an electoral system so discouraging that that turnout rates are extremely low even by U.S. and California standards."
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> *Source: "Generation Now – What People Do, When There Seems to be Nothing to Do." The Atlantic. April 28, 2015.*

The State of Municipal Services

The City of San Bernardino has been in progressive decline for decades. It has been losing population growth to other areas of San Bernardino and Riverside Counties continuously throughout the 1980s, 1990s and since 2000. The City has experienced a similar decline in assessed valuation, median household income, and sales tax. As it lost ground to other municipalities, it evolved from a city that was the epitome of middle class living into one of the poorest communities in the United States. With a median household income of just $38,000, San Bernardino is by far the poorest community for its size in California.

As the City has declined and grown progressively poorer, municipal services have suffered. The City's convoluted governance and management approach has made even simple operational improvements and industry best practices unattainable. Moreover, without a strategic plan to realign the organization, the City has made little progress toward improving the minimal services it provides. In the years of decline, the City's deferred facility and infrastructure maintenance needs have grown to hundreds of millions of dollars. The community continues to suffer from a severe crime problem (ranking among the worst for cities of its size in the state). Not surprisingly, people that can live elsewhere choose to do so, leaving San Bernardino a poor and disenfranchised community.

Major Plan Provisions

The following summarizes the major elements of the City's proposed Plan.

<u>Charter Issues and Core Team Recommendations</u>

Management and program effectiveness must improve. The City must also address huge infrastructure deficiencies and the need to pay their employees market rate compensation. To do so will require additional expenditures; yet, these issues are so severe that money is only one of the major problems. Just as important, the Core Team, along with outside municipal government experts hired by the City to prepare this plan, have expressed strongly and clearly that San Bernardino must address the reform of its system of governance and management. San Bernardino is an outlier in comparison to other cities of its population size in the State as it does not employ a true Council/Manager form of government. It also has an elected City Attorney, a peculiarity shared by only eleven other cities in California (mainly very large cities), and an unusual and unwieldy Charter. All of this has led the Core Team to recommend that the existing Charter be repealed and replaced with a Charter that clearly spells out responsibilities for policy (Mayor and Common Council) and administration and management (city manager) so the government can operate effectively and efficiently. The current Charter so impairs the operation of the City that it has been forced to seek an interim operating agreement (see Attachment I) even to be able to develop and implement this Plan. This fact was dramatically illustrated by a strategic planning committee which unanimously told the Mayor, majority of the Common Council, City Attorney and City Manager, that operations and management needs fundamental reform. The City intends to establish a Charter committee to draft a new Charter and place that new City Charter on the November 2016 ballot for consideration by the voters, or sooner if possible.

Expenditures and Labor Costs

Labor costs are the City's largest expenditure, yet the City is continuing to experience severe retention and recruitment problems throughout the organization. Some of this is due to poor morale resulting from bankruptcy and the chaotic operating environment spawned by the flawed governance and management system. However, the bankruptcy team also commissioned a detailed study of total compensation paid to City workers. The study revealed that City employees' total compensation, for many groups of employees, is below the market, especially for non-safety personnel. This is somewhat surprising given all the attention to Charter Section 186 which results in automatic salary adjustments for police and fire sworn personnel. Overall, non-safety compensation appears to be 15% to 32% below the relevant market averages. Base salaries for safety employees are above average, which would be expected given the impact of Charter Section 186, but are below average when all compensation (including benefits, but not overtime) is taken into consideration.

The realities of the compensation issue result in a challenging situation for the City. The approach taken in the Plan is to eliminate City positions to the extent possible by contracting for service delivery as a number of peer jurisdictions do, but to gradually move those positions remaining in the organization to market compensation levels and stop the crippling recruitment and retention problems it now experiences. In other words the City needs to become a leaner organization, by moving to alternative service delivery approaches which result in satisfactory services without the need for the City to directly employ personnel. The City also needs to compensate employees which remain at an average market level.

Annual Deficit, Potential Solutions and Treatment of Creditors

The Plan includes a detailed fiscal model which includes projections going out 20 years. The Plan clearly documents all the assumptions made in this model and the resulting projected fiscal position of the City today and going forward. Decades of organizational failure have yielded a huge backlog of maintenance and infrastructure needs that must be addressed for the City to have service solvency. In addition, the City must restore the internal service funds utilized to pay for budget deficits in at least four of the fiscal years prior to bankruptcy in order to balance the City's budget in the years to come.

In contrast to labor obligations, the City has a relatively modest debt load burden. Further, in many cases secured debt has relatively strong collateralization. Therefore, the City plans to request appropriate assistance from secured obligation holders, but ultimately it simply cannot continue to operate if the collateral, mainly essential City buildings, is lost.

Given the lack of real flexibility with secured debt and labor (aside from the contracting or alternative service delivery approach mentioned above), the Plan is inevitably hard on unsecured creditors. All of the unsecured creditors will receive very little towards the amounts owed. Rebuilding the City, albeit with a much smaller employee foot print, and paying secured creditors is all the financial capacity the City has.

Figure 2 shows the annual deficit after fiscal stabilization expenses, but before restructuring savings.

Figure 2. Fiscal Model Annual Estimated Deficit ($ in millions)

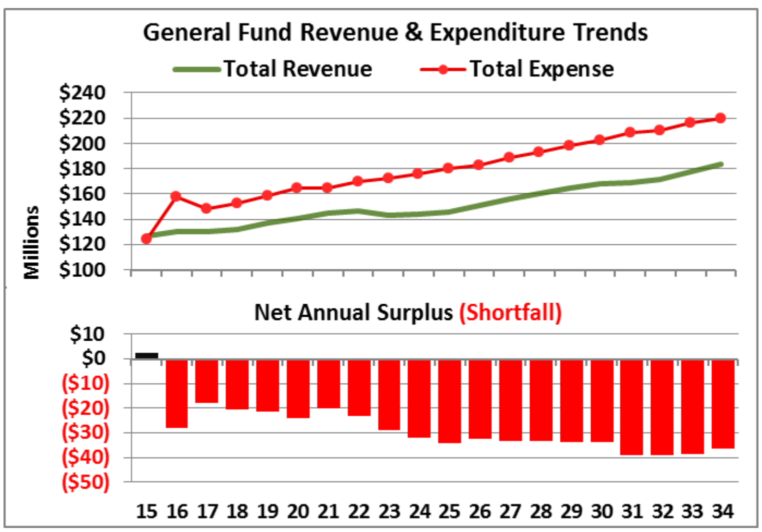


Table 1 provides a summary of the actions the City proposes to return to fiscal solvency. Action items are organized by the financial components of the Recovery Plan presented in Figure 1. Further details on each element of the overall plan are provided in the body of this document. It is important to note that these actions require implementation and inevitably there will be changes in the overall fiscal impact.

Table 1. Cost Saving and Revenue Enhancement Actions and Estimates (General Fund)

Cost Savings and Revenue Opportunities	One-Time	Ongoing (Annual) Savings	Implementation Schedule
Efficiency Improvements			
Contract fire and EMS services[1]		$7,000,000 – 10,000,000	2015
Contract business license administration[2]		$650,000 to $900,000	2016
Contract fleet maintenance[3]		$400,000	2016
Contract soccer complex management and maintenance		$240,000 to $320,000	2016
Contract custodial maintenance		$150,000	2016
Contract graffiti abatement		$132,600	2016
Implement other efficiency improvements		$1,000,000 or more	2016
Health care savings (retirees)		$370,000	2016
Debt Restructuring			
General Secured Bond Obligations		$487,450	2015-2016
General Unsecured Bond Obligations	$13,481,000[4]	$3,510,000	2015-2016
Restructuring of other creditor obligations	$4,300,000		2015-2016
New Fee Revenue and Tax Adjustments			
Seek reauthorization of the Measure Z sales tax in 2021 (requires voter approval)		$8,300,000	2021
Perform a transient occupancy tax (TOT) audit		$200,000	2015
Collect new waste management franchise fee (once service has been contracted)	$5,000,000		2015
Increase waste management franchise fee		$2,800,000	2016
Implement water/sewer utilities franchise fee		$1,050,000	2015
Update master fees and charges schedule[5]		$200,000	2016
Implement program for collecting street sweeping parking violations		$200,000	2015
Organizational Improvements	One-Time Costs	Ongoing Costs	Implementation Schedule
Implement compensation adjustments for all City employees		$400,000 and growing (2% adjustment for non-safety employees)	2016 and ongoing
Provide resources to Charter Task Force and schedule election to consider revised Charter	$150,000		2016
Implement strategic planning initiatives		$1,000,000 to $3,000,000 depending on timing and ability to fund	2015 and ongoing
Rebuild corporate support functions[6]	$500,000	$100,000	2015 and ongoing

[1] In 2012, the City of Santa Ana contracted with Orange County Fire Authority (OCFA) for fire protection services. The City obtained savings of 18%-21% ($8.7-10 million) of the Fire Department's annual budget. This preliminary estimate for San Bernardino incorporates the estimated cost savings from contracting fire and EMS service delivery to an outside agency and implementing a variety of service efficiencies identified in the Citygate Study.
[2] Represents a combination of cost savings in City staff and increased revenues.
[3] Estimated cost savings do not include savings from avoiding fleet replacement costs, the costs of fleet maintenance and part-time staffing costs; excludes Water Department fleet.
[4] This reflects obligations deferred to date and that are due in 2014-15.
[5] The Common Council implemented a practice that reduces building permit fees by 50 percent. Fees collected do not cover the cost of providing the service.
[6] One-time cost to rebuild corporate support functions is for consulting assistance and implementation of technology improvements.

It should be noted that the City may have the opportunity for other one-time revenue development options. The largest of these would probably be the eventual sale of former redevelopment agency properties. Currently the City roughly estimates it may be able to generate approximately $3.9 million in one-time revenue from sale of such properties over a 5 year time period. Since this revenue is not substantial and is subject to significant legal and market risk factors it is not included in the Plan of Adjustment at this time.

Table 2 describes the remaining revenue enhancement opportunities which may be available to the City; however, they are reliant on voter approval, or some similar hurdle such as legislative approval. Only renewal of the City's sales tax measure (Measure Z) is included in the gap revenue projections. Assuming any of the other options could pass is speculative at this time.

Table 2. Cost Saving and Revenue Enhancement Estimates (General Fund) – Requires Voter Approval

Revenue Opportunities	Ongoing (Annual) Savings	Implementation Schedule
Tax Adjustments		
Measure Z renewal (sales tax)	$8,300,000	2021
Utility user tax increase (1%)	$3,000,000	TBD
Utility user tax on water, sewer and refuse	$5,000,000 to $6,900,000	TBD
Real property transfer tax increase ($5 per $1,000 of value)[1]	$3,600,000	TBD
Fee Revenues		
New 911 communication fee	$3,878,000	TBD
Business license fee changes[2]	$1,500,000	TBD
Edison (electrical) franchise fee increase[3]	$922,500	TBD
Total Voter-Approved Potential Fiscal Impact of Plan of Adjustment	**$22,200,500 to $28,100,500**	

[1] Ability to increase the property transfer tax subject to detailed legal review. It is anticipated that there would be major, organized opposition to such an increase, and there may be significant legal impediments.
[2] San Jose generates $44 per capita utilizing a business license structure based on number of employees. Because San Bernardino has fewer businesses and employees, it is estimated that the City would generate revenues of $39 per capita by similarly revising its schedule.

[3] SCE has been unwilling to change its older franchises, and implementation of this would be difficult. Options include increasing the City's franchise fees by adding .5% to customer bills or requesting the California legislature to sponsor a change in legislation to level the franchise percentage among cities.

Table 3 shows the proposed treatment of the major creditors of the City. In virtually all cases, the City has not been able to negotiate these terms, but intensive attention will be turned to these negotiations after the filing deadline for the Plan is met.

Table 3. Proposed Treatment of the Creditors - Summary

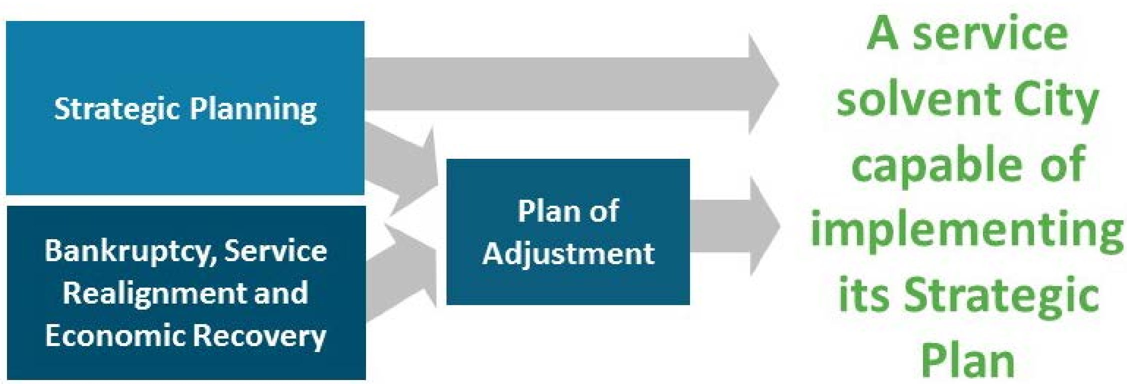
Creditor Obligation	One-time Savings	Ongoing (Annual) Savings	Year Savings Will Be Recognized
Unsecured Obligations			
Pension Obligation Bonds		$4,039,881[1]	2016-2036
Retiree Health Claims [2]	$40,000,000 to $50,000,000 in avoided OPEB costs		2015
Employee Leave Claims [2]	TBD, estimated at $10,000,000 to $16,000,000		2015-2016
Trade Claims	TBD, estimated at $2,000,000		2015-2016
Litigation Claims	TBD, estimated at $5,000,000 to $10,000,000		2015-2016
Subtotal	**$57,000,000 to $78,000,000**	**$4,039,881**	
Secured Obligations			
1999 COPs [3]		$487,450	2016 to 2025
1996 LRBs[4]		$0	2016 to 2023
Subtotal		**$487,450**	
Other Obligations			
Secured Financial Lessor Claims	TBD, estimated at $1,000,000		2015-2016
Subtotal	**$1,000,000**		
Estimated Total	**$58,000,000 to $79,000,000**	**$4,527,331**	

[1] Savings escalate from $3,453,894 in 2016 to $4,719,163 in 2036.
[2] The City has made no provision for making these payments.
[3] Assumes that the General Fund portion of the 1999 COPs are defeased.
[4] The City will continue to make payments based on the current debt schedule but has the asked the bond insurer to provide a surety to replace the cash reserve fund. The use of the cash has yet to be determined.

Recovery Plan and Conclusion

It will take time for San Bernardino to recover. To recover and emerge from bankruptcy will require both economic restructuring and fundamental changes in the functioning of government. Obligation restructuring is a necessary component of the Plan but alone will not be sufficient for recovery. San Bernardino will have to use a variety of strategies moving forward to become a modern, sustainable organization. As described in Figure 3, two fundamental components are required for the City to emerge as a service solvent city following implementation of the Plan. As noted, strategic planning is a process critical to ensuring the City keeps its focus on the long range goal: a service and budget solvent city.

Figure 3. Creating a Service Solvent City



The Plan first analyzes the problems facing San Bernardino and then describes how the City must be restructured to ensure that it can improve the service delivery structure so it is modern, effective and efficient. The Plan then identifies what the City can do to make itself function like other cities of its size and type in California. Finally, the Plan provides the City's financial projections and proposed treatment of creditors.

San Bernardino can recover, but the road to recovery will be a long one because it must fix its governing structure as well as align expenditures with revenues.

This document is composed of the following major sections:

1. Approach and Methodology
2. Principles Underlying the Plan
3. City Setting
4. City Governance, Management and Organizational Effectiveness
5. Inadequate Municipal Services
6. Expenditures and Employee Compensation
7. Recovery Plan: Governance and Service Realignment First
8. Financial Forecast Underlying the Plan
9. Conclusion
10. Attachments

Approach and Methodology

This Plan provides a path out of bankruptcy for the City of San Bernardino. It is designed so the City can have both a "service solvent" and financially solvent future. This section describes the process and strategy used by a multi-disciplinary team of subject matter experts to develop a Plan that would and could result in such a future for the City.

The team was composed of representatives from the City including the Mayor, City Manager, City Attorney, Deputy City Managers, Special Projects Manager, and experienced local government consultants. Management Partners, a local government consulting firm, was hired by the City in December of 2014 to lead this effort. Other consultants included Urban Futures, The Law Office of Linda Daube and Associates, and Stradling Yocca Carlson & Rauth, P.C. The team included individuals experienced in managing and consulting with cities in fiscal crisis throughout California, including those few which ultimately went through bankruptcy (Vallejo and Stockton). The Mayor and Common Council were briefed throughout the process.

The team relied on a variety of techniques including strategic planning, peer agency analysis, and organizational assessments. A section of this document is devoted to the strategic planning effort by the community which provided a critical component of the Plan. That process included substantial public outreach and discussion about San Bernardino's needs and opportunities, all grounded in the reality that the City was forced to seek bankruptcy protection and will need to have moderate near-term goals. In spite of these constraints, the strategic planning effort was well received by the community which indicated a strong interest in defining a sustainable future for themselves.

Another major component to this Plan is the information provided through peer agency analysis. While every city is somewhat unique, there are many similarities. Many cities in California are close in size and have similar operational footprints to San Bernardino. The peer agency analysis allowed the team and the City to draw comparisons and establish parameters for service delivery in solvent organizations.

San Bernardino is a poor city in terms of median household income, with high crime rates. We know from experience that service delivery funding and allocation decisions are made based on service demands and influenced by basic demographic factors such as income and crime levels. By looking at organizations with similar underlying factors, we can understand what San Bernardino would look like as a functional and sustainable organization. In determining benchmarking comparisons, three basic variables were considered: population, median income and crime level. We developed a list of 41 cities between 120,000 to 400,000 in population as reported by California Department of Finance. Next, cities with similar median household incomes were examined. San Bernardino was found to have the lowest median household income of any of the 41 cities. Cities with median income within 150% (below $56,208) of San Bernardino's were considered for selection. The list of cities was further narrowed by examining crime rates. The top 10 cities with Part 1 crime rates per 1,000 residents were selected. Table 4 showed the cities selected for detailed peer agency comparisons.

Table 4. Cities Selected for Detailed Benchmarking

City	Population
Bakersfield	367,315
Fontana	202,177
Modesto	206,785
Moreno Valley	199,258
Ontario	167,382
Pomona	151,713
Riverside	314,034
Salinas	155,205
San Bernardino	212,721
Stockton	300,899
Visalia	129,582
Peer Average	*219,435*

We believe the composite picture that can be derived from looking at these cities provides a reasonable snapshot of what San Bernardino post reorganization might look like. There are, however, two important caveats. First, San Bernardino has the lowest level of median household income ($38,385) by a large margin. The next lowest is Stockton ($46,831). Second, San Bernardino has the third highest rate of Part 1 crimes, behind only Stockton and Modesto.

Organizational assessment tools were also used to develop the Plan. This included in-depth interviews with the City Manager, City Attorney, department directors, the Mayor and members of the Common Council. Team members reviewed budgets and other documents that explain service delivery to the community. Most importantly, we heard from those working for the City that it is exceptionally challenging to get anything done, and that management has been changing constantly for many years. This led to many of the insights shared in this document relative to the failed governance structure in San Bernardino. The organizational assessment informs the Plan's findings and recommendations in several ways, including the development of potential contracting opportunities, efficiency options and observations concerning the basic governance and management system.

Principles Underlying the Plan

In developing the Plan, the bankruptcy team and the Mayor and Common Council found it important to identify a set of core principles on which the document, and most importantly the plan's component parts, would be based. These principles have been informed by a public strategic planning approach that included a series of workshops in all parts of the City and a two-day strategic planning workshop with a committee of community leaders, the Core Team. The principles are explained below:

1. The end result of the bankruptcy restructuring process must be a sustainable government able to deliver a competitive mix of municipal services meeting industry standards in a manner that is solvent from a budgetary and service delivery standpoint. The service levels must be geared to the unique needs of San Bernardino's citizenry, now and into the future.

2. The City's Plan must demonstrate financial stability over at least a ten-year period, with all costs of service covered and appropriate reserve levels maintained with recurring revenues.
3. In realigning expenditures with the resources available, the City will attempt to balance competing needs in an equitable manner taking into consideration such factors as security for obligations and its need to be a viable service provider (i.e., recruit and retain qualified employees). Priority will be placed on continued delivery of basic and satisfactory municipal services.
4. The City must deliver services in an effective and efficient manner following industry best practices. Therefore, it must be open to delivering services in the manner and mode to deliver good value and be effective for taxpayers. Consideration will be given to contracting and regionalizing service delivery consistent with accepted industry standards and practices.
5. The City recognizes it will need to remain a viable employer, and therefore, will need to offer "market neutral" salary and benefits consistent with the labor market for its employees. We define "market neutral" as being the mean or median of the labor market for similar positions. The City also recognizes that while each position is important, each represents considerable ongoing expense. Therefore, it will strive to keep employee levels at or below the average for comparable jurisdictions and to equip employees with tools and technology as needed to maximize individual productivity.
6. Finally, in accordance with these principles, the Core Team concluded that a significant barrier that could prevent San Bernardino from becoming a modern and sustainable organization involves its governance structure. The Core Team has expressed that the City needs a form and system of governance proven to support satisfactory performance by other municipal corporations of comparable size and complexity. The Core Team believes that the application of this principle requires that the existing City Charter be repealed and replaced with a much simpler charter approach embodying a standard council-manager form of government. As noted, the Mayor, the Common Council (all who voted yes or no on the issue), the City Manager and the City Attorney have agreed to and signed an interim resolution outlining the way they intend to work together going forward until a new charter can be considered by voters.

These principles are the bedrock upon which this Plan is built. They are generally "good government" principles upon which experienced practitioners in local government could agree. Moreover, given the extremely low incomes and poverty observed in San Bernardino, it is believed that the need to protect and preserve basic municipal services, even at the expense of some creditors and other stakeholders, is critically important and even more important than would be the case in most cities.

City Setting

The City of San Bernardino, which has more than 200,000 residents, is located in southern California, south of the San Bernardino Mountains and approximately 60 miles east of Los Angeles. The City was originally established in 1810 by Spanish missionaries before emerging as an important trading post in the 1830s during the period of the rancheros. In the late 1800s, railway companies entered the region and made the City the center of their California operations.

At the time it was incorporated (1869), San Bernardino was in the company of only three other cities in Southern California: Los Angeles, San Diego and Ventura. San Bernardino was the principal city of the Inland Empire. By 1930 it was the 12th largest city in the state and the largest and most dominant city in the Inland Empire. San Bernardino continued to be the dominant city in the region through the 1960s and into the 1970s. In 1970, it remained the largest city in the area and was larger than most Southern California cities. While population growth continued into the 1990s, things began to change in the last two decades of the 20th century.

During this time, a profound and continuous decline began for San Bernardino. The City began to experience major economic challenges in the 1980s with the significant loss of jobs in the regional economy and the growth of the Los Angeles freeway network eastward. From 1982 to the early1990s, the region lost about 25,000 jobs as a result of the closing of Kaiser Steel in Fontana (now relocated to Ontario as Kaiser Ventures), the Santa Fe Railroad Depot, and Norton Air Force Base. As a result, impacted employees retired, moved elsewhere for work, or remained locally as job-seekers, many unsuccessfully. While employment recovered to a degree over time, employers chose to locate in other areas of the Inland Empire (Riverside County and western San Bernardino County), primarily due to land availability and access to the expanded freeway. Retail sales destinations also moved west to attract higher income residents in the region, including those from the Los Angeles area.

Even though the greater metropolitan region has seen major economic growth in the last 25 years, San Bernardino has for the most part been left behind. By 2013, it was no longer the largest or dominant city in the Inland Empire having been eclipsed by population and economic growth in Riverside, Ontario, Fontana, Moreno Valley and Rancho Cucamonga. San Bernardino slipped to the 17th largest city in the state and was one of many cities of the same approximate size in Southern California. It is no longer a dominant municipal hub city, although it does continue to be the County seat for San Bernardino County.

Accompanying this drag on the City's economic base and probably exacerbating it was the development of a cumbersome governance system in the 1990s through the present day and an inability to develop a viable political consensus as to the City's direction and future. The City Charter was amended in 1988, 1989, 1992, 1995 (twice), 1999, 2004 and 2014, supplemented by more than 80 City Attorney opinions. During this same period, the City experienced severe political infighting arising from the separate electoral power bases operating via an elected City Attorney, Mayor and Common Council. With the focus of the elected officials elsewhere, San Bernardino began losing population, assessed valuation and income to other areas.

The Riverside-San Bernardino-Ontario metropolitan statistical region (MSA) is one of the largest, fastest growing regions in the United States, but San Bernardino lags behind. As shown in Table 5, San Bernardino's population from 1981 to 2014 increased by 73% while San Bernardino County's more than doubled and Riverside County's more than tripled. As a result, San Bernardino's population made up 5% of San Bernardino and Riverside Counties in 2014, a 3% drop from 1981. People have been actively choosing to reside in other cities in the region over San Bernardino.

Table 5. Population Growth from 1981 to 2014

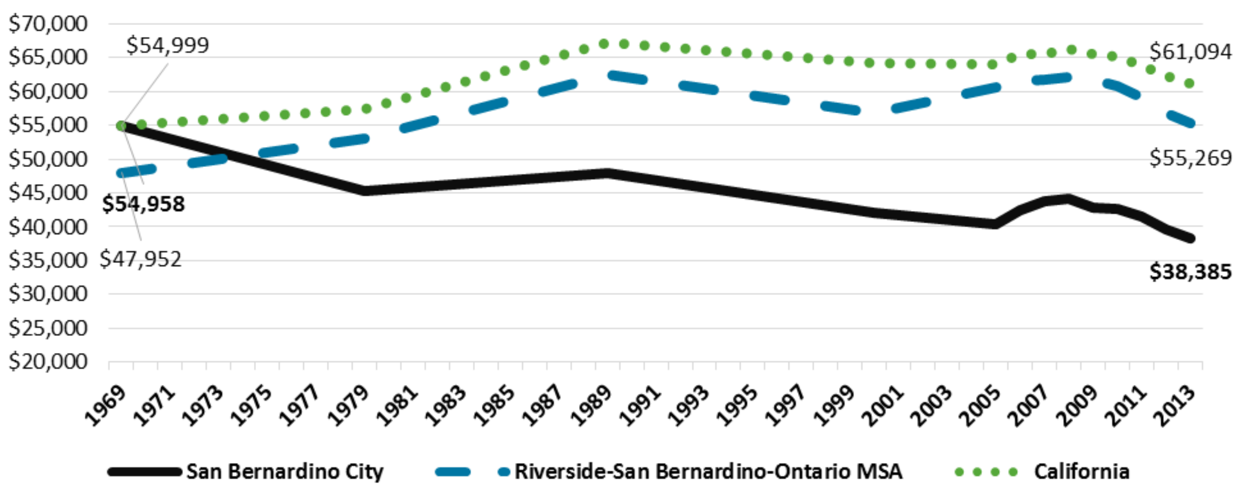
Region	Percent Change from 1981 to 2014
City of San Bernardino	73%
San Bernardino County	127%
Riverside County	234%

Sources: California Department of Finance

Economic Development

The decline in population growth is accompanied by a decrease in median income in the community. As shown in Figure 4, the median household income in San Bernardino dropped 30% from 1969 to 2013 while the MSA's increased by 15% during the same time period. The most current median income for San Bernardino City is 69% of the MSA's.

Figure 4. Median Household Income from 1969 to 2013



Sources: US Decennial Census; US Census, American Community Survey.
Note: 2013 adjusted dollars as according to the BLS CPI.

San Bernardino's population is extremely impoverished; by a wide margin, it has the lowest median household income of any city with a population greater than 50,000 in the state. This affects the City's ability to deliver a base level of needed services and must be considered going forward. A community without much income relies more on basic municipal services such as libraries, accessible recreation, and public safety than residents with greater disposable income and choices.

The decline in the median household income of residents in the City is aggravated by the slow recovery from the Great Recession, particularly in comparison with the larger region. The slow recovery is evident from the recent trends in assessed valuations (AV) and sales tax revenue. As shown in Table 6, the City's AV in 2012 is only 27% greater than in 2003, while San Bernardino County is 65% greater and Riverside County is 88% greater. Furthermore, the following Table 7 shows that the City's sales tax revenues are still 27% below pre-recession levels while the two counties have almost fully recovered.

Table 6. Assessed Valuation Growth from 2003 to 2012

Region	Percent Change from 2003 to 2012
City of San Bernardino	27%
San Bernardino County	65%
Riverside County	88%

Sources: San Bernardino FY 2012 CAFR; San Bernardino FY 2013 Annual Report; Riverside County Assessor's Press Release, 2015
Note: Based on assessments of secured rolls. San Bernardino's secured rolls excludes redevelopment.

Table 7. Assessed Valuation Growth from 2006 to 2013

Region	Percent Change from 2006 to 2013
City of San Bernardino	-27%
San Bernardino County	-5%
Riverside County	-3%

Sources: California State Board of Equalization

San Bernardino's land values and its residents' income have declined significantly. Consistent with a declining economic base, San Bernardino's poverty and unemployment rates are significantly higher than the region's. The poverty rate of the City was double that of the MSA and the State of California in 2013 according to the US Census Bureau. San Bernardino's unemployment rate in December 2014 was 9.5% compared with California's 6.7% and the MSA's 7.2% according to the Bureau of Labor Statistics.

Education

The City's economic struggles are accompanied by low educational achievement. As shown in Table 8, 32% of San Bernardino's population does not have a high school diploma compared to the regional and state average of 21% and 19%, respectively. Only 11% of San Bernardino's population has a bachelor's degree or higher compared to the state's 31%.

Table 8. Education Indicators in 2013

Region	No High School Diploma	Bachelor's Degree or Higher
City of San Bernardino	32%	11%
Metropolitan Region*	21%	20%
State of California	19%	31%

**Riverside-San Bernardino-Ontario MSA as defined by the US Census Bureau.*
Sources: US Census 2013 5-year estimates, American Community Survey
Note: Educational attainment for populations 25 or older.

Crime

San Bernardino's crime rates are considerably higher than the nearby regions. In 2013, California and surrounding jurisdictions' (Fontana, Moreno Valley, Rancho Cucamonga, Ontario, Riverside and Corona) Part 1 crime rate was half that of San Bernardino's; violent crime was one-third, as shown in Table 9. San Bernardino's crime rates are considerably higher than most of the peer cities.

Table 9. Crime Rates in Comparison to San Bernardino in 2013

	Crime Rates (Crimes per 1,000 Residents)		
Region	**Violent Crime Rate**	**Property Crime Rate**	**Total Part 1 Crime Rate**
City of San Bernardino	**9.2**	**44.1**	**53.7**
Region	**2.8** (30% of San Bernardino)	**25.7** (58% of San Bernardino)	**28.6** (53% of San Bernardino)
State of California	**3.3** (35% of San Bernardino)	**22.7** (51% of San Bernardino)	**26.1** (49% of San Bernardino)

Sources: California Department of Finance, 2014; FBI Uniform Crime Report 2013
Note: The FBI uses three categories to define Part 1 Crimes: violent crime (murder and non-negligent manslaughter, forcible rape, robbery and aggravated assault), property crime (burglary, larceny-theft, and motor vehicle theft), and arson. Average includes nearby jurisdictions with populations above 150,000. Region includes nearby jurisdictions with populations above 150,000: Fontana, Moreno Valley, Rancho Cucamonga, Ontario, Riverside, and Corona.

The City of San Bernardino has been in a state of decline for the last several decades, which has resulted in a poor economy, low educational achievement and high crime. Within this demographic and economic environment, investment by residents and businesses is not occurring. To begin to strategically plan for its future and serve a community in need, the City needs to position itself to be able to efficiently and effectively deliver a basic level of public services.

City Governance, Management and Organizational Effectiveness

Coupled with the fact that the City of San Bernardino lost its economic footing and place in an otherwise thriving region, decades of operational failure is largely attributable to its governance and management structure. The Core Team and the residents attending the workshops described below indicated concerns that long-standing systemic organizational shortcomings combined with confused lines of authority over the organization established by the City Charter have given rise to a city unable to deliver even an average level of service. As evidence, consider the following: Nearly 500 residents attending strategic planning workshops were asked to rank the City on a scale from one to ten (with ten being best) in terms of whether they could recommend a friend or relative move to the City. Fully 62 percent of respondents ranked San Bernardino at three or less. Over 31% scored the City as a 1. These results signal that service delivery in the City of San Bernardino is not nearly adequate and that creating a more viable community should be high on the City's agenda.

The Core Team has expressed the concern that until the City Charter is replaced with a better approach based on best industry standards, and empowered, professional city management is established, full implementation of the long-term recovery described in the Recovery Plan will be challenging.

While the City Charter provides for the position of city manager, the City organization actually operates under a type of quasi strong mayor-city manager (not council-manager), which is an unusual hybrid not found in other cities in California. Combined with these peculiarities is the presence of an elected (as opposed to appointed) city attorney. This is highly unusual, and the resultant confusion about roles and responsibilities makes day-to-day management much more complex. Typically in California, only the very largest cities (Los Angeles, San Francisco, San Diego, Oakland, and Long Beach) have an elected city attorney, and just 11 of 482 cities in California use this structure.

Other cities operate under a strong mayor (not to be confused with directly elected mayor) or council-manager form of government. In San Bernardino, some municipal functions report to the Mayor and/or Common Council, others to advisory bodies (Component Boards), while still others report to the city manager. In some cities with a directly elected mayor with specified authority as well as a city manager (such as the City of San Jose), there are clear delineations about who has the force and authority of the chief administrative officer of the city; e.g., the city manager in San Jose. In San Bernardino, the mayor is designated as the chief executive officer and the city manager is designated as the chief administrative officer of the City. The police and fire chiefs are under the general supervision of the Mayor, yet the city manager is the immediate supervisor and accountable for the organization and operation of two of the most costly and important municipal functions.

The Core Team, along with outside local government experts, has expressed a concern that these concepts are at odds with the basic precepts of management and public administration and that effective management requires assignment of responsibility and the delegation of sufficient authority to allow management to obtain results consistent with the assigned responsibility. The ambiguity so effectively created by San Bernardino's Charter, in the view of the Core Team and outside experts, dilutes the ability to manage the organization. The Core Team along with other experts believe that this has had a highly corrosive effect on the organization's ability to implement needed changes over the years. The organization is in disarray as it does not know who really is in charge: the Mayor, City Attorney, Common Council, independent authorities (not elected) or the City Manager. The results are self-evident.

A number of operational impacts result from the confused lines of authority as provided in the current San Bernardino City Charter, including the following:

- Internal service functions struggle to modernize, streamline and provide valued, cost-effective service to the community and the organization.
- Significant and unnecessary allocation of staff time and severely constrained resources are trying to bring various municipal functions into a unified, goal-oriented team with a common vision and strong commitment to public service.
- Compromised problem solving and strategic planning due to fragmented and conflicting lines of authority. This has been highlighted in the decades-long power struggle between the elected mayor and city attorney positions.
- An inability to make informed management or policy decisions

A Singular City Charter

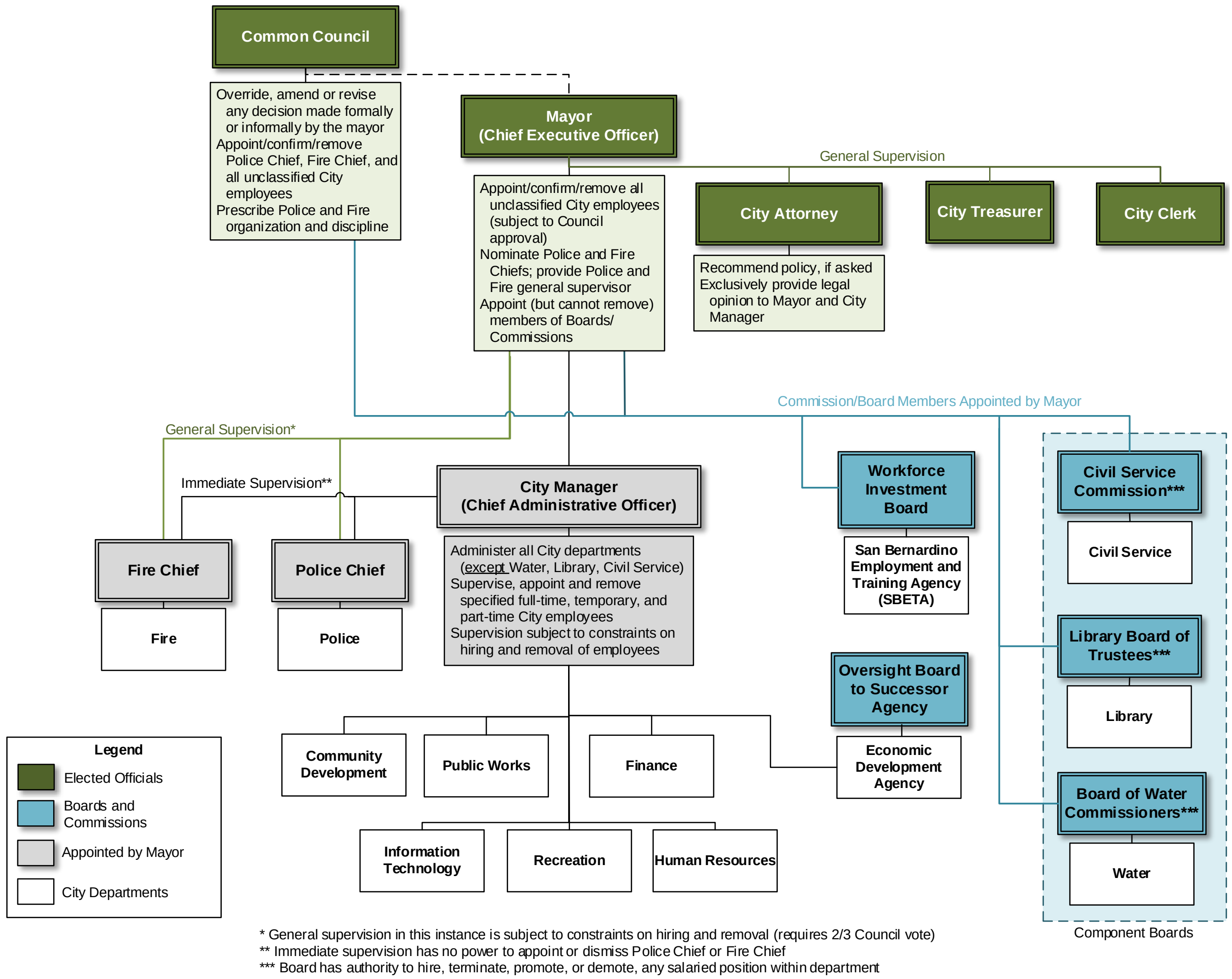
The San Bernardino City Charter was first created in 1905. Today, it is a 46 page document with 133 sections. Beginning in about 1988, city attorney opinions began to be issued regarding certain sections. There are now over 80 of these referenced, with 28 separate opinions on the Office of Mayor alone.

In the early 2000s, City leaders ostensibly recognized the need to begin to create a professional city management structure. In November 2004, the voters of San Bernardino approved a ballot measure (Measure G) that repealed the City Charter in effect at the time and replaced it with a new one. According to the Impartial Analysis by the city attorney, the major differences between the old Charter and the new "revolve around the creation of the position of city manager, and to make it easier to file initiatives and recall City-wide elected officials." The new Charter became effective in March 2006. Some provisions related to overall management of the City in the new Charter included:

- Designating the Mayor as the chief executive officer of the City of San Bernardino.
- Creating a "position of city manager and the eligibility, requirements to be appointed to that position."
- Designating the city manager as the chief administrative officer of the City to be responsible for the administration of all City departments, *except* the offices of the Mayor, City Attorney, City Clerk, City Treasurer, the Water Department, the Free Public Library and the Civil Service System.
- Setting forth the authority and duties of the city manager relative to supervision, appointment and removal of certain full-time, temporary and part-time City employees.
- Designating the Mayor as the person who appoints and removes the city manager, acting city manager, police chief and fire chief, subject to Council approval.
- Maintaining the Mayor's present general supervision of the police chief and fire chief.

The Core Team and the City expert consultant team believe that the Charter revision effectively made a bad situation untenable. As a result, the City has had five city managers since 2004. Clearly, trying to "manage" San Bernardino is extremely difficult. As it exists today, Figure 5 shows the confused reporting and authority relationships of the City of San Bernardino municipal organization.

Figure 5. San Bernardino Existing Organization Structure



While the new Charter created the position of city manager, an important step toward a council-manager form of government, the new Charter continued provisions that impede the city manager from exercising full responsibility and authority for effectively and efficiently delivering services throughout the entire city organization. Specifically, the new City Charter:

- Did not formally establish a council-manager form of government for the City of San Bernardino. Unlike many city charters, no form of government was specifically stated.
- Designated the Mayor as the chief executive officer of the City (strong Mayor), with responsibility for general supervision of the police chief and fire chief. While the city manager was designated to have day-to-day supervision of these functions, the new Charter did not achieve the objective of having a city manager position with full responsibility for managing the City.
- Maintained three separate departments under the administrative and operational direction of three advisory bodies (Component Boards) appointed by the Mayor and Common Council, not the city manager. The Mayor, however, lacks the authority to remove members from

each of these boards. As a result, the water utility, library and civil service functions are not accountable to the municipal operation.

- Retained the authority of the Mayor and Common Council to appoint and remove department heads, division heads, and all unclassified City employees. Only classified employees within city manager-directed departments may be removed upon the recommendation of the city manager, without the additional required consent of the Mayor and Common Council. Due to contradictions within the Charter, it is unclear whether the city manager can remove department or division (classified employees) heads without the expressed consent of the Mayor and Common Council.

There are 482 incorporated cities in California. Among these, 121 have their own charters. Most of the cities with a charter (like San Bernardino) were incorporated during the first half of the 20^{th} century, or earlier. About 75% of California cities operate under the general laws of the State of California rather than their own charter.

The council-manager form of government is the predominant form of local municipal government in California, although some cities operate under a strong mayor system. Charter cities typically designate the form of government within their charter, which is more often than not the council-manager form of government. The San Bernardino City Charter does not. Of 28 cities in California with populations between 150,000 and 400,000, 27 use the council-manager form of government, as shown in Table 10 below.

Table 10. Selected Characteristics of Californian Cities with Populations between 150,000 and 400,000

	Total number of cities	Charter	Council-Manager	Elected City Attorney
Number of Cities	28	18	27	3
Percent	-	64%	96%	11%

Sources: California Department of Finance, 2014; City websites and CAFRs

In most municipalities in California, and under the council-manager form of government, the council, elected by the public, is the governing body of the city. The city manager is hired by the council to carry out the policies it establishes. The council generally provides legislative and policy direction while the city manager is responsible for administration of day-to-day operations based on council policy. However, in San Bernardino, the Common Council and Mayor have an extensive list of executive powers. Most critically, the Charter sets forth crippling ambiguities with respect to the authority of the city manager, the Mayor and the Common Council regarding the management of a $211 million municipal corporation.

In a following section, both an interim and permanent fix to the charter issues are discussed. A group of community residents and leaders invited to a strategic planning summit on March 18 and 19, 2015 felt so strongly about this matter that they devoted at least a quarter of their total time to understanding the issue and developing ways to address it.

Executive and Department Head Turnover

Running a municipal corporation requires committed employees, visionary leaders with decision-making authority, and most important, a scalable and stable organization capable of sustaining core functions and innovation over time. In other words, it requires effective management. The City of San Bernardino has experienced exceptionally high turnover and short tenure in its executive management team, as demonstrated below in Table 11.

- Five city managers, police chiefs and public works directors over ten years.
- Four finance directors and fire chiefs over ten years.
- An annual turnover rate of 24% over ten years, and over 50% in 2009 and 2013.

Table 11. Executive Level Turnover for Major Service Departments

Department	Number of Directors (2004 to 2014)	Average Tenure (Years)
City Manager	5	2.20
Finance	4	2.75
Fire	4	2.75
Police	5	2.20
Public Works	5	2.20

Experts hired by the City, including the national consulting firm of Management Partners, who have been engaged repeatedly by the City, and the Core Team concluded that the high rate of turnover is a direct result of poorly functioning and confusing management authorities, structures and reporting relationships embodied in the City Charter. No city can be effectively managed with this amount of management and leadership turnover. In fact, it is unheard of in such a broad scale in other municipalities. Further, this period includes only two years of bankruptcy, which is obviously a highly stressful environment to manage a municipal organization. However, in 2009, the City experienced over 50% turnover of executive leadership.

Inadequate Municipal Services

As noted by the Core Team and the City's expert consultants, there are many reasons – including an ineffective City Charter, management instability, poor financial policies, and the lack of strategic planning – that explain why policy makers and City managers are struggling to make resource allocation choices in support of basic municipal services.

Major Service Reductions

Throughout the recession and after filing for bankruptcy, the City has made a number of decisions that cut General Fund costs but ultimately limited the City's ability to deliver core services. Some of the significant decisions are discussed below:

- ***Public Safety***. The City has reduced sworn staffing for police and fire, closed one fire station, and eliminated or reduced a number of specialized law enforcement functions. These actions have resulted in slower response times for priority 1 (highest emergency) police calls.

- ***City Infrastructure***. The City's Public Works Department has deferred infrastructure repairs and improvements, resulting in costs that are too high for future taxpayers to absorb.
- ***Park and Recreation***. The City has eliminated ball field maintenance and its entire youth sports program, closed two pools and two community centers, and significantly limited its recreation programming.
- ***Library***. Two-thirds of the City's library staff positions were cut, making it necessary to limit library hours. There is no budget for new books or computer replacement.

These major service-level reductions, along with others, are summarized in Figure 6.

Figure 6. Summary of Major Service-Level Reductions, by Department

Police

- Sworn staffing reduced from 349 full-time equivalent (FTE) employees in 2008 to 248 today (29% reduction)
- Patrol division sworn staffing reduced by 25% since 2008
- Community policing teams discontinued
- Narcotics enforcement reduced by 50% since 2008
- Traffic enforcement personnel reduced by 58% since 2008
- Priority 1 average response times increased 76% since 2008
- Almost three-fourths (73%) of patrol vehicles are overdue for replacement

Fire

- Total staffing (sworn and non-sworn) reduced 18% since FY 2011, 27% since 2008
- Number of units deployed reduced from 15 in 2008 to 13 in 2014
- One engine company eliminated
- One fire station closed in November 2014

Parks and Recreation

- Significantly reduced recreation programs; primary information tool for advertising programs eliminated
- Two pools closed to public (although maintenance costs persist)
- Two community centers closed; reduced hours at six other centers
- Youth sports eliminated
- Routine ball field maintenance eliminated

Public Works

- Public Works staff reduced by 50 (19%) since 2008
- Deferred street repairs and improvements estimated at $180 million, up from $88.4 million in 2008
- Deferred facility repairs and improvements estimated at $131 million
- Only 20% of sewer collection system has been video inspected; deferred sewer system improvements estimated at $23 million
- Over 730 claims filed for damages to vehicles caused by potholes since 2003
- 1,200 locations identified for sidewalk and curb gutter repairs
- Vehicle and equipment replacement deferred (56% of fleet units due for replacement)

Library

- Central library hours reduced from 54 to 37 per week (30% reduction)
- Reduced library hours at the three branches from 54 to 20 hours per week (63% reduction)
- Library staff reduced by 68% from 31 in 2008 to 10 FTE
- All 60 public computers are 7 to 10 years old with no funds for replacement
- No book budget (all acquisitions rely on fundraising)

City Support Functions

- Two years behind in fiscal year-end audits
- IT staffing reduced 30% since 2012
- Many computers more than 10 years old
- Systems disaster recovery at risk

The result of these reductions has been a City with public safety apparatuses unable to keep pace with service demands, a deteriorating infrastructure and a poor residential population without access to parks and recreation opportunities or adequate library services. Well over 90% of public school students are eligible for no or low-cost lunches, representing one of the highest rates in California, and the highest rate for this size urban area. People at this level on the income scale have only the public sector to provide basic municipal services like parks and recreation, libraries and public safety services.

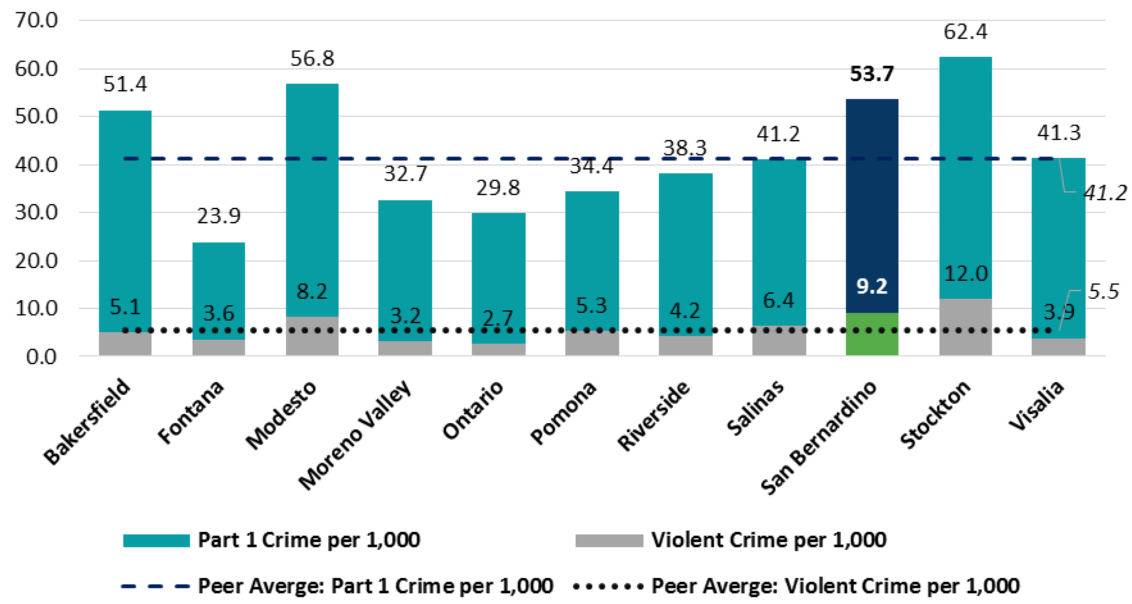
Police Services

Similar to other cities in California (and nationally) that find themselves in or on the brink of bankruptcy, the San Bernardino Police Department (SBPD) had to change its service and policing delivery framework. While the predictable result has been longer response times and significantly reduced community policing efforts and incidence clearance rates, the more critical outcome has been an inability to respond to serious community concerns about crime and related quality of life issues.

Streamlining and civilianizing many administrative functions and some services, and contracting others over the last several years have reduced overall operational costs; however, the department still faces the challenge of policing a City with the second highest violent crime rate and third highest Part 1 crime rate among peer cities in the state. Meeting this challenge will require additional financial resources, a stable, credible department capable of attracting and retaining quality sworn officers, and a proactive policing model in partnership with the community. Figure 7 summarizes the crime rates of San Bernardino against its peer cities. Police expenditures among the peer agencies are shown in Figures 8 through 10. An historical comparison of police expenditure and staffing in San Bernardino is summarized in Table 12.

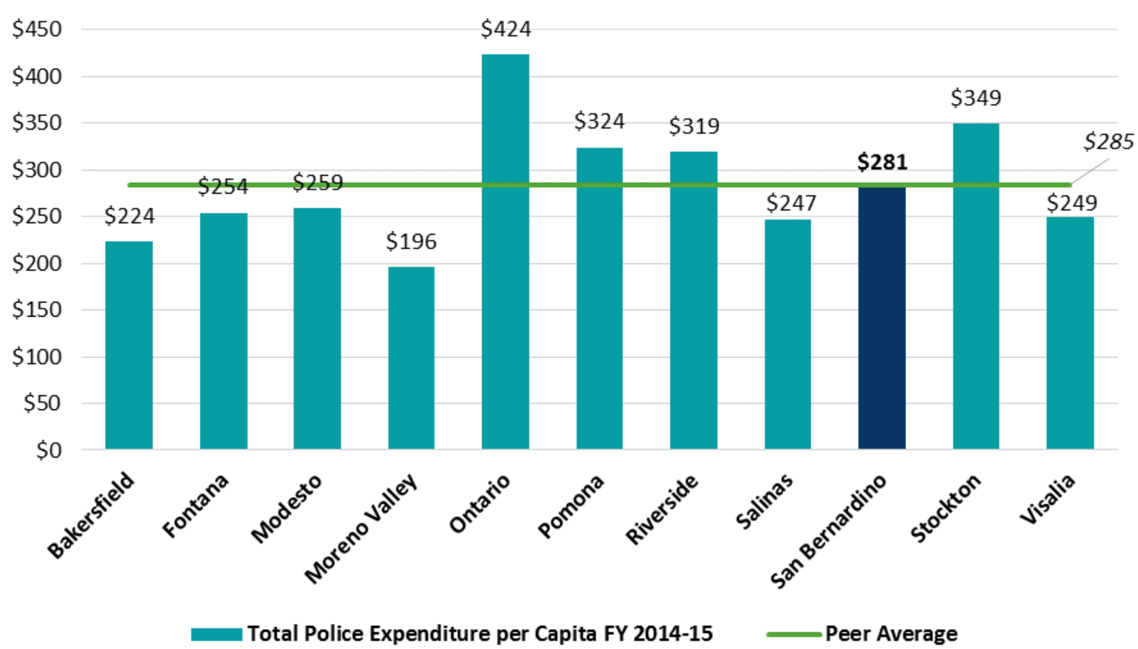
High Crime and Low to Average Expenditures

Figure 7. Part 1 Crime Rate and Violent Crime Rate in 2013



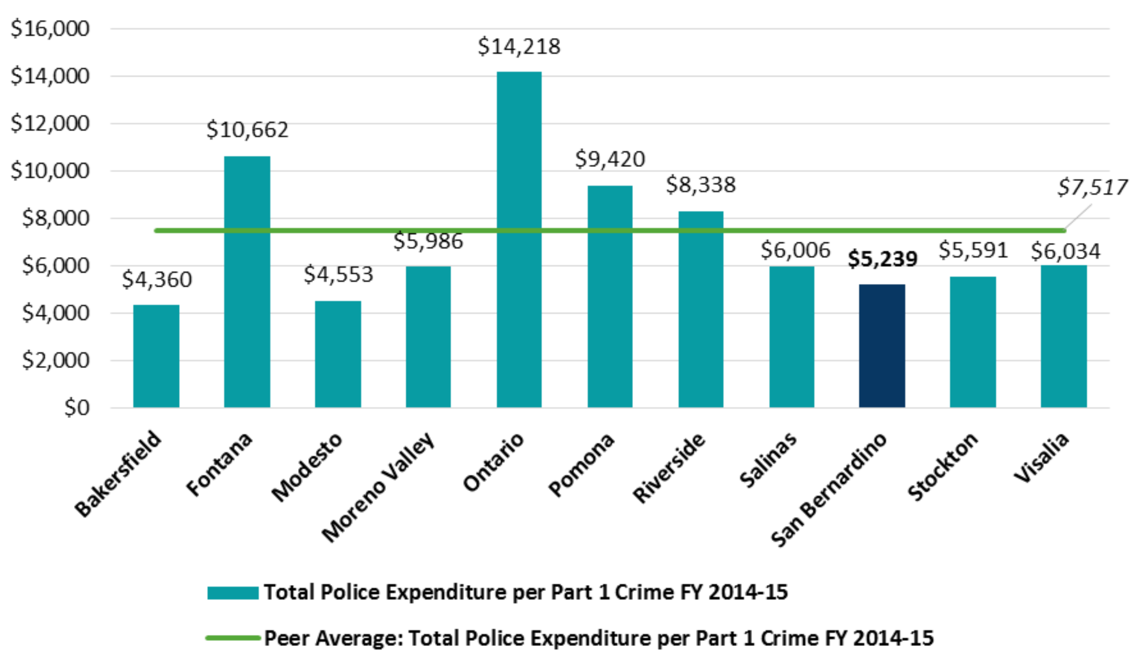
Sources: FBI Uniform Crime Report 2013; California Department of Finance, 2014
Note: The FBI uses three categories to define Part 1 Crimes: violent crime (murder and non-negligent manslaughter, forcible rape, robbery and aggravated assault), property crime (burglary, larceny-theft, motor vehicle theft), and arson.

Figure 8. Police Expenditures per Capita in FY 2014-15



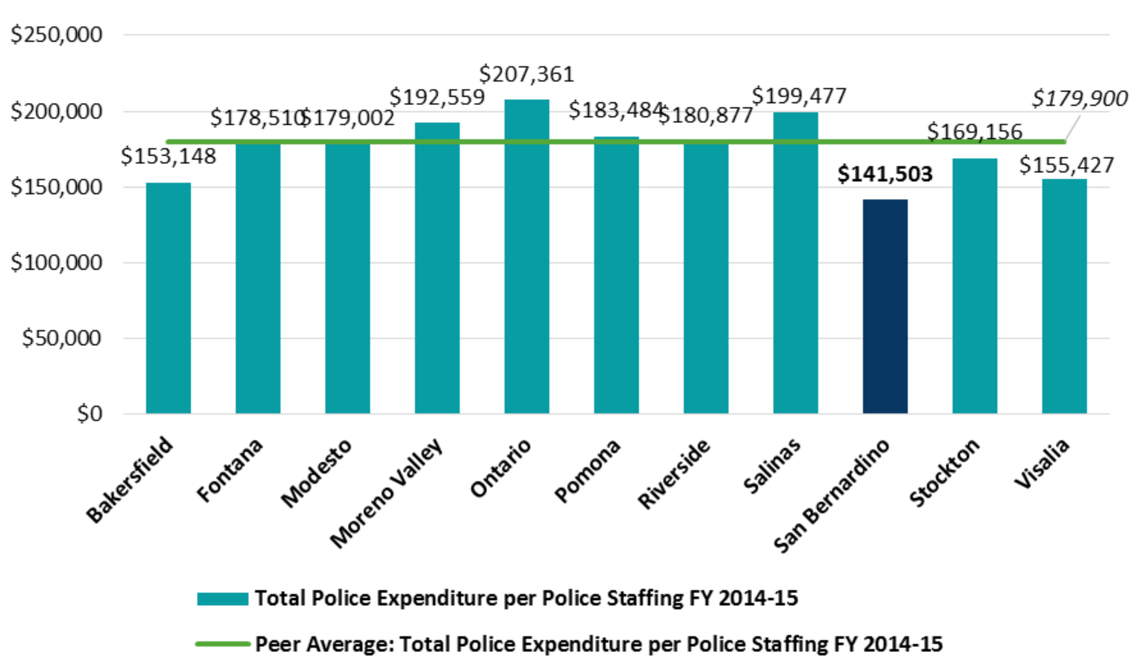
Sources: FY 2015 Adopted City Budgets; California Department of Finance, 2014
Note: Moreno Valley's police service is provided through a contract with the Riverside County Sheriff's Department.

Figure 9. Police Expenditure per Part 1 Crime in FY 2014-15



FBI Uniform Crime Report 2013; FY 2015 Adopted City Budgets
Note: The FBI uses three categories to define Part 1 Crimes: violent crime (murder and non-negligent manslaughter, forcible rape, robbery and aggravated assault), property crime (burglary, larceny-theft, motor vehicle theft), and arson.

Figure 10. Police Expenditure per Police Staffing in FY 2014-15



Sources: FY 2015 Adopted City Budgets

<u>Budget and Authorized Sworn Officers</u>

The SBPD operational expenditures and authorized sworn officers over the last five years are described in Table 12.

Table 12. Historic Total Police Expenditures and Staffing from FY 2011 and FY 2015

	2010-11 Adopted	2014-15 Adopted	Percent Change
Total Police Expenditures	$66,804,200	$59,855,766	-10.4%
Total Police Staffing	529	423	-20.0%
Sworn Police Staffing (Budgeted)	312	248	-20.5%
Sworn Police Staffing (Actual)	306	230	-24.8%

Sources: San Bernardino City Budgets

Note: Staffing information was provided by the Police Department.

The SBPD has experienced difficulty in attracting quality candidates. In a recent hiring effort for sworn officers, three successfully made it through the process. Only two were hired out of 508 applicants who had progressed to the testing phase. One person resigned almost immediately, and the other was injured early in the training phase. While many police officers are attracted to a police department where they can obtain broad experience, competition in the region is fierce and opportunities to serve in other agencies with more stability and reliable resources have impacted the SBPD hard. Table 13 shows the sworn officer turnover over five years.

Table 13. Sworn Police Safety Turnover from Calendar Year 2010 to 2014

	2010	2011	2012	2013	2014
Turnover Rate	5%	7%	8%	11%	13%

Sources: Provided by the City of San Bernardino

<u>Core Functions Reduced 40% to 50%, Delayed Response Times and Aging Fleet</u>

Severe reductions in staffing allocations have resulted in a major redesign of the community policing program. While somewhat streamlined, the department is unable to respond to community concerns in depth or develop long-term strategies for the future. Both narcotics enforcement and responses to gang-related issues have been reduced by about 50%. A 40% reduction in officers allocated to traffic enforcement increases safety concerns on City streets and reduces citation revenue that could be used to offset enforcement costs. Emergency priority calls (violent felonies) have increased 31% since 2009, response times have increased 34%, and Priority 4 calls (policy reports) response times are up 212%. Finally, there are 161 police patrol vehicle units of which 117 (73%) are overdue for replacement at an estimated cost of $4.9M.

Fire Services

The San Bernardino Fire Department and the community have been suffering from what a fire services consultant (Citygate Associates) described in a *2014 Fire Services Deployment Study* as "severe stress." The report indicated this has resulted from a combination of factors found in a community with little economic investment, a city in bankruptcy and a low median income. Operational staff reductions combined with exceptionally high emergency medical incident call volumes and frequent structure fires have resulted in longer response times and an inability to stem the perception that San Bernardino may not be a community safe from fire. The 2014 study concluded that the City is "not over-deployed to serve its diverse geography and risks." However, given the level of emergency medical incidents, resources typically available for fire suppression are too often unavailable for an appropriate level of response in an urban setting. So while the department has an average number of total fire employees as measured by its peers, the calls for service make effective deployment challenging.

Budget Reductions and Staffing

The Fire Department operational expenditures and authorized sworn fire fighters over the last five years are shown in Table 14.

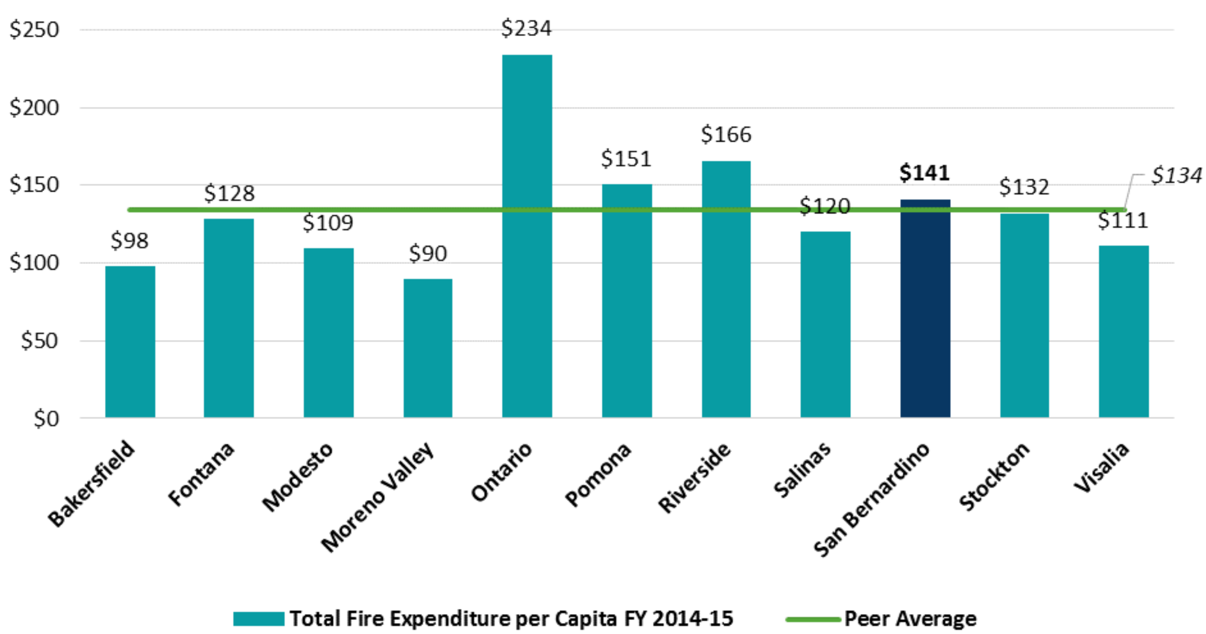
Table 14. Historic Fire Expenditures from FY 2011 and FY 2015

	2010-11 Adopted	2014-15 Adopted	Percent Change
Total Fire Expenditure	$32,621,400	$30,001,462	-8.0%
Total Fire Staffing	191.00	157.00	-17.8%
Sworn Fire Staffing	150.75*	123.00	-20.0%

Sources: San Bernardino City Budgets
**FY 2011 budget did not indicate sworn or non-sworn positions. The figure assumes "Fire and EMS" category indicates sworn staffing.*

Even with the operational reductions, the Citygate study concluded the department's "daily staffing is adequate for the immediate response fire risk needs presented in the more built-up urban areas of the city." Even at FY2014-15 spending levels as shown in Figure 11, fire expenditures compare relatively favorably with peer agencies.

Figure 11. FY 2014-15 Fire Expenditure per Capita



However, the Citygate report also states that the department's incident statistics indicate that far too frequently the closest crews to a building fire are already deployed to an emergency medical call. Emergency medical calls represent 87% of the department's calls for service and increased 15% between 2012 and 2013. Fire alarm calls increased 19.5% during this same period.

The City has taken action to reallocate emergency medical calls to other resources for response, but the volume remains high. Additionally, the City closed one fire station and reduced staffing at a second by eliminating a pumper and replacing it with a two-person EMS squad. Despite these efforts to control costs, the City fire department continues to exhibit expenditure growth in excess of the growth of general city revenues. If alternative service delivery options are not explored, the fire department will continue to absorb budgeted resources beyond what the City can sustain.

Community Risk Reduction

In addition to fire suppression and emergency medical response, fire departments in California are also responsible for mandated inspections including new construction and a range of permitted occupancies, e.g., community care facilities, high rise buildings, hazardous materials facilities. The department has reduced staff in this area by over 30% in the last several years. Consequently, it is lagging in such inspections, putting the community at risk due to non-compliance.

City Infrastructure and Maintenance

Over the last decade, the City of San Bernardino has been unable to plan for or provide the resources required to address even a minimum of maintenance, replacement, repair and reconstruction of its public infrastructure and facilities. Major areas of deficiency that have a direct impact on the ability to attract economic development and the quality of life in the community include the following basic municipal functions.

City Hall

In 2007, the City hired an engineering firm to undertake a preliminary risk analysis of the San Bernardino City Hall building, primarily focused on liquefaction risks. The building is a seven story reinforced concrete structure designed in 1970 which relies upon "non-ductile" concrete frames for seismic resistance. Because of experience with the 1971 San Fernando earthquake the 1973 Building Code prohibited this type of construction in areas with high and moderate seismic potential. San Bernardino is in one of the most seismically hazardous locations in California. The report concluded that City Hall was designed "at best to the minimum requirements of the applicable code and is thus vulnerable to significant damage and collapse." The report also stated that seismic rehabilitation is "strongly recommended" with costs at the time ranging from $12 to $15 million. No formal action by the City in response to this report has been taken and the City must now urgently consider next steps through further study, including consideration of relocation of City Hall offices on an interim basis.

Street System

The City of San Bernardino has approximately 629 miles of public streets comprised of the arterial system and local and collector streets. A pavement management study, the mechanism by which most municipalities assess the condition of their streets, was last conducted in 2008. At that time, costs for routine maintenance, preventive maintenance, rehabilitation and reconstruction of the City's streets were estimated at $88,493,404.

Due to the continued deferral of repairs and maintenance and increased deterioration since 2008 and minimal investment by the City in maintaining the street system, street system maintenance and repair costs have likely increased to an estimated $150 million (in 2008 dollars). Based on the construction cost increases tracked by *Engineering News Records*, estimated costs in 2015 of repairing the City's streets are now likely to be 20.13% more (or approximately $180,300,000). Table 15 shows the breakdown of deferred costs for the areas with the greatest funding deficiencies.

Table 15. Deferred Cost Estimates

All City Streets with Five-Year Deferral	Estimated Cost
Routine Maintenance (crack seal, patching, etc.)	$1,739,623
Preventative Maintenance (slurry seal, scrub seal, etc.)	$18,848,920
Rehabilitation (mill & cap, scrub seal & cap, etc.)	$60,797,310
Reconstruction (full depth reclamation, cold-n-place)	$68,688,320
Total (2008 Dollars)	$150,071,173
Total (2015 Dollars)	$180,300,000

The Public Works Department has a streets capital projects budget of approximately $17.5 million in FY 2014-15, clearly insufficient to even begin to address the deferred street maintenance needs. Additionally, the City also maintains a street maintenance work crew of nine to ten staff members with an additional $400,000 in contract work allocated for asphalt repair. Ninety percent of the staff's time is spent repairing potholes; however, they are unable to keep up with the average of 150 potholes needing to be repaired at any given time.

Public Facilities

The City currently allocates little or no funding beyond critical needs to basic improvements or major capital maintenance to its public facilities, including City Hall, police headquarters, libraries, the City corporation yard and fire stations. Maintenance for these facilities has been delayed, and some facilities continue into advanced stages of deterioration. Examples include the failure of the HVAC system at City Hall; leakage of the skylight and roofs at the Felheym Library, City Hall and at the City yard; failure of the emergency generator at Station 221 (for the Emergency Operations Center); and mold remediation required at the Villa Senor Library. Table 16 provides the breakdown of deferred public improvement costs.

Table 16. Deferred Cost Estimates by Facility Type

Description	Cost
City Hall, Police Dept., Convention and Career Centers, Animal Control*	$34,012,000
City Yard Facilities	$1,961,000
Fire Stations	$3,785,400

Libraries	$1,670,000
Parks (from Parks Master Plan)	$89,828,100
Total in 2015 Dollars	$131,256,500

** includes seismic retrofit of City Hall and Parking Structure at $25 million*

Failure to continue with a responsible maintenance program will result in future accelerated repair costs due to weather, earthquakes or other issues related to regular and repeated use of the facilities. As maintenance is deferred, the public buildings will continue to deteriorate and fall into a costlier state of repair.

Fleet Services

There are over 852 vehicles in the City's fleet. These include fire trucks; police, refuse, street sweeping and maintenance vehicles; and a range of others required to support basic municipal services. A recent assessment concluded that 479 units, representing 56% of the City's total fleet, are past due for replacement at an estimated cost of more than $41.4 million. No vehicle replacement funds or investment plan is in place to replace the aging vehicles except on an ad hoc basis through special allocations in response to critical needs. In addition, the City has not supported a modern fleet maintenance operation. This causes frustration to users who are not able to rely on properly maintained vehicles and equipment. As a result, preventive maintenance is practically non-existent and state mandated vehicle safety inspections are seriously backlogged.

To support a municipal fleet operation, the City will need to identify funding to address the critical backlog of vehicles and equipment overdue for replacement. Additionally, the City must improve and modernize its fleet maintenance operation either internally or through contract services. Either avenue will require significant additional financial resources on an ongoing basis.

Sewer System Improvements

Sewer system improvements are financed through the sewer service fee. The City maintains 510 miles of sewer lines including 8,056 sewer manholes, sewer siphons and 12 sewer left stations. Pursuant to a video inspection of the sewer system, 1,723 locations have been identified as needing repair. The total cost for these repairs is estimated at $23 million today and will only increase as a result of deferred maintenance. The FY 2014-15 sewer capital expenditures, financed by sewer services fees, are estimated at $2.5 million. The existing sewer service fee is insufficient to maintain this critical infrastructure.

Concrete Repairs

As of January 1, 2015, there are approximately 1,200 locations identified by residents and staff in the City's work order tracking system for sidewalk, curb and gutter repairs. These locations include trip hazards, lifted sidewalks due to roots or damage from other causes. There are also 11 bridge repairs identified that need to be completed. The total cost for these repairs is approximately $7.2 million. The City budgeted $300,000 in FY 2014-15 for curb, gutter and sidewalk repairs and $1.5 million for bridge repairs for a total of $ 1.8 million.

Tree Trimming

There are over 62,000 trees maintained by the City under contract. For proper tree health, industry standards recommend that all trees be trimmed every five years, which for San Bernardino would require an annual allocation of $1.26 million. The City allocates $400,000 annually for contract tree maintenance, 70% below that required to preserve the investment in its urban forest.

<u>Traffic Signal Maintenance</u>

The City is responsible for 288 traffic signals which are maintained by City staff. There are 187 controllers or detectors for traffic signals in need of replacement or repair at a total cost of $2,900,000. Repair and replacement is critical to traffic flow and to mitigate ongoing maintenance by an already lean public works staff. In FY 2014-15, the City allocated $600,000 to replace or repair these signals, far less than needed.

<u>Street Lighting</u>

The City owns and maintains 6,640 street lights. Southern California Edison owns and maintains an additional 6,488 street lights in the City. The City has experienced extensive vandalism of its lighting system due to the rising value of copper wiring. The City contracts for its street lighting maintenance, an annual $580,000 contract, but this is not adequate to keep the lighting in good repair. As of the end of January 2015, there were 475 inoperable City-owned street lights. Additionally, to reduce ongoing costs, the City should be migrating to LED lights. There is no financial or other plan to do so.

Parks and Recreation

In a community with high poverty and unemployment rates and increased drug and gang activity, parks and recreation amenities and programs should be a priority. Yet, San Bernardino has been unable to provide a municipal program to meet community needs, in part due to a population unable to pay for such services. Cost-prohibitive internal service fund policies increase program costs, and low staffing levels and little training as well as poor technology leave little opportunity for innovation. Also, the need to allocate scarce recreational funding resources to maintain existing facilities that are closed or minimally available to the public means that little remains for direct programming. The City's investment in its parks is at risk, and basic recreation programs are unavailable to a community that yearns for recreational alternatives other than those found on city streets.

The City ranks eighth in parks and recreation expenditures per capita among peer agencies within the state. The City spends $18.43 less per capita than the peer agency average even though it is the fourth largest in population, and its population is 3% or 6,104 less than the peer agency average.

When evaluated against four major cities within the region (Inland Empire), the City:

- Ranks last in parks and recreation funding. Annually, the City spends about $5.6 million less than the average of the peers.
- Expends $44 less per capita on parks and recreation services despite a population that is 2% larger than the average peer.
- Is the only city that does not provide any organized youth sports, camps, extensive teen programs or adult sports leagues, except one summer adult men's baseball league.
- Is the only city not producing an activity guide or publication (an industry standard) to inform the community about its park and recreation programs.

Park Maintenance

While the City contracts for park maintenance, the contract does not include ball field maintenance and sport lighting. San Bernardino spends $2,000 less per acre than the national average; therefore, the quality of park and cemetery turf is well below standards putting the community at risk for play on poorly maintained fields. Some Little Leagues are maintaining their fields instead of the City; however, other ball fields have significantly deteriorated, making them effectively unavailable for play.

Library

The San Bernardino Public Library (SBPL) fares poorly when compared with other public libraries in the state with a population between 150,000 and 249,000. Average per capita funding is $22.04 compared to SBPL's approximately $7.00 per person, according to the state library's Public Library Statistics portal. According to the portal, on average, each library is open 35 hours; however, SBPL's three branches are only open 20 hours at each location. According to the portal, peers provide $1.81 per capita collection expenditure for materials; however, the City provides no funding for materials to the SBPL.

Some public libraries sustain a three- to five-year cycle for computer replacement; the SBPL's computers are between seven and nine years old with no funding for replacement. While benefiting from grant funds for discounted telecommunication access, SBPL is unable to meet the Federal Communication Commission's goal of 1 gigabit connections as it offers only 100 Mbps at the Central Library and 10 Mbps at branch libraries. The goal is all the more challenging due to annual budget uncertainties.

San Bernardino (approximately 60 square miles) also lacks public library facilities in the western and eastern portions of the City. These underserved areas critically need library services to bridge the "digital divide" for those who lack access to current technology. This includes having access to computers to draft documents and find a job. Opportunities only available at a free public library are vitally needed for a community that has the highest percentage of residents below the poverty line in the state among cities with populations of 200,000 and second nationally behind Detroit.

Outdated or Nonexistent Corporate Business and Support Services

Administrative, business and corporate support systems and services within the City government have suffered from a lack of focus and necessary fiscal support for more than a decade. The result is a $211 million corporation relying on outdated and in many cases non-existent administrative and business systems to make management decisions on a daily basis. The fact that the City is behind in its audits, cut its information technology staff by one-third (including the manager) during the last three years and has no purchasing agent are only a few examples of a city that struggles to keep up with its regulatory obligations or strategically plan system improvements. The lack of up-to-date, integrated corporate support systems, or an implementable business plan, represent major obstacles to recovery. Understanding this, the City began developing a Strategic Plan in January of 2015 that will be implemented as the City rebounds from bankruptcy. Part of this Strategic Plan will include the creation of modern, or at the very least, adequate administrative, management information and financial systems, which are a requirement for any municipality to effectively and efficiently manage its operation. Good policy decision-making must also rely on those same systems to make informed decisions.

Examples of inadequate business and corporate support systems include:

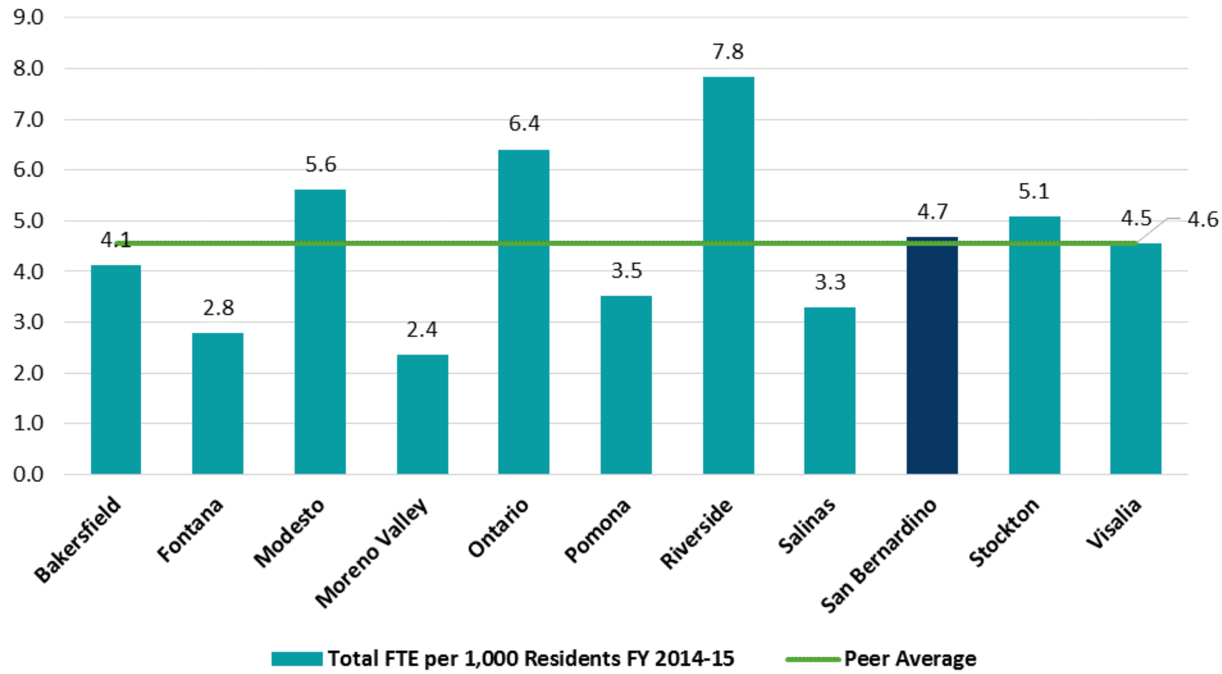
1. *Information Technology*. No overall governance; end-of life hardware and software (ten-year old computers and systems); new system modules not implemented or not being used to their potential; unused software still being paid for; no application architecture and standards; no comprehensive plan for business continuity or disaster recovery should systems fail.
2. *Manual Processes.* Manual time attendance and payroll systems not effectively integrated with City financial system; paper-based invoice processing and a document management system for handling of paper across the organization that has not been implemented.
3. *Contract Management.* Inconsistent and non-centralized contract management policies and practices.
4. *Purchasing Policy.* Outdated purchasing policies and decentralized purchasing practices that prevent economies of scale across the organization.

Expenditures and Employee Compensation

Most City expenditures are directly impacted by labor costs, representing the largest component of the City's annual budget. As was detailed earlier in this document, most maintenance and capital spending is being deferred, as is proper management and funding of internal service funds (i.e., fleet). Rebuilding the City will require rebuilding in these areas, which will require funding. Therefore the City must scrutinize all existing spending so it can fund these areas and pay creditors. This section addresses the City's history in trying to control employee labor costs and its current philosophy concerning this cost center.

Historically, San Bernardino has had a relatively high number of full-time employees. In 2007 when Management Partners conducted an organizational assessment for the City, it found that San Bernardino had about six FTE per 1,000 residents, which was similar to such well-funded cities as Ontario and Riverside, and almost three times the number of employees as the nearby City of Fontana. This has changed somewhat as San Bernardino shed positions as its fiscal situation became bleak and it entered bankruptcy. Figure 12 shows a current comparison of San Bernardino's FTEs compared with peer agencies.

Figure 12. San Bernardino FTE per Capita among Peer Agencies



As the figure shows, San Bernardino has slightly more FTE on average than the peers. While much lower than Ontario and Riverside (Riverside has an electric utility), the City's FTE per 1,000 is much higher than Fontana, Moreno Valley or Pomona, which contract for service delivery more than San Bernardino

This illustrates a challenge for San Bernardino. Public employees are expensive, chiefly because of the defined benefit pension plan common to the industry. Thus, each employee is valuable and must be as productive as possible. Unfortunately, San Bernardino stopped investing in training and or productivity-boosting information technology systems years ago.

Moreover, independent evidence on total employee compensation shows that non-safety employees are well below the market for such workers. As a consequence, the City has a recruitment and retention problem. The City needs fewer public employees so it can operate more efficiently, using a contract model like Fontana or Moreno Valley, and to pay the employees it retains competitively so it can recruit and retain qualified employees. This is true even with respect to positions within police because while Charter Section 186 has distorted salary compensation, the City has tried to balance this by cutting non-salary compensation, leading to a non-competitive overall package and higher CalPERS liability due to high "PERSable" compensation.

To realign and effectively manage its service delivery, improve public safety and provide a municipal infrastructure capable of attracting economic development investment, the City must be able to recruit and retain a competent, competitive work force. This will require, in the opinion of the experts retained by the City to develop this plan:

1. Competitive wages and benefits;
2. Continued membership in CalPERS for those remaining City employees, the state's defined retirement benefit plan; and
3. Charter reform and/or replacement.

The City recognizes and bargains with seven bargaining groups:

1. General Unit Employees represented by the International Union of Operating Engineers (IUOE)
2. Mid-Management Employees represented by the San Bernardino Public Employees Association (SBPEA)
3. Police Management Unit represented by the Police Management
4. Police Safety Unit represented by the San Bernardino Police Officers Association (SBPOA)
5. Fire Management Unit represented by the Fire Management Association
6. Fire Safety Unit represented by the San Bernardino City Professional Firefighters Association, Local 891 (SBCPF)
7. Management/Confidential Association

While employees of the Water Department are considered City employees, they negotiate their own salaries and benefits separate from the rest of the City, subject to approval of the Water Board of Commissioners (not the Mayor and Common Council). Because of this separation, and because it has access to independent revenues, the Water Department has been able to better implement human resource management (as well as other core municipal support functions).

Ten Years of Trying to Contain Labor Costs

The filing of the Chapter 9 petition on August 1, 2012 was preceded by several years of efforts to address escalating labor costs, driven mostly by significant increases to health care and pension rates and City Charter Section 186 raises for safety employees. Miscellaneous employees have not received any cost of living adjustments (COLA) since FY 2006-07. However, in FY 2007-08, the Mayor and Common Council authorized an enhanced CalPERS retirement formula of 2.7% @ 55 for miscellaneous or general (non-safety) employees. All salaries for safety employees are established through the provisions set forth in the City Charter, specifically Charter Section 186 (Section 186).

Faced with a structural budget deficit in March 2009, all non-safety employees agreed to a reduced 36-hour work-week, forgoing four hours of pay per week (which negatively impacted the City's ability to deliver municipal services). This concession reduced overall salary compensation by approximately 10% each year, realizing annual savings of about $ 3.7 million per year. In 2011, the Mayor and Common Council continued the reduced work-week and established new CalPERS pension retirement formulas for all new employees. For the Miscellaneous employees, two pension formula tiers were in effect: 2.7% @ 55 (Tier 1) and for employees hired after October 4, 2011, 2% @ 55 (Tier 2). For safety employees, there were two pension formula tiers: 3% @ 50 (Tier 1) and for those employees hired after September 1, 2011, 3% @ 55 (Tier 2). By the spring of 2012, the City had achieved significant concessions, including suspension of merit increases and required contributions to CalPERS retirement benefit by new employees, as shown in Table 17.

*Table 17. Labor Concessions Implemented between 2010 and April 2012**

Bargaining Unit	10% Concessions	Forego Annual Merit Increases	Two-Tier Retirement Plan for New Employees	PERS Pick-up for New Employees
General	✔	✔	✔	✔
Middle Management	✔	✔	✔	✔
Management	✔	✔	✔	✔
Police Safety	✔	✔	✔	✔
Police Management	✔	✔	✔	✔
Fire Safety			✔	✔
Fire Management	✔		✔	✔

**Merit increases for police safety are established through the salary survey methodology in Section 186. While the table indicates that police safety and management had agreed to forgo annual merit increases, the reason is that for FY 2010-11 and 2011-12, police agreed to give up any salary increases resulting from Section 186 surveys.*

While these labor concessions helped to contain labor costs, the negative General Fund cash balance at the beginning of FY 2012-13 was estimated at $18 million. Given the severity of the financial situation, the City explored other options for reducing labor costs including reducing vacation and sick leave accruals; eliminating or deferring sick leave cash outs; expanding cost sharing of CalPERS pension costs to all employees, not just new hires; eliminating the Employer Paid Member Contribution for safety employees; and reducing retiree medical contributions.

Public Safety Compensation - City Charter Section 186

The basic standard for fixing salaries, classifications and working conditions of the safety employees in the City's Police and Fire Departments is provided under City Charter Section 186. In essence, Section 186 eliminates the collective bargaining process regarding the setting of public safety salaries and inhibits City management's ability to address the full range of factors that impact public safety salaries. Past attempts to reduce salaries have resulted in litigation with adverse results to the City.

Section 186 requires the comparison of base salaries for each of seven public safety classifications in ten California cities (which have been reduced from 50 cities) with populations between 100,000 and 250,000. (Comparison cities are not based on the region which is a typical public sector practice.) Salary ranges for each of the seven classification levels are then established, and salary adjustments are effective annually on August 1.

Section 186 has been the subject of numerous legal opinions generated by the City Attorney's Office which have affected, in part, its implementation. The result of the implementation opinions has created established practices that have impeded the City's ability to control how Section 186 surveys are conducted. As a consequence, the City's ability to exercise any fiscal control over safety salaries has been curtailed and the salary increases as well as the increases to salary-driven benefits such as pension benefits have been significant as illustrated in Table 18.

Table 18. FY 2006-15 Public Safety Adjustments Resulting from City Charter 186

Fiscal Year	Average Annual Change: Police Safety[1]	Average Annual Change: Fire Safety[2]
2006-07	7.21%	3.36%
2007-08	3.34%	4.90%
2008-09	5.53%	2.45%
2009-10	2.48%	2.95%
2010-11[3]	-	0.40%
2011-12[3]	-	0.46%
2012-13	1.72%	0.82%
2013-14	3.04%	0.66%
2014-15	4.29%	-

[1]Includes police officer, detective/corporal, and sergeant positions.
[2]Includes fire fighter, paramedic, engineer, and investigation/captain positions.
[3]Police Safety and Management agreed to no financial impact resulting from City Charter 186 formula in FY 2010-2011 and in FY 2011-12.

Labor Cost Reductions during the Fiscal Emergency (Pendency Plan)

Following the declaration of a fiscal emergency on July 18, 2012, the Mayor and Common Council adopted Resolution 2012-214 in August. The resolution suspended employees' accrued leave bank payoffs, cash-outs and/or sell backs. This suspension was subsequently incorporated into five labor agreements and extended by Mayor and Common Council action in June 2014. They also amended Civil Service Rule 511 expediting the time for department heads to give notice of layoffs to facilitate workforce reductions. On November 26, 2012, the Mayor and Common Council adopted the Pendency Plan as Resolution 2012-278, which reduced General Fund expenditures through continued staff and compensation reductions. A summary of the Pendency Plan elements is provided in Table 19.

Table 19. FY 2012-13 and FY 2013-14 Pendency Plan Elements

Item	FY 2013 Projected Savings	Notes
Workforce and Service Reductions	$13,452,000	Pre-Pendency Plan savings less SAFER grant.
Police Vacancies (voluntary separations)	$3,280,000	Reduction in sworn positions from 281 to 260.
Police 13.989% Employee CalPERS Rate Contribution (benefit concession)	$3,252, 000	50% of the normal PERS costs
Fire 13.989% Employee Cal PERS Rate Contribution (benefit concession)	$1,994,000	50% of the normal PERS costs
Miscellaneous 9.304% Employee CalPERS Rate Contribution (benefit concession)	$651,000	50% of the normal PERS costs
Fire Overtime Reduction	$921,375	Elimination of Constant Manning provisions in MOU; 35% reduction in Fire OT.

Item	FY 2013 Projected Savings	Notes
OPEB Implied Subsidy Phase Out	Pending actuarial valuation	Reduction of the implied annual subsidy to existing retirees of roughly $800,000 to 1,000,000 beginning January 1, 2014.
OPEB Direct Subsidy Phase Out	$213,750	Reduction of the direct payment to existing police retirees to the $112 per month afforded to other retirees beginning January 1,2013
Employer Paid Member Contribution (EPMC)	$2,400,000	Elimination of the 9% City contribution and require all safety employees receiving this benefit to pay the contribution through salary deductions.

To date, all of the Pendency Plan Elements regarding labor costs have been implemented, some through agreement with the bargaining groups and others through imposition by resolution of the Common Council. Following adoption of the Pendency Plan, the Mayor and Common Council approved agreements with four of the City's labor groups in January and February 2013 implementing cost-sharing and other benefit concessions as outlined in the Pendency Plan. The Mayor and Common Council also imposed terms modifying the terms and conditions of the existing Memorandum of Understandings (MOU) with the fire and police safety unions and the middle management unit. The imposed terms incorporated the elements set forth in the Pendency Plan. Four of the seven bargaining groups also agreed to pension cost-sharing in the 18-month agreements ratified by the bargaining units. In August 2013, the City and the Mid-Management unit reached an agreement that incorporated the Pendency Plan elements including cost-sharing. The cost sharing for police and fire safety units and the middle management unit was imposed on January 28, 2013. The cost-sharing for all employees became effective February 1, 2013.

<u>Fire Overtime Reduction</u>

Overtime for fire fighters has averaged approximately $6.5 million per year for the last few years. This significant overtime cost is primarily the result of a provision in the SBCPF MOU providing for constant manning of stations. The Honorable Judge Jury granted the City's Motion to Reject the SBCPF's MOU on September 11, 2014. Thereafter, on October 6, 2014, the Mayor and Common Council adopted Resolution 2014-364 imposing new terms and conditions of employment including the elimination of the constant manning provision. Nonetheless, overtime costs have not been significantly reduced by the imposition of these new terms.

<u>Employer Paid Member Contribution (EPMC) to CalPERS</u>

The four safety MOUs provided that the City would pay the 9% employee contribution. On January 28, 2013, the Mayor and Common Council approved agreements for police and fire management units that included the elimination of the EPMC. Also, on this date, the Mayor and Common Council imposed eliminating this benefit on the SBPOA and the SBCPF. Because the benefit was negotiated as part of the respective MOUs and was not part of a contract amendment to the CalPERS safety plan agreement, elimination of this benefit was allowable under California law.

<u>CalPERS Employee Cost Sharing</u>

The City has successfully negotiated cost-sharing agreements for active employees with five of the seven bargaining groups. On January 28, 2013, the Mayor and Common Council imposed cost sharing in the amount of 13.989% for both the SBPOA and the SBCPF, representing 50% of the

City's FY 2013-14 normal costs. This imposition is the subject of ongoing litigation. General employees (legacy members) pay 9.304%, which also represents 50% of the FY 2013-14 normal costs.

<u>Other Post-Employment Benefits (OPEB)</u>

As part of the actions by the Mayor and Common Council in January and February 2013, the direct subsidies to retiree health care were reduced for all employees to $112 per month from a maximum stipend of $450 per month. To implement the Pendency Plan elements regarding OPEB and achieve other budget objectives, the City directed its health insurance broker to separate all retirees from active employees when marketing for health plans. The goal was to stop active employees from subsidizing the cost of health care benefits for retirees. This resulted in a reduction in the cost of health care benefits of approximately $200 per month for active employees, while retiree costs for the same plans increased about $200 per month. With this reduction in premiums for active employees, the City's contributions to these premiums could also be reduced without significantly impacting the affordability of the health care plans available to employees. This enabled the City to realize a $1.1 million reduction in health care costs.

Further, the City has been negotiating with the Retiree Committee with respect to health care and pension issues. The City has reached a tentative agreement with the Retiree Committee where, with the exception of some retirees hired before 1986 and not Medicare eligible, all direct monthly subsidies of $112 will be discontinued. These actions have significantly reduced the OPEB liability as illustrated in Table 20. The significant reduction in liability was the result of reductions in premiums and plan changes ($13.1 million) and the elimination of the implied subsidy for all but a few grandfathered participants ($ 32.2 million).

Table 20. GASB 45 Estimated Actuarial Valuation of City's Retiree HealthCare Plan

	AAL *(in Thousands)*
Actual @ 6/30/12	$48,819
Expected @ 6/30/14	53,937
Gains)/Losses	
• Premiums and plan changes	(13,082)*
• Eliminate medical plan implied subsidy for all but grandfathered participants	(32,184)
• Demographic and other	(1,450)
Assumption changes	601
Total Gains/(Losses)	(46,115)
Actual @ 6/30/14	7,822

**Includes approximately $6.3 million from removing Medicare-eligible retirees and $0.8 million from eliminating medical benefits for hires after January 1, 2013.*

Currently, the City's OPEB liability is based on life insurance and some direct subsidization of retirees. OPEB liability for Water Department employees is approximately $20.27 million, as there have been no changes to retiree benefit contributions and the active employees still indirectly subsidize retiree health benefits.

Suspension of Paid Time-Off; Caps on Sick Leave Accruals

On August 8, 2012, the Mayor and Common Council suspended all payouts, cash-outs, and/or sell-backs for accrued vacation, sick and other leaves through Resolution 2012-214. This resolution authorized the City Manager to negotiate payouts with those employees separating from the City. In the five agreements that modified terms and conditions of employment for all bargaining units except Police and Fire Safety employees adopted by the Mayor and Common Council on January 28 and February 4, 2013, the suspension of accrued leaves was extended through June 30, 2014. The Mayor and Common Council also adopted resolutions in January 2013 imposing a freeze on all leave payouts, cash-outs, and sell backs for the police and fire safety units. Through the collective bargaining process, in addition to the suspension of leave payouts,, sick leave accruals were reduced for all employee groups to no more than 1,040 hours and the amount of payout at the time of separation was significantly reduced so that no more than 35% of the accrued hours could be cashed out provided that the separating employee had six or more years of service.

The impact of these initiatives as shown in Table 21 has been that within a two year period total leave liability, or the amount payable to employees upon separation of service, has been reduced by more than half, from $22.3 million to $9.6 million as of December 31, 2014.

Table 21. Employee Leave Liability Report as of 12/31/14

	Comp Time	Sick	Holiday	Vacation	Excessive Sick Leave (ESL)	Total Liability
100% of Current Leave Balance	**$1,832,558**	**$13,421,274**	**$1,255,778**	**$4,924,792**	**$902,195**	**$22,336,595**
Amount Payable Upon Separation	**$1,832,558**	**$1,268,886**	**$1,191,839**	**$4,884,466**	**$451,098**	**$9,628,847**

[1] The Chief of Police and Fire Chief are included in the Police and Fire Management groups respectively.
[2] Fire safety year-end holiday cash outs: hours are removed from employee banks at year-end for payment (currently suspended); therefore, they are not included in the fire safety line item "Holiday Payoff."

As part of the agreements approved or imposed by the Mayor and Common Council in January 2013, new caps were placed on sick leave accruals which had not been previously been in place.

Workforce and Service Reductions

Through layoffs, retirements, and voluntary separations, there has been a significant decrease in the City's workforce (Table 22). Since July 2012, 350 employees have separated from City service. The attrition rate for police and fire safety employees was provided in previous sections of this report as Tables 12 and 14. Most of the reductions, however, have resulted from retirements and voluntary separations as opposed to strategic or business decisions regarding municipal services. The ad-hoc nature of the labor reductions has further eroded the ability of the City to delivery basic services. For example, the City now finds itself without experienced employees in fundamental basic services, especially in finance and other corporate support functions. Without appropriate corporate support functions, departmental service delivery suffers. Moreover, inefficiency and poor results go unaddressed because of the lack of corporate oversight. Going forward the City must become much more intentional about its services and delivery methods.

Table 22. Full-Time Funded Positions

Description	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
General Fund Positions	1,014	925	951	895	730	735	701
Full-Time Funded Positions	1,224	1,179	1,220	1,142	941	963	985

Sources: Adopted City Budgets

Why A Defined Benefit Retirement Program

If the City could be relieved of costs and liability associated with the CalPERS defined benefit pension program, its economics would be improved. While the City is strongly considering contractual services for many services which will reduce its future CalPERS obligations, as other cities have found, it is simply not realistic in the current statewide municipal environment to exit the defined benefit program for the remaining City employees.

In 2012, there were 482 cities and 58 counties in the State of California. Not including 17 cities with less than 7,000 population who were not CalPERS cities and one newly incorporated city, 451 or over 97% contracted with CalPERS to provide a defined benefit plan for their employees and eight or 6.6% either contracted with a 1937 Act County Employee Retirement System or had their own independent defined benefit plan. (Voters in two of the four cities with independent defined benefit plans, San Jose and San Diego, have passed initiatives to modify the defined benefit plans for new employees. In the City of San Jose the modifications affect existing employees, and the City has faced what has been called a crisis in recruiting and retaining police officers.) These mega cities are large enough to deal with the complexity and costs of having an independent retirement system. Cities the size of San Bernardino simply cannot, which is why they do not exist to any degree in the State in cities of San Bernardino's relative size.

In July 2012, cities and towns throughout California (not including counties and special districts) employed approximately 263,000 people while counties employed another 330,900 individuals[1]. From these data, it is estimated that about 267 employees of the 464 cities were employed by cities that do not provide a defined benefit plan. (The number of employees for seventeen cities with populations below 7,000 was not able to be verified at the time of the analysis.) Based on these calculations, approximately 99.9% of municipal employees and 100% of county employees were provided a defined benefit plan in California.

These statistics are sobering because, when filling vacancies, most qualified employees are found in other cities and counties. CalPERS provides for reciprocity which allows for employees to move from local government to local government. If a local government is not a member of CalPERS it will face a huge challenge in recruitment, which theoretically could be overcome only with significant additional salary or bonus compensation. We say theoretically because there is no demonstrated example of a city such as San Bernardino migrating away from CalPERS to another approach. It has never happened.

[1] Source: California Employment Development Department, LMI Division, California Industry Employment and Labor Force

Given this reality, San Bernardino will not be able to recruit or attract employees to deliver the core services which remain without staying in the CalPERS defined benefit retirement system. However, a significant challenge for San Bernardino will be to continue to fund CalPERS retirements. Projected employer contribution rates (exclusive of the statutory employee contributions and any cost sharing) as determined by CalPERS actuaries reflect rates increases from 24.2% (2015-16) to 32.0% (2020-21) for miscellaneous non-safety employees and 38.8% (2015-16) to 49.3% (2020-21) for safety employees. In addition, to better understand the impact of the CalPERS costs, the employee's share must be added to these projected rates.

The biggest challenge for the City will be to reorganize functions, realign service delivery and recruit and retain staff to address the present service insolvency. This will indeed result in less City employees; nonetheless, part of this task will be to determine a competitive employee compensation program that over time will attract and retain competent and committed employees to provide municipal services to the residents of San Bernardino. Toward this end, the City has completed a total compensation survey and is evaluating total compensation compared with benchmark agencies.

Status of Labor Agreements

On July 7, 2014, the Mayor and Common Council approved extensions to the General Unit and Management/Confidential employee agreements that had been approved in January 2013 and the Mid-Management agreement reached in August 2013. All terms negotiated in accordance with the Pendency Plan concessions were continued in these agreements. These agreements will terminate on June 30, 2015 and the City has initiated discussions with all three of the Miscellaneous bargaining groups. The City has met with both police and fire management associations and has reached some interim agreements pending the outcome of negotiations with both safety units. The Mayor and Common Council imposed terms and conditions on the SBCPF unit on October 6, 2014. Finally, on March 17, 2015, Judge Jury granted the City's motion to reject the SBPOA MOU. Notwithstanding the rejection of the MOU, the City and the SBPOA continue to meet with the goal of reaching a settlement.

Recovery Plan: Governance and Service Realignment First

The preceding sections of this report have discussed the myriad problems and issues facing the City. These include the inadequate municipal services the City now provides; the consequent flight of population, investment and income from the City; the peculiar City Charter that underlies the City's challenging operating environment; executive turnover; and the inability to adopt systems and operational paradigms common in most other California cities. San Bernardino has many challenges, and creating a modern and sustainable organization will take fundamental change and time. To survive bankruptcy and grow into a fully functional municipal government, San Bernardino will also require political wherewithal and patience, as well as executive leadership and skill.

This section of the Plan outlines the recovery plan for the City and begins by describing the critical need identified by the Core Team to implement changes to governance and management. In addition, the need for change was also well articulated by various other constituencies in the strategic planning process that the City just completed. Community stakeholders and City residents clearly do not want more of the same.

Next, the recovery plan addresses the fundamental changes in service delivery the City must undertake. The last several years have witnessed an uncertain trajectory as the City attempted to cope with its insolvency. The City must realign municipal service delivery to be more efficient. Like many other cities when faced with limited resources, San Bernardino needs to consider different ways of doing business. Public employees are expensive and the City needs a more affordable approach. This means contracting for service delivery on a wide scale as do many of the other newer cities in the state, and ceasing to provide some non-essential services altogether.

In tandem with contracting for services, the City must phase in a more competitive compensation program for the employees it intends to retain. It is not sustainable to operate with total compensation lagging the market by between 10%, 20% or even 30%. The recruitment and retention of employees so critical to effective and efficient services delivery will not be successful if this continues.

The City also needs to consider the revenue side of the equation and this section addresses this as well. While San Bernardino receives average to above average revenues, inefficiency has been ingrained into the organization. Consequently the City struggles with keeping revenues current, updating overhead, or generally following industry best practices in managing typical revenue sources. There are also opportunities for modernizing some revenues. Enhanced revenue opportunities cited here will sometimes require voter approval; a difficult proposition in a city as poor as San Bernardino.

Finally this section introduces the City's long-range fiscal plan and the planning and assumptions that go into it. These include baseline assumptions, revenues, expenditure assumptions and the all-important matter of labor cost planning and estimating.

The section concludes with a discussion of how the recovery plan fits together and its impact on creditors. The City simply lacks the ability to do so, while continuing to provide adequate municipal services. In developing the creditor treatment plan, the City must harken back to the principles set forth earlier in this document. The City's duty first and foremost must be to provide adequate public services, a situation made all the more acute when one considers just how poor and in need the population is.

Charter Impact

In March 2007, Management Partners, a local government consulting firm, reported the results of an organization review of the City of San Bernardino and in March 2010 provided a status update to the 2007 organization review. The 2007 report concluded that the current state of operations within the government was not the result of wastefulness but,

> *…rather the natural result of the historical development of a government that has outmoded information systems, inadequate management support and a multitude of convoluted low value processes. Compounded by a serious (and now urgent) fiscal situation, the primary recommendation of the report was that the*

> *government must modernize... and the political and management superstructure needs to be streamlined.*

The Core Team, along with Management Partners, which was retained to assist the City in preparing this plan after Judge Jury imposed the May 30 deadline, determined that virtually nothing has been done to address these issues since the report was issued. The Core Team identified the City's organization and policy structure as one of the foremost obstacle to developing the organization into a unified, well-functional operating team. After review, the Core Team concluded that to accomplish this critical objective will require major changes to the City Charter. This is a difficult process but the Core Team believes it is absolutely necessary for recovery. The Core Team also believes that the consequence of making little or no change in the governance structure will sidestep one of the most important issues to be addressed to allow the City to become a cost-effective, progressive and sustainable government delivering valued services to the community. As previously noted, the Mayor, a strong majority of the Common Council, the City Manager and City Attorney have agreed to and signed an interim resolution outlining the way they intend to work together going forward until a new charger can be approved.

Out of five cities with comparable populations in the state who also operate under a city charter, only San Bernardino does not operate under a council-manager form of government or close equivalent. In fact, it is difficult to define the type of government contemplated in the Charter, as it presents a mish-mash of overlapping and conflicting provisions. Management Partners, the Core Team, and other experts hired by the City are all cognizant that no other city follows this particular approach and the condition and performance of the municipality strongly suggested to them that it is not an effective approach.

The council-manager form of government is the predominant form of government in California, although some cities operate under a strong mayor system. A 2004 City Charter change created the position of city manager; however, it did nothing to create a council-manager form of government or any other recognizable structure. The charter change created the position of city manager, but designated the Mayor as the chief executive officer providing, among other things, general supervision of the police and fire chiefs. The city manager as the chief administrative officer is responsible for all City departments, *except the Mayor, City Attorney, City Clerk, City Treasurer, the Water Department, the Free Public Library and Civil Service.* The Mayor and Common Council can appoint and remove all unclassified City employees except for "deputies, assistants… holding office at the pleasure of an elective officer." Incredibly, the Common Council can also override, amend or revise any decision made informally or formally by the Mayor with a 2/3 vote. Neither the community or the City organization or business understands who is really in charge and can reliably make decisions. This structure is not even remotely comparable to any other found in a California city.

For a true chief executive officer (city manager) of San Bernardino to be able to manage and lead the operations of the City government, mandate and implement efficient and effective services to the community, and be held accountable for such operations by the Mayor and Common Council, s/he needs to have authority to:

- Hire, discipline and terminate all department heads (effectively) and employees (following collective bargaining agreements, state and federal laws, and a merit-based personnel system).
- Direct changes for efficiency and improvement in *all* City departments.
- Recommend to the Mayor and Common Council policy changes and improvements regarding all City operations and implement them with consistency and professionalism across all municipal functions.

By having a position called city manager (which has been the job title used since the 1930s to define the chief administrative officer for professionally managed cities), the residents of San Bernardino should expect professional management.

As stated by International City/County Management Association (ICMA), under the council/manager system, a professional city manager is hired by the governing body to provide the following:

- ***Administration of personnel:*** *Provide direction and leadership to department heads and those that provide direct services to the community.*
- ***Management of public funds****: Ensure the cost-effectiveness of programs, balance budgets, and secure the financial health of the city.*
- ***Implementation of programs and policies:*** *Work with elected officials and community leaders to achieve common goals and objectives for the community.*
- ***Coordination of service delivery:*** *Anticipate future needs, organize work operations, and establish timetables to meet community needs.*

Under the council-manager form of government, the council is the governing body of the city, elected by the public, and the city manager is hired by the council to carry out the policies it establishes. The council generally provides legislative and policy direction while the city manager is responsible for administration and day-to-day operations based on council policy. The mayor and council set city policy, community goals and objectives, make land use decisions, and authorize a municipal budget. The city manager is responsible for managing the affairs of the city, recommending a budget, directing day-to-day operations, hiring and firing personnel, and serving as the council's chief advisor. The city manager serves at the pleasure of the council.

Given the policy of non-intervention in distressed cities or counties by the State of California, the experts hired by the City and the Core Team have strongly recommended that San Bernardino must now move forward to bring its system of governance within generally accepted principles and modern municipal management practices by putting forth a major charter change for consideration by the voters. In the meantime, the City adopted an interim operating agreement, OPGG, to outline how it plans to operate. The City intends to place a new City Charter before the voters and is forming a committee charged with drafting one and placing it on the November 2016 ballot, or earlier if possible. The Core Team and other constituents have indicated that placing Charter reform before the voters should be one of the highest priorities for the City.

A Strategic Plan: What Does Service Solvency Look Like

One criterion for a confirmable Plan is that it must provide reasonable assurance the City can provide adequate services and will not end up back in bankruptcy court in the foreseeable future. In other words, the City must be sustainable. Public service professionals describe this sustainable condition as being cash, budget and service-solvent. The cash and budgetary solvency standards are addressed in the long range financial plan. The service solvency standard is addressed in there as well as the Service Realignment section below. This section provides the results of a strategic planning process held by San Bernardino community members in March, April and early May of this year which resulted in a Preliminary Strategic Plan (Attachment II).

Strategic Plan Process - Overview

The classic strategic plan method used by most successful private and public corporations includes an assessment of the organization(strengths and weakness), a survey of trends and emerging issues (opportunities and threats), and then identifies strategies to manage or mitigate challenges to the vision of that organization. During early bankruptcy status conferences, the creditors commented that the City was not transparent enough and did not adequately engage the public in its Plan development. The result of the work by the community in general and the Core Team in particular these past several months as part of the strategic planning process strongly indicates they are very much understand what's at stake.

Because the City had no dedicated resource to conduct such an effort significant assistance was provided by the San Bernardino City Unified School District (SBCUSD). The planning process included five well-attended community meetings (over 500 participants) to solicit public input about the City. This was an impressive turnout for a strategic planning process and a strong indication of the community's interest in the future of its City.

The SBCUSD also solicited participation through an online survey, of which 459 members of the public provided input to their City leaders. The results of the survey and the facilitated community meetings were reported to a Strategic Planning Core Team (Core Team) composed of 17 community leaders. This group was selected to represent the diversity of the City. It included university presidents (past and current), leaders of faith-based institutions, non-profit organizations, governmental agencies and business groups. The San Bernardino County Chief Executive Officer also attended, which brought insights not only from the perspective of County government, but also as a past city manager in Ontario and Fontana. The San Bernardino City Council participated in the team's activities as observers to ensure the recommendations in the Plan were driven by the community. This Core Team met for two days (March 18 and 19, 2015) and completed a framework for the City's new Strategic Plan, including a vision, core principles, and specific strategic goals.

Figure 13 presents the word cloud of the strategic planning team's vision for the City of San Bernardino. Note the relative importance of safety, business, beautification, jobs and governance.

Figure 13. Strategic Planning Team's Vision for San Bernardino

The framework of the Strategic Plan was discussed by the City's leadership team (city manager and department heads). They developed specific programmatic proposals to achieve the goals identified in the Strategic Plan. The results were then reported to the Core Team on April 24 and the final work product, San Bernardino's Preliminary Strategic Plan 2015, will be considered by the City Council in May 2015, along with this Plan of Adjustment.

There is an allocation included in the long range financial plan to implement components of the City's Strategic Plan. While the funding available is much less than what City leadership believes is necessary the fiscal plan does set aside $1 million beginning in 2015-16 and this amount grows to $3 million five years into the fiscal model, allowing for modest enhancements consistent with San Bernardino's fiscal position, and critical need for updated service levels. Actual programming and funding decisions will be made as part of the City's annual budget process.

The Strategic Planning process also showed that the City budget process could be significantly improved in terms of community participation and leadership. An explanation of how another city with fiscal challenges implemented a very successful Participatory Budgeting project is included as Attachment III.

<u>Strategic Plan Detail - Community Meetings and Survey Results</u>

After provided with the meeting purpose and the agenda, attendees were invited into small groups to answer three questions:

1. What existing assets does the City have?
2. What possibilities do they see for the City's future?
3. What changes would they like to see in achieving that future?

Each group was to prioritize one preference for change. The results of the small groups' work can be found in the Preliminary Strategic Plan, but can generally be grouped into the following three areas of improvement:

- Visibility of the City,
- Public Safety, and
- Pride, Community Ownership and Volunteerism.

The most often-mentioned need (22 small groups) was to improve the visibility of the City by repairing and maintaining the community infrastructure (streets, lighting, parks, trees, walking and biking, visible homelessness). The City has not adequately maintained its infrastructure, and as a result, is accumulating a significant and growing deferred maintenance liability.

The second highest priority identified was public safety (17 small groups) with specific goals of reducing crime, gang graffiti, illegal marijuana dispensaries and increasing community policing activities. Clearly the cuts made to the City's public safety programs to maintain cash solvency were being felt by the community.

The third highest priority was pride, community ownership and volunteerism (12 small groups). Specifically mentioned were creating and administering volunteer programs to clean up and restore blighted neighborhoods and leverage existing community assets to develop pride and ownership in the City. The City has a disproportionate amount of non-owner occupied housing. The remaining priorities can be found in the Preliminary Strategic Plan (see Attachment II).

The results of the community survey (see Appendix H of Attachment II) were disturbing and indicative of San Bernardino's need to dramatically change course to reverse its slide as a viable community, both from a livability and economic viability standpoint. When asked, "How likely would you be to recommend a friend, relative or colleague to move to the City" using a scale of 1 to 10, with 1 being least likely and 10 being most likely, the results were alarming, as indicated in Table 23.

Table 23. Responses to "How likely would you be to recommend a friend, relative or colleague to move to the City of Bernardino?"

Answer Choices	Responses
1 (Least Likely)	127 (31.59%)
2	62 (15.42%)
3	60 (14.93%)
4	33 (8.21%)
5	51 (12.69%)
6	29 (7.21%)
7	20 (4.98%)
8	13 (3.23%)
9	1 (0.25%)
10 (Most Likely)	6 (1.49%)

About 70% responded with 1 to 4 and only 10% responded with a 7 to 10 response. If the vast majority of San Bernardino residents would not recommend moving to the city, this is a major barrier to community image and economic revitalization. Given this result, it is abundantly clear that the City of San Bernardino is not working very well for residents.

Residents were also asked, "If you didn't rate the previous question as an 8 or above, what would have to take place for you to increase your rating to an 8 or above?" Responses are indicated in Table 24.

Table 24. Responses to "If you didn't rate the previous question as an 8 or above, what would have to take place for you to increase your rating to an 8 or above?"

Answer Choices	Responses
A safer community	336 (90%)
Clean streets and neighborhoods	288 (77%)
A vibrant downtown	228 (61%)
Community revitalization	222 (59%)
Neighborhood pride (55%)	206 (55%)
More jobs (53%)	198 (53%)

The priorities and issues derived from the community engagement meetings and the survey produced roughly the same concerns around public safety, community image, housing, and neighborhood condition.

Strategic Plan Detail - Core Team Recommendations

The survey results from the community engagement portion of this project were presented to the Core Team. The Core Team was also presented a PowerPoint presentation from Management

Partners, which was the result of a truncated organizational assessment of the City to facilitate the Plan development in time for the May 30 deadline. The Management Partners' report was intended to address the causes for San Bernardino's slide into bankruptcy and discuss organizational barriers to be addressed to transition into a sustainable service-solvent City coming out of bankruptcy. The report highlighted the City's gradual slide into extreme poverty, low wages, and the creation of a "poverty island" in one of the fastest growing regions in the country. The issues have been well-documented in previous sections of this document.

As a result of discussion around this issue, these community leaders identified that poor governance and inadequate management was a core problem for the City, stemming, in their view, from the highly unusual and cumbersome system set up by the City Charter. Knowing that a true fix to this problem would be time consuming, the unanimous recommendation of the Core Team was to ask the Mayor and Common Council to agree to a document entitled Operating Practices for Good Government (OPGG) that would require them to adhere to a list of good-governance behaviors commonly found in high functioning cities. Recognizing that adoption of the document by the Common Council on April 6, 2015 was an interim solution that may not be adopted by subsequent Mayors and Common Councils, the Core Team also recommended that City pursue outright replacement of the current City Charter.

The remaining recommendations of the Core Team in priority order were:

1. ***Safety and Crime.*** Reduce crime significantly, increase community involvement through empowerment, and improve City appearance and creation of safe zones.
2. ***Housing.*** Strengthen the condition of the overall housing inventory through code enforcement, receivership programs, housing incentives for local government employees and increasing home ownership rates.
3. ***Education and Workforce Development.*** Develop programs and internships to encourage residents to apply for City jobs, pursue additional education, and upon successful completion of the collegiate programs, to stay and live in the City.
4. ***Community Engagement***. Develop and implement a comprehensive program to leverage and engage the San Bernardino citizenry including enlisting community groups to understand and share in the Plan's vision; creating a City culture of community engagement; leveraging resources to clean up the City; showing visible improvements to infrastructure and City gateways, etc.
5. ***Business Development and Partnerships.*** Provide incentives and programs for new business to locate in the City or current businesses to expand, review and streamline City regulations and processes to assist businesses and create new partnerships and tools to revitalize the local economy.
6. ***Public Relations***. Develop programs to highlight the right things about the City, work with local media to produce more positive coverage, increase public engagement, and expand usage of the community access television channel.

The City leadership team (city manager and department heads) took this direction from the Core Team and developed programmatic strategies to achieve the goals in the Preliminary Strategic Plan. The Long Range Financial Plan includes some of these strategies, but it will take some time and continued dedication to a strategic approach, along with continued commitment to developing a modern and responsive government and management system for this initial effort to be fully operationalized

These initiatives were discussed with the Core Team on April 24 and the results of this discussion are contained in the Preliminary Strategic Plan attached to this document. It will take several years to make significant progress in funding these critically needed improvements but the Strategic Planning process has given the City a roadmap. It is anticipated that further detail on funding of initiatives will be contained in the 2015-16 City budget.

The City of San Bernardino is currently not a sustainable and viable service delivery organization. In order to meet the confirmation standards of service solvency and sustainability long after bankruptcy exit, the City needs to implement and find ways to fund the recommendations found in San Bernardino's Strategic Plan. It is crucial to emphasize that this plan heavily relied on community engagement and input, a standard practice in local government, but also one suggested by creditors in the bankruptcy case, and it was adopted by the Common Council of San Bernardino. These factors make the Strategic Plan a key guiding light in terms of the development of this Plan of Adjustment.

Service Realignment - Contracting Services

The City continues to provide many core service functions to the public using its employees. With the continued escalation of employee retirement costs under CalPERS, the cost of providing services using City staff has increased when compared with costs of providing services through contract services. Due to its decades-long management and operational inefficiencies as well as its current Charter, the City has been unable to cost-effectively manage its operations. Therefore, to reduce its costs of operations on an ongoing basis, San Bernardino must consider alternative service delivery methods.

San Bernardino is currently providing a number of services in house which can be more cost-effective when contracted with other agencies or private entities. Contracting some or all of the services in Table 25 will allow San Bernardino to reduce its costs while continuing to provide equivalent (and likely improved) levels of service to the public. Contracting for service delivery is well established in Southern California, and indeed some jurisdictions, known as contract cities, deliver the vast majority of services by contract. All the services discussed in this section are commonly contracted by cities, and reduce overall expenditures.

The following are services the City should contract to the private sector including cost saving opportunities in the major service areas.

Table 25. Estimated Cost Savings and Efficiency Gains from Contracting Specified City Functions

	Estimated Annual Cost Savings (Ongoing) from Contracting[1]		
Contract Opportunity	**General Fund**	**Non-General Fund**	**Efficiency**
Fire Department[1]	$9,000,000 or more		Significant
Fleet Maintenance[2]	$400,000	$580,000 (Various funds)	Significant
Waste Management		$1,280,000 to $1,780,000 (Integrated Waste Management Fund)	Significant
Street Sweeping			Significant
Right-of-way Clean-up			Moderate
Graffiti Abatement	$132,600		Moderate
Traffic Signal Maintenance		$118,000 (Gas Tax Fund)	Moderate
Street Maintenance (Pothole repair and Capital Projects)		$150,000 to $300,000	Significant
Custodial Maintenance	$150,000		Moderate
Soccer Complex Management/ Maintenance	$240,000 to $320,000		Moderate

[1]In 2012, the City of Santa Ana contracted with Orange County Fire Authority (OCFA) for fire protection services. The City obtained savings of 18%-21% ($8.7-10 million) of the Fire Department's annual budget. This preliminary estimate for San Bernardino incorporates the estimated cost savings from contracting fire and EMS service delivery to an outside agency and implementing a variety of service efficiencies identified in the Citygate Study.
[2]Estimated cost savings do not include savings from avoiding fleet replacement costs, the costs of fleet maintenance and part-time staffing costs.
[3] Excludes Water Department fleet

Fire Department - According to the City's FY 2014-15 adopted budget, the Fire Department is projected to cost $31.5 million or 24% of the City's General Fund. A $2 million adjustment was required at mid-year for additional overtime expenditures. Fire expenditures per capita are higher than the average of peer cities ($141 per capita compared to a peer average of $134) as is the number of fire department personnel (0.74 per capita compared to the peer average of 0.58). This is due to fire station configurations, the service delivery method for high medical call volumes, and deployment choices. Many cities contract for fire protection and EMS services. In fact, several cities of the same general size as San Bernardino save money as a result of this service delivery approach. These contracts are commonly with regional fire service providers such as the San Bernardino County Fire Department, which serves a number of cities in San Bernardino County or the California Department of Forestry and Fire Protection (CalFire), which serves 150 jurisdictions in the State including several in San Bernardino and Riverside Counties. Typically these contract approaches can be significantly less expensive as a result of economies of scale and in the case of CalFire an alternative scheduling approach.

The City has issued a Request for Proposal (RFP) for fire services and is expecting proposals on May 20, 2015. The City has invited both the County and CalFire to respond, as well as neighboring cities and private service providers.

In addition, the status of the fire fleet is poor and the Fire Department budget does not include funding to adequately address the costs of maintaining or replacing its fleet.

Fleet Maintenance - The City has been financially unable to replace its vehicles and equipment in accordance with industry standards or provide an effective fleet maintenance operation. About 479 units, representing 56% of the City's total fleet, are currently due or past due for replacement at an estimated cost of more than $41 million. The aging fleet has resulted in a significant burden on the understaffed fleet maintenance employees who must contend with an aging fleet and an inefficient fleet operation. (The division has been without the leadership of a qualified fleet manager for several years). Deferred fleet maintenance also puts the City at risk for compliance with state-mandated equipment and vehicle inspections.

Waste Management - San Bernardino has a separate enterprise fund (non-General Fund) designated for solid waste and recycling services. The fund also supports two related services, street sweeping and clean-up of the City's rights of way. Most municipalities in California contract with the private sector for solid waste and recycling. With state recycling requirements that have been in place for over 15 years, refuse haulers have gradually expanded their businesses to include materials sorting, recycling, public education, and in some cases, street sweeping and other related services, working in partnership with individual cities and counties.

There are several large waste companies in the San Bernardino area that could provide the same services now provided by the City. These companies currently provide services to San Bernardino's neighboring cities. One waste company owns and operates a materials recovery operation (a plant for receiving, sorting and preparing recyclable materials for marketing to end users) located in the City. In addition, the more sophisticated companies use specialized routing systems to reduce travel times and produce and closely monitor work measurements based on their experience. Given the expertise developed in multiple jurisdictions and by these waste companies, and the economies of scale that larger operations can provide, it is likely that contracting these services to a private company will result in lower costs to provide the service and increased franchise fees to the General Fund.

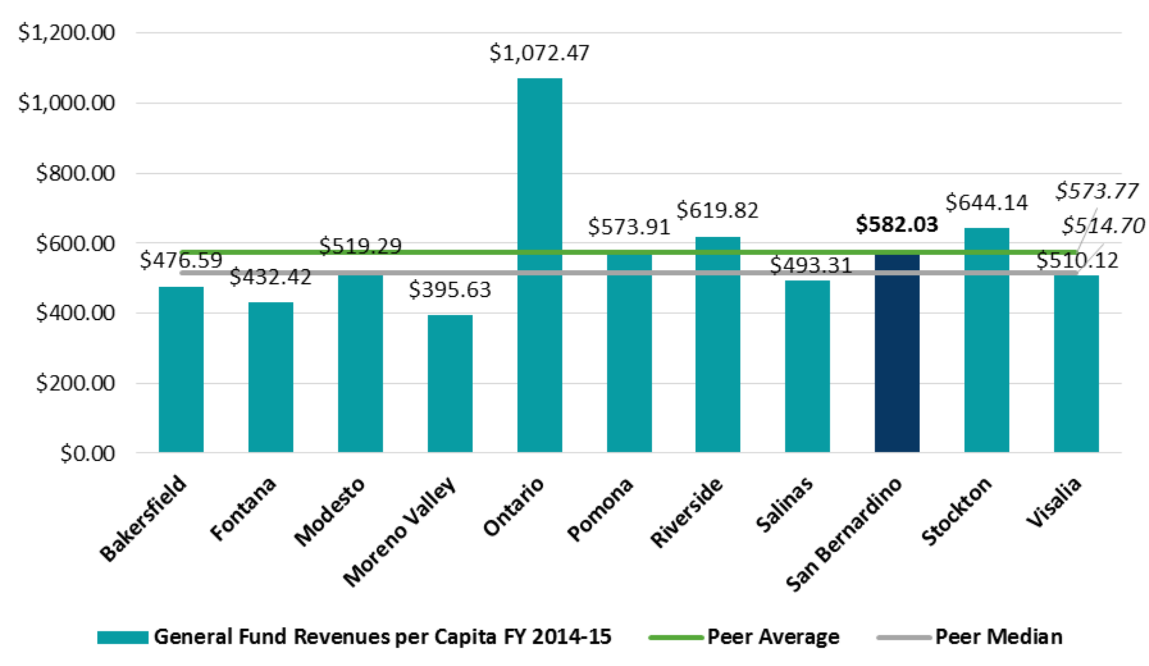
Soccer Complex - The City has an opportunity to contract the maintenance, marketing and operations of its Soccer Complex to an organization that may provide better marketing of the facility and a higher level of service to the public. To provide an incentive for the potential providers, the City may need to fund improvements to the existing fields and participate in marketing efforts.

Other Services - While the scope of savings may not be as great, there are many other areas where the City may derive efficiencies from a contract approach. Some areas where known savings have been identified include custodial maintenance, graffiti abatement, right-of-way cleanup and traffic signal maintenance. Areas where savings have yet to be identified but might offer benefit include engineering, inspection, code enforcement and attorney services.

New or Enhanced Revenue Opportunities

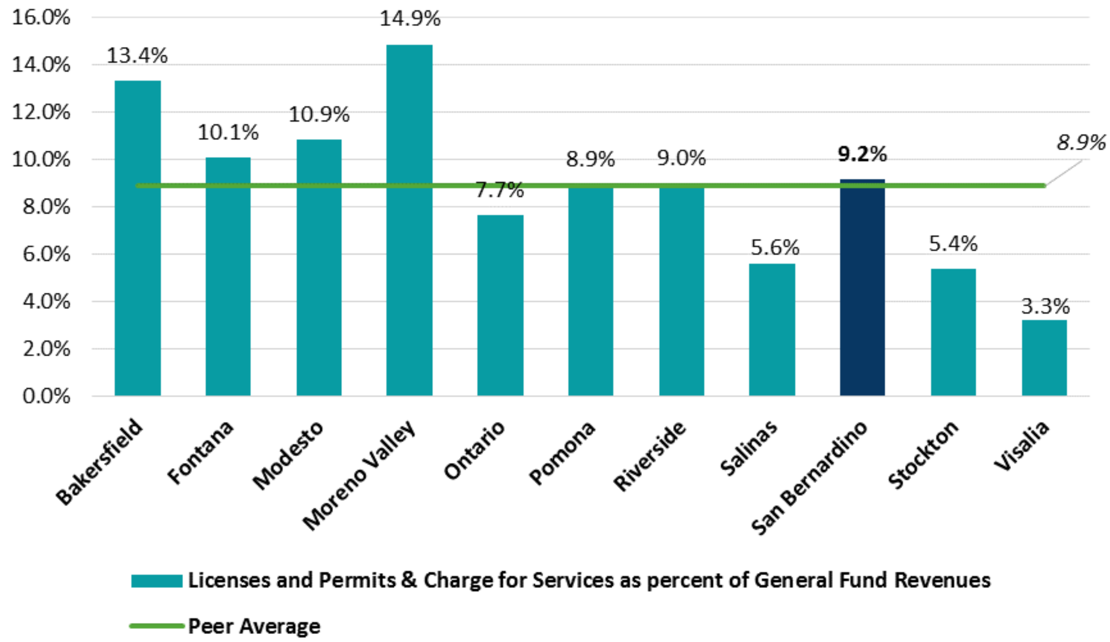
As demonstrated in Figures 14 and 15, the City is about average in terms of revenues per capita and cost recovery for services provided.

Figure 14. General Fund Revenues per Capita in FY 2014-15



Sources: Adopted City Budgets; California Department of Finance, 2014
Note: Moreno Valley has a business gross receipts tax.

Figure 15. Licenses and Permits & Charge for Services as Percentage of General Fund Revenues



Sources: Most Recent CAFRs and City Budgets
Note: All figures are from FY 2014 CAFRs except San Bernardino (FY 2012) and Visalia (FY 2013).
Figures exclude business license revenues.

While there are opportunities for the City to improve revenues from existing sources and generate revenue from new sources as shown in Table 26, there is not significant margin for gain. This is due primarily to a poor residential community unlikely to vote for tax or fee increases. While the opportunities should be pursued for the City to be sustainable for the long term, implementing them will require some time. Some changes will require voter approval; others are fees or enhanced revenues that the City could realize with updated fee schedules, better collection, and resource management. The latter, however, will require fundamental governance and management changes as well as technology improvements before developing a plan to pursue them.

Table 26. Revenue Generation Opportunities

	Current Rate or Fee Amount	Current Yield	Revenue Generation Opportunity	Estimated Annual Yield
Taxes				
Utility User Tax (UUT)	7.75% *(includes telephone, cable, electric and gas)*	$22,800,000	1% tax increase, *Requires voter approval*	Up to $3,000,000
			Apply existing rate to water, sewer and refuse collection; a lower revenue amount could be derived while lowering the overall percentage rate	$6,900,000

	Current Rate or Fee Amount	Current Yield	Revenue Generation Opportunity	Estimated Annual Yield
Transient Occupancy Tax (TOT)	10%	$2,600,000	Conduct audit of revenues received	$200,000
Real Property Transfer Tax	$1.10 for each $1,000 of value (County tax; City receives only $0.55)	$400,000	Adjust tax to $5 per $1,000 of value; higher rates are commonly observed among California Charter cities but raising existing rate may be problematic *Requires voter approval, if determined to be legally possible.*	$3,600,000
Fees				
Business License Fee	Average per capita receipts at $32	$6,700,000	Revise fee structure to be employee- based at $39 per capita[1] *Requires voter approval*	$1,500,000
911 Communication Fee	None	None	$1.69 per month per phone (household and businesses) *Requires voter approval*	$3,878,000
Paramedic Subscription Fee	$24 per year (subscribers) $200 per call (non-subscribers)	$6,000 from subscribers; $306,000 from non-subscribers	Increase subscriber fee to $48 per year; market program with goal of 50% of all households as subscribers	$690,000
Emergency Response Fees	Varies	Unavailable	Some cities charge for emergency response fees in cases of automobile accidents or similar responses. Typically limited to non-structure fire responses. Strongly opposed by insurance industry	Up to $100,000
Master Fees and Charges Schedule	Varies	Unavailable	Review and adjust all City fees to institute full cost recovery for applicable services[2]	$200,000 to $500,000
Waste Management Franchise Fee	8.9%	$2,200,000	Require one-time payment from private contractor for franchise. Increase annual franchise fee to 20%.	$2,800,000 per year and $5,000,000 one-time
Water/Sewer Utilities Franchise Fee	Varies	Varies	Update agreement with Utilities for payment of franchise fees	$1,050,000 to $3,550,000 per year
Electricity Franchise Fee	0.05%	$922,500	The City has an old franchise agreement with Southern California Edison (SCE) which provides .5% in franchise fee to the City. Newer cities have a 1% franchise fee.[3] *May require voter approval*	$922,500

	Current Rate or Fee Amount	Current Yield	Revenue Generation Opportunity	Estimated Annual Yield
Other				
Business License Administration	Not applicable	None	Contract business license administration[4]	$650,000 to $900,000 (in each of first five years)
Street Sweeping Parking Violations	None	None	Implement parking violations for street sweeping (once or twice per month)	$200,000 to $400,000
Sale of former redevelopment agency property	Not applicable		City proceeds of residual property sales revenues	$3,900,000 over a 10-year period

[1] San Jose generates $44 per capita utilizing a business license structure based on number of employees. Because San Bernardino has fewer businesses and employees, it is estimated that the City would generate revenues of $39 per capita by similarly revising its schedule.
[2] The Common Council implemented a practice that reduces building permit fees by 50 percent. Fee collected do not cover the costs of providing the service.
[3] SCE has been unwilling to change its older franchises and implementation of this would be difficult. Options include increasing the City's franchise fees by adding .5% to customer bills or requesting the California legislature to sponsor a change in legislation to level franchise among cities.
[4] Using a formula from a potential contractor, projected revenue represents a combination of cost savings in City staff and increase revenues.

It should be noted that there may be other items added to this list as legislative authorization evolves. One such item of potential significance would be Ground Emergency Medical Transport (GEMT) fee revenues. Legislation that would have provided some potential revenue to cities like San Bernardino, that provide emergency paramedic response in advance of ambulance arrival, was passed in 2013-14 but vetoed by Governor Brown. Another similar piece of legislation (SB534) is currently pending in Sacramento. Importantly revenue would flow to public agencies that provide ground transport of Medi-Cal eligible emergency patients something that San Bernardino typically does not do. (The county franchised ambulance provider provides such transport, but there may be revenue sharing potential. At this time, however, to count on such revenues would be speculative.

Efficiency Improvements

The City has struggled for at least the last two decades with governance issues and management systems codified in the City Charter. As has already been observed, this has led to a generally low level of City services and a pronounced lack of satisfaction from residents as validated in the Strategic Planning process. This fact coupled with the fact that San Bernardino does obtain an average level of revenues suggests that service delivery efficiency is an issue.

In a 2008 report, Management Partners identified a number of efficiency improvements that have yet to be implemented and others have been identified as part of the current high-level organization assessment. Table 27 summarizes a number of examples of opportunities which the City will pursue as part of the Plan's implementation. Undoubtedly there are many more opportunities than just those noted here. The key to further definition and implementation will be a commitment to modernizing the organization.

Table 27. Examples of Efficiency Improvements

Efficiency Improvements	Ongoing (Annual) Savings
Corporate Support Services	
Establish a centralized bad debt collections operation (by contract)	$75,000[1]
Update the cost allocation plan every two years	$200,000
Consolidate the duties, responsibilities and resources (including funding and staff) of the Civil Service Administration and Human Resources Department into a single Human Resources Department	$130,000
Direct Services	
Implement a light-duty program for City firefighters (if the City continues to provide fire service)	$75,000 to $200,000
Conduct Proposition 218 elections to increase assessment district fees to recover actual costs	$150,000 (General Fund and other funds)
Open a consolidated City impound yard	$200,000 to $500,000
Charter-Related	
Amend the City Charter to allow the municipal election cycle to consolidate with state and other elections, a practice followed in most California cities, and one found to increase voter turnout and reduce costs per voter	$270,000
Amend City Charter to authorize design-build contracting.	$500,000 to $1,000,000 (General Fund and other funds)
Total	**$1,600,000 to $2,525,000**

[1]*Establishing a centralized bad debt collections operation would also generate approximately $100,000 in one-time revenue.*

The Plan of Adjustment assumes that some efficiency measure will be identified and implemented each year.

Financial Forecast Underlying the Plan

This section provides financial context and discusses the constraints facing the City of San Bernardino and how the City proposes to address them over time. The City has developed a financial model based on current and historical data to understand its financial and service delivery constraints. This, in turn, provides the platform for the 20-year Long-Range Financial Plan for the General Fund.

Forecast Assumptions

The financial portion of the Plan includes the following sections:

Baseline Budget **–** Revenue projections are based on current revenue sources. Expenditure projections are based on the current FY 2014-15 budget level of staffing, including future salary adjustments pursuant to the City's Charter for sworn public safety staff and cost-of-living increases for non-sworn staff to remain competitive, and projected pension rate changes. These costs are inclusive of the labor agreements negotiated during the City's Bankruptcy Case as well as the rejection of the San Bernardino Police Officers Association and San Bernardino City Firefighters Association Memorandums of Understanding which have since been approved by the court and implementation of new terms and conditions of employment. Services, supplies and program support assume inflationary growth. Debt service is based on original amortization schedules and projected contributions. The baseline budget is the status quo and the starting point, but it is neither viable, as it is not service-solvent nor sustainable, because it is cash insolvent. Sustainability is addressed in the following two sections.

Fiscal and Service Stabilization **–** This section contains strategic investments added to the status quo baseline budget, including funding for working capital and modest increased contributions to deferred maintenance, deferred information systems and fleet replacement, and restoration of internal service fund reserves (workers' compensation and liability insurance reserves). Because the City has not funded information systems and fleet replacement in several years, many of these systems and vehicles are well beyond their useful life, requiring an aggressive replacement schedule. Their continued deferral poses risks to service delivery. Additionally, the City must address its approximately $200 million backlog of infrastructure maintenance to be economically healthy. While the fiscal stabilization budget does not meet all of the City's needs, it does set the City up to adequately provide basic municipal services. For this reason, the fiscal stabilization budget is service-solvent. Nevertheless, the fiscal stabilization budget, absent restructuring savings, remains unsustainable from a budgetary and cash standpoint due to the higher level of spending. This section also allocates funding to implement programmatic strategies the Core Team recommended to the City through the strategic planning workshops. Specifically, this section makes available funding for crime reduction strategies, improved housing inventory, workforce development, community engagement, economic and business development and public relations, starting in FY 2020-21.

Restructuring Savings **–** This section includes proposed savings that require Chapter 9 protection to be implemented for pension and labor agreements, retiree medical benefits, debt obligations, and lawsuit claimants. This prudent approach is necessary to resolve the City's insolvency issues. This section also includes proposed service restructuring accomplished through contracting with private vendors along with additional efficiencies, cost recovery and income from increased fees for services. With all of these savings and new revenues, the City realizes a balanced budget that is solvent from a service perspective.

Tables 28 and 29 summarize these elements of the General Fund budget and show the resulting net surplus or shortfall projected to remain after each element over the next 20 years. The entire long-range forecast is shown in Attachment IV. The modeling assumptions, which are detailed in the discussion of revenues and expenditures later in this document, have to be realistic, given the long-term nature of City obligations, and the pressure to restore City services and pay creditors.

Given the forecast period of 20 years, the estimates are inherently subject to significant variability. Even a small change in assumptions can have a major impact over this period. However, revenues are likely to fall within the range of plus or minus 0.5% of the forecasted annual growth rate. This potential variance compounds annually, and thus over time the potential range of revenue widens. However, as Figure 16 shows, even the optimistic end of this revenue range is well short of the resources needed to meet the projected expenditure levels, and it would be imprudent to count on optimistic revenue estimates to try to balance this financial plan. The forecast is considered the most likely outcome, but is still subject to risks based on the assumptions made.

Figure 16. Long-Range Financial Plan With Restructuring Savings (FY 2014-15 to FY 2023-24)

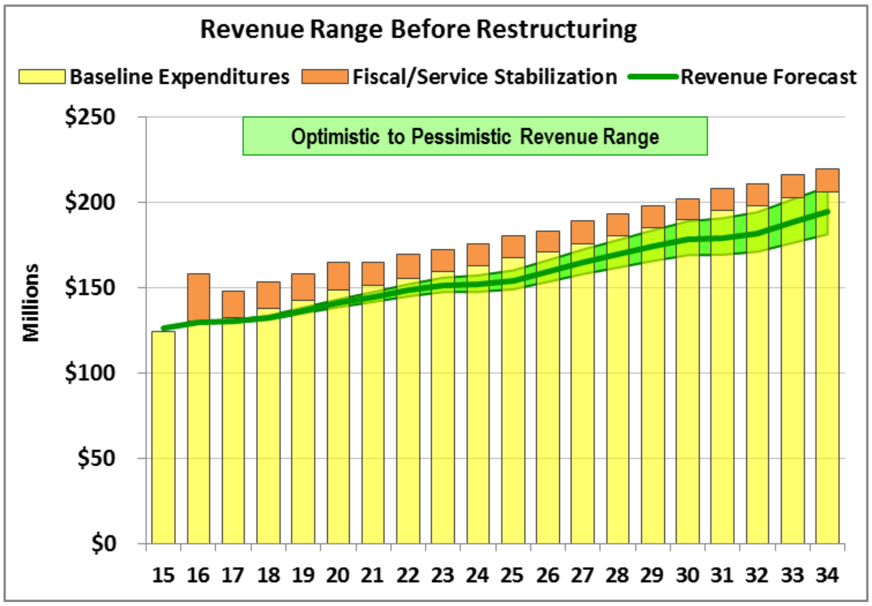


Table 28. Long-Range Financial Plan With Restructuring Savings (FY 2014-15 to FY 2023-24)

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Total Revenue	$126.3	$129.9	$130.3	$132.3	$136.6	$140.8	$144.5	$146.3	$143.2	$143.7
Total Expenditures	124.0	130.2	132.2	137.4	142.5	148.7	151.3	155.3	159.4	162.8
Net Surplus (Deficit)	2.3	(0.3)	(1.9)	(5.1)	(5.9)	(7.8)	(6.8)	(9.1)	(16.2)	(19.1)
Deferred Obligations	0.0	14.7	0.4	0.4	0.4	0.4	0.0	0.0	0.0	0.0
Fiscal & Service Stabilization	0.0	13.0	15.6	15.1	15.3	15.7	13.4	14.0	12.6	12.8
Adjusted Surplus (Deficit)	2.3	(28.0)	(17.8)	(20.6)	(21.6)	(24.0)	(20.2)	(23.1)	(28.8)	(31.8)
Restructuring Savings	0.0	31.2	20.6	21.7	21.7	21.7	22.2	24.8	31.4	31.7
Net After Restructuring	2.3	3.2	2.7	1.1	0.1	(2.3)	2.0	1.7	2.7	(0.2)
Beginning Fund Balance	9.4	11.7	14.9	17.6	18.7	18.8	16.5	18.5	20.2	22.9
Ending Fund Balance	11.7	14.9	17.6	18.7	18.8	16.5	18.5	20.2	22.9	22.7
Bal as % of Total Adj Expend	9.4%	11.8%	13.8%	14.2%	13.8%	11.5%	13.0%	13.8%	15.4%	14.9%
Balance Goal (15% of Total Exp)	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%

Table 29. Long-Range Financial Plan With Restructuring Savings (FY 2024-25 to FY 2033-34)

($ in millions)	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Total Revenue	$145.6	$150.5	$155.6	$160.0	$164.4	$168.4	$169.1	$171.4	$177.3	$183.2
Total Expenditures	167.1	171.1	175.7	180.3	185.1	190.0	195.1	197.6	202.9	206.2
Net Surplus (Deficit)	(21.5)	(20.6)	(20.1)	(20.3)	(20.6)	(21.6)	(26.0)	(26.2)	(25.6)	(23.1)
Deferred Obligations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal & Service Stabilization	12.9	11.9	13.3	13.0	13.0	12.2	13.0	13.0	13.1	13.3
Adjusted Surplus (Deficit)	(34.4)	(32.5)	(33.3)	(33.3)	(33.7)	(33.8)	(39.0)	(39.1)	(38.7)	(36.3)
Restructuring Savings	32.8	33.3	34.3	35.1	36.0	36.9	37.3	38.3	39.4	40.6
Net After Restructuring	(1.5)	0.8	0.9	1.8	2.3	3.0	(1.7)	(0.8)	0.7	4.3
Beginning Fund Balance	22.7	21.2	22.0	22.9	24.6	26.9	29.9	28.2	27.4	28.1
Ending Fund Balance	21.2	22.0	22.9	24.6	26.9	29.9	28.2	27.4	28.1	32.4
Bal as % of Total Adj Expend	13.6%	13.9%	14.0%	14.7%	15.7%	17.1%	15.6%	15.0%	15.0%	17.0%
Balance Goal (15% of Total Exp)	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%

The City will need to be carefully managed to make sure the General Fund balance maintains a prudent level of reserves over time. To weather the impacts created by near-term increases in CalPERS rates and to address much-needed deferred maintenance and equipment replacement, the City will have to exercise disciplined expenditure control through priority-based budgeting.

Figure 17 compares the fund balance after restructuring to the City's reserve goal of 15% of total expenditures. Small changes to base revenues, compounded over time, can significantly improve or worsen the fund balance outlook and capacity to address unmet needs. For example, Figure 18 compares what the fund balance would look like after the proposed restructuring if the City's annual revenue growth rate was consistently 0.5% better or 0.5% worse than projected under the baseline budget.

Figure 17. General Fund Balance Compared to Reserve Goal

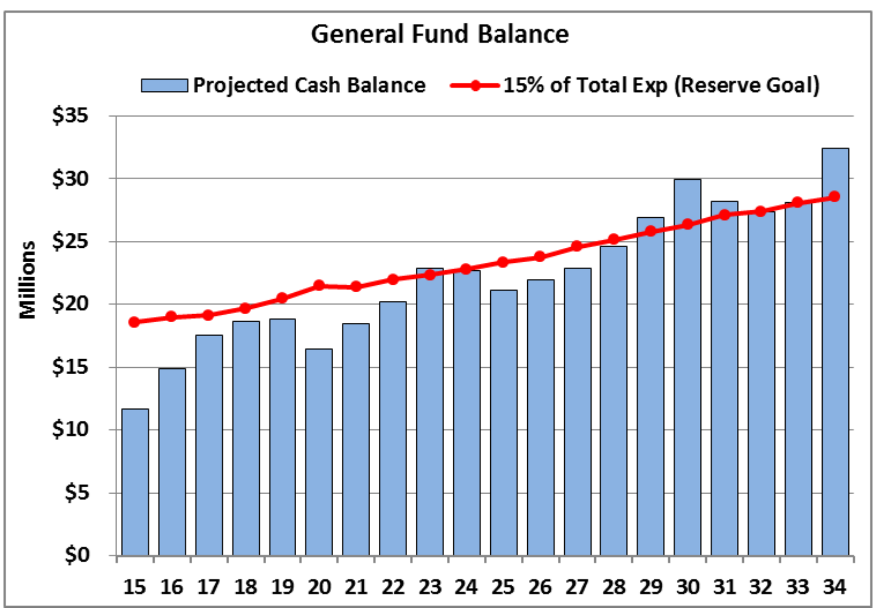
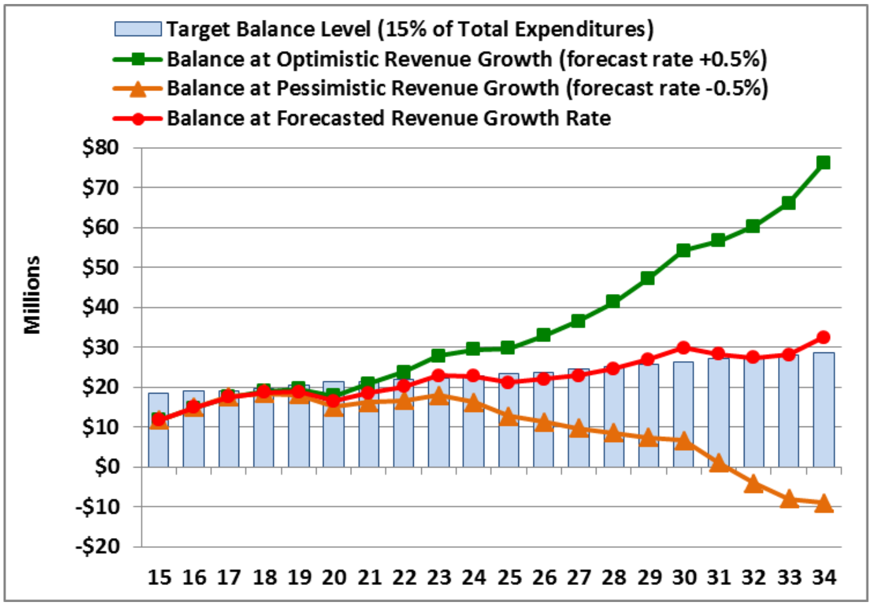


Figure 18. General Fund Balance Under Alternate Revenue Growth Scenarios, After Proposed Restructuring



Baseline Assumptions

The Long-Range Financial Plan is based on the City's FY 2014-15 budget. Revenue projections are based on prior year trends and current revenue sources, using estimates from the City's property and sales tax auditor. Expenditure projections are based on current budget staffing levels. Projections include a 2% annual cost-of-living increase for non-sworn employees and a 3% annual increase for sworn. Overtime for sworn is also increased at 3%. All other costs are increased at 2% to 3%, including inflationary increases for materials, supplies, and contract services. Pension costs are predicated on an analysis of employer rates by an independent actuary. Budgeted expenditures for debt service and lease payments are based on original amortization schedules and projected contributions from other funds.

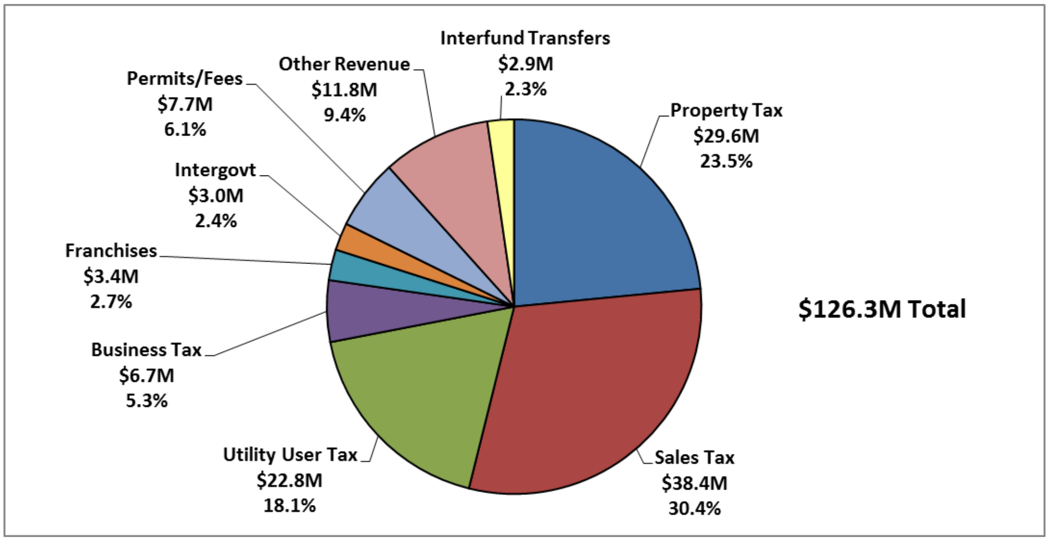
With the budgeted increases in salaries, benefits, operating expenditures, and near-term bankruptcy costs, the city is cash insolvent. The baseline budget forecast does not include significant costs for deferred capital maintenance, fleet needs, and working capital. The following summary provides the key revenue and expenditure assumptions on which the forecast is based.

Assumptions were developed with an understanding of California's cyclical economy. Therefore the revenue estimates represent a good-faith estimate of the resources most likely to be available to the City over time. While small changes in the assumptions can have a significant impact over the course of a 20-year forecast, we believe this approach is prudent and appropriate given the City's desire to meet its service needs while addressing the interests of its creditors.

Major Revenue Sources

Figure 19 shows the distribution of a projected $126.3 million in General Fund revenues for FY 2014-15. The top three sources alone, property tax, sales tax (including Measure Z) and the utility user's tax, comprise 72% of total revenues. With a forecast extending 20 years, it is important to include economic downturns. Since 1928 on average there has been an official recession approximately every seven years, so this forecast builds in assumed modest recessions in 2017 and 2024 (2% to 5% reductions from forecasted rates of growth, followed by a recovery period of two to four years, with property tax impacts lagging by one year due to the annual lien date for setting value).

Figure 19. FY 2014-15 General Fund Revenues by Type



Property Tax

The property tax revenue base reflects varying uses of land in the City. Typical of a large, older community, the City is fairly balanced with 52% of taxable value residential, 19% commercial, and 15% industrial. Despite the diversity in property tax value, 80% of the City's taxable parcels are residential, which points out the relatively low assessed value of the City's housing stock when compared with commercial and industrial uses. The high ratio of residential parcels is a measure of service demand and an indication that a sustainable and resilient revenue base is vital to support essential City services.

Property tax comprises 23.5% of total FY 2014-15 General Fund revenues, and includes property tax in lieu of vehicle license fees (VLF). With the improving economy, property values have begun to recover over the past year, but not at the recovery levels of other regions in California. San Bernardino's property tax revenue collections peaked at approximately $30.2 million in FY 2008-09, and then fell sharply for the next two fiscal years. As the FY 2014-15 budget forecasts continued slow recovery in this large revenue source, the projected $29.6 million is still, six years later, approximately 2% below the peak revenue level. Once the Proposition 8 reappraisals are completed, there will be no more "catch-up" valuation increases, and value growth will be limited to the Proposition 13 inflator (the lesser of California Consumer Price Index or 2%), along with ownership transfers and new construction.

Going forward, the forecast assumes secured property tax growth of 5.5% for FY 2015-16, 2.8% in FY 2016-17, and -2.2% in FY 2017-18, when the impact of a 2017 recession would first be reflected in revenues. The compound annual growth rate (CAGR) through FY 2033-34 is projected at 3.1% for secured roll taxes, and 3.5% for all property taxes, including the VLF adjustment amounts and residual tax increment. The latter represents anticipated distributions of residual tax revenues resulting from the State of California's collection of revenues previously assigned to redevelopment agencies. After transferring funds to agencies to meet ongoing dissolution costs, monies are redistributed to successor agencies.

Table 30. Property Tax Revenue Forecast

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Secured Tax Revenue	$9.6	$10.1	$10.4	$10.1	$10.5	$11.0	$11.5	$12.0	$12.4	$12.8
Growth Rate		5.5%	2.8%	-2.2%	3.9%	4.0%	4.6%	4.6%	3.1%	3.2%
Total Revenue incl VLFAA	$29.6	$32.0	$33.0	$32.4	$33.8	$35.2	$36.9	$38.7	$40.0	$41.3
Growth Rate		8.0%	3.1%	-1.8%	4.2%	4.3%	4.8%	4.8%	3.4%	3.4%
	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33	33/34
Secured Tax Revenue	$12.5	$13.1	$13.7	$14.4	$15.1	$15.6	$16.1	$15.8	$16.5	$17.2
Growth Rate	-1.8%	4.2%	5.2%	4.7%	4.8%	3.3%	3.3%	-1.7%	4.4%	4.4%
Total Revenue incl VLFAA	$40.7	$42.5	$44.8	$47.0	$49.3	$51.0	$52.8	$52.0	$54.4	$56.9
Growth Rate	-1.6%	4.4%	5.4%	4.9%	5.0%	3.5%	3.5%	-1.5%	4.5%	4.5%

Sales Tax

Sales tax is another important revenue stream for San Bernardino and is projected to account for 30.4% of General Fund revenues in FY 2014-15. Sales tax includes the 0.75% local tax rate, 0.25% "triple flip" tax rate paid by the state through the annual property tax remittance from the county (which reverts to the City in 2016), Proposition 172 public safety sales tax allocation, and Measure Z's 0.25% safety sales tax. The total sales tax rate in San Bernardino is 8.25%, which is at the 55th percentile of rates statewide (weighted for population, the statewide rate among cities is 8.46%).

Like property taxes, sales tax receipts have declined significantly due to the general economic downturn. They are also subject to increased spending on non-taxable services and via the internet, which will slow the rate of revenue growth in future years. Taxable sales as a percent of personal income have dropped from a high of 53% in 1979 to 33% in 2012, according to the California Legislative Analyst, a trend exacerbated by an aging population. California's taxable sales today, adjusted for inflation, are 28% lower than in 2000. Census figures also show that 2013 California real median household income, adjusted for inflation, has fallen 10% from its 2006 peak, which is nearly back to its 1997 level.

Excluding Measure Z and Proposition 172, sales tax revenues peaked in FY 2005-06 at $36.7 million, but plummeted in FY 2009-10 to $20.4 million. At $30.5 million in FY 2014-15, this portion of the overall sales tax is still 17% below peak year revenue. The estimates for FY 2014-15 were supplied by HdL Companies, the City's sales tax consultant. The forecast assumes overall sales tax growth of 1.8% for FY 2015-16, a decline of 0.8% in FY 2016-17 due to the assumed recession with recovery in the ensuing three years. The CAGR through FY 2033-34 for the local

1% tax would be 3.0%. Revenues, however, will be negatively impacted by the expiration of the Measure Z sales tax late in FY 2021-22. Unless, extended, this will reduce annual sales tax revenues by approximately $8.6 million (based on the last full year).

Table 31. Sales Tax Revenue Forecast

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Bradley-Burns Revenue (1%)	$31.5	$32.1	$31.9	$33.4	$35.1	$36.9	$38.1	$39.3	$40.6	$39.8
Measure Z Revenue (0.25%)	$6.9	$7.0	$6.9	$7.2	$7.5	$7.8	$8.1	$6.2	$0.0	$0.0
Total Revenue	$38.4	$39.1	$38.8	$40.6	$42.6	$44.7	$46.2	$45.5	$40.6	$39.8
Growth Rate		1.8%	-0.8%	4.6%	5.0%	5.0%	3.2%	-1.3%	-10.9%	-1.8%
	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Bradley-Burns Revenue (1%)	$41.5	$43.5	$45.6	$47.0	$48.4	$49.8	$48.8	$50.7	$53.1	$55.5
Measure Z Revenue (0.25%)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Total Revenue	$41.5	$43.5	$45.6	$47.0	$48.4	$49.8	$48.8	$50.7	$53.1	$55.5
Growth Rate	4.1%	4.9%	4.8%	3.0%	3.0%	3.0%	-2.0%	3.9%	4.6%	4.6%

Utility Users Tax (UUT)

The UUT is a 7.75% tax on gas, electric, telecommunications, and cable TV. This rate compares to a statewide average of 5.3% for the 30% of cities that impose a UUT. The UUT is the third largest revenue source in the General Fund (18.1% of the total), and is projected to raise $22.8 million in FY 2014-15, which is 9.2% below peak year revenue of $25.1 million in FY 2006-07. This reduction is due to several issues, including the City's exposure to foreclosures, which were 3.5 times above the national average; changing technology trends that are reducing taxes on cable and telecommunications; and energy conservation efforts that affect the tax revenue from gas and electric customers. Assuming an improvement in foreclosures and a slowly recovering economy, forecasted revenue growth is 4.5% in FY 2015-16, with a 2.0% decline in FY 2016-17, exacerbated by the projected recession. The CAGR through FY 2033-34 for the UUT is projected to be 0.6%. This rather anemic growth rate is attributable to the technology and conservation trends noted above, which is being assumed by firms that do UUT forecasting. (The San Bernardino UUT does not include water, sewer or refuse, although 56% of cities with UUTs statewide do tax one or more of these activities. Including these utilities would allow the City to set the rate lower than at present, but still high enough to net millions in additional revenue to the City. Such action would require voter approval.)

Table 32. Utility Users Tax Revenue Forecast

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Utility Users Tax Revenue	$22.8	$23.9	$23.4	$23.6	$23.9	$23.9	$24.0	$24.1	$24.1	$23.8
Growth Rate		4.5%	-2.0%	1.0%	1.0%	0.2%	0.2%	0.3%	0.4%	-1.6%
	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Utility Users Tax Revenue	$24.1	$24.4	$24.5	$24.7	$24.9	$25.0	$24.7	$25.1	$25.5	$25.8
Growth Rate	1.4%	1.4%	0.5%	0.6%	0.6%	0.7%	-1.3%	1.7%	1.7%	0.8%

<u>Other Revenue Sources</u>

The remaining General Fund revenue is comprised of the following sources.

- ***Transfers In and Reimbursements*** – These revenues account for funds received by the General Fund from other City funds through a combination of means including operating and capital fund overhead charges, transfers, and reimbursements for services rendered. The revenues in this category can vary significantly each year and are influenced by the following: changes in staffing costs, staffing levels, and the relative proportion of services delivered to other funds; the availability of funding in other funds that are appropriate to transfer to the General Fund; and the performance of gas tax revenues, which are transferred to the General Fund to reimburse the City for eligible expenditures. Growth in these revenues growth is projected to remain flat over the projection horizon.
- ***Business Registration, Licenses and Permit Revenues*** – These revenues are generated from payments for the issuance of business licenses, building permits, fire permits, and miscellaneous health and safety-related licenses and permits. Forecasted annual revenue growth of 2% reflects changes in the overall economy and expected slow growth in coming years given local economic conditions.
- ***Other Revenues*** – These revenues include Fines, Forfeitures, and Penalties; Transient Occupancy Tax; Other Revenue; and Use of Money and Property. While some of these revenue sources are highly dependent upon market performance, such as the Transient Occupancy Tax and interest earnings, economic conditions do not drive the majority of these revenues.

Table 33. Other Revenue Forecast

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Other Revenue	$35.4	$34.9	$35.1	$35.7	$36.4	$36.9	$37.4	$38.0	$38.5	$38.8
Growth Rate		-1.4%	0.6%	1.7%	1.8%	1.5%	1.3%	1.5%	1.3%	0.7%
	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Other Revenue	$39.4	$40.1	$40.7	$41.3	$41.9	$42.5	$42.8	$43.5	$44.3	$45.0
Growth Rate	1.7%	1.8%	1.4%	1.5%	1.4%	1.5%	0.6%	1.8%	1.7%	1.6%

Revenue Gap

Similar to other municipalities in California, the Great Recession had a significant effect on the City's ability to balance revenues against expenditures. Prior to the recession, the City was able to meet its financial obligations with annual revenues and funds on hand. Since the City's peak General Fund revenue of $133.3 million in FY 2007-08, it has experienced severe losses in key areas such as sales tax, property tax, franchise fees, the UUT, permits, and funds transferred from the Economic Development Agency (EDA). As a result, meeting the City's financial obligations came at the expense of decreasing service levels. With continued declines in revenues and increased operating expenditures, the City has reduced its workforce and implemented several reductions in expenditures which have further reduced essential services. Despite the City's efforts, all reserves have been exhausted and now the City is faced with necessary restructuring to meet its obligations and to deliver essential services to the community.

As supported by the City's forecast, actual revenues have yet to rebound to pre-recession levels. Based on projected trends revenues will not reach such levels until approximately FY 2019-20. Therefore, it is unlikely that the City will ever achieve the trend level of growth assumed in the pre-recession period. Many of the expenditures, such as all the labor, debt and service obligations taken on during the last 10 to15 years assumed that consistent annual revenue growth would be achieved. This failure is at the heart of the bankruptcy.

Table 34 shows the magnitude of this revenue gap from the 2009 perspective of a City that had not yet seen the worst from the Great Recession's negative impact on local government revenues. The City had just experienced 5.3% average annual growth over the past 11 years, with a peak growth rate of 12.2% in FY 2005-06. Assuming a continuation of that average annual growth rate as the best-case scenario, the resulting annual revenue gap would be $48 million in FY 2014-15, and would grow to $84 million by FY 2019-20. A growth rate of 3.5% (two-thirds of the best-case outlook, and exceeded in seven of the prior 11 years from FY 1997-98 through FY 2008-09) might have been assumed to be "most likely" outcome, and the resulting revenue gap under that scenario would be a $32 million in FY 2014-15, rising to $46 million by FY 2019-20. In that 2009 context, growth of only 2% would probably have been seen as a worst-case scenario over the long term, which leads to the lowest gap, $18 million in FY 2014-15 and just higher than that by FY 2019-20.

Table 34. General Fund Revenue Gap between Reality and Pre-Recession Expectations

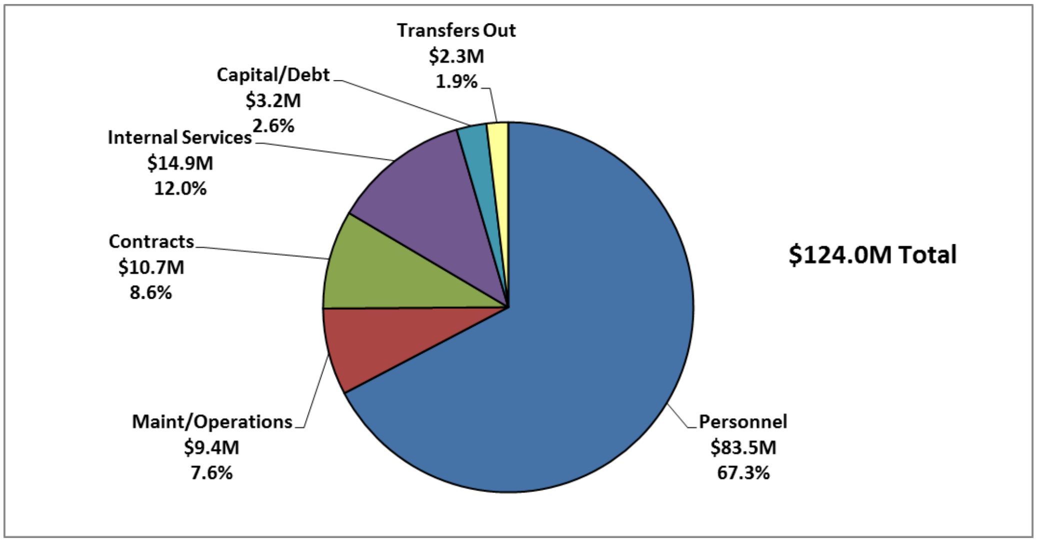
($ in millions)	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09
Actual Revenues (4)	$74.3	$80.4	$87.5	$90.3	$95.5	$100.9	$113.2	$119.6	$130.3	$133.3	$125.9
Growth Rate	3.0%	8.1%	8.8%	3.2%	5.8%	5.6%	12.2%	5.7%	8.9%	2.3%	-5.6%
	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18	18-19	19-20
Actual/Forecast Revs (4)	$116.7	$118.5	$116.2	$114.2	$115.9	$123.4	$127.0	$127.4	$129.4	$133.7	$137.9
Growth Rate	-7.3%	1.6%	-2.0%	-1.7%	1.5%	6.5%	2.9%	0.3%	1.6%	3.3%	3.1%
Pre-Recession Expectations:											
Best-Case (1)	$132.5	$139.5	$146.9	$154.6	$162.8	$171.4	$180.5	$190.0	$200.0	$210.6	$221.7
Growth Rate	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Most-Likely (2)	$130.3	$134.9	$139.6	$144.5	$149.6	$154.9	$160.4	$166.0	$171.9	$177.9	$184.2
Growth Rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Worst-Case (3)	$128.4	$130.9	$133.6	$136.2	$139.0	$141.7	$144.6	$147.5	$150.4	$153.4	$156.5
Growth Rate	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Resulting Revenue Gap:											
Pre-Recession Best-Case	(15.8)	(21.0)	(30.7)	(40.4)	(46.9)	(48.0)	(53.5)	(62.6)	(70.6)	(76.9)	(83.8)
Pre-Recession Most-Likely	(13.6)	(16.3)	(23.4)	(30.3)	(33.8)	(31.5)	(33.4)	(38.6)	(42.4)	(44.2)	(46.3)
Pre-Recession Worst-Case	(11.7)	(12.4)	(17.4)	(22.0)	(23.1)	(18.3)	(17.6)	(20.0)	(21.0)	(19.7)	(18.6)

(1) Starting FY 09/10 assumes average annual growth rate over prior 10 years (FY 97/98 to FY 08/09) as a reasonable "best-case"
(2) Starting FY 09/10 growth rate is two-thirds of "best-case" growth as a reasonable "most-likely" outcome
(3) Continues FY 08/09 growth rate as an assumed "worst-case" scenario
(4) Excludes transfers in, which may vary widely from year to year

Expenditure Assumptions

The widening gap between ongoing revenues and annual expenditures resulted from several factors, including loss of revenues due to the Great Recession and increases in labor and retirement costs. For several years, the City used reserves and other sources of one-time funding to maintain solvency. However, such alternatives were exhausted during FY 2009-10 and FY 2010-11. Consequently the City was forced to make severe reductions in staffing and services, resulting in an overall decline of $20 million in General Fund expenditures, from $144 million in FY 2008-09 to $124.0 million in FY 2014-15. Figure 20 shows the major elements of projected FY 2014-15 General Fund expenditures by type. Personnel costs comprise 67% of total expenditures. Starting in FY 2015-16 the forecast builds in deferred obligation payments to CalPERS, and approximately $10 million in annual fiscal and service stabilization costs, such as rebuilding insurance reserves, reducing the backlog of deferred maintenance, and funding the replacement of vehicles and technology required by the City organization to sustain the current level of services to the public.

Figure 20. Projected FY 2014-15 General Fund Expenditures by Type



Compensation

The City's budget is heavily focused on public services. Government service delivery is labor-intensive, relying on the City workforce to patrol the streets, respond to emergencies, provide libraries and community programs, and deliver the other direct and supporting services of San Bernardino. The Long-Range Financial Plan assumes the current level of staffing, despite increasing workload demands. Thus, the City must continue to seek service delivery efficiencies to continue to provide essential and necessary services within its available resources.

This forecast assumes public safety employees continue to receive salary increases at 3% annually pursuant to City Charter Section 186. While this is a revised estimate, up from the prior 2% assumption, it is reflective of increases in the marketplace that under the Charter would have to be given to safety employees. To remain competitive in the workforce, and to address zero salary adjustments over the past five years for non-safety employees, salary compensation for non-safety employees is forecasted to grow by 2% annually. As a result of these forecasted adjustments, pension costs, overtime and workers compensation contributions also increase, as they are a direct function of overall compensation.

Pension Costs

In general, the increasing costs of pension benefits are attributable to a dramatic increase in the Plans' unfunded liabilities. There are four major causes of this increase in unfunded liability:

- Timing of increases in benefits beyond the basic plans, which were not paid for during the working lives of employees receiving benefits, including making the benefits retroactive;
- Past investment losses by CalPERS, leading to a failure to meet earnings expectations on Plan assets;
- Actuarial changes in assumptions based on experience, including increased longevity; and
- An increase in the number of retirees and the size of their pensions.

To forecast future retirement costs, the City retained the actuarial consulting firm of Bartel & Associates to prepare a 20-year forecast based on the following assumptions:

- Rate smoothing and amortization changes previously adopted by CalPERS.
- Adjusted mortality improvement assumptions (retirees living longer) previously adopted by CalPERS.
- Reduced City-reported payroll compared to CalPERS assumptions.
- Reduction of 0.25% in the PERS discount rate for interest earnings (previously proposed by CalPERS staff but not adopted by the board); assumes CalPERS ultimately approves a more risk-averse investment strategy that reduces potential volatility in employer rates, but results in lower investment returns, which is passed on to employers in the form of higher rates.
- Elimination of Employer Paid Member Contribution (EPMC) benefit.
- Anticipated savings from Public Employee Pension Reform Act (PEPRA) changes (not incorporated into CalPERS's own rate projections).
- Employee cost sharing at Pendency Plan levels (PEPRA allows cities to impose higher employee contribution rates starting in 2018, but this assumes early implementation).

According to Bartel & Associates, CalPERS contribution projections for miscellaneous employees will rise from the current (2015-2016) rate of 26.3% to 33.8% in 2020-2021. For safety employees, contribution rates will climb from the current (2015-2016) rate of 33.8% to 56.9% in 2020-2021.

Despite a 5% reduction in the City's unfunded liability through the implementation of its Pendency Plan, the City's Miscellaneous and Safety CalPERS plans carry an unfunded liability of $116.5 million and $169 million, respectively, totaling $285.5 million equal to a 74% funded status.

The City also provides a supplemental retirement benefit for 23 retired police safety and police safety management employees. The supplemental retirement benefit (referred to as the PARS Enhancement to 3% at 50 benefit level) is provided by Public Agency Retirement Services (PARS). As of December 31, 2014 the Plan assets were $2.12 million, with an actuarial liability of $4.91 million leaving the PARS Plan with an unfunded actuarial liability of $2.79 million. Because the PARS Plan has sufficient assets to meet its current obligations, the City will not allocate funds to pay the deferred obligation of $407,586 for FY 2014-15. The baseline forecast assumes the PARS Plan is funded on a pay-go-basis at approximately $245,000 per year.

Table 35 shows the projected total pension costs from CalPERS and PARS and the percentage of total General Fund expenditures that these costs represent. CalPERS costs, which comprise 99% of the total pension costs, will escalate steadily over the next five years under a planned schedule of employer rate increases. Pension costs are expected to peak at 19.3% of total expenditures in FY 2019-20.

Table 35. Projected Pension Costs as a Percent of Total General Fund Expenditures

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Pension Expense	$14.2	$19.3	$21.2	$23.5	$25.5	$27.5	$28.0	$28.7	$29.4	$30.1
Pension as % of Total GF Exp	11.9%	15.6%	16.3%	17.8%	18.6%	19.3%	18.8%	19.0%	18.9%	18.9%
	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Pension Expense	$30.8	$31.5	$32.2	$32.8	$33.5	$34.3	$35.0	$33.0	$33.7	$32.3
Pension as % of Total GF Exp	18.9%	18.9%	18.8%	18.7%	18.6%	18.5%	18.4%	16.9%	17.1%	15.9%

Other Retirement Costs (OPEB)

The City's labor Memorandums of Understanding also provide for other post-employment benefits (OPEB), specifically retiree medical and dental coverage. Generally, employees are eligible for retiree medical insurance coverage after retirement from public service. Employees are eligible to retire at pre-Medicare age (55 for miscellaneous and 50 for police and fire), which contributes to the significant cost of the benefit. Both non-safety and safety eligible retirees receive a monthly benefit ranging from $112 to $450 to cover monthly premium costs for healthcare insurance. With the adoption of the City's Pendency Plan all eligible retirees are now receiving $112 per month.

The OPEB plans are funded through separate trust funds associated with the retirement plan. The Plan has an independent actuarial analysis, which establishes the contribution rates and funding levels. Unlike pension costs, retiree medical costs are limited to fixed dollar amounts. Currently, the City's OPEB benefits and unfunded obligations are funded on a pay-as-you-go basis.

Health Care

The City offers a variety of health care options and funding levels to its employees through collective bargaining. Currently, the City's health care plan includes active employees and retirees. The City is diligently working with its health care broker to separate active employees and retirees into two plans. This will result in the elimination of the implied subsidy to retirees and a reduction of health care costs to the City of $1.1 million in 2015. The forecast assumes health care costs will rise at a 3% annual rate.

Other Compensation and Benefits

The forecast assumes $650,000 in FY 2014-15 and $100,000 thereafter annually to fund compensated absences in accordance with current labor agreements, including vacation leave at termination which is required by California law. No adjustments regarding benefits are assumed in the forecast.

Vacancy Savings

The forecast assumes 4.5% vacancy savings in FY 2015-16, dropping to 3.0% in FY 2016-17 and thereafter. All authorized positions are budgeted as if filled for the entire year, and the vacancy savings credit accounts for the periods where positions remain vacant, so the result is that the budget better approximates the ultimate level of personnel expenditures.

Miscellaneous Expenditures

The following assumptions were made with respect to miscellaneous expenditures.

- ***Services and Supplies*** – A 3.0% annual increases in costs associated with contract services, equipment, utilities, and general expenses.
- ***Library Program Support*** – Continued allocation from the General Fund to support Library operations.
- ***Debt Service and Lease Obligations*** – The City has substantial lease obligations for a variety of equipment and facilities including vehicles, computer software, and miscellaneous capital equipment. All secured and lease obligations are funded in FY 2014-15 and beyond based on the original amortization schedules.
- ***Essential Service Capital Needs*** – A total of $156 million is programmed over a 20-year period to address a capital maintenance backlog of over $200 million in parks, public buildings, right-of-way, information technology, and fleet replacement
- ***Working Capital*** – The forecast provides approximately 60 days of operating capital based on Government Finance Officers Association (GFOA) best practice guidelines. There is a 10-year phase-in period over which the financial plan ramps up the reserve level to 15% of total General Fund expenditures.
- ***Deferred Obligations*** – To establish liquidity, the City proposes to continue to defer obligations for trade payables, litigation, pension obligation bonds and compensated absences "current deferrals" and the forecast does not allocate funds to pay for them. Payments to deferred obligations are addressed in the Creditors under the Plan of Adjustment section of the Financial Plan.

Treatment of Creditors under the Plan

The restructuring section of the forecast includes reductions in expenditures not yet implemented that require the Chapter 9 process: retiree medical benefits, pension benefits, debt obligations, and legal settlement payments. Approximately $51.7 million of the $357.9 million in potential labor savings for FY 2014-15 through FY 2033-34 already have been implemented through negotiations and mediation, and these savings are incorporated into the baseline personnel costs. In addition, the $15.6 million in annual compensation and service cuts that were enacted by the City through the pendency plan are assumed to stay in effect and to gain in value of avoided costs over time.

Retiree Medical

The forecast assumes retirees are placed into a separate health care plan from the active employees resulting in the elimination of the City's implied health care subsidy. This transition was made in January 2015. Implementation of this Plan will significantly reduce the City's OPEB obligations including a reduction of $350,000 in FY 2014-15. This step results in a substantial decrease in unfunded liability relative to the earlier Plan.

CalPERS Retirement

To meet cash flow needs and ensure the continuation of essential services, the City had previously deferred payments to CALPERS of approximately $14.5 million. In a post-bankruptcy agreement, the City has committed to repaying the outstanding balance and interest and penalties as follows:

- FY 2014-15: $7,239,960 principal
- FY 2015-16: $7,239,960 principal
- FY 2019-20: $400,000 annually in penalties and interest

Supplemental Retirement (PARS)

The City is currently attempting to negotiate a resolution regarding the PARS Plan. As noted previously, the PARS plan is underfunded on a long-term basis. Approximately $2.12 million remains in the PARS trust.

Debt Obligations

1996 Lease Revenue Bonds (the "96 Bonds") and 1999 Certificates of Participation (the "99 COPs"). Under the proposed Plan, the City will provide for the following: (i) to defease the General Fund portion of the 1999 COPs using unexpended bond proceeds, (ii) the debt service reserve fund will be resized and will remain in place as security for the remaining portion of the 1999 COPs not defeased, (iii) any remaining unexpended bond proceeds not used for the defeasance and any cash from the resizing of the reserve fund will be released to the City, (iv) that upon defeasance of the General Fund portion of the 99 COPs, the collateral securing the 99 COPs, the Police Station, will be released, and (v) the balance of the 1999 COPs shall continue to be paid through the Successor Agency as an enforceable obligation of the former Economic Development Agency (EDA).

The Plan also proposes that the balance of the 1996 Bonds will be paid as regularly scheduled. The City has also requested the bond insurer provide a surety to replace the cash reserve fund. The use of the dollars from the reserve fund release are yet to be determined. The collateral for these bonds consists of City Hall, which is an essential facility and therefore must be retained by the City.

2005 Pension Obligation Bonds (the "POBs"). These bonds ($48.4 million outstanding) refinanced an unfunded liability due to CalPERS. These bonds are not secured. Under the proposed Plan, the outstanding bonds including the deferred amount of $10,027,094 will be treated as unsecured obligations. Distributions to holders of the POBs will be made over time and will approximate 1%, as calculated on a present value basis. The General Fund saves approximately $3.5 million annually. Total stated debt service increases from $3.5 million in FY 2015-16 to $4.6 million in FY 2033-34.

General Unsecured Claims. Under the proposed Plan, general unsecured claims, which will include, but not be limited to, deferred litigation expenditures and deferred General Fund trade payables, will receive a pro rata portion of a fixed amount of cash payable on the effective date of the Plan or as soon as reasonably practicable thereafter. Distributions to general unsecured claims are estimated to equal an approximate 1% recovery on such allowed general unsecured claims.

Revenue and Service Stabilization

Renewal of Measure Z Sales Tax

The Financial Plan assumes that the City will secure voter approval to extend the current Measure Z local 0.25% sales tax rate for an indefinite period. This tax is projected to generate $8.3 million in FY 2020-21, the year it is currently set to expire. Without the extension of this tax, expenditures will have to be reduced by that $8.3 million.

Other Expenditure Reductions

In addition to actions implemented through the Chapter 9 process the City will undertake the following actions:

- ***Efficiencies and Contract Fire*** **–** The City has initiated a series of studies designed to reduce costs through efficiencies, alternative service delivery, or increased cost recovery. The annual savings start at $4.5 million in FY 2015-16 and increase to $8.9 million in FY 2016-17.
- ***Staffing and Service Cuts*** **–** Despite the City's current level of service insolvency, the $15.6 million in cuts previously enacted through the Pendency Plan would remain in effect. However, failure of Measure Z to be renewed in FY 2021-22 would force an additional $8.3 million in budget cuts to make up for the loss of revenue.

As shown in Tables 36 and 37, an average of $29.5 million will be required in annual ongoing restructuring savings and additional resources over the 20-year forecast period to balance the long-range financial plan. Of the $591 million in total restructuring through FY 2033-34, $222 million or 38% is from increased revenues, and $369 million or 62% is from reduced expenditures.

Table 36. Proposed Restructuring: FY 2014-15 to FY 2023-24

($ in millions)	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	23-24
Measure Z Extension	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$2.1	$8.3	$8.1
General Unsecured Bonds	0.0	13.5	3.5	3.6	3.6	3.7	3.7	3.8	3.8	3.9
General Secured Bonds	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Fee Revenues	0.0	5.2	4.3	4.4	4.5	4.6	4.7	4.8	4.9	5.1
Contract Fire and EMS	0.0	4.5	8.9	9.9	9.6	9.6	10.0	10.2	10.4	10.5
Efficiency Improvements	0.0	2.7	2.8	2.9	2.9	3.0	3.1	3.2	3.3	3.3
Creditor Obligations	0.0	4.2	0.0	0.0	0.0	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)
Tax Adjustments	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Retiree Health Care Savings	0.0	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Grand Total Restructuring	0.0	31.2	20.6	21.7	21.7	21.7	22.2	24.8	31.4	31.7

Table 37. Proposed Restructuring: FY 2024-25 to FY 2033-34

($ in millions)	24-25	25-26	26-27	27-28	28-29	29-30	30-31	31-32	32-33	33-34
Measure Z Extension	$8.5	$8.9	$9.3	$9.5	$9.8	$10.1	$9.9	$10.3	$10.8	$11.3
General Unsecured Bonds	4.0	4.0	4.1	4.1	4.2	4.3	4.3	4.4	4.5	4.5
General Secured Bonds	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fee Revenues	5.2	5.3	5.4	5.6	5.7	5.9	6.0	6.2	6.3	6.5
Contract Fire and EMS	10.8	11.0	11.3	11.6	11.9	12.2	12.5	12.8	13.1	13.4
Efficiency Improvements	3.4	3.5	3.6	3.7	3.8	3.9	4.0	4.1	4.2	4.3
Creditor Obligations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax Adjustments	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Retiree Health Care Savings	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Grand Total Restructuring	32.8	33.3	34.3	35.1	36.0	36.9	37.3	38.3	39.4	40.6

Long-Range Financial Plan Is Solvent

The Long-Range Financial Plan meets the three tests of solvency:

1. ***Cash Solvency*** - Balances will be adequate to pay bills when they come due.
2. ***Budget Solvency*** - The budgets are balanced with all spending categories accounted for, including compensated absences and internal service contributions. Continued fiscal discipline will be required to prevent excess spending growth between now and when the fund balance reaches its reserve goal in the mid to late 2020s to avoid reducing fund balance at a faster pace.
3. ***Minimal Service Solvency*** - The Baseline and Fiscal and Service Stabilization Forecast restores a significant amount of deferred expenditures for capital maintenance, information technology and fleet replacement. In the near-term, no additional service level improvements can be funded.

Conclusion

This Plan is currently in draft form and will be reviewed by the bankruptcy team initially and then by the Common Council. Approval is slated for mid-May. Conclusion section will be drafted following presentation to and presumed approval by the Common Council.

Attachments

I. Operating Practices for Good Government (Interim Operating Agreement)
II. Preliminary Strategic Plan
III. Summary of Participatory Budgeting Framework Implemented in the City of Vallejo
IV. Long-Range Financial Plan