STAFF REPORT
CITY OF YORBA LINDA

Finance Department

DATE: JANUARY 21, 2014

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

FROM: DAVID J. CHRISTIAN, ASSISTANT CITY MANAGER & FINANCE DIRECTOR/TREASURER DC

SUBJECT: CAPITAL REPLACEMENT COST AND RESERVE ANALYSIS REQUEST FOR PROPOSAL

RECOMMENDATION

It is recommended that the City Council:

1. Provide direction to staff regarding the issuance of a Request For Proposal (RFP) to hire a consultant to analyze the City's capital assets and recommend appropriate reserve requirements for estimated replacement costs, and provide direction to staff regarding the universe of assets to be included in the analysis, and any other items that Council would like included in the RFP.

2. Discuss and provide direction regarding the consideration of any additional capital improvement projects for the current budget, or making any decisions regarding the West Bastanchury property.

BACKGROUND

At the December 3rd Council meeting, staff was directed to return with information to discuss the potential issuance of an RFP for further analysis of the City's capital assets as it relates to future replacement costs and the funding thereof.

In addition, the staff report presented on December 3rd relating to the CIP Amortization and Funding Analysis included a recommendation to direct staff to revisit the remaining CIP projects that were not approved at the July 16th Council meeting. However, no additional direction was given to staff at that meeting on FY 13/14 or FY 14/15 CIP projects.

Also, at the October 15th Council meeting, a workshop to discuss the West Bastanchury property was established for November 12th. However, at the November 5th Council meeting an announcement was made that the workshop was being postponed in order for staff to return with financial information related to capital improvement projects prior to commencing with a workshop.

Based on the above information, staff has been operating under the assumption that approving additional capital projects or making decisions on the West Bastanchury property were on-hold pending completion of the CIP Amortization and Funding Analysis which would include this RFP process.

DISCUSSION / ANALYSIS

An RFP could be developed by staff to include a scope of work which would include the following components:

- Determining the universe of assets to be included (Council)
- Obtaining access to the assets and/or relevant data (Staff)
- Establishing the remaining useful lives (Consultant)
- Estimating future replacement costs (Consultant)

Determining the universe of assets to be included

As indicated in the last staff report on December 3rd, the total historical cost of all assets currently on the City's books exceeds $420 million and is made up of several thousand individual asset records. These assets include everything from the largest City facilities to the smallest pieces of equipment, and everything in between. As opposed to including all asset records in the universe to be studied, Council may want to consider limiting the scope to only certain major assets, assets exceeding certain dollar thresholds, or assets with useful lives beyond a certain point in order to simplify the analysis and keep the costs down.

Obtaining access to the assets and/or relevant data

Depending on the decision made regarding the above universe of assets, obtaining access to assets and records may or may not be a big challenge. However, as with the work performed in FY 2002-03, retrieving pertinent records related to older assets is always a challenge and could require a significant amount of staff time. When access to assets is unobtainable and records are not available, estimates and assumptions will need to be prepared by the consultant which could potentially increase costs.

Establishing the remaining useful lives

Typically, Internal Revenue Service guidelines for useful lives are used when assets are accounted for and depreciated. However, the actual useful life of an asset may extend far beyond its depreciable useful life. The consultant will need to establish the actual remaining useful lives of existing assets utilizing available data and industry standards. Knowing both the actual and depreciable useful lives will be helpful when considering the funding of replacement costs.

Estimating future replacement costs

As opposed to depreciating an asset where its known cost is spread over a period of time, estimating future replacement costs must take all potential cost increases into account. The consultant will need to estimate these future costs based on either the consumer price index or some other guidelines.

FISCAL IMPACT

There would be no cost other than staff time for preparing and issuing an RFP. However, based on information from a financial consultant, the cost of the analysis could range anywhere from $25,000 on the low end to something considerably higher depending on the universe of assets to be included. In addition, the project could take upwards of six months to complete. There are currently no funds budgeted for this work.

ALTERNATIVES

Do not move forward with the RFP and use the estimates generated in-house (provided in the December 3rd Staff Report) as a basis for establishing replacement funding guidelines.

ATTACHMENTS

December 3, 2013 Staff Report

Approved By:

Mark A. Pulone
City Manager

STAFF REPORT
CITY OF YORBA LINDA

Finance Department

DATE: DECEMBER 3, 2013

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

FROM: DAVID J. CHRISTIAN, ASSISTANT CITY MANAGER & FINANCE DIRECTOR/TREASURER DC

SUBJECT: CAPITAL IMPROVEMENT PROJECTS AMORTIZATION AND FUNDING ANALYSIS

RECOMMENDATION

It is recommended that the City Council:

1. Authorize staff to look into hiring a consultant to further refine the analysis if Council wishes to pursue more detail; and
2. Direct staff to pursue item nos. 2 & 3 below under Discussion/Analysis at the appropriate time.

BACKGROUND

At the July 16th Council meeting, staff was directed to return at a later date with information regarding the amortization of all capital projects and assets, both current and future, to determine a funding status within the parameters of the City's reserve balances.

This report is in direct response to that directive and was presented to the Finance Committee on November 19th in order to receive their input. The Finance Committee then directed staff to bring this report to the full Council for consideration.

DISCUSSION / ANALYSIS

Staff feels that this entire process should involve the following three components:

1. Determine the scope of CIP amortization and funding analysis.
2. Review the Reserve Policy for potential modifications.
3. Revisit the remaining CIP projects that were not approved on July 16th.

With that said, this report will focus on the first item of trying to get our arms around the scope and universe of our projects and assets, and to determine the amount of funding available for allocation. Items 2 and 3 are significant enough to warrant a separate discussion on their own and could be considered at a subsequent meeting.

This report is not intended to be an "all inclusive" detailed analysis of all projects and assets, but rather a summary "ball park" analysis based on information readily available in house. Should the Council feel that a more in depth analysis of all City projects and assets is warranted to further refine the numbers, staff would need to look into hiring a consultant who specializes in this type of work and return with additional information on scope of work and cost.

In FY 02-03 Yorba Linda was required to implement Governmental Accounting Standards Board (GASB) Statement No. 34 which required all state and local governments to report the net value of all capital assets, including infrastructure, in their financial statements and accounting records. Previously, these costs were recorded as expenditures in the year they were incurred in accordance with the standards in place at the time.

Prior to GASB 34, government entities had not included infrastructure assets such as streets, parks, storm drains and right-of-way on their balance sheets, nor had they reported depreciation for the assets they were reporting such as buildings and equipment. This meant that implementing GASB 34 would require a full inventory of all capital assets in the City and reporting them at their historical cost as well as estimating the amount of accumulated depreciation from their creation date to the implementation date. This was a huge undertaking for all government agencies and for Yorba Linda, required the use of a valuation service consulting firm. When the consultant's work was complete, Yorba Linda's total assets were valued at $362 million.

However, of the $362 million in total assets at the time, depreciation was only being calculated on $172 million. The City elected to not depreciate about $150 million for infrastructure related to streets and roads as allowed by GASB 34. An additional $40 million was not depreciable because it represented land.

Since implementing GASB 34, these asset records have been updated annually with additions and deletions along with corresponding calculations for depreciation. From the most recently compiled data, total assets being depreciated are $223 million and corresponding accumulated depreciation on these assets is $69 million. While some individual asset categories are as much as 80% depreciated, as a total group of assets the depreciation is on average approximately 30% (see Table 1). As a "ball park" analysis, this information could also be used to support the position that 30% of the costs of these assets, or $69 million, should currently be set aside to replace them someday. (It should be noted that this analysis does not factor in any consumer price index (CPI) increases for replacement costs and that simply using the depreciation amount for set aside funding will most likely not be sufficient to fully replace an asset.)

TABLE 1

Asset Category	Historical Cost	Accumulated Depreciation	Percentage Depreciated
Buildings/Improvements	$ 72,825,593	$ 25,668,077	35%
Machinery/Equipment	10,085,832	8,144,695	81%
Vehicles	1,192,548	902,973	76%
Other Infrastructure	138,503,718	33,760,772	24%
Total Depreciable Assets	$ 222,607,691	$ 68,476,517	31%

If we also look at the streets and roads infrastructure assets which are currently valued at $200 million and assume a similar 30% depreciation, this would equate to about $60 million in designated funding to be set aside. However, because much of the funding for street improvements comes from Gas Tax and Measure M funds, an argument could be made that designating $60 million in General Fund reserves is too high. In fact, over the last several years Gas Tax and Measure M funding have accounted for roughly 85% of all streets and road capital project spending on average. Using this logic, the General Fund would only need to have 15% of the $60 million in reserves set aside, or $9 million.

While we have no reason to believe that Gas Tax revenue will not continue to be available in the future, Measure M funding is set to end in 2041. In addition, since the City is required to use its Gas Tax and Measure M funding within a relatively short period of time after receiving it, there is no way to build up a reserve of these funds for the long term.

Depending on the future availability of Gas Tax and Measure M funds, the City would need to have somewhere between $78 million and $129 million in General Fund reserves set aside to replace or maintain assets that are currently on the books (see Table 2). However, in addition to the assets discussed above, the City continues to maintain a list of capital projects for which no funding source has been identified. We refer to these projects as "Tier 2" and the current list totals approximately $94 million in unfunded projects. If added to the analysis at 30%, the General Fund reserves required to be set aside would increase to between $106 million and $157 million (see Table 2). With or without the Tier 2 projects included, the needed set aside amount is far in excess of the available current General Fund reserves.

TABLE 2

	Value	30% Set Aside *	30% Set Aside
Total Depreciable Assets	$ 222,607,691	$ 68,476,517	$ 68,476,517
Street & Road Infrastructure	200,603,744	9,027,168	60,181,123
Total		$ 77,503,685	$ 128,657,640

* Street & Road Infrastructure reduced to 15%

Through the end of FY 12-13, available General Fund reserves were estimated to be approximately $38.5 million. After recently paying off the golf course bonds, the amount of available reserves has been reduced to $24.5 million. Of this amount, approximately $9.6 million has been designated to other special reserve funds for items such as general liability, employee benefits and various capital costs. In addition, at the July 16th Council meeting certain capital projects were approved with General Fund spending in the amount of $1.5 million over the next two years. These last two items together further reduce the amount of available undesignated reserves to around $13.4 million. According to Council Policy A-4, 50% of General Fund operating expenditures, or about $14 million is required to be set aside to fund operations. With only $13.4 million of undesignated reserves available, we are slightly below that level at 48%.

Of the $9.6 million in other special reserve funds, approximately $5.4 million is designated for buildings, equipment and infrastructure. Based on the earlier depreciation figures, if the City feels that it should have a minimum of $69 million set aside to replace all existing depreciable capital assets and infrastructure (per Table 1), then the $5.4 million in reserves specifically designated for those items represents about an 8% funding level of the overall requirement (see Table 3). When the Street & Road Infrastructure and Tier 2 Project totals from Table 2 are factored in, the overall funding levels are reduced even further.

TABLE 3

Depreciable Assets	Accumulated Depreciation	Designated Reserves	Percentage Funded
Buildings/Improvements	$ 25,668,077	$ 4,479,676	17%
Machinery/Equipment	8,144,695	390,029	5%
Vehicles	902,973	576,056	64%
Other Infrastructure	33,760,772	-	0%
Total	$ 68,476,517	$ 5,445,761	8%

As indicated earlier, all the figures discussed in this report are "ball park" estimates and summarized at a high level. While Yorba Linda has not fully funded the replacement costs of all of its capital assets and infrastructure, like most other cities, we have continued to fund capital projects and replace assets when needed. We have a balanced operating budget and generally healthy reserves when compared to other cities. However, based on the analysis in this report, the City should be cautious in moving forward with CIP projects.

FISCAL IMPACT

Should staff be directed to pursue hiring a consultant, we would return at a later date with cost estimates and a request to appropriate funding.

ALTERNATIVES

Provide direction to staff on a different type of analysis.

ATTACHMENTS

None

Approved By:

Mark A. Pulone
City Manager