THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: November 15, 2010

TO: Honorable Members of the City Council

FROM: Mary Lewis, Chief Financial Officer Mary Lewis

SUBJECT: Teeter Plan Analysis

BACKGROUND

On February 17, 2010, the Office of the City Auditor issued a report "Citywide Revenue Audit Report" (Audit Report), which recommended that the City evaluate participation in the Teeter Plan (Plan):

Recommendation #5:
"The City's Financial Management Department should evaluate the benefits of joining the Teeter Plan, and unless there is compelling information to suggest otherwise, take appropriate steps to become part of the Plan."

On March 8, 2010, the Chief Financial Officer provided a response to the Office of the City Auditor, (memorandum "Management Response to the Citywide Revenue Audit Report"). Management's response clarified certain information on the Teeter Plan presented in the Audit Report and agreed with the audit recommendation to conduct an analysis to determine if the City would benefit by joining the Plan.

SUMMARY OF RECOMMENDATION

Based on the analysis presented in this memorandum, I do not recommend the City's participation in the Plan. The City would lose approximately $2.6 million in annual revenue in exchange for improved cash flow if it were to participate in the Plan. This amount of revenue loss to the City will fluctuate annually depending on economic conditions, property tax collection rates, and other factors. Since the City can manage the delay in the receipt of uncollected property tax revenue and revenue from penalties and interest on this uncollected amount, there is no fiscal benefit in joining the Plan; in fact, joining the Plan would result in a fiscal loss.

In addition, the statement in the Audit Report that the City would receive an "additional $6.39 million in property tax revenue" is incorrect since it is not additional or new revenue as reported.

ANALYSIS

Fiscal Impact
Financial Management contacted the County Auditor and Controller's Office before the end of FY 2010. Financial Management received an analysis from the County related to participation in the Teeter Plan and discussed this analysis both in person with County staff and in numerous conference calls. The County was forthcoming with the information it had available and County staff were helpful in reviewing the information with City staff.

Based on the analysis received from the County, and Financial Management's internal analysis, the impact of participation in the Plan would, in the long run, be a revenue loss to the General Fund. The revenue loss would be primarily due to the elimination of penalties and interest revenue. The City would lose all current and future penalties and interest revenue to the County immediately upon joining the Plan. The County's analysis detailed the City's potential *estimated* cash benefit and revenue loss for the first fiscal year of joining the Plan. In this analysis, the County concludes that there would be a one-time infusion of cash to the City of approximately $15.3 million in delinquent receivables in FY 2011 with an estimated offset (loss) of $4.3 million in accrued penalties and interest receivable revenue. It should be noted that this one-time infusion of $15.3 million does not ultimately represent additional or new revenue to the City since the City would eventually receive these funds once the delinquencies become current in future fiscal years without joining the Plan. It should be noted, however, that the loss of $4.3 million in receivable revenue from penalties and interest will be permanent to the City. As it was mentioned earlier, this estimated revenue loss to the City will fluctuate from year to year depending on the status of the economy, property tax collection rates (which range on average between 94-96%), and other factors.

Financial Management also confirmed with the County that participation in the Plan would not change the administration fees that are currently charged to the City for the distribution, collection, and auditing of property taxes.

Revenue Distribution
The distribution of property tax revenue is dependent upon the City Council and San Diego County Board of Supervisors' adoption date of the City into the Plan. Delinquent property taxes ("teeter" payment) from the fiscal year when the City joins the Plan would be paid in June of that fiscal year. For instance, if the City were to join the Plan in FY 2012, the payment of the FY 2012 delinquent receivables would be paid in June 2012. In the following fiscal years, these "teeter" payments would occur annually in June.

Additionally, only during the first year in the Plan, would the City be owed accrued delinquent property tax amounts from prior fiscal years. These accrued delinquent receivables would be paid in July of the following fiscal year (after the fiscal year in which the City joined the Plan). For instance, if the City had joined effective FY 2012, the payment of the FY 2012 delinquent property tax receivables would be in June 2012 and prior years' accrued receivables would be paid in July 2012 (or FY 2013). If the City were to adopt a resolution to join the Plan and have the County Board of Supervisors approve in FY 2011, the City could not enter the Plan until FY

2012. Accrued delinquent receivables from FY 2011 and prior years would be paid in July 2012 (FY 2013), while FY 2012 delinquent receivables would be paid to the City in June 2012.

Process to Join

If the City were to join the Plan, the City Council would need to adopt a resolution and forward it to the County Board of Supervisors. The Board of Supervisors would then be required to adopt a resolution allowing the City to participate in the Plan. The County Board of Supervisors must adopt a resolution to include the City by July 15 of the fiscal year in which the City would begin participation (i.e. the Board of Supervisors would have to adopt a resolution by July 15, 2011 to allow the City to participate in the Plan in FY 2012).

The City Council's adoption of a resolution to join may be at any time during the fiscal year; however, the Council-approved resolution must be provided to the County Auditor's Office at least two weeks prior to the next meeting of the County Board of Supervisors.

Revenue Audits

The State of California does not audit the County's distribution of revenue to be received under the Plan. The City would be responsible for ensuring accurate payment of revenues due from delinquent property tax amounts. Additionally, there is no accompanying detailed report for payment of this revenue to participating jurisdictions. Reporting of these revenues is included in the same monthly report the County Auditor's Office provides the City for the payment of 1% property taxes. This is a limitation in reviewing the City's revenues.

County Administration of Property Tax Revenues

Individual County offices that administer, collect, distribute, or audit property taxes include the County Tax Collector/Treasurer, County Auditor and Controller, and County Assessor. Statewide, County offices follow the California Revenue and Taxation Code (R&TC). The R&TC specifically addresses when payments are considered delinquent (R&TC, section 2617), the amount of penalties and interest allowed, and dates for when different County offices should begin preparation and analysis of all information related to delinquent payments (section 2624). Secured delinquent properties greater than five years are subject to R&TC, which details the process for deeding the property to the State for sale to recover due amounts. Property owners have recourse to avoid deeding their property to the State according to provisions in R&TC, which allows property owners to create a payment plan with the County to pay back property taxes over time.

Other Findings

- Out of 18 cities in San Diego County, only three cities (Coronado, National City, and Vista) participate in the Teeter Plan.

- The County Auditor's Office confirmed that upon acceptance into the Plan, the City cannot leave the Plan.

CONCLUSION

Based on our research and communication with the County Auditor's Office, I do not recommend the City's participation in the Teeter Plan. Even though the City would receive 100% of property taxes *billed* (rather than *collected*), it would be financially disadvantageous to the City due to the revenue loss of $4.3 million from receivable delinquent tax penalties and interest as estimated by the County. The City would lose a revenue source in exchange for improved cash flow if it were to participate in the Teeter Plan. Since the City can manage the delay in the receipt of uncollected property tax revenue and receives interest and penalties on this amount, there is no fiscal basis for joining the Teeter Plan.

Mary Lewis
Chief Financial Officer

cc: Honorable Mayor Jerry Sanders
Jay M. Goldstone, Chief Operating Officer
Mark E. Leonard, Financial Management Director
Eduardo Luna, City Auditor
Andrea Tevlin, Independent Budget Analyst
Kevin Casey, Director of Council Affairs