



KENNETH MEJIA
CONTROLLER

January 24, 2024

Honorable Karen Bass, Mayor
Honorable Members of the Council of the City of Los Angeles
Community Members of the City of Los Angeles

As the Controller for the City of Los Angeles, our Office has the Charter responsibility to prepare and publish the City's Annual Comprehensive Financial Report (ACFR) of the City for the fiscal year ended June 30, 2023. I can report a year of strong revenue growth that contributed to record reserves on July 1, the beginning of the current fiscal year.

Unfortunately, it is also my responsibility to report the bad news: this year the City is spending well beyond our actual revenues. Projected deficits for years to come will force wrenching choices that threaten the vital services Angelenos rely on. This is not the result of a sudden economic downturn, but the culmination of years of short-term budget balancing at the cost of long-term fiscal sustainability.

The ACFR accounts for revenues and expenses for all the City's funds, including the Harbor, Airports, and Department of Water and Power and a snapshot of the fiscal condition of the City as it ended the fiscal year on June 30 of 2023.

- Total City revenues, including Governmental and Business-Type activities, were approximately \$21.6 billion, an 8.1 percent increase over FY 2021-22.
- Total City expenses, including Governmental and Business-Type activities, were approximately \$19.5 billion, a 17.8 percent increase over FY 2021-22.
- The aggregate fund balances of the City's governmental funds were \$8.6 billion, a net increase of \$1.2 billion from June 30, 2022.
- The assets and deferred outflows of resources of the City exceeded the liabilities and deferred inflows of resources at the close of Fiscal Year 2023 by \$30.6 billion (City's net position), an increase of \$2.0 billion over fiscal year 2022.
- The Reserve Fund balance began FY 2023-24 at a record-high \$648.3 million or 8.2 percent of the General Fund Budget, up from \$601.7 million at the beginning of Fiscal Year 2022-23.
- The City's bonded debt and long-term notes payable as of June 30, 2023, totaled \$39.2 billion, an increase of \$1.9 billion from the prior year's balance of \$37.3 billion.

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- The largest General Fund departmental expenditures (including encumbrances) went to Police (\$1.9 billion); Fire (\$845.6 million); and Sanitation (\$359.5 million).

As reported in our Preliminary Financial Report issued on October 18, 2023, which provided cash basis information on revenues, expenditures, reserves, and bonded indebtedness, including a comparison to the Adopted Budget, all City spending for all budgeted funds (including the General Fund) was \$1.2 billion below the level in the Adopted Budget. Special purpose funds accounted for nearly \$600 million of those savings, along with \$316 million in underspending on capital projects meaning the City was not spending what it was budgeting for which means less services, resources, and infrastructure were being provided for Angelenos.

The Preliminary Financial Report highlighted a number of key indicators:

- Major contributors to the strong revenue increase include Utility Users Tax revenue (\$93 million above budget) primarily from higher natural gas and electric prices; franchise income (\$53.7 million above); Transient Occupancy (Hotel) Tax \$46.8 million above; and Business Tax (\$38.9 million above).
- Some revenue sources fell below budget projections: Documentary Transfer Tax (\$77.3 million below); Licenses, Permits and Fines (\$40.8 million below); Parking Fines (\$21 million below); and Grant Receipts (\$15.6 million below).
- While staff vacancies resulted in \$118 million in savings among civilian employees, Police and Fire salaries were \$29 million over their budgeted amount. The overspending was attributed to increased overtime, unbudgeted salary payouts associated with agreements with sworn employee unions and excess sick payouts.
- Liability pay-outs of \$172.5 million exceeded budget by nearly 100%.

Grim news requires serious long-term solutions for the future

We've already seen the whiplash as the State of California has gone from a record-breaking surplus to a projected huge deficit next fiscal year. While not as dependent on volatile revenues as the State, the reality is that both the strong economic recovery from the pandemic and major Federal emergency aid are behind us. Not only has revenue growth slowed, it is falling far short of the optimistic projections contained in this year's adopted budget. Meanwhile, spending is exceeding expected levels. The estimates of the City Administrative Officer contained in his recent January statement point to a budget shortfall in excess of \$143 million to be addressed by a partial hiring freeze and tapping the City's Reserve Fund. The shortfall could swell to as much as \$400 million next year, according to the CAO.

Even as we look back on the positive results from the prior year, the warning signs were there:

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- As previously reported, despite widespread staff vacancies, General Fund departmental spending actually exceeded last year's adopted budget by nearly \$200 million. Had the vacancy rate been closer to normal, the budget would have been in the red.
- As our Office has consistently pointed out, citywide deferred maintenance of vital infrastructure requires urgent attention. Last year's underspending of \$316 million in budgeted capital expenditures underscores that the City continues to fall behind – which means even higher costs in the long run.
- Again, as we have warned, current staff shortages and long-term underinvestment in the training, technology, equipment and facilities for our workforce hobbles productivity and shortchanges our residents. The homelessness crisis and the reality of a changing climate put even further strain on City resources.

The contract for rank-and-file police staff ratified last fall will add nearly a billion dollars in additional costs over the next four years, with the likelihood of commensurate increases in compensation for police management. The new five-year contracts negotiated with civilian bargaining units will have an even larger budget impact, putting budget projections deeply in the red for the next five years.

Without a long-term approach to putting our fiscal house in order, short-term decisions will doom Los Angeles to an inexorable decline in public services, undermining our quality of life and the economic prospects of our residents.

Nothing short of a serious, strategic five-year plan to fix our City's finances can meet this moment. Scrambling every year to paper over budget gaps will result in ever-worsening political pain and economic hardships.

A transition to a two-year budget cycle would save enormous staff time, give greater opportunity for meaningful community participation, and allow for a more strategic approach to the City's Finances. The City also needs a transparent Capital Improvement Program beyond the current wish list of billions of dollars in unfunded projects. Participatory budgeting, expanded beyond its current experimental pilot, would offer greater citizen engagement in the City's fiscal health.

The City should also break with the opaque process where annual departmental budgets are simply marginally adjusted (up or down) without fundamentally altering the long-standing budgetary status quo. Given the daunting financial realities, the City needs to undertake a strategic reallocation of resources to what matters most to the long-term wellbeing of all of our residents. Budgets are not just numbers; they are a statement of values. As our city changes, so should our financial priorities.

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Our Office is eager to collaborate with the Mayor, Council, and greater community to reform the City's budgeting process and priorities. This must be a long-term commitment because the problems are long-standing and will require a phased approach to solving. Budget reform and more accountable stewardship of the public's resources are vital to minimize abrupt service cuts (which disproportionately hurt our most vulnerable) – especially if economic conditions deteriorate.

Los Angeles is a vibrant, dynamic center of one of the world's most diverse and influential regions. Our City has the potential to restore fiscal health, improve vital City services, and lead the world in confronting climate change, housing insecurity, and a changing economy. It would be tragically short-sighted not to tackle the City's fiscal challenges to capture that potential. We must put our City on the path to fiscal sustainability so we can do the job our residents expect us to do.

My staff and I appreciate the cooperation shown by City departments as we prepared this report. Should you have questions or require additional information, please contact my Director of Financial Analysis and Reporting, Rahoof Oyewole at rahoof.oyewole@lacity.org.

Respectfully submitted,



Kenneth Mejia (Jan 24, 2024 14:04 PST)

KENNETH MEJIA
L.A. Controller

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