Chula Vista’s Path to Financial Recovery, Using the GFOA’s 12-Step Process

BY MARIA KACHADOORIAN
The City of Chula Vista, California, grew by 47 percent (approximately 75,600 people) between 1998 and 2008, but everything changed with the recent downturn in the housing market. Since 2008, the city has experienced minimal increases in population and little demand for new development, creating a significant decline in development-related revenues and a decline in assessed values citywide (see Exhibit 1). At the same time, the city experienced additional fiscal stress from several sources: expenditure increases and revenue losses when a local power plant closed, State of California revenue takeaways, rising pension costs, and generous long-term labor contracts. In addition, a class action lawsuit challenged the city’s ability to collect the tax from wireless customers, creating uncertainty about the future of the city’s telecommunications utility tax revenues. On the bright side, the dam did not break and wash away the town — but Chula Vista has experienced significant fiscal stress in recent years, and it needed to find a path to recovery.

After the economic downturn started in December 2007, the city implemented several budget balancing plans in an effort to keep expenditures in line with revenues. The incremental economic declines necessitated mid-year budget reductions to avoid deficit spending, and in all, the city’s general fund operating budget went from $170 million to $125 million, a 26 percent reduction over five years.

By 2011, the city had already cut 330 permanent positions, representing 36 percent of its workforce, but more cuts were needed to achieve a structurally balanced budget. The time was right to assess the damage and to implement fiscal reforms based on lessons learned — in other words, the city wasn’t going to let a good crisis go to waste. But in this era of economic uncertainty, Chula Vista had to proceed with caution.

ONE STEP AT A TIME

In 2010, the Government Finance Officers Association developed a 12-step financial recovery process, including a road map that outlines each step, providing guidance to organizations going through financial distress and explaining methods for moving beyond financial sustainability to financial resiliency. The City of Chula Vista used this process to guide it through some of the most difficult financial challenges in its 100-year history.

The 12-step financial recovery process identifies three major stages:

- The bridge stage covers short-term retrenchment (fiscal first aid) tactics that jurisdictions can use to stabilize their financial condition. The bridge stage concludes with the development of a short-term recovery plan.
- In the reform stage, a jurisdiction carries out the recovery plan and further develops and implements long-term recovery strategies.
- The transformation stage institutionalizes long-term financial planning, with the goal of becoming more adaptable to changing conditions, more resistant to financial distress, and better able to regenerate in the face of setbacks. (A full discussion on the GFOA 12-step model can be found on the GFOA’s website at www.gfoa.org.)

**Step 1: Recognition.** The first step in moving toward resolving any problem is acknowledging that a problem exists. In 2007, Chula Vista fell into fiscal crisis denial, even though its quarterly financial reports identified significant issues with development-related permit revenues, which had dropped by 68 percent. Other economic indicators were also telling the city that there was a problem. Unfortunately, after years of healthy revenue increases and a booming building environment, the city was not ready to accept that it was entering a period of significant slowdowns in development. The disconnect between the reality of the financial indicators and development projections resulted in general fund operating reserves falling to $10.3 million, from $14.9 million, by the end of 2007. Reserves fell to 6.1 percent, less than the 8 percent reserve policy, and as a result, Standard & Poor’s downgraded the city’s credit rating from A to A-1. The time to take action in a timely manner had passed.
**Step 2: Mobilize.** Once the city got past the denial and finger pointing stage, it focused on avoiding further deterioration in the city’s fiscal health. A team was created to implement changes, but significant changes in city leadership meant that acceptance of the team evolved over time. From 2006 to 2009, the city had five city managers — with different approaches to budget development and varying degrees of experience in managing a city through a financial crisis — making it difficult to solidify the team structure and present a balancing plan that could be implemented citywide.

**Step 3: Generic Treatments.** Initially, the city used generic treatments such as reduced hourly staffing, a hiring freeze, centralized review of all expenditures, and delays in general fund capital projects. The goal was to minimize the effects on the community as much as possible without further affecting the reserves. Generic treatments helped the city regain its fiscal footing but, because of the delayed response, significant citywide cuts were required in a very short period of time.

**Step 4: Initial Diagnosis.** An initial diagnosis is needed to determine the most appropriate actions for bringing the budget back into balance. In a 2005 attempt to focus more on long-term financial planning, the city began using a software forecasting model, after consulting with the City of San Clemente, California, which had been through some tough financial challenges years earlier. The goal was to identify financial challenges as early as possible so the city would be able to take steps allowing it to avoid a financial crisis that would result in service-level impacts. The initial five-year forecast created in 2005 did identify that the city was headed for some challenges, even if the economy continued at a positive pace. It was difficult to promote fiscal conservatism, however, when the city still believed it could build its way out of any budgetary deficit — and as a result, Chula Vista was not prepared when the economic downturn affected all major revenue streams. The city struggled to take action or develop a contingency plan that the executive team would support, but this group felt that it had no role in the decision-making process, further delaying the necessary budgetary adjustments.

The months spent building internal support, which involved detailed discussions and further analysis, had a significant effect on the city’s general fund, which absorbed development-related expenditures that were no longer being offset by development-related revenues. Including development activity within the general fund made it difficult to identify changes in housing market trends and demand for development services in a timely manner, and a development services enterprise fund was created, improving the city's ability to quickly identify these types of budgetary variations. During this period of budget cuts, the development services department budget was reduced by approximately 34 percent, consistent with the downturn in the housing and development market.

**Step 5: Fiscal First Aid.** This step involves taking action to stop the bleeding and provide immediate relief. These actions are meant to stabilize the situation; they are not necessarily going to be the permanent solution or address the root cause of the problem. The 12-step model discusses a number of potential treatments, categorized as primary treatments, treatments to use only with caution, treatments to use only with extreme caution, or treatments that are not advised.

The City of Chula Vista made use of various treatments from the first three categories, based on the severity of the crisis. By 2011, the city had already cut 330 permanent positions, representing 36 percent of its workforce, but more cuts were needed to achieve a structurally balanced budget. The time was right to assess the damage and to implement fiscal reforms based on lessons learned. Some of the actions the city took to stabilize the organization and avoid deficit spending included:

- Making organizational changes that reduced executive positions by 46 percent.
- Divesting non-core programs such as after-school activities, which were put back under control of the elementary and middle schools.
- Outsourcing fire dispatch services.
- Reducing operating hours at all recreation and library facilities.
- Offering early retirement incentives.
Eliminating or deferring scheduled compensation increases.

Eliminating vacant positions to avoid layoffs wherever possible (which caused a workload imbalance in departments that experienced greater turnover).

Transferring the budget function from the city manager’s office to the finance department.

Making across-the-board cuts to all departments.

As the economy continued to decline, the city found itself implementing fiscal first aid tactics for several years to balance the budget. Many of the changes implemented during this time should have been made years before, as part of managing the city in an efficient manner, but they weren’t accepted until the fiscal pressures occurred. Eventually, as the budget crisis continued, the reductions began hitting the city’s core services and affecting the maintenance of facilities, which, if not addressed, could create additional financial challenges to the city in future years.

**Step 6: Detailed Diagnosis.** By 2012, the adjustments needed to keep the budget in balance became less severe. At this point, the city began a detailed diagnosis of the causes of financial distress. This step was critical if the city was to avoid a repeat of the recent cuts. The GFOA’s 12-step process discusses two elements that should be considered at this stage: political and economic/technical, both of which include internal and external components. The City of Chula Vista identified several areas to address within these categories. The political environment made some changes more difficult to implement than others, but the time had come to improve the budget development process, expand the five-year financial forecast and fiscal analysis included in City Council agenda statements, develop a citywide strategic plan, support manageable retirement benefits, develop a fiscally responsible compensation plan, improve political cooperation, and focus on long-term financial planning.

**Step 7: Recovery Plan.** The recovery plan sets forth strategies that can be used to achieve financial resiliency. Chula Vista started developing a recovery plan in late 2011, and one of the most significant outcomes was the government-wide acceptance that a cultural shift was necessary. The organization accepted that priorities would need to be identified to ensure that resources were being used efficiently and effectively. The recovery plan shone a light on the areas where financial risk continued, making the situation clear to the entire organization, not just to the finance staff. The cultural shift toward becoming a fiscally conservative city with clear priorities is not yet complete; it will require further commitment from the political leadership, management, and employees. And it is especially important because the city’s financial standing remains fragile.

**Step 8: Long-Term Treatments.** One of the long-term treatments the city implemented was pension reform. Existing employees were required to pay their share of their pension cost, and a second pension tier was created for new employees. In addition, retiree health-care subsidies were eliminated for new hires. Seeking ways to eliminate waste in the city’s processes, it also implemented the City NOW continuous improvement program. Other areas the city is working on include moving toward a priority-based budget that identifies the most important strategic priorities and aligns services and revenue allocations. In addition, the city is working to contain personnel costs by developing a quality workforce program that discusses goals for wages that are tied to economic indicators.
Step 9: Long-Term Financial Planning. Chula Vista is currently working on expanding its recovery plan into a long-term financial plan. One of the challenges a growing city faces is that the timing of new revenues do not always align with the demand for services caused by new development. This has happened in the past, and may happen again in the near future. The city is committed to continuing with its long-term financial plan, which will include planning for the variations in the housing market and the timing of service demands that come along with increases in population. This might require setting aside funds to address the highs and lows in revenues that will be needed to fund additional police, fire, and park maintenance services — which will not be an easy task, given the mounting pressures to reinstate service levels, address compensation cuts or deferrals, and fund maintenance deferrals after years of budgetary constraints.

Step 10: Recovery Leadership. Implementing any significant organizational change requires strong leadership. The executive team is committed to moving the city toward financial resiliency. The executive team is involved in all meetings about contingency plans, and with improved communication and new financial reports, it receives better information about the city’s finances than it did in the past. The City Council is also taking a leadership role in the city’s financial recovery. The full transition will take time and require the continued commitment from all city leaders.

Step 11: Manage the Recovery Process. As the city begins to recover, there will be a temptation to return to past practices and stop making difficult choices. Chula Vista has recently allocated anticipated resources to restoring programs, increasing compensation, increasing operating hours at library and recreation facilities, and increasing funding for public safety, all based on the assumption that the economy will continue to recover at levels greater than assumed in the five-year forecast. The difference today is that policy discussions are occurring in a transparent manner, and the potential effects are presented through improved financial reporting and analysis. Decision makers understand that these policy decisions can put the city back into a fiscal relapse that could require additional adjustments going forward. To help manage the recovery process, the city has developed a fiscal recovery and progress plan team that meets monthly to continue addressing the challenges that face the city. Team members come from throughout the organization.

Step 12: The Outcome of Recovery. The GFOA’s 12-step process discusses three possible outcomes of recovery. The first is the most desirable: financial resiliency, where a government has achieved financial stability and implemented strategies, control mechanisms, budget techniques, and early warning systems to make sure it can withstand future financial shocks. The second outcome is financial sustainability, where an organization has achieved a structurally balanced budget but has not adopted the institutional practices necessary to withstand future shocks. A sustainable system is balanced but could fall back into distress. The final outcome is relapse, where a city falls back into fiscal crisis because of a new economic downturn or decisions that continue to strain the city’s finances.\(^2\)

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About the City

The City of Chula Vista, California, is located at the center of one of the richest cultural, economic and environmentally diverse zones in the United States. It is the second-largest City in San Diego County, with a population of nearly 250,000. Chula Vista boasts more than 50 square miles of coastal landscape, canyons, rolling hills, mountains, and a variety of natural resources and quality infrastructure. The city lives up to its name (Chula Vista means “beautiful view”), with great year-round weather, miles of trails, coastline, mountains and open space.
Chula Vista’s goal is to achieve financial resiliency, particularly regarding the risks associated with a growing city. Identifying this goal has prompted the management group to have the conversations needed to begin the process of influencing policy decisions. The city’s goal of achieving financial resiliency will not happen overnight, particularly with the severity of the budgetary cuts taken over the past few years.

**ARE WE THERE YET?**

Today, the City of Chula Vista is somewhere between financial sustainability and relapse. Although the housing market is showing signs of recovery, the city’s overall local economy remains fragile — although it has recently experienced some positive results. In the past few years, the City Council supported a revised reserve policy, increasing the goal from 8 percent to 15 percent. The added focus on reserves helped the city manage its way through the recent recession without further affecting the operating reserves. In fact, the city’s operating reserves increased slightly, from $10.3 million to $13.9 million — from 6.1 percent to 11 percent — resulting in a credit ratings increase, from A- back to A.

With the leadership of the City Council and the cooperation of the city’s bargaining groups, Chula Vista was also able to make other needed changes: implementing full pension reform, eliminating the retiree health-care subsidy for new hires, eliminating or deferring negotiated salary increases, paying off some outstanding pension obligation bonds, and refinancing other debt for savings. These steps made it possible for the city to get through severe financial distress unlike anything seen in its 100-year history.

But Chula Vista is not done yet. In this new world of economic uncertainty, the city needs to proceed with caution and continue taking steps toward increased financial sustainability. Assuming the bottom has been reached in this economic crisis, the city must move beyond immediate fiscal crisis and begin addressing “high risk” areas in order to avoid a relapse back into fiscal crisis. The GFOA 12-step process helped Chula Vista identify the components of financial stability that the city has successfully addressed, but some of the challenges, such as unfunded pension liabilities and infrastructure maintenance and replacement needs, will require long-term strategic measures that the city will continue to tackle through a long-term financial plan.

**CONCLUSIONS**

Chula Vista is truly at a crossroads. It can either continue down the path toward financial resiliency — which is critical because of the continued focus on development and major projects — or it can head in the direction of continual fiscal crisis. Implementing changes to an organization and its management practices takes strong leadership and unrelenting focus on the long-term goal. The city is just starting to build a strong foundation to support a long-term financial plan. The true test will be if the city can continue to make prudent fiscal decisions without the pressures of a fiscal crisis. As tough as it was to implement budget cuts and affect service levels to the community, the city really had no choice. The 12-step process helped Chula Vista assess the necessary steps to manage its way through a severe fiscal crisis, but more important, the process has helped place the city on the road toward financial resiliency. Whether Chula Vista stays on the right path will be determined in time, but there is no doubt that using the GFOA 12-step recovery process has put it in a better position to do so.  

**Notes**

2. Ibid.

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