

# **GUADALUPE SHELL GAME MUST END**

## **SUMMARY**

The 2014-15 Santa Barbara County Grand Jury (Jury) received numerous requests to investigate the financial condition of the City of Guadalupe (City). Three previous Juries have looked into similar issues in Guadalupe. In May 2003 the Jury found “A city in turmoil”, troubled by “...unrest amongst various factions of local citizens and elected officials...”, and faced with “....declining budgetary resources.” In June 2006 the Jury noted that “...little if anything had changed.”

In the Grand Jury report dated March 2008, the Jury followed up and found reason for optimism: “...positive changes.....including a city council working together...” with goals to increase employment, housing, tourist activities and revenue for the city. However, the 2008 City Council (Council) was not successful and the current investigation of 2008 financial reports show continuing patterns of inappropriate financial actions during that period.

Clearly, Guadalupe continues to be a city in trouble, caused by over 12 years of repeated financial mismanagement, improper transfers of money from restricted funds to the General Fund, years of deficit spending, uninquisitive and undertrained city council members, and overworked employees, many of whom have or had little training or background for their positions.

Based on its investigation in 2014-15, this Jury has concluded that Guadalupe continues to have ongoing financial problems that are not easily solved because of insufficient General Fund revenue to pay for its day-to-day operations. It is a continual shell game, moving money from one account to another to keep the City afloat.

## **INTRODUCTION**

The City of Guadalupe (City) was founded in 1840 adjacent to the sand dunes that lead to the Pacific Ocean. The City was incorporated in 1946 when the main north/south route through central California was Highway 1, which runs right through town. US Highway 101, built approximately 10 miles to the east of Guadalupe through the City of Santa Maria, has isolated the City, stifling economic development and causing economic decline. In 2013, the population of Guadalupe was 7,225. The City is a general law city governed by an elected City Council, with a mayor and four council members. Guadalupe has 47 full and part-time employees, including a City Administrator, a Finance Director, a part-time Human Resources Director, and a Director of Public Safety.

The median home value is approximately \$285,000, the lowest of all cities in Santa Barbara County. The community is largely agricultural, with an average per capita income of approximately \$22,000. Approximately 25 percent of the City’s General Fund revenue comes from property taxes.

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In 2013, Guadalupe's per capita sales tax revenue was \$44, compared to the average of all Santa Barbara County cities of \$224, and an overall average for the county, including unincorporated areas, of \$150 per capita. There are no supermarkets, (although there is a small local market) and very few retail or eating establishments, and thus very little sales tax revenue for the General Fund. Approximately six percent of the City's General Fund revenue comes from sales tax.

There are no hotels in Guadalupe, and therefore no Transient Occupancy Tax (bed tax) revenues for the General Fund.

Over the summer of 2014, the Jury received numerous requests to investigate alleged inappropriate transfers from restricted funds to the City's General Fund. In the course of the Jury's investigation, evidence of inappropriate transfers was indeed found, as well as several other significant issues.

### **METHODOLOGY**

The Jury's investigation consisted of interviews with elected officials as well as current and former city staff. The Jury also visited the City of Guadalupe and reviewed hundreds of pages of City Council meeting minutes, audited financial statements, expense registers, reports from outside consultants, applicable rules and regulations, and additional information provided by Council and City staff.

### **OBSERVATIONS**

Over the past 12 years or more, Guadalupe's elected and reelected leaders (see Appendix A) have neither requested nor been given the necessary training to effectively execute their respective offices. The Council has sometimes relied, without serious inquiry, on unqualified,<sup>1</sup> incompetent and/or overworked staff. In some cases, staff deceptively failed to inform the Council of financial issues. More detailed information may be found in previous Grand Jury reports.<sup>2</sup> The City's auditors have repeatedly called attention to miscoding, misallocation, questionable fund transfers and year-end closing issues.

The audit reports for 2012 and 2013 questioned whether or not the City can "continue as a going concern." The June 30, 2013 audit Note 17: Going Concern, states "The consistency of key revenue sources still remains unproven. The General Fund must experience the reversed trend over the long-term in order to be considered permanently solvent. This set of circumstances has raised substantial doubt about the City's ability to continue as a going concern."<sup>3</sup> Previous annual audits of the now defunct City of Guadalupe Redevelopment Agency included the same concern.

The Jury also doubts that, fiscally, the City of Guadalupe can continue "as a going concern." Since 2002 the Jury repeatedly found the City operated in a fiscally irresponsible manner.<sup>4</sup> This Jury estimates that

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<sup>1</sup> 2005-06 Santa Barbara County Grand Jury Report [www.sbcgj.org](http://www.sbcgj.org)

<sup>2</sup> 2002-03, 2005-06, 2007-08 Santa Barbara County Grand Jury Reports

<sup>3</sup> 2012 and 2013 Audit Reports City of Guadalupe and Guadalupe Redevelopment Agency

<sup>4</sup> 2002-03, 2005-06, 2007-08 Santa Barbara County Grand Jury Reports

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over the past 12 years, the City's General Fund revenues have cumulatively fallen short of operating expenses by approximately \$7,600,000 (see Table 1). The City inappropriately transferred this amount from restricted funds to the General Fund, over and above the reasonable allocations allowed by Generally Accepted Accounting Principles, without written loan and repayment agreements. Due to the fact that restricted funds have been used in this manner, these funds are now in fiscal difficulty, and in some cases rate increases have been implemented to pay for negative balances in said funds. Based on the fact that inappropriate transfers averaging over \$630,000 annually have been made, it is clear that the City's General Fund revenues do not provide enough money to pay for day-to-day operations in Guadalupe.

Table 1.  
Actual and Estimated Excess City of Guadalupe Interfund Transfers

<b>Fiscal Year</b>	<b>Expenses of Overhead Depts.*</b>	<b>Appropriate Interfund Transfer for Allocation**</b>	<b>Actual Interfund Transfer***</b>	<b>Excess of Actual over Appropriate Interfund Transfer</b>
2002-03	\$725,067	\$471,294	\$847,471	\$376,177
2003-04	\$609,290	\$396,039	\$838,780	\$442,742
2004-05	\$722,960	\$469,924	\$934,552	\$464,628
2005-06	\$710,631	\$461,910	\$918,276	\$456,366
2006-07	\$739,678	\$480,791	\$1,237,840	\$757,049
2007-08	\$940,715	\$611,465	\$1,511,940	\$900,475
2008-09	\$843,429	\$548,229	\$1,561,400	\$1,013,171
2009-10	\$871,668	\$566,584	\$1,669,944	\$1,103,360
2010-11	\$793,371	\$515,691	\$1,533,923	\$1,018,232
2011-12	\$850,657	\$552,927	\$1,242,561	\$689,634
2012-13	\$930,615	\$604,900	\$923,586	\$318,686
2013-14	\$914,400	\$594,360	\$660,000	\$65,640
<b><u>12 Year Cumulative Budget Deficits - Total</u></b>				<b>\$7,606,160</b>
<p>*Includes City Council, Administration, City Attorney, and Finance Departments.  **65% of total overhead given by City of Guadalupe  ***Source – City of Guadalupe</p>				

The Jury found the following examples of misfeasance during this investigation:

- Elected Officials Essentially Received no Training When First Assuming Office
- Inexperienced and Unqualified Staff
- 82 Mishandled and Misfiled IRS W2 Forms
- Solid Waste Fund Inappropriate Accounting Practices
- Inappropriate Interfund Transfers
- Inappropriate use of State Gas Tax Funds
- Failure to Meet the Minimum Spending Obligation for Street Repairs under Measures A and D
- Wastewater Fund Deficit
- Additional Debt/Loans

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### **Inadequate Training**

Each member of the City Council the Jury interviewed confirmed that, with the exception of a short introduction to Brown Act requirements, they received essentially no training when first assuming office. Nor did they ask for any training. Similarly, several past employees said that they had basically been thrown into the job and told to learn as they went along. Many of the issues identified by the Jury and listed above stem from this lack of knowledge and training. The Jury learned that, prior to 2012, there was no adequate financial reporting to the Council in open session, and the City accounting processes did not follow Generally Accepted Accounting Principles.

Member after member of the Council confirmed that they didn't really understand the financial reports they routinely received, that they relied on the staff's reassurance that everything was being handled properly. Year after year, the Council voted to accept budgets presented by staff without much questioning. Many council members appeared uncomfortable with the whole subject of financials and budgets.

### **Inexperienced and Unqualified Staff**

A 2007-08 Grand Jury report found that a finance director for the City had been hired who "did not know how to balance the books." A former City Administrator told the current Jury his predecessor had no government experience and that a Human Relations employee was hired who had no Human Relations experience. In reaction to the revelation to the City Council of a long-standing deficit in the solid waste fund, a former Mayor was quoted as saying, "Sadly, you are in this position because former staff have not done their jobs." The former Mayor added, "Quite frankly, to have a negative balance for 13 years, starting in 2001, having an audit comment since 2005 and having no recommendations to the Councils to do anything about it, is really pretty inexcusable."<sup>5</sup> It should be noted that audits were provided to the City Councils and there is no indication that members of these councils ever inquired into the noted deficits.

### **Mishandled and Misfiled W2 Forms**

In 2006, 41 Internal Revenue Service (IRS) W2 forms were incompetently filed with errors by City staff. In an attempt to correct the initial errors, an additional 41 forms were filed with errors, compounding the problem. Although the City was apparently notified by the IRS of the tax errors in July, 2009, the Jury has no evidence that staff at that time informed the City Council. Over subsequent years escalating penalties were levied by the IRS. The IRS is now attempting to collect over \$456,000 in taxes, interest and penalties. The City recently hired a consultant, at additional cost to the City, to resolve this matter with the IRS.

### **Solid Waste Fund Inappropriate Accounting Practices**

The City contracts with a vendor for solid waste collection. The City bills and collects for this service without compensation and remits payments to the vendor, in accordance with the contract. The Solid Waste Fund has been running a deficit for a number of years because it has been paying more to the contractor than it has collected from the customers. The vendor charges the City for 180 more customers than the City bills, at a \$4,000 per month loss. "This inappropriate practice is largely responsible for the

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<sup>5</sup> Noozhawk.com 12/11/2014 "New City Council in Guadalupe Deals with Old Financial Woes"  
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\$240,100 negative financial position in this fund: stated simply, the City has remitted more to the vendor than it has collected.”<sup>6</sup> A rate increase has been approved to cover the negative fund balance by June 30, 2020. The City intends to begin negotiations with the vendor to do its own billing and free the City of the billing tasks and costs.

### **Inappropriate Interfund Transfers**

The City’s many years of inappropriate transfers of restricted funds to the General Fund were revealed in 2014 (see Appendix B). Cities maintain certain funds earmarked (restricted) for specific purposes; so-called “special funds” and/or “enterprise funds”. The inappropriate transfers of restricted funds included money from the State Gas Tax and County Measure A and also money intended for lighting, solid waste, water, and waste water treatment funds.

Generally Accepted Accounting Principles allow a city to allocate a “reasonable” portion of its general overhead to the special funds, in acknowledgment of the personnel time required to administer the funds. The amount allocated should be based on a documented cost allocation plan. In a larger city, the percentage of general personnel time and compensation (or “overhead”) charged to special funds might be 10-15 percent (or less) of the total overhead. In Guadalupe, because it is a comparatively small city, with the City Administrator also supervising several departments, the reasonable allocation percentage should be approximately 65 percent, which was publicly acknowledged by current City officials.

However, over the past 12 years, Guadalupe has allocated between 99 percent and 193 percent of overhead cost to the General Fund from the special funds (see Appendix B). For example, in fiscal year 2010-11, overhead expenses for Guadalupe totaled \$793,371. But \$1,533,923 was billed as “overhead allocation” to the various special funds administered by the City for an allocation percentage of 193 percent.

Over the past 12 years, the Jury estimates that these inappropriate transfers totaled over \$7.6 million (see Table 1). These funds should have been spent on specific projects for which the money was collected such as repairing streets and other infrastructure, and building a reserve to handle emergencies. The money was instead inappropriately diverted to the General Fund to pay for various City operations such as police, fire, City Council, administration, City Attorney, Parks and Recreation, building maintenance, permits, and Finance.

The Guadalupe City Council has, for over 12 years, been using these General Fund overhead allocations as a way to cover ongoing budget deficits. These interfund transfers could have been appropriate if the City had put in place loan agreements with repayment schedules, and the City Council had approved them by resolution. Witness after witness confirmed that no such agreements exist and the City Council never approved such loans.

The current City Administration recognizes the need to follow Generally Accepted Accounting Principles. On November 25, 2014 the Guadalupe City Council unanimously approved a \$575,000 loan to the General Fund from the Water Enterprise Fund and the Lighting District to cover the projected General Fund deficit for fiscal years 2013-2014 and 2014-2015. This action was taken by resolution and

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<sup>6</sup> Financial Assessment Memorandum, William C. Statler, August 18, 2014  
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included a 10 year repayment schedule.

### **Inappropriate use of State Gas Tax Funds**

Guadalupe has, on multiple occasions, used State Gas Tax funds for purposes other than those expressly allowed by Section 330, page 3, Table 1 of the “Guidelines Relating to Gas Tax Expenditures for Cities and Counties”, published by the California State Controller's Office in 2004. Over the last 12 years, the City has transferred funds which exceeded the amount allowed from state gas tax funds to the General Fund (see Appendix B), which is expressly prohibited by Article XIX of the California Constitution.

Also from the Gas Tax guidelines, allocations of overhead “...will only be allowed via an approved cost allocation plan or an equitable and auditable distribution of overhead to all departments.” Until just recently, the City had neither a Council approved cost allocation plan, nor an equitable distribution of overhead to all departments. Loans from Gas Tax Funds can be made to a General Fund, but they must be repaid during the same fiscal year that the loan was made.

### **Failure to Meet the Spending Obligations for Street Repairs**

Guadalupe did not meet the minimum Maintenance of Effort obligation on street repairs to continue to qualify for county Measure D (subsequently replaced by Measure A) funding,<sup>7</sup> which resulted in a temporary suspension of Measure D funding during April to June, 2010.

### **Wastewater Fund Deficit**

The City of Guadalupe has been described to the Jury as a City that operates on a day-to-day basis from one emergency to another. The City has no reserve funds for emergency repairs or capital improvements to the infrastructure. The fiscal effect of operating the City in this way was seen on October 29, 2013, with the failure of a main sewer line. The construction was completed on August 15, 2014 at a cost of \$540,000. The entire expense was unbudgeted and the Wastewater Enterprise Fund was left with a negative cash balance of \$610,000.

Contributing to the mounting deficit in the Wastewater Enterprise Fund are loan repayments the City must make to the State. This money was borrowed from the Bond Refinance Fund of the former Redevelopment Agency (RDA) in August 2006 to fund wastewater improvements in the City. According to a City Staff Report in the agenda of December 9, 2014, staff reported being denied loans by three different local banks, “undoubtedly a result of the 2012 and 2013 audit findings which questioned whether the City was a ‘going financial concern’ plus the General Fund deficiencies discovered by staff this year.”

The negative cash balance would have grown to \$710,000 by June 30, 2015, without a rate increase. The City has implemented a 30 percent wastewater rate increase. Even with this rate increase, it will take three and one half years to eliminate the negative cash balance.

The wastewater rate increase should return the cash balance of the wastewater fund to the positive by December 31, 2020. At that time there will still be no reserve funds to pay for the estimated \$4.7 million

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<sup>7</sup> Feb 17, 2011 Santa Barbara County Association of Governments staff report,  
<http://meetings.sbcag.org/Meetings/SBCAG/2011/02%20Feb/Item%206A%20Guadalupe%20MOE.pdf>

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in existing wastewater infrastructure deficiencies, let alone the additional \$6.2 million in long term capital improvements that were identified in the Wastewater Master Plan, presented to City Council on October 28, 2014.

### **Long-Term Debt/Loans**

The Independent Auditor's Report Financial Statement for the fiscal year ended June 30, 2013, specifically in Note 6: Long Term Liabilities, indicates the City has several debt service payments due on Certificates of Participation (COP) issued by the City as far back as 2000 with payments continuing, in one case, to 2042. In December 2000, a COP of \$1.4 million was issued for water and sewer line replacement. Principal and interest payments average approximately \$77,500 each year to 2038 and then a lesser amount until 2042. A second COP was issued in July 2005 for \$1.2 million for water tank construction and upgrades. Principal and interest payments on this COP average approximately \$71,500 each year to 2033.

Other significant long-term debt includes repayment of two loans from the RDA, which was dissolved and replaced by the Successor Agency Trust Fund, for an August 2006 loan of \$1 million to construct the wastewater treatment plant (WWTP) and a June 2002 loan for \$167,629 to eliminate the deficit of the solid waste fund. Payments on these two loans will increase from \$30,000 in 2014 to \$170,000 in 2015 and continue at this level to 2018.

Also, Supplemental Educational Revenue Augmentation Fund (SERAF) loans provided funds on four occasions totaling \$438,988. These funds went to the Affordable Housing Fund to pay for the Lantern Hotel project. Funds are being repaid to the California Department of Finance.

The Table 2 below summarizes the loan type and annual payments on long-term debt already encumbered by the City of Guadalupe.

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Table 2.  
City of Guadalupe Long-Term Debt

<b>Type of Loan / Year</b>	<b>Reason for Loan</b>	<b>Total Amount</b>	<b>Annual Payments</b>	<b>Last Loan Payment</b>
<b>COP/ 2000</b>	Water & Sewer Line Replacement	\$1.4 M	~ \$77,500	2042
<b>COP/ 2005</b>	Water Tank Construction & Upgrades	\$1.2 M	~ \$71,500	2033
<b>From RDA 2002 &amp; 2006</b>	Solid Waste Fund Deficit & WWTP construction	\$1.2 M	\$30,000 ~ \$170,000	2014 2015 to 2020
<b>Sewer Bonds 1971 &amp; 1978</b>			~ \$16,500	2019
<b>SERAF 2010-11</b>	Affordable Housing	\$438,988	\$28,902 \$14,451	2014-2019 2038
<b>Lighting District &amp; Water Fund 2014</b>	General Fund Deficit	\$575 K	Year 1 , \$14,375 escalating to \$100,625 in 2024	2024

### **Is There a Silver Lining for the City of Guadalupe?**

#### **Outside Consultant Advice**

In June 2014, a consultant was hired to perform a “high level” assessment of the City’s finances. The financial consultant provided a road map to put the City’s finances on the straight and narrow. The City Council, upon recommendation of administrative staff, has moved to implement many changes.

The consultant noted interfund transfers for 2013-14 and 2014-15 were sharply reduced by the City to conform to Generally Accepted Accounting Principles. However, this created a General Fund budget deficit of \$557,000 for these two years. He recommended the City Council approve a loan from the enterprise funds to the General Fund to be repaid over a 10-year period to cover this deficit. The Council has followed this advice and approved loans from the water and lighting districts with a repayment schedule.

The Guadalupe City Council has formed an audit committee as recommended by the consultant. It has also implemented rate increases for solid waste and wastewater services. It intends to negotiate with the solid waste collection vendor to turn over billing and collections to the vendor. However, it should be kept in mind that there is no assurance the negotiations with the solid waste vendor will be successful. These changes are not being implemented to build up the City’s financial reserves, rather they will only cover current budgetary deficits that accumulated over many years of running the City of Guadalupe with

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insufficient revenue.

### **Ballot Measures V, W, and X**

In November 2014, the voters of the City passed three ballot measures (Measures V, W, and X) that, when fully implemented, are projected to add approximately \$300,000 in annual revenue to the City's General Fund. This only covers about one-half of the \$630,000 average annual deficit. The outside consultant estimated that funds from the three measures, along with the \$575,000 interfund loan and minimal increases in property and sales taxes, will result in a "structurally balanced" budget in FY 2015-16, when all three measures will be in full effect. This means revenues will equal expenditures. The consultant made no predictions on the possibility of a "structurally balanced" budget beyond FY 2015-16.

The increased revenue from the three tax measures allows the city to limp along with day-to-day operations. It is not enough to provide funding for essential changes to city operations such as building up a reserve fund for emergencies, repairing or maintaining aging infrastructure, needed capital improvements, restoring salary or benefits to employees who have agreed to furloughs and salary cuts, or adding staff.

### **DJ Farms Development Project**

In 1993, a plan was proposed to build 980 homes on the southeast corner of the intersection of Highway 1 and 166 in Guadalupe. In 2006, a revised 800 unit housing development commonly referred to as DJ Farms (now renamed Pasadera) was proposed. The Jury was told by the project developer that ground breaking on the first 150 units would occur in January 2015. Ground was actually broken in March 2015. Plans are for 20 units to be ready for sale by September 2015. The developer anticipates these will be sold within six months. The remaining homes are expected to be brought to market at the rate of six homes per month. Full build out of the DJ Farms project has been estimated to take 10 to 15 years.

The developer assumes an average selling price of \$300,000. If the 150 homes are built as anticipated by the developer by July 2017, this would yield a property tax to the General Fund of \$75,929. Refer to Table 3 below for details. The average yearly General Fund deficit is \$630,000 of which the recently approved Measures (V, W, & X) will cover only \$300,000. The DJ Farms property tax revenue will only partially offset General Fund deficit of \$330,000 leaving a deficit of \$254,071.

Even assuming the above very favorable scenario, the General Fund deficits will continue until at least 2024. During that period the deficits will likely require additional interfund loans which will increase the General Fund yearly loan payments, adding to the deficit.

The front 18 acres of the project are reserved for commercial development and there has been interest from supermarket chains and fast food companies. This could increase sales tax revenue. The developer speculates this will not happen until the first 150 to 200 homes are built. However, major national and regional retailers look for a certain customer base before moving into an area. This is estimated at a minimum population of 10,000 within the immediate geographic area. The additional population DJ Farms would bring, at full build out in 2026 or later, would barely satisfy this requirement.

The City of Guadalupe's reliance on the vagaries of the residential and/or commercial real estate market

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to eliminate ongoing General Fund deficits is ill advised. Hope is not a strategy.

The Jury must conclude that a Silver Lining is an illusion.

**Table 3.**  
Guadalupe DJ Farms Property Tax Impacts to General Fund

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Homes/ Year	Homes Total	Gen Fund Prop Tax Revenue Total/yr*	Gen Fund Deficit*4,5,6
2015			Start						20	6	6	6	38	38	\$ 19,235	(\$310,765)
2016	6	6	6	6	6	6	6	6	6	6	6	6	72	110	\$ 55,682	(\$274,318)
2017	6	6	6	6	6	6	4						40	150	\$ 75,929	(\$254,071)
2017							2	6	6	6	6	6	32	182	\$ 92,128	(\$237,872)
2018	6	6	6	6	6	6	6	6	6	6	6	6	72	254	\$ 128,574	(\$201,426)
2019	6	6	6	6	6	6	6	6	6	6	6	6	72	326	\$ 165,020	(\$164,980)
2020	6	6	6	6	6	6	6	6	6	6	6	6	72	398	\$ 201,466	(\$128,534)
2021	6	6	6	6	6	6	6	6	6	6	6	6	72	470	\$ 237,912	(\$92,088)
2022	6	6	6	6	6	6	6	6	6	6	6	6	72	542	\$ 274,358	(\$55,642)
2023	6	6	6	6	6	6	6	6	6	6	6	6	72	614	\$ 310,804	(\$19,196)
2024	6	6	6	6	6	6	6	6	6	6	6	6	72	686	\$ 347,251	\$17,251
2025	6	6	6	6	6	6	6	6	6	6	6	6	72	758	\$ 383,697	\$53,697
2026	6	6	6	6	6	6	6	2					44	802	\$ 405,969	\$75,969

\* - Calculations assume a \$300K home, 1% assessment, 16.9% allocation factor to General Fund, for a \$506/home revenue

\*1 - Developer projects the first 20 homes will be built in six months after ground breaking; started in March 2015.

\*2 - After first 20 the remaining 150 homes in Phase 1 will be built at a rate of six per month depending on buyer participation.

\*3 - Remainder of 802 homes (652) to be built at six per month rate depending on buyer participation.

\*4 - Average yearly General Fund deficit the past 12 Years was approximately \$630K with \$300K covered by Measures W,X,&Y leaving a yearly deficit of \$330K.

\*5 - New home property tax will not cover the \$330K deficit until 2024 assuming the full built-out occurs at the 6 per month rate.

\*6 - Calculations don't account for salary furlough restoration and increases, fund reserve built-up, future emergency loan payments, home built-out delays, etc.

### Special District Option

The inappropriate transfers from restricted enterprise and special funds discussed in this report were driven by the need to pay for General Fund operations. Official City audits have repeatedly questioned the City's viability "as a going concern." Voter approval of three November 2014 tax measures provided only a minimal amount of additional General Fund revenue, barely enough to balance the 2015-16 General Fund budget.<sup>8</sup> Guadalupe has recently recognized that General Fund usage of restricted funds must be handled as loans, must be repaid,<sup>9</sup> and become additional future General Fund expenses.

Prior to approval of the three tax measures, serious discussions regarding the disincorporation of the City ensued<sup>10</sup> pursuant to *California Government Code Sections 57400-57425* which provide for the transfer of the city's assets and liabilities to the county as the successor agency, including the ability to assume

<sup>8</sup> Financial Assessment Memorandum, William C. Statler, August 18, 2014

<sup>9</sup> Guadalupe City Council Action, November 25 2014, Resolution No. 2014-68

<sup>10</sup> Santa Maria Times, August 25 2014

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control of, and administer, all systems of waterworks, street lighting, or any other public utility owned by the city at the time of its disincorporation. Regarding city indebtedness, *California Government Code Section 57409* requires that the county “cause to be levied, and there shall be collected from the territory formerly included within the city, taxes sufficient to pay the indebtedness as it becomes due.” Any taxes levied pursuant to *Section 57409* are additional taxes upon the property included within the territory of the disincorporated city. Additionally, “No tax shall be levied upon any territory not included within the former limits of the disincorporated city for any debt or liability of the disincorporated city.”<sup>11</sup> Thus, the General Fund indebtedness will be frozen at the time of disincorporation.

An alternative could be a reorganization of the City to a Community Services District or several special districts. Special districts are a form of local government created by a local community to meet a specific need. Inadequate tax bases and competing demands for existing taxes make it difficult for cities and counties to provide all the services desired by their citizens. When residents or landowners want new services or higher levels of existing services, they can form a district to pay for and administer them.<sup>12</sup> Multi-function districts, like community services districts, provide two or more services.<sup>13</sup> Just over a quarter of California’s independent special districts are enterprise districts. Enterprise districts operate more like a business, charging customers for their services. Non-enterprise districts provide services that don’t lend themselves to fees because they benefit the entire community, provide services such as parks and fire protection, and rely overwhelmingly on property taxes to fund their operating budgets.

Reorganization can be accomplished by a City resolution and petition to the Santa Barbara County Local Agency Formation Commission (LAFCO). Established under *California Government Code Section 56000*<sup>14</sup>, LAFCO has the powers and duties to approve or disapprove proposals for changes of organization or reorganization of a city,<sup>15</sup> and “the authority to condition approval or disapproval of a reorganization with or without election.”<sup>16</sup>

*California Government Code Section 56001*, in part, notes “...that community service priorities be established by weighing the total community service needs against the total financial resources available for securing community services; and that those community service priorities are required to reflect local circumstances, conditions, and limited financial resources” and “...responsibility should be given to the agency or agencies that can best provide government services.”

## **CONCLUSIONS**

The 2014-15 Santa Barbara County Grand Jury finds that Guadalupe simply does not generate enough General Fund revenue from the sources most cities rely on (property, sales and bed taxes) to provide basic services to its citizens. Guadalupe remains a city run by the same well-intentioned, but ultimately untrained and uninquisitive elected officials, who in past years have relied on unqualified and

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<sup>11</sup> *California Government Code Section 57419*

<sup>12</sup> <http://www.csda.net/special-districts/> last visited March 16, 2015

<sup>13</sup> *ibid*

<sup>14</sup> *California Government Code Section 56000*, the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.

<sup>15</sup> *California Government Code Section 56375.3 (a)*

<sup>16</sup> *California Government Code Section 56885.5.(a)(3)*

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undertrained staff. For over 12 years the City has floated budget deficits by way of inappropriate interfund transfers from special and enterprise funds to the General Fund. The Jury recognizes the many financial changes made by the City of Guadalupe over the past year. However, budget deficits continue to this day, leading to a series of financial problems from which there is no recovery.

The FY 2015-16 budget includes an initially modest \$14,375 payment to cover the first year debt service for the \$575,000 FY 2014-15 stop gap loan. However, these repayments increase annually over the ten-year loan period with a final payment in 2024 of \$100,625. Other significant long-term debt includes repayment of two loans from the Redevelopment Agency for an August 2006 loan of \$1 million to construct the wastewater treatment plant (WWTP) and a June 2002 loan for \$167,629 to eliminate the deficit of the solid waste fund. Payments on these two loans will increase from \$30,000 in 2014 to \$170,000 in 2015 and continue at this level to 2020.

The November 4, 2014 voter approval of Measures V, W, and X will help the City achieve a “structurally balanced” General Fund budget in FY 2015-16,<sup>17</sup> but will not provide a long-term solution. Once fully implemented these Measures will annually provide approximately \$300,000 in new revenue. This is less than half of what is needed each year to cover the City’s General Fund revenue deficits going forward. These deficits have averaged approximately \$630,000 per year over the last 12 years. These voter approved Measures offer no funding to recompense City employees who took pay cuts or accepted furloughs to help keep the City operating over the past several years, let alone provide for future pay raises. Also, these Measures will not provide funding for capital improvements, adequate reserves, or handling aging infrastructure emergencies that may occur, such as the past broken water and sewer lines.

City Council members interviewed consistently mentioned the DJ Farms housing development as something that might save the City. Unfortunately, this project will not be completed until 2026, at the earliest, and projected property tax revenue will still be insufficient to cover the General Fund’s day-to-day operations.

After public disclosure of years of mismanagement of Guadalupe City funds, the Jury notes that many of those who were in positions of responsibility during those years have been repeatedly reelected or rehired.

This is the fourth Grand Jury report since 2002 on Guadalupe’s financial dysfunction, and this Jury believes it is time to say “enough.” There is no bridge to solvency in the estimation of the Jury. The Jury concludes that the City Council of Guadalupe should take the necessary steps to disincorporate.

Santa Barbara County Grand Jury reports are fact-based investigative observations that offer recommendations to improve governmental operations. This report is no exception, but it is the first time the Jury has recommended that a city disincorporate. The Jury understands an initial reaction would be for the Guadalupe City Council to reject this action feeling that Guadalupe would lose its identity. This would not be the case nor would the community of Guadalupe vanish. All one would have to do is look at other unincorporated communities throughout the State.

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<sup>17</sup> Financial Assessment Memorandum, William C. Statler, August 28, 2014  
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## **GUADALUPE SHELL GAME MUST END**

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The Jury challenges the Guadalupe City Council to realistically consider the disincorporation recommendation when responding to this report.

### **FINDINGS AND RECOMMENDATIONS**

#### **Finding 1**

Guadalupe does not generate enough General Fund revenue (sales tax, property tax, and bed tax) to pay for General Fund expenses, such as police and fire operations.

#### **Finding 2**

Guadalupe's current debt payment obligations will increase annually until 2024 (see Table 2) with insufficient corresponding increases in revenue.

#### **Finding 3**

The recent passage of Measures V, W, and X will not provide a long-term solution to Guadalupe's financial issues.

#### **Finding 4**

There is no revenue to restore salary or benefits to employees who have agreed to furloughs and salary cuts, or to add staff.

#### **Finding 5**

There is no revenue to build up a reserve fund for emergencies or pay for needed infrastructure repair.

#### **Finding 6**

There is no revenue to eliminate the need for the City of Guadalupe to borrow an additional \$330,000 per year to meet General Fund obligations.

#### **Finding 7**

Guadalupe is losing \$4,000 per month in the Solid Waste Fund, due to faulty accounting practices, resulting in a \$240,100 fund deficit as of August 18, 2014.

#### **Finding 8**

Guadalupe has, for over 12 years, charged up to 193 percent of overhead expenses through inappropriate interfund transfers from its special funds and enterprise funds to the General Fund.

#### **Finding 9**

Guadalupe's inappropriate transfers included money taken from the State Gas Tax Fund, which was used for purposes expressly forbidden in the Gas Tax regulations.

#### **Finding 10**

Guadalupe did not, until recently, follow rules that allow loans of funds from special funds to help finance General Fund activities which must be approved by the City Council, be documented, and include a repayment schedule.

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## **GUADALUPE SHELL GAME MUST END**

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### **Finding 11**

Guadalupe has a large tax liability to the IRS, which started in 2006 as a relatively minor dollar figure, but over the past eight years, with penalties and interest, has grown to over \$486,000.

### **Finding 12**

Guadalupe's decades long hope and expectation that future housing and commercial development will improve its financial situation have not been realized.

### **Finding 13**

Disincorporation will freeze the existing debt of the City of Guadalupe at the current level.

### **Recommendation**

That the City of Guadalupe disincorporate.

## **REQUEST FOR RESPONSE**

Pursuant to *California Penal Code Section 933 and 933.05*, the Jury requests each entity or individual named below to respond to the enumerated findings and recommendations within the specified statutory time limit:

### **City Council of Guadalupe – 90 days**

Findings 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, and 13

Recommendation

## **GUADALUPE SHELL GAME MUST END**

### **APPENDIX A Guadalupe Council and Staff Timeline**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
<b>Mayor</b>	Sam Arca			Lupe Alvarez								Frances Romero		John Lizalde	
<b>Councilmember</b>	Carlos Aguilera					John Lizalde								Virginia Ponce	
<b>Councilmember</b>		Virginia Ponce										Gina Rubalacaba			
<b>Councilmember</b>	L. Alvarez			Myrtle Parra		Ariston Julian					Jerry Tucker		Ariston Julian		
<b>Councilmember</b>	Joe Talaugon			John Sebedra								Jerry Beatty			
<b>City Administrator</b>		Carolyn Galloway-Cooper							Regan Candelario		Tim Ness	Andrew Carter			
<b>Finance Director</b>	Carolyn Galloway-Cooper	Kendra Wright			Cynthia White				Carolyn Galloway-Cooper		Annette Munoz				

# GUADALUPE SHELL GAME MUST END

## APPENDIX B Transfers from Special Funds to General Fund

### Transfers from Special Funds to General Fund – Revised

Transfer	Actual 1999/00	Actual 2000/01	Actual 2001/02	Actual 2002/03	Actual 2003/04	Actual 2004/05	Actual 2005/06	Actual 2006/07	Actual 2007/08	Actual 2008/09	Actual 2009/10	Actual 2010/11	Actual 2011/12	Actual 2012/13	Original Budget 2013/14	Revised Budget 2013/14
Water	145,481	99,038	109,460	125,652	110,000	62,002	99,502	200,000	350,000	275,000	200,000	306,000	250,000	300,000	425,000	200,000
Wastewater	118,500	105,403	115,988	125,652	125,000	59,472	59,472	140,000	300,000	200,000	225,000	200,000	250,000	125,000	175,000	150,000
Gas Tax	21,058	26,633	28,640	31,883	49,000	57,720	57,720	150,000	100,000	60,000	60,000	55,000	45,000	60,000	70,000	50,000
Measure A/D	15,110	48,437	55,750	53,206	55,000	67,980	67,980	150,000	100,000	60,000	60,000	120,000	134,000	134,000	70,000	50,000
LTF	43,409	54,071	10,523	0	0	12,902	12,902	15,000	15,000	60,000	125,000	6,252	40,000	25,000	50,000	25,000
Transit	0	0	0	9,952	10,000	16,596	16,596	15,000	25,000	24,400	25,000	25,000	25,000	25,000	35,000	35,000
RDA	278,858	375,586	386,698	397,810	400,000	456,340	456,340	450,000	460,000	450,000	450,000	450,000	250,000	185,000	200,000	60,000
RDA, Bond Refinance	0	0	0	0	0	0	0	0	0	228,000	228,000	60,000	25,000	0	0	0
RDA, Afford. Housing	9,295	18,972	52,233	63,050	64,000	151,082	62,775	75,000	75,000	150,000	200,000	200,000	125,000	0	0	0
Drug Task Force	0	1,406	22,766	22,766	13,280	22,148	22,148	42,555	18,000	49,000	96,944	63,203	90,000	69,586	60,000	60,000
CDBG	0	0	11,790	2,500	2,500	0	25,532	0	52,940	5,000	0	994	8,561	0	15,000	15,000
Other Funds	9,765	30,739	9,791	15,000	10,000	37,310	37,309	286	16,000	0	0	47,474	0	0	0	15,000
<b>Total Transfers</b>	<b>641,476</b>	<b>760,285</b>	<b>803,639</b>	<b>847,471</b>	<b>838,780</b>	<b>943,552</b>	<b>918,276</b>	<b>1,237,841</b>	<b>1,511,940</b>	<b>1,561,400</b>	<b>1,669,944</b>	<b>1,533,923</b>	<b>1,242,561</b>	<b>923,586</b>	<b>1,100,000</b>	<b>660,000</b>

General Gov't Expenses	Actual 1999/00	Actual 2000/01	Actual 2001/02	Actual 2002/03	Actual 2003/04	Actual 2004/05	Actual 2005/06	Actual 2006/07	Actual 2007/08	Actual 2008/09	Actual 2009/10	Actual 2010/11	Actual 2011/12	Actual 2012/13	Original Budget 2013/14	Revised Budget 2013/14
City Council	19,896	NA	24,570	27,717	22,667	16,517	16,876	11,258	11,780	8,522	5,875	8,904	10,002	9,147	10,000	10,000
Administration	359,912	NA	311,970	376,127	331,354	364,898	359,433	379,360	519,496	454,956	419,735	408,662	465,676	541,122	475,325	475,325
City Attorney	52,148	NA	44,696	57,127	91,120	65,701	55,857	56,467	52,084	75,726	78,709	65,562	65,573	60,980	74,000	74,000
Finance	206,644	NA	345,285	264,096	164,149	275,844	278,465	292,593	357,355	304,225	367,349	310,243	309,406	319,366	355,075	355,075
<b>Total Gen. Gov't</b>	<b>638,600</b>	<b>NA</b>	<b>726,521</b>	<b>725,067</b>	<b>609,290</b>	<b>722,960</b>	<b>710,631</b>	<b>739,678</b>	<b>940,715</b>	<b>843,429</b>	<b>871,668</b>	<b>793,371</b>	<b>850,657</b>	<b>930,615</b>	<b>914,400</b>	<b>914,400</b>
<b>Ratio</b>	<b>1.00</b>	<b>NA</b>	<b>1.11</b>	<b>1.17</b>	<b>1.38</b>	<b>1.31</b>	<b>1.29</b>	<b>1.67</b>	<b>1.61</b>	<b>1.85</b>	<b>1.92</b>	<b>1.93</b>	<b>1.46</b>	<b>0.99</b>	<b>1.20</b>	<b>0.72</b>

\* The total of all transfers should always be less than the total expenses of the "overhead" departments. That's because those departments also work on General Fund activity.