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The Desert Sun

Nov. 17, 2013 | [10 Comments](#)

Desert Hot Springs: Careening toward bankruptcy

Leaders split on how community arrived at multimillion-dollar shortfall

DESERT HOT SPRINGS — Faced with a budget plan that spends almost 1½ times what it has in revenue, and nearly \$27 million in looming debts, Desert Hot Springs is considering bankruptcy for the second time in 12 years.

Much like they did in 2001, most city leaders have insisted they didn't expect this to happen.



City Hall in June announced the budget was balanced by using \$2.3 million from reserves. In their re-election campaigns, three council members assured voters the city was on solid financial footing.

The latest projections now show the general fund's balance is \$1 million smaller than expected and that the city will run out of cash by the end of March.

Faced with a budget plan that spends almost 1½ times what it has in revenue, and nearly \$27million in looming debts, Desert Hot Springs is considering bankruptcy for the second time in 12 years. / Desert Sun file photo

The changes are largely the result of a change in perspective from the city's administration and a five-year review of the former administration's spending habits.

Unlike former City Manager Rick Daniels, leaders are now expressing a reluctance to bank on one-time revenue and are relying on more conservative projections.

State officials have ruled out a bailout. Riverside County financial experts are being asked to work with the city, but the county's own budget realities may not provide them much flexibility in helping.

If city leaders decide to pursue steps toward bankruptcy — a decision they'll formally consider Tuesday — Desert Hot Springs would rejoin a small club of municipalities, small tax districts and governments that have filed for Chapter 9.

Since 1937, 651 such bankruptcies have been filed, the vast majority of them by small special tax districts.

"Really, Chapter 9 has always been intended to be the last resort," said James Spiotto, a Chicago attorney and part-time La Quinta resident who has been working on municipal bankruptcy issues for more than 40 years.

"Many times, these are situations where municipalities need bridge financing. They need a breather so they can look at it. ... They can disincorporate, but they still have the debt and how it's going to be dealt with."

Experts say there's no magic number at which point a city needs to declare bankruptcy, and council members have insisted they want to avoid it at all costs.

Yet at the same time, those elected leaders expressed reservations about cutting civic donations or slashing public safety funds, which made up about 70 percent of the budget last year.

And when Finance Director Amy Aguer was asked whether she'd tell the council to declare a fiscal emergency — a legal maneuver that sets the stage for municipal bankruptcy — she told The Desert Sun, "I would say yes."

"We always knew that this year was going to be lean and tough to get through. No one knew when Rick Daniels brought his budget forward that we really didn't have those reserves," Mayor Pro Tem Scott Matas said.

"We went from one administration to another. One administration was over-projecting, one administration is under-projecting in my eyes. We're still trying to figure it out."

Spending plan revisions

Daniels left the city in September after accusing two council members of workplace harassment and is now the city manager in Needles.

Daniels, who was well-known for his accessibility to the media when he was in the Coachella Valley, did not return multiple emails or phone messages The Desert Sun left every day last week at his office, on his cell phone and with his Needles City Hall assistant.

The 2013-14 budget proposal he pitched to the council this summer was supposed to be balanced by using \$2.3 million from reserves. It also had nearly \$921,000 in revenue sources that have a “very high likelihood of occurring.”

An unexpected, one-time financial windfall — a \$2.75 million boost from the valley’s new power plant — allowed the city to avoid serious cuts in the 2012-13 budget, Aguer said.

The new budget projections are the result of a number of revisions to a spending plan that guides City Hall through June 30:

- Revenue projections were reduced by about \$2.4 million, in part because the city lost an appeal with the Board of Equalization and will get less funding than expected.
- The city is combing through every dollar spent since 2008, but initial projections show expenses are going to be almost \$2 million more than expected.
- City officials thought they would end the last fiscal year with \$4.1 million, but actually ended up at \$3.1 million.

The numbers are likely to change again in coming weeks: Officials have conducted an extensive review of the revenue side of the budget but are still analyzing years of expenditures.

This year alone, the city expects to spend about \$20.1 million.

Even the head of the finance committee, Councilwoman Jan Pye, said she was caught off-guard by the numbers when they were first announced on Election Day, Nov. 5.

But she concedes that “we knew we were in serious financial shape.”

“Our books are being audited now.” said Pye, who planned to spend all weekend reviewing the latest information. “Even the numbers our current finance director gave us may be different.”

More red ink

To date, city leaders have been debating only the ongoing operating budget.

But as of June 30, the city had \$19.995 million in debts. The largest single debt is \$9.7 million in judgment obligation bonds from the 2001 bankruptcy.

The city also has another \$6.7 million in unfunded liabilities for its two pension plans, according to the latest figures from the California Public Employees' Retirement System, which manages the benefits for Coachella Valley's retirees.

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The city has the required money set aside to cover one year of debt service, Aguer said.

The city's figures pale in comparison to those posted by other bankrupt cities.

Detroit owed nearly \$20 billion to more than 100,000 creditors. San Bernardino had \$1 billion in debts and Stockton owed \$900 million in pension debts alone.

When Desert Hot Springs filed for bankruptcy in 2001, Aguer said it had a healthy \$7 million in reserves.

"It was an entirely different situation," then-Desert Hot Springs City Manager Joe Guzzetta told The Desert Sun last week.

"The city was in good financial shape at that time, it had a balanced budget and adequate reserves."

But the city had lost a major legal battle when an appeals court decided the city should have given housing developer Silver Sage permission to build a low-income mobile home park.

Suddenly, the city had a multimillion-dollar legal bill that threatened its ability to make payroll, Guzzetta said.

The \$10 million bankruptcy "was just to protect the city against that judgment," he added.

"Until that ruling was determined, it cast a shadow over activities and developers not knowing whether to proceed or not," said Guzzetta, who spent just a couple years in Desert Hot Springs and is now city manager in Twentynine Palms.

"It was strictly reactionary to that one lawsuit."

The city exited bankruptcy in 2004, officials said.

Taking the plunge

The five-member elected council has expressed reservations about returning to bankruptcy.

The first test will come Tuesday, when city officials are asked whether to declare a fiscal emergency.

Such a vote would give Desert Hot Springs more flexibility to negotiate with unions and others about the money that's owed to employees and outside agencies.

California law says cities cannot enter Chapter 9 bankruptcy unless they declare a fiscal emergency or begin negotiations with a neutral evaluator and their debtors, including employees who expect a paycheck.

Declaring a fiscal emergency does not guarantee they will file for bankruptcy.

"The real success of this is not just adjusting the debt," bankruptcy expert Spiotto said. "It's a real recovery plan that needs buy-in from the community."

Such recovery plans could include economic development such as business recruitment, cutting services or raising taxes.

But other cities have found that, if taxes are raised too high, residents and businesses could move out, creating less revenue and sparking what Spiotto described as "a death spiral."

"Obviously, it's a question of what the local citizens want to pay for and the cost of it," Spiotto said.

As much as city leaders have insisted they were caught off-guard by the newest budget numbers, city staffers have warned for years that council members had to make some serious budget decisions to ensure expenses matched revenue.

In 2007, when the city hired Daniels as city manager, he declared the city was "on the razor's edge of existence."

"If the city doesn't get its act together, it's going to be an insolvent city," Daniels told The Desert Sun at the time.

In a special May 2009 election, voters overwhelmingly approved a ballot initiative that renewed the city's utility users tax and created more revenue for the police department.

By February 2010, the city's then-finance director Jason Simpson warned council members they would face serious issues in the 2012-13 fiscal year.

Councilman Adam Sanchez is the city's mayor-elect, after a narrow Nov. 5 victory over incumbent Mayor Yvonne Parks.

When he was first elected in 2011, Sanchez said Daniels warned him they would see deficits in the 2014-15 fiscal year, which starts next July.

"Back then, my gut feeling was ... we were already in the deficit," Sanchez said.

"How does a city get to this point? I was saying, 'We need to reduce spending.' "

Sanchez and Councilman Russell Betts are often the minority votes on a split council.

"They've been overspending like this for six years," Sanchez said.

Parks, a Daniels supporter who is asking county officials for a recount of the election results, has a different recollection.

"We knew we were going to have to make cuts," she said. "We talked about cutting salaries. We talked about cutting City Council travel budget, we talked about cutting a lot of things.

"There was nothing — nothing — leading to a fiscal emergency or bankruptcy or annexation or disincorporation."

H.D. Palmer, the spokesman for California's Finance Department, said it is general policy not to assist cities on the verge of bankruptcy.

"The state does not come in and lend money," Palmer said.

Riverside County Supervisor John Benoit said Friday he's met with city officials and expects a formal request for county assistance.

The county's financial team is expected to meet with city leaders as soon as this week to start reviewing the books.

But county officials haven't said yet what assistance they might provide, as they've spent years using rainy day funds and cost-cutting measures to cover their own multimillion-dollar budget gaps.

"We've started the process," Benoit said Friday. "It starts with making sure we know what their situation is."

It was not clear last week whether a majority of council members would support a fiscal emergency.

If the votes aren't there, Betts expects the idea will go before the council again in December after the mayoral recount is resolved and officials swear in councilman-elect Joe McKee.

McKee scrutinized city spending habits during the campaign.

"There's nobody playing politics on this issue," said Betts, who will support the fiscal emergency Tuesday. "This is not the time to play phantom economics."

Reach reporter Erica Felci at (760) 778-4644.

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