Attachment A

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Analysis on Fiscal Status of the Lake Resorts

Summary

The County Administrative Office (CAO) reviewed the financial condition of the lake resorts enterprise (fund 452) as a result of the fund having a negative cash balance at the end of the 2017-18 fiscal year. On August 31, 2018, the CAO issued a memorandum to notify the Board of Supervisors (Board) that the lake resorts fund required a temporary interfund loan to cover the negative cash deficit of $2.1 million. The interfund loan covered the cash deficit temporarily but the fund has a remaining budget deficit of $2.0 million and a negative net positon of $5,465,290 as reported in the FY 2016-17 Comprehensive Annual Financial Statement (CAFR). Our analysis shows the deficit is part of an ongoing annual operating deficit which has required general fund subsidies over many years. Even with the general fund providing subsidies exceeding $16 million since the County assumed full operational responsibility, the lake resorts fund still has a $2.0 million deficit at the end of FY 2017-18. These subsidies have drained funding from the general fund and in the long-run will continue to diminish the capacity of the County to fund other priorities and rebuild reserves.

Prior to FY 2008-09, the resort and recreational facilities at Lake San Antonio and Lake Nacimiento operated under a long-term lease by a concessionaire. In July 2007, the County purchased the lake resort assets from the former concessionaire, Water World Resorts, Inc., and authorized the Parks Department to operate the resorts under an enterprise fund. The fund was established to maintain a high-quality resort and recreational area that generates sufficient revenue through user fees to recover operational costs as well as invest in infrastructure improvements. Since FY 2007-08, the Parks Department contracted out the resort operations which includes marinas, stores, restaurants, fueling facilities, lodging units, and boat rentals. The County has provided maintenance, park ranger, and administration services during this time.

The Balance Sheet

The balance sheet for the lake resorts fund has a negative net position of $5.5 million as of the FY 2016-17 CAFR. The balance sheet has had a negative net position every year since the lake resorts operated under an enterprise fund. There are many factors why the net position has continued to be in the negative. First, a short and long-term issue has been the insufficient amount of income generated from operations. To put it simply, the lake resorts have not operated under a profit any fiscal year. Secondly, the fund faces long-term liabilities such as advances from other funds (loans) and pension liabilities. Other short-term liabilities have been temporary interfund loans due to other County funds.

In FY 2007-08, the County issued $15.5 million in notes payable as part of a settlement agreement to terminate a lease agreement that authorized the lessee to operate the lake resorts on behalf of the County. Part of the agreement included the acquisition of assets owned by the lessee. The lake resorts operations were to pay $6.3 million to the general liability internal service fund (ISF) for lake resort assets. In FY 2010-11, the fund began reporting the repayment from the general liability ISF and showed $6.3 million owed in its balance sheet. This loan provided to the lakes is being repaid every year by a subsidy from the general fund. At the end of FY 2017-18, the lakes fund owes the general liability ISF $3.1 million. The schedule of payments has the lake resorts paying off the advance in FY 2023-24.

In FY 2014-15, in accordance with GASB 68, the lake resorts balance sheet began to include the lake resorts' pension liability, which began at $2.5 million and has continued to grow; it is estimated that in FY 2017-18 it may reach $3.0 million. The combination of the loan owed to the ISF and this new reporting standard for pensions increased the liabilities of the lake resorts. It is not uncommon to see enterprise funds with liabilities such like those faced by the lake resorts fund. Usually assets like cash and capital assets are large enough to cover these long-term liabilities. However, this is not the situation of the lake operations as the fund has little, and at times, no cash along with capital assets that do not exceed short and long-term liabilities. Hence, the largest impact affecting the balance sheet is the lack of profitability in lake resorts operations.

Chart 1

Operational Deficiencies

The CAO conducted a historical analysis of operating revenues and expenditures. The operating activities should be considered separately from its non-operating activities to better comprehend the operational sustainability at the lake resorts. Operating activities directly relate to the core business functions such as camping, lodging, and marina operations. The non-operating activities are functions that do not directly relate to providing recreational goods and services such as general fund subsidies and interest expenses. Since its inception as an enterprise fund, the lake operations expenditures have exceeded revenues. In the past eight fiscal years, operating expenses surpassed operating revenues by an average of $2.0 million. Interfund loans and general fund subsidies have offset most of the operating deficits of the lake resorts.

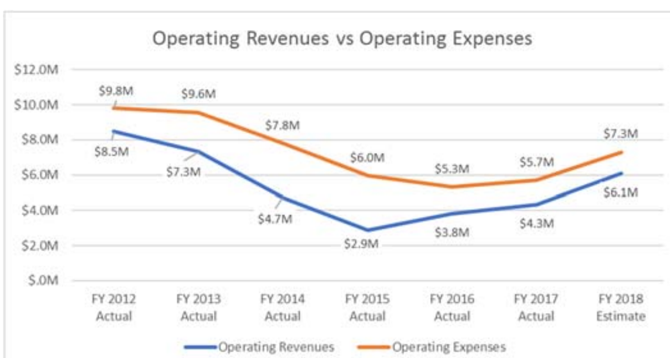

Chart 2

To continue to operate with positive cash -and as a business in general -the lake resorts fund has depended on general fund subsidies and interfund loans from other funds. In the past six years, the Auditor-Controller's Office has provided the lake resorts four temporary interfund loans. *Table 1* lists the temporary interfund loans that were issued to cover the cash deficits in each appropriate year.

Fiscal Year	Amount	Repaid in Fiscal Year
FY 2009-10	$160,141	FY 2011-12
FY 2011-12	$580,000	FY 2013-14
FY 2012-13	$282,762	FY 2013-14
FY 2014-15	$1,271,143	FY 2017-18

Table 1

Temporary interfund loans such as the ones listed above are meant to be repaid immediately at the beginning of the next fiscal year as they are to be used only to resolve cash flow issues relating to the timing of revenues. An issue which has served to shield the deficit from being exposed earlier is that the Auditor-Controller's Office did not repay the loans immediately and advised that such loans were required so further fiscal analysis could be completed. In reality these loans did not cover timing of revenues, they covered operating deficits. A major issue was a loan of $1.3 million issued in FY 2014-15 which stayed on the balance sheet in FY 2015-16 and FY 2016-17. This meant that the fund's balance sheet was inflated by $1.3 million for almost three fiscal years. When this accounting error was discovered and subsequently paid back at the end of FY 2017-18, the transfer of $1.3 million in cash back to the general fund immediately revealed a financial deficit. As a result of repaying this loan and unsustainable operations, the fund ended FY 2017-18 with a cash deficit of $2.1 million. When a fund like the lake resorts fund has negative cash, it is essentially using cash from other funds to operate. The General Financial Policies adopted by the Board this spring delegated interfund loan authority to the County Administrative Office. Scrutiny of department operations and their need for end-of-year interfund loans seeks to end the past practice of booking loans without oversight and allowing temporary interfund loans roll over past the intended fiscal year.

The lake resorts fund has also received general fund subsidies every year. If the lake resorts operations continue under the current business model, the fund will continue to need general fund subsidies. Chart 3 gives an overview of the general fund subsidies given each fiscal year. Some of the general fund subsidies include an annual contribution of $711,240 to repay the notes payable for assets purchased from the former lake lessee. In addition, from FY 2011-12 to FY 2016-17, the Agricultural Commissioner transferred a total of $1.4 million to the lake resorts for the abatement of zebra and quagga mussels.

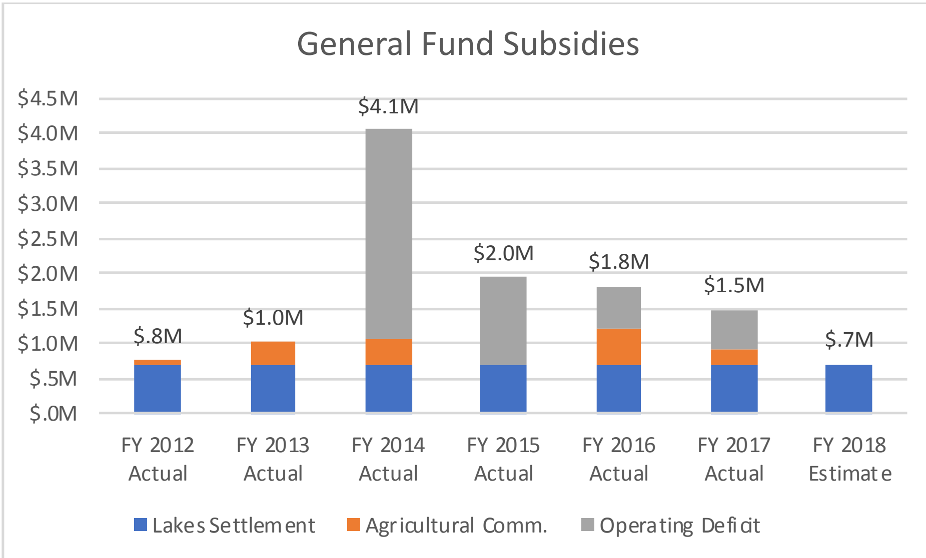

Chart 3

The income statement for the lake resorts fund separates the operating and non-operating revenues and expenditures. Table 2 gives a historical outlook of the lake resorts. Although operating revenues have increased from a low of $2.9 million in FY 2014-15, operating expenses continue to outpace growth. Past performance indicates that the lake resort operations are not currently sustainable without a major operational change or continued general fund subsidies.

Income Statement	FY 2012 Actual	FY 2013 Actual	FY 2014 Actual	FY 2015 Actual	FY 2016 Actual	FY 2017 Actual	FY 2018 Estimate
Operating Revenues							
charges for services	3,631,950	3,444,125	1,877,591	1,492,371	2,128,393	725,277	433,858
other operating revenues	4,850,080	3,881,630	2,850,908	1,386,251	1,704,428	3,613,709	5,649,689
Total Operating Revenues	**8,482,030**	**7,325,755**	**4,728,499**	**2,878,622**	**3,832,821**	**4,338,986**	**6,083,546**
Operating Expenses							
salaries and benefits	3,471,128	3,236,656	2,835,402	2,371,470	1,326,335	578,509	123,214
services and supplies	5,551,651	5,359,930	4,016,943	2,647,479	3,031,842	4,160,650	6,704,553
depreciation	778,039	968,682	860,577	863,300	868,692	866,302	392,526
other expenses	-	-	79,403	79,763	82,835	84,096	88,045
Total Operating Expenses	**9,800,818**	**9,565,268**	**7,792,325**	**5,962,012**	**5,309,704**	**5,689,557**	**7,308,338**
Non-Operating Revenues (Expenses)							
intergovernmental revenue	159,805	3,000	96,139	-	1,857	26,183	-
interest income	1,770	(2,421)	(7,483)	(7,826)	-	3,578	4,674
interest expense	(328,164)	(320,368)	(290,874)	(269,368)	(250,066)	(222,997)	(198,018)
rental income	-	-	-	-	5,526	-	-
other non-operating revenues	14,897	-	-	-	-	-	25,968
Total Non-Operating Revenues (Expenses)	(151,692)	(319,789)	(202,218)	(277,194)	(242,683)	(193,236)	(167,376)
Net Income (Loss) before transfers	**(1,470,480)**	**(2,559,302)**	**(3,266,044)**	**(3,360,584)**	**(1,719,566)**	**(1,543,807)**	**(1,392,168)**
Capital Contributions	-	1,573,959	-	391,762	-	-	-
Transfer In	771,240	1,038,498	4,051,240	1,958,144	1,826,008	1,492,973	711,240
Transfer Out	(436,262)	-	-	(60,000)	-	-	-
Change in Net Position	(1,135,502)	53,155	785,196	(1,070,678)	106,442	(50,834)	(680,928)

Table 2

The agreement with the concessionaire, CalParks, costs the County instead of providing profit. Under the current agreement with the concessionaire, the concessionaire draws a monthly management fee of 1.5% of monthly gross revenue and an annual management incentive fee of 25% of the annual profit (if any). If CalParks has a loss for the month, the lake resorts fund is invoiced the difference. Additionally, our understanding is if the north or south shores of Lake San Antonio operate at a loss but Lake Nacimiento has profit, the County pays CalParks for the losses.

In FY 2017-18, it is estimated that the lake resorts fund will pay CalParks $1.1 million, per the management agreement. This payment is in addition to the operating profit of $1.3 million reported by CalParks.

County Payments to Concessionaire FY 2017-18	
CalParks Deficit	669,891
Management Fee	74,883
Incentive Fee	326,818
	$ 1,071,592

Table 3

Deferred maintenance as a result of unsustainable operations has caused the County to not adequately maintain current assets placing the County at risk for health and safety issues as well as diminish the assets value at a premature rate. The more maintenance is deferred, the more costly and urgent matters become. The County currently does not have an complete estimate of how much investment in infrastructure would be required to keep the lake resorts in a state that is ideal for recreational use; however, it is clear that current funding levels cannot even begin to fund basic maintenance.

Risks Associated with Operating Resort Activities at the Lakes

An October 3, 2017 board report stated that revenues at the lakes are uncertain and that having an agreement with a concessionaire allows flexibility to maintain services with the ebb-and-flow of revenue. Our analysis indicates that this statement is correct regarding revenues at the lakes being uncertain but in the past ten years it has become apparent that our concessionaire agreement has been unable to operate with the ebb-and-flow of revenue without needing assistance from the general fund. Is it not possible to determine what the water levels at both lakes will be in the near future but a conservative analysis sides with the assumption that winter rains will not increase water levels that are suitable for the maximizing of marine recreational activities. In FY 2017-18, the RMA issued a request for proposals to enter a long-term agreement to manage resort operations at lakes San Antonio and Nacimiento. The County only received a response from the current concessionaire, an indicator that other competitor's analysis of the business does not provide favorable income opportunities.

Consequences of the General Fund Subsidizing the Lake Resorts

Since FY 2006-07, the general fund has subsidized the lake's enterprise fund with $16.6 million. If status quo operations remain in place, it is estimated that the lakes enterprise fund would require at least $1 to $2 million in general fund subsidies every fiscal year, under the current operational management. There are short and long-term consequences of subsidizing an enterprise like the lake resorts. In the short-term, the funding allows the operations to continue to operate and allows an organization to react and begin planning for solutions. However, if the issue is not solved, as has been the case with the lakes, operations remain the same and a general fund subsidy becomes the norm. The subsidies have diminished the County's capacity to build reserves, fund other operational priorities, and leverage state and federal monies.

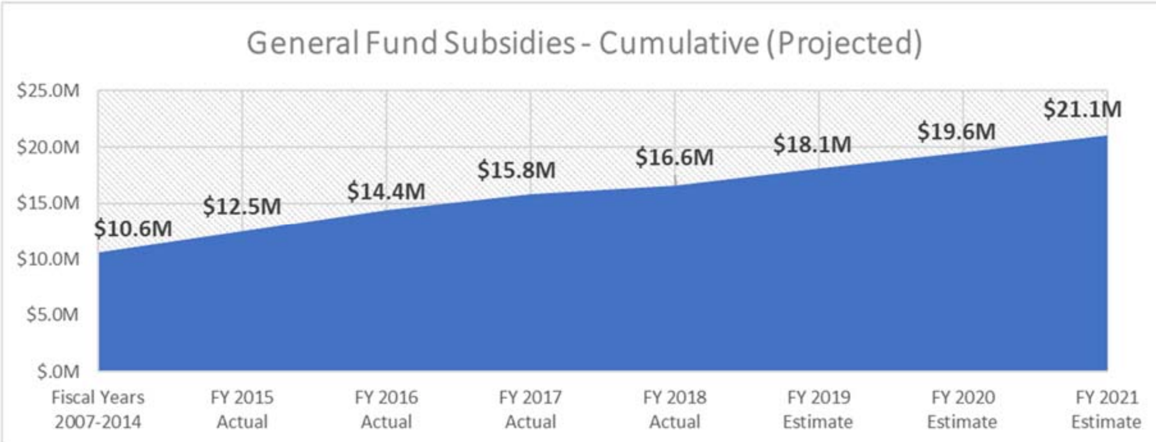

Chart 4

Recommendations for the Lake Resorts

1. The immediate crisis is funding the deficit of $2.0 million, since this deficit is already realized the County has no option other than to transfer a subsidy. The recommendation to fund this deficit is to transfer $2.0 from general fund (001) contingencies to the lake resorts fund (452). Since these funds are already expended this does not provide any operational cash for FY 2018-19 lake operations. Cash is essential for operating the program and this must additionally be addressed.
2. *Decrease appropriations by $1,993,149 in Appropriation Unit CAO020-001-8034-7811 and increase appropriations in CAO017-001-8038-7614 by $1,993,149.*
3. Given the historical annual operating loss it is recommended that an additional $1.0 million be transferred from general fund (001) contingencies to the lake resorts fund (452) to provide both operational cash and financing for current fiscal year.
4. *Decrease appropriations by $1,000,000 in Appropriation Unit CAO020-001-8034-7811 and increase appropriations in CAO017-001-8038-7614 by $1,000,000.*
5. The CAO was recently advised by County Counsel that fuel spill remediation at the lakes requires an additional $515,000 in FY 2018-19. When the County settled with the prior concessionaire we assumed responsibility for a known fuel spill. County Counsel (Risk Management) has been managing the fuel spill remediation and was recently advised of additional work required beyond current year funding of $515,000. It is recommended that the general fund (001) contingencies source this additional cost to be incurred in County Counsel unit Enterprise Risk fund 001 unit 8429.
6. *Decrease appropriations by $515,000 in Appropriation Unit CAO020-001-8034-7811 and increase appropriations in COU006-001-8429-6613.*

The above actions will reduce general fund contingencies by $3,508,149 leaving a contingency balance for the remainder of FY 2018-19 of $1,142,532.