City of San Diego

Fiscal Year 2007

Annual Budget

General Fund Revenue

General Fund Revenue

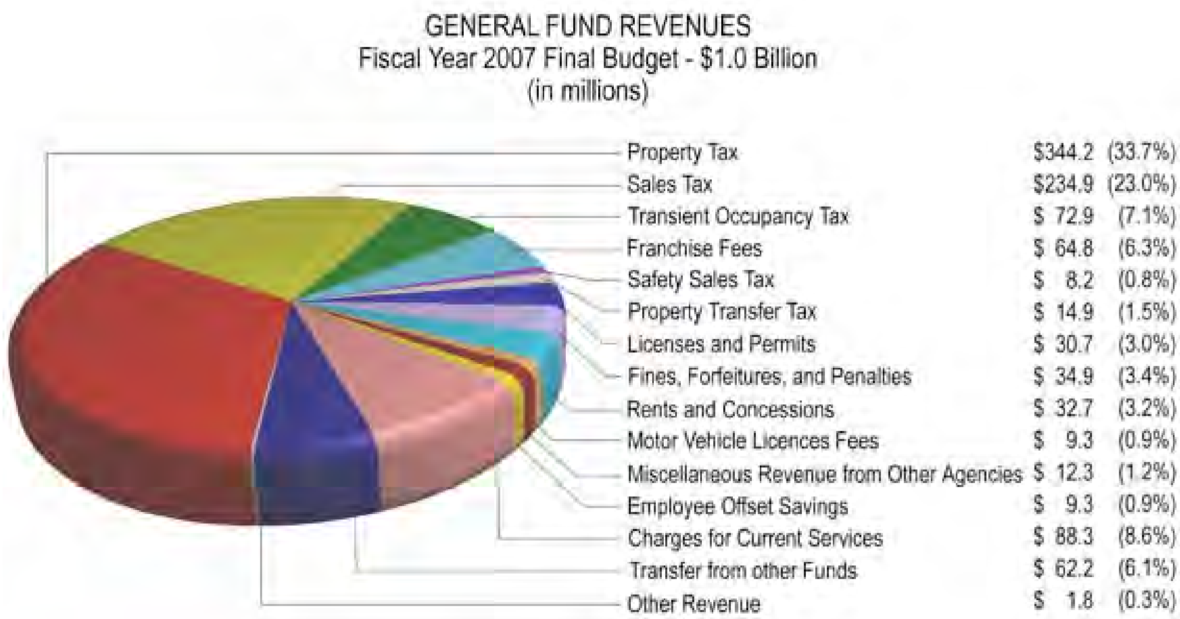
SAN DIEGO ECONOMIC INDICATORS

Economic conditions are the primary forces that dictate either growth or decline in local government revenues. The stronger the economy, the stronger the revenue growth and vice versa; a slowdown in the economy eventually leads to a decline in municipal revenue. San Diego's economy is expected to perform positively in calendar year 2006[(1)], similar to the performance in calendar year 2005, with the same trend continuing in the first half of calendar year 2007. The following are the key projected economic indicators that had been taken into account during preparation of the Fiscal Year 2007 budget:

- Gross Regional Product is projected to increase to $155 billion, almost 7.0% from the previous year.[(1)]
- The City's population is estimated to increase by 13,338 people, from 1,311,162 on January 1st of 2006 to 1,324,500 on January 1st of 2007.[(2)]
- The unemployment rate for San Diego County is projected to remain relatively low during 2006 – around 4.2%, which is slightly less than a year ago.[(1)] In April and May of 2006, the unemployment rate in San Diego County remained stable at 3.7%, lower than the estimated 4.1% a year ago.[(3)]
- Nearly 20,000 new jobs are predicted to be created in the region during the year, up from the estimated 17,000 created jobs in 2005. The sectors that are projected to grow include such employment sectors as visitor services, local defense and transportation, construction and high-tech industries.[(1)]
- Home prices are projected to stay either flat throughout calendar year 2006 and first half of calendar year 2007 or decline slightly in certain areas of the region. The median sales price in San Diego County including existing single-family homes, condos and new homes in May 2006 was $490,000, down by $15,000 or 3.0% from April 2006 and up $2,000 or 0.4% compared to May 2005. The volume of sales in May 2006 was up by 13.8% compared to April 2006, totaling 4,217 transactions, but down by 18.0% from the same period a year ago.[(4)]

(1) The San Diego Barometer (San Diego Workforce Partnership's Research and Labor Market Information.)
(2) The City population figure reflects the projection as of January 1, 2007 prepared by the City of San Diego, Planning Department, Urban Analysis section and is subject to revision.
(3) California Employment Development Department.
(4) Dataquick Information Systems.

The total Fiscal Year 2007 General Fund revenue is $1.02 billion, which represents an increase of 18.1% over the Fiscal Year 2006 Annual Budget. The 18.1% increase consists of a 7.0% increase in economic growth in major revenue sources, a 9.4% increase in revenue transparency, and a 1.7% increase in revenue adjustments. The Fiscal Year 2007 Annual Budget includes $9.3 million in employee offset savings, which replaces the tobacco revenue infused into the San Diego City Employees' Retirement System as part of the securitization of the Tobacco Settlement Revenues in Fiscal Year 2006. The majority of the General Fund revenue is comprised of four major revenue sources: Property Tax, Sales Tax, Transient Occupancy Tax (TOT), and Franchise Fees, which is equivalent to approximately $716.7 million, or 70.2%, of the City's General Fund. General Fund revenues fund core City services including police, fire, refuse collection, library services and parks and recreation programs.



This section provides a detailed description of the revenue categories for the City of San Diego, including background information describing the method of allocation and economic factors affecting the revenue source. Analysis of various economic trends at the local, State, and national level helps to shed light on current trends in a given economic sector and aids in the forecast of a particular revenue source for the next fiscal year. An analysis of individual economic sectors has been conducted to prepare major revenue projections for the Fiscal Year 2007 Annual Budget.

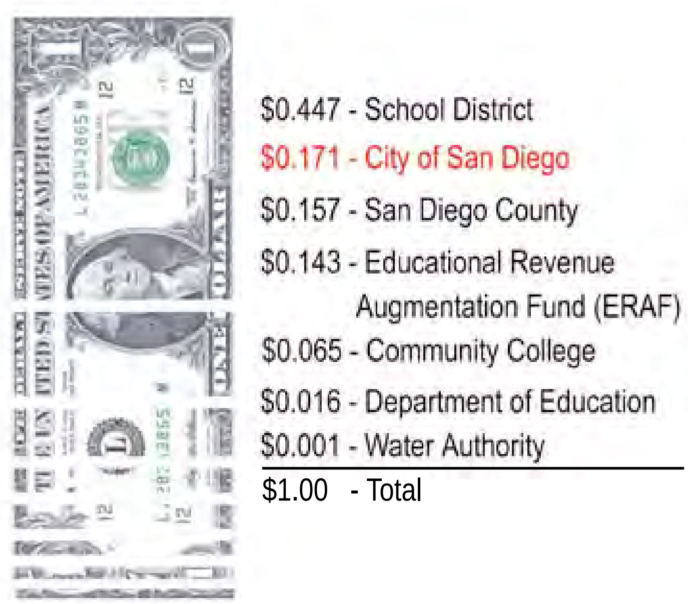
PROPERTY TAX

Overview and Background

Property tax is the City's largest revenue source representing 33.7% of the total General Fund revenue. The City of San Diego receives property tax revenue based upon a 1.0% levy on the assessed value of all real property. Property tax revenue is collected by the County of San Diego, which allocates the revenue to a number of agencies within the City's geographic area, including the County itself, the City of San Diego, school districts, and special districts. The City's share is approximately 17.1% of the 1.0% tax levy.

Prior to 1979, each local jurisdiction had the authority to levy its own property tax; therefore, a single residence might have been subject to a separate tax levy by the City, the County, the local school district, and any special districts that served the residence. In 1979, California voters passed Proposition 13, dramatically changing the face of State and local public finance. Proposition 13 limited the aggregate property tax rate to 1.0% of assessed value, and specifies that the assessed value of any real property may increase by a maximum of 2.0% per year. There are two exceptions where the property is reassessed at market value: a new construction on the property or if the property is sold. Under the current system established by Proposition 13, all local jurisdictions receive a share of the 1.0% tax levy.

Since the early 1990s, the City's property tax revenue has undergone many changes. First, in Fiscal Year 1993, the State of California faced a serious deficit. In order to meet its obligations to fund school districts at specified levels under Proposition 98, the state enacted legislation that shifted partial financial responsibility for funding education to local governments. These revenue shifts, otherwise known as the Educational Revenue Augmentation Fund (ERAF) shifts, have resulted in an estimated cumulative loss of over $468.3 million in property tax revenue for the City through Fiscal Year 2006. In addition, in order to collect and distribute property tax, the State authorized counties to charge cities for administrative fees, which further reduces the City's annual property tax receipts by approximately $2.1 million per fiscal year.



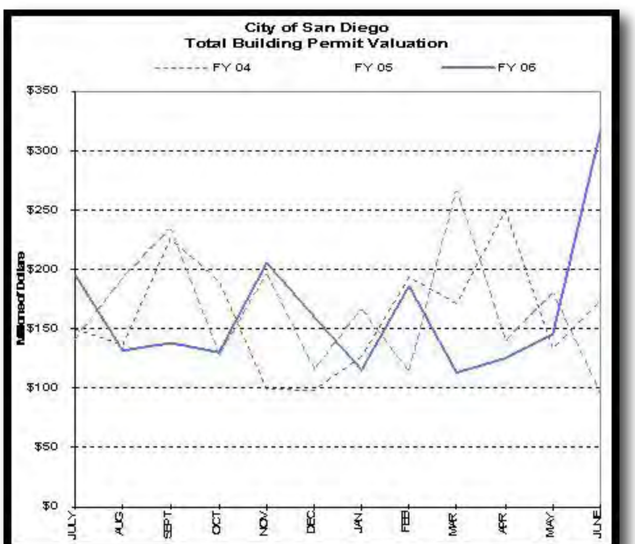
Another two-year ERAF shift (ERAF III) was enacted in Fiscal Year 2005, which mandated local agencies to contribute $1.3 billion per year to the State. This contribution was "offered" by the State in exchange for Proposition 1A (approved by voters in November 2004), which was designed primarily to protect local governments from future revenue losses resulting from the State actions. For the City of San Diego, this contribution has resulted in an approximately $16.9 million property tax loss in Fiscal Years 2005 and 2006. Any increases in assessed valuation in redevelopment areas do not increase the General Fund's share of property tax revenue, as any increase in property tax due to redevelopment must stay in the redevelopment zone.

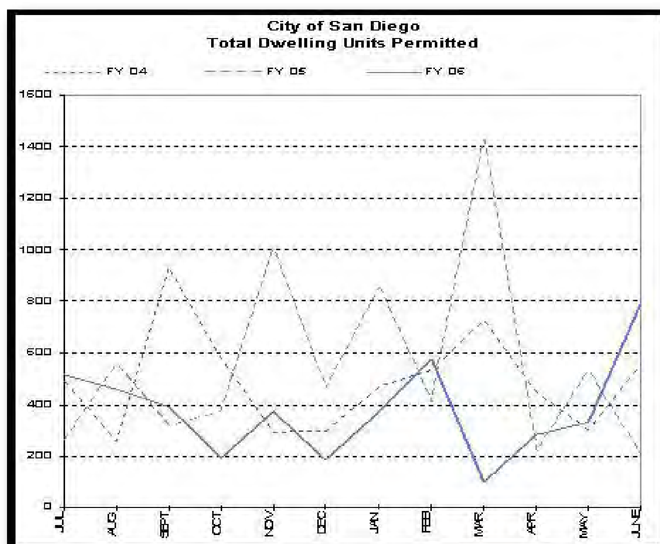
Beginning in Fiscal Year 2005, Vehicle License Fee (VLF) backfill was eliminated by the State and was replaced dollar-for-dollar with property tax, resulting in a property tax revenue increase by approximately $69.1 million in Fiscal Year 2005 and $74.3 million in Fiscal Year 2006. Beginning in Fiscal Year 2006, this "property tax in-lieu of VLF" revenue will grow annually at the rate of growth in assessed valuation.

Economic Trends and Fiscal Year 2007 Property Tax Budget

According to DataQuick Information Systems, the overall median sales price in San Diego County including existing single-family homes, condos and new homes in May 2006 was $490,000, down by $15,000 or 3.0% from April 2006 and up $2,000 or 0.4% compared to May 2005. The volume of sales in May 2006 was up by 13.8% compared to April 2006, totaling 4,217 transactions, but down by 18.0% from the same period a year ago. Homes for sale are staying on the market much longer than a year ago and the supply of unsold inventory has been significantly increasing. Therefore, it is projected that in Fiscal Year 2007, the property tax revenue will reflect the slowdown on the local real estate market.

Total building permit valuation (residential and nonresidential) is an indicator of overall construction activity. During Fiscal Year 2005, the value of permits issued totaled $1.963 billion or 1.0% more than the prior fiscal year. For Fiscal Year 2006, the value of permits issued totaled $1.960 billion, a 0.2% decrease from 2005. New residential construction is an indicator of trends in both the construction industry and the overall economy. For single family units, 1,290 permits were issued in Fiscal Year 2006, up 1.0% from Fiscal Year 2005. Multifamily units decreased by 39.0%, from 5,334 in Fiscal Year 2005 to 3,260 in Fiscal Year 2006.





The Fiscal Year 2007 projected growth rate for property tax has been reduced to 7.25% versus 7.50% in Fiscal Year 2006. The reduced rate is the result of the projected slowdown in the local real estate market. Earlier in 2006, the California Association of Realtors predicted a "soft landing" of housing prices for calendar year 2006. The UCLA Anderson Forecast also projected a statewide slowdown or "leveling off" of the home sales prices stating that the cooling off of local housing markets would result in a slowdown in spending and some job losses in construction and other real estate related industries. Economists expect an increase in delinquencies and foreclosures from today's historically low levels. According to the San Diego

Association of Governments (SANDAG) Chief Economist's projections, a slowdown in the rate of increase in residential real estate would continue in calendar year 2006 with prices increasing approximately 5.0%. No major collapse is expected in San Diego's residential market in 2006 if economic conditions and job growth remain strong, and the trend is expected to continue in the first half of calendar year 2007. SANDAG's Chief Economist predicts that the cooling off of the housing market will eventually affect consumer spending, but not earlier than the third quarter of 2006. Overall, the forecast for the next two years calls for a weak growth in the local housing market with home prices flattening, a moderate decrease in home sales and a slower pace of new building construction.

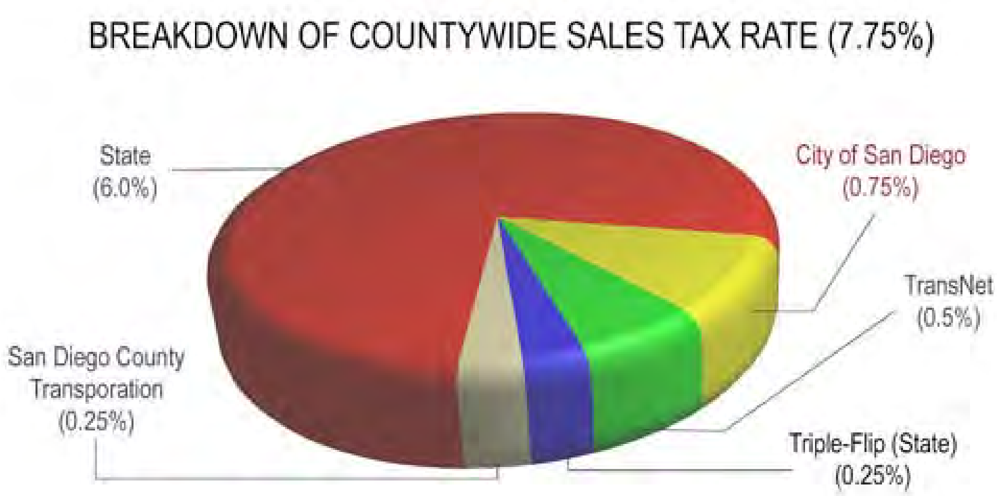
The Fiscal Year 2007 Property Tax budget is $344.2 million, which consists of $254.5 million in base property tax (Proposition 13), the estimated "property tax in-lieu-of VLF" payment of $72.8 million, and the reinstated $16.9 million of the City's ERAF III contribution to the State, explained earlier in the Overview and Background section. The table below demonstrates the breakdown of the Fiscal Year 2007 Property Tax budget:

FISCAL YEAR 2007 PROPERTY TAX BUDGET	
Base Property Tax	$254.5 million
Property Tax in-lieu of VLF	$72.8 million
ERAF III Shift	$16.9 million
TOTAL PROPERTY TAX	$344.2 million

SALES TAX

Overview and Background

Sales tax is the City's second largest revenue source representing 23.0% of the total General Fund revenue. Collected at the point of sale, sales tax receipts are remitted to the State Board of Equalization, which allocates tax revenue owed to the City in the form of monthly payments. According to the Bradley-Burns Sales and Use Tax law, cities are to receive one cent (or 13.0%) of the total 7.25 cent statewide sales tax levied on each dollar of taxable sales. In addition to the Bradley-Burns sales tax, San Diego County voters approved a half-cent supplemental



sales tax in 1987 to fund the San Diego Transportation Improvement Program (TransNet), resulting in a total countywide sales tax of 7.75%. This tax rate includes a ½-cent tax that was passed by California voters in 1993 for the purpose of funding local public safety expenditures. The revenue from this ½-cent sales tax, known as safety sales tax, is discussed in the next section.

Economic Trends and Fiscal Year 2007 Sales Tax Budget

The State Employment Development Department recently reported that the unemployment rate in San Diego County remained stable at 3.7% in April 2006 and May 2006, lower than the estimated 4.1% a year ago. For comparison, an unadjusted unemployment rate for California was 4.6% and 4.4% for the nation during the same period. Between April 2006 and May 2006, nonfarm wage and salary employment in San Diego County rose by 5,300 jobs to reach 1,302,500 jobs with construction recording the largest increase (up 1,800 jobs), followed by the leisure and hospitality sector (up 1,300 jobs), and the trade, transportation and utilities sector (up 1,000 jobs.) Between May 2005 and May 2006, total nonfarm employment was up by 17,500 jobs, an increase of 1.4% with leisure and hospitality recording the largest increase (up 5,100 jobs.) Construction grew by 4,300 jobs, with most of the increase occurring in the specialty trade contractors sector. Educational and health services added 2,800 jobs since May 2005.

The Fiscal Year 2007 sales tax estimate reflects the sustained growth in local taxable sales, though there are some concerns among economists related to the performance of taxable sales in San Diego County for 2006 and 2007, as a result of a possible increase in the unemployment rate related to the job losses in the real estate industry and the impact of rising gas prices on consumer spending. The UCLA Anderson Forecast stated that incomes in San Diego have been rising over the last two years but not at the same level as spending which is largely due to increases in new housing wealth. In addition, employment related to real estate remains a significant contributor to overall job growth. If there is less spending related to new housing wealth, and if there is a job loss in the real estate industry, the local economy may be somewhat negatively affected unless this loss is made up in other high wage industries. The forecast for San Diego predicts some weakness in the real estate sector which will be offset by continued growth in tourism and professional services. Despite a projected growth in personal income, taxable sales are projected to slowdown in late calendar year 2006 as the consumption driven by a home equity wealth factor declines.

The projected sales tax revenue for Fiscal Year 2007 is $234.9 million. The increase in sales tax revenue from Fiscal Year 2006 to Fiscal Year 2007 is nearly $91 million, which includes approximately $17 million of projected economic growth and an estimated $74 million due to the restructure of the Sales Tax. This figure reflects greater transparency in budgeting, for example, total City sales tax revenue previously budgeted in a variety of funds throughout the City is now budgeted totally in the General Fund. In past fiscal years, upon receiving sales tax revenue from the State, the City allocated portions of the sales tax revenue directly to selected programs and funds. The programs and funds that received allocations included but are not limited to Special Promotional Programs, Police Decentralization Fund, Centre City Maintenance Coordination Fund, the Unappropriated Reserve and Street Division. Any remaining portion was then budgeted in the General Fund. Beginning in Fiscal Year 2007, the General Fund sales tax figure reflects total revenue received by the City.

The Fiscal Year 2007 sales tax projection also includes the property tax reimbursement that the City will receive as a result of the triple-flip (triple-flip is the shift enacted by the State in Fiscal Year 2005 whereby local governments shift ¼-cent of their Bradley-Burns Sales and Use Tax to the State in exchange for an equivalent amount of property tax.) It should be noted that the property tax reimbursement amount that the City receives is equivalent to the growth in taxable sales, not the growth in assessed valuation. In addition, once the Economic Recovery Bonds are paid off by the State, local governments will no longer receive the property tax reimbursement, but will instead regain the ¼-cent sales tax that was diverted to the State by the triple-flip, which makes this shift different from the VLF property tax swap which is considered to be a permanent shift of revenues from VLF to property tax. As previously mentioned in the Property Tax section, beginning in Fiscal Year 2006, the in-lieu-of VLF payment is considered to be a permanent increase in property tax revenue, with year-over-year growth being based on the growth in assessed valuation.

The chart below demonstrates the breakdown of the total Fiscal Year 2007 sales tax projection:

FISCAL YEAR 2007 SALES TAX BUDGET	
Sales Tax Revenue	$177.5 million
Property Tax Reimbursement	$57.4 million
TOTAL SALES TAX	$234.9 million

SAFETY SALES TAX

Overview and Background

Safety sales tax revenue is derived from a half-cent sales tax that resulted from the passage of Proposition 172 on November 2, 1993, and must be utilized solely for local public safety purposes. The State Controller's Office disburses safety sales tax revenue to the County Local Public Safety Fund for distribution. Cities receive 5.0% of the amount in the fund, which is allocated among the cities based upon their proportionate loss of Property Tax revenue in the 1993-94 ERAF shift. Subsequent legislation (Senate Bill 8) changed the allocation system for Proposition 172 revenue and lifted the cap on the share that the City of San Diego and other cities within the County could receive. Total revenues reflect additional funds received by the City as a result of this legislation.

Economic Trends and Fiscal Year 2007 Safety Sales Tax Budget

As with the Bradley-Burns sales tax revenue, safety sales tax revenue is sensitive to economic conditions, particularly factors that influence taxable sales, such as employment levels, per-capita income, and business investment. However, safety sales tax is allocated first to counties in proportion to their share of taxable sales, and then to the cities within the county. As a result, the City of San Diego's share of total countywide safety sales tax revenue depends not on taxable sales within the City, but rather on San Diego County's share of total statewide taxable sales which results in a different growth rate than the one used to project Sales Tax revenue.

The Fiscal Year 2007 Annual Budget includes total safety sales tax revenue of $8.2 million, a 4.0% growth over Fiscal Year 2006 year-end estimates. Approximately $1.6 million will be allocated to the Fire and Lifeguard Facilities Fund for debt service payments on fire facility improvements, a reduction from past years due to the delay in anticipated debt issuances. The remainder, or approximately $6.6 million, is allocated for public safety expenditures within the General Fund. City Council Policy 500-07 directs the use of Proposition 172 funds for new public safety expenditures to ensure an augmentation of existing General Fund public safety expenditure levels. Increases to public safety expenditures in the Police and San Diego Fire-Rescue departments have far exceeded the revenue growth of safety sales tax, ensuring the City's compliance with Council Policy 500-07.

TRANSIENT OCCUPANCY TAX

Overview and Background

San Diego's Transient Occupancy Tax (TOT) is levied at 10.5 cents per dollar of the daily room price in hotels and motels used by visitors staying in San Diego for less than 30 consecutive days. The allocation of TOT is at the discretion of the Mayor and City Council with guidelines provided by Council Policy 100-3. This Council Policy stipulates that, of the 10.5% of TOT, 4.0% shall be applied toward promotion of the City of San Diego as a tourist destination, 5.5% shall be applied toward general government purposes, with the remaining 1.0% to be allocated for any purposes that the Mayor and City Council may direct. Currently, 5.0% of the 10.5%, or approximately 48.0%, is allocated to Special Promotional Programs for the promotion of tourism and other purposes designated by City Council policy. Of the remaining 5.5%, approximately 52.0%, is allocated directly to the General Fund for general government purposes.

Economic Trends and Fiscal Year 2007 Transient Occupancy Tax Budget

Overall, San Diego tourism performance is projected to have a moderate growth. This trend is reflected in the TOT revenue growth rate in Fiscal Year 2007 which has been increased to 6.0% versus 5.0% in Fiscal Year 2006. According to the San Diego Convention and Visitor Bureau (ConVis), hotel room night demand is projected to grow by 2.0% in 2006, down from the 3.0% growth in 2005. Hotel room nights sold in the market will reach 14.5 million room nights in 2006, putting occupancy at 72.9%, an increase of 0.9%. The average daily rate is expected to continue growing along with the national rates. The forecast is for 4.5% growth in the rate to an average of $127.09 per night. Recent data published by ConVis shows that the year-to-date (January 2006 through May 2006) average occupancy rate was 72.1%, a 2.3% increase over the same period in calendar year 2005, and that the average daily rate was $126.59 per night, a 6.7% increase over the same period in calendar year 2005. As an example, an increase of just 1.0% in tourism spending by visitors to San Diego would create $58 million in additional visitor spending, $13.9 million in additional hotel spending and over $1.4 million in Transient Occupancy Tax, according to statistics collected by ConVis.

San Diego continues to be one of the most desirable travel destinations in the U.S. Its market benefits from its diverse visitor mix, since it is not overly dependent on business travel, which is cyclical and depends on economic conditions. While the business segment spends more per person and stays primarily in hotels, the large visitor volume is in the leisure market, which continues to grow locally and nationwide and now contributes more room nights than the business segment. In addition, downtown San Diego continues to experience high demand at high average daily rates. Home to the San Diego Padres' new PETCO Park, the San Diego Convention Center, the Gaslamp Quarter, Horton Plaza and numerous restaurants, demand continues to be strong for the urban experience. In the forecast for calendar year 2006, demand of rooms will outpace supply due to increases in group and corporate travel, following San Diego's current lodging trends. In addition, leisure travelers who never previously stayed downtown are now finding it desirable, according to the ConVis's 2006 Visitor Industry Forecast.

Despite San Diego remaining as one of the most desirable travel destination in the U.S., the hotel room demand growth in calendar year 2005 was slower than other competitive markets in the Pacific region, according to Smith Travel Research. The executive director of the San Diego Lodging Industry Association

has stated that San Diego's tourism industry is suffering by not marketing itself more aggressively. Thus, the San Diego Lodging Industry Association has proposed a 2.0% assessment on nightly hotel room rentals to create a Tourism Improvement District (TID.) The TID, if approved, proposes to raise $20-$24 million annually which would be spent on marketing San Diego to potential visitors. With the creation of large hotel developments such as the Hard Rock Hotel downtown, the Hilton at the Marina, plus several smaller projects in North County and downtown San Diego, an estimated 8,000 to 9,000 new hotel rooms are expected to be available between 2008 and 2010, according to the executive director of the San Diego Hotel-Motel Association. With the increase in supply, there needs to be an increase in demand. The TID proposal carries an idea of promoting San Diego as a travel destination and keeping occupancy rates high by marketing San Diego more aggressively through the use of the revenue generated by the TID. Opponents to the formation of the TID believe that this assessment could result in a percent loss in rooms sold. The TID proposal is expected to be brought to Council in early fall with the enabling ordinance and in mid-fall for an industry vote.

For Fiscal Year 2007, the TOT allocated to Special Promotional Programs is $66.2 million and the TOT allocated to the General Fund is $72.9 million. The total Fiscal Year 2007 Annual TOT Budget is $139.1 million, a 6% growth over Fiscal Year 2006 year-end estimates.

PROPERTY TRANSFER TAX

Overview and Background

The property transfer tax is levied on the sale of real estate property. The County charges $1.10 per $1,000 of the sale price when any real property is transferred. The City of San Diego charges $0.55 per $1,000, which is credited against the County's charge, so that the City and the County both receive $0.55 per $1,000. The funds are collected by the County for property transfers that occur within City limits, and transferred to the City in 13 apportionments throughout the year.

Property transfer taxes are highly reflective of the housing market and are generally more volatile than overall property taxes. Appreciation or deprecation in property values and sales volume in the local real estate market specifically affect property transfer tax revenues. Property transfer tax revenue is being impacted by a slowdown in construction, and, in the long term, by a reduction in the supply of City land that may be developed. In Fiscal Year 2006 property transfer tax receipts were slightly below expectations and can be attributed to such factors as a slowdown in the local real estate market, higher interest rates, and the modest growth in the economy overall. As previously mentioned in the Property Tax section, fewer homes are being sold in calendar year 2006. A comparison between May 2006 and May 2005 shows that the number of home sales, including existing detached houses, new detached houses, and condominiums, decreased by 18.0% and that the prices are either staying flat or decreasing in certain areas. According to local economists, this trend is expected to continue in calendar years 2006 and 2007.

The Fiscal Year 2007 Property Transfer Tax budget reflected the market conditions and trends at the time of the budget preparation. The budgeted growth rate was reduced to 7.0% compared to 10.0% in Fiscal Year 2006. The total Property Tax projection for Fiscal Year 2007 is $14.9 million. The trend of continued decline in the number of home sales indicate that it may be necessary to readjust the Property Transfer Tax budget in Fiscal Year 2007.

LICENSES AND PERMITS

Overview

The Licenses and Permits category reflects revenue generated to recover costs associated with performing regulatory functions. These functions are typically performed by government due to public safety considerations. Included in this category are general business license taxes, rental unit taxes, parking meter collections, and the refuse collection business license tax.

The general business license tax for companies with 12 or fewer employees is a flat fee of $34. Companies with 13 or more employees pay a fee of $125 plus $5 per employee. Rental unit taxes are calculated as a flat rate plus a fee per rental unit. Currently, the rental unit tax has three rate tiers for residential properties and two rate tiers for hotel/motel properties.

Fiscal Year 2007 Licenses and Permits Budget

The Fiscal Year 2007 Annual General Fund Budget for Licenses and Permits is $30.7 million, a 8.4% increase over the Fiscal Year 2006 year-end estimates.

FINES, FORFEITURES, AND PENALTIES

Overview

Fines, Forfeitures, and Penalties include revenue generated from monetary sanctions associated with the violation of a law or regulation such as California Vehicle Code violations, City parking and ordinance violations, and litigation awards.

Fiscal Year 2007 Fines, Forfeitures, and Penalties Budget

The Fiscal Year 2007 Annual General Fund Budget for Fines, Forfeitures, and Penalties is $34.9 million, a 5.0% increase from the Fiscal Year 2006 year-end estimates.

REVENUE FROM MONEY AND PROPERTY

Franchise Fees

SDG&E Revenue. Revenue from franchise rents result from agreements that allow utility and cable companies to use the City right-of-way. The largest of the City's five franchise accounts is the revenue resulting from an agreement with San Diego Gas & Electric Company (SDG&E.). The revenue derived from this franchise, 3.0% of the gross sales of gas and electricity within the City, is constrained by the City Council Policy in terms of how it may be used. The SDG&E franchise revenue is split as follows: 75% is deposited into the General Fund and the remaining 25% is deposited into the Environmental Growth Fund (EGF.) One-third of the EGF is used to finance various environmental programs such as litter control. The remaining two-thirds of the EGF is used for debt service on open space acquisition bonds. For Fiscal Year 2007, the franchise revenue from SDG&E is projected to be $50.9 million with 75% or $38.1 million allocated to the General Fund and 25% or $12.7 million allocated to EGF. The Fiscal Year 2007 SDG&E revenue budget assumes a 7.0% growth over Fiscal Year 2006 year-end estimates.

Cable Revenue. In addition, the City has Franchise Agreements with two cable companies: Cox Communications and Time Warner Cable. Effective January 8, 2004, the Franchise Agreement with Time Warner Cable was amended to increase the franchise rate from 3.0% to 5.0% of gross sales. The Franchise Agreement with Cox Communications was renegotiated in 2002, increasing the franchise fee from 3.0% to 5.0%. Due to the introduction of AB 2987, the revenues from cable companies, which are budgeted at $15.8 million in Fiscal Year 2007, may be in jeopardy. Currently, the law states that any city may authorize by franchise or license the construction and operation of a community antenna television system, prescribe rules and regulations to protect the subscribers and ensure that cable and video service providers comply with specified customer service standards and performance standards. The new bill would establish a procedure for state-issued authorizations for the provision of cable service or video service that would be administered by the Department of Corporations and all franchise fees generated would be received by such department. The Fiscal Year 2007 cable revenue budget assumes a 7.5% growth over Fiscal Year 2006 year-end estimates.

Revenue from Refuse Haulers. The City also collects a refuse hauler franchise fee from private refuse haulers. The refuse hauler franchise fee was increased by $1 in July 2003 to an effective rate of $11 per ton for Class I haulers (less than 75,000 tons per year) and $12 per ton for Class II haulers (more than 75,000 tons per year.) For Fiscal Year 2007, the refuse hauler franchise fee is projected to be $10.6 million or 0.9% decrease over Fiscal Year 2006 year-end estimates. Miscellaneous other revenue from franchise fees is expected to be approximately $ 250,000 in Fiscal Year 2007.

Undergrounding Utility Fee. In addition to the 3.0% franchise fee, the City Council approved a 3.53% surcharge on SDG&E's electricity sales for the undergrounding of electric utility lines which was approved by the California Public Utilities Commission in December 2002. The Utility Undergrounding surcharge is estimated to raise $42.0 million in Fiscal Year 2007 or 0.2% higher than in Fiscal Year 2006, which will be deposited into the Undergrounding Utility District Fund to be used solely for the purpose of placing utility lines underground.

Interest Earnings

The City Treasurer is responsible for investing the City's cash assets exclusive of City Pension Trust Funds. All City funds are pooled and invested together in a Pooled Investment Fund ("Fund") to facilitate increased flexibility in the management of the City's cash flow requirements and the overall management of the Fund for the purpose of maximizing interest earnings. Fund investments must be consistent with the City Investment Policy and the State of California Government Code guidelines and restrictions. The maximum maturity of any investments may not exceed five years. Selection of an investment is based on safety, liquidity, risk, interest rate environment and the cash flow requirements of the City, and the course of a full economic cycle. Major deviations in returns from one fiscal year to the next can generally be attributed to changes in market interest rates or the actual average amount invested during the fiscal year. Past interest earnings performance is no guarantee or indicator of future results.

Interest rates have been rising since June 2003. This change in the overall level of interest rates will be reflected in the estimated interest earnings for Fiscal Year 2007, which will take into account the realization of any capital gains or losses on portfolio securities that occur as securities are regularly turned over during the fiscal year. In a rising interest rate environment, the value of securities held in the portfolio declines, while the opposite is true in a declining interest rate environment. When this change in portfolio value occurs, the impact on overall interest earnings, whether positive or negative, is mitigated to some degree by the earnings derived from the reinvestment of cash from coupon payments, the turnover of portfolio securities and the investment of new revenues at higher current market rates of interest.

Interest rates are expected to continue to rise through at least the first half of Fiscal Year 2007. The adverse effect of rising interest rates on the market value of the securities held in the portfolio will be mitigated to some extent by the reinvestment of coupon payments, maturing investments and proceeds of sold securities at higher reinvestment rates. It should be noted that interest rates are market driven and therefore subject to a number of uncontrollable or unpredictable factors.

Rents and Concessions

The Fiscal Year 2007 Annual Budget includes $32.7 million in Rents and Concessions revenue with Mission Bay Park, Balboa Park and Torrey Pines Golf Course generating the majority of this source of General Fund revenue. In turn, Mission Bay Park's rents and concessions comprise the majority of the revenue in this category with revenue generated from leases with Sea World, the Marina Village Conference Center, and several hotels and marinas. This revenue source is projected to generate $24.4 million in Fiscal Year 2007,

an increase of 2.4% over Fiscal Year 2006 year-end estimates. The Mission Bay Ordinance requires that one-half of all revenue from Mission Bay rents and concessions in excess of $20 million is to be allocated to the Mission Bay Improvements Fund and the Regional Park Improvements Fund. This requirement was waived for Fiscal Year 2006; however, in Fiscal Year 2007, $1.1 million was allocated to the Mission Bay Improvements Fund, $1.1 million was allocated to the Regional Park Improvements Fund and the remaining $2.2 million was allocated to the General Fund. Another component of the Rents and Concessions category relates to revenue generated from lease agreements on City Pueblo lands, which in Fiscal Year 2007 is projected to be $3.3 million.

REVENUE FROM OTHER AGENCIES

Motor Vehicle License Fees

Motor Vehicle License Fees (VLF) are levied as a percentage of an automobile's purchase price, subject to depreciation, and are paid annually to the Department of Motor Vehicles at the time of registration. The fees are forwarded to the State Controller's Office which allocates the funds to local governments. Prior to Fiscal Year 2004, approximately 25.0% of total statewide VLF revenues were allocated to counties in order to fund realignment of various health and social service programs, while the remaining 75.0% was allocated to cities and counties on a per capita basis. Notably, because statewide revenues are distributed on a per capita basis, increases to local vehicle sales do not directly translate into local VLF revenue increases.

Beginning in 1999, the VLF underwent a series of offsets, first initiated by the State legislature as part of the 1998-1999 Budget agreement. These offsets ultimately resulted in a 67.0% reduction in the effective VLF rate, from 2.0% of a vehicle's value to 0.65%. To compensate cities and counties for the tax offset, the State began providing State General Fund revenue to cities and counties on a dollar-for-dollar basis, otherwise known as the VLF backfill. As part of the 2004-2005 Budget agreement, the VLF rate was statutorily reduced to 0.65%, thereby eliminating the VLF backfill. As described in the property tax section, cities were compensated for this loss with increased property tax revenues. In Fiscal Year 2005, approximately $69.1 million was shifted from VLF to property tax. As a result of this revenue shift, VLF is no longer considered a major General Fund revenue source for the City of San Diego. The Fiscal Year 2007 Annual Budget for VLF is $9.3 million, a 3.5% growth over Fiscal Year 2006 year-end estimates.

Miscellaneous Revenue from Other Agencies

A significant amount of revenue received by the City is initially collected by other agencies and then returned (or subvened) to the City. Within the General Fund, Revenues from Other Agencies include federal and State grants and reimbursement for general City services provided to the Unified Port District.

The Fiscal Year 2007 General Fund Budget includes revenue totaling approximately $12.3 million in this category, including $5.2 million in State reimbursements for booking fee expenses. The Fiscal Year 2007 Budget also includes $1.5 million from the State for the Community Policing Services (COPS) Program and $400,000 in Local Law Enforcement Block Grant funds. The State Police Officer Standards and Training (POST) grant reimbursement is budgeted at $100,000.

Charges for Current Services

Charges for Current Services include revenue generated by General Fund departments resulting from services provided to other City funds. General Fund departments regularly incur expenses in the process of performing services for other City funds and receive reimbursement for direct, indirect, and overhead costs. Such instances include general government services and facilities maintenance services provided to other City funds. The Fiscal Year 2007 Budget for Charges for Current Services within the General Fund is $88.3 million, a 13.9% increase over Fiscal Year 2006 year-end estimates. Refer to Schedule III of this budget document for a breakdown of the budgetary data by subcategory.

Transfers from Other Funds

The Fiscal Year 2007 General Fund Budget for Transfers from Other Funds is $62.2 million. Revenue in this category reflects transfers to the General Fund from various other funds, such as Capital Improvements Program Funds, Storm Drain Fund, Environmental Growth Fund, TransNet Fund and other funds. Prior to Fiscal Year 2007, the Transfers from Other Funds category included the transfer from the Special Promotional Programs. Beginning in Fiscal Year 2007, this transfer was not included due to the restructuring of the Special Promotional Programs budget.

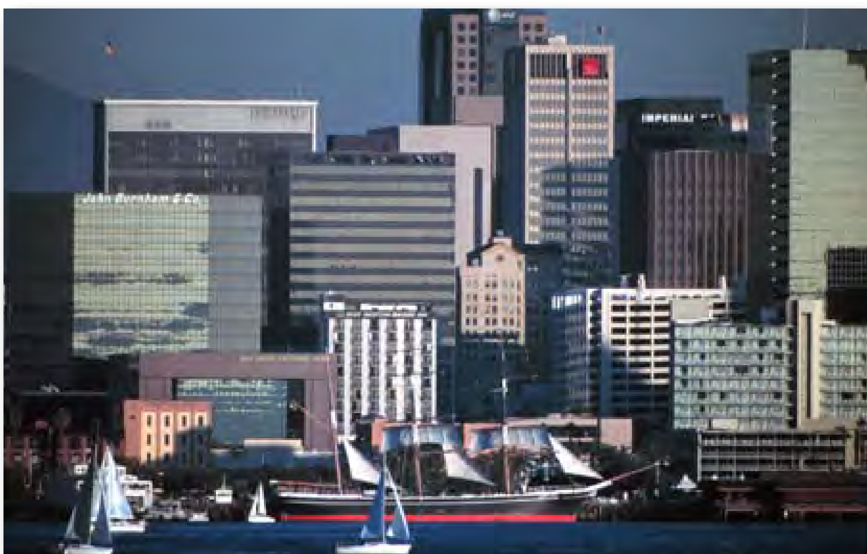
Other Revenue

Other Revenue is mainly composed of refunds and revenue generated from the sale of publications and excess inventory. The Fiscal Year 2007 Budget includes revenue totaling $1.8 million in this category, representing approximately 0.3% of total General Fund revenue.

STATE OF CALIFORNIA STATE BUDGET IMPACTS

For Fiscal Year 2007 the State reinstated the booking fees reimbursement program and repaid the City's ERAF III contribution, explained earlier in the Overview and Background section of the Property Tax Revenue.

San Diego's Fiscal Year 2007 Annual Budget includes $5.2 million of booking fees reimbursement from the State. The State supplemental budget bill, AB 1811, contains in Fiscal Year 2007 $35 million to reimburse cities for booking fees paid to counties and sets out a new booking fee structure to begin on July 1, 2007. The new booking fee program would provide that in any year in which the state provides at least $35 million in subventions for local jail facility funds, existing booking fees would be eliminated. Instead, counties and cities with jails will be restricted to charging arresting agencies a new jail access fee for booking of municipal code and misdemeanor violations that exceed the most recent three-year average of each local arresting agency. Misdemeanors for driving under the influence or related to domestic violence would be excluded from the jail access fee calculation. Local governments could reinstate booking fees in any year in which the state appropriates less than $35 million, but only in proportion to the shortfall in the appropriation. Also, after Fiscal Year 2007, the maximum rate of any future booking fees would be limited to the fee in effect on June 30, 2006 plus an annual inflation adjustment equal to the increase in the consumer price index plus 1.0%. An analysis is currently underway to predict how the budget bill AB 1805 will affect the booking fees in Fiscal Year 2008.



The Fiscal Year 2007 Annual Budget includes a $16.9 million repayment of the ERAF III property tax revenue shift. As explained in the Property Tax Revenue section, the ERAF III property tax revenue was taken by the State only in Fiscal Years 2005 and 2006, with a full amount of $16.9 million reinstated in Fiscal Year 2007 and beyond.