THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: April 19, 2010

TO: Honorable Council President and Members of the City Council

FROM: Jay M. Goldstone, Chief Operating Officer

SUBJECT: Revised FY 2011 – 2015 Five-Year Financial Outlook

In October 2009, the Mayor released the FY 2011-2015 Five-Year Financial Outlook (October 2009 Outlook) which projected a deficit of $179 million for FY 2011 and deficits through FY 2015. In order to address the projected FY 2011 deficit early, the Mayor released the FY 2011 Proposed Budget in December 2009 which was approved by City Council. Subsequently, an additional $28 million was identified as a projected budget gap in FY 2011 due to a higher than estimated ARC payment and revenues that were lower than projected in FY 2010.

The Proposed FY 2011 Budget released on April 15 includes the December budget actions and serves as the baseline in this Revised Outlook for updating projections for FY 2012-2015. In addition, staff have revised the City's revenue and expenditure projections for FY 2011-2015 (Attachment I). Some of the major assumptions used in this Revised Outlook include: 1) flat to modest revenue growth and no tax increases; 2) no salary increases and the continuation of the 6.0% compensation reductions; 3) modest growth in the cost of supplies, utilities and other City non-labor expenses; and 4) funding for priority areas, including funding reserves. The major changes to the revenue and expenditure assumptions are described further in this memorandum. Not included in this memorandum are those revenue and expenditure assumptions that were not changed since the October 2009 Outlook.

In addition, this is an abridged version of the FY 2011-2015 Five-Year Financial Outlook and a comprehensive, detailed Five-Year Financial Outlook with updated revenue and expenditure assumptions, along with a detailed discussion of the City's deferred capital improvement needs will be released in the fall of 2010.

Below are the updated assumptions for FY 2012-2015 used in this Revised Outlook which are based on the balanced FY 2011 Proposed Budget.

MAJOR REVENUES

The most significant revenue adjustments in this updated Outlook have been made mainly to major revenues from property tax, sales tax and transient occupancy tax, based on the most recent economic updates, year-to-date actual receipts and revised projections for FY 2010. In addition, in FY 2012 specific adjustments were made in other revenue categories as described further in this memorandum.

The San Diego economy is projected to improve during the forecasted period compared to the economic environment in FY 2009-2010, which was characterized by marked declines in nearly all the City's General Fund revenue sources as local real estate values and sales activity, consumer spending, and business investment weakened. Many major economic indicators have shown positive growth over recent months, reversing trends that led to declining General Fund revenues. The improvement in major revenues, however, is expected to lag the overall economic recovery.

Property Tax
The property tax revenue forecast has been updated to reflect growth of 3.0%, 3.0%, 4.0%, and 4.0% for FY 2012-2015, respectively, compared to 2.0%, 3.0%, 4.0%, and 4.0% in the October 2009 Outlook. The more conservative growth rate in FY 2012 is due to the expectation of a slower recovery in the local housing market than projected in October 2009. The property tax growth rate in the FY 2011 Proposed Budget is flat due primarily to a still declining commercial real estate market. Assessed value is projected to increase gradually in FY 2012 as single-family residential properties maintain their current growth in median price and as vacancy rates in commercial properties decline, thereby strengthening the commercial sector (vacancy rates affect property values and thus affect assessed values.) A projected increase in assessed value is expected to increase property tax revenue by 3.0% in FY 2012 as local housing prices are expected to gradually increase. In FY 2013-2015, property tax revenue growth is projected to increase at slightly above the growth rate in FY 2012. However, growth rates throughout the Revised Outlook are not forecasted to approach levels experienced in calendar years 2000-2007.

Sales Tax
The sales tax revenue forecast has been updated to reflect growth of 4.0%, 4.5%, 5.0%, and 5.5% for FY 2012-2015, respectively, compared to 2.7%, 3.2%, 4.0%, and 5.2% in the October 2009 Outlook resulting in increased projected revenue in FY 2012-2015. Taxable sales in the City of San Diego are projected to remain flat with no growth assumed in the FY 2011 Proposed Budget due to expected stabilization in the local economy and in discretionary spending by consumers on taxable goods. The sales tax projection for FY 2012 of 4.0% growth in taxable sales from taxable sales is based on the expectation that average economic growth will resume beginning at the beginning of FY 2012. Taxable sales in the next two fiscal years in the Revised Outlook are projected to grow at long run compounded average historical growth rates of 3.0%-4.0% for the City and marginally above average growth rates in subsequent years of the Outlook.

Transient Occupancy Tax
The transient occupancy tax (TOT) revenue forecast has been updated to reflect growth of 2.0%, 3.5%, 4%, and 4.5% for FY 2012-2015, respectively, compared to 3.0%, 3.5%, 4.0% and 4.0% in the October 2009 Outlook. The more conservative growth rate of 2.0% in FY 2012 is based on the expectation of slower economic recovery and its effect on tourism in San Diego. The TOT

growth rate in the FY 2011 Proposed Budget is projected to be flat. Industry analysts cautiously expect San Diego's travel to improve in calendar year 2010. This recovery, however, is expected to be slow as group hotel bookings are expected to be significantly lower due to declining business travel until calendar year 2011. Concerns about the high level of unemployment and low consumer confidence, despite the slow improvement in some economic sectors, are projected to continue to impact tourism trends in FY 2012. A slow recovery is expected to begin later in calendar year 2010 but a return to calendar year 2008 growth rate levels is not expected until calendar year 2011. A conservative 2.0% growth rate in FY 2012 is therefore assumed in the Revised Outlook.

Other Financial Sources & Uses
(Formerly Transfers from Others Funds)
This Revised Outlook includes removal of one-time revenues from FY 2012 in the *Other Financial Sources & Uses* category. This includes $24.6 million set aside from FY 2010 savings to mitigate a portion of the $179 million projected deficit in FY 2011 and $9.5 million of undesignated fund balances budgeted as transfers in FY 2011. This accounts for the decline in revenues in this category of $34.1 million in FY 2012.

Other Revenue Adjustments
This Revised Outlook includes the removal of the $11.3 million payment in FY 2014-2015 from the Redevelopment Agency (CCDC) for PETCO Park debt service. If this payment continues past FY 2013, the projected deficit for FY 2014-2015 would be $58.6 million and $36.8 million, respectively.

In addition, the annual payment of $4.5 million from the Unified Port District (UPD) for the Convention Center debt service ends after FY 2014 as specified in the City's agreement with the UPD. As a result, the projected deficit for FY 2015 is increased to $48.1 million due to the $4.5 million in expenditure increase.

One-time revenues which were added in the FY 2011 Proposed Budget and removed from FY 2012 include $3.3 million in Proposition 1B funds and $4.3 million in Mission Bay revenues (to be transferred to the General Fund in FY 2011.)

EXPENDITURES

Below are the most significant expenditure adjustments to the October 2009 Outlook that are included in this Revised Outlook.

Pension Annual Required Contribution
The total City's pension annual required contribution (ARC) for FY 2012 as included in this Revised Outlook is $257.7 million ($200.4 million in the General Fund) inflated at 4.0% each year thereafter. The $257.7 million ARC payment is based on a 7.75% annual investment return assumption. The investment returns through the end of December 2009 (for six months of the current fiscal year) were 15.8%.

General Fund Reserves
The Revised Outlook includes the additional funding needed to meet the City's reserve goals for the General Fund, Public Liability, and Workers' Compensation funds. The General Fund Reserve goal is 7.5% for FY 2012 and 8.0% for each fiscal year thereafter. The contribution toward the 7.5% goal for FY 2012 (based on the total General Fund revenue projection) is estimated to be $3.4 million compared to $7.9 million in the October 2009 Outlook which assumed 8.0% goal for FY 2012.

Workers' Compensation Fund Reserve
The calculation methodology for this reserve has been modified to smooth the annual reserve contribution to achieve 50% of the average value of the annual actuarial liability for the most recent three fiscal years (FY 2007-2009), currently $155 million (average for FY 2007-2009). By extending reserve goal targets through FY 2016, the Revised Outlook assumes General Fund annual payments to the Workers' Compensation Fund Reserve to be $5.1 million annually for FY 2012-2015 (total City payments are $6.2 million annually.)

Public Liability Fund Reserve
Similar to the Workers' Compensation Fund Reserve, the calculation methodology for this reserve has been modified to determine a consistent annual amount for the reserve contribution to build the reserve to 50% of the total liability. By the end of FY 2016, the annual funding included in the Revised Outlook results in reserves that will equal 50% of the average value of the annual actuarial liability for the most recent three fiscal years (FY 2007-2009), currently $114.5 million (average for FY 2007-2009). This requires a General Fund contribution of $5.7 million annually to the Public Liability Fund reserve in FY 2012-2015.

McGuigan Settlement Debt Restructuring
The October 2009 Outlook included a payment of a remaining balance ($31.7 million in the General Fund) in FY 2011 and no payments in the following years. Based on the new debt structure (if approved by the Court in April 2010), the General Fund annual payments for the settlement would be approximately $8.0 million for FY 2012-2015 which are included in this Revised Outlook.

Deferred Capital Projects
This Revised Outlook includes debt service totaling $13.6 million for the planned 2010A Master Refunding Bonds in FY 2012 (comprised of $7.8 million for deferred capital projects, $4.9 million for Qualcomm Stadium, and $0.9 million for Balboa Park COPs.) In addition, the Revised Outlook assumes the future issuance of $120 million in bonds for additional capital projects in mid-FY 2012 and mid-FY 2014 which include $20 million in each issuance for ADA projects. The debt service payments for these financings are included in this Revised Outlook in FY 2012-2014.

This Revised Outlook also includes $0.8 million for Community Plan updates annually in FY 2012-2015.

One-Time Expenditure Adjustments
This Revised Outlook includes a removal of $4.4 million savings from fleet usage allocations and $3.3 million in Proposition 1B funds in FY 2012 that were included in the FY 2011 Proposed Budget.

CONCLUSION
This Revised Outlook has been updated based on the FY 2011 Proposed Budget. It also reflects changes to revenue and expenditure assumptions since the release of the FY 2011-2015 Five-Year Financial Outlook in October 2009 by taking into account the most recent economic trends and other adjustments as described earlier in this memorandum. As a result of the actions taken in December 2009 to structurally address a significant portion of the projected deficits in FY 2011, and the additional budget adjustments in the Revised FY 2011 Proposed Budget, the projected deficit for FY 2012-2015 is significantly reduced compared to the October 2009 Outlook. FY 2012 reflects the largest projected deficit compared to the following years. The projected deficits in FY 2012-2015 in the October 2009 Outlook were $159 million, $156 million, $166 million, and $137 million, respectively. This Revised Outlook shows a projected deficit of $72.5 million, $68.4 million, $69.9 million, and $48.1 million respectively for FY 2012-2015.

A more comprehensive and detailed Five-Year Financial Outlook for FY 2012-2016 with updated revenue and expenditure assumptions will be released in the fall of 2010.

Jay M. Goldstone
Chief Operating Officer

Attachment I

cc: Mayor Jerry Sanders
Mary Lewis, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst

Attachment I

FISCAL YEAR 2011 - 2015 FIVE YEAR FINANCIAL OUTLOOK

GENERAL FUND REVENUES	FY 11 Proposed	FY 2012	FY 2013	FY 2014	FY 2015
Property Tax (Includes Transfer Tax)	$ 394.7	$ 406.9	$ 419.4	$ 436.2	$ 453.7
Sales Tax (Includes Safety Sales Tax)	193.8	199.6	208.7	217.5	227.6
Transient Occupancy Tax	66.1	67.4	69.8	72.6	75.9
Franchise Fees	67.2	69.2	71.3	73.4	75.6
Motor Vehicle Licensing Fees	3.1	3.3	3.5	3.6	3.8
Interest Earnings	1.7	2.1	2.6	3.2	4.0
Licenses & Permits	31.0	31.0	31.0	31.0	31.0
Fines, Forfeitures, and Penalties	31.4	31.4	31.4	31.4	31.4
Revenue from Money & Property	43.6	39.9	40.4	40.9	41.5
Revenue from Federal & Other Agencies	2.1	2.1	2.1	2.1	2.1
Charges for Current Services	144.9	142.0	142.2	142.5	142.8
Other Financial Sources & Uses	110.2	76.5	76.9	77.4	78.0
Other Revenue	2.5	2.5	2.5	2.5	2.5
TOTAL GENERAL FUND REVENUES	**$ 1,092.3**	**$ 1,073.8**	**$ 1,101.7**	**$ 1,134.4**	**$ 1,169.9**

GENERAL FUND EXPENSES	FY 11 Proposed	FY 2012	FY 2013	FY 2014	FY 2015
Salaries & Wages	$ 471.8	$ 471.8	$ 471.8	$ 471.8	$ 471.8
Salary Annual Leave	1.7	1.7	1.7	1.7	1.7
Retirement (1)	180.1	200.4	208.4	216.7	225.4
Retirement Offset	4.8	4.8	4.8	4.8	4.8
Pension Liability	8.9	8.9	8.9	8.9	8.9
OPEB/Retiree Health	40.0	40.0	40.0	40.0	40.0
Fringe Benefits	43.7	43.7	43.7	43.7	43.7
Flexible Benefits	37.3	37.3	37.3	37.3	37.3
Supplies & Services	236.8	241.5	245.2	248.8	252.6
Information Technology	32.7	32.7	32.7	32.7	32.7
Energy / Utilities	27.3	28.6	30.1	31.6	33.1
Equipment Outlay	7.2	7.2	7.2	7.2	7.2
TOTAL GENERAL FUND EXPENSES	**$ 1,092.3**	**$ 1,118.6**	**$ 1,131.6**	**$ 1,145.1**	**$ 1,159.1**

INCREMENTAL EXPENDITURE ADJUSTMENTS*	FY 11 Proposed	FY 2012	FY 2013	FY 2014	FY 2015
Community Plan Updates	$ -	$ 0.8	$ 0.8	$ 0.8	$ 0.8
Incremental OPEB Contribution	-	3.1	6.3	9.6	12.8
Deferred Maintenance Debt Service	-	4.2	8.5	12.8	17.1
Annual Leave Liability	-	3.1	4.6	14.3	1.2
Planned New Facilities	-	1.7	0.6	0.7	0.1
Unappropriated & Appropriated GF Reserves	-	3.4	7.6	2.6	2.8
Workers' Compensation Fund	-	5.1	5.1	5.1	5.1
Public Liability Fund	-	5.7	5.7	5.7	5.7
McGuigan Settlement	-	8.0	8.0	8.0	8.0
Long Term Disability Reserve (2)	-	-	-	(1.6)	(1.6)
Transfer to SDRPI Fund & MBPI Fund (3)	-	0.5	1.1	1.6	5.2
INCREMENTAL REVENUE ADJUSTMENTS *	**FY 11 Proposed**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
TOT Discretionary Above 1 Cent (4)	-	(7.9)	(9.8)	(0.4)	1.6
TOTAL INCREMENTAL ADJUSTMENTS	**$ -**	**$ 27.8**	**$ 38.5**	**$ 59.2**	**$ 58.9**
TOTAL SURPLUS / (DEFICIT)	**$ 0.0**	**$ (72.5)**	**$ (68.4)**	**$ (69.9)**	**$ (48.1)**

* Reflects incremental changes over FY 2011 Proposed Budget.

(1) FY 2012 based on total City ARC of $257.7mm (77.8% General Fund portion). ARC grows at 4.0% per year after FY 2012.

(2) Elimination of expense in FY 2014 and FY 2015 based on reduction in contribution to Long Term Disability Reserve.

(3) Reflects increase in transfer of Mission Bay revenue to San Diego Regional Park Improvement Fund & Mission Bay Park Improvement Fund

(4) Negative values in FY12 - 14 are additional TOT revenue based on excess revenue above discretionary 1 cent amounts.