City of San Diego

FISCAL YEARS 2009-2013

FIVE-YEAR FINANCIAL OUTLOOK

JANUARY 2008

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EXECUTIVE SUMMARY

In November 2006, the Mayor released the City's first Five-Year Financial Outlook (2008-2012 Outlook) for the City of San Diego which presented a comprehensive examination of the City's long range fiscal condition. The Financial Outlook has proven to be an important planning tool for the City of San Diego. The Outlook guided the City in establishing the fiscal year 2008 annual budget and has served throughout the year as the basis for longer term fiscal decision-making. The Outlook has communicated the City's fiscal priorities along with the City's strengths and the challenges that remain in achieving a balanced General Fund budget and fiscal health.

The updated Five-Year Financial Outlook (2009-2013 Outlook) includes revised revenue and expenditure projections for fiscal years 2009 through 2013 as well as additional fiscal commitments that have emerged since the 2008-2012 Outlook was issued. Similar to the 2008-2012 Outlook, the revised revenue and expenditure estimates in the 2009-2013 Outlook are based on a variety of assumptions in the context of current and projected economic conditions. The updated Outlook not only identifies revenue and expenditure trends but also discusses risks and opportunities that affect fiscal decisions and the City's ability to accomplish its strategic goals over the next five-year period. Those goals include:

- Preservation of City services to the fullest extent possible. Fund the operations of new public facilities.
- Meet contractual obligations and fund mandated programs.
- Contribute the full payment of the Annual Required Contribution (ARC) for the City's pension system.
- Establish and maintain adequate General Fund reserves according to City Charter Section 91 and the City Reserve Policy recently approved by the City Council.
- Address other significant financial obligations with a longer-term strategy.

The 2009-2013 Outlook report is divided into four sections: the General Fund Revenue Forecast, the General Fund Expenditure Forecast, Eight Significant Areas, and Corrective Actions. The first section covers the development of the revenue projections and includes a detailed discussion of San Diego's economy and its affect on the City's major revenues. The second section outlines the expenditure forecast including future mandated expenditure requirements and expected cost growth rates. The Eight Significant Areas section discusses the funding requirements for the critical areas that were outlined in the 2008-2012 Outlook. Lastly, a series of Corrective Actions are identified to begin addressing a projected gap of $32 million for fiscal year 2009 between projected revenues and expenditures in the General Fund.

REVENUE FORECAST

The General Fund revenue categories and the related background information are discussed in the Revenue Forecast section along with methods and assumptions affecting growth projections for each major revenue source. There are four major General Fund revenue sources: Property Tax, Sales Tax, Transient Occupancy Tax and Franchise Fees which make up nearly 70.5 percent of General Fund revenue and are affected by changes in local, State, and national economic conditions. Other General Fund revenue sources such as licenses and permits, fines, forfeitures, and penalties are also influenced by economic conditions. A change in existing fees or the implementation of a new City Council policy for existing programs can reduce or increase projected revenue derived from fees. For example, the City's renewed efforts in fiscal year 2007 to enforce City policy requiring all businesses to obtain business license permits in a timely manner resulted in a one-time spike in revenues of approximately $5 million in the licenses and permits revenue category in fiscal year 2008. In fiscal year 2009, however, projections for business license permits revenue is expected to return to a growth rate more in-line with historical trends.

EXPENDITURE FORECAST

The General Fund expenditure forecasts are based on the City's current fiscal year expenditures trended forward assuming inflationary rate changes for certain expense categories and incorporate added costs for new facilities, City Council, State and federal mandates, and legal or contractual obligations. The expenditure categories discussed include Salaries and Wages, Pension and Other Post-Employee Benefits (Pension Retirement Liability, Retirement Offset, and Retiree Health and OPEB), Other Fringe (Flexible Benefits and Fringe Benefits), Supplies and Services, Information Technology, Energy/Utilities and Equipment Outlay. The Vacancy Factor is also discussed as it affects the projected personnel costs for the City.

With the implementation of corrective actions outlined in the 2009-2013 Outlook, projected General Fund expenditures for City operations exceed projected General Fund revenues in fiscal years 2009 through 2013 (**Attachment I**). Although the City's basic operational needs can be met, additional funding is required to address the City's fiscal priorities and Eight Significant Areas which have been under-funded in the past.

EIGHT SIGNIFICANT AREAS

This section describes the funding for Eight Significant Areas that must be addressed in order to restore or preserve the fiscal health of the City and/or meet its legal obligations. The recommended rationale for funding of each area is discussed below. The eight areas that require funding are listed in priority order:

1. Funding the Employee Pension Plan
2. Funding the General Fund reserves
3. Funding deferred maintenance and capital improvement needs
4. Funding retiree healthcare obligations/Other Post Employment Benefits (OPEB)
5. Funding new obligations under Storm Water Runoff Permits
6. Funding the American with Disabilities Act (ADA) obligations
7. Funding the Workers' Compensation Fund
8. Funding the Public Liability Fund

CORRECTIVE ACTIONS

The final section presents possible solutions to bridge budget gaps in fiscal years 2009-2013, the time period covered by the 2009-2013 Outlook. These solutions include reductions in costs as well as enhancing revenues to ensure that the City is recovering its full costs from providing services supported by fees. A number of the possible solutions require further analysis and will serve as the basis for developing the fiscal year 2009 budget. Most of the solutions contained in this forecast represent an ongoing realization of expenditure savings and additional revenue growth. The solutions for fiscal year 2009 will carry forward through the forecasted period.

FIVE-YEAR FINANCIAL OUTLOOK
FISCAL YEARS 2009-2013

The City of San Diego Five-Year Financial Outlook for fiscal years 2009 through 2013 (2009-2013 Outlook) continues to serve as a guide for long-range fiscal planning while providing the framework for the development of the annual budget. The 2009-2013 Outlook incorporates a variety of economic assumptions and new mandated expenditure requirements that will likely influence revenues and expenditures over the next five years.

The Government Finance Officers Association (GFOA) recommends that local governments follow a financial planning process that combines the forecasts of revenues and expenditures into a single financial model over a three-to-five year period to be used as a tool to assess the long-term financial implications of current and proposed policies, programs, and assumptions in developing appropriate strategies to achieve established goals. The Financial Outlook is consistent with the GFOA best practices recommendations.

SCOPE OF THE FORECAST

The City's General Fund is the primary focus of the 2009-2013 Outlook. Approximately 70.5 percent of the City's major revenues (projected to be about $779.9 million for fiscal year 2008) are made up of four revenue sources: property tax, sales tax, transient occupancy tax, and franchise fees. The remainder of General Fund revenues consists of licenses, permits, fines, rents and concessions, funding from other agencies, service charges, transfers from other funds, and miscellaneous revenues are deposited into the General Fund. The 2009-2013 Outlook forecasts General Fund revenues and expenditures for the next five years, beginning in fiscal year 2009.

REVENUE BASELINE FORECAST

The Revenue forecast combines an analysis of the economic factors driving the City's revenue base and the specific revenue sources available to the City. While San Diego's economy is increasingly diverse, the City's revenue structure has a lower tax base compared to most other large cities. For example, the City does not levy a utility user's tax or refuse collection fee and has low business taxes.

The City's revenues continue to be affected by decisions made by the State regarding the allocation of local revenue. Three of the City's largest historical General Fund revenues – property tax, sales tax, and motor vehicle license fees (prior to fiscal year 2005) – are all subject to State legislative actions, and have been significantly impacted by past State budget decisions resulting in revenue loss to the City. In November 2004, California voters passed Proposition 1A in order to prevent the State government from leveraging local government resources to balance the State budget; this proposition has gone a long way in protecting local government revenues from further State intervention.

ECONOMIC ASSUMPTIONS

The Baseline Financial Outlook reflects assumptions about the current and future economic environment which were developed after analyzing the national, State and local economic forecasts. San Diego's strong and diverse economy serves as a buffer against economic forces that could otherwise result in a recession. Indicators of a regional economic recession are an economic slowdown in several industrial sectors and a significant rise in unemployment rates. While there has been a decline in job growth and a slowdown in construction and financial services tied to the real estate market, the slowdown is not pervasive and a recession is not being forecasted for San Diego.

The Five-Year Financial Outlook takes into consideration a number of general economic factors that currently affect the City's major revenues and will continue to do so in the future.

POPULATION

Between 2000 and 2007, the City's population grew at an average annual rate of 1.06 percent. It is anticipated that in the foreseeable future the growth rate will remain fairly stagnant and hover around 1 percent annually.

UNEMPLOYMENT

Unemployment rates for the City of San Diego have been consistently below that of the State and national averages, but slightly above the San Diego County average. It is expected that the City's unemployment rate will be 4.8 percent at the end of calendar year 2007; in 2008 and into 2009, the rate is expected to be between 5.0 and 5.2 percent whereas an average of 5.5 percent is projected for the rest of California. The probable rise in unemployment is a result of the job losses in the real estate and construction sectors.

EMPLOYMENT

A number of economic forecasters, including UCLA Anderson Forecast, identify San Diego as one of the top ten cities in the United States projected for job growth in the next 20 years; the growth of small business in the City currently accounts for over half of all new jobs created in the City. At present, the services industry (unskilled/semi-skilled/part-time) is the major contributing sector to job growth in the region; however, this sector also pays the lowest average wages for workers.

RETAIL SALES

Between 2001 and 2006, the City's taxable sales transactions grew at an average annual rate of 4.5 percent. It is expected that the average growth rate at the end of 2007 will be 4.2 percent. In 2008 and 2009, this growth rate will likely experience a slowdown due to rising unemployment in the real estate and construction sectors, moderating household income growth, and the continued increase in energy and gasoline prices.

INCOME GROWTH

It is anticipated that personal income growth will continue to be relatively flat and will most likely mirror inflationary levels in fiscal year 2009. Due to the loss of jobs in the real estate and construction sectors, personal income growth will slow considerably; however, income growth in the San Diego region will likely outpace that of the state of California.

VISITOR INDUSTRY

Transient occupancy tax (TOT) is the most accurate indicator of the health of San Diego's visitor industry. TOT has experienced positive revenue growth every year since September 11, 2001, and in the coming fiscal years TOT is projected to continue growing at rates between 7.0 and 7.5 percent per year. San Diego is already one of the most desirable places to visit in the country, and marketing activities to bring new visitors into the City will be aided by a proposed Tourism Marketing District (TMD). The TMD will generate funds from an assessment on room rates of hotels and motels.

REAL ESTATE

The current wave of tighter lending policies for home loans and the skyrocketing number of San Diego County foreclosures (551 percent increase over 2006, with 2,896 foreclosures occurring in the first half of 2007 versus 445 in the same period for 2006) are potential areas of concern and are considered in forecasting the City's property tax revenue. However, indications from DataQuick Information Systems and the UCLA Anderson Forecast are that the number of foreclosures has not yet reached the threshold to cause a significant, long term impact on housing prices. The median price of homes is largely stagnant although in some areas home values have declined.

Current price depreciations affect properties for sale and as a result the City's property transfer tax receipts; however, they do not affect the underlying valuation base that has grown significantly over the past few years. As a result, the forecast for property tax revenue in San Diego is for moderate growth.

Like any forecast, the current and future economic landscape only paints a portion of the picture; historical data also contributes to the Five-Year Financial Outlook. The following section will incorporate many of the current observations and forecasts about the local economy and will also introduce other factors that affect each of the City's General Fund revenue sources.

I. GENERAL FUND REVENUES

In comparing year-to-year changes, it is important to note that General Fund revenues from many of these sources will reflect both economic activity and in some cases the change in allocating these revenues between the General Fund and various special funds. **Table I** demonstrates a summary of the major revenues growth rates for fiscal years 2009-2013.

TABLE I

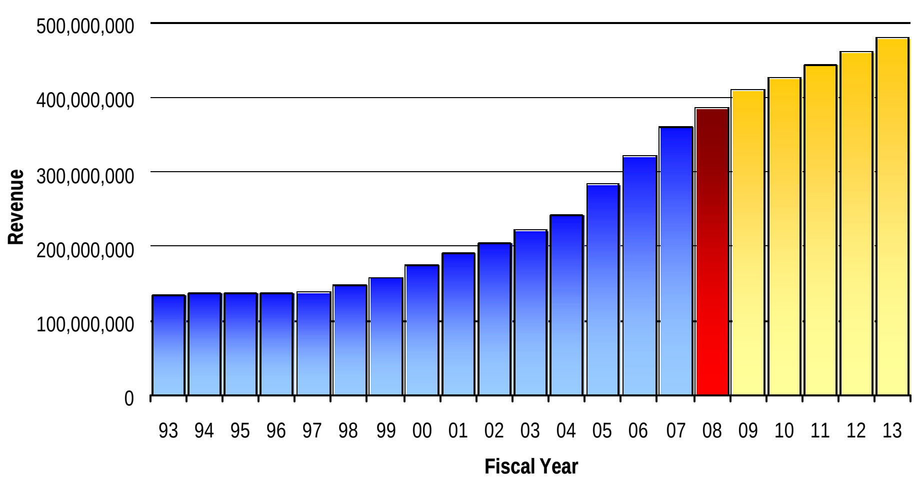
Revenue Category	2009 Forecast	2010 Forecast	2011 Forecast	2012 Forecast	2013 Forecast
Property Taxes	6.00%	4.00%	4.00%	4.00%	4.00%
Sales Tax	1.25%	3.00%	4.00%	4.00%	4.00%
Transient Occupancy Tax	7.50%	7.00%	7.00%	7.00%	7.00%
Franchise Fees	7.50%	7.50%	7.50%	7.50%	7.50%

PROPERTY TAX

Property tax is the City's largest revenue source, representing 34.9 percent of the total General Fund revenue in fiscal year 2008. The City of San Diego receives property tax revenue based upon a 1.0 percent levy on the assessed value of all real property. Property tax revenue is collected by the County of San Diego, which then 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.

Due to a year-around, ideal climate, attractive beaches, and a wealth of vacation activities, San Diego continues to be regarded as one of the most desirable places in the country to live. Despite a decline in median home prices and stagnant income levels, property tax revenue continues to grow. The base property tax revenue experienced a tremendous growth over the last 10 years from $69.8 million to $163.6 million primarily due to robust increases in local housing values. DataQuick Information Systems reports that median home prices in the County have declined 3.1 percent between September 2006 and September 2007. City residents experienced a less dramatic decline in median home prices than many experts projected and subsequently property tax revenues have not suffered significantly. The actual growth in property tax revenue was 6.6 percent in fiscal year 2007. The fiscal year 2008 property tax budget is $385.7 million, which consists of $287.5 in base property tax and the estimated "property tax in-lieu of VLF" payment of $98.2 million; both categories assumed 6.0 percent growth in assessed valuation. However,

Property Tax Historical Trends and Outlook



FY	Dollars	Change	FY	Dollars	Change	FY	Dollars	Change
1993	134,155,644	-	2000	174,591,631	9.4%	2007 [2]	360,369,450	10.8%
1994	136,750,090	1.9%	2001	191,294,297	8.7%	2008 [3]	391,805,306	8.7%
1995	136,586,197	-0.1%	2002	204,771,748	6.6%	2009 [3]	414,320,781	5.7%
1996	136,903,411	0.2%	2003	222,371,289	7.9%	2010 [3]	430,893,613	4.0%
1997	139,080,165	1.6%	2004	242,165,458	8.2%	2011 [3]	448,129,357	4.0%
1998	148,860,209	6.6%	2005 [1]	284,283,986	14.8%	2012 [3]	466,054,532	4.0%
1999	158,201,532	5.9%	2006 [2]	321,479,420	11.6%	2013 [3]	484,696,713	4.0%

[1] Beginning in fiscal year 2005, the City started receiving reimbursements in property tax "in-lieu of Vehicle License Fees."

[2] Unaudited actual [3] Forecast

per the County Assessor's Office projections, the expected growth for fiscal year 2008 is estimated to be approximately 9.0 percent, which results in higher property tax revenue projection of approximately $6 million over budget.

The projection for fiscal years 2009-2013 assumes a 6.0 percent growth in fiscal year 2009 followed by 4.0 percent growth thereafter. The fiscal year 2009 property tax projection is based on the fiscal year 2008 year-end estimates. The decline in the property tax revenue projected for fiscal years 2009-2013 is due to the overall decrease in the total building permit valuation for residential and nonresidential units. During fiscal year 2006, the value of permits issued totaled $1.96 billion or 1.0 percent more than the prior fiscal year. However, for fiscal year 2007, the value of permits issued totaled $1.49 billion, a 23.9 percent decrease from 2006. The $47 million decrease in assessed valuation is comprised of an 18.5 percent decline from $1 billion to $820.6 million in residential valuation, and a 29.7 percent decrease from $953.7 million to $670.5 million in commercial valuation. New residential construction is a strong indicator of trends in both the construction industry and the overall economy. For single-family dwelling units, 903 permits were issued in fiscal year 2007, down 30.0 percent from fiscal year 2006. Multifamily dwelling units decreased by 7.9 percent to 3,260 units in fiscal year 2007.

The UCLA Anderson Forecast projects a continued statewide slowdown or "leveling off" of the home sale prices stating that the cooling off of local housing markets would result in a drop in spending and some job losses in construction and other real estate related industries. Economists expect further increases in delinquencies and foreclosures from historically low levels in prior years. Due to the uncertainty in the real estate market and general pessimism among regional economists, a conservative growth projection in property tax is warranted.

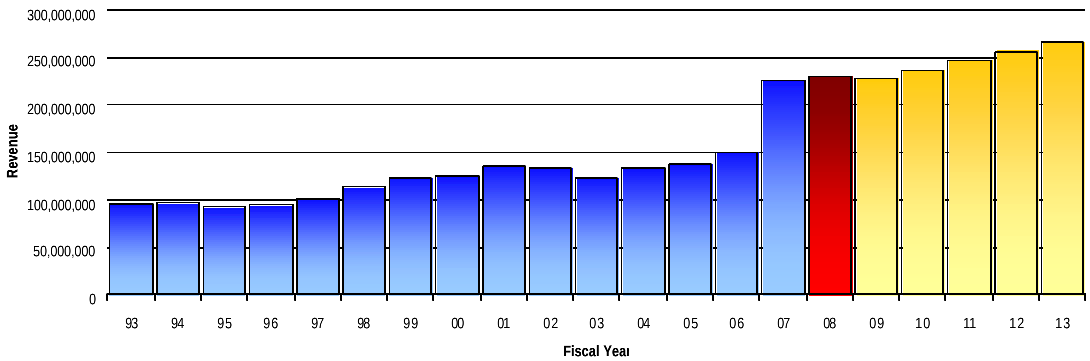
SALES TAX

Sales tax is the City's second largest revenue source, representing 21.7 percent of the total General Fund revenue. The fiscal year 2008 sales tax budget is $239.5 million. The budget includes the property tax reimbursement that the City receives as a result of the triple-flip. The triple-flip is the shift enacted by the State in fiscal year 2005 whereby local governments shifted one-quarter of a cent of their Bradley-Burns Sales and Use Tax to the State in exchange for an equivalent amount of property tax. Based on the latest receipts, it is projected that the sales tax revenue will be approximately 1.3 percent lower than the prior year which results in a projected shortfall of nearly $10 million in fiscal year 2008. The decline is mainly due to a slowdown in construction, retail, and automobile sectors.

The projection for fiscal year 2009 assumes a 1.25 percent growth rate; fiscal year 2010 assumes a 3.0 percent annual growth and a 4.0 percent annual growth is assumed for fiscal years 2011-2013. This forecast will be re-evaluated regularly as additional economic data becomes available.

Declining employment rates and concerns about the health of the American economy play key roles in the overall performance of retail sales. The pressures on consumers from the increased cost of home mortgages, declining home prices and increased energy and gasoline costs may translate into stagnant or declining sales revenue as consumers reduce discretionary spending. The weakness in the real estate sector, however, may be offset by continued growth in tourism and professional services. Despite a projected growth in personal income (3.7 percent in 2007), sales activity is forecast to remain weak.

Sales Tax Historical Trends and Outlook



FY	Dollars	Change	FY	Dollars	Change	FY	Dollars	Change
1993	95,914,487	-	2000	124,863,032	1.0%	2007 [1,3]	225,838,611	50.8%
1994	97,598,407	1.7%	2001	136,033,804	8.2%	2008 [2]	229,130,716	1.5%
1995	92,676,991	-5.3%	2002	133,360,239	-2.0%	2009 [2]	227,063,285	-0.9%
1996	94,309,920	1.7%	2003	123,666,737	-7.8%	2010 [2]	235,543,950	3.0%
1997	100,911,551	6.5%	2004	133,137,512	7.1%	2011 [2]	245,847,758	4.0%
1998	113,546,677	11.1%	2005 [1]	138,162,840	3.6%	2012 [2]	256,304,729	4.0%
1999	123,639,440	8.2%	2006 [1]	149,718,613	7.7%	2013 [2]	266,605,778	4.0%

[1]Unaudited actual [2]Forecast

[3]Beginning in fiscal year 2007, the City's 1 percent sales tax revenue was budgeted in the General Fund.

SAFETY SALES TAX

Safety sales tax revenue is also sensitive to economic conditions, particularly factors that influence taxable sales, such as employment levels, per-capita income and business investment. Safety sales tax is allocated first to counties in proportion to their share of taxable sales with the State and then to cities within the county. As result, the City of San Diego’s share of total countywide Safety Sales Tax revenue does not depend on taxable sales within the City, but rather on San Diego County’s share of total statewide taxable sales. Although the economic factors that influence Safety Sales Tax are very similar to the factors influencing sales tax, a comparison of annual historical growth rates shows that the two fluctuate dramatically.

The fiscal year 2008 safety sales tax revenue budget is $8.4 million, representing a 3.0 percent increase over fiscal year 2007. As the rate of foreclosures continues to increase not only locally but statewide and nationally, it is likely that consumer spending will decline and unemployment will rise. The UCLA Anderson Forecast suggests that unemployment in California could rise to a level of 5.5 percent by the end of calendar year 2008, while personal income growth is expected to decrease below inflationary levels during the same time period. The projection for fiscal year 2009 assumes a 1.25 percent growth rate; 2010 assumes a 3.0 percent annual growth and a 4.0 percent annual growth is assumed for fiscal years 2011-2013.

TRANSIENT OCCUPANCY TAX

The fiscal year 2008 General Fund TOT budget is $85.2 million, representing a 7.5 percent increase over the fiscal year 2007 year-end projection. The total TOT revenue received by the City in fiscal year 2007 was $153.5 million; 5.5 cents of the 10.5 cents collected in TOT is deposited into the General Fund. Based on the latest receipts for the current fiscal year, it is estimated that actual TOT revenue will be close to the budget.

Overall growth in TOT revenue has been somewhat constant over the last decade, aside from a nearly 13 percent one-year decrease in fiscal year 2002 due to the events on September 11, 2001. For the forecast period, San Diego tourism performance is projected to have a continued steady growth. Industry experts estimate that by the end of calendar year 2007:

- Annual room supply will increase by 1.9 percent;
- Number of occupied rooms will increase by 2.0 percent;
- Market occupancy will increase by 0.1 percent;
- Average daily room rate will increase by 5.0 percent;
- Revenue per available room will increase by 5.2 percent.

A trend of steady growth between 7.0 and 7.5 percent per year is reflected in the forecast for fiscal years 2009-2013. It is projected that with establishment of the Tourism Marketing District (TMD) in fiscal year 2008 and additional marketing of the region, the number of tourists as well as revenue collected from TOT and sales tax will increase. With the establishment of the TMD, the City is projected to save $10.0 million annually from funding of organizations that are currently underwritten by the City for marketing and tourism promotion. Budgetary savings from the establishment of the TMD would be realized in the Special Promotional Programs budget.

PROPERTY TRANSFER TAX

The property transfer tax is levied on the sale of residential and commercial real estate property. Property transfer taxes are highly reflective of the housing market and are generally more volatile than overall property-related taxes, as evidenced by fiscal year 2007 receipts of $9.4 million, which were $5.5 million under the fiscal year 2007 budget projection and $2.6 million less than fiscal year 2006 actual receipts. Appreciation or depreciation in property values and sales volume in the local real estate market specifically affect property transfer tax revenues; similarly, the recent surge in home foreclosures has lowered the City's property transfer tax revenues. In addition, property transfer tax revenue is being negatively affected by a slowdown in new construction and in the long-term by the reduced availability of City land to develop additional properties. This revenue is also adversely affected by a continued decrease in housing demand, and conversely, the rapid increase in supply that has depressed housing prices. In recent months, DataQuick Information Systems released a report stating that total residential sales (new and existing single-family homes/condominiums) have decreased 35.5 percent in the San Diego County between September 2006 and September 2007.

The fiscal year 2008 property transfer tax budget is $7.6 million, 49 percent less than the $14.9 million originally projected in fiscal year 2007. The UCLA Anderson Forecast predicts that this decline in transfer tax revenue (and more specifically the credit crunch and large number of foreclosures) indicates a continued decline in the number of property sales. A large number of sub-prime adjustable rate mortgages are due to reset at the beginning of 2008; the upward trend of foreclosures is expected to continue for at least another six months and go on possibly even longer.

Future Federal Reserve interest rate cut(s) will potentially affect the activity in the housing market and subsequently the City's projections for transfer tax. These assumptions have been factored into the Financial Outlook for fiscal years 2009 through 2013: there is no growth expected in 2009; a 2.0 percent growth in fiscal years 2010 through 2012; and 3.0 percent growth in 2013.

LICENSES AND PERMITS

The licenses and permits category reflects revenue generated from the issuance of business license permits as well as revenue from performing regulatory functions that are cost-recoverable. Major budgeted revenues in this category include general business license taxes, rental unit taxes, parking meter collections, and the refuse collection business license tax.

The fiscal year 2008 licenses and permits budget is $34.4 million. The forecast for fiscal years 2009-2013 is based on the historical performance of this revenue category and assumes a 16 percent decline for business license taxes in fiscal year 2009 due to a one-time increase in new business registrations in fiscal years 2007 and 2008; the projections for fiscal years 2009-2013 more closely reflect historical trends. In subsequent years, a constant 2.0 percent positive growth is expected. The same 2.0 percent growth is projected for parking meter revenue, and 1.0 percent growth is projected for other licenses and permits.

FINES, FORFEITURES, AND PENALTIES

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. Parking violations represent approximately half of this revenue category.

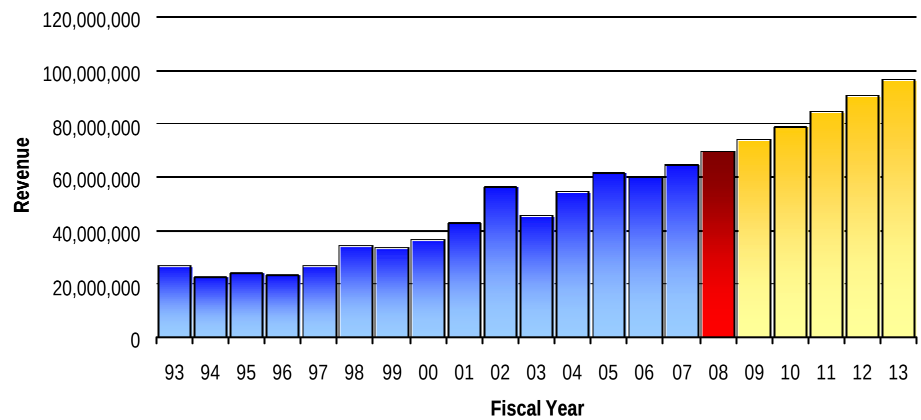
The fiscal year 2008 budget for this revenue category is $35.1 million. The forecast for fiscal years 2009-2013 is based on the historical performance of this revenue category and assumes a 2.0 percent growth for vehicle code violations, 1.0 percent growth for City parking violations, and 5.0 percent for other fines, forfeitures, and penalties.

REVENUE FROM MONEY AND PROPERTY

The major components in the revenue from money and property category include revenue from franchises fees collected for the use of the City's rights-of-way from San Diego Gas and Electric (SDG&E) and cable television providers, and rents and concessions from tenants of City-owned property in Mission Bay. Refuse haulers revenue is also included in this category and is based on the total amount of refuse hauled annually. Also included in this revenue category are interest earnings and rents and concessions from miscellaneous City-owned properties.

The fiscal year 2008 budget for revenue from the money and property revenue category is $118.1 million. The forecast for fiscal years 2009-2013 is based on the historical performance of this revenue category with the exception of SDG&E and rents and concessions. The Mission Bay

Franchise Fees Historical Trends and Outlook



FY	Dollars	Change	FY	Dollars	Change	FY	Dollars	Change
1993	26,569,347	-	2000	36,597,204	9.0%	2007[1]	64,633,832	6.8%
1994	22,675,137	-17.2%	2001	42,708,007	14.3%	2008[2]	69,585,776	7.1%
1995	24,261,544	6.5%	2002	56,239,380	24.1%	2009[3]	73,991,718	7.5%
1996	23,235,000	-4.4%	2003	45,504,113	-23.6%	2010[3]	79,068,095	7.5%
1997	26,655,165	12.8%	2004	54,414,774	16.4%	2011[3]	84,511,011	7.5%
1998	34,264,638	22.2%	2005[1]	61,839,221	12.0%	2012[3]	90,347,529	7.5%
1999	33,290,634	-2.9%	2006[1]	60,270,543	-2.6%	2013[3]	96,606,732	7.5%

[1]Unaudited actual [2]Budget [3]Forecast

rents and concessions revenue is projected to grow at 3.0 percent in fiscal years 2009-2013; SDG&E and cable television franchise fees are projected to grow at 7.5 percent per year between fiscal years 2009-2013. No growth is projected for other rents or interest earnings.

REVENUE FROM OTHER AGENCIES

The major revenue in the Revenue from Other Agencies category is Motor Vehicle License Fees (VLF) allocated by the State. Prior to fiscal year 2005, the VLF was one of the City's major revenue sources; however, as a result of the triple-flip, VLF revenues have largely been replaced by property taxes (in addition to the 1 percent of base property tax received by the City).

The fiscal year 2008 budget for VLF is $7.6 million. The forecast for fiscal years 2009-2013 projects a reduction in revenue in fiscal year 2008 assuming a slowdown in vehicle sales due to a softening in consumer spending, including automobile sales, rising consumer debt, and higher gasoline prices. For fiscal years 2009 through 2013, the VLF forecast assumes a conservative 1.0 percent growth rate per year. Other revenue sources in this category include State grants, the projected surplus revenue from securitized tobacco revenue (to be received by the City), and employee "pick-up" savings.

CHARGES FOR CURRENT SERVICES

This category includes revenue generated by General Fund departments for services provided to other City funds, including the Water and Metro Wastewater funds. In addition, a number of departmental charges for public services are included in this category; the most significant are from the Fire-Rescue and Police Departments.

The fiscal year 2008 charges for current services budget is $81.3 million. The forecast for fiscal years 2009-2013 is based on the historical performance of this revenue category and assumes a 2.0 percent annual growth.

TRANSFERS FROM OTHER FUNDS

Revenue in this category reflects transfers to the General Fund from various funds such as Special Promotional Programs, Capital Improvement Programs, Storm Drain, the Environmental Growth Fund, and TransNet funds.

The fiscal year 2008 budget for transfers from other funds is $91.6 million. For fiscal year 2009, this category includes the removal of one-time revenue gain of $10.1 million related to Employee Offset Savings (EOS) budgeted at $20.2 million in fiscal year 2008. In addition, a total of $19 million in EOS will be budgeted in this revenue category in fiscal year 2009; of that amount, $10.1 million is to backfill the pledged tobacco settlement revenues. There is a reduction in revenues of $5.3 million in TransNet revenues allocated by the San Diego Association of Governments (SANDAG). The reductions in this category are partially offset by an increase of $5.8 million as a transfer from Special Promotional Programs (TOT) to the General Fund.

II. GENERAL FUND EXPENDITURES

Expenditure forecasts are based primarily on the City's budgeted fiscal year 2008 General Fund expenditures; future expenditure growth from expected inflationary cost increases; full or annualized funding of new facilities planned to open in a fiscal year; new expenditures mandated by the City Council or by the State and federal government programs; and legal or contractual obligations.

SALARIES AND WAGES

The General Fund fiscal year 2008 salaries and wages budget is $499.2 million which represents 45.1 percent of total General Fund expenditures. The 2009-2013 Outlook incorporates annual employee salary step increases as well as funding for approved additional staff.

From fiscal year 2009 through 2013, the 2009-2013 Outlook factors in only committed departmental salary and wage expenditures. No new salary increases are assumed for any City employee. Pending the results of upcoming labor negotiations, this expenditure may need to be adjusted in the 2009-2013 Outlook.

RETIREMENT

A top priority for the long-term fiscal health and stability of the City has been to restore the integrity of the City's Retirement System. Voters approved the passage of the Mayor's initiative, Proposition B, in November 2006, which requires voter approval of any future increase in pension benefits for City employees.

In fiscal year 2008, the City's total pension payment is budgeted at $165 million which included $137.7 million for the contribution to the Unfunded Actuarial Accrued Liability (UAAL); the General Fund portion of expense is $123.9 million. This amount is based on the City's Annual Required Contribution (ARC) as determined by the San Diego City Employees' Retirement System (SDCERS). The Gleason Settlement of July 2004 requires that the City's contribution be based on the ARC payment, amortized over a 30-year fixed period. To avoid negative amortization, the City contributed an additional $20 million to the UAAL. In addition, in fiscal year 2008, the City budgeted $7.3 million to pay back the pension plan for assets spent inappropriately in prior years on retiree health.

It is anticipated that the expenditure for the pension contribution will be $165 million in fiscal year 2009 and grow at 4.25 percent per year from fiscal year 2009 through 2013.

RETIREMENT OFFSET / "PICK-UP"

The Retirement Offset or "Pick-Up" is the City's contribution to employee retirement benefits under current labor union agreements. The fiscal year 2008 General Fund portion of this expense is $14.1 million. The growth of this expense is tied proportionately to the growth of Salaries and Wages, and is based upon the same assumptions. No other growth factors are applied to this expenditure from fiscal year 2009 through 2013. Pending the results of upcoming labor negotiations, this expenditure may need to be adjusted in the 2009-2013 Outlook.

PENSION LIABILITY

This line item of expenditure in the 2009-2013 Outlook represents the savings or leveraged amount that the City of San Diego must use to address the Retirement System's unfunded liability within the timeframe of the respective contracts. All subsequent fiscal years assume no change to the rate applied to the fiscal year 2008 budgeted salaries. Per labor union agreements, the retirement liability funds shall be used to support a leveraged mechanism to increase the funding ratio of the City Employees Retirement System. The fiscal year 2009 budget will include an estimated $19 million to be generated from Employee Offset Savings (EOS), of which $10.1 million will backfill the pledged tobacco settlement revenues (described earlier in the Transfers from Other Funds section of this report); the remaining $8.9 million will be used to leverage an additional contribution to the City Employees' Retirement System.

RETIREE HEALTH / OTHER POST-EMPLOYMENT BENEFITS

The fiscal year 2008 cost in the General Fund associated with Retiree Health Contributions and Other Post-Employment Benefits (OPEB) is $32.2 million which is comprised of the annual cost for current retirees ($15.5 million) and the contribution to pre-fund the retiree health liability for current city workers ($16.7 million). The 2009-2013 Outlook bases the cost of these benefits for fiscal year 2009 through 2013 on the estimated pay-as-you-go and ARC payment schedule provided by Buck Consultants in June 2007. Instead of making a separate pay-as-you-go payment and a payment to pre-fund the retiree health liability, the City will make one payment of $50 million for fiscal year 2009 to the CalPERS Trust Fund. This entire amount will be contributed to the Trust Fund so that the City can receive the benefit of higher interest earnings. On a monthly basis, funds will be drawn down from the Trust Fund for the annual retiree healthcare expenses estimated to be $23 million. Therefore, approximately $27 million from all City funds will be dedicated to the ARC payment in fiscal year 2009.

The 2009-2013 Outlook assumes the full ARC payment beginning in fiscal year 2010 and thereafter in the amount of $75 million Citywide, grown by 4.5 percent annually. It should be noted that the Fiscal Year 2008 Annual Budget includes a $25 million payment to the Trust Fund, which was established to cover the future liability for retiree health. The City's Unfunded Accrued Actuarial Liability (UAAL) for OPEB was estimated in the June 30, 2006 valuation to be $1.1 billion based on a rate of return on investments of 5.0 percent. The establishment of a retiree health trust fund in fiscal year 2008 will mean a higher discount rate can be applied to trust fund assets thereby reducing the unfunded liability to approximately $800 million when the full ARC is contributed.

FLEXIBLE BENEFITS

The flexible benefits category includes the City's cafeteria benefits plan, of which health insurance is the highest cost component.

An estimated $1 million in savings from the health care reform was added to the Fiscal Year 2008 Budget (the savings were estimated prior to the completion of the employees' health care enrollment). Health care reform was part of the labor negotiations in fiscal year 2007 for the Police Officers' Association (POA), Local 145, and Deputy City Attorneys' Association (DCAA) and also included unclassified and unrepresented City employees. Assumptions for health care reform savings of approximately $1.2 million were built into the 2009-2013 Outlook.

The only additional cost factored in this expense category for fiscal years 2009-2013 is the cost associated with committed department Salary and Wage additions and the Flexible Benefits resulting from those additions. Pending the results of upcoming labor negotiations, this expenditure will be adjusted.

FRINGE BENEFITS

The fiscal year 2008 budget for the remaining employee-related costs such as workers' compensation, Medicare, unemployment insurance, risk management, and compensated time off is $49.6 million. The estimated cost of these expenditures is based proportionately on budgeted fiscal year 2008 salaries and wages. In addition, these expenses are adjusted for inflation at 3.0 percent, 3.09 percent, 3.18 percent, 3.28 percent, and 3.38 percent for fiscal years 2009 through 2013, respectively.

SUPPLIES AND SERVICES, INFORMATION TECHNOLOGY, ENERGY/UTILITIES, AND EQUIPMENT OUTLAY

The total fiscal year 2008 budget for these categories is $335.5 million, representing the City's General Fund non-personnel expenses. In addition to committed department expenditures, the 2009-2013 Outlook assumes these categories will grow from fiscal year 2009 through 2013 by an inflation rate of 2.0 percent for Supplies and Services, 4.0 percent for Information Technology, 5.0 percent for Energy/Utilities, and 3.0 percent for Equipment Outlay.

VACANCY FACTOR

The 2009-2013 Outlook includes a vacancy savings factor which is defined as the estimated personnel expense savings from temporarily vacant budgeted positions due to attrition, leaves of absence, turnover, under-filled positions, and newly hired employees who may start at a salary lower than the average budgeted salary. The 2009-2013 Outlook assumes vacancy factors of 3.4

percent, 3.2 percent, 3.0 percent, 2.5 percent, and 2.4 percent for fiscal years 2009 through 2013, respectively.

FUTURE COMMITTED EXPENDITURES

As mentioned earlier in previous sections related to expenditures, the 2009-2013 Outlook incorporates the cost impacts associated with the staffing of new facilities and increases resulting from the City Council, State, and federal mandates. A major budgetary challenge facing the City in recent years has been the long-term costs of staffing and maintaining public facilities constructed by non-City funds. Since these new facilities and their related operational costs are phased in over a period of time, their future fiscal impacts, including the capacity of forecasted revenues to support the increased costs, are built into the 2009-2013 Outlook.

SUMMARY OF EXPENDITURES

The table in **Attachment I** demonstrates the projected revenues and expenditures in 2009-2013 Outlook along with a projected deficit for fiscal years 2010 through 2013. It should be noted that the projected revenues exceed projected expenditures without the funding of the eight significant areas; however, the City's strategy to fund not only these eight areas but other commitments results in a projected deficit of nearly $32 million in fiscal year 2009, $66 million in fiscal year 2010, $85 million in fiscal year 2011, $76 million in fiscal year 2012, and $50 million in fiscal year 2013.

ADDITIONAL AREAS TO BE FUNDED

In addition to achieving a balanced budget that comes close to maintaining existing levels of service, the City has identified other financial and service objectives that are critical to the City's continuing goals of providing critical City services, maintaining a favorable business climate, and maintaining a sound financial structure.

FUNDING OF TERMINAL LEAVE

In the past the City has not budgeted the additional expense of terminal leave that is paid to employees who end their employment with the City with large leave balances. While a portion of terminal leave expense has been absorbed in departmental budgets, there will be a large number of employees expected to retire over the next several years and budgeting for this expense will be more fiscally responsible. The 2009-2013 Outlook addresses this issue by incorporating a projected expense for employees over the next five years. The 2009-2013 Outlook estimates this expense to be $5.6 million for fiscal year 2009 growing to $11.0 million in fiscal year 2010, $11.4 million in fiscal year 2011, and $13.0 million for fiscal years 2012 and 2013.

III. FUNDING OF EIGHT SIGNIFICANT AREAS

The 2008-2012 Outlook identified eight significant areas (pension system, reserves, deferred maintenance, other post-employment benefits, storm water compliance, ADA, workers' compensation, and public liability funding needs) that required the City's immediate attention and funding at appropriate levels. The Fiscal Year 2008 Annual Budget included funding for seven of the eight significant areas. The following describes the funding levels for each of the eight significant areas included in 2009-2013 Outlook.

PENSION SYSTEM

Under the current funding approach, the City is paying down the Unfunded Actuarial Accrued Liability (UAAL) over a 30-year time horizon. Under the Gleason Settlement, the City is currently in year 27. In order to eliminate the negative amortization associated with the pension deficit, fiscal year 2008 included an additional $20 million payment to SDCERS and the General Fund portion of this amount is $15.0 million. In addition, the City contributed $7.3 million in fiscal year 2008 to pay back prior inappropriate contributions to retiree health. The City's pension payments for all funds are projected to be as shown in **Table II**:

TABLE II

Citywide Pension Payment
(in millions)

FY08 Budget	FY09 Projected	FY10 Projected	FY11 Projected	FY12 Projected	FY13 Projected
$ 165.0	$ 165.0	$ 172.0	$ 179.3	$ 186.9	$ 187.3

The 2009-2013 Outlook includes an estimated pension payment of $165 million in fiscal year 2009. This amount assumes a 20-year time horizon to pay down the UAAL with no negative amortization. For fiscal years 2010-2013, the forecast assumes a 4.25 percent growth in the ARC payment. The final ruling from the IRS relating to the use of pension plan assets to pay for retiree health eliminated the need to include an additional payment of $7.3 million to the pension plan as was budgeted in fiscal year 2008.

RESERVES

Building healthy reserves helps insulate City services against periodic swings in the economy and the demands placed on the City to pay the costs from emergencies (such as natural disasters). In addition, since the City's reserve level is one of several factors considered by rating agencies, a strong reserve balance may help lower the City's cost to borrow money.

The City Reserve Policy recently approved by the City Council outlines the policy targets for reserves in the General Fund and enterprise funds such as Water, Metropolitan Wastewater, and Development Services. The Reserve Policy establishes in the General Fund an Emergency Reserve, an Appropriated Reserve, and describes the Unallocated Reserves.

The Emergency Reserve, conforming to Charter Section 91, will only be used for qualifying emergencies as declared by the Mayor and/or the City Council and funds will only be accessible by two-thirds vote of the City Council. The Appropriated Reserve will fund operational needs not anticipated during the development of the annual budget. The Reserve Policy requires that 8.0 percent of the General Fund budget be placed in reserves by fiscal year 2012. From time to time there may be an accumulated fund balance in the General Fund (the Unallocated Reserve), which exceeds the percentage required under the City's Reserve Policy. These "excess funds" may be available for the City Council to appropriate as required for city priorities.

The fiscal year 2008 budgeted contribution to the General Fund Reserve is $3.3 million; for fiscal year 2009, the contribution to this reserve is estimated to be $7.0 million in order to reach the policy target of 6.5 percent.

The City's Reserve Policy establishes a policy goal to fund appropriate reserve levels for the Long-Term Disability Fund. The reserve level in this fund is projected to be $12 million by fiscal year 2012, as recommended in the Long-Term Disability Actuarial report. The City will increase the reserve by a minimum of $2.25 million in fiscal year 2009 and each year thereafter to achieve the reserve target of $12 million by fiscal year 2012.

DEFERRED MAINTENANCE/CAPITAL IMPROVEMENTS

Deferred maintenance/capital improvements includes all needed repairs to City facilities, including roof replacement, heating and cooling system upgrades, painting, structural repairs, as well as repairs and improvements to storm drains and streets. It is estimated that the City's deferred maintenance/capital needs, excluding those related to Water and Wastewater, may be at least $800 to $900 million.

These estimates were made before the release of Proposition 1B funding for streets and roads, approved by California voters in November 2006. These funds are allocated to local governments for projects targeted to improve local roads and highways. The City expects to receive $21.2 million in Proposition 1B funding in fiscal year 2008 (early calendar year 2008) with the remaining balance of $19.9 million to be distributed on a schedule yet to be determined. None of these bond proceeds have been budgeted for fiscal year 2008. These monies would be used solely to address the City's deferred maintenance backlog for streets.

The infusion of Proposition 1B funds in fiscal year 2009 have reduced the need for the City to contribute additional cash in fiscal year 2009 budget for streets and storm drain improvements. Given the magnitude of a projected gap of $32 million, it would be more prudent for the City to first spend the State bond funds for eligible projects and supplement that funding with bond proceeds. The 2009-2013 Outlook includes project funding totaling $70 million for streets and storm drains for fiscal year 2009, $52.5 million of which will be financed and $17.5 million will be paid in cash (to be supported by Proposition 1B funds). The 2009-2013 Outlook includes a revised projection for facility improvements totaling $31.8 million for fiscal year 2009; $25 million of which will be financed and $6.8 million paid in cash.

OTHER POST EMPLOYMENT BENEFITS (OPEB)

Since the annual costs of the City employee benefits are projected to increase substantially over the next five to ten years and Governmental Accounting Standards (GASB 45) will require the City to begin disclosing this liability in its Comprehensive Annual Financial Report (CAFR), retiree health care, otherwise known as other post employment benefits (OPEB), is being more aggressively funded. In addition to pay-as-you-go funding for the annual costs of this benefit, the Fiscal Year 2008 Annual Budget includes $25 million to create an irrevocable trust to pre-fund the OPEB liability. The 2009-2013 Outlook continues to assume funding for the annual costs in fiscal year 2009 and includes a $25 million contribution to pre-fund the retiree health obligation.
In fiscal year 2010, the 2009-2013 Outlook assumes that the City will begin paying the full OPEB ARC, estimated to be $75 million, part of which is for the annual costs and the remaining for the future OPEB liability.

STORM WATER RUNOFF COMPLIANCE

Compliance with new storm water runoff regulations associated with new permits has created a large impact on the City's budget. Preliminary estimates show that it will cost the City an additional $18.6 million in fiscal year 2008 to comply with the public education and monitoring requirements. This amount has been included in the Fiscal Year 2008 Annual Budget. The 2009-2013 Outlook includes $11.5 million for fiscal year 2009 and $18.6 million for fiscal years 2010-2013 for street sweeping, public education and monitoring requirements. The full impact of these regulations on the City's finances in future years is still being analyzed.

AMERICANS WITH DISABILITIES ACT

The Americans with Disabilities Act (ADA) went into affect in 1990 and since then, public agencies and private companies have been required to make facilities and infrastructure accessible. Similar to deferred maintenance, the City has put very little funding towards this effort. As such, in addition to the funding budgeted for deferred maintenance/capital improvements, the 2009-2013 Outlook includes $10 million per year to be allocated to ADA-related improvements. This is in addition to any Community Development Block Grant funds (CDBG) or other funds allocated for this purpose. In fiscal year 2008, a total of $2.3 million in CDBG funds is allocated for ADA improvements; the fiscal year 2008 total citywide allocation for ADA-related purposes is $12.3 million.

WORKERS' COMPENSATION FUND

The City has approximately $150 million in outstanding workers' compensation claims and only $20.4 million in reserve balance. By establishing a reasonable reserve level, the City will provide better insulation for its programs and services. The City's new Reserve Policy recommends a funding strategy to achieve a reserve that is 50 percent of the value of outstanding claims by fiscal year 2014. While the Fiscal Year 2008 Annual Budget includes $26.1 million to cover the regular projected annual costs, $5 million will be allocated in the fiscal year 2009 budget and $10 million in fiscal year 2010 for each year thereafter in addition to the expected annual costs.

PUBLIC LIABILITY FUND

The City has approximately $100 million in outstanding public liability claims and no allocated reserves. Similar to the Workers' Compensation Fund Reserve, the City's new Reserve Policy recommends funding strategy to achieve a 50 percent level of the value of outstanding claims by fiscal year 2014. The Financial Outlook calls for $5 million to be allocated to this reserve in fiscal years 2009 and 2010; beginning in fiscal year 2011, annual allocations will increase to $10 million per year. This amount is in addition of the budgeted amount each year to cover projected annual payment.

FINANCIAL OUTLOOK SUMMARY

Table III demonstrates the impact of funding eight significant areas to the total City budget and the General Fund budget.

TABLE III

Funding for Eight Significant Areas Total City Cumulative Budget Impact (in millions)	FY08 Budget	FY09 Projected	FY10 Projected	FY11 Projected	FY12 Projected	FY13 Projected
"ARC Plus" [1]	$ 27.3	$ 9.7	$ 9.7	$ 9.7	$ 9.7	$ 9.7
Unappropriated Reserve	$ 3.3	$ 7.0	$ 8.6	$ 9.3	$ 9.9	$ 3.9
Deferred Maintenance [2]	$ 13.6	$ 29.7	$ 53.0	$ 67.1	$ 75.4	$ 69.9
OPEB	$ 25.0	$ 50.0	$ 75.0	$ 75.0	$ 75.0	$ 75.0
Storm Water Runoff Compliance	$ 18.0	$ 29.5	$ 36.6	$ 36.6	$ 36.6	$ 36.6
ADA Compliance	$ 10.0	$ 10.0	$ 10.0	$ 10.0	$ 10.0	$ 10.0
Workers' Compensation Fund	$ -	$ 5.0	$ 10.0	$ 10.0	$ 10.0	$ 10.0
Public Liabilities Fund	$ 5.0	$ 5.0	$ 5.0	$ 10.0	$ 10.0	$ 10.0
SUBTOTAL	**$ 102.2**	**$ 145.9**	**$ 207.9**	**$ 227.7**	**$ 236.6**	**$ 225.1**
Financed Capital Projects	$ 24.8	$ 77.5	$ 92.5	$ 92.5	$ 92.5	$ 92.5
TOTAL	**$ 127.0**	**$ 223.4**	**$ 300.4**	**$ 320.2**	**$ 329.1**	**$ 317.6**

[1] The ARC Plus payment represents the amount required to eliminate negative amortization in order to pay down the City's unfunded liability. The $9.7 million amount beginning in fiscal year 2009, along with the 20 year amortization schedule approved by the SDCERS Board, achieves this objective.

[2] Fiscal year 2009-2013 projection includes debt services expenditure for bond issuances.

Financed Capital Projects fiscal year 2008: $24.8M Streets & Storm Drains

Financed Capital Projects fiscal year 2009: $52.5M Streets & Storm Drains and $25M Facilities

Financed Capital Projects fiscal years 2010-2013: $67.5M Streets & Storm Drains and $25M Facilities

IV. GENERAL FUND CORRECTIVE ACTIONS

The City began a recovery program with the approval of the Fiscal Year 2008 Annual Budget and the funding of seven of Eight Significant Areas outlined in the 2008-2012 Outlook. The 2009-2013 Outlook includes funding for all Eight Significant Areas as projected in the 2008-2012 Outlook as well as expected inflationary growth in operating costs and new mandated expenditures resulting from prior approvals by the City Council or requirements mandated by the State and federal government. The fiscal year 2009 General Fund projected expenditures (including funding for significant areas) total $1.16 billion whereas projected revenues total $1.13 billion, resulting in a projected deficit of approximately $32 million. Since no new significant revenue sources are expected in fiscal year 2009, the General Fund expenditures need to be reduced to create a balanced budget for fiscal year 2009. Insofar as the expenditure solutions implemented in fiscal year 2009 are permanent, the shortfalls identified in future years will also be addressed.

In order to bridge the identified gap and achieve a structurally sound and balanced budget, the City is developing options to mitigate the projected fiscal year 2009 budget shortfall. These options, along with the estimated savings to the General Fund, are discussed in the following section. If these solutions are fully implemented, the Fiscal Year 2009 Budget will include savings from each of the corrective actions.

LEVERAGING CITY ASSETS ($6.5 MILLION)

The Real Estate Assets Department (READ) has identified a number of properties including vacant land that could be sold to generate significant one-time revenue of approximately $100 million over a five-year period (fiscal years 2008-2012). In accordance with the City Charter, any revenues derived from the sale of public property must be directed toward funding of capital projects. The 2008-2012 Outlook projected $15.3 million in revenue from real estate sales for fiscal year 2008 and $21.8 million for each year thereafter totaling approximately $102 million. It is expected that in fiscal year 2009, the incremental revenue from real estate sales will be approximately $6.5 million over the fiscal year 2008 budgeted amount of $15.3 million. These funds can support some of the projected increase in deferred maintenance costs in the General Fund since several projects can be identified as capital improvements. Addressing the backlog of deferred maintenance needs in the City is one of the Eight Significant Areas to be funded and the 2009-2013 Outlook has increased the revenue projection from $15.3 million in fiscal year 2008 to $21.8 million in fiscal year 2009.

SAVINGS FROM THE HEALTH CARE REFORM ($0.5 MILLION)

The City expects to realize savings resulting from the implementation of the health care reform agreement that resulted from concluded labor negotiations for fiscal year 2008. The reform was approved by the Mayor and City Council and the expected Citywide savings of nearly $1 million were implemented in the Fiscal Year 2008 Annual Budget. Discussions with labor organizations have not begun for fiscal year 2009 and the change in the enrollment options may result in additional projected savings. The outcome of labor negotiations, the premium increases for health insurance, and plan selection by employees are the main factors that will serve as a basis for savings projection for fiscal year 2009. Based on the enrollment data in fiscal year 2008, the changes in enrollment options for Police Officers Associations (POA), Local 145, and the Unclassified/Unrepresented employees, the General Fund savings of an additional $0.5 million may be realized in fiscal year 2009 pending labor negotiations.

PROPOSITION 1B FUNDING ($17.5 MILLION)

Proposition 1B was approved by California voters in order to provide funding for local streets and roadway infrastructure. Based on current estimates, the City is expected to receive up to $21.2 million in Proposition 1B funds in calendar year 2008 and the remaining balance of approximately $19.9 million to be distributed on a schedule yet to be determined. This funding is pending State approval of the City's streets and highways improvement recommendations. The City will include $17.5 million in qualified projects (that can be funded by Proposition 1B funds) in the Fiscal Year 2009 Proposed Budget.

SPECIAL PROMOTIONAL PROGRAMS ($1 MILLION)

In fiscal year 2009, approximately $1 million may be available in the City's Special Promotional Program (TOT Fund) for appropriate cost reimbursement for TOT-related activities currently budgeted in the General Fund. The creation of the Tourism Marketing District (TMD) will relieve the City of $10.5 million in expenditures in the TOT Fund. In addition, after the full 1 cent of discretionary TOT has been transferred back to the General Fund, $1 million in unallocated revenue is projected to remain in the fund that can be budgeted to support appropriate City promotional costs.

In order to maximize the use of TOT revenue, costs currently budgeted in the General Fund that should be supported by the TOT Fund will be identified. Specifically, the Police Department service costs for Qualcomm Stadium and additional funding for the Office of the City Treasurer for the TOT Audit Program will be considered. Services and programs in the General Fund that directly relate to promoting the City, such as a portion of the funding for maintenance of facilities in Balboa Park, partial funding of lifeguard expenses, and funding related to beach maintenance will be considered.

BUDGET REDUCTIONS

Table IV shows the remaining $32 million budget gap that will be addressed in fiscal Year 2009 through budget reductions. As these reductions are implemented as permanent solutions, they will also address the deficit in future years. In order to achieve a balanced budget, all mayoral departments (excluding Police and Fire-Rescue sworn personnel) have been required to submit a budget reduction plan for fiscal year 2009. The initial target is 10 percent of the fiscal year 2008 operating budget and departments are identifying the effect of the reductions on operations. Not all of the proposed reductions will be taken to balance the budget. The expenditure reductions will be necessary to align revenues with expenditures and may result in service and program reductions.

The budget reductions will be achieved by eliminating non-personnel expenses, and as labor costs account for approximately 70 percent of the total budget, reducing the workforce will be required to balance the budget.

TABLE IV

GENERAL FUND BUDGET DEFICIT
Fiscal Years 2009-2013
(IN MILLIONS)

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
SURPLUS/(DEFICIT)	$ (32)	$ (66)	$ (85)	$ (76)	$ (50)

CONCLUSION

This Five-Year Financial Outlook is a fundamental tool for preparation of a comprehensive, long-range analysis of the City's General Fund revenues and expenditures and it serves as a basis for the preparation of the City's annual budget.

This long-term forecast identifies structural challenges facing the City. Given the magnitude of the obligations needed to be addressed to close the projected deficit, service levels may be affected in fiscal year 2009. While the Outlook presents the scope of the problem and some possible reductions in expenditures needed to achieve a balanced budget, the specific course of action that will be presented in the Fiscal Year 2009 Proposed Budget will require a dialogue with elected officials, staff, labor representatives as well as the public. As alternative solutions to the City's challenges are identified, they will be incorporated into subsequent versions of the

Financial Outlook in order to forecast their long-term impact. The Financial Outlook will continue to be an ongoing planning tool and will be updated on a continuous basis.

FIVE-YEAR FINANCIAL OUTLOOK REFERENCES:

Buck Consultants, "Actuarial analysis for the City of San Diego" (June 2007)
San Diego Business Journal, "Mid-Year Economic Trends" (July 2007)
UCLA Anderson Forecast, "Focus On San Diego-Economic Outlook for 2007-08" (May 2007)
UCLA Anderson Forecast (June, September 2007)
DataQuick Information Systems

ATTACHMENT I

Fiscal Years 2009 - 2013
General Fund
Financial Outlook Summary

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
FIVE YEAR FINANCIAL OUTLOOK					
REVENUES					
Property Tax	421.9	438.6	456.0	474.1	493.0
Sales Tax	235.2	243.9	254.5	265.3	276.0
TOT	91.6	98.0	104.8	112.2	120.0
Franchise Fees	74.0	79.1	84.5	90.3	96.6
Other Revenues	340.9	353.2	338.5	343.8	337.5
Total Revenues	1,163.6	1,212.8	1,238.3	1,285.7	1,323.1
EXPENSES					
Salary & Wages	517.2	527.1	530.7	536.7	537.3
Employee Benefits	116.8	120.8	123.1	125.1	125.8
Pension Payments to SDCERS	123.6	128.8	134.3	140.0	146.0
Retiree Health Care	33.8	50.2	52.4	54.8	57.2
Services and Supplies	236.1	242.1	248.5	255.6	263.2
Implementation of Kroll Recommendations [1]	0.82	0.80	0.02	0.08	0.02
Information Technology	40.7	42.3	44.1	45.8	47.8
Energy/Utilities	28.8	32.2	35.6	39.1	42.8
Equipment Outlay	12.6	13.2	13.7	14.3	14.4
Reserves	7.0	8.6	9.3	9.9	3.9
Deferred Maintenance/Capital	29.7	53.0	67.1	75.4	69.9
Storm Water Runoff Compliance	29.5	36.6	36.6	36.6	36.6
ADA Improvements	10.0	10.0	10.0	10.0	10.0
Workers' Compensation Fund	4.1	8.2	8.2	8.2	8.2
Public Liability Fund	5.0	5.0	10.0	10.0	10.0
Total Expenses	1,195.6	1,279.0	1,323.6	1,361.5	1,373.1
Surplus/(Deficit)	(32.0)	(66.2)	(85.3)	(75.8)	(50.0)

[1] Reflects only the expense for SEC monitoring and outside audit services.

[2] Eight Significant Areas are highlighted.