THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of FY 2012 Mid-Year Budget Monitoring Report

OVERVIEW

The Chief Financial Officer issued the FY 2012 Mid-Year Budget Monitoring Report (Mid-Year Report) on February 23, 2012. The Mid-Year Report describes the current status of revenues and expenditures, and their year-end projections, based on actual (unaudited) data from July through December 2011. The IBA reviewed the Mid-Year Report and also compared information to the City Comptroller's Financial Performance Report for Period 6, dated February 2, 2012, and the First Quarter Monitoring Report (presented to City Council on December 5, 2011).

The Mid-Year Report reflects increased revenues and a decrease in expenditures from the First Quarter Monitoring Report. Projections for major revenues have continued to increase due to increased actual revenue received above forecasted levels and revised growth rates for the remainder of the fiscal year; while total departmental revenues have also increased. General Fund expenditures have declined from the First Quarter Monitoring Report largely due to a decrease in contract expenditures that were delayed to FY 2013. The combined increase in revenues and decrease in expenditures from the First Quarter Monitoring report have negated the $2.6 million reported deficit at that time, and have resulted in a forecasted $16.5 million surplus at year end.

Additionally, current General Fund reserves estimated in the Report exceed forecasted levels in the First Quarter Report; totaling $130.4 million, or 11.4 percent of forecasted revenue and $38.5 million above the FY 2012 reserve target of 8.0 percent of projected General Fund revenue. This Mid-Year Report is also the first time Ordinance 20084, adopted in August 2011, has been in place. This Ordinance requires the Mayor to identify how to mitigate any projected shortfall in the General Fund or how to utilize any surplus, and allows for Council review and modification. Further discussion of this Ordinance, the Mayor's utilization of the identified surplus in the Report, and Council options are presented later in this report.

The February 29, 2012 Budget and Finance Committee meeting will be the first of two required public hearings to begin the process to amend the budget, as recommended in the Mid-Year

Report. Following the Committee meeting, the City Council will be asked to hold a second public hearing, after which the Council will consider the adoption of a resolution to authorize the requested budget amendments. Assuming no changes are made to the requested budget amendments, the Council will be asked to introduce and adopt an ordinance to amend the Annual Appropriations Ordinance, consistent with the adopted resolution.

FISCAL/POLICY DISCUSSION

General Fund Revenues

General Fund revenues have increased significantly from both the FY 2012 Adopted Budget and First Quarter Budget Monitoring Report, primarily due to the General Fund's three largest revenues: Property Tax, Sales Tax, and Transient Occupancy Tax. Total General Fund revenue is projected to be over the FY 2012 Adopted Budget by $21.9 million; of which, $18.2 million, or 83.2 percent of this overall growth is attributable to the three noted revenue categories.

Additionally, departmental and other revenues have increased $3.7 million over the Adopted Budget, due mostly to a $2.8 million increase in the 4.0 cent special promotion transient occupancy tax transfer to departments (which corresponds with the overall increase in TOT revenue), and $4.3 million in tow referral fees that was released by the courts after resolving outstanding litigation regarding this revenue. These increases were offset by the elimination of motor vehicle license fees and other negative variances in departmental revenues.

The following revenue sections outline the major General Fund revenues and any additional departmental revenue items of note.

Major General Fund Revenues

Revenue Source	Fiscal Year 2012 Adopted Budget	Fiscal Year 2012 First Quarter Report	Fiscal Year 2012 Mid-Year Report	$ Change from Adopted Budget to Mid Year	$ Change from First Quarter to Mid Year
Property Tax	$ 380,908,544	$ 384,686,705	$ 386,178,988	$ 5,270,444	$ 1,492,283
Sales Tax	211,589,835	217,596,602	220,672,541	9,082,706	3,075,939
Transient Occupancy Tax	74,787,161	76,128,190	78,667,129	3,879,968	2,538,939
Total Three Revenues	**$ 667,285,540**	**$ 678,411,497**	**$ 685,518,658**	**$ 18,233,118**	**$ 7,107,161**

Property Tax

Property tax is projected to end the fiscal year $5.3 million over the Adopted Budget of $380.9 million, at $386.2 million. This projection is based on an increase in the amount of property tax due from secured properties – which encompasses both residential and commercial properties. During the economic recession, residential and commercial property assessed valuation declined significantly, increasing the amount of applications from property owners to reduce their assessed valuation and amount owed to the City. However, the residential and commercial property market is stabilizing and most property owners received an increase in their property tax bills based on an increase in the California Consumer Price Index for FY 2012 (as mandated by Proposition 13). As noted in the Mid-Year Report, the collection rate for secured properties was increased from the Adopted Budget by approximately 1.2 percent; however, it should be clarified that this was the collection rate utilized for the projection incorporated into the First Quarter Budget Monitoring Report. Based on our review of the property tax projection included in the Mid-Year Report, we believe that projected growth is conservative and appropriate.

Sales Tax

Sales tax is projected to end the fiscal year $9.1 million over the Adopted Budget of $211.6 million, at $220.7 million. This projection is based on actual performance for the first and second quarters of the fiscal year, demonstrating growth of 8.4% and 11.5%, respectively, over the same periods in FY 2011. The current year-end projection assumes growth of 4.5 percent over FY 2011 performance for the remaining quarters of the fiscal year, which is an increase of 0.5 percent over projections included in the First Quarter Budget Monitoring Report. The assumed growth rate of 4.5% for the remainder of FY 2012 is relatively conservative in consideration of the current performance trend for sales tax and indications of a continued economic recovery. If sales tax performance continues to trend at current levels, revenue performance will exceed the current projection. Each additional 1.0 percent increase in sales tax growth over FY 2011 performance for the remainder of the fiscal year would equate to an approximate addition of $1.0 million in revenue.

Transient Occupancy Tax (TOT)

The year-end projection for General Fund TOT is $78.7 million, $3.9 million above the budget of $74.8 million. This projection is based on actual monthly performance for the first half of the fiscal year, with an assumed growth rate of 5.0% over same period performance in FY 2011. This is an increase in the projected growth rate of TOT of 1.0 percent above the growth rate included in the First Quarter Budget Monitoring Report. TOT receipts in the first six months of FY 2012 averaged growth of 9.2% over receipts for the same months in FY 2011. A continuance of this growth trend will lead to TOT year-end performance above the current projection. Each 1.0 increase in the growth rate for TOT above the current assumption of 5.0 percent for the remainder of the fiscal year would equate to approximately $350,000 in additional revenue above the current projection.

Departmental Revenue Issues

Engineering & Capital Projects (E&CP)

The Mid-Year Report identifies a projected $1.3 million revenue shortfall from the Adopted Budget in E&CP due to lower than projected reimbursements for engineering services from other City departments. This issue was first identified in the First Quarter Budget Monitoring Report and no explanation was provided at that time for the shortfall. The Mid-Year Report provides an explanation for the revenue shortfall, which was due primarily to revenue being projected based on prior year data, rather than as a percentage of budgeted personnel expenditures. Based on current vacancies in the department, revenue projections should also be lowered accordingly. Financial Management plans to address this in FY 2013 and subsequent-year budgets by budgeting the revenue based on the new methodology.

The department has continued to hire for vacant positions since the First Quarter Budget Monitoring Report and improved the accuracy of staff charged reimbursable time, which has improved revenue from projections at that time. Despite the revenue improvements from the First Quarter Report, expenditures in the department are still projected to be $1.0 million above Adopted Budget levels; so E&CP still has an overall combined shortfall of $2.3 million.

E&CP personnel expenditures do not include the six additional staff required as part of the Departments CIP streamlining efforts. However, staff has indicated to us that these positions will be included in the FY 2013 budget and are proposed to be funded through bond proceeds.

Fire-Rescue Fees

1.) Fire-Rescue Alarm Permit Fees

The FY 2012 Budget includes $910,000 in fee revenue associated with the implementation of the Fire-Rescue Alarm Permit Fee program. It is anticipated that this program, that began implementation in November, will not meet budgeted expectations due to a lower number of permits issued than originally estimated, by between 52-64%, and a delay in penalty billings. Before the implementation of the program, the number of existing fire-alarm systems was unknown. Based on actual permit issuance, the number of alarm systems is estimated at 15,000-20,000, as compared to the 42,000 originally assumed.

Earlier in the year, the budgeted revenue projection for the Alarm Permit fee of $910,000 was revised upward by $174,008 to $1,084,008 to reflect an earlier start date for the program at the beginning of November, versus the start date assumed in the budget at the beginning of December. The revised projection for the new alarm permit revenue was comprised of two components: $236,960 in actual permit fee collections and $837,048 related to revenue generated from revocation and cost recovery penalties. The permit component of the revenue is now projected at approximately $180,000 for FY 2012, with the new projection for the penalty component of the fees to be determined. The true impact of the reduction in the number of the permits will take place in FY 2013 where permit revenue was anticipated at $370,440, representing a full year of collections based on the original alarm system estimate.

The new projection for the penalty component of the fees, comprising the majority of the budgeted $910,000, is yet to be determined. There have been delays associated with the imposition of false alarm penalty fees due to a technicality involving the Council approved names for the penalty fees that are inconsistent with those used in the City Clerk's Rate Book and during the City Council presentation. Once the penalty fee title revision is approved by Council, the department will move forward with billings. Penalty activity will not be truly know until the latter half of the year due to the allowance of two false alarms before penalties are imposed.
The projection for the Fire-Rescue Alarm Permit Fee program incorporated in the Mid-Year Report is $910,000 and does not reflect the expected decline in the year-end projection.

2.) Air Medical Transport Fees

The FY 2012 Budget incorporated $53,625 in revenue associated with implementing the Air Medical Transport fee. After budget adoption, the FAA ruled that the City cannot charge patients an air medical transport fee unless the City complies with the FAA requirements for commercial operators, which is associated with additional costs. In operating under a Public Agency provision, the City avoids the additional costs associated with specific staffing and equipment requirements for commercial operators. Complying with the commercial operator requirements are cost prohibitive. Due to this, this fee will not be imposed by the City, and the Mid-Year projection reflects the removal of the $53,635 in related revenue.

Parking Citation Revenues

The Mid-Year Budget Monitoring Report forecasts parking citation revenue to come in $2.8 million under budget. This under budget performance is attributed in the Mid-Year Report to offenders not paying fines, over budgeted parking citation revenues, and a decreased number of citations. The information our office has attained from the Police Department reflects that the number of issued citations by the department has increased in the first half of FY 2012 by 3.9% when compared to the number issued in the first half of FY 2011, with issued citations projected to increase by 5.3% in FY 2012. Information from the Transportation and Storm Water Department also conveys that the number of citations issued by their department has continued to increase. Based on information provided by staff, the number of citations issued is not the cause of the variance, with the likely cause of a revenue shortfall being a drop in the collection rate of parking citations.

The FY 2012 Adopted Budget for parking citation revenue included the addition of $1.3 million in delinquent parking citation revenue. This revenue was added to the Police Department budget. Treasurer staff estimates that only $450,000 of the budgeted amount will have been collected by the end of FY 2012, with approximately $370,000 collected to date. Given this feedback, it appears this projected $850,000 shortfall is contributing in part to the total $2.8 million under budget Citywide parking projection in FY 2012.

Also, $3.2 million in revenue was added to the parking citation revenue budget in the Police Department related to the pass-through of State mandated surcharges to offenders. The $3.2 million in additional revenue was based on a three year average of the number of parking citations issued, multiplied by the surcharge amount. The City Treasurer's Office has indicated that the program is operating as planned. It is important to note that if offenders are not paying fines as is referenced in the Mid-Year Report, the projection of $3.2 million in additional revenue could be overstated.

General Fund Expenses

General Fund expenses have increased $3.7 million from the FY 2012 Adopted Budget, but have declined $3.2 million since the First Quarter Budget Monitoring Report. The increase from Adopted Budget levels is due to an increase in personnel expenses and fringe, with the largest increases occurring in public safety departments. The decline in expenditures from the First Quarter Budget Monitoring Report is due primarily to revised projections for contract expenditures or delaying them into FY 2013. This includes a delayed expenditure of $1.2 million for Kinder Morgan litigation, delaying $0.7 million in Community Plan update expenditures; and a reduction of $2.1 million in revised expenditures for special consulting services. The following expenditure sections detail any additional city-wide and departmental expenditure items of note.

Expenditure Category	Fiscal Year 2012 Adopted Budget	Fiscal Year 2012 First Quarter Report	Fiscal Year 2012 Mid-Year Report	$ Change from Adopted Budget to Mid Year	$ Change from First Quarter to Mid Year
Personnel Expenditures	$ 504,576,341	$ 507,436,024	$ 507,280,269	$ 2,703,928	$ (155,755)
Fringe Benefits	308,939,938	311,487,269	311,046,673	2,106,735	(440,596)
Contracts	174,522,415	174,284,512	169,571,029	(4,951,386)	(4,713,483)
Energy & Utilities	33,748,202	34,602,637	34,688,198	939,996	85,561
Information Technology	23,227,591	23,347,630	23,235,382	7,791	(112,248)
Supplies	17,872,193	19,929,459	21,666,275	3,794,082	1,736,816
Other Expenses	65,501,594	64,190,394	64,568,916	(932,678)	378,522
Total GF Expenses	**$ 1,128,388,274**	**$ 1,135,277,925**	**$ 1,132,056,742**	**$ 3,668,468**	**$ (3,221,183)**

City-Wide Issues

MRO / Supplies Expenditure Increase

The FY 2012 Mid-Year report projects supply expenditures to be approximately $3.8 million or 21% over budget. Based on information received from the Purchasing & Contracting Department and information provided in the FY 2012 Mid-Year report, this over budget projection appears to be due to a number of factors including:

1) Increased demand for supplies in certain departments;
2) Reduced Maintenance, Repair and Operation (MRO) budgets with demand consistent with previous fiscal years;
3) Inflationary costs of certain supplies within the cooperative purchase agreements;
4) Unrealized projected savings in some departments from the MRO cooperative purchasing agreements approved by Council in June 2011.

In addition, not all items are covered in the City's cooperative purchasing agreement and other vendors have been used to source items outside the agreement. In these cases, the resulting mark-ups may have increased certain City commodity costs. The IBA understands that the Purchasing & Contracting Department is currently evaluating where the cooperative purchasing agreements are or are not working with client departments and MRO contractors to improve performance and control within the program.

ERRP Change to OPEB Contribution

The Federal Early Retiree Reinsurance Program (ERRP) program was created to provide financial help to group health care plans, such as the City's, that provide health coverage to retirees. This funding was intended to be used by the City to offset retiree health costs in FY 2012. Because the City received approval for ERRP funding eligibility in April 2011, the FY 2012 Citywide budget for retiree health costs was reduced by $2 million (from $57.8 million to $55.8 million). However, on February 24, 2012, in a memorandum from COO Jay Goldstone, the Council was informed that outstanding requests for ERRP reimbursement have been placed on hold, as funding has run out for this program.

The City intends to fund the Citywide retiree health program at $57.8 million in FY 2012, whether it receives ERRP reimbursement or not. Therefore, unless new ERRP funding becomes available, the City is projected to incur an additional $1.4 million in General Fund retiree health expenditures ($2.0 million Citywide) for FY 2012. This would reduce the Mid-Year projected General Fund surplus from $16.5 million to $15.1 million. However, some departments may be able to absorb some or all of the additional retiree health expenditures allocated to them based on an improved expenditure outlook in the last two quarters of FY 2012 (beyond what is included in the Mid-Year Report). If necessary, Financial Management will address potential funding needs with a year-end budget adjustment request presented to Council later this fiscal year.

Termination Pay Forecast

The First Quarter Budget Monitoring Report noted a potential $3.3 million increase in termination pay above budgeted levels due to a high number of projected retirements prior to the April 1, 2012 change in retiree health benefits.

The projection included in the Mid-Year Report is only $1.6 million above budgeted levels based on staff analysis of employees who have communicated their intent to retire to SDCERS or their departments (94 General Fund employees). Individual employee termination payments are forecasted as of March 31 based on their current leave balance and pay level, among other factors. The IBA would note that this amount may increase, since City employees that may retire prior to the change in retiree health benefits are not required to notify anybody of their intent. Accordingly, the number of retirees may increase above 94 employees.

Gas Price and Usage Fees

The First Quarter Budget Monitoring Report noted a potential $1.7 million increase in unleaded gasoline prices for the General Fund, which was not included in projections for the Mid-Year Report. The IBA was not able to review the methodology behind this change, and will continue to work with staff to determine any potential change in gasoline prices charged to General Fund departments.

Departmental Issues

Storm Water Vacancies

The Mid-Year Report states that the Transportation and Storm Water Department is $745,000 under budget in expenditures, mostly due to vacant positions in the Street, Storm Water and Transportation Engineering Operations (TEO) Divisions. As of the end of January 2012, these vacancies totaled approximately 67 positions, or about 15.2 percent of total positions budgeted in the FY 2012 Adopted Budget. The department states that they have approval to fill these vacant positions, but hiring of employees has been hampered by two items: 1.) the lengthy process of completing medical and security clearance for individuals hired outside the City; and 2.) the availability of current certification lists of vacant classifications. The Personnel Department is in the process of creating these lists for several classifications.

The Mid-Year Report states that the Storm Water division expects to fill 10 of their vacancies by year end, and that the TEO division is in the process of filling many of their 9 vacancies. Additionally, the Street Division has offered 5 Utility Worker II positions to candidates and several other interview panels are in progress. The Transportation and Storm Water Department declares that service levels have not been significantly impacted by these vacancies and the department's ability to shift resources to critical functions is a significant reason for this.

Library Vacancies

From the FY 2012 Mid-Year Budget Report, the Library Department is projecting to be approximately $1.3 million under budget in expenditures, with under budget personnel expenditures contributing approximately $1.1 million to this total. The Library Department realized savings in the first half of the fiscal year due to vacancies, but the Department is actively filling vacancies, specifically within the Branch Libraries. The Library Department plans to address a majority of these vacancies in February through April, and it is the intention of the Library Department to have staffing needs addressed by the end of the year.

Fire-Rescue Department

The Fire-Rescue Department is projected to end the year $4.8 million over budget in personnel costs. This overage is the net of the interplay of overtime and personnel expense that is intended to be offset by savings in salary and fringe benefits in accordance with the constant staffing budgeting model utilized by the department. The following are the personnel expense overages projected: $16.4 million in overtime, $372,000 in hourly wages, $312,000 in special pays, $804,000 in vacation pay in lieu, $1.3 million in industrial leave, and $2.8 million of other non-productive time categories (e.g. vacation, sick leave, etc). These overages fall short in being offset by the savings over budget in the following personnel expense categories: $16.6 million in salaried wages and $823,199 in fringe.

The Mid-Year Report projections are informed by an historical trend analysis being performed by Financial Management and the Fire- Rescue Departments of departmental personnel costs that is intended to identify the reason for the over budget personnel expenses. It is important to note that the historical analysis is still is ongoing. There are many issues that complicate a trending analysis encompassing data from past fiscal years, including new overtime accounting methodologies established with the migration to SAP, citywide fringe cost reallocations during the fiscal year, and the comparison of fiscal years that have overtime anomalies.

Even so, with an attempt to account for these variables, the analysis reveals that it is typically the case that increased overtime related to constant staffing is not fully offset by savings in salary and fringe benefits. It is important to note that the preliminary analysis speaks to an issue with how the constant staffing model is budgeted rather an operational issue. Staff plans to address this issue in the FY 2013 Budget. This may involve reallocations within the personnel budget and/or an overall increase in the overtime budget for the department. Addressing this issue may also involve a reevaluation of the appropriateness of a budgeted vacancy savings factor for the Fire-Rescue Department given its use of the constant staffing model. The department's FY 2012 budgeted vacancy factor is $3.4 million.

Police Department

The First Quarter Monitoring Report identified the need for $900,000 in additional funding from the General Fund to support the overhaul of the Police Department's two helicopters due to insufficient monies available from Seized Assets Funds to support the expenses. This projected increase in General Fund expenditures has been removed from the Mid-Year Monitoring Report given that COPS funding has been identified as funding source for the overhauls. As a part of State of California budget actions, an additional $800,000 in Citizen's Option for Public Safety (COPS) grant funding will be received by the State above the current $1.3 million budget. The receipt of this additional revenue was not included in the First Quarter Report given the expectation that it would be used to support the required helicopter maintenance.

Park & Recreation Department

Funding for work on the Children's Pool Site Development/Coastal Development Permit to erect a barrier rope for continued joint use of the Children's Pool in La Jolla was not included in the Park and Recreation Department's FY 2012 Adopted Budget. The IBA has confirmed that $30,000 has been included in the Park and Recreation Department's FY 2012 Mid-Year Budget adjustments for work to be completed in FY 2012.

Other Issues

Council District Nine

The Mid-Year Report includes a $500,000 requested budget adjustment in the Council Administration department for the complete funding of the construction of the ninth Council District office. If the appropriation of $500,000 is approved, the funds will be transferred from the General Fund to a capital improvement project to segregate the funds necessary for construction in order to not complicate funding when payments are required in FY 2013.

Redevelopment Agency Dissolution and Unwinding

The Mid-Year Report does not include specific potential fiscal changes to the budget that may result from the dissolution and unwinding of the City's Redevelopment Agency which occurred on February 1, 2012 as required by Assembly Bill x1 26 (AB 26). Impacts to the budget have not been included due to the numerous unknown factors at this time.

As the Successor Agency responsible for dissolution and unwinding, the City has submitted an Enforceable Obligation Payment Schedule (EOPS) to the State Department of Finance and has heard no objections. Several payments included in the EOPS are based on agreements between the former Redevelopment Agency and the City which may not be allowed under AB 26, such as reimbursement agreements, loan agreements, and a cooperation agreement for payment of costs for redevelopment funded projects. Payments that are not approved could impact the City's General Fund. Examples of such payments include: annual debt service to Petco Park; costs associated with the expansion of the Convention Center Phase II[1]; the City's Community Development Block Grant repayment to the U.S. Department of Housing and Urban Development; and repayment for general long term debt owed to the City.

Issues associated with the dissolution and unwinding for the former Redevelopment Agency are concerning given the potential risk to the General Fund and we will continue to monitor how these are addressed in future budgets.

Status of General Fund Reserve

The FY 2012 reserve target of 8.0 percent of projected General Fund revenues had been surpassed as of the First Quarter Budget Monitoring report. The projected excess reserves in the First Quarter Report was $10.2 million, which was based on a then-projected deficit of $2.6 million in the General Fund in combination with an additional $5.0 million in expenses that offset the total reserve level. In the Mid-Year Report, three positive adjustments have been made to components that are incorporated into the reserve calculation that are primarily responsible for having increased the excess reserve balance above levels forecasted in the First Quarter Report.

The General Fund estimated reserve has increased significantly from the First Quarter Budget Monitoring Report due to the following items:

[1] The Redevelopment Agency agreed to pay $2.0 million in fiscal year which will increase by $500,000 annually until the payment reaches $9 million in FY 2026. Annual payments of $9 million will continue through per year until FY 2014. Annual payments of $9 million will continue through FY 2042 with a final payment of $2 million in FY 2043.

1.) The General Fund is forecasted to end with a $16.5 million surplus (including items to be re-budgeted in FY 2013). This surplus is $19.1 million higher than the First Quarter Report's forecasted deficit of $2.6 million.
2.) Based on audited figures included in the FY 2011 CAFR, beginning reserve levels for FY 2012 are known to have increased from an estimated $108.6 million (including release of encumbrances) from the first quarter report, to $113.9 million; adding an additional $5.3 million in reserves.
3.) The First Quarter Report deducted $5.0 million in potential expenditures from fund balance. This was comprised of an estimated increase in gas prices of $1.7 million and an increase in terminal leave payments of $3.3 million. In the Mid-Year Report, no increase in gas prices was included, while terminal leave payments were only forecasted to increase $1.6 million above budgeted levels. The difference between the $5.0 estimated increase in costs in the first quarter and only $1.6 added to the mid-year further increased reserves by $3.4 million.

The total ending reserve balance of $130.4 million is approximately 11.4 percent of projected General Fund revenues; $38.5 million in excess reserves above the policy level of 8.0 percent of General Fund projection revenues (prior to the Mayor's recommended utilization of surplus according to Ordinance-20084 and re-budgeted items in FY 2013 in the Mid-Year Report). It should also be noted that this reserve balance estimate includes $1.3 million of Council CPPS funds, which will be part of the FY 2013 Adopted Budget.

IBA Review of FY 2012 Budget Balancing Solutions (Attachment One)

During the FY 2012 budget process, a number of revenue and expenditure changes were identified to be incorporated into the Adopted Budget as solutions to achieve a balanced budget while restoring certain services to the citizens of San Diego. Some were included in the Mayor's FY 2012 Preliminary Budget while others were added to the FY 2012 budget by the City Council to restore services in the Public Safety, Park and Recreation, and Library areas. Our office has reviewed the most significant of those solutions to determine if the original projected savings have been or will be achieved and to identify reasons for any variances. For the most part, the solutions have been fully implemented as proposed and adopted. Some solutions such as increasing TOT and sales tax projections, have exceeded budgeted expectations due to greater economic improvement. A few items have not achieved projected results for various reasons discussed in the attachment. Examples include revenue expected for recovery auditing; delinquent parking citations revenue; and savings in cell phone expenditures. Progress continues on many of these items and additional savings or revenue could result in FY 2013.

Mid-Year Adjustments Ordinance and General Fund Surplus

On July 18, 2011, City Council passed an ordinance (Ordinance-20084) amending the municipal code regarding mid-year budget adjustments and reporting significant reductions in City services or programs. The ordinance requires the Mayor to report any deficit or surplus in the General Fund projection to the City Council and recommend solutions for addressing the deficit or surplus. In the case of a surplus, such as projected for the current year, the ordinance then specifies:

- *The Mayor may recommend budgeting all, none, or any portion of any projection surplus.*
- *The City Council may approve the Mayor's recommendation or modify such recommendation in whole or part.*

- *The City Council may budget and appropriate up to the total amount recommended by the Mayor; or, if the Mayor recommends budgeting less than $5 million of the projection surplus amount, the City Council may only increase the adopted General Fund budget by up to $5 million or not more than 50% of any projection surplus, whichever total dollar amount is less.*

Of the identified $16.5 million surplus, the Mayor has proposed re-budgeting $3.2 million in FY 2013 for the following projects, which were originally budgeted in FY 2012:

1.) $1.3 million for Council CPPS funds;
2.) $1.2 million for continued Kinder Morgan litigation funding;
3.) $0.7 million for DSD community plan updates.

These funds will be set aside for FY 2013, so the remaining available General Fund surplus of $13.3 million more accurately reflects the current level of General Fund surplus. The Mayor has proposed to utilize $5.0 million of the projected $13.3 million surplus for the following:

1.) Restore services in Library and Park & Recreation for $0.3 million in FY 2012;
2.) Add 15 cadets to the April Police academy for $1.0 million;
3.) Undertake $3.7 million in one-time expenditures to fully fund the fire alert system and create a CIP emergency fund.

The $0.3 million funding for the restoration of Library and Park & Recreation hours is the projected amount to add four hours and five hours to all library branches and recreation centers each week, respectively, for the remainder of FY 2012. The proposed increase in hours would occur after Council approval and the mid-year budget adjustments amendment is approved. Staff has indicated the restoration of services is projected to occur in May for the Recreation Centers, and April Library hours. The $1.0 million in additional funding for the April Academy will support an additional 15 recruits and one-time non-personnel expense, bringing the total number of recruits for the academy to 35. The department currently has 38 sworn vacancies above the 100 vacancies assumed in the FY 2012 Budget. The additional recruits will allow the department to fill the 38 vacancies sooner than anticipated due to the academy attrition.

Finally, the Mayor recommends the remaining $8.3 million of the General Fund surplus to remain unbudgeted to provide a hedge against any potential downturn in revenues and / or increase in expenditures during the final half of FY 2012. Any surplus remaining at the end of the fiscal year would then be placed into General Fund reserves.

Council Options

The Office of the IBA discussed the Mayor's proposed utilization of $5.0 million in funds in FY 2012 and $3.2 million in re-budgeted items in FY 2013 with the City Attorney's Office to determine these proposed actions in relation to new Ordinance-20084. As previously mentioned, the more accurate surplus is $13.3 million because deferring $3.2 million of expenditures to FY 2013 isn't based on performance in the General Fund. The recommendations that are then subject to the ordinance are the Mayor's utilization of $5.0 million of the surplus. Based on the Mayor's recommendations and the ordinance language, Council may:

1.) Accept the Mayor's $5.0 million of budget recommendations in full;
2.) Modify the Mayor's recommendations as desired for any amount less than or up to $5.0 million;

3.) Decide to not budget any of the forecasted General Fund surplus.

The Mayor's veto authority and Council override authority would apply to this action.

Current Status of FY 2013 Projected Deficit and Impact of Mid –Year Recommendations

The deficit for FY 2013 is currently estimated to be $12.2 million, after adjusting for a reduction to the FY 2013 retirement ARC estimate utilized in the Outlook, released by Cheiron in January. This $12.2 million deficit is expected to be offset by a $2.0 million reduction in FY 2013 debt service costs based on a pending proposal to issue $75 million in 2012 deferred capital bonds this spring rather than $100 million as originally reflected in the Outlook. This will reduce the FY 2013 projected deficit to $10.2 million.

The Mayor's mid- year surplus recommendations would impact the $10.2 million deficit projection as follows:

- Utilizing FY 2012 surplus funds of $2.7 million for the Fire Alert System would eliminate the need for FY 2013 one-time funding of $2.6 million which was included in the Outlook for this purpose.
- Recurring costs for FY 2013 associated with the restoration of library and recreation center hours are estimated at $1,000,000 and $381,000, respectively. These costs will likely be offset by recurring increases to major revenue categories including sales tax and TOT, which are expected to be reflected in the Mayor's FY 2013 Preliminary Budget.
- Recurring costs in FY 2013 for 15 additional officers are estimated at $ 1.8 million. These costs may be offset through attrition, filling existing vacancies, and anticipated recurring revenues.

IBA Recommendations

Based on our analysis of the FY 2012 mid-year monitoring report we recommend the Budget and Finance Committee consider the following actions:

1.) Support the Mayor's proposed re-budgeting of $3.2 million from FY 2012 to FY 2013 for Council Community Project, Programs, and Services, Kinder Morgan litigation, and community plan updates;
2.) Approve the Mayor's recommendations for utilizing $5.0 million of the $13.3 million surplus for recreation center and library hours, 15 police cadets, CIP emergency fund creation, and completion of the fire alert system;
3.) Request the Mayor to commit the remaining $8.3 million surplus to increasing cash funding of deferred capital projects in the Mayor's FY 2013 Preliminary Budget. Based on the deferred capital funding options proposed by the Mayor and currently under consideration by the Budget and Finance Committee, this action would increase deferred capital cash funding in FY 2013 from $45.8 million to $54.1 million, and would achieve the "status quo"[2] funding level for O&M deferred capital projection in FY 2013. By way of example, sixteen additional miles of streets could be resurfaced with this additional allocation.

[2] The "status quo" funding level refers to the level necessary to prevent further deterioration.

We make these recommendations after taking into consideration our understanding of the Council's options under new Ordinance 20084, the status of the financial outlook for FY 2013 and the critical funding needs related to the City's deferred capital backlog.

We will continue to work with Financial Management on specific revenue and expenditure changes which could impact year-end projections, including FY 2012 budget solutions not yet implemented.

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Attachment: 1. FY 2012 Budget Solution Status