THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of the Mayor's Five-Year Financial Outlook for FY 2014 – 2018

OVERVIEW

On October 24, 2012 Mayor Sanders released his Five-Year Financial Outlook for FY 2014-2018, marking the seventh and final financial outlook prepared under his administration. In stark contrast with past outlooks, this latest Outlook shows surpluses in each of the five years beginning with a $4.9 million surplus in FY 2014 increasing to a $94.2 million surplus projected for FY 2018. Since 2007 all of the Mayor's outlooks have projected deficits in every year of the five-year outlook period with one exception. Last year's FY 2013-2017 Financial Outlook projected, for the first time, a surplus of $22.7 million in FY 2017.

Over the past seven years significant progress has been made toward reducing costs and increasing efficiencies of City operations to achieve a structurally balanced budget through business process reengineering; managed competitions; IT outsourcing; retiree health care and other benefit reforms; pension restructuring; and salary reductions and freezes. The improvement in the City's budget picture can be attributed largely to these strong actions although reductions to City services have also been necessary during this time to balance the budget. Fortunately, over the past two years better than expected revenue growth has allowed for restoration of several detrimental reductions including elimination of Fire engine "brown outs" and restoration of cuts to library and recreation center service hours.

It is important to acknowledge the accomplishments that have been achieved but to also remain vigilant about the financial challenges facing the City and continue to exercise caution given the backdrop of a persistent uncertain economy. While we agree with the underlying assumptions in the Mayor's FY 2014-2018 Financial Outlook baseline projections, our review has identified a number of significant risks to the Outlook, as well as pending policy issues, that need to be addressed. To facilitate this we have presented a revised five-year outlook which incorporates the financial impacts to the Mayor's Outlook projection should any or all of these potential risks come to fruition.

IBA REVISED OUTLOOK

In the IBA Revised Outlook, we have identified three categories of risks: non-discretionary and discretionary expenditures, and potential revenue fluctuations. ***Non-discretionary expenditures*** fall into two categories: 1.) those where it is uncertain whether they will occur, but the financial impacts must be addressed if they do occur; and 2.) those that have occurred but their impact is still being analyzed. Included are the impacts of pending State decisions regarding ***redevelopment dissolution***; impacts of ***pension plan investment losses***; and impacts of ***Proposition B and new GASB rules*** on the pension plan.

Discretionary expenditures are significant programmatic needs, not included in the Mayor's Outlook, that have been identified as priorities for future funding through recent Council Committee deliberations or City Council action. Committing funding to these items remains discretionary based on availability of funds and the need for balancing competing priorities. These items include increased funding for ***deferred capital***; the ***Penny for the Arts Blueprint***; and ***Full Funding of 35 Member Police Recruit Academies.***

While we believe the revenue assumptions in the Mayor's Outlook are appropriate, we address the possibility of ***revenue fluctuations*** by including the impact of more modest sales tax and property tax revenue projections than what are shown in the Mayor's Outlook.

The following table and accompanying notes illustrate the financial impact on the Mayor's Outlook "baseline" forecast for FY 2014-2018 with items discussed in individual sections in this report related to addressing non-discretionary and discretionary expenses, in addition to potential major revenue changes based on our Office's sensitivity analysis.

COMPARISON OF MAYOR'S OUTLOOK TO IBA REVISED OUTLOOK SCENARIO

$ in millions	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Mayor's Five-Year Outlook "Baseline"	**$ 4.9**	**$ 6.1**	**$ 32.2**	**$ 62.0**	**$ 94.2**
IBA Adjustments					
Non-Discretionary Adjustments					
1.) Redevelopment Impacts	$ (14.3)	$ (14.8)	$ (15.3)	$ (15.8)	$ (16.3)
2.) Pension Plan Investment Experience Loss	(6.0)	(11.2)	(15.6)	(19.3)	(22.7)
3.) Pension Change - Proposition B	(21.6)	(17.7)	(13.7)	(9.7)	(5.6)
Sub-Total Non-Discretionary Adjustments	**$ (41.9)**	**$ (43.7)**	**$ (44.6)**	**$ (44.8)**	**$ (44.6)**
Revised Outlook - "Baseline" + Non-Discretionary	**$ (37.0)**	**$ (37.6)**	**$ (12.4)**	**$ 17.2**	**$ 49.6**
Discretionary Adjustments					
4.) Deferred Capital "Enhanced Option B" vs. "Status Quo"	$ (30.1)	$ (18.2)	$ (6.3)	$ (0.2)	$ 1.1
5.) Penny for the Arts Blueprint	(3.8)	(6.0)	(7.6)	(10.1)	(10.1)
6.) Full Funding for 35 Member Police Recruit Academies	(7.7)	(13.0)	(18.4)	(23.8)	(29.1)
Sub-Total Discretionary Adjustments	**$ (41.6)**	**$ (37.2)**	**$ (32.3)**	**$ (34.1)**	**$ (38.1)**
Revised Outlook - "Baseline" + Non-Discretionary + Discretionary	**$ (78.6)**	**$ (74.8)**	**$ (44.7)**	**$ (16.9)**	**$ 11.5**
Revenue Sensitivity Analysis					
7.) Sales Tax Sensitivity	$ (0.2)	$ (8.3)	$ (14.9)	$ (22.7)	$ (30.9)
8.) Property Tax Sensitivity	(5.4)	(10.9)	(16.2)	(21.9)	(23.7)
Sub-Total Revenue Sensitivity Analysis	**$ (5.6)**	**$ (19.2)**	**$ (31.1)**	**$ (44.6)**	**$ (54.6)**
Revised Outlook: "Baseline" + Non-Discretionary + Discretionary + Revenue Sensitivity	**$ (84.2)**	**$ (94.0)**	**$ (75.8)**	**$ (61.5)**	**$ (43.1)**

Non-Discretionary Adjustments

1.) Redevelopment Impacts- Figures represent annual payments of $11.3 million for Petco Park and payments for Convention Center Phase II ranging from $3.0 million in FY 2014 to $5.0 million in FY 2018, should these items continue to be denied by the California Department of Finance. If the State also exercises the "claw-back" provision, the General Fund would have to pay an additional $28.0 million for payments already made in FY 2012 and FY 2013. (See pages 26-31 for further discussion)

2**.) **Pension Plan Investment Experience Loss- Figures represent the latest estimates from SDCERS of the impact of lower than assumed investment returns on the pension ARC. Note that the investment return experience loss due to a lower than assumed investment return is only one type of experience loss (or experience gain) that could occur. The impact of demographic experience and other pension variables is unknown at this time. Because of the complexity of the pension system variables, the total of all effects on the ARC is not yet known. (See pages 17-19 for further discussion)

3.) Pension Change- Proposition B - Figures represent estimated cost increases to the Annual Required Contribution (ARC) for each year of the Outlook. These estimated cost increases are based on a change in the Unfunded Actuarial Liability (UAL) payment methodology that was incorporated into the June 2012 Proposition B fiscal analysis. However, it is now uncertain whether the UAL payment methodology used in the Proposition B fiscal analysis will be used to calculate the FY 2014 ARC. Since this fiscal analysis was produced, new Governmental Accounting Standards Board (GASB) standards have been issued which could change the analysis and its results. This analysis and decision rests with the SDCERS Board and its actuary. (See pages 17-19 for further discussion)

Discretionary Adjustments

4.) Deferred Capital- "Enhanced Option B" vs. "Status Quo"- The Budget and Finance Committee requested our Office to include in the IBA scenario the additional funding required to achieve what is known as the "Status Quo" deferred capital funding option. This is the funding level that is estimated to be required to prevent further deterioration of our assets, while Enhanced Option B (which is reflected in the Outlook, consistent with City Council action) is estimated to slow deterioration annually to 5-10 percent. While this scenario assumes the gap would be cash funded, it should be noted that increasing the amounts of future lease revenue bond issuances for this purpose should also be evaluated. (See pages 22-26 for further discussion)

5.)"Penny for the Arts"- The Mayor's Outlook does not include the costs associated with the implementation of the Penny for the Arts Five-Year Blueprint adopted by City Council on October 22, 2012. While the proposal contemplates the new Blueprint expenditures will be recovered through growth in TOT revenue, this additional revenue growth has already been incorporated into the Mayor's Outlook as an offset to qualifying General Fund expenditures. (See pages 40-41 for further discussion)

6.) Full Funding for 35 Member Police Recruit Academies - The Mayor's Outlook indicates that each of the four annual Police academy classes over the five-year period has been increased from 30 recruits to 35 recruits. However, our analysis has identified a funding shortfall to accomplish this in each year of the Outlook. (See pages 31-35 for further discussion)

Revenue Sensitivity Analysis

7.) Sales Tax Sensitivity – Figures reflect the possible impact of more modest sales tax growth projections on the Outlook, based on MuniServices' "most likely" five-year forecast for sales tax. The projection assumes sales tax growth of 5.8 percent in FY 2014, 2.4 percent in FY 2015, 3.4 percent in FY 2016, 3.7 percent in FY 2017, and 3.6 percent FY 2018. (See pages12-13 for further discussion)

8.) Property Tax Sensitivity - Figures reflect the possible impact of more modest property tax growth projections on the Outlook, assuming a property tax growth rate reduction of one percent FY 2014-FY 2017 from that currently incorporated in the Outlook. (See pages 10-12 for further discussion)

RESOURCES POTENTIALLY AVAILABLE TO OFFSET IMPACTS OF REDEVELOPMENT DISSOLUTION

As discussed in our report on pages 26-31, the City has taken steps to prepare for the potential impacts of redevelopment dissolution. These potential resources should be taken into consideration when reviewing the IBA Revised Outlook.

In the FY 2013 budget, the Mayor and City Council set aside approximately $28.5 million in the General Fund Reserve to ensure significant funding was available to help mitigate the potential impacts of redevelopment dissolution. This $28.5 million is part of the $153.4 million General Fund Reserve which currently stands at 13.3 percent of revenues, well in excess of the 8.0 percent requirement of the Reserve Policy.

Utilization of reserves should always be exercised with extreme caution as the strength of a city's reserve is one of several key factors that influence a city's credit rating. However, this $28.5 million was set aside in preparation for a specific potential financial event which is the very purpose of a reserve; and it would be appropriate to use a portion of the reserves for this purpose. If it was determined necessary to utilize the full $28.5 million for this purpose, the General Fund reserve would stand at $125.3 million or 10.8 percent of revenues, still in excess of the 8.0 percent requirement of the Reserve Policy.

In addition, currently the TOT fund has a projected fund balance of $10.7 million carried over from previous fiscal years. In the Mayor's FY 2013 May Revise, issued May 23, 2012, it was recommended that this funding be kept in the TOT fund balance to also be available to help mitigate the potential impacts of redevelopment dissolution.

OTHER PENDING ISSUES DISCUSSED IN REPORT

The IBA Revised Outlook incorporates several of the most pressing needs or potential risks not addressed in the Mayor's Outlook. Other funding requirements and potential risks are discussed in the body of our report but due to pending issues they are not reflected in our Revised Outlook. These include the following:

Potential Expenditure Items

Implementation of the Fire-Rescue Citygate Report

As discussed in our report, while $19.6 million of the Citygate recommendations have been implemented or are under way, $53.3 million of identified needs remain including $39.2 million to fund the costs associated with constructing four new stations within the working group plan timeline. Funding sources to support long term bond financing will need to be identified for these fire stations given that they are costly and are considered long term community assets. Once financing has been identified for the fire stations, future Outlooks will need to incorporate related staffing costs for the new stations. Each new fire station will require a minimum of $2.2 million in new staffing costs. (See pages 35-37 for further discussion)

Additional Public Safety Expenditures Proposed by Mayor-elect Filner
At a November 15, 2012 press conference, Mayor-elect Filner outlined plans to fund an additional $21.6 million in public safety expenditures. The $21.6 million in expenditures consisted of the following:

DESCRIPTION		COST
Police Department		
Replacement of Public Safety CAD System	$	8.0
Refurbishment of Firing Range		2.0
Sub-Total	**$**	**10.0**
Fire-Rescue Department		
Home Avenue Fire Station Design, Construction, and Engine	$	9.5
Paradise Hills Fire Station Design		0.8
Mission Valley Fire Station Engine		0.8
Cliff-Rescue Vehicle		0.5
Sub-Total	**$**	**11.6**
TOTAL EXPENDITURE	**$**	**21.6**

If this proposal is approved by Council, operating costs associated with the Home Avenue and Mission Valley fire stations would add approximately $4.4 million per fiscal year. Additionally, as is stated in the Police Department section of this report (on pages 31-35), the projected implementation timeline for the public safety CAD system is three to five years. Based on this projected timeline, we believe the Mayor's Outlook appropriately includes costs related to the system's implementation beginning in FY 2017.

Potential Need to Replace Funding for Public Liability Fund Reserve - Mayor-elect Filner's recent proposal to take $21.6 million from the Public Liability Fund would necessitate increased annual contributions over the Outlook period to fund the reserve. If $21.6 million is removed from the Public Liability Fund, in order to meet the reserve target of $59.8 million by FY 2019, the City would need to contribute approximately $3.6 million above the amount included in each year of the Mayor's Outlook. See the Reserves section (on pages 21-22) of this report for more details.

Restoration of Service Levels
With the exception of additional funding for the Storm Water Division, which must comply with newly adopted requirements, the Mayor's Outlook assumes current service levels for operating departments. For example, while recreation center hours reduced in recent years' budgets have recently been restored, the current 45 hours per week of operation is substantially below the 2001 service level of 62 hours per week.

Additional Impacts of Redevelopment Dissolution
The financial impacts of redevelopment dissolution are discussed extensively in our report on pages 26-31. In our Revised Outlook we have only incorporated the potential impacts of the California DOF continuing to deny the inclusion of Petco Park and Convention Center Phase II payments in the City's ROPs. Other General Fund impacts are possible, but are difficult to determine at this point.

Restoration of 6 Percent Salary Reductions
In our review of the Mayor's Outlook last year we provided a scenario which included an ongoing financial impact to the General Fund for general salary increases of 2 percent in both FY 2015 and FY 2017. The increase in salaries and variable fringe based on this scenario was approximately $11.1 million annually beginning in FY 2015 and an additional $11.3 million annually beginning in FY 2017. We did not include this scenario in this review in consideration of Proposition B.

Potential Cost Saving Items
Managed Competition
Storm Water operations and maintenance, Public Utilities Department (PUD) customer service, Transportation Engineering Operations (TEO), Capital Improvement Program (CIP) delivery, and solid waste collection are in various stages of the managed competition process. Several of the Preliminary Statements of Work (PSOW's) are being prepared for Rules Committee and Council consideration following the holiday recess. These functions, with the exception of PUD customer service, have the potential to reduce General Fund costs for FY 2014 – FY 2018. Potential cost savings estimates for future competitions are difficult to project and will be calculated after the competitions occur, and therefore are not included in the Outlook. Managed competition is discussed in greater detail on page 16.

REVIEW OF GENERAL FUND REVENUES

Revenue Source *(in millions)*	FY 2012 Unaudited Actuals	FY 2013 Budget	FY 2013 Revised	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast
Property Tax	$ 408.8	$ 387.1	$ 386.6	$ 398.7	$ 410.1	$ 425.2	$ 445.0	$ 465.6
Sales Tax	220.3	236.3	232.7	244.0	258.0	273.1	290.6	308.0
Transient Occupancy Tax	78.3	81.7	83.0	87.6	92.4	98.0	110.5	116.7
Franchise Fees	69.1	71.7	71.7	72.2	74.4	76.8	79.5	82.3
Other Revenue	412.3	374.4	378.2	374.8	378.2	388.6	403.1	412.1
Total GF Revenue	**$ 1,188.8**	**$ 1,151.2**	**$ 1,152.2**	**$ 1,177.4**	**$ 1,213.0**	**$ 1,261.7**	**$ 1,328.8**	**$ 1,384.8**
% Growth		**(3.2)%**	**0.1%**	**2.2%**	**3.0%**	**4.0%**	**5.3%**	**4.2%**

The Mayor's Outlook projects revenues to increase from FY 2013 budget levels of $1.15 billion to $1.38 billion in FY 2018, a total of $233.5 million or 20.3 percent over the Outlook period. Total General Fund growth ranges from 2.2 to 5.3 percent per year in the Outlook. The largest increase in FY 2017 is due to an increase in major revenue growth rates from a projected continuation of economic expansion in the region and revenue growth associated with the Convention Center expansion beginning in this fiscal year. As in previous Outlooks, total revenue growth is generated by increases in the City's four largest major revenues: property tax, sales tax, transient occupancy tax, and franchise fees. Growth in these four major revenues accounts for $198.7 million or 85.5 percent of this total increase in revenues over the Outlook period. Growth in each major revenue source is outlined in the following table:

Revenue Source *(in millions)*	FY 2013 Revised	FY 2018 Forecast	$ Change	% Change
Property Tax	$ 386.6	$ 465.6	$ 79.0	20.4%
Sales Tax	232.7	308.0	75.3	32.4%
Transient Occupancy Tax*	83.0	116.7	33.7	40.6%
Franchise Fees	71.7	82.3	10.6	14.9%
Total Major Revenue	**$ 774.0**	**$ 972.7**	**$ 198.7**	**25.7%**

** Growth excluding the additional TOT for Convention Center expansion is 34.7 percent over the Outlook period. Review TOT section for additional detail.*

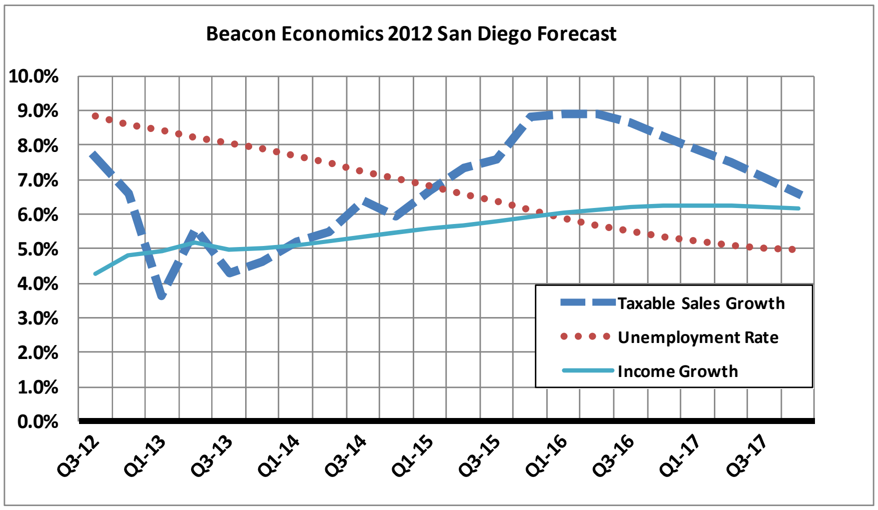
The FY 2013 revised forecast incorporates the latest revenue distributions during the current fiscal year to establish an updated year-end projection and base budget utilized in the Outlook. The revised forecast also includes updated projections for property transfer tax, safety sales tax, rental tax income, parking citation revenues, and Mission Bay rental revenues, among others. Additionally, the FY 2014 forecast in the Outlook also excludes $8.9 million in one-time revenues that were included in the FY 2013 Adopted Budget and revised forecast.

Economic Outlook

Since the end of the recession in June of 2009, the U.S. recovery has continued at a steady, albeit slow, gradual pace. Although Gross Domestic Product (GDP) has demonstrated growth for thirteen straight quarters, it is weaker than the 3.0 percent growth that economists opine is necessary to accelerate the nation's economy to pre-recession levels in the near term. According to the latest advance estimate released by the U.S. Bureau of Economic Analysis (BEA), GDP grew by 2.0 percent in the third quarter of 2012. This is after growth of 1.3 percent in the second quarter, and 2.0 percent in the first quarter. Per Beacon Economics' 2012 San Diego Economic Forecast, GDP will increase to 2.5 percent by the fourth quarter of 2012, with growth not reaching over 3.0 percent until after the end of 2013. The UCLA Anderson September 2012 forecast for the Nation and California is more sluggish in the near term, with GDP only reaching 1.5 percent in the fourth quarter of 2012 and growth not reaching over 3.0 percent until the second quarter of 2014.

In the midst of slow steady growth in the national economy, local economic improvements are evident with employment, personal income, taxable sales, construction activity, and the real estate market all showing positive signs, with forecasts of continual improvements. The unemployment rate in San Diego County as of August 2012 was 9.0 percent. This is a decrease over July's rate of 9.3 percent, and represents a 1.3 percent improvement over the August 2011 unemployment rate of 10.3 percent. According to Beacon Economics' Forecast, unemployment rates will continue to improve, with the unemployment rate forecast to reach pre-recession levels of 5.0 percent by the third quarter of 2017. Jobs in the Leisure and Hospitality, Professional Services, and Construction sectors are forecast to lead the region's job recovery.

Coinciding with improvements in the unemployment rate, both the Beacon San Diego Forecast and the UCLA California Forecast project continual personal income growth that will support growth in consumer spending, and thus taxable sales. Beacon forecasts that the County's personal income will grow quarterly at a seasonally adjusted annual rate ranging from 4.8 percent in the fourth quarter of 2012 to 6.2 percent in the fourth quarter of 2017. This forecast is relatively consistent with the UCLA California Forecast of 4.3 percent growth in the fourth quarter of 2012, to 5.9 percent in the fourth quarter of 2014. The following chart details the Beacon Economics forecasted improvements in employment, personal income, and taxable sales in San Diego County.



A previous weak spot in the economy, the real estate market, is showing signs of stabilization in route to recovery. In contrast to declines in the previous year, the median residential sales price in the County has increased by 14.8 percent from $305,000 in January to $350,000 in September. Sales increased during the same period by 12.3 percent. Beacon forecasts continual increases in median home prices and sales, with growth ranging from 3.4 to 4.5 percent through FY 2017. Sales are forecast to increase by 7.7 percent in FY 2013, with growth tapering off to 1.3 percent in FY 2017. Default and foreclosure activity that dampened valuation growth in the real estate market over the past few years has also seen substantial year-over-year improvements in 2012, with the most recent quarter showing a 26.2 percent decline in notices of default, and foreclosures declining by 40.8 percent. Residential and non-residential construction activity is also projected to continue to improve and bolster the real estate market recovery.

A major factor that can threaten forecasted economic improvements is the pending "fiscal cliff". The immediate shock of tax increases and spending cuts in the beginning of 2013 could lead to the onset of another recession without timely political resolution. Particularly, at the local level, cuts to defense spending would greatly impact the San Diego economy due to the great military presence here. According to the San Diego Military Advisory Council, 311,000, or a quarter of the jobs in the region, are supported by defense spending. At this time both Beacon and UCLA forecasts assume a political resolution in due time to avert long-term adverse effects on the economy.

Given economic forecasts of a steady, but slow overall growth in the economy in comparison to pre-recessionary levels, it is anticipated that the performance of economically sensitive revenues such as property tax, sales tax, TOT, and franchise fees will be reflective of these trends. In general, the General Fund revenue projections in the Mayor's Outlook are appropriate given current economic forecasts. The IBA does have concerns regarding the Outlook projection for property tax given information attained from the County regarding a likely lower assessed valuation growth than what is projected in the Outlook for FY 2014, which would negatively impact the property tax forecast in the outer years. The following sections discuss each of the major revenue projections in greater detail.

Property Tax

The Mayor's Outlook anticipates that property tax receipts will experience 1.5 percent growth in FY 2014, 2.5 percent growth in FY 2015, 3.5 percent growth in FY 2016, and 4.5 percent growth in FY 2017 and FY 2018. Assumed are continual improvements in the residential real estate market, with declines in foreclosures and notices of default, and an increase in the California Consumer Price Index (CCPI) used to assess property valuation growth.

Property tax revenue in FY 2014 will be based on the valuation of property on or around January 1, 2013, which will reflect market activity in the 2012 calendar year. With this, current year-over-year improvements in the housing market bode well for growth in property tax receipts within the next fiscal year. According to current DataQuick housing data, the average monthly median sales price of homes within San Diego County from January to September is $329,450. This represents a 3.3 percent increase in the average median sales price of $319,250 for the same period in 2011. Moreover, home sales activity in 2012 has increased by 12.3 percent when compared to the January through September period in 2011. Foreclosure and notice of default activity has also shown positive improvements with recent third quarter 2012 data demonstrating year-over-year declines in foreclosures of 40.8 percent, and notices of default of 26.2 percent.

According to the 2012 Beacon San Diego Economic Forecast, median home prices and single family home sales will continue to improve within the County. Beacon forecasts growth in median home prices of 4.5 percent in FY 2013, 3.6 percent in FY 2014, 3.5 percent in FY 2015, and 3.4 percent in FY 2016 and FY 2017. During the same periods, single family home sales will increase by 7.7 percent, 2.9 percent, 5.8 percent, 4.3 percent, and 1.3 percent, respectively. This activity will positively impact the growth in the assessed valuation related to real estate sales.

Beyond change of ownership activity, the annual growth in the assessed valuation for property, and thus property tax collections, are also impacted by reassessment activity, new construction, and the annual CCPI adjustment. Positive adjustments in these factors are anticipated to impact the property tax roll in FY 2014 and beyond.

Over the past few years, the County Assessor's Office proactively reviewed the values of properties sold during the peak of the real estate boom for a temporary reduction in assessed valuation based on the current market value. Those properties for which the assessed valuation was temporarily lowered can be automatically increased back up to the original purchase price of the home, plus an allowable Proposition 13 CCPI increase of 2 percent, once their market value increases back to the original sale price. Currently the County Assessor's Office anticipates that adjustments to temporary reassessments will not result in a significant increase in the FY 2014 property tax roll. These temporary reassessments will be reviewed on an annual basis by the Assessor's Office and are anticipated to positively impact assessed valuation growth as the real estate market recovery continues in future forecast years.

Aside from proactive reassessments performed by the County Assessor's Office, assessment appeals from property owners and resulting refunds increased steadily over the past few years, applying downward pressure to assessed valuation growth. Although appeals cases are still being processed, resulting in reassessments at reduced values, the volume of new appeals is declining. Per the County Assessor's Office, in the current year, assessment appeals are down by 24 percent year-to-date, with total refunds anticipated to decrease from that of the previous year. Appeals activity and the resulting reduction in property assessed valuations are anticipated to taper off as the real estate market moves further along in the recovery.

The CCPI adjustment that is applied as assessed valuation growth for properties that have not changed ownership or had structural improvements in the past year is anticipated to be 2.0 percent, given the current trend in the monthly index that was 2.5 percent in August. The CCPI adjustment of up to 2.0 percent, as allowed by Proposition 13, will positively impact approximately 70 percent of properties within the City on the roll.

Positive movement in new construction will also support growth in the future property tax rolls. Beacon forecasts growth in both residential and commercial permitting activity going forward. During the Outlook period, nonresidential construction is anticipated to increase by 3.5 percent in FY 2014, tapering off to 0.1 percent by FY 2017. Residential permits are forecast to increase by 26.8 percent in FY 2014, with growth tapering off to 11.7 percent in FY 2017.

Although there have been positive adjustments in reassessment activity, the CCPI, and new construction currently, with improvements anticipated in the future, their impact on year-over-year growth during the Outlook period will be modest. With the real estate market correction resulting from the recession, the annual growth in property values seen in pre-recessionary times are not anticipated to return any time soon. Gradual growth should be anticipated in the years of the Outlook. Based on the County's preliminary assessments of current 2012 market activity, it is anticipated that assessed valuation growth will be even more modest than that forecasted for FY 2014 in the Outlook, with likely growth ranging from 0 percent to less than 1 percent.

If growth in the assessed valuation for FY 2014 is flat or even 0.5 percent, the impact on property tax collections in FY 2014 could range from $1.9 million to $7.3 million. This reduction in property tax collections in FY 2014 would effectively reduce the nominal property tax projection for each of the years of the Outlook. The growth assumptions for each of the years of the Outlook would also have to be reevaluated to reflect a trend of even slower anticipated annual growth in property tax. The following table reflects the possible impact of a reduction in the assumed property tax growth rate by one percent for FY 2014 – 2017 of the Outlook. These projections based on more modest growth rates are included in our IBA Revised

Outlook to highlight the potential fiscal impact.

Impact of More Modest Property Tax Growth Projections on Five-Year Outlook Forecast
(in millions)

Forecast	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Five-Year Outlook	$ 393.9	$ 405.3	$ 420.4	$ 440.2	$ 460.8
Growth Rate	*1.5%*	*2.5%*	*3.5%*	*4.5%*	*4.5%*
IBA Scenario	$ 388.5	$ 394.3	$ 404.2	$ 418.3	$ 437.2
Growth Rate	*0.5%*	*1.5%*	*2.5%*	*3.5%*	*4.5%*
$ Impact on Outlook	**$ (5.4)**	**$ (10.9)**	**$ (16.2)**	**$ (21.9)**	**$ (23.7)**

**Property tax totals do not include the RDA pass-through.*

With the dissolution of Redevelopment Agencies in the state of California, going forward, the City of San Diego can expect to receive additional property tax revenue from the Redevelopment Property Tax Trust Fund (RPTTF) both in the form of pass-through payments, residual distributions, and other one-time distributions. However, it is currently difficult to predict these amounts with any certainty due to ongoing unknown factors. This issue is discussed further in the Redevelopment Dissolution section of this report which overviews the potential financial impact of redevelopment dissolution within the City over the years of the Outlook.

Sales Tax

The Mayor's Outlook forecasts 5.5 percent year-over-year growth in sales tax in FY 2014 and FY 2015, with growth of 6.0 percent in FY 2016 through FY 2018. Incremental increases in sales tax revenue of $800,000 are added in FY 2017 and FY 2018 to account for an anticipated boost in sales tax performance related to the proposed Convention Center Expansion III. The Outlook assumes improved employment levels, increases in payroll jobs, personal income growth, and an improving housing market that will support continued spending in San Diego.

The Outlook's growth assumptions align with Beacon's 2012 San Diego County Forecast and the UCLA California Forecast. The 2012 Beacon forecast assumes that unemployment rates will continue to improve, with the unemployment rate forecast to reach pre-recession levels of 5.0 percent by the third quarter of 2017. Jobs in the Leisure and Hospitality, Professional Services, and Construction sectors are forecast to lead the region's job recovery.

Alongside improvements in the unemployment rate, both the UCLA California Forecast and the Beacon San Diego Forecast project continual personal income growth that will support growth in taxable sales. Beacon forecasts that the County's personal income will grow quarterly at a seasonally adjusted annual rate ranging from 4.8 percent in the fourth quarter of 2012 to 6.2 percent by the end of 2017. This forecast is relatively consistent with the UCLA California Forecast of 4.3 percent growth in the fourth quarter of 2012 to 5.9 percent in the fourth quarter of 2014.

In addition to improvements in employment and personal income, Beacon holds that growth in taxable sales will also be supported by population growth, expanding the San Diego County consumer base at a growth rate averaging 1.5 percent quarterly going into 2018. This population growth will be due to the attraction of San Diego for quality of life and employment in growing economic sectors. This combined growth in employment, personal income, and in population is anticipated to support growth in taxable sales. At the County level, Beacon forecasts taxable sales year-over-year growth of 5.5 percent for the FY 2013 fiscal year, ranging up to 7.9 percent in FY 2016, and 7.5 percent in FY 2017.

The Outlook's annual sales tax growth forecast is notably more optimistic than the City's sales tax consultant MuniServices, LLC's "most likely" five-year forecast for sales tax performance of 5.8 percent in FY 2014, 2.4 percent in FY 2015, 3.4 percent in FY 2016, 3.7 percent in FY 2017, and 3.6 percent FY 2018. MuniServices' five-year forecast is based on an analysis of the future performance of the City's economic sectors, business level adjustments, and inflationary assumptions. This more modest sales tax forecast for FY 2015-FY 2018 would reduce the projected collections for those years of the Outlook. It is expected that forecasted projections will differ, but this discrepancy is highlighted here to note vulnerability in the sales tax Outlook. Sales tax revenue projections based the City's sales tax consultant's growth rates is included in our IBA Revised Outlook to highlight the potential fiscal impact.

Impact of More Modest Sales Tax Growth Projections on Five-Year Outlook Forecast (in millions)

Forecast	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
MuniServices	5.8%	2.4%	3.4%	3.7%	3.6%
Five-Year Outlook	5.5%	5.5%	6.0%	6.0%	6.0%
$ Impact on Outlook	$ (0.2)	$ (8.3)	$ (14.9)	$ (22.7)	$ (30.9)

Despite possible vulnerability, the sales tax growth projections in the Outlook are appropriate at this time, as they are consistent with sourced economic forecasts of improvements in employment, personal income, and consumer spending. A worsening of or improvement in any of the economic indicators or FY 2013 sales tax performance outside expectations would be a cause for a modification in the sales tax forecast.

Transient Occupancy Tax (TOT)

The Mayor's Outlook projection for TOT includes revenue growth projections of 5.5 percent for both FY 2014 and FY 2015, increasing to 6.0 percent growth per year for FY 2016 through FY 2018. The projection for TOT revenue throughout the Outlook is based on an updated FY 2013 year-end forecast above adopted budget levels. Budgeted revenue for FY 2013 was $81.7 million while the updated year-end projection is $83.0 million due to actual receipts for the first part of the fiscal year exceeding budgeted amounts.

TOT revenue is primarily driven by the total hotel room demand and the average daily rate (ADR) in the City of San Diego. As projected in the September 2012 San Diego Convention and Visitors Bureau (CONVIS) Quarterly Travel Forecast, ADR is projected to grow an average of 3.6 percent per year throughout the report's forecast period (to calendar year 2016); while total room demand is forecasted to grow an average of 1.8 percent per year. In addition to projected growth in ADR and room demand, the most recent economic forecast for the City of San Diego by Beacon Economics notes that the hotel industry is "strong and growing" and "the outlook for the San Diego tourism industry is bright."

Growth rates for TOT revenue over the next five fiscal years are consistent with growth experienced in years that were not impacted by recession over the last 11 years, with growth in TOT revenue averaging approximately 8.5 percent. However, TOT revenue is sensitive to any economic slowdown in both the regional and national levels as discretionary spending on business and leisure travel is curtailed during these times, as evidenced by the decline in TOT during the recession of 2001 and 2008-2010. Any reduction in economic growth from levels forecasted in the Outlook will immediately impact TOT revenue projections.

TOT in the Outlook for FY 2017 and 2018 also includes an additional $12.7 million in projected revenues to be received by the City due to the proposed expansion of the convention center. The additional revenue in these fiscal years is derived from the November 2010 AECOM report on the estimated financial impact of a comprehensive expansion of the convention center, comprised of new exhibit space, meeting spaces, ballroom expansion, and support spaces, among others. In our Office's sensitivity analysis of the revenue estimate (Report 12-02REV), we noted that the revenue estimate provided by AECOM may potentially be inflated and a lower revenue estimate of $5.2 - $9.7 million annually during these fiscal years may be more appropriate.

Franchise Fees
Franchise fee revenue included in the Mayor's Outlook is comprised primarily of three major categories: 1.) cable television franchise fees; 2.) San Diego Gas & Electric (SDG&E) franchise fees; and 3.) refuse hauling and disposal franchise fees. The growth rate for cable franchise fees is 4.0 percent for FY 2014 and 5.0 percent per year for FY 2015 – 2018. This estimate has remained unchanged since the prior Outlook was published, and can be considered to be on the optimistic side of growth projections. Actual revenue growth in cable franchise fees has been positive every fiscal year since 2008, but has only averaged 3.4 percent growth per year.

Projected revenue increases from SDG&E franchise fee revenue is 2.0 percent for FY 2014, 2.5 percent for FY 2015, 3.0 percent for FY 2016, and 3.5 percent for both FY 2017 and 2018. Revenue growth from SDG&E is difficult to predict due to the erratic nature of commodity prices and sales in the City underlying their payments for their franchise fee, in addition to a lack of information provided by SDG&E for forecasting purposes. Since FY 2008, growth in SDG&E revenue has averaged a 1.0 percent decline. This revenue source experienced a 10.2 percent growth from FY 2008 to 2009 and then a subsequent decline of 12.3 percent in FY 2010, skewing historical growth performance. Based on this volatility in the revenue source, a small growth rate is prudent based on the positive estimated growth in both population and the consumer price index that may lead to an increase in commodity usage from SDG&E.[1]

Refuse based franchise fees are primarily comprised of the City's refuse hauler franchise fee, in addition to franchise fee payments from the operation of the Sycamore landfill and Police Department franchise fee towing revenue. Growth estimates for the refuse hauler and Sycamore franchise fees in the Outlook are based on the Environmental Service Department's (ESD) projections that were incorporated into their own five-year financial outlook for the Waste Disposal Enterprise Fund. The FY 2014 projection for refuse based franchise fees included in the Outlook is based on an average of actual revenue from FY 2011 and 2012, which is a

[1] Beacon Economics forecast, September 2012 / UCLA Anderson forecast, September 2012.

reduction of approximately $1.0 million from FY 2013 budgeted amounts. The growth rates for the remaining years of the Outlook (per ESD's outlook) are 1.8 percent for FY 2015, 1.7 percent for FY 2016, 1.5 percent for FY 2017, and 1.3 percent for FY 2018. The City's refuse hauler franchise fee has averaged 0.2 percent growth per year since FY 2008, while the Sycamore franchise fee has averaged a 0.6 percent decline since being instituted in FY 2010. While the projected growth rates are above historical rates since FY 2008, the adjustment made to the FY 2014 base projections for these revenues result in a forecast that can be considered to be a reasonable estimate.

As detailed in our Office's review of the FY 2013 Proposed Budget (Report 12-16), the Police Department's new Towing Program fee structure revised towing fees previously charged by the department. The new program is comprised of four separate fees, three of which are budgeted in the Police Department's operating budget, while the fourth fee is a franchise fee to the General Fund to create full cost recovery for the City's administrative expenses incurred in towing vehicles. Revenue of $1.6 million is included in the current year budget based on a $96 per tow charge. No growth in this revenue is estimated throughout the Outlook.

Other General Fund Revenues

- Safety sales tax revenue continues to support debt service for Fire and Life Safety bonds throughout the Outlook in addition to providing equal support to the Police and Fire Departments. The growth of safety sales tax revenue, and subsequent transfers to departments, is based on the same estimated growth rates throughout the Outlook as mentioned in the sales tax revenue section. As noted in the sales tax section, these growth rates utilized to forecast revenue in the Outlook are appropriate given current economic conditions.
- The forecast for property transfer tax is based on an 8.0 percent growth rate in FY 2014 and 9.0 percent per year thereafter. Property transfer tax experienced large, consistent declines in revenue from its peak level in FY 2005. Property transfer tax declines averaged 22.6 percent per year between the peak and the trough in FY 2009. Since FY 2009, the average growth has been 7.8 percent per year. In addition to strong growth in transfer tax revenue in recent years, Beacon Economics continues to forecast an increasing number of residential properties to be sold in the region, generating additional property transfer tax revenues above current levels. Based on this information and the fact that forecasted revenues in FY 2018 are only projected to reach FY 2007 actual revenue levels, the revenue growth included in the Outlook is reasonable.
- Due to previous issues with under budget performance for parking citation revenue, the 2013 Budget of $18.0 million reflects a budget reduction of $3.5 million that was consistent with earlier FY 2012 projections of parking citation revenue performance. Based on actual parking citation revenue performance in FY 2012 of $18.7 million, parking citation revenue is expected to exceed budgeted levels in FY 2013. Due to this, an anticipated revenue increase has been integrated into the revenue projections in the Outlook of approximately $1.0 million.

MANAGED COMPETITION RESULTS

Of the ten functions identified for the managed competition process, publishing services, street sweeping and fleet maintenance cost savings have been included in the FY 2013 Adopted Budget, thus incorporated into the Outlook. Estimated General Fund savings of approximately $340,000 from publishing services was realized in FY 2012 and is expected to continue annually. Not enough time has passed to evaluate initial cost savings estimates for street sweeping and fleet maintenance due to the fact that they are transitioning to managed competition adjustments during FY 2013. The Business Office expects the annual savings estimate for street sweeping of approximately $560,000 to remain unchanged; however, the original fleet maintenance General Fund cost savings estimate of $2.7 million may need to be adjusted once labor negotiations and procurement activities are complete. Any negative adjustment may impact General Fund savings for the Outlook.

Two additional functions have been awarded contracts and are expected to realize savings beginning in FY 2014. Street and sidewalk maintenance is expected to result in annual savings to the General Fund of $0.9 million, and has been included in the Outlook. Savings to the Environmental Services Department from the landfill operations managed competition, although no direct savings to the General Fund, may help to mitigate future costs. As a result of these savings, the department is able to reduce the originally proposed FY 2015 tipping fee increase from $6 to $3, reducing the impact to the General Fund from $2.4 million to $1.2 million annually, as reflected in the Outlook.

Storm Water operations and maintenance, Public Utilities Department (PUD) customer service, Transportation Engineering Operations (TEO), Capital Improvement Program (CIP) delivery, and solid waste collection are in various stages of the managed competition process. Several of the Preliminary Statements of Work (PSOW's) are being prepared for Rules Committee and Council consideration following the holiday recess. These functions, with the exception of PUD customer service, have the potential to reduce General Fund costs for FY 2014 – FY 2018. Potential cost savings estimates for future competitions are difficult to project and will be calculated after the competitions occur, and therefore are not included in the Outlook.

REVIEW OF GENERAL FUND EXPENDITURES

The Mayor's Outlook projects General Fund expenditures to increase by approximately $126.6 million, or 10.9 percent, over the five-year forecast period. The projected increase in General Fund expenditures is largely driven by higher pension Annual Required Contribution (ARC) payments based on the June 30, 2011 valuation; deferred capital operations and maintenance costs; and deferred capital debt service costs associated with anticipated bond issuances in FY 2013 through FY 2017 – ranging from $80 to $90 million per year.

Other notable expenditure increases include salary adjustments related to step increases, increased costs related to compliance with Storm Water regulations and other departmental programmatic additions. These and other issues are discussed in greater detail throughout this report. Additionally, Attachment One to this report contains a listing of the increases and decreases in expenditures from the FY 2013 Adopted Budget to the FY 2018 Outlook.

Salaries and Wages
The Outlook reflects a $13.9 million increase in salaries and wages over the five-year forecast period. This increase includes $7.4 million for step increases; $1.4 million in increased annual leave; $2.8 million in staffing increases; and $2.6 million in other increases that are largely related to overtime. These increases of $14.2 million are offset by approximately $0.3 million in one-time salary reductions.

Funding for step increases included in the Outlook could be underestimated to some extent. The projected salary step increase is $1.5 million, or approximately 0.3 percent of salaries and wages, annually for FY 2014 through FY 2018. If the actual step (and promotion) increases are higher than 0.3 percent for FY 2014 through FY 2018, salaries could be a few million higher than projected. Note that there are no general salary increases included in the Outlook, and no restoral of the 6 percent employee compensation reductions.

In our review of last year's Outlook, we provided a scenario which included general salary increases of 2 percent in both FY 2015 and FY 2017 (a General Fund increase of $11.1 million and $11.3 million for FY 2015 and FY 2017, respectively). We have eliminated this scenario in this review in consideration of the passage of Proposition B this past June. This information is available, however, in IBA report number 11-66REV, "Review of the Mayor's Five-Year Financial Outlook for FY 2013-2017," dated December 1, 2011.

Retirement/Pension
Pension Estimates in the Mayor's Outlook
The retirement figures included in the Mayor's Outlook are based on the most recent actuarial valuation for the City, which is dated June 30, 2011. The valuation revealed that the City's June 30, 2011 Unfunded Actuarial Liability (UAL) is $2.18 billion, up from $2.15 billion at June 30, 2010. The City's FY 2013 Annual Required Contribution (ARC), which is based on the June 30, 2011 valuation, totals $231.1 million. The General Fund portion of the FY 2013 ARC is $179.7 million.

The pension forecast through FY 2018 reflects the most recently provided projections from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, and is presented in the following table. This table shows the Citywide ARC increasing by $35.3 million from FY 2013 to FY 2018. These figures are based on the June 30, 2011 valuation and will be updated upon the completion of the June 30, 2012 valuation.

Pension Forecast (in millions)	FY 2013 Budget	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast
Citywide Payment	$ 231.1	$ 236.2	$ 242.8	$ 250.0	$ 257.9	$ 266.4
Increase from FY 2013	*N/A*	*$ 5.1*	*$ 11.7*	*$ 18.9*	*$ 26.8*	*$ 35.3*
General Fund Payment	179.7	183.7	188.8	194.4	200.6	207.2
Increase from FY 2013	*N/A*	*$ 4.0*	*$ 9.1*	*$ 14.7*	*$ 20.9*	*$ 27.5*

The June 30, 2012 valuation, which determines the FY 2014 ARC, is anticipated to be released in January 2013. At that time, the actual FY 2014 ARC will be presented, and updated ARC estimates for FY 2015-2018 are expected.

Factors that Could Change Pension Estimates

As noted in the Mayor's Outlook, the actual FY 2014 ARC (and forecasted ARC's in the out-years) could be higher than the current estimate presented in the Outlook, which would reduce or eliminate the FY 2014 projected surplus.

First, lower than assumed investment returns will increase the ARC. The assumed investment rate of return for FY 2012 is 7.5 percent, whereas the actual FY 2012 return is 0.9 percent. This has increased from an earlier estimated actual return of 0.3 percent, according to the SDCERS CEO, Mark Hovey. The resulting estimated dollar increases to the ARC during the Five-Year Outlook are shown below. These are based on the estimated actual return of 0.3 percent, as estimated ARC increases based on the updated return of 0.9 percent are not available at this time. Note that the FY 2012 investment return experience loss due to a lower than assumed investment return is only one type of experience loss (or experience gain) that could occur. The impact of demographic experience and other pension variables is unknown at this time. Because of the complexity of the pension system variables, the total of all effects on the ARC is unknown. However, the impact of just investment return is shown in the following table.

Estimated ARC Increases Due to Lower than Assumed Investment Return

(in millions)	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast
Citywide	$ 7.8	$ 14.5	$ 20.2	$ 25.0	$ 29.2
General Fund	$ 6.0	$ 11.2	$ 15.6	$ 19.3	$ 22.7

Second, the impact of the June 2012 Proposition B ballot measure could increase the ARC as well. The City's fiscal analysis for Proposition B included a short-term increase in ARC payments. This short-term increase was due to a change in the way the UAL was estimated to be paid over the years because of the partial closure of the defined benefit plan – the plan is closed to all employees except police officers. In the initial years, ARC payments would be higher than without Proposition B implementation, but succeeding years would have lower ARC payments. The estimated cost increases to the ARC due to this change in the UAL payment methodology, per the Proposition B fiscal analysis, is as follows:

Estimated ARC Increases Due to UAL Payment Change

(in millions)	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast
Citywide	$ 27.7	$ 22.7	$ 17.6	$ 12.5	$ 7.2
General Fund	$ 21.6	$ 17.7	$ 13.7	$ 9.7	$ 5.6

However, it is now uncertain whether the UAL payment methodology used in the Proposition B fiscal analysis will be used to calculate the FY 2014 ARC. Since the fiscal analysis was produced, new Governmental Accounting Standards Board (GASB) standards related to pension accounting have been issued. SDCERS is in the process of analyzing whether and how these new standards will apply to the FY 2012 actuarial valuation. As mentioned previously, the FY 2012 valuation determines the FY 2014 ARC. The Board is anticipating it will receive a recommendation for when and how to implement the standards from its actuary, Cheiron, at its December 14, 2012 meeting.

Projected increases to the ARC attributable to the Proposition B UAL payment methodology change have not been included in the Mayor's Outlook in light of uncertainty; however, the IBA Revised Outlook incorporates potential impacts for each year of the Outlook period.

OPEB/Retiree Health

During the second half of FY 2011, the City negotiated with its six labor unions to modify the retiree health benefit for eligible active employees. Objectives of the negotiations included reducing the retiree health benefit Unfunded Actuarial Liability (UAL) and ARC, and the related cash flow pressures.

At the end of FY 2011, the City reached agreement with its six labor unions regarding a restructured benefit level, effective April 1, 2012.[2] The agreement also provided that the City does not anticipate paying more than $57.8 million annually for the retiree health benefit through FY 2015, and thereafter does not anticipate increasing the payment by more than 2.5 percent annually. The Mayor's Outlook is budgeted accordingly. Note that the duration of the agreement with the labor unions is 15 years, but it can be modified after June 30, 2014.

The effect of the retiree health benefit restructure on the City's *defined benefit* retiree health plans is evident in the most recent actuarial valuation for the City, for the period ending June 30, 2012. The OPEB UAL at June 30, 2012 is $449.1 million, down from $1.1 billion at June 30, 2011. Additionally, the June 30, 2012 valuation establishes the OPEB ARC for FY 2014 at $33.9 million, a decrease from the FY 2013 ARC of $97.4 million.

However, the ARC figure does not reflect the payment components the City plans to make with respect to its retiree health benefits. In addition to the defined benefit retiree health plans, there is also a *defined contribution* plan that must be funded. The following table shows the different retiree health payments the City estimates it will make. As mentioned previously, the Outlook reflects the Citywide fiscal impact of the newly restructured retiree health benefit at $57.8 million through FY 2015, increasing by 2.5 percent thereafter. The General Fund portion is $41.0 million through FY 2015, increasing by approximately 2.5 percent thereafter. The following table shows the Citywide impact, which is based on estimates provided by Buck Consultants in the June 30, 2012 actuarial valuation.

[2] There are three options associated with the restructured retiree health benefit: Option A is a defined benefit with a full annual allowance (at 20 years of service) equal to $8,883 per year, with a 2 percent annual escalator beginning FY 2014; Option B is a defined benefit with a full annual allowance (at 20 years of service) equal to $5,500 per year, with no escalator; Option C is a defined contribution plan projected to yield $8,500 annually (with 20 years of service). Options A and B require that employees make nonrefundable contributions.

- The first row contains the pay-as-you-go (PAYGO) estimates associated with retiree health benefit payments for eligible retirees under the City's retiree health *defined benefit* plans. Note that there is a defined benefit plan for eligible employees retiring before April 1, 2012, as well as restructured defined benefit options for eligible employees retiring on or after April 1, 2012.
- The second row contains estimated amounts that will either be paid into or withdrawn from the CalPERS OPEB Trust Fund for the City's retiree health benefits. When funds are needed to cover expenses above the City's budgeted retiree health contribution amount, they will be withdrawn from the trust fund (to fund PAYGO). During the Outlook, this occurs in FY 2015 through 2018.
- The third row contains estimated City contributions to Health Reimbursement Arrangement (HRA) accounts. These amounts will fund HRA accounts for eligible employees retiring on or after April 1, 2012 who selected the *defined contribution* retiree health plan (restructured retiree health benefit Option C).
- The fourth row contains estimates for contributions that will be made by employees retiring on or after April 1, 2012 who selected the *defined benefit* retiree health plan options (restructured retiree health benefit Options A and B).
- The last row is the sum of the first four rows and equals the total Citywide payments to be made for each fiscal year.

OPEB/Retiree Health Forecast (in millions)	FY 2013 Budget	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast
PAYGO	$ 36.3	$ 39.7	$ 42.3	$ 44.1	$ 45.4	$ 46.1
CalPERS Trust Contribution/(Withdrawal)	16.0	2.6	(8.5)	(7.7)	(12.2)	(7.2)
Contribution to HRA Accounts	7.5	17.3	25.6	24.3	28.9	24.6
Less: Employee Contributions	(2.0)	(1.8)	(1.6)	(1.4)	(1.3)	(1.2)
Total City Contribution	*$ 57.8*	*$ 57.8*	*$ 57.8*	*$ 59.3*	*$ 60.8*	*$ 62.3*

Non-Personnel Expense

Non-personnel expenditures (NPE) included in the Outlook are categorized as supplies, contracts, information technology, energy/utilities, and "other". Growth in NPE includes additions to General Fund departments. Also, inflation rates are applied to specific expenditure categories. The inflation rates applied in the Outlook are as follows:

NPE Category	FY14-18 Outlook
Supplies	1%
Contracts	1%
Information Technology	0%
Energy/Utilities	5%
Other	0%

Certain specific departmental adjustments to NPE are noted in the individual departmental detail sections of this report. However, some NPE expenses in the "other" expenditure category are not detailed in that section due to their impact occurring Citywide. Much of the budgeted items in the "other" expenditure category are General Fund transfers to other City funds for reimbursement for services, payment of required debt service, and other required transfers. These additional required transfers include the City's public liability transfer, preservation of benefits payment, and transfer to the Park Improvement Funds. Some additional items of note included in this category are as follows:

- Increases in debt service – $5.6 to $6.3 million per fiscal year for each of the five anticipated deferred capital bond issuances in FY 2013 through FY 2017 (which range from $80 to $90 million per year).
- An increase in deferred capital operations and maintenance (O&M) expenditures of $21.9 million over the Outlook period.
- An increase of $8.5 million in the transfer of Mission Bay rent and concession revenues to the Park Improvement Funds over the Outlook period. This is due to increases in estimated Mission Bay revenues, as well as the Charter requirement that a larger portion of revenues be transferred to the Park Improvement Funds beginning in FY 2015.
- An increase of $3.5 million in Convention Center Expansion funding, beginning in FY 2017.
- Elimination of the annual required $8.0 million McGuigan settlement payment in FY 2016 through 2018, as the last of four required payments is scheduled in FY 2015.

Reserves
A city's credit rating can create significant financial benefit and can be influenced by its level of unassigned reserves that are available to provide a hedge against any potential financial impact that may jeopardize a bond holder's security. However, a city's credit rating is based on a compilation of factors that are reviewed to determine the overall confidence and perceived aptitude in management's ability to continue fiscal stability and cash flow. Factors that influence a credit rating include the strength and diversity of the local economy, the average income level of citizens, the city's overall debt load, financial management, management culture and reserves, among others.

The estimated General Fund Reserve for FY 2013 is 13.3 percent of budgeted revenues – above the target level of 8.0 percent specified in the City's Reserve Policy. Surplus amounts provide a means to address a number of future uncertainties, including uncertainties regarding the economy and the impact of redevelopment dissolution.

Recent discussions on the General Fund Reserve can be found in the following reports:

- IBA report number 12-37, "City of San Diego General Fund Reserve Benchmark and Review," dated September 20, 2012;
- Financial Management's "Report to the City Council" number 12-115, "Fiscal Year 2012 General Fund Ending Balance and Public Liability Fund," dated September 17, 2012.

The Public Liability and Workers' Compensation Fund Reserves are anticipated to meet their reserve targets of 50 percent of outstanding claims by FY 2019. The 50 percent of outstanding claims amounts which appear in the Reserve Policy are equal to $59.8 million for the Public Liability Fund and $76.0 million for the Workers' Compensation Fund. The Citywide contribution to the Workers' Compensation Fund Reserve is $6.4 million for each of the five years of the Outlook. This is increased from the Reserve Policy amount of $5.9 million per year due to a lower than anticipated fund balance at the end of FY 2012.

During FY 2012, the City deposited $27.0 million related to a wildfire settlement with SDG&E into the Public Liability Fund. This deposit lowered the annual contributions needed to achieve the reserve target of $59.8 million by FY 2019. Thus, the annual contribution amounts (which are the sole obligation of the General Fund) were lowered by $4.5 million, from $6.1 million to $1.6 million for each of the five Outlook years.

However, Mayor-elect Filner announced that he intends to immediately seek Council approval to utilize $21.6 million for Police and Fire-Rescue Department needs – see the Other Pending Issues section of this report. Mayor-elect Filner proposed that the $21.6 million be taken from the Public Liability Fund. If $21.6 million is removed from the Public Liability Fund, in order to meet the reserve target of $59.8 million by FY 2019, the City would need to contribute approximately $5.2 million each year for FY 2014 through 2019. Since $1.6 million is currently included in each year of the Outlook, $3.6 million would need to be added for each of those five years. We believe that funding our reserves to our policy level is essential. As stated in our reserve policy, "One of the key attributes of a financially stable organization is appropriate reserves." We note again that reserves are one of a number of factors that credit agencies review.

Lastly, the Long-Term Disability Fund Reserve is anticipated to achieve its reserve target of $12.0 million by FY 2014, with the FY 2014 Citywide contribution amount of $1.9 million.

Deferred Capital

Funding deferred capital will remain a top priority over the next five years and beyond. In February 2012, the Mayor's Office reported that the City has an estimated $898 million in deferred capital projects for buildings, streets, and storm drains. The estimates of deferred capital for streets and storm drains are generally considered accurate since they are based on comprehensive condition assessments of the assets conducted in 2010 through 2012.[3] However, deferred capital for buildings could be significantly higher than the estimated $185 million since this amount was based on three condition assessments of about 30 percent of the City's 1,600 facilities conducted in fiscal years 2007 and 2009. In addition, facilities conditions may have declined since 90 percent of maintenance conducted by the Facilities Division is

[3] Note that for the City's 700 miles of Reinforced Concrete Pipe which is part of the storm drain system, staff developed a model based on the age, type of soil, etc., since conducting a physical condition assessment would have been cost prohibitive.

reactive/breakdown maintenance rather than preventative maintenance.[4] The Public Works-General Services Department plans to conduct a comprehensive assessment of the City's buildings in FY 2014.

Asset Type	Estimated Backlog	Basis for Estimate
Buildings	$185 million	Three condition assessments conducted on (1) 31 public safety buildings in 2007; (2) the 5 Civic Center Complex facilities condition assessments in 2008 (Staubach Report); and (3) 443 major facilities in 2009 (Parsons Report).
Streets	$478 million	Comprehensive condition assessment of 100% of streets completed in November 2011.
Storm Drains	$235 million	Assessments/inspections conducted between 2010 and 2012 for all pump stations and corrugated metal pipe (CMP). Risk based modeling for reinforced concrete pipe (RCP).
Total	$898 million	

Funding Deferred Capital Projects

First Deferred Capital Bond

In March 2009, the City issued the first Deferred Capital Bond issuance of $103 million in General Fund-backed lease revenue bonds (10-year maturity) to fund deferred capital projects. These bonds were refinanced to be 30-year bonds in May 2010 as part of the Master Refunding lease revenue bond issue. About 91 percent of funds have been encumbered or expended for projects as of October 2012.

Enhanced Option B - The Five-Year Deferred Capital Program Funding Plan

In March 2011, City staff presented two alternatives for reducing the deferred capital backlog and improving service levels—known as Alternative Service Levels 1 and 2. After further assessing the issue, in February 2012, City staff noted that Alternative Service Level 1 should be the ultimate goal, but provided a more practical and affordable Status Quo Funding Option that showed the bond and cash funding necessary to prevent further deterioration of these assets. Staff also presented funding Options A and B, which would achieve the Status Quo Option over a longer period of time. Both Options A and B included lower amounts of funding in the early years and gradually ramped up infrastructure investment over the five-year period.

While both Options A and B provided total Capital/Maintenance program funding of $713 million for deferred capital over the five-year period and were considered achievable, our Office recommended approval of Option B because it represented greater cash contributions relative to capital bond requirements. This is important since revenue bonds, which are typically issued for a term of 20 to 30 years, add annual long-term debt service obligations to the General Fund. In addition, since bond proceeds can only be used to fund capital projects, ongoing operations and maintenance must be funded with cash.

As part of the Mayor's FY 2012 Mid-year Budget Report, our Office recommended to the Budget and Finance Committee that $8.3 million of the projected $16.5 million revenue fund surplus be used to further increase cash funding of deferred capital projects in FY 2013. This addition increased cash funding from $45.8 million to $54.1 million and became known as Enhanced Option B.

[4] Since FY 2007, Facilities' FTEs and non-personnel expenditures have been reduced by about 29 percent and 56 percent, respectively due to Business Process Reengineering and other budget cuts. Facilities also has a historically high vacancy rate—currently 14 percent.

Difference between Status Quo Funding Option and Enhanced Option B

Enhanced Option B, now known as the Five-Year Deferred Capital Program Funding Plan, was approved by the City Council in March 2012 and provided a total of $721.3 million for fiscal years 2013 through 2017. This funding plan was anticipated to slow the rate of deterioration of City buildings, streets, and storm drains to 5-10 percent annually; but this decline could be offset if investment levels are increased during this time period. In October 2012, the Council authorized moving forward with an additional $25 million in lease revenue bonds which increased total funding to $746.3 million. Over the five-year period, this additional funding reduced the shortfall between the Status Quo Funding Option (for preventing further deterioration of assets)[5] and Enhanced Option B (5-10 percent deterioration of assets) from $84.7 million to $59.7 million. While a higher service level is needed, this is an important step toward addressing the backlog. It will be important for the City to continue to identify opportunities for adding funding within existing resources.

The following table provides a comparison of the Status Quo Funding Option and Enhanced Option B. A few items of note about the data:

- For our comparison of the Status Quo and Enhanced Option B Funding Options, we are showing bond issuances in the fiscal year in which proceeds are planned to be used for implementing projects. Note that bonds are generally anticipated to be issued in 4th quarter of the preceding fiscal year from which they are shown in the table below. For example, the $75 million bond issuance shown in FY 2013 was issued in June 2012 with proceeds being expended on projects in FY 2013 and beyond. The Outlook includes the bond issuances in the year in which they are issued to accurately reflect debt service payments in the subsequent fiscal year.
- Our data reflects the most recent version of the five-year funding schedule (Attachment 1 to Staff Report 12-021), dated March 12, 2012, that was approved by the City Council on March 20th. For operations and maintenance funding for FY 2017, we include $79 million which is $5.2 million higher than the Outlook. Financial Management used an earlier version of the schedule which showed $73.8 million for FY 2017.

$ in millions	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Total
Status Quo/Preventing Further Deterioration						
Operations and Maintenance	53.8	54.9	56.0	57.1	58.2	280.0
Net Bond (for Capital Projects)	105.2	105.2	105.2	105.2	105.2	526.0
Total	**159.0**	**160.1**	**161.2**	**162.3**	**163.4**	**806.0**
Enhanced Option B						
Operations and Maintenance	54.1	50.0	62.0	66.0	79.0	311.1
Net Bond (for Capital Projects)	75.0	80.0	81.0	90.0	84.2	410.2
Total	**129.1**	**130.0**	**143.0**	**156.0**	**163.2**	**721.3**
Difference	***(29.9)***	***(30.1)***	***(18.2)***	***(6.3)***	***(0.2)***	***(84.7)***
New Issuance of CIP Bonds	25.0	-	-	-	-	25.0
Difference	***(4.9)***	***(30.1)***	***(18.2)***	***(6.3)***	***(0.2)***	***(59.7)***

[5] Current service levels for the City's streets facilities, and storm drains are below what staff consider to be a low level of service. For example, 42 percent of streets are in good condition, 36 percent are in fair condition, and 22 percent are in poor condition.

Cash Commitments and Impact on the General Fund

Cash commitments of $494.3 for the period of the Outlook (FY 2014-2018) for both operations and maintenance and deferred capital/CIP debt service, including principal and interest, are shown below. This includes a total of $338.4 million for operations and maintenance and $155.9 million in existing and projected debt service for the Deferred Capital Bond issuances. All of these cash commitments have been accurately reflected in the Outlook with two exceptions. As discussed above we are showing $79 million for operations and maintenance in FY 2017 which is an increase of $5.2 million over the Outlook. Secondly, for consistency with Financial Management, we calculated FY 2018 operations and maintenance of $81.4 million assuming a 3 percent increase from FY 2017 to FY 2018. This results in an increase of $5.4 million over the Outlook for Operations and Maintenance in FY 2018. The addition of $5.2 million and $5.4 million for FY 2017 and FY 2018, respectively, are included in the IBA Revised Outlook.

$ in millions	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	Total
Operations and Maintenance	$ 50.0	$ 62.0	$ 66.0	$ 79.0	$ 81.4	$ 338.4
Existing Debt Service						
2010 Deferred Capital Bond 1 ($103 million)	7.3	7.3	7.3	7.3	7.3	36.5
2012 Deferred Capital Bond 2 ($75 million)	4.6	4.6	4.6	4.6	4.6	23
Projected Issuances Debt Service						
2012 CIP Bond ($25 million)	1.8	1.8	1.8	1.8	1.8	9
2013 Deferred Capital Bond ($80 million)	5.6	5.6	5.6	5.6	5.6	28
2014 Deferred Capital Bond ($81 million)	-	5.7	5.7	5.7	5.7	22.8
2015 Deferred Capital Bond ($90 million)	-	-	6.3	6.3	6.3	18.9
2016 Deferred Capital Bond ($84.2 million)	-	-	-	5.9	5.9	11.8
2017 Deferred Capital Bond ($84.2 million)	-	-	-	-	5.9	5.9
Subtotal Existing and Projected Debt Service	$ 19.3	$ 25.0	$ 31.3	$ 36.9	$ 42.8	$ 155.9
Total Cash Commitments	**$ 69.3**	**$ 87.0**	**$ 97.3**	**$ 115.9**	**$ 124.2**	**$ 494.3**

In accordance with the City's Debt Policy, staff strives to maintain total General Fund backed debt service as a percentage of available revenue—known as the lease burden—below 10 percent. Rating agencies consider lease burden percentages over 10 percent to be above average or high. The Debt Management Department recently reported that the lease burden percentage is about 4.4 percent. If the Deferred Capital Funding Plan is implemented as shown in the table above, our Office estimates the lease burden percentage would grow to be about 6 percent in FY 2018, assuming that no additional General Fund-backed lease revenue bonds are issued.[6] Over the next few years as the City moves forward to develop a Multi-Year Capital Improvement Program Plan and identify a strategy for financing deferred capital and other capital needs, including redevelopment projects formerly funded through tax increment, it will be important to consider the Debt Policy 10 percent limit and long-term impact of debt financing on the General Fund.

[6] This 6 percent estimate includes $1.1 million annual debt service for the proposed Balboa Park Parking Garage bonds beginning in FY 2016 and $3.5 million annual debt service for the proposed Convention Center expansion bonds beginning in FY 2017.

Factors to Consider Moving Forward

The following factors should be considered as the City continues to move forward to address deferred capital:

- The actual amount of deferred capital could be significantly higher than the current estimates, particularly for buildings. Public Works-General Services plans to conduct a comprehensive condition assessment of the City's facilities in FY 2014.
- Given recently implemented CIP streamlining efforts, it will be important to monitor expenditures of proceeds from existing bonds to ensure that Public Works-Engineering & Capital Projects has sufficient capacity to efficiently implement projects. Future planned issuances can be adjusted based on the Department's performance.
- The City may be moving toward developing a Multi-Year Capital Improvement Plan. As part of this process, City staff will need to develop an effective method for identifying and prioritizing capital needs, such as based on Asset Management principals.
- In developing a financing strategy for the Multi-Year Capital Plan, the Mayor, City Council, and other stakeholders will need to consider the impact of issuing lease revenue bonds on the General Fund. Note that Mayor's Outlook adds $96.4 million in debt service payments for deferred capital bond issuances to the General Fund over the next 25-30 years. Further, these planned bond issuances do not address needs for new facilities, such as fire stations.

Redevelopment Dissolution

The City as Successor Agency has made notable progress moving forward with redevelopment dissolution and wind up activities despite significant and ongoing challenges. Although the fiscal impact to the City's General Fund is based on many variables and is still unclear, there is an ongoing high level of risk. The City has set aside about $28.5 million in the General Fund Reserve to mitigate the potential impacts and will continue to receive its share of property tax revenue distributed to local taxing entities. Redevelopment Dissolution will continue to be an important issue for the City over the next five years and beyond.

Background

Per AB 26 enacted on June 28, 2011, California Redevelopment Agencies (RDA) were dissolved on February 1, 2012, and their rights, powers, duties, and obligations were vested in the successor agencies. The City Council designated the City of San Diego to serve as the former RDA's Successor Agency for purposes of winding down its operations; making payments on enforceable obligations; and liquidating the agency's unencumbered assets for distribution to the county, school districts, and other local public agencies. The City also chose to serve as the Housing Successor Entity and retain the former RDA's affordable housing assets and assume related responsibilities. An additional dissolution law—AB 1484—was passed as a trailer bill to the FY 2013 state budget on June 27, 2012. AB 1484 took immediate effect and requires successor agencies to learn and implement significant new rules of conduct and includes new deadlines and severe late penalties.

A large part of winding down activities includes making payments on enforceable obligations of the former RDA.[7] Per AB 26, successor agencies are required to prepare Recognized Obligation Payment Schedules (ROPS) for enforceable obligations allowed to be made during each applicable six-month period (January 1- June 30 and July 1-December 30) until all obligations are fulfilled. AB 26 includes restrictions on what constitutes an enforceable obligation and each ROPS must be approved by the (1) City Council as the approval body for the City as Successor Agency, (2) Successor Agency Oversight Board, and (3) State Department of Finance (DOF). Sources of funds for making payments include the Redevelopment Property Tax Trust Fund (RPTTF), bond proceeds, reserve balances, and the Low and Moderate Income Housing Fund (LMIHF). AB 26 also provides for a limited administrative allowance equal to 3 percent of the Successor Agency's distribution of RPTTF.

Redevelopment Property Tax Trust Fund (RPTTF)
From the State's perspective, a primary goal of dissolution and unwinding activities is to maximize the amount of property tax that previously would have been provided to RDAs for distribution to local taxing entities, such as cities, counties, and schools. Going forward, the City of San Diego can expect to receive additional property tax revenue from RPTTF both in the form of pass-through payments, residual distributions, and other one-time distributions. However, it is currently difficult to predict these amounts with any certainty due to ongoing unknown factors.

Pass-through Payments
Per the dissolution laws, the County Auditor and Controller (CAC) distributes RPTTF monies on January 2nd and June 1st of each year via the "waterfall" method. After deducting its own administrative costs from the RPTTF, the CAC distributes the first tier of funds based on pass-through payments that would have been received under Community Redevelopment Law.[8] In previous years, the City generally has received about $2.4 million in annual pass-through payments. The Outlook includes additional property taxes of $4.8 million in each of the five years from pass-through payments. The County confirmed that the City will receive a pass-through payment from each of the January 2nd and June 1st distributions but did not confirm or project the amount. Financial Management's assumption of $2.4 million for each of the two semi-annual distributions is based on the amount of the pass-through payment from the June 1, 2012 RPTTF distribution. However, the CAC's estimated RPTTF pass-through payment to the City for the period covering June through December 2012 is about $1.6 million.

Enforceable Obligations
The second tier of RPTTF monies is for AB 26 distributions including enforceable obligations, the successor agency's administrative cost allowance, and the State Controller's invoices for audit and oversight. AB 26 requires the Successor Agency to utilize all available cash from non-RPTTF sources first to pay enforceable obligations; therefore, the Successor Agency has paid the majority of enforceable obligations in ROPS 1 and 2 with reserves, bond proceeds, and other revenues. This requirement as well as the Successor Agency's $89 million true-up payment to the CAC in July 2012 has depleted reserve balances. As a result, the Successor Agency will be

[7] Enforceable Obligations are generally defined to include several categories, such as bond obligations and written contracts for specific performance with parties that are not the sponsoring entity, such as the City.
[8] California RDAs make either negotiated or statutory pass-through payments to other taxing entities.

more reliant on RPTTF and may face challenges for paying enforceable obligations on future ROPS.

Residual Distributions
The residual balance remaining after the first tiers have been distributed is allocated pro rata to the local taxing entities. The City's pro rata share is about 21 percent given its June 1, 2012 residual distribution of $2.4 million and its $18.6 million share of the $89 million of the July 2012 true-up payment. The City's percentage may have increased to 21 percent from the amount previously assumed (14-17 percent) because the former RDA no longer receives a portion of these funds. Residual distributions are based on a number of variables, such as the amount of the pass-through payments and RPTTF needed by the Successor Agency and approved by the DOF to pay enforceable obligations.

Other One-time Distributions
AB 1484 requires successor agencies to retain the services of a licensed accountant to review unobligated LMIHF and other reserve fund balances available for transfer to the CAC for distribution to local taxing entities. There are potential risks to the General Fund if the Successor Agency does not have sufficient funds to make the required payment to the CAC. The audit of the LMIHF is currently ongoing and is expected to be completed by late November 2012, and the audit of non-LMIHF balances is expected to be completed in December 2012. The Oversight Board and the DOF will review the outcome of those two audits before the DOF makes a preliminary determination regarding the total amount of unobligated balances. The Successor Agency has the right under AB 1484 to meet and confer with the DOF if there is any dispute regarding the actual amount of unobligated balances. It is uncertain at this time how much money will be owed by the Successor Agency to the CAC as a result of the two audits and whether the Successor Agency will possess adequate funds to make the two required payments. If the Successor Agency has inadequate funds to make the payments, then it is expected that the City will need to make up any deficiency. AB 1484 allows the State to withhold sales and use taxes from the City or RPTTF distributions from the Successor Agency in order collect any underpayment or late payment of the unobligated balances.

The City may receive additional property tax revenue when these audits are completed in mid-FY 2013 and unobligated balances are distributed to local taxing entities. The amounts that the City may receive could depend largely on whether the DOF ultimately approves of several items in ROPS 3 that were expected to be paid from reserves, but which have been preliminarily challenged by the DOF.

Recognized Obligation Payment Schedule (ROPS) 3
Although ROPS 1 and 2 were approved without challenges, in its approval letter the DOF reserved the right to question and remove items included in future ROPS that are not enforceable obligations even if they were not removed from a previous ROPS. On October 19, 2012 the City as the Successor Agency received a letter from the DOF stating that about $54.6 million of payments for items included on ROPS 3 do not qualify as enforceable obligations and reducing the amount of RPTTF requested by the Successor Agency from about $76.6 million to $22.2 million. The reduction in RPTTF does not show the full impact of items denied because some of the items were not scheduled for payment on ROPS 3 and others were scheduled to be paid from

reserves, bond proceeds, or other funding sources. The items that have been denied by DOF include certain debt repayment agreements between the City and the former RDA; projects to be conducted as part of the Cooperation Agreement between the City and the former RDA; various capital improvement projects; and at least two affordable housing projects.

Successor Agency staff maintains that the items that have been denied are enforceable obligations and should be allowed. As part of the appeal process per AB 1484, staff are scheduled to Meet and Confer with the DOF on November 29th and expect to receive a final determination on these items in mid-December. The CAC's distributions from RPTTF for ROPS 3 will occur on January 2, 2013.

Long-term Debt

Several of the enforceable obligations included in ROPS 3 that were denied by DOF were based on agreements between the City and former RDA, which the State DOF does not consider enforceable obligations per AB 26. This includes debt service for improvements to Petco Park and the expansion of the Convention Center Phase II, as well as miscellaneous startup/general debt.[9] If DOF's final determination invalidates these agreements, the City's General Fund would be impacted as shown in the table below. Note that DOF has not adjusted RPTTF for these items since no payments were scheduled in ROPS 3.

Millions of Dollars

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	Total
Petco Park Improvements	$ 11.3	$ 11.3	$ 11.3	$ 11.3	$ 11.3	$ 56.5
Convention Center Phase II Expansion	3.0	3.5	4.0	4.5	5.0	20.0
Total	**$ 14.3**	**$ 14.8**	**$ 15.3**	**$ 15.8**	**$ 16.3**	**$ 76.5**

This potential General Fund impact has not been reflected in the Mayor's Outlook. We have included it in the IBA Revised Outlook to call attention to this possibility.

"Clawback" Provision

Importantly, if the DOF's objection to these items is upheld, the State Controller could exercise its right under the "claw-back" provision of AB 26 to order the City to reimburse the Successor Agency for any payments previously made under those agreements dating back to January 1, 2011. If this occurs, the City would have to rely on the General Fund to make the total $28.0 million payment to CAC. This includes two annual payments made for the Convention Center Phase II expansion and Petco Park improvements in FY 2013 and FY 2012 totaling $4.5 million and $22.6 million, respectively. It also includes one payment of $867,407 that was made in FY 2012 under an agreement between the City and former RDA for repayment of startup/general debt.

[9]For the future, each annual payment for the Convention Center will increase from $2.5 in FY 2013 by $0.5 million annually until it reaches $9 million in FY 2026. The $9 million payments will continue through FY 2041 with a final payment of $2 million in FY 2042. Note that the last debt service payment for Petco Park Improvements will be made in FY 2026.

Conditional Reinstatement of Loans between the City and Former RDA

After the Successor Agency has received the Finding of Completion for completing the required audits of housing and non-housing assets and remitting unencumbered funds to the CAC, AB 1484 conditionally allows the Oversight Board to reinstate loans between the City and the former RDA as enforceable obligations of the Successor Agency. However, there are several stipulations:

- must be for legitimate redevelopment purposes;
- maximum limit on the amount of annual repayments;
- no repayments prior to FY 2014;
- limits interest rate and re-sets commencement date;
- priority to repay LMIHF if balance due; and
- 20 percent of repayments deposited to housing asset fund.

Given the statutory formula for calculating the maximum limit on the annual repayment, the City would be precluded from receiving meaningful loan repayments for at least several years. The maximum annual repayment amount is 50 percent of the increase in the residual RPTTF balance distributed to local taxing entities from the base year (FY 2013) to the given fiscal year. This formula assumes that the amount of residual distributions to local taxing entities will increase in future fiscal years as redevelopment obligations are paid. However, in San Diego's case, the Successor Agency has primarily relied on reserve balances to pay for enforceable obligations which resulted in relatively higher residual distributions. As discussed earlier in this section, in future ROPS the Successor Agency will need to rely on RPTTF distributions rather than reserve balances resulting in decreased residual distributions.

Cooperation Agreement Projects

The Cooperation Agreement between the City and the former RDA for payment of costs for certain redevelopment projects, dated February 28, 2011, included projects totaling about $4.1 billion. The DOF's position is that agreements between the City and former RDA generally are not considered enforceable obligations per AB 26. In addition, the DOF contends that most of the projects do not have contracts with a third party signed by June 27, 2011, as required by AB 26. For ROPS 3, the DOF denied $45.6 million in Cooperation Agreement projects that were scheduled to be paid with RPTTF monies. Since these projects generally have not been started and the City has not expended funds, the General Fund will not be directly impacted. Going forward, some projects may be funded with outstanding non-housing bond proceeds. AB 1484 allows the Successor Agency to expend such bond proceeds for future improvement projects consistent with the original bond covenants after receiving a Finding of Completion from the DOF, which is expected to occur in mid-2013. Until alternative funding sources are identified these projects will likely be delayed or cancelled.

Administrative Cost Allowance

Since the administrative cost allowance for the Successor Agency is 3 percent of enforceable obligations paid with RPTTF, the DOF's rejection of various line items in ROPS 3 has resulted in a corresponding reduction of $2.1 million to the administrative allowance from about $2.8 million to $648,000. In addition, the DOF reclassified two items on the ROPS as administrative costs that must be paid from the Administrative Cost Allowance. These items totaled $450,000, including $200,000 for the required Annual Audit of Successor Agency's Financial Statements and $250,000 for the Oversight Board’s Legal Counsel. If the DOF’s objections are upheld and the DOF does not allow the Successor Agency to use non-RPTTF sources of funding for administrative costs, the City will have to make difficult decisions about providing supplemental funding for the Administrative Budget or further reducing Successor Agency staff.

Preserving Funds for the Impacts of Redevelopment Dissolution

The City has about $28.5 million available in the General Fund Reserve which could be used to mitigate these and other unforeseen risks to the General Fund as shown in the following table.[10] In addition, the FY 2013 budget recommended that the $10.7 million Transient Occupancy Tax (TOT) fund balance, stay in the fund pending decisions on redevelopment dissolution.

Amount	General Fund Reserve - Available to Mitigate the Impact of Redevelopment Dissolution
$ 5.0	Portion of FY 2012 revenue surplus retained in reserves (FY 2012 Year-End Budget Monitoring Report) for unforeseen circumstances or to mitigate impacts of dissolution
4.8	City’s allocation of June 1, 2012 RPTTF distribution (Residual/Pass-through).
18.7	City’s allocation of July True-Up Payment
$ 28.5	**Total**

It is important to preserve the $28.5 million in the General Fund Reserve at a minimum to mitigate the impacts of redevelopment dissolution given the ongoing high level of risk. Further, since the $28.5 million may not be sufficient, we believe that it is important to consider setting aside additional property taxes that the City receives from future residual RPTTF distributions for this purpose.

Police Department

The Implementation of the Police Five-Year Plan within the Outlook

The Mayor’s Outlook includes the addition of $762,224 throughout the years of the Outlook to support an additional 5 recruits in each of the Police Department’s four academies, bringing the total number of recruits in each academy to 35 from the current 30. $1.3 million is added in FY 2017, and $57,000 in FY 2018 for the annual costs associated with financing a Computer Aided Dispatch (CAD) System for the Police Department.

These two additions only in part address the needs outlined in the Police Department’s Five-Year Plan presented to PS&NS on July 18, 2012. The Plan outlines the Police Department’s funding needs to address service areas adversely impacted by budget reductions since FY 2009. Outlined are needs in sworn and civilian staffing, equipment, and facility maintenance, with FY 2017 incurring additional one-time costs associated with the replacement of the department’s outdated CAD system. The costs that would be associated with addressing these needs in the Mayor’s

[10] The Appropriated Reserve of $3.7 million that we have previously included in our calculations has not been included here since it is forecasted to be expended in FY 2013.

Outlook are shown in the table below summarizing components of the Police Five-Year Plan as compared to the Outlook.

Police Five-Year Plan Impact on Five-Year Outlook	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Five-Year Outlook					
Number of New Recruit Positions	20	20	20	20	20
Cost of New Positions	$ 500,140	$ 500,140	$ 500,140	$ 500,140	$ 500,140
Recruit Equipment/Services	262,140	262,140	262,140	262,140	262,140
Replace CAD System				1,258,000	1,315,000
Total	**$ 762,280**	**$ 762,280**	**$ 762,280**	**$ 2,020,280**	**$ 2,077,280**
Police Five-Year Plan					
Staffing					
Sworn					
Number of New Positions	32	31	32	31	32
Estimated Cost of New Positions[1]	$ 9,306,000	$ 15,445,000	$ 21,969,000	$ 28,109,000	$ 34,632,000
Civilian					
Number of New Positions	20	20	20	20	20
Estimated Cost of New Positions[2]	$ 1,335,000	$ 3,355,000	$ 5,375,000	$ 7,395,000	$ 9,415,000
Equipment					
New Recruit Equipment	$ 217,000	$ 210,000	$ 217,000	$ 210,000	$ 217,000
New Police Vehicles	616,000	616,000	616,000	616,000	616,000
Restore Canine Unit & ABLE Hours[3]	382,000	419,000	419,000	419,000	419,000
Replace Outdated Equipment	2,132,000	2,557,000	2,552,000	2,568,000	2,542,000
Replace CAD System	-	-	-	8,000,000	-
Maintain Existing Facilities	$ 600,000	$ 600,000	600,000	$ 600,000	$ 600,000
Total	**$ 14,588,000**	**$ 23,202,000**	**$ 31,748,000**	**$ 47,917,000**	**$ 48,441,000**
Remaining Cost to Implement Police Plan[4]	**$ 13,825,720**	**$ 22,439,720**	**$ 30,985,720**	**$ 39,154,720**	**$ 47,678,720**

[1] Cost of new sworn positions reflects updated cost calculations from those depicted in the the Police Five-Year Plan based on current sworn attrition rate of 7 per month and revised estimated staffing costs that exclude fixed fringe costs. Costs are compounded annually.

[2] Cost of new positions are compounded annually. Assumes full funding of staff additions, which could be offset by savings from unfilled vacancies within the department over the Outlook period. Revised staffing cost estimates from Police Five-Year Plan report exclude fixed fringe costs.

[3] Does not include full costs associated with the funding of helicopter related maintenance and equipment.

[4] Calculation removes costs associated with the replacement of the CAD System in FY 2017 given that it is addressed within the Outlook through lease financing.

Funding Shortfall for 20 Additional Recruits Annually

The total annual cost included within the Outlook to support an additional 20 recruits is comprised of $500,084 in salary costs, and $262,140 for primarily non-personnel expenditures for equipment and services for the recruits. Based on our Office's analysis, we have determined that the $500,084 added for salary costs will only support a portion of the personnel costs associated with the addition of 20 recruits annually. The Outlook does not appear to consider that while the academy size was increased from 25 to 30 recruits in FY 2013 without additional personnel costs due to the high number of vacancies, this will not be the case in FY 2014. Funding for the increased recruit salary expenses in FY 2013 came from salary and fringe savings related to sworn vacancies within the Police Department. In contrast, in FY 2014, with lower vacancy levels due to larger academy sizes we expect available salary savings to be absorbed, creating the need for additional funding.

Compounding this is that incorporated in the Outlook is the assumption that $8.0 million in salary savings related to vacancies for the department is built into all of the years of the Outlook (equating to funding for 127.5 FTE sworn positions). The Outlook does not include a reduction in the department's vacancy savings to accommodate increases in staffing due to larger academies. Our Office's analysis estimates that supporting an additional 20 FTE sworn staff will exceed the available budget for sworn personnel, requiring an estimated $7.7 million in additional funding in FY 2014 to support salary costs beyond the $500,140 included in the Outlook. This number could vary based on sworn officer attrition and the number of academy graduates. In subsequent years, the costs are expected to increase annually as staffing levels exceed budgeted vacancy expectations with the continuation of 35 recruit academies. Our office estimates these costs at $13.0 million in FY 2015, $18.4 million in FY 2016, $23.8 million in FY 2017, and $29.1 million in FY 2018. Again, these estimates could vary based on other factors previously noted.

Funding for 35 Recruit Academy Personnel Costs (in millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Five-Year Outlook	$ 0.5	$ 0.5	$ 0.5	$ 0.5	$ 0.5
IBA Estimated Incremental Increase	8.2	13.5	18.9	24.3	29.6
Estimated Additional Costs	**$ 7.7**	**$ 13.0**	**$ 18.4**	**$ 23.8**	**$ 29.1**

Sworn Staffing Goals

As outlined in Police's Five-Year Plan, it is the department's goal to attain FY 2009 sworn staffing levels of 1969.5 sworn personnel. In adding an additional 31/32 recruits per the Police Five-Year Plan, the department would reach its goal of attaining FY 2009 sworn staffing levels of 1969.5 over the course of FY 2016. This assumes a sworn attrition of eight per month.

With the current funding provided in the Mayor's Outlook for sworn police staffing, assuming attrition of seven per month, the Police Department is projected to reach its budgeted staffing levels of 1969.5 FTE in FY 2015. The table below outlines the annual progress toward attaining FY 2009 staffing levels within the Outlook. The chart assumes annual sworn attrition of seven per month based on current projections.

Staffing Forecast FY 2013-2018, Assuming Four 35 Recruit Academies in FY 2014 Forward

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Budgeted Sworn	1969.5	1969.5	1969.5	1969.5	1969.5	1969.5
Filled at Beginning of FY[1]	1832	1871	1927	1983	2039	2095
Beginning FY Vacancies	137.5	98.5	43	(13.5)	(69.5)	(125.5)
Projected Departures During FY[2]	84	84	84	84	84	84
Total Vacancies Created During FY	221.5	182.5	127	70.5	14.5	(41.5)
New Recruits[3]	123	140	140	140	140	140
Total Vacancies Remaining	98.5	42.5	(13.5)	(69.5)	(125.5)	(181.5)
Projected Year End Sworn Staffing	1871	1927	1983	2039	2095	2151

[1]Includes recruits as of beginning of fiscal year.

[2]Projected departure FY 2013-2018 is based on assumed monthly attrition of 7 sworn FTEs during the fiscal year based on current year actuals.

[3]Projected new recruits FY 2013-2018 is based on the assumed conduct of four 35 recruit academies. Projected academy attrition is accounted for in projected departures calculation.

Police Civilian Staffing Challenges
In May 2012, the department had 62.25 vacancies out of 504.25 budgeted positions. These vacancies compounded the impact from reductions in civilian staffing since FY 2009, straining the department's support resources. So far, in the current fiscal year, the department has made progress in hiring staffing, bringing vacancy levels to 53.5 in the beginning of November 2012, but processes relating to background checks, the development of certified lists, testing, and interviewing take time to complete. While the Police Department Five-Year Plan adds an additional 20 civilian staff annually beginning with the Communications Division, Crime Laboratory, Records Division, and the Property Room to address support resource needs, the Mayor's Outlook does not assume the addition of any civilian staffing over the years of the Outlook period.

Computer Aided Dispatch System (CAD)
The current total anticipated costs for the CAD system is $8.0 million. The Department anticipates that the timeline for the implementation of the system can range from 3-5 years, depending on the extent of the system's integration with other citywide dispatch systems beyond Police and Fire-Rescue's to include Public Utilities, Environmental Services, and General Services. During this timeframe an extensive needs assessment and design phase will take place in addition to the RFP, vendor negotiations, and installation. A consultant has been selected by the City to oversee this multi-year process. The costs could be less or more than $8.0 million depending on the extent of the cross-departmental integration of the system. The Outlook assumes that the total costs for the CAD system will be financed over a seven-year term.

Impact on Outlook for Full Funding of Police Five Year Plan
Funding the remainder of the Police Five-Year Plan annually, including the addition of 11/12 more sworn recruits, 20 civilian employees, and remaining equipment and facilities maintenance needs would have a structural impact of $6.1 million in FY 2014, increasing to $18.6 million in FY 2018, as more structural costs are added annually. The table below details the discretionary funding range for the Police Five-Year Plan in the Outlook, with the low range including the additional funding necessary to fund four 35 recruit academies, and the high range including funding for the entire Police Five-Year Plan.

Funding Range to Address Police Five-Year Plan (in millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Addtl Funding for 35 Recruits	$ 7.7	$ 13.0	$ 18.4	$ 23.8	$ 29.1
Funding for Remainder of Five-Year Plan	6.1	9.4	12.6	15.4	18.6
Total Additional Costs	**$ 13.8**	**$ 22.4**	**$ 31.0**	**$ 39.2**	**$ 47.7**
Estimated Range of Additional Costs	**$ 7.7 - 13.8**	**$ 13.0 - 22.4**	**$ 18.4 - 31.0**	**$ 23.8- 39.2**	**$ 29.1-47.7**

The IBA Revised Outlook addresses the shortfall of funds we have identified to increase academy classes from 30 to 35 recruits, but does not incorporate the cost necessary to fully implement the department's five-year staffing plan.

<u>Remaining Unfunded Needs in the Police Department</u>
Beyond the Police Department's critical equipment and facilities maintenance costs outlined in the Police Five-Year Plan totaling approximately $3.9 million annually, IBA Report 12-24 discussed Police Department funding needs aside from those related to staffing totaling $3.2 million that have not been addressed in the Mayor's Outlook. These needs include: a net

$392,000 increase in the Animal Services Contract costs, a $340,000 contractual Uniform Allowance expense obligation, and $2.5 million to support maintenance and equipment for police helicopters due to insufficient monies in the Seized Assets Funds. Our Office has concerns regarding these outstanding needs since they will impact future budgets unless the Department is able to absorb these costs in identifying offsetting savings in other areas.

Fire-Rescue Department

Fire-Rescue Citygate Report Recommendations

In November of 2011, the City Council approved the recommendations in the Citygate Working Group Report outlining a five-year implementation plan for addressing the most critical fire-rescue resource and deployment recommendations in the 2011 Citygate Associates, LLC (Citygate) report.

Since Council adoption of the Citygate Working Group Report, progress has been made on a number of the needs identified in Year 1 and Year 2 of the Report, with total projects completed or in process totaling $19.6 million, with remaining costs of $14.1 million for the first years of the implementation plan. The table below details the departmental needs identified to be addressed in the first and second years of the plan and their corresponding estimated costs and current status.

Citygate Working Group Five-Year Implementation Plan

Identified Needs	Cost (In Millions)	Status
Year 1 Plan		
Adopted revised deployment (response time) measures	$0.0	Completed
Adopt revised fire station location measures and create revised fire station CIP projects	$0.0	Partially Completed
Adopt aggregate population definitions	$0.0	Completed
Add back (restore) the 8 browned out fire engines	$11.5	Completed
Adopt Citygate priorities for adding needed resources	$0.0	Completed
Review and adopt dispatch process improvements	$0.0	In Process
Develop Fast Response Squad Pilot Program and Corporate Partnership Program to ID 100% funding	$0.0	Not Completed
Replace fire station alerting system (Phase 1)	$1.7	In Process
Purchase Truck for East Mission Valley Fire Station 45	$1.1	Not Completed
Design and planning for Home Ave. Fire Station	$0.8	Not Completed
Year 2 Plan		
Staffing and capital for one Battalion Chief Unit	$0.5	Not Completed
Replace fire station alerting system (Phase 2)	$2.7	In Process
Completion of East Mission Valley Fire Station 45	$3.7	In Process
Staffing of East Mission Valley Fire Station 45 for second crew	$2.2	Not Completed
Fund Construction of Home Ave. Fire Station	$8.0	Not Completed
Purchase of fire engine for Home Ave Fire Station	$0.8	Not Completed
Design and planning for Paradise Hills Fire Station	$0.8	Not Completed
Total Project Costs	**$33.7**	
Completed & In Process Project Costs	**$19.6**	
Outstanding Costs	**$14.1**	

The Mayor's Outlook does not address any of the remaining Fire-Rescue resource and facility needs outlined in the Citygate Working Group five-year implementation plan. The total remaining costs associated with implementing the working group plan is $53.3 million. The following chart outlines the total annual costs that would be associated with implementing the plan over the course of the Outlook. The costs for addressing identified needs are spread over the next five years, beginning with addressing the remaining project costs from the first and second years of the plan in FY 2014 and FY 2015.

Citygate Working Group Five-Year Implementation Plan FY 2014-FY 2018

Identified Needs	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Year 1					
Purchase Truck for East Mission Valley Fire Station 45	$1.1				
Design and planning for Home Ave. Fire Station	$0.8				
Year 2					
Staffing and capital for one Battalion Chief Unit		$0.5			
Staffing of East Mission Valley Fire Station 45 for second crew		$2.2			
Fund Construction of Home Ave. Fire Station		$8.0			
Purchase of fire engine for Home Ave Fire Station		$0.8			
Design and planning for Paradise Hills Fire Station		$0.8			
Year 3					
Staffing of Home Ave Fire Station			$2.2		
Construction of Paradise Hills Fire Station			$8.0		
Engine for Paradise Hills Fire Station			$0.8		
Aerial Ladder Truck for Parasise Hills Fire Station			$1.1		
Design & planning of College Ave Fire station			$0.8		
Year 4					
Staffing of Paradise Hills Fire Station				$4.4	
Construction of College Ave Fire Station				$8.0	
Engine for College Ave Fire Station				$0.8	
Design & Planning of Skyline Hills Fire Station				$0.8	
One Fire Academy				$0.8	
Year 5					
Staffing of College Ave Fire Station					$2.2
Engine for Skyline Hills Fire Station					$0.8
Construction of Skyline Hills Fire Station					$8.0
Design & planning of Stresemann/Governor Fire Station					$0.8
Total Project Costs	**$1.9**	**$12.2**	**$12.8**	**$14.7**	**$11.7**

It is important to note that long term bond financing is the most practical and appropriate approach for addressing capital needs that are long term assets, such as fire stations. Of the remaining $53.3 million required to implement the five-year plan, $39.2 million is to fund the cost associated with four new stations within the working group plan timeline. It would be extremely difficult to cash fund new fire stations though the General Fund operating budget, given competing operating needs and limited funds.

Fire Academies
In the FY 2013 May Revise, $1.1 million in funding was added to the Fire-Rescue budget to support a second 30 member fire academy. $494,305 of this funding is removed as a one-time from the Outlook. The removed funding supported instructor overtime and recruit screening costs for the second academy. Remaining within the Outlook is funding for one academy in each year. The approximate $600,000 in budget remaining from that added during the May Revise will support the post academy personnel costs for the new firefighters. The Fire-Rescue Department has expressed that conducting two fire academies annually would further mitigate overtime staffing costs. This would also work to address increased mandatory overtime and the low morale and disciplinary issues that typically result from increasing current staff overtime hours rather than hiring additional staff to meet constant staffing needs.

Marine Vessel Replacement Plan
The Outlook does not include funding to support the implementation of a Marine Vessel Replacement Plan within the Fire-Rescue Lifeguard Services Division. Prior fiscal year's Outlook included the addition of $644,286 in FY 2013, that would be reduced over the years of the Outlook, to create a Lifeguard Marine Vessel Replacement Fund to fund the replacement of aging marine vessels in the lifeguard fleet. The new estimate for the implementation of the Marine Vessel Replacement Plan that is not included within the current Outlook is $286,101, with a reduction in annual costs over time. The cost is much less from before given that the need for three of the vessels originally a part of the replacement plan where addressed in the Council adopted FY 2013 Master Lease Purchase Agreement. A fireboat valued at $1.0 million, and two surf rescue vehicles valued at $110,000 each were a part of the Master Lease Purchase, with the debt service estimated at $192,700 annually for seven years not beginning until FY 2014.

Park and Recreation Department
Facilities
The Outlook includes funding associated with the planned opening of new Park and Recreation facilities and enhancements to several existing facilities for the forecasted period. The Park and Recreation Department anticipates the need to add 29.71 FTEs and approximately $2.2 million in expenses (personnel and non-personnel) during the forecasted period to address additional park acreage and maintenance and management of additional facilities. The table below aligns the additional FTEs and related expenses to four specific purposes.

PURPOSE	FY 2014		FY 2015		FY 2016		FY 2017		FY 2018		Total	
	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses
1) Additional Acreage Developed/ New Acreage	3.80	338,215	8.49	733,591	4.11	301,186	1.52	118,722	1.59	95,347	19.51	1,587,061
2) New Facility / Expansion & Renovation	4.21	180,776	2.25	142,000	2.25	88,000	0.40	39,812	0.00	-	9.11	450,588
3) Joint Use Management Agreement	0.21	21,741	0.80	82,364	0.08	8,114	0.00	-	0.00	-	1.09	112,219
4) Additional Lighting (Utlity cost)	0.00	-	0.00	7,300	0.00	-	0.00	-	0.00	-	0.00	7,300
TOTAL	**8.22**	**$540,732**	**11.54**	**$965,255**	**6.44**	**$397,300**	**1.92**	**$158,534**	**1.59**	**$95,347**	**29.71**	**$2,157,168**

Attachment III of the Outlook includes a list of the specific park and recreation facilities expected to be completed each year and their related costs.

The prior year's Outlook anticipated the need for 19.80 new FTEs as compared to the 29.71 in the current Outlook. This is largely due to changes in the estimated opening or acquisition dates from prior year's Outlook. Changes of note in the current Outlook include the addition of 5.00 FTEs for the Plaza de Panama (only 0.22 FTEs were anticipated in the FY prior year's Outlook) and the addition of 3.00 FTEs associated with the renovation and expansion of the Memorial Pool project.

Recreation Center Hours

In the FY 2013 Budget, the City Council approved the addition of five hours per week for all 55 recreation centers throughout the City. The additional hours brought the service levels for all recreations centers to 45 hours per week. Costs of these additional hours are carried through the Outlook.

Library Department

New Central Library

Construction of a new Central Library began in August 2010 and the facility is on schedule to open in July 2013. The project has a projected maximum price of $184.9 million, and the required funding has been secured from multiple sources including the Centre City Development Corporation, the California State Library, the San Diego Unified School District, and private donors. In addition to the construction costs, private donors have contributed an additional $10 million to address the first five years of operating costs associated with the new facility.

The Mayor's Outlook includes the addition of 1.00 FTE during the forecast period. The added position will assist with the utilization of new library specific technology including more than 300 new public access computers. In the FY 2013 – 2017 Outlook, it was anticipated that 5.00 FTEs would be added to the General Services Department to address the additional maintenance of the new facility. However, the current Outlook assumes the maintenance of the new facility will be contracted to an outside vendor. Therefore, the additional positions in last year's Outlook have now been excluded from the current Outlook. Some janitorial services and security services are currently contracted out for the existing Central Library.

The annual additional expenses above the FY 2013 budget related to the new Central Library for personnel and non-personnel are $2,559,630, including the anticipated contract costs associated with the outside building maintenance. Library staff projects $2,582,401 in additional revenue to offset the increased expenses. The Library Foundation has confirmed $2 million in annual donations has been secured for five years beginning in FY 2014 to address the increased operational costs. Staff estimates $825,000 annually will be generated through management of the parking facilities, rental of library rooms, and operation of the café as well as other revenue generating operations. While last year's Outlook projected a negative impact of approximately $364,000 related to the opening of the new Central Library; the current Outlook forecasts a net positive impact of $22,771 annually. The following table illustrates the projected additional revenues and expenditures identified for the new Central Library.

Additional Revenues & Operating Expenditures related to the new Central Library (from FY 2013 Budget)				
Revenues				Total
Private Donations[1]				$1,757,401
Parking related revenue				600,000
Rental Space Receipts				150,000
Other				75,000
Total				$2,582,401
Expenditures	FTE	PE	NPE	Total
Library Department	1.00	$59,363	$2,500,267	$2,559,630
General Services[2]	0.00	-	-	-
Total	1.00	$59,363	$2,500,267	$2,559,630
			Positive Net Impact to General Fund	**$22,771**

1. Total operating costs equal $2.0 million. $1.76 million is the incremental portion above operating costs included in the FY 2013 Budget.

2. The previous Five-Year Outlook (FY2013 - FY2017) reflected the addition of 5.0 FTE for the General Services Dept to address building maintenance needs (anticipated cost of $403,249). However services are now anticipated to be contracted from an outside building operator.

Branch Library Facilities

The Mayor's Outlook includes funding for three branch libraries anticipated to open or be expanded during the forecast period. These facilities will be the:

- Skyline Hills Branch Library (15,000 square-foot expansion) opening in FY 2015 (addition of 2.55 FTEs and $309,294 in additional expenses);
- San Ysidro Branch Library (15,000 square-foot replacement library) opening in FY 2016 (addition of 2.05 FTE and $235,026 in additional expenses); and the
- Hillcrest/Mission Hills Branch Library (15,000 square-foot replacement library) opening in FY 2017 (addition of 1.55 FTEs and $214,313 in additional expenses).

As presented in the Outlook, these new/expanded branch libraries would add a total of 6.15 FTEs and $758,633 in expenses (personnel and non-personnel) during the forecast period.

However, in reviewing updated construction schedules from the Engineering and Capital Projects Department developed for a new $25 million bond issuance for capital improvements in FY 2013, the anticipated opening dates for the aforementioned branch libraries have changed slightly. The Skyline Hills Branch Library is anticipated to open in FY 2017 (Winter 2016); the San Ysidro Branch Library is anticipated to open in FY 2019 (Winter 2018); and the Hillcrest/Mission Hills Branch Library is anticipated to open in FY 2018 (Winter 2017). Per the updated construction schedules, the financial impact of the Skyline Hills Branch Library will occur in FY 2017; the financial impact for the San Ysidro Branch Library will occur outside the forecast period; and the Hillcrest/Mission Hills Branch Library financial impact will occur in FY 2018. These small schedule changes will reduce 2.05 FTEs and $235,026 in expenses from the Outlook.

Library Hours

In the FY 2013 Budget, the City Council approved the addition of five hours per week to each branch library and five hours of Saturday service for the Central Library. The additional hours brought the service levels to 41 hours per week for branch libraries and 49 hours per week for the Central Library. Costs for these additional hours are carried through the Outlook period.

Penny for the Arts Blueprint

The Mayor's Outlook does not include the costs associated with the implementation of the Penny for the Arts Five-Year Blueprint adopted by the City Council on October 22, 2012. The adopted Blueprint restores Arts, Culture, and Community Festivals allocations within the annual Special Promotional Programs budget to FY 2002 funding levels. It also expands the programs, projects, and initiatives supported by the Commission, supports annual contributions to the Public Art Fund, and re-establishes the Arts and Culture Festival Revolving Fund. Implementing the Blueprint, as presented by the Commission for Arts and Culture, would incrementally increase Commission funding from the current $7.8 million budgeted in FY 2013, to $17.9 million in FY 2017, an increase of $10.1 million over the next four fiscal years. The increase would bring the total annual Arts, Culture, and Community Festivals allocation to 1.0 cent, from the current 0.5 cent allocation within the Transient Occupancy Tax (TOT) Fund. Also, as a part of the October City Council action, by FY 2017, an additional $1.0 million in funding is proposed to support school-related arts and culture activities. The details regarding implementing this proposal will be explored at a future Economic Development Strategies and/or Budget & Finance Committee meeting. The table below details the annual increase in funding in FY 2014 to FY 2017 necessary to implement the adopted plan presented by the Commission for Arts & Culture.

Penny for the Arts Five-Year Blueprint
(in millions)

Allocation	FY 2013 Adopted Budget	FY 2013 Budget Adjustment	FY 2014	FY 2015	FY 2016	FY 2017
Arts, Culture, and Festivals	$ 7.8	$ 8.9	$ 11.6	$ 13.8	$ 15.4	$ 17.9
Annual Increase*		1.0	2.7	2.2	1.5	2.6

** Calculation may reflect rounding.*

The Blueprint assumes that the additional funding necessary to support the Penny for the Arts Five-Year Blueprint will come from TOT revenue growth which is currently projected at 5.5 percent-6.0 percent during the years of the Outlook period. It is assumed that, if implemented, a share of TOT revenue growth (within the TOT Fund) over the next four fiscal years will be dedicated to funding the Blueprint, which would effectively reduce the potential increase in the budgeted levels for the other expense categories within the Special Promotional Programs budget, which in FY 2014 is projected at $79.8 million. These annual expenses would otherwise fall to the General fund if TOT funding was not available or reduced. Other expense categories within the Special Promotional Programs budget include debt service payments for visitor-related facilities, economic development programs, operating support for visitor-related facilities, a City Council discretionary transfer into the General Fund, and reimbursements for General Fund tourism and promotions-related expenses.

The Outlook assumes that the Arts, Culture, and Community Festivals funding will remain flat throughout the forecast period. Furthermore, it assumes that TOT growth (within the TOT Fund) will be utilized to offset qualified expenses within the General Fund, such as those related to the maintenance of visitor-related parks and facilities. The following table shows the projected available balance within the TOT Fund that will be used to support other promotions related expenditures within the City over the Outlook period. It is important to point out that, as was noted in the Outlook report, in FY 2015, the San Diego Port District's annual contribution of $4.5 million toward Convention Center debt service will end. This dramatically reduces the available fund balance in FY 2015 as shown below.

Five-Year Outlook Projected TOT Fund Balance
(in millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
TOT Fund Revenue (5.0 cents)	**$ 79.8**	**$ 84.2**	**$ 89.2**	**$ 100.6**	**$ 106.3**
Allocations					
Arts, Culture, & Community Festivals	$ 7.8	$ 7.8	$ 7.8	$ 7.8	$ 7.8
Capital Improvements	15.6	20.1	20.1	20.1	20.1
Economic Development	1.8	1.8	1.8	1.8	1.8
Major Events Revolving Fund	0.2	0.2	-	-	-
Council Discretionary TOT to GF	15.5	16.4	17.4	19.7	20.8
Safety & Maintenance of Visitor-Related Facilities	36.7	37.3	37.4	37.4	37.4
Total Allocations	**$ 77.6**	**$ 83.6**	**$ 84.5**	**$ 86.8**	**$ 87.9**
Fund Balance Available*	**$ 2.1**	**$ 0.5**	**$ 4.6**	**$ 13.7**	**$ 18.2**

**Fund balance totals do not reconcile in chart due to rounding.*

Fully funding the Penny for the Arts Blueprint would cost an additional $3.8 million in FY 2014, up to $10.1 million in FY 2018, as shown in the following table. The impact of funding the Blueprint is addressed in the IBA Revised Outlook.

Impact of the Implementation of the Penny for the Arts Five-Year Blueprint on Five-Year Outlook
(in millions)

Arts, Culture, and Festivals Allocation	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Five-Year Outlook	$ 7.8	$ 7.8	$ 7.8	$ 7.8	$ 7.8
Penny for the Arts Blueprint	11.6	13.8	15.4	17.9	17.9
Increase Over Outlook Assumption	$ 3.8	$ 6.0	$ 7.6	$ 10.1	$ 10.1

** Calculation may reflect rounding.*

Currently the TOT Fund has a projected fund balance of $10.7 million carried over from previous fiscal years resulting from TOT collections above budget that were not reallocated to special promotional programs and expenses during the fiscal year. Financial Management stated in their FY 2013 May Revise, issued May 23, 2012, that this funding will be kept in the TOT Fund balance to be available for any obligations that may come up related to the dissolution of the former Redevelopment Agency, such as debt service on Petco Park and the Convention Center Expansion.

Transportation & Storm Water Department

The Storm Water Division must comply with requirements of the Municipal Storm Water Permit issued by the California Regional Water Quality Control Board and other surface water quality regulations issued by the State of California. In April 2011, Indicator Bacteria Total Maximum Daily Load (TMDL) regulations issued by the San Diego Regional Water Quality Control Board were adopted. This requires a gradual 100 percent reduction of dry weather bacteria in City watersheds within 10 years and a 100 percent reduction of wet weather bacteria within 20 years. Additionally, Chollas Creek Dissolved Metals TMDL, adopted in 2008, must achieve 80 percent of the reduction target by 2018 and 100 percent by 2028. These reductions are addressed in a comprehensive implementation strategy which requires additional contract funding and staff support over the Outlook period.

In addition to TMDL regulations, the new Municipal Storm Water Permit is expected to be issued in spring of 2013 and becomes effective one year after adoption. It is likely that increased funding may be required to comply with new mandates, however, because the Municipal Permit is currently in draft version, the Storm Water Division cannot determine associated costs at this time, and therefore they were not included in the Outlook.

In order to fund storm water pollution prevention controls necessary to comply with TMDL regulations, the Outlook has increased related contract funding. Additional funding over the FY 2013 Adopted Budget ranges from an extra $2.0 million in FY 2014 to a total increase of $8.4 million by 2018. As shown below, the first year of the Outlook raises contract funding by $2.0 million which continues into the second year. The Storm Water Division originally requested additional contract funding in FY 2014 and FY 2015 of approximately $3.5 million. This is $1.5 million more than what was included in the Outlook for the first two years. Funding is ramped up in later years to achieve an increased contract funding total that is consistent with the division's requested need for the Outlook. Storm Water anticipates that the funding difference in the first two years would not significantly affect compliance efforts because of the time it will take to fill new positions that are necessary to execute the TMDL compliance work.

Contract Funding Increase Related to TMDL Compliance Over FY 2013 Adopted Budget (in millions)				
FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
$ 2.0	$ 2.0	$ 4.9	$ 8.4	$ 8.4

Information provided by Storm Water staff indicates that cost estimates for TMDL compliance during the Outlook period are consistent with cost estimates for TMDLs that have been developed for other parts of the region and state. Looking forward, it should be noted that compliance costs for the bacteria TMDLs were projected over the full 20 year compliance schedule, and are estimated to increase after the first five years. This begins to take effect in FY 2017, as reflected above, and extends beyond the Outlook period.

The Outlook also adds a total of 9.75 FTEs and $0.7 million in associated costs by FY 2018. Of the 9.75 FTEs added in the Outlook, 8.00 FTEs are associated with TMDL compliance efforts, consistent with Storm Water requests. The additional 1.75 FTEs will perform duties related to both TMDL compliance and Municipal Storm Water Permit regulations, and are added during the first two years of the Outlook when the new permit is estimated to take effect.

FTE Increases Related to TMDL Compliance Over FY 2013 Adopted Budget				
FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
2.75	6.75	7.75	8.75	9.75

Five additional positions dedicated to Municipal Permit work and other related Storm Water activities were requested in FY 2014 and FY 2015, however they were not fully included. Some of these duties fall within the position class of the 1.75 FTEs that were added in these same years. The division believes the number of FTEs included will be sufficient in early years of the Outlook to staff Municipal Permit work and related activities. However, because Storm Water does not fully know the impact of all potential mandates in the next five years, they may make additional staffing requests during the Outlook period if warranted by new regulations.

Information Technology

The Mayor's Outlook includes an estimated $7.1 million in cumulative savings during the five years as a result of the transition of the City's IT services from the San Diego Data Processing Corporation to three firms (Atos, CGI, and Xerox). When the IT services Contracts were heard at Council on May 14, 2012 and June 25, 2012, staff was estimating total savings of $13.1 million for five years and $35.5 million over seven years. The Outlook estimates a cumulative total of $14.8 million for all City departments with 48 percent, or $7.1 million, in estimated savings related to the General Fund over five years. The IBA did ask IT Department management why they did not include a larger estimate for savings related to the IT services contracts and they stated that they were being conservative due to the fact that a significant portion of the savings would come in the later years of the contracts with the majority coming from the two option years which would need to be approved by the City Council. In addition, one of the option years falls outside the scope of the Outlook.

The Mayor's Outlook also includes $2.7 million in one-time funding in FY 2014 for the purchase of an estimated 3,500 desk-top computers. As noted in the Outlook, the City is required to upgrade its computers as a result of switching from the Microsoft Windows XP operating system to Windows 7 due to the fact that Microsoft will end support of XP, including security patches, in 2014. Many of the City's computers are over five years old and will not run Windows 7 efficiently.

It should be noted that the $2.7 million in one-time funding will be in addition to $500,000 for computer replacements included in the Information Technology Department's FY 2013 Budget and continued through the Outlook. IT department staff has stated that once the City's computers have been upgraded they will then use the $500,000 annually to update computers that break or are aging. Due to the City's financial situation, City computers have not been updated regularly thus requiring the substantial one-time investment in FY 2014.

The IBA did ask IT Department management why the replacement of the City's computers was not included in the IT service contracts. They stated that from their experience the City would have had to pay for the computers regardless of whether they were included as part of the contracts or not. In addition, IT Department management stated that the cost difference between vendors is very small due to the low margins for computers and they believe little, if any, costs savings would have resulted from including desktop computer hardware with the IT services contracts.

Fleet Department

The Fleet Department impacts General Fund operations through assignment fees and usage rates charged to departments for the replacement and maintenance of vehicles, respectively. The Fleet Department's operations were recently put under the managed competition process, and the City employees' proposal was accepted as the winning bid, with implementation and savings occurring in FY 2013. General Fund savings from this process were realized through a reduction in usage rates, which is discussed in the managed competition section of this report.

The Outlook does not reflect potential savings from implementation of Fleet's GPS system since the extent of savings is currently unknown. Savings are expected to be realized as departments use GPS data to reduce vehicle costs by route planning, reducing idling, and potentially reducing the number of vehicles needed. In addition, working with the Mayor's Office, Fleet recently developed a new policy that establishes City vehicle utilization standards and requires an annual vehicle utilization review by Fleet Services in conjunction with each department. These improved management practices are expected to adjust each department's inventory to the appropriate number based on verified workload. In addition, efficiencies realized with GPS implementation may result in assignment fee savings over the life of the Outlook in addition to a reduction in usage rates based on reduced mileage and wear on vehicles. Future savings will be reflected in individual departments' budgets.

CONCLUSION

For the first time in seven years, the Mayor's Five-Year Financial Outlook shows surpluses in each of the five years of the Outlook period beginning with a $4.9 million surplus in FY 2014 and increasing to $94.2 million in FY 2018. However, our review and analysis of the Mayor's Outlook shows that over the next several years the City will be facing a number of significant financial challenges as well as confronting critical funding needs in the Public Safety area that are not addressed in the Outlook. While the City's financial position has improved substantially over the past several years due to numerous reforms, it is far too early to celebrate. Our Outlook, which shows the potential for significant deficits as illustrated in the chart below, has been provided to inform the City Council and the public about the financial impacts of possible events should they occur. Given all of the competing funding needs and the uncertainty of the economy, it is important to remain fiscally cautious and committed to the "Structural Budget Deficit Principles" adopted by City Council in February of 2010.

COMPARISON OF MAYOR'S OUTLOOK TO IBA REVISED OUTLOOK SCENARIO

$ in millions	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Mayor's Five-Year Outlook "Baseline"	$ 4.9	$ 6.1	$ 32.2	$ 62.0	$ 94.2
Sub-Total Non-Discretionary Adjustments	$ (41.9)	$ (43.7)	$ (44.6)	$ (44.8)	$ (44.6)
Sub-Total Discretionary Adjustments	$ (41.6)	$ (37.2)	$ (32.3)	$ (34.1)	$ (38.1)
Sub-Total Revenue Sensitivity Analysis	$ (5.6)	$ (19.2)	$ (31.1)	$ (44.6)	$ (54.6)
Revised Outlook: "Baseline" + Non-Discretionary + Discretionary + Revenue Sensitivity	$ (84.2)	$ (94.0)	$ (75.8)	$ (61.5)	$ (43.1)

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Fiscal & Policy Analyst

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Deputy Director

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Attachment: 1.) Increases/(Decreases) in Expenditures From the FY 2013 Adopted Budget to FY 2018 Mayor's Outlook