THE BOTTOM LINE

Solutions for San Diego's Budget Crisis

A Comparative Analysis of California's Largest Cities

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April 2005

A Publication of the Center on Policy Initiatives

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EXECUTIVE SUMMARY

San Diego has experienced the most economic growth among the largest cities in California over the last decade. The level of services offered by a municipality – such as police, fire fighting, and street maintenance – wields a significant impact on economic development. In turn, rapid growth in businesses and population densities creates a significant demand for municipal services. However, in order to keep up with this demand, there is a reciprocal expectation for businesses and individuals to pay their fair share for the services from which they benefit.

This report finds that there is a significant discrepancy between the growth in business revenues and personal incomes, and the proportional contributions to municipal revenues to ensure adequate provisions of city services. This growth is unparalleled by any other large city in California in key sectors like construction, tourism and real estate. Yet businesses and households in the City of San Diego contribute far less as a proportion of their revenue or income to the provision of general city services than do the average businesses and households in the ten largest cities in California.

Summary of Principal Findings

1. The City of San Diego has an outdated general revenue tax structure.
Although the bedrock of city financing is still sales taxes and property taxes, since the passage of Proposition 13 (1978) and other measures California cities have moved toward raising revenues by other means, such as Business License Tax and Utility Taxes, to pay for core local services. San Diego still lacks access to several of these revenue sources used by other cities.

- Sales and property taxes constitute almost two-thirds (67 percent) of San Diego's general revenue sources. In comparison, less than half (47 percent) of the average general revenue sources of the ten largest cities in California come from sales and property taxes.
- The City of San Diego raises $38.67 per month per resident to pay for general services. This is far less than the average of the ten largest California cities, at $57.75 per month per resident. The City of San Diego raises the least General Revenue per household, as percentage of household income, of any of the ten largest cities in California.
- Taxes on utilities, such as electricity and gas, are used in other cities as sources to fund additional municipal services. San Diego does not have any utility taxes.
- San Diego is the only city, among the ten largest cities in California, which does not charge for residential refuse/trash collection.
- Local businesses pay the least among any of the cities for Business License Fees for any type of business, at an average of 1/5 of the amount paid in the ten largest cities in California.

2. The City of San Diego's general revenues have not benefited from overall economic growth.

San Diego leads in economic indicators among other cities in the nation. The County of San Diego's gross regional product (GRP), the estimated total value of the economy, reached a record $129.2 billion in 2003, with the highest growth rate of any region in California. Some of the leading industries have been the tourism industry, the real estate industry and the construction industry. However, because of its tax structure San Diego has not been able to benefit from the growth of these industries.

- Last year, San Diego had the highest hotel occupancy rate (71.5 percent) in California. The City of San Diego also has the second largest hotel industry in California, behind only San Francisco. An average San Diego hotel charges $15 higher in room rates than comparable rooms in Los Angeles and Anaheim. However, San Diego has the lowest Hotel Room Tax (Transient Occupancy Tax @10.5%) among all these major tourism destinations in California.
- San Diego had the highest value of real estate transactions of any city in California. The median price of a single-family home rose 23.85 percent over the past year alone. Both sales and median prices are making national records. Yet the City of San Diego charges the lowest rate (0.055 percent) in real estate transfer fees among the ten largest cities in California.
- The value of new construction exceeded $1.7 billion in the city of San Diego in 2003. This is the second largest in California, behind only Los Angeles. The relative value of construction permit revenues to the value of new construction is below the average of California's largest cities.

3. $279 million in revenue could be generated annually if the City of San Diego were to charge average California rates.

The City of San Diego raises the least general revenue per household in proportion to the average household income. If the City of San Diego raised revenue at the same rate as the average of the ten largest California cities, it would generate $358 million in additional revenue annually. Table 1 illustrates examples of revenue sources from which $279 million in general revenue could be generated annually if the City were to charge average California rates.

Table 1 Potential Revenue Generation from Selected Sources			
	San Diego	Average of ten largest California cities	Additional Revenue if San Diego were to charge @ average California rates
Transient Occupancy Tax	10.5%	12.4%	$9.9 million
Real Estate Transfer Tax	0.055%	0.328%	$41.4 million
Business License Fee	$34 for small business; $125 for businesses over 12 employees + $5/employee (0.20% of gross revenue)	Overall 0.108% of gross revenue	$60.9 million
Refuse Collection Fee	$0	$9.80/month/hhld	$54.3 million
Utility Users' Taxes	$0	$92 per person	$112.6 million
Total			**$279.1 million**

These rates are the weighted average for the ten most populated cities in California. The weight is selected appropriately based on the category of revenue.

4. The provision of General Services has not kept pace with regional economic growth.

Growth of population and business generates a demand for general services such as police, fire fighting, libraries, parks and road maintenance. During the 1990-2000 period, when personal income rose by 33.9 percent and the annual payroll for all businesses in the City rose by 58.8 percent, the spending by the city on general services increased by only 16.0 percent. This resulted in the City's workforce being stretched thin.

- Annual expenditure on police per person in the city of San Diego ($239) is far lower than the average of what is spent by the ten largest California cities ($317). As a result, San Diego has fewer police officers as a proportion of the population (1.69 officers per 1,000 people) than the average of the ten largest cities in California (2.11 officers per 1,000 people).
- Annual expenditure on fire fighting per person in the city of San Diego ($101) is the third lowest among the ten largest California cities, above

only Fresno and Santa Ana. Although expenditures on fire fighting increased 18.75 percent in the last budget following the Cedar fires, expenditure per person is still among the lowest in the State and far below the state average of $140. The number of firefighters per 1,000 people (0.69) is the lowest in San Diego among any city in California for which data are available.

- San Diego has invested heavily in library books (3.71 books per capita) and facilities, higher than the average of the ten largest cities (2.35 books per capita). This also creates a greater burden on librarians in San Diego: at 10,032 books per librarian; San Diego has the highest ratio among any large city in the state. This is far greater than the average of 6,129 books per librarian.
- As a result of its natural heritage, San Diego has the largest park acreage (31.87 acres/1000 people) among the eight largest cities in California (10.98 acres/1000 people) for which data are available. However, San Diego's expenditures as a proportion of park acreage is the lowest ($2,610 per park acre) among all of the cities, far below the state average ($6,442 per park acre).

Recommendations

We are now seeing the consequences of the growing gap between the expectations for local services such as police, fire fighting, parks, libraries, roads and infrastructure; and the availability of funds to pay for them. In order to move the city out of its fiscal crises, and into a sustainable state, we recommend the following:

1. **Create a public awareness campaign to inform residents and businesses on the role of city services and the need to raise funds for providing them.**
   Local officials, media and advocacy organizations can do a better job of educating voters about revenues and expenditures. There needs to be greater awareness of the role of the City's general services in the lives and functioning of individuals and businesses. This will not only educate taxpayers, it will also increase employee morale in the municipal workforce.
2. **Introduce ballot measures to raise taxes and fees at least to the average California level.**
   A majority voter approval is needed for increase in general taxes such as transient occupancy tax, business license tax, utility users' tax and real property transfer tax. In order to collect refuse collection fees, a majority voter approval is needed to amend the charter (pursuant to Proposition C, 1986).
3. **Raise revenues through fees that can be implemented through Council ordinances**.
   Although Propositions 62 and 218 limited the ability of the City to raise taxes without voter approval, the city does have some leeway to collect fees for the cost of providing a service. Therefore some of the current

governmental fund services should be converted to full cost-recovery services so that the city can levy fees for the usage of the service. These include the cost-recovery portions of business licenses, planning and building services. Some of these may be implemented through emergency ordinances.

4. **Prioritize expenditures based on overall needs, using departmental goals and productivity as benchmarks**.
   Departmental productivity, rather than employee efficiency, should be used as a measure of performance. This will lead to major savings from programmatic improvements and accountability, rather than minor savings from targeting individual employees.

INTRODUCTION

Thirty years ago, the concept of home rule[1] was taken for granted in California. It was a self-evident truth that local governments had the authority to tax residents and to fund services with the generated revenue.[2] However, since then, state legislation and voter-approved measures have diminished local control over financing local services.[3] These measures include:

(1) Loss of the bedrock of local property taxes with the passage of Proposition 13 in 1978.

Proposition 13 reduced local property tax revenues by approximately $6.1 billion (53 percent) virtually overnight by capping property tax rates at 1 percent and rolling back property values for tax purposes to the 1975-76 level.[4] Table 2 shows that there was a distinct shift in the revenue structure of all cities in California, particularly in the relative importance of property taxes before and after Proposition 13.

Table 2
Shift in the Importance of Revenue Sources for All Cities in California

Category	% of aggregative City Revenue	
	1977-78	1995-96
Property Tax	16	8
Sales Tax	11	9
Intergovernmental Aid	24	14
Service Charges	6	11
Enterprise Income	26	29
Other	17	29
Total	**100**	**100**

Source: Jeffrey Chapman (1998), "Prop 13: Some Unintended Consequences" Public Policy Institute of California.

(2) Loss of all other methods of taxation without voter approval.

Enacted as a statutory initiative in 1986, Proposition 62 required majority voter approval for general taxes. Proposition 62 also prohibited local transaction taxes or sales taxes on the sale of real property within the city without voter approval.[5] In 1996, the California electorate approved Proposition 218, the self-titled "Right to Vote on Taxes Act" which ensured that all taxes and most charges on property owners would be subject to voter approval. This measure characterized all taxes as either "general taxes" or "special taxes." A tax is called a "special tax" if its revenues are used for specific purposes, and a

[1] In 1879, the California Constitution was amended to grant local jurisdiction home rule authority.
[2] Silva, J. Fred and Barbour, Elisa (1999). *The State-Local Fiscal Relationship in California: A Changing Balance of Power*.
[3] Institute for Local Self Government (2003). "The Fiscal Condition of California Cities" prepared by Charles Summerell.
[4] California Budget Project (1997). "Proposition 13: Its Impact on California and Implications for State and Local Finances."
[5] Institute for Local Self Government (2003), *op cit*, 24.

"general" tax if its revenues may be used for any governmental purpose[6]. General taxes require majority voter approval, and special taxes require two-thirds approval.[7]

(3) Property tax shifts by the State.

Facing a serious deficit in 1992, the State of California began shifting local property tax revenues from cities, counties and some special districts into state funds to reduce the cost of education paid by the state general fund. To date, these Education Revenue Augmentation Fund (ERAF) transfers have deprived cities of more than $7.7 Billion. For the City of San Diego, there was a net ERAF loss of $32.1 million during FY2003-04, and a cumulative ERAF loss of $382.8 million.[8] In 2004, Proposition 1A restored some stability to local budgets by restricting the ability of the state to take Vehicle License Fees due to cities, and from requiring unfunded mandates.

In Summary

The fiscal distress that local governments experience today is certainly the result of all of the above factors. At a more basic level we are now seeing the consequences of the growing gap between the expectations for local services, such as police, fire, parks, libraries, roads and infrastructure; and the availability of funds to pay for them. The voters who support tax limitations are simply voting against higher taxes, but they want the current level of services to be maintained or expenditures increased for enhanced public services.[9]

At a more basic level we are now seeing the consequences of the growing gap between the expectations for local services, such as police, fire, parks, libraries, roads and infrastructure; and the availability of funds to pay for them.

The purpose of this report is to provide factual information about San Diego's revenues, expenditures and service levels so we can objectively evaluate our financial situation vis-à-vis other large cities in California.

Cities lack a prescribed uniform system of accounting. As a result, it is difficult to compare cities' budgets by looking at the size and distribution of the General Fund. Therefore we have used the California State Controller's *Cities Annual Report* which standardizes this data for all jurisdictions. Most revenue and expenditure data presented within this report are compiled from the Cities' Financial Transactions Reports.

[6] Legislative Analyst's Office (1996). "Understanding Prop 218." (Available online at http://www.lao.ca.gov)
[7] League of California Cities. "Prop 218 Implementation Guide." (Available at www.cacities.org)
[8] californiacityfinance.com
[9] *Ibid*., p. 21.

Therefore, there may be some discrepancy in certain line items and the use of the terms such as "General Fund" used by the City, and "General Revenue" used by the State.[10]

In this report, we have explained the overall revenues and expenditures for the City of San Diego, identifying the structural problems with the budget. We did not examine revenues and expenditures in Special Revenue Districts such as Maintenance Assessment Districts, Facilities Assessment Districts and other development impact fees and services which are also used by other cities. However, we have examined the core sources of revenue that other cities use, except for sales tax and property tax which are to a great extent controlled by state or regional formulas. In our consideration of the expenditures and service levels, we have identified only those expenses that we judged to be a significant service performed by the city based on the net general governmental expenditures[11] and recent City budgets.

[10] For example, The State Controller reports Transient Occupancy Tax in San Diego as a functional revenue rather than a general revenue. Thus the total General Revenue for the City of San Diego in FY2002-03 was $ 582,755,655 (Source: California State Controller, *Cities Annual Report*, 2005), which is less than the General Fund reported by the City.

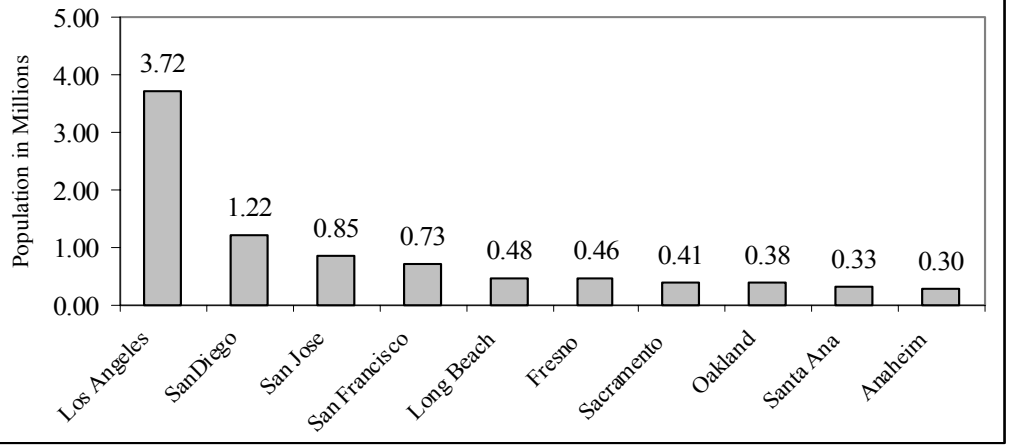
[11] Net Expenditures = Total Expenditure – Functional Revenues (California State Controller)

REVENUES

San Diego is the second largest city in California (see Figure 1) and the seventh largest in the nation. While cities such as San Francisco, Oakland and San Jose lost population during the early 2000s, San Diego added about 10,000 people to its population each year[12].

Figure 1

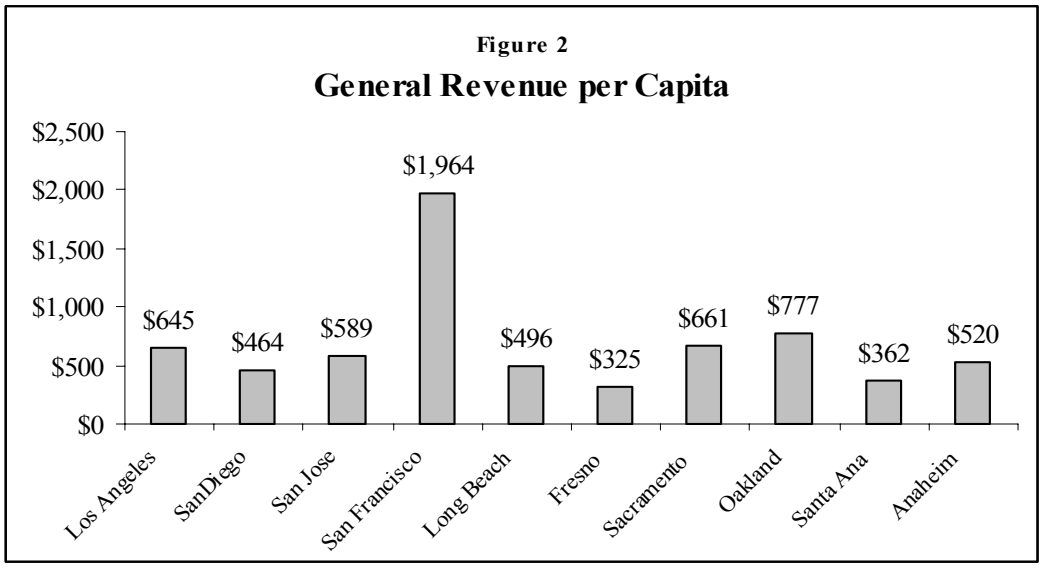
Population of the Ten Largest Cities in California



Source: US Census Bureau, American Community Survey (2003).

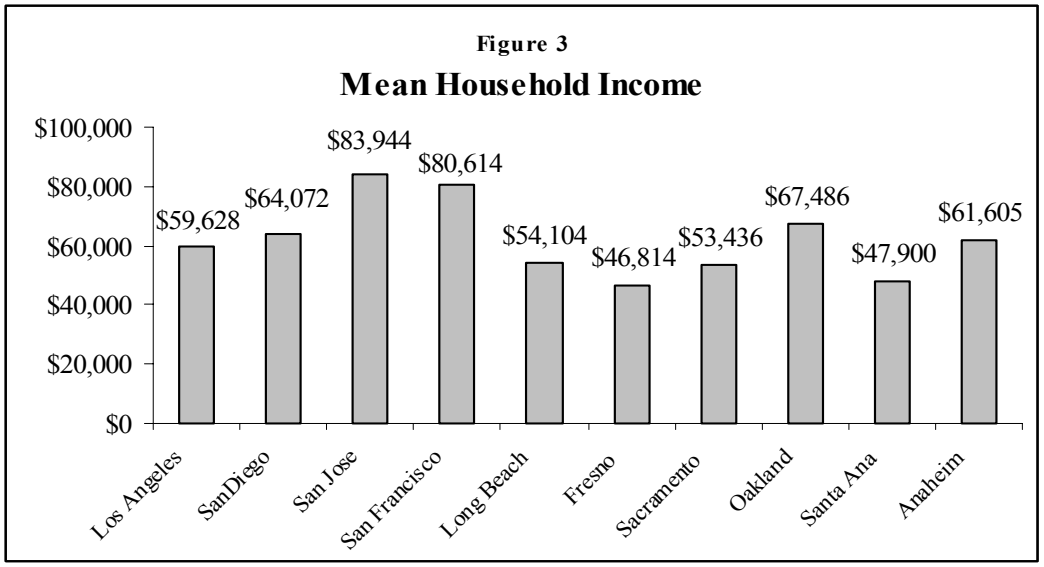
In FY2002-03, the City of San Diego raised $464 per resident in General Revenue. In contrast, the average general revenue raised by the ten largest cities was $693 per resident (see Figure 2). We have used the California State Controller's definition of General Revenue, which is revenue that cannot be associated with a specific expenditure and is therefore discretionary. Examples are property taxes (other than voter-approved indebtedness such as Mello-Roos bonds), sales taxes, and business license taxes. These do not include special assessment funds (e.g. facilities assessment districts), internal service funds, pension trusts, or agency transactions. For example, the majority of fees charged for construction permits by the Development Services Department are used in the expenses made by that department in evaluating the engineering and safety components of the construction. These are considered enterprise funds/functional revenues and are not included in General Revenues.

[12] During 2000-2003 the population of San Diego increased by 30,009. During the same period, the population of San Jose, San Francisco and Oakland fell by 33,201; 24,998; and 23,580; respectively. (Source: American Community Survey data for 2000 and 2003).



Sources: Data on General Revenues from the California State Controller (2005), Cities Annual Report, 93rd ed using FY2002-03 financial statements. Data on population from 2002 US Census estimates (extracted from RAND).

The per capita contribution of San Diegans to the City's General Revenue was the third-lowest among the ten largest cities (see Figure 2). At the same time, San Diegans earn a lot more than their counterparts in most other cities (see Figure 3). Only the Bay Area cities (San Francisco, San Jose and Oakland) have mean household incomes higher than San Diego's.



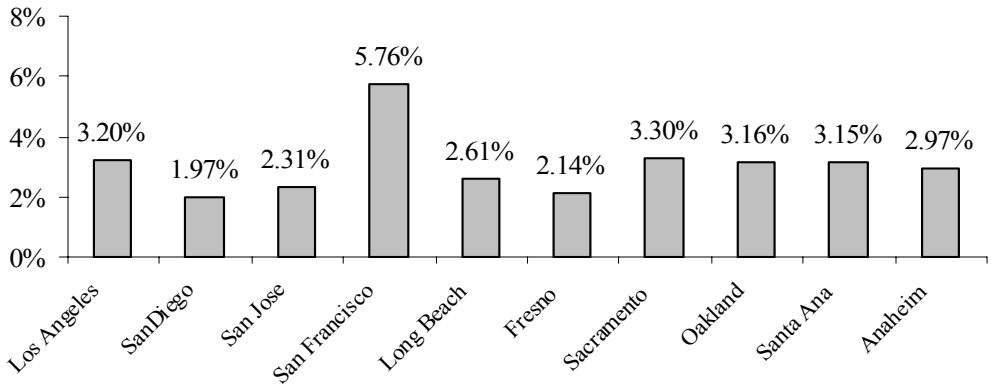
Source: US Census Bureau, American Community Survey (2003).

When considering the contribution of residents to the city's General Revenue, their incomes (and thus capacity-to-pay) should be factored in. The mean of all household incomes in San Diego was $64,072 in 2003. This translates into a total income of $29.58

billion for all San Diego households combined[13]. The total amount of the City's General Revenue in the corresponding year was $0.58 billion[14]. This implies that the City of San Diego was able to raise as General Revenue only 1.97% of the total household income. In contrast, on average the ten largest cities were able to raise 3.18% of the total household income in General Revenue. Among the ten largest cities in California, the City of San Diego was able to raise the *least* amount of revenue, in proportion to the total income of households residing in the city, to pay for the City's general services. If the City were to raise its general revenues to the average rate in proportion to household-income for Californians in the ten largest cities, it would generate an additional annual revenue of $358.6 million.

Figure 4

General Fund Revenues as a % of Household Income



Sources: General Revenue data from the California State Controller (2005), Cities Annual Report, 93rd ed. Based on FY2002-03 financial statements; Household Income and Number of Households from the US Census Bureau, American Community Survey (2003).

In the home rule era, cities would raise General Revenue through increasing property taxes. In the post-Proposition 13 era, the bedrock of city financing is still a combination of property taxes and sales taxes. However, even as other cities have moved towards raising revenue by other means (such as Business License Tax and Utility Taxes), the City of San Diego has a pre-Proposition 13 structure for other taxes. Figures 5 and 6 show that to raise General Revenue, the City of San Diego is more reliant than the average of California's ten largest cities on Property Taxes and Sales Taxes.

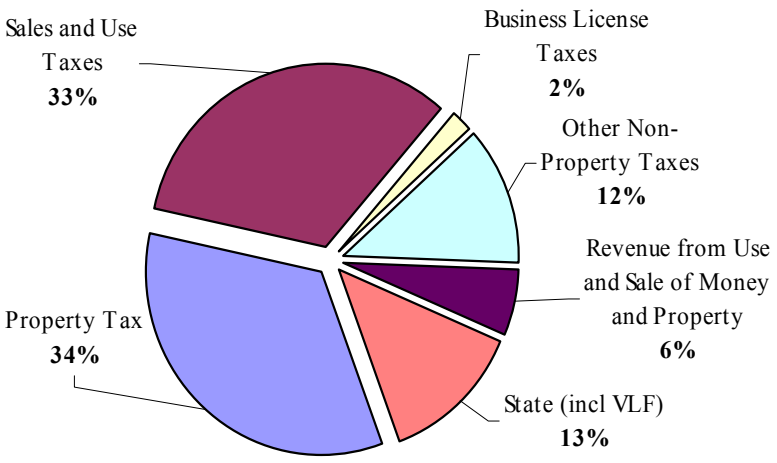
If the City were to raise its general revenues to the average rate in proportion to household-income for Californians in the ten largest cities, it would generate an additional annual revenue of $358.6 million.

[13] The total household income is $64,072 (mean income) x 461,618 (# of households) = $29,576,788,500. (Source: American Community Survey 2003).

[14] Total General Revenue for the City of San Diego in FY2002-03 was $ 582,755,655. (Source: California State Controller, 2005, *Cities Annual Report*).

Figure 5

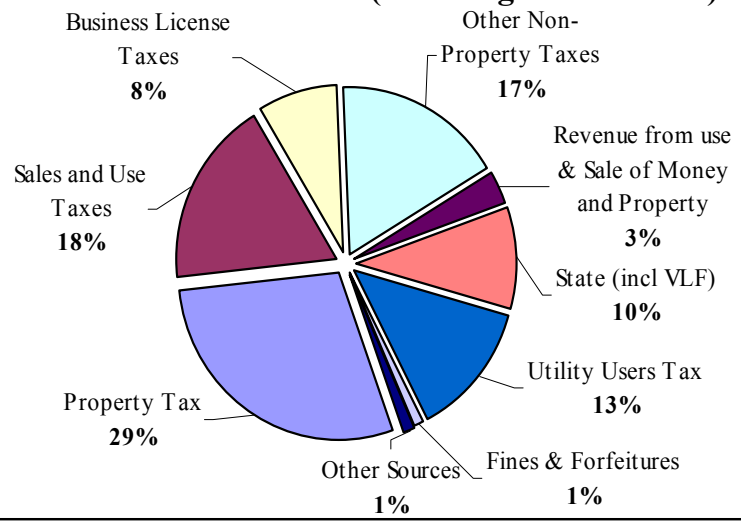
General Revenue Sources (San Diego)



Source: General Revenue data from the California State Controller (2005), Cities Annual Report, 93rd ed. Based on FY2002-03 financial statements.

Figure 6

General Revenue Sources (Ten Largest CA Cities)



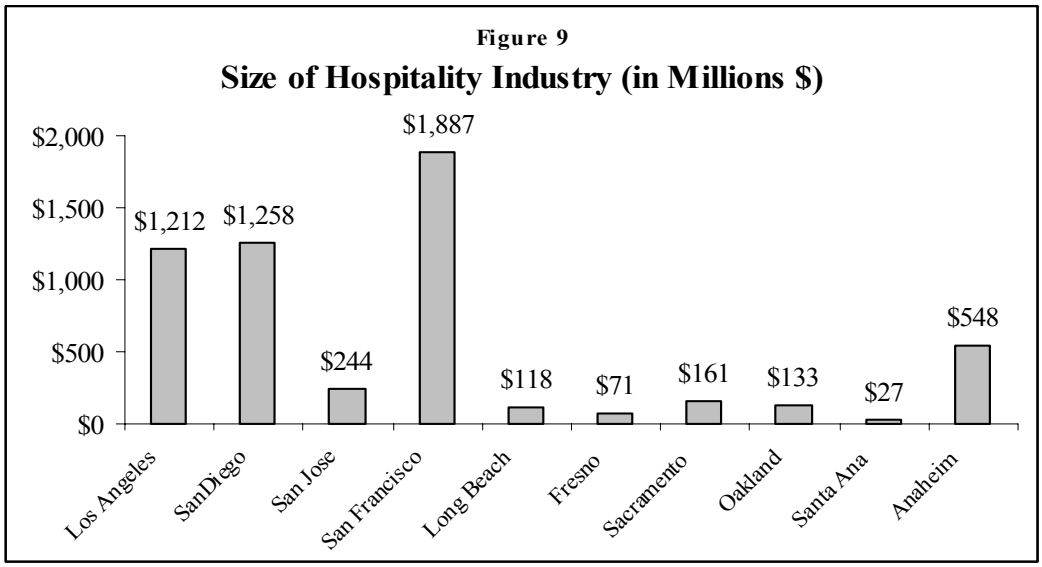
Source: General Revenue data from the California State Controller (2005), Cities Annual Report, 93rd ed. Based on FY2002-03 financial statements.

In the following sections, we have identified some of the primary sources that other cities use to generate additional revenue, with the exception of sales and property taxes.

Revenues from Tourism

Since the rebound of the nationwide tourism industry last spring, San Diego's hotel industry has been doing quite well. Last April, hotel occupancy levels averaged 71.5 percent, ranking fourth in the nation. Overall revenues from hotel rooms increased by more than 20 percent, and the demand for rooms soared over 15 percent in the course of one year.[15] San Diego commands an average of $15 more per room per night compared to properties in Anaheim, Los Angeles and Orlando[16].

Figure 9 shows that in terms of gross receipts from the Accommodation industry, San Diego has the second-largest hotel industry in California following San Francisco. San Diego is followed by Los Angeles and Anaheim.



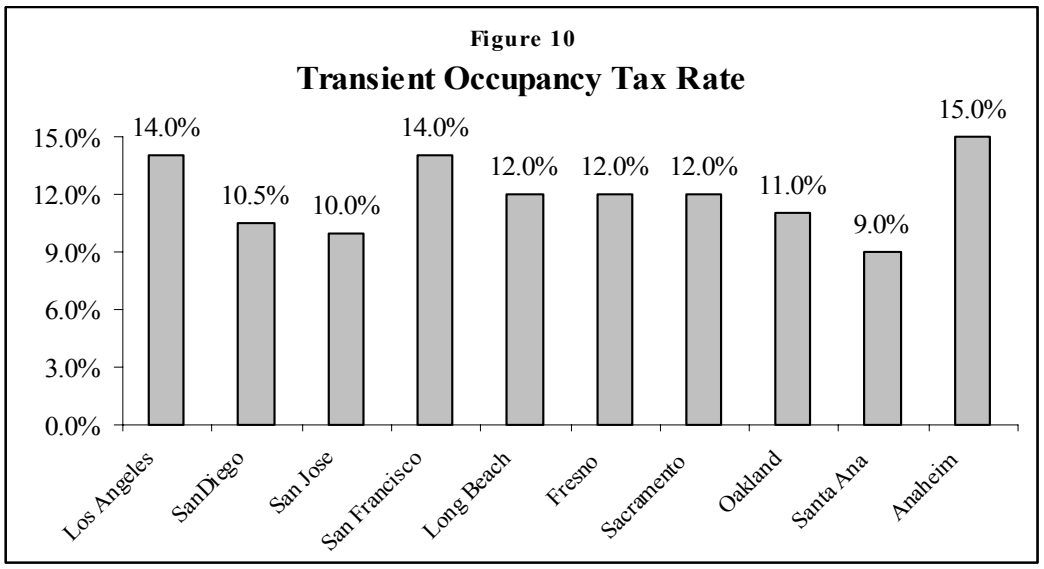
Sources: U.S. Bureau of the Census, 1997 Economic Census, data for gross receipts for the Accommodation Industry (NAICS: 721). CPI-U for California from 1997-2003 is from BLS obtained from California Department of Finance.

However, San Diego has the lowest Transient Occupancy Tax (TOT) rate among these top tourism destinations (see Figure 10). The TOT is tax imposed on the hotel room rate and is 15 percent in Anaheim, 14 percent in San Francisco and Los Angeles, and 10.5 percent in San Diego. In FY2005, the City of San Diego received $105 million in TOT, only about half of which can be used for funding general services.[17] If the City of San Diego were to charge TOT at 12.4 percent – the average[18] of the ten largest California cities – it would generate $9.9 million more in General Revenue annually.[19]

[15] San Diego ConVis News Release, May 26, 2004, quoting Reint Reinders.
[16] Smith Travel Research (2004).
[17] Currently, 48 percent of the Transient Occupancy Tax is spent on tourism Special Promotional Programs.
[18] Weighted mean (by size of the accommodation industry) of the ten largest California cities.
[19] TOT @ 12.41 percent generates $124.1 million. Additional General Revenue= 52 percent of ($124-$105) million.

Furthermore, if voters eliminated the requirement to expend 48 percent on Special Promotional Programs, this would enable the city to apply all of the $124 million to general services.

Figure 10



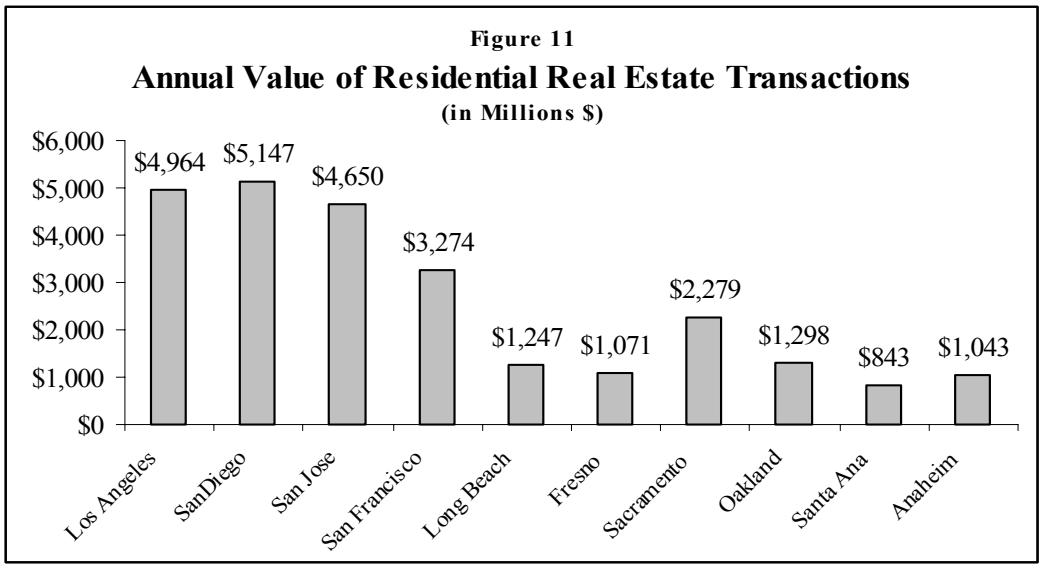
Source: California City Finance Almanac: http://www.californiacityfinance.com/

Revenues from Real Estate

The median price of an existing single-family home in the San Diego region in January 2005 was $580,220 - an increase of 23.85 percent over the prices last year.[20] The average increase in median home prices has been consistent over the past four years. "We're out of the starting gate with a bang," CAR President Jim Hamilton recently said. "Both sales and median price of a home hit new records in January as homebuyers continue to flood the market."[21]

Figure 11 shows that the City of San Diego had the highest value of real estate transactions among any city in California in 2002. Yet the city is not capitalizing on these high values when real estate changes hands. A property transfer tax is levied on the sale of real estate. Figure 12 shows the percentage of real estate transfers/sales that is contributed to cities. On behalf of the City, the County collects 0.055 percent of assessed valuation when ownership of real property is transferred. In FY2003, the City received $8.4 million in total real estate sales/transfer tax. If San Diego's Property Transfer Tax were increased to 0.328 percent for all transactions (residential and commercial), which is the weighted average of all the ten largest cities in California[22], then the City would generate additional revenue of $41.4 million[23].

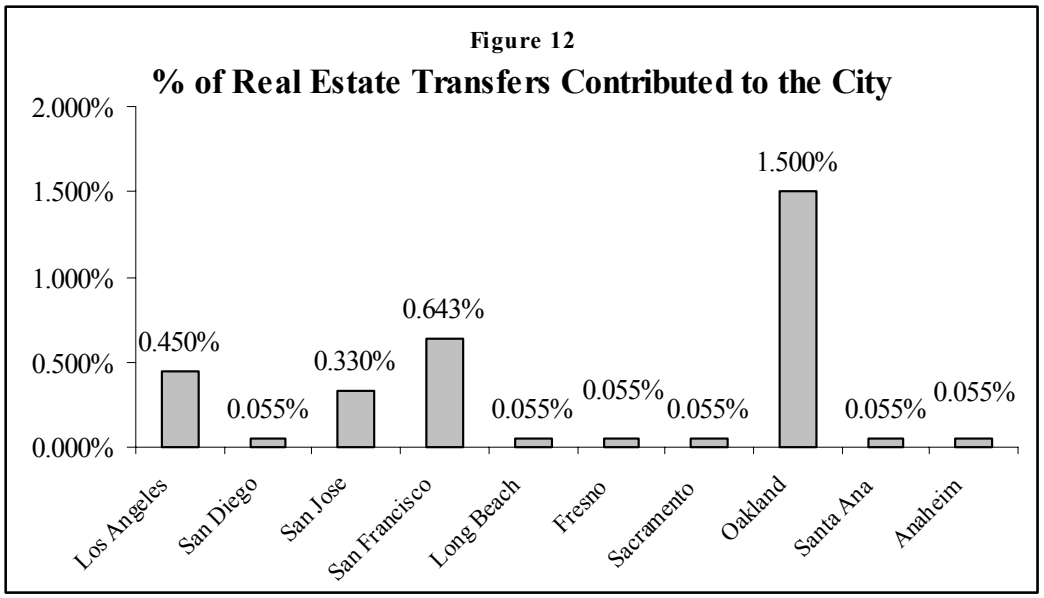
Figure 11



Source: Residential transactions data for 2002 from California Association of Realtors, extracted from RAND. Annual Value = Number of Transactions x Average Sales Price for all homes.

[20] Source: California Association of Realtors quoted in the *San Diego Union Tribune* (February 25, 2005) "Median Home Price Rises to $580,200 Realtors Say."
[21] *Ibid*.
[22] The average is weighted by the total value of residential transactions in each city for the ten largest cities in California.
[23] A 0.328 percent tax on all real estate transactions would generate $49.8 million.

Figure 12

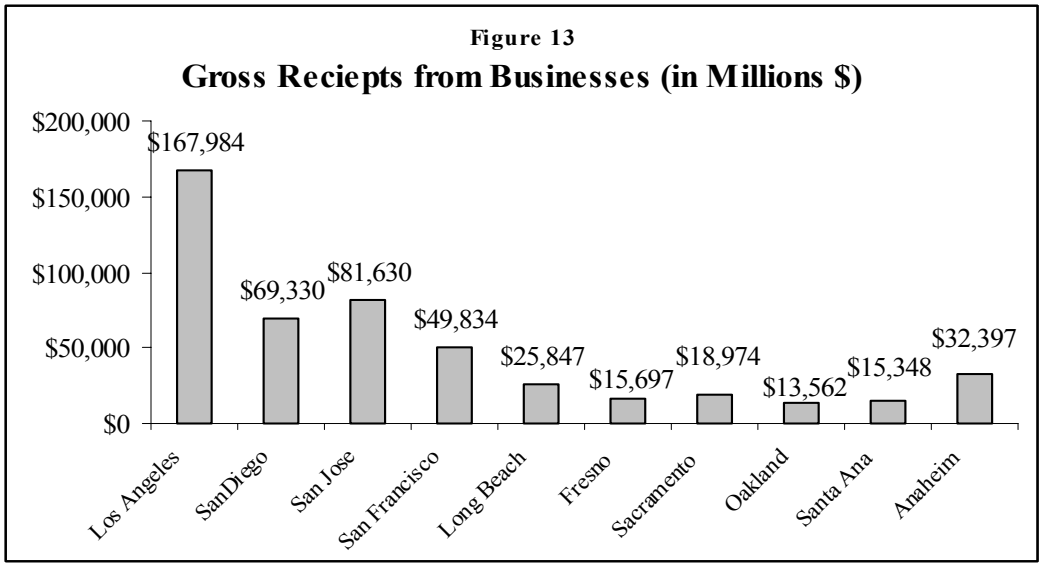


Source: Real Estate Transfer Taxes, Controller's Office, City and County of San Francisco, 2004

Revenues from Business Licenses

San Diego leads the nation in business indicators. The County of San Diego's gross regional product (GRP), the estimated total value of the economy, reached a record $129.2 billion in 2003, with the highest growth rate among any region in California.[24] If San Diego County were a country, it would be the 30th largest economy in the world – equal in economic output to the dollar value of goods and services produced by Finland or Thailand.[25]

Figure 13 shows that the City of San Diego has the third-highest gross receipts from businesses in California, following Los Angeles and San Jose. In the last Economic Census for which data is available, there were 33,450 business establishments in the City,[26] the second highest among any city in California. More recent estimates point at over 60,000 businesses with over 11,000 new business licenses being issued by the City every year[27].



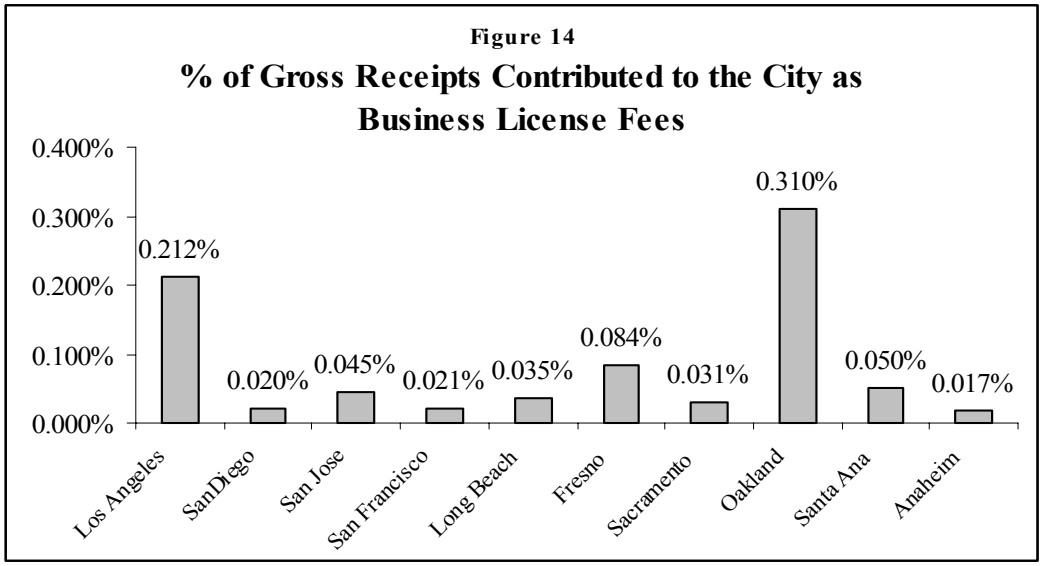
Sources: Data for Shipments/Sales/Receipts from the 1997 Economic Census extracted from State of the Cities Data Systems (HUD). CPI-U for California from 1997-2003 is from BLS obtained from California Department of Finance.

Since the schedules for Business License Fee and the basis for charging the fee vary from city to city, it is extremely difficult to arrive at an overall "tax rate." Therefore, we compared the overall business revenues and the total General Revenue for the cities from Business License Fees. Figure 14 shows that San Diego's businesses pay the lowest Business License Fees, in proportion to the gross business receipts, of any of the cities

[24] Source: San Diego Regional Chamber of Commerce.
[25] San Diego Chamber of Commerce (2004) *San Diego Economic Bulletin,* 52(1).
[26] Source: 1997 Economic Census.
[27] New Business License data for 2003 is available from San Diego Economic Indicators (San Diego Regional Chamber of Commerce).

considered.[28] For example, Los Angeles businesses contribute 25 times as much as San Diego businesses even though the total gross receipts of all businesses in Los Angeles are only 2.4 times that of San Diego[29].

Figure 14



Sources: Business License Revenues from the California State Controller (2005), 93rd Cities Annual Report based on FY2002-03 annual financial statements. Gross Receipts is extracted from State of the Cities Data Systems (HUD): Data for Shipments/Sales/Receipts using the 1997 Economic Census. CPI-U for California from 1997-2003 is from BLS obtained from California Department of Finance.

Currently Business License Fees in San Diego are $34 for small businesses and $125 for large businesses, with an additional $5 per employee. Table 3 shows that San Diego businesses pay the *least* for most types and sizes of businesses among the four largest cities in California.

[28] The City of Anaheim was not considered comparable since business receipts are highly skewed by Disneyland and the sports stadium.

[29] It should be noted that after the Northridge earthquake, the City of Los Angeles had significantly increased the business license fees.

Table 3 Comparison of General Business License Fees in the 4 largest cities in California				
Sample Business Description	Los Angeles	San Diego	San Jose	San Francisco
Retail shop of $1 million sales with 2 employees	$1,480	$34	$150	$943
Professional services of $15 m revenue with 60 employees	$88,650	$365	$1,086	$13,340
Restaurant group with $36 million in revenues and 850 employees	$53,280	$4,315	$15,306	$83,314
Hotel with $50 million in revenues and 600 employees	$74,000	$3,065	$10,806	$80,192
Large construction company with $500 million in revenue and 800 employees	$590,107	$4,065	$14,406	$254,577
Multimedia/Hi tech company with $6b in revenues and 4,500 employees	$7,080,000	$22,565	$25,000	$2,095,037

Sources: The above values have been calculated from the Business License Rates for each business size and type. The License Rates are from: Business Tax Booklet, City of Los Angeles Information, Business and Other Taxes (January 2005); City of San Diego Municipal Code Article 31.0301; City of San Jose Office of Economic Development: Guide to Doing Business in San Jose; City and County of San Francisco Office of Treasurer and Tax Collector; Payroll estimates were calculated using Bizstats.com for the closest business categories. We verified these rates by calling the business permit department in each city. (see Appendix 2)

In FY2002-03, the City of San Diego received about $14 million from Business License fees (Table 4). If San Diego businesses were to pay an average of 0.108 percent of the gross revenue, which is the weighted average for the ten largest cities in California[30], then the City of San Diego would generate $60.9 million more in general revenue[31].

Table 4 Business License Taxes for San Diego in FY2001 (in thousands)	
General Business Licenses	$5,198
Refuse Collection Business Licenses	$1,762
Other Regulatory Business Licenses	$2,358
Rental Unit Tax	$5,041
Total Business License Taxes	**$14,359**

Source: City of San Diego Annual Financial Report, FY 2000-01. Only those items which we estimate are included in the State Controller's definition of "Business License Tax" have been listed. The city has not released its FY2003 CAFR due to ongoing SEC/FBI investigation.

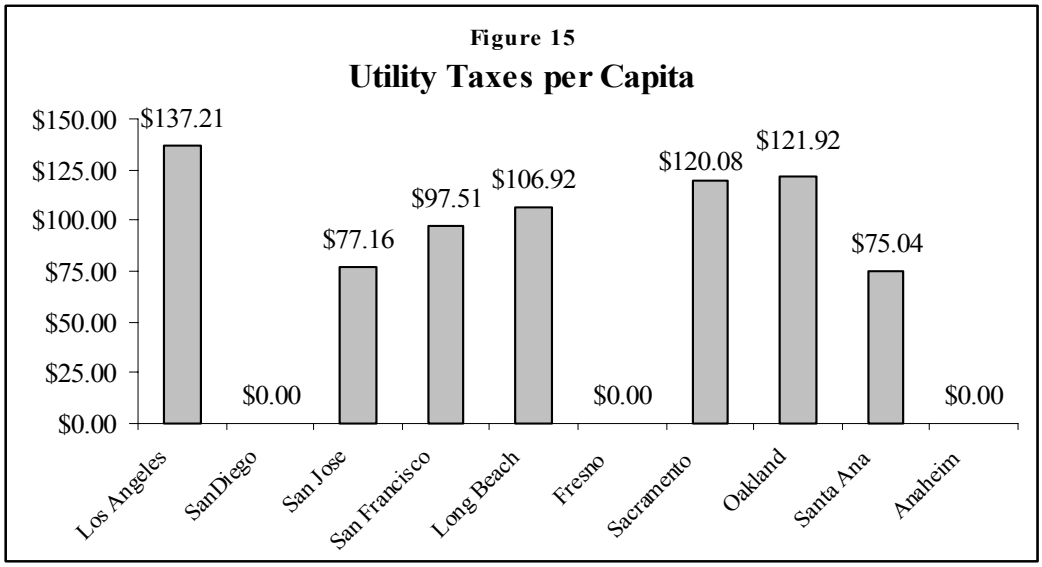
[30] The average is weighted by the value of gross receipts from business in each city.
[31] $14,034,824 x (0.108%-0.020%)/0.020% = $60,884,325.

Revenues from Utilities and Refuse

Utility taxes are commonly used by most other cities in California to pay for specific enhanced services or to generate general revenue. FCC regulations prohibit the City from establishing regulations that overly restrict the communications utilities. Other cities, therefore, have imposed third party taxes on utilities. Cities such as Oakland have regularly used utility taxes as an option for citizens to pay for a higher level of services. A third-party tax is a tax that is collected directly from users or customers by a business, and then remitted to the Tax Collector. In most cases, these taxes take the form of billing surcharges that customers pay, usually as a percentage of the total bill.

The average Californian in the ten largest cities pays about $92 annually on the consumption of utilities such as electricity, natural gas, telephone, cell phone,[32] cable television and water. Almost all major cities in California charge taxes on electricity and natural gas consumption.[33] San Diegans, in contrast, do not pay the City for any of these utilities or services (see Figure 15).[34] Third Party Taxes are levied in addition to the franchise fees for the added burden on the City's police and fire due to electricity- and gas-related incidents. If the City were to charge what is paid by the average Californian in the ten largest cities, this would generate $112.6 million in additional revenue for the City.

Figure 15



Sources: General Revenue data (annual) from the California State Controller (2005), Cities Annual Report, 93rd ed. For FY2002-2003; Population estimates for 2003 from the American Community Survey (US Census Bureau).

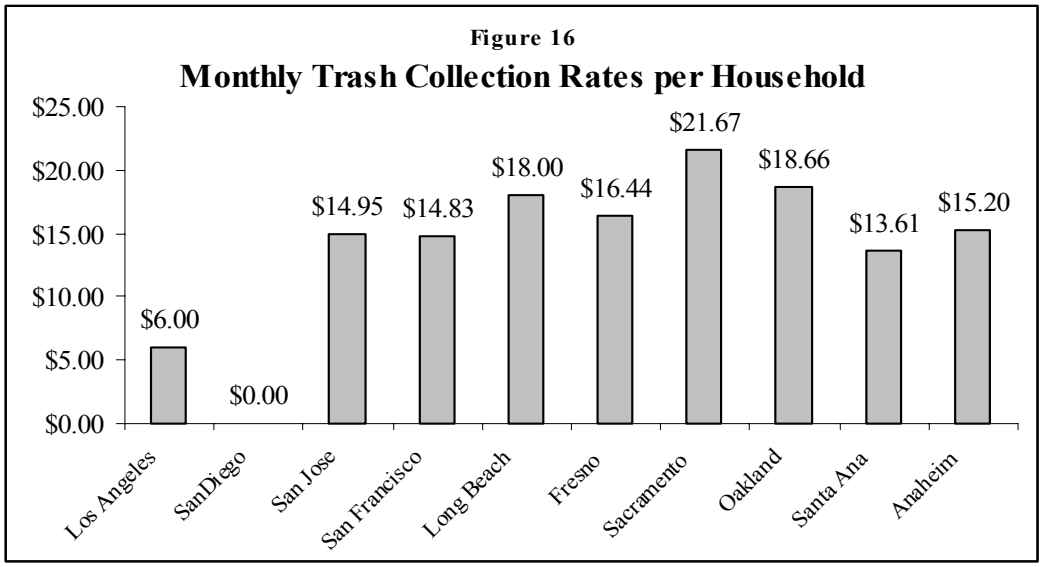
[32] Rapid increase in cell phone usage has also been tapped by many cities for revenues. However, along with the rapid proliferation of telecommunication companies comes the burden of identifying and collecting taxes from each company, as realized by the City of Palo Alto in a recent lawsuit with Verizon Wireless.

[33] Among the ten largest cities in California, the only cities that do not charge electricity and natural gas taxes are San Diego, Fresno and Anaheim.

[34] However, San Diego does get significant revenue (12 percent of total revenue) from the utility companies as franchise fees, for using public right-of-way in running the services. Charging utility companies for the use of public property is also common in all other California cities.

A free service offered by the city of San Diego is residential refuse collection (see Figure 16). It costs the City of San Diego $8.64 per month per household to pick up the trash.[35] Moreover, there is no limit on the amount of residential trash collected. The "People's Ordinance" of 1919 and Prop C (1986) made it impossible to collect fees for trash collection without amending the City Charter. Were the City to charge the cost-recovery rate to the residential generators of trash, this would generate $47.9 million in annual revenue.[36] Alternatively, were the City to charge at the average rate of the largest California cities ($9.80/household/month) this would generate $54.29 million in annual revenue.

Figure 16



Source: Kelling, Northcross & Nobriga (2002), City of San Diego Facilities Financing Study prepared for the Strategic Framework Citizen Committee (Finance Subcommittee).

[35] *FY 2004 City of San Diego Annual Budget*: Benchmarking Report.
[36] $8.64 x 461,618 x12 = $47,860,554 (Source: Number of households is from the American Community Survey, US Census).

Revenues from Construction Permits

Although revenue from construction permits is not used for general governmental functions, we decided to examine how the proportion of construction costs compares with permit issuing fees. These fees do not include development impact fees for which new construction has to mitigate. Permit fee schedules differ from city to city, and the schedules are based on the evaluation of projects within the framework of jurisdiction and area-specific codes and plans. Therefore, we used overall indicators for the total construction activity, comparing them with the total revenue from construction permits for each city.

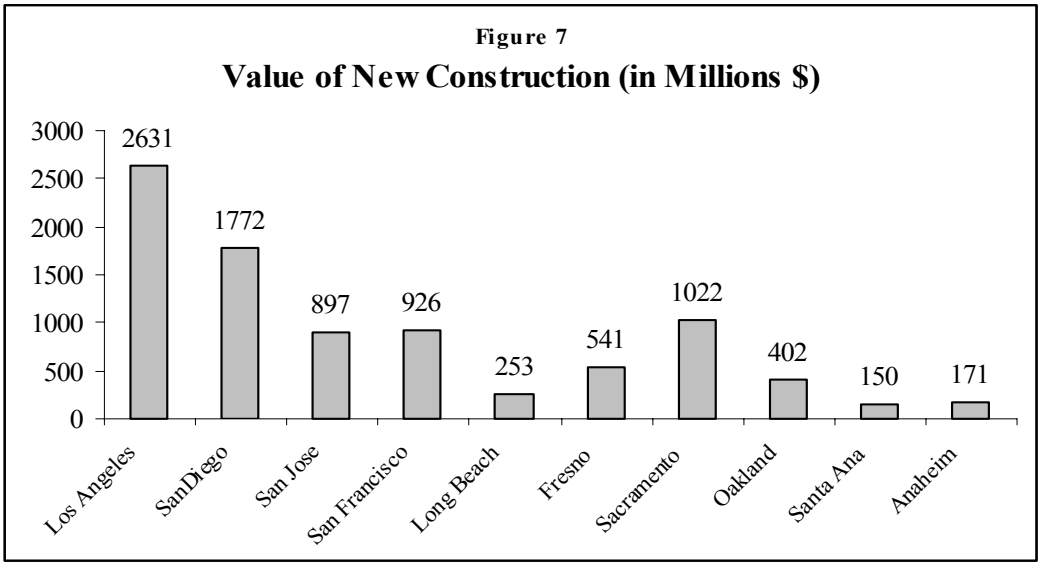
Construction permits generate revenues through fees charged for plan checks and inspections; electrical, mechanical and structural permits; variances, subdivision maps, and environmental documents; and policy changes (rezones, plan amendments). California Government Code Section 66014(a) prohibits those fees from exceeding the estimated reasonable cost of providing the service for which the fee is charged, unless approved by a two-thirds vote. Therefore, those fees cannot be used for general fund activities. However, cities such as Los Angeles have created Special Revenue Funds for revenue from construction permits. These then become governmental funds, and the revenue can be used for specific activities related to building permitting and planned growth. This frees up other unrestricted governmental funds to be spent on general services.

The value of new construction exceeded $1.7 billion in San Diego in 2003 (see Figure 7). This is the second highest among the major cities in California. Almost three-quarters of it is residential construction spurred by low mortgage rates and high demand for housing. However, San Diego's proportion of overall revenues from construction permits (2.05 percent) was lower than the average of the largest cities in California (2.20 percent). Were the City of San Diego to charge construction fees and permits at the rate of the average[37] of the largest California cities, San Diego would generate $2.6 million more in revenue per year.[38]

[37] Average is calculated by the weighted mean (weighted by value of construction) of the eight largest cities in California. The construction activity in Anaheim and Santa Ana was too small, and data not available to make a meaningful comparison.

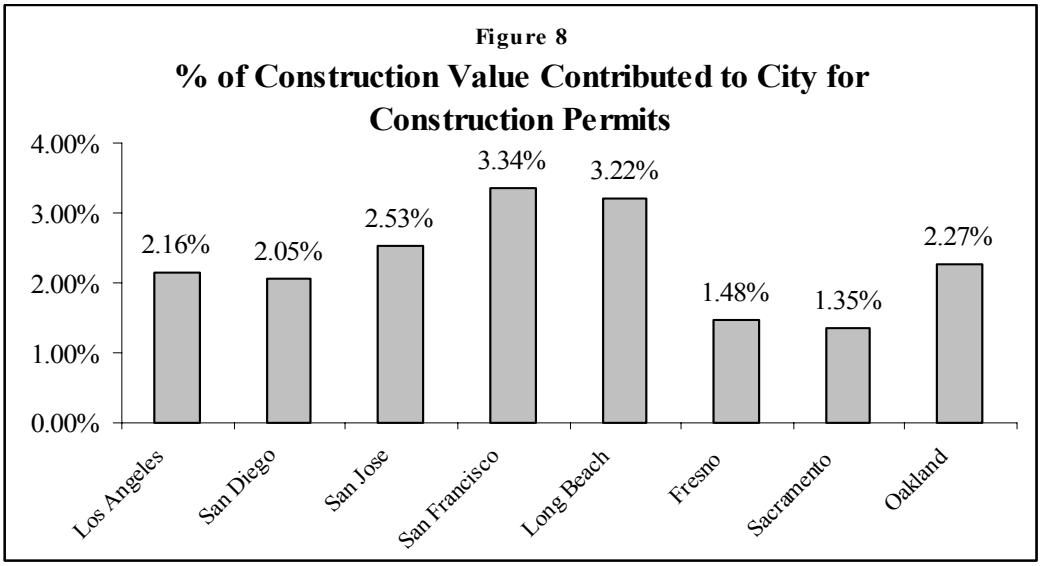
[38] $1,771.7 million x (2.20%-2.05%) = $2.6 million.

Figure 7



Source: New City Construction data is from 2003 Building Permit Valuations (residential and non-residential) by the Construction Industry Research Board, extracted from RAND.

Figure 8



Sources: For sources on City revenue from construction permits, see Appendix 3. New City Construction data is from 2003 Building Permit Valuations (residential and non-residential) by the Construction Industry Research Board, extracted from RAND.

EXPENDITURES AND SERVICE LEVELS

San Diego's finances have recently been the favorite of conservative think tanks like Reason Public Policy Institute. In 2002, Reason ranked San Diego as the *most* efficient city government among the ten largest cities in California.[39] San Francisco was ranked as the least efficient city. Reason has not updated its rankings since then.

According to a survey published by the New England Economic Review, the level of service offered by a municipality exerts a positive and statistically significant effect on economic development.

What made San Diego the most efficient city? For each of the services examined,[40] one consistent input variable was the number of employees performing the service. Thus, labor-cost inputs determine efficiency, which is presented quite questionably as the mainstay of public sector performance. However, such a simplistic calculation – that more employees leads to lower efficiency and poor performance – overlooks the concept of productivity which combines output, efficiency, savings, cutbacks , measurement, and effectiveness. From a public sector managerial standpoint, productivity is a varying concept based on the overall performance or function of the organization within a given context.[41] Besides efficiency and effectiveness, a study funded by the National Science Foundation funded found that managers usually consider the following factors in evaluating productivity: decreased disruptions in operations, decreased absenteeism and turnover, increased client satisfaction, and employee morale, as well as measures of output.[42] Thus, overall departmental productivity should be used as a measure of performance rather than singling out employee efficiency. This will lead to major savings from programmatic improvements and accountability rather than minor savings from targeting individual employees.

This section uses overall departmental productivity measures and does not presume that greater staffing leads to performance inefficiencies. For example, the sustained police expenditures in San Diego may have led to a decrease in crime rate over the last decade (see section on Police). Thus, police officers are not inefficient if there are fewer crimes per officer (as Reason concludes); rather, they are more effective. Furthermore, according to the Reason rankings, San Diego received a low-efficiency score in fire efficiency since it had too many fire personnel in 2002. This is based on the low civilian deaths in 2002 which was an indicator of low performance among fire personnel.

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[39] Segal, Geoffrey; Moore, Adrain; and Nolan, James (2002). "California Competitive Cities: A Report Card on Efficiency in Service Delivery in California's Largest Cities." Reason Public Policy Institute.

[40] Building Maintenance, Emergency Medical Services, Fire Protection, Fleet Management, Fire Protection, Libraries, Parks and Recreation, Police, Solid Waste, Streets, and Water.

[41] Kearney, Richard and Berman, Evan (Eds.) (1999). *Public Sector Performance: Management, Motivation, and Measurement.* Westview Press.

[42] Katzell, Raymond; Yankelovich, Daniel, et al (1975). *Work, Productivity and Job Satisfaction: An Evaluation of Policy-Related Research*. New York: Harcourt Brace.

However, the 2004 fires exposed that the Fire Department budget and staffing were actually inadequate. These examples illustrate that a temporal analysis of departmental productivity should be used as a measure of performance rather than employee efficiency in a given year.

In the previous section, we calculated that the City of San Diego receives $464 annually for general city services per resident. In other words, $38.67 a month pays for all of the items shown in Table 5.

Table 5
What does $38.75 a month pay for?

Item	Description	Monthly Cost per person
24 hour police protection	1.69 police officers per 1,000 people who protect the 1,000 people from 0.5 violent crimes (like murder and rape) and 3 property crimes (like larceny and motor vehicle theft) every month.	$15.25
24 hour fire protection	0.75 firefighters per 1,000 people with facilities, transportation and communications equipment, such that at an average, a fire engine responds in 5½ minutes to an emergency call. In summer, lifeguards perform 5 rescues per 10,000 beach visitors.	$7.87
Streets, highways and storm drains	Maintenance, cleaning and road repair of over 3,000 miles of streets, 4,000 miles of sidewalks, repairing potholes and installing streetlights. Cost only includes net expenditures after deducting revenues from assessment districts and other capital funds.	$0.14
Libraries	3.7 books per person and 0.37 librarians per 1,000 population. This cost does not include construction of new facilities.	$2.64
Legislative Costs	Offices of the Mayor and Council for each council-district to legislate, and address community issues. Legal advice and City Attorney before judicial and administrative bodies in civil proceedings	$2.64
Management and Support	A City Clerk to handle record documents, an auditor, personnel and human resources, professional financial management with centralized purchasing and contracting, and legal staff to protect the interests of taxpayers.	$4.63

Sources: Based on Net Expenditures (= Total Expenditures-Functional Revenue) for FY2002-03 in the California State Controller's (2005) Cities Annual Report, pg. 433. Population estimates are from 2003 American Community Survey (US Census). See Appendix 4 for detailed methodology.

As the population of a city grows, so does the need for services such as parks, recreational facilities and emergency services. Studies show that at higher densities, there is a significant non-linear increase in current operating costs of infrastructure and public services with increasing population.[43] However, it is not the growth of population alone that causes an increased need for services. When exports rise, more and larger trucks use the city's roads. When construction rises, utility lines have to be replaced. When shopping centers start sprouting up, the City has to deal with added traffic and crime. In sum, the growth of both the number and size of business establishments also contributes to an increased demand on general city services such as safety and roads.

Last year, the San Diego Citizen's Budget Plan, funded by Reason Foundation, showed a 58 percent increase in general fund expenditures over the past decade and labeled this as "Runaway City Spending."[44] The claim of a 58 percent increase in general expenditures is factually inaccurate, since the decade-old values of the City's general fund expenditures were not adjusted for inflation. Moreover, a broader look at both population as well as business indicators shows a far different picture (see Table 6). Not only is the inflation adjusted general fund spending (16.07 percent) below the growth the total personal income of people living in San Diego (33.9 percent), it is also far behind the growth of business payroll (58.8 percent) within the city during the same period.

It must be noted that the City Charter prohibits expenditures for the general operations of the City (excluding water utilities, funds, capital improvements, bond interest, retirement system contributions, emergency and grant funded programs) from exceeding the prior year's expenditure levels, adjusted by no more than three quarters (3/4) of the percentage change in the price index added to any percentage increase in population growth.[45]
This makes it very difficult to have "Runaway City Spending" on general services.

Both individuals as well as businesses create an increased demand for services. Although there have been structural changes in the economy with a greater role of high-tech and financial services, it is still dominated by low-wage high-service impact industries such as retail and tourism. If we assume that the level of service demanded by a business is proportional to the size of the business, then the City's expenditures are lagging far behind. Whereas the annual payroll for all businesses in the City rose by 58.8 percent over the 1990-2000 period, the spending by the city on general services increased by only 16 percent. The region continues to grow economically at a very rapid pace; it is estimated that the County of San Diego's gross regional product (GRP) reached a record $129.2 billion in 2003 with the highest growth rate among any region in California.[46] It is therefore not surprising that our City's workforce is stretched thin trying to meet the growing demand for services from a growing economy.

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[43] Ladd, Helen F. (1992). "Population Growth, Density and the Costs of Providing Public Services." *Urban Studies*. 29(2), 273-295.
[44] Performance Institute (2004) "The San Diego Citizen's Budget Plan." (Available online at www.sandiegobudget.org)
[45] That is, for any given year, $\Delta E <= 0.75 \times CPI + \Delta P$, where E is the expenditure level, CPI is the price index, and P is the population. (Based on Article 7, Section 71 of the San Diego Charter.)
[46] Source: San Diego Regional Chamber of Commerce.

Table 6 Key Growth Indicators Over the 1990-2000 Period			
	1990/1	2000/1	Percentage Change
City of San Diego General Fund Spending	$411m *($532 in 2000 dollars)*	$618m	16.07%
Number of Positions in the City of San Diego government	8,850	10,226	15.5%
Number of Jobs in all Businesses in the City	500,573	627,458	25.3%
Population	1.110 m	1.223 m	10.2%
Personal Income	$52.366 b *($69.2 b in 2000 dollars)*	$92.654 b	33.9%
Number of Business Establishments	29,501	33,919	15.0%
Annual payroll of all Businesses	$16.365 m (*in 2000 dollars)*	$ 26.159 m	58.8%
Gross Metropolitan Product	$70.5 b *(in 1996 dollars)*	$98.0 b *(in 1996 dollars)*	39.0%

Sources: Data on the General Fund and Number of Positions is from the FY1990 and the FY2000 budgets (City of San Diego). Data on population is from the 1990 and 2000 censuses (US Census Bureau). Data on jobs, business establishments and annual payroll is from the 1991 and 2001 SOCDS County Business Patterns (Bureau of Labor Statistics) Special Data extracted for the City of San Diego from HUD. Data on Personal Income (CA1-3 Personal Income is income derived from all persons and all sources including wages) for San Diego-Carlsbad-San Marcos MSA from Bureau of Economic Analysis Regional Economic Accounts. Data on Gross Metropolitan Product is for the whole County from DRI, Bureau of Economic Analysis, the 2000 data is a forecast by DRI. This data was compiled by SANDAG Indicators for Sustainable Competitiveness.

Public services are inputs to production and economic growth, and they reduce the costs of private inputs used by businesses and individuals.[47] According to a survey published by the *New England Economic Review*, the level of service offered by a municipality exerts a positive and statistically significant effect on economic development.[48] For example, transportation services show the greatest impact on employment, income and new investments, often surpassing the original investment. In general, individuals and firms purchase publicly-provided inputs at a tax price which affords them an economy of scale.

[47] Bartik, Timothy (1991). *Who Benefits from State and Local Economic Development Policies?* Kalmazoo, MI: W.E. Upjohn Institute.

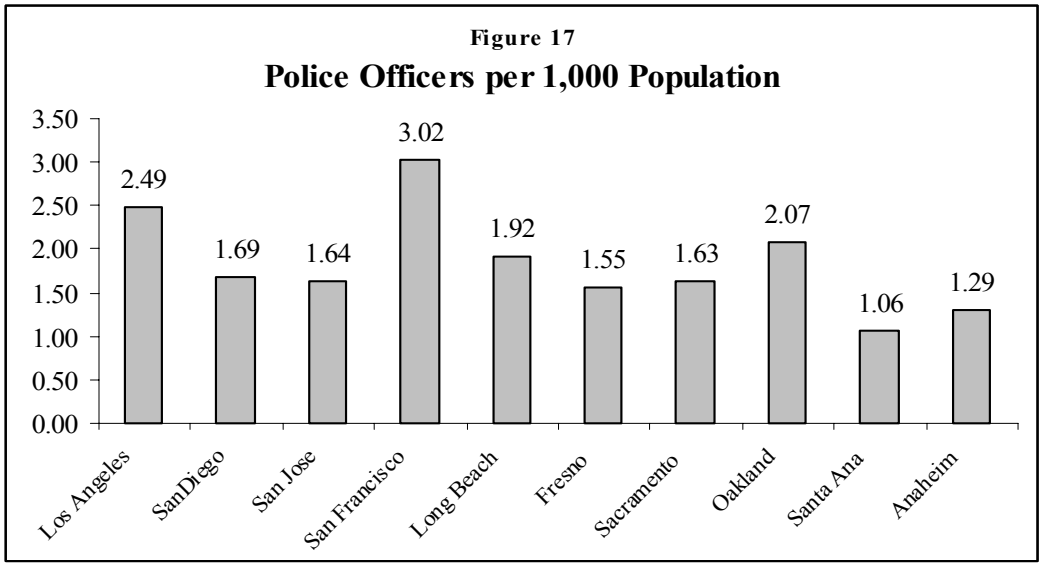
[48] Fisher, Ronald (1997) "The Effects of State and Local Public Services on Economic Development." *New England Economic Review*. March/April 1997.

Safety Expenditures

A decade ago, San Diego was ranked as the sixth most dangerous city by the FBI Index rate for cities of more than 500,000 residents.[49] Over the past ten years, however, San Diego has become a much safer place compared to other cities; in fact, the overall crime rate in San Diego has fallen significantly (almost 19 percent) since the mid-1990s.[50] In 2003, San Diego was ranked as the seventh-safest city among major cities in the nation.[51] There are about six violent crimes per 1,000 people in a year in San Diego, compared to 9.5 violent crimes in the average of the ten most populous California cities. In 2002, San Diego also had the third-lowest FBI Index crime rate nationally among major cities (only New York and San Jose were lower).[52]

To provide more than 2,000 police officers on the streets, on an average the City of San Diego spends $5,160 per business establishment. Figure 17 shows that San Diego has 1.69 police officers per 1,000 people – a moderate level compared to other cities. Thus, fewer than two police officers protect a thousand people from 6.03 violent crimes (like murder and rape) and 36.46 property crimes (like larceny and motor vehicle theft) every year. Despite stagnating revenues, over the last four budget cycles, annual expenditure per person on police has increased from $206 to $239.[53] This is still lower than the amount per capita spent by the ten largest cities California ($317) on police.

Figure 17



Source: Uniform Crime Reports, 2003, Federal Bureau of Investigation

[49] SANDAG (2004). *Crime in the San Diego Region: Annual 2003*; 9.

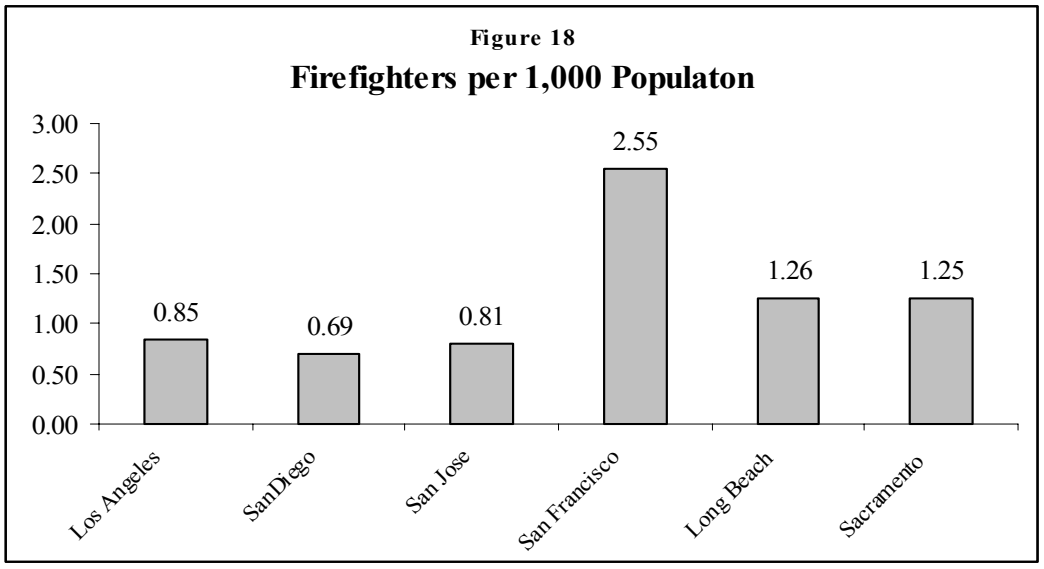
[50] In 1996 the FBI Crime rate was 52 crimes per1,000 people which included homicide, rape, robbery, aggravated assault, larceny, burglary and motor vehicle theft. In 2003 the FBI Crime rate was 42.2. (Sources: San Diego County Sheriff's Department).

[51] 11th Annual America's Most Safest (and Dangerous Cities), Morgan Quitno Awards. The ranking is based on crimes per 1,000 people from FBI 2003 Uniform Crime Reports.

[52] SANDAG (2004), *op cit.*

[53] The Police budget increased from $252.8 million in FY2001 to $309.8 million in FY2005 (Sources: FY2001 and FY2005 Annual Budgets). The City of San Diego population during this time increased from 1.22 million to 1.29 million (SANDAG estimates for years 2000 and 2004).

Similarly, annual expenditure per person on fire ($101) in FY2003 lagged behind the average of the largest California cities ($140), with San Diego as the third lowest after Fresno and Santa Ana. In 2002, a survey of cities comparable to San Diego found that the Cost Loss Index (the average cost per resident for fire protection and fire loss) was the lowest of any city in the survey.[54] Figure 18 shows that San Diego has 0.69 firefighters per 1,000, (the lowest ratio) with significant needs for facilities, transportation and communications equipment. The National Fire Protection Association (NFPA) standard is to arrive on scene within six minutes 90 percent of the time. In San Diego, we hit six minutes less than 50 percent of the time. As population density increases, it becomes exponentially difficult for fire personnel to reach the affected areas immediately. A low expenditure directly leads to a lower number of firefighters and equipment, a vulnerability that became exposed in last year's wildfires. In addition, during summer, millions flock to the beaches. Lifeguards perform five rescues per 10,000 beach visitors. The City therefore struggles to at least keep intact the Public Safety budget at the expense of all other services. For example, last year expenses for San Diego Police and Fire departments increased by 13.84 percent and 18.75 percent, respectively; while the General Fund revenues increased by only 9.61 percent[55].

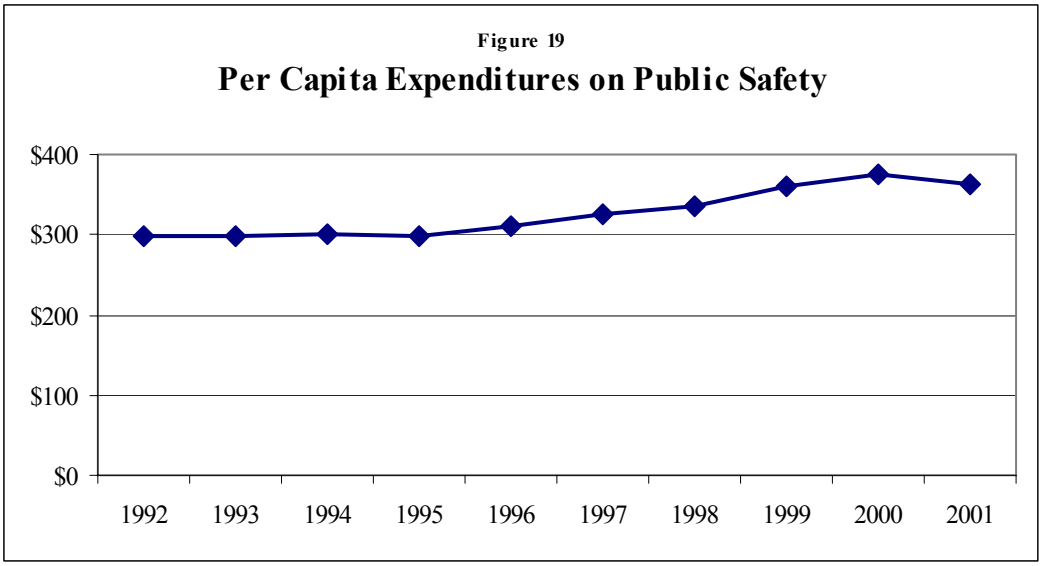


Source: International Association of Fire Chiefs.

When we combine the expenditures on public safety from all governmental funds, we observe a 22.9 percent increase in inflation-adjusted per capita expenditures over the 1992-2001 period (see Figure 19). This is the highest increase in per capita expenditures of any governmental fund function that reflects the priorities of city expenditures.

[54] City of San Diego (2004). *San Diego FY2005 Proposed Annual Budget*, 42.
[55]City of San Diego (2004). *San Diego FY2005 Proposed Annual Budget*, 31.

Figure 19



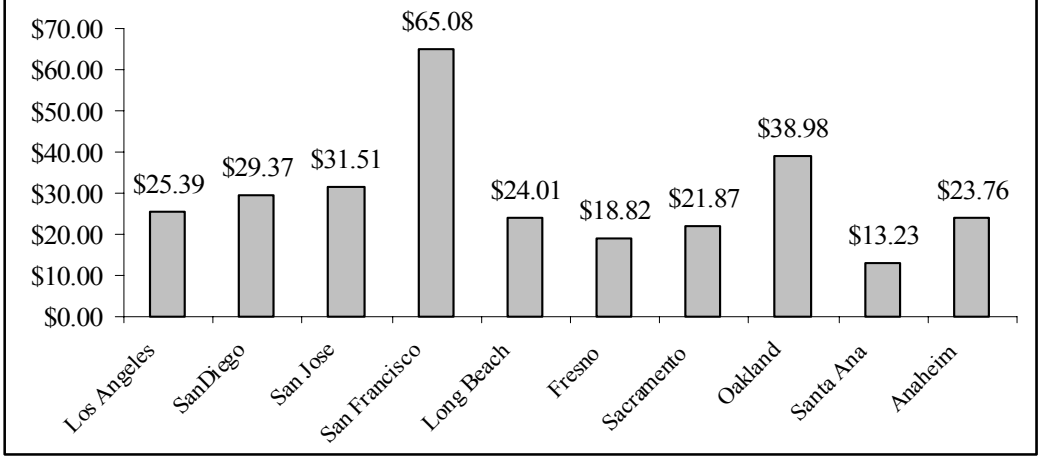
Source: Governmental Fund Expenditures from the Comprehensive Annual Financial Report, FY2001. Inflation adjustment using CPI-U from the Bureau of Labor Statistics, Population estimates are from US Census, extracted from RAND.

Library Expenditures

San Diego invests significantly in its libraries. Figure 19 shows that San Diego spends $29.34 per capita on libraries, higher than the state average ($26.34). As a result, San Diego has more books per person (3.71) than the average of the ten largest cities (2.35). This also creates a greater burden on librarians in San Diego. San Diego has 10,032 books per librarian, which is the highest among any large city in the state and far greater than the California average (6,129 books per librarian). San Diego has a moderate level of staffing with 2,704 people served per full-time staff person.

Figure 20

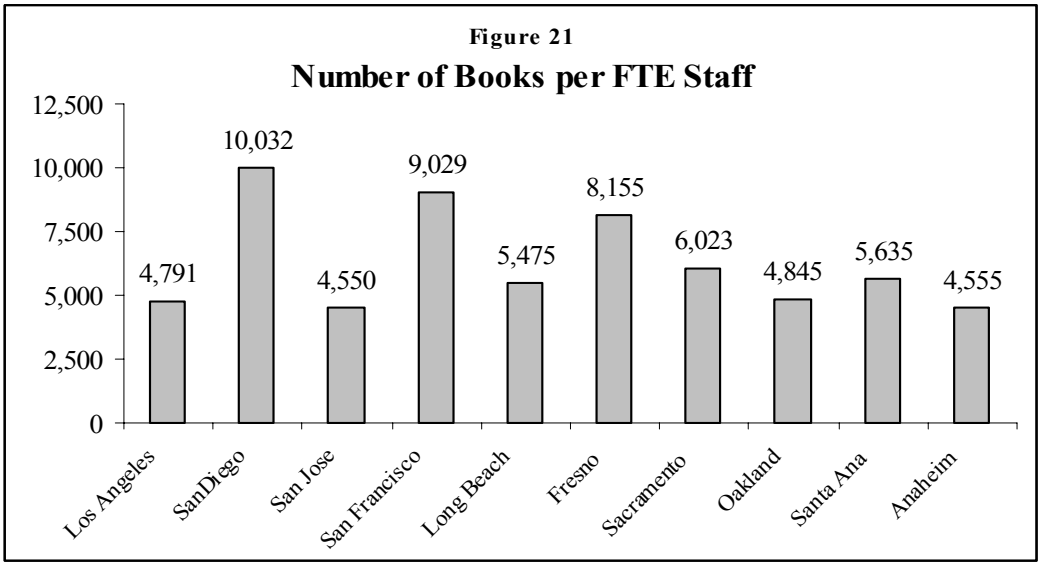
Library Expenditures Per Capita



Source: California Library Statistics 2004, FY2002-03, Library Department Services Bureau.

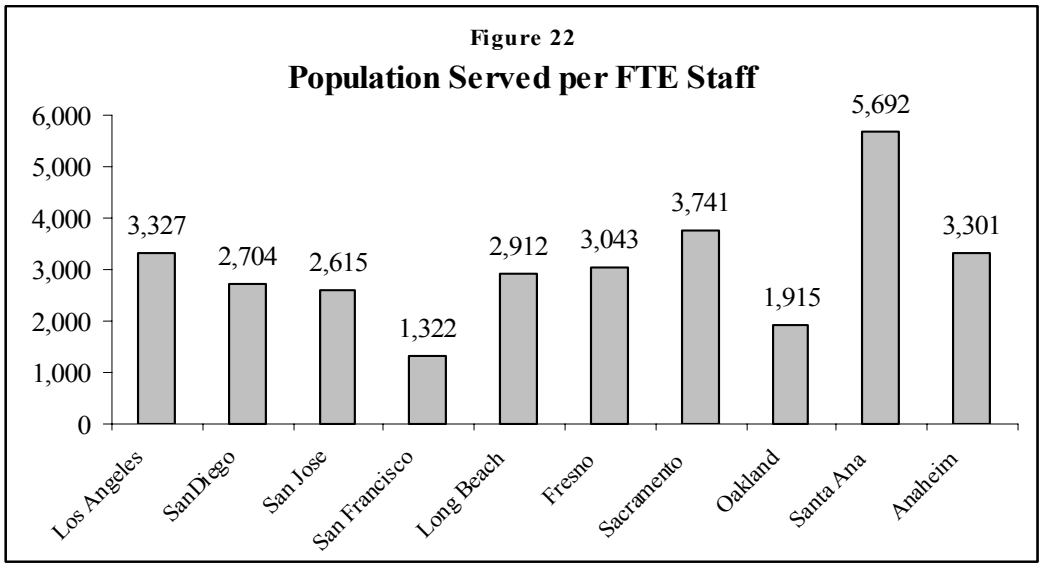
Figure 21

Number of Books per FTE Staff



Source: California Library Statistics 2004, FY2002-03, Library Department Services Bureau.

Figure 22



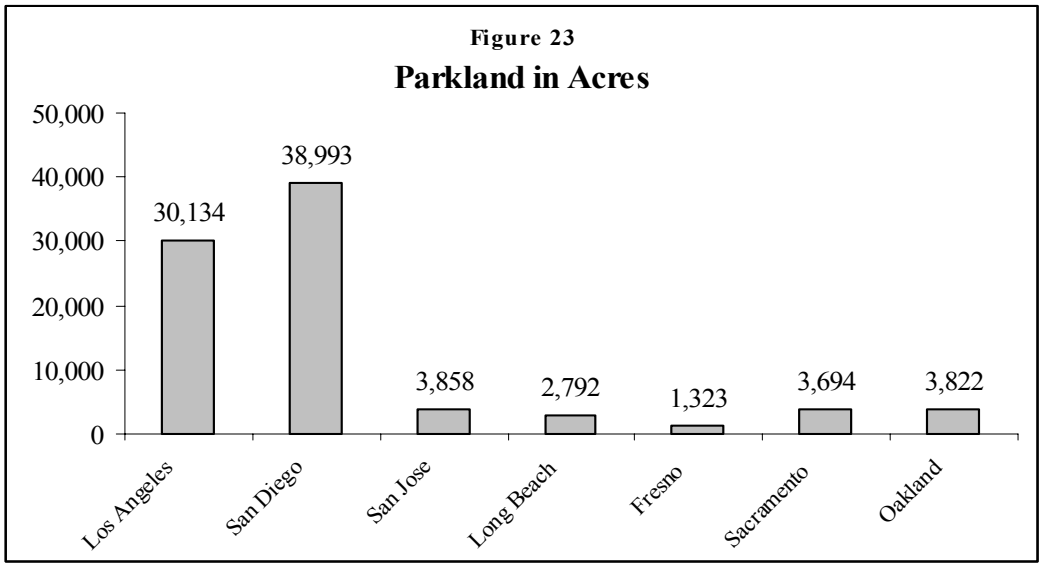
Source: California Library Statistics 2004, FY2002-03, Library Department Services Bureau.

Parks

City parks serve a multitude of purposes.[56] Collectively, they provide playfields and tot-lots, offer exercise trails, mitigate flood waters, host concerts, protect wildlife, provide space for gardens, give a respite from commotion, and provide community space. The real estate market consistently demonstrates that property value increases with proximity to a park. The higher value of these residences means that their owners pay higher property taxes. Recent research shows that if the incremental amount of taxes paid by each property which is attributable to the presence of a nearby park is aggregated, it is often sufficient to pay the annual debt charges required to acquire and develop the park. This process of capitalization of park land into the value of nearby properties is termed the "proximate principle."[57]

In FY2001, the City of San Diego spent over $100 million on parks, including capital expenses and maintenance. However, the spending is to a large extent determined by the vast acreage of parks that the City maintains and builds. It is endowed with the heritage of Balboa Park, beaches and canyons (see Figure 23). In fact, San Diego has the largest acreage of parks among any city in California (31.87 acres/1000 population). As a result, San Diego has the second highest proportion of the City's land devoted to parks (18.8 percent) following San Francisco (19.8 percent).[58] Figure 24 shows that compared to the vast acreage of parks, the budget appears lacking. San Diego spends the *least* per acre of park land ($2,610) of the ten largest cities in California, far below the state average ($6,442 per park acre).

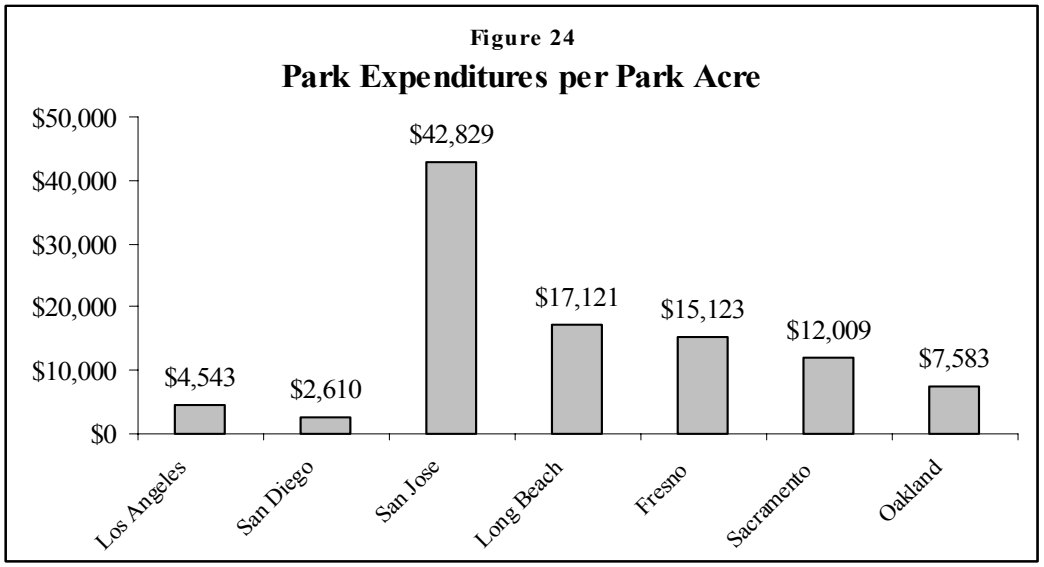
Figure 23



Sources: *Inside Parks* (2002): Urban Land Institute and The Excellent City Park System (2003): The Trust for Public Land. Data on San Francisco, Anaheim and Santa Ana was not available.

[56] The Trust for Public Land (2003). *The Excellent Park System.*
[57] Crompton, John L. (2001). "The Impact of Parks on Property Values: A Review of the Empirical Evidence." *Journal of Leisure Research,* January 01, 2001.
[58] *Ibid.,* Appendix IV.

Figure 24



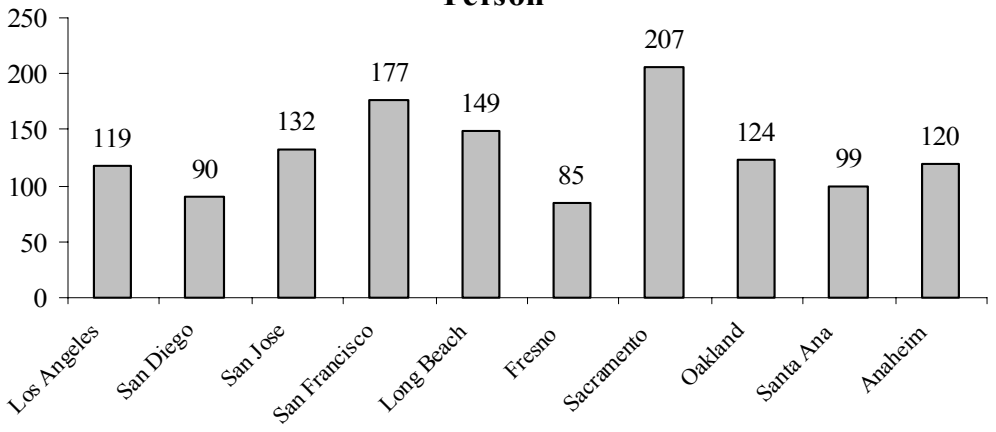
Sources: The acreage and adjusted spending are from *Inside Parks* (2002): Urban Land Institute and The Excellent City Park System (2003): The Trust for Public Land. The Adjusted Park Expenditures are for FY2001, except San Jose (FY2002). All expenditures are for Cities, except Oakland where the parks are operated on a regional basis. They consist of the agency's actual operating expenses plus its actual capital expenses, minus all expenses associated with museums, stadiums, zoos or aquariums. Data on San Francisco, Santa Ana and Anaheim was not available.

Streets, Highways and Storm Drains

For consistency of comparison amongst all cities, we have used only the total governmental expenditures on streets, highways and storm drains. This analysis does not include expenditures by business improvement districts, maintenance assessment districts and other enterprise funds since method of levy varies district-by-district and the accounting procedures differ for different jurisdictions. Further research and analysis is required to get a more complete and accurate picture of comparative expenditures on streets and other infrastructure.

Figure 25

Streets, Highways and Storm Drain Expenditures per Person



Sources: Data on General Revenues from the California State Controller (2005), Cities Annual Report, 93rd ed using FY2002-03 financial statements. Data on population from 2002 US Census estimates (extracted from RAND).

The City of San Diego has to maintain, clean and repair of over 3,000 miles of streets, 4,000 miles of sidewalks.[59] In addition, it repairs over 3,000 potholes and installs hundreds of streetlights every year.[60] Still, it ranks among the lowest in its expenditures for streets, highways and storm-drains per household amongst the ten largest cities in California. According to Planning Department estimates in 2002, there were $1.8 billion in estimated needs for transportation and streets, which includes capital fund expenses[61].

[59] This is an approximate estimate is based on the City of San Diego FY1990 budget which stated that there were 2,810 miles of streets and 3,670 miles of sidewalks. Based on the FY1980 budget, the growth over the 1980-1990 period was 25.9% for streets and 32.5% for sidewalks.

[60] See the FY2004 Budget for the City of San Diego for benchmarking information.

[61] Source: City of San Diego Facilities Financing Study, Kelling Northcross and Nobriga (July 3, 2002) prepared for the Strategic Framework Citizen Committee Finance Subcommittee. The Planning Department estimates are from Facilities Financing Plans for different communities in the City.

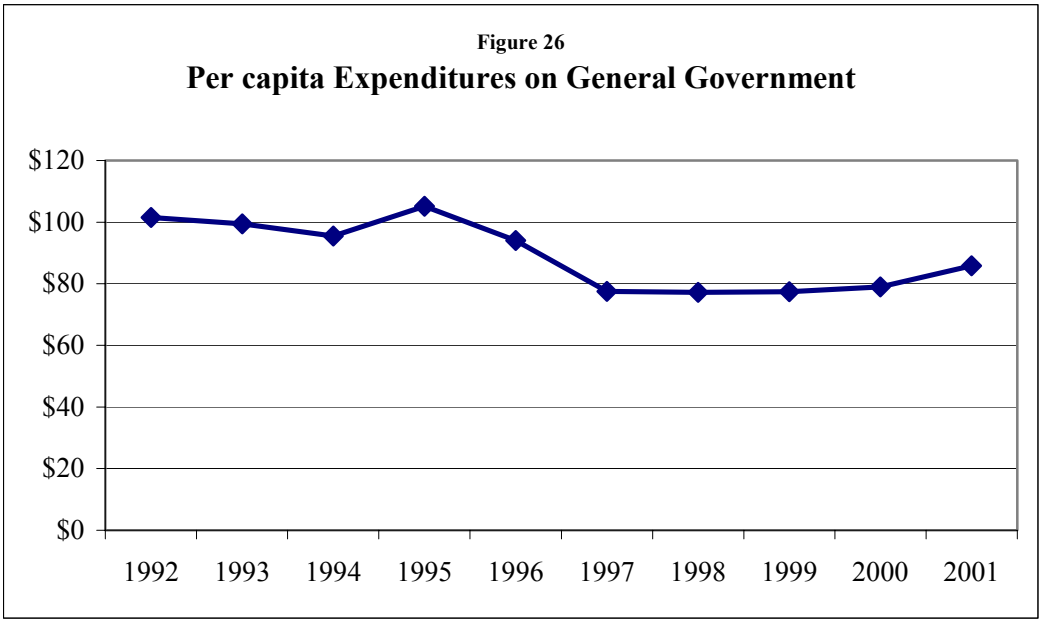
General Government Expenditures

General governmental expenses include the cost of legislation, recording of documents, responding to public inquiries, preparing budgets and financial reports, human resources, maintaining city facilities, outreach to communities, hosting venues to conduct public hearings, staffing public representatives who can address community needs, and a centralized procurement system for goods and services so that the city can negotiate bulk rates.

Over the last decade, the contribution of Special Funds, Capital Funds and other governmental funds to general government expenditures has been decreasing. Expenditures on general governmental activities were cut significantly between 1995 and 1997. There is a slight rebound to a rate that is still far lower than the early 1990s (see Figure 26). In this chart we have included all governmental fund expenditures which include the general fund, special funds and capital funds. However, we notice that during the last couple of years the General Fund absorbed most of the cost of the increase in general governmental expenditures since 1997.

Figure 26

Per capita Expenditures on General Government



Source: Governmental Fund Expenditures from the Comprehensive Annual Financial Report, FY2001. Inflation adjustment using CPI-U from the Bureau of Labor Statistics, Population estimates are from US Census, extracted from RAND.

It should be noted that although the general fund charges other funds for providing governmental services, there is considerable room for maneuvering within the funds. For example, the City of Oakland charges its enterprise funds (redevelopment agency) for a significant portion of the salaries of the Mayor, Council staff and the Manager.

CONCLUSION

This study demonstrates that the City of San Diego is not generating enough revenues to keep pace with the increased demand for services from businesses and residents. The study also finds that, rather than a minor isolated problem in the budget, the problem of revenue deficiency is pervasive at a more structural level.

The study identifies the following potential revenue sources (totaling $279 million) that have been tapped by other large cities in California, but not adequately by the City of San Diego.

- Transient Occupancy Tax, which is the lowest among the top tourism destinations ($9.9 million).
- Real Estate Transfer Tax, which is the lowest among the ten largest cities ($41.4 million).
- Business License Fees, which are the lowest for any type or size of business among the ten largest cities ($60.9 million).
- Utility user's fees which are currently not levied at all ($112.6 million) and refuse collection fees ($54.3 million).

This lack of revenue has had a significant impact on the City's ability to provide general services. This study found the following alarming indicators:

- We have 20 percent fewer police officers per 1,000 residents than the average California city.
- Although we have been exposed to large fires of regional scale, we have the lowest per capita expenditure on firefighters and firefighting equipment of any other large city in California.
- San Diego has the highest ratio of books to librarians of the largest cities in California.
- San Diego spends the least per acre of park land ($2,610) of the ten largest cities in California, far below the state average ($6,442).
- Only Fresno ($90) spends less per capita on streets, highways and storm drains than San Diego ($85).

In order to move the city out of its fiscal crises and into a healthy state, we recommend the following:

1. **Create a public awareness campaign to inform residents and businesses on the role of city services and the need to raise funds for providing them.** There needs to be greater awareness of the role of the City's general services in the lives and functioning of individuals and businesses. This will not only educate taxpayers, it will also increase employee morale among the municipal workforce.
2. **Introduce ballot measures to raise taxes and fees at least to the average California level.** A majority voter approval is needed for increase in general taxes such as Transient Occupancy Tax, Business

License Tax, Utility Users' Tax and Real Property Transfer Tax. In order to collect refuse collection fees, a majority voter approval is needed to amend the Charter.

3. **Raise revenues through fees that can be implemented through Council ordinances**. Although Props 62 and 218 limited the ability of the city to raise taxes without voter approval, the city does have some leeway to collect fees for the cost of providing a service. For example, non-residential refuse collection fees, general service impact fees for new development and public service surcharges for certain business licenses that attract crime and/or higher traffic. Some of these may be implemented through emergency ordinances.

APPENDIX 1
Description of Taxes and Fees

Property Tax: The property tax is based upon the value of real and tangible personal property. The tax rate is constitutionally limited to one percent of the property's assessed value. For the purpose of taxation, appraised real property values are limited to 1975-76 "full-cash value" plus an annual adjustment for inflation not to exceed two percent. Property is re-assessed at current full cash value upon a change of ownership. Cities may not increase the property tax.

Sales and Use Tax: The sales tax is imposed on retailers for the privilege of selling tangible personal property in California. A use tax is imposed on purchasers whenever sales tax does not apply, such as goods purchased out of state for use in California. The state sales tax rate is 6.25 percent. In addition, a 1 local sales tax is collected by the state as part of the larger sales and use tax levied on most items for sale. It generates revenues that are returned to the local government in which the sale occurred (see Table S.1). This return of funds to the point-of-sale jurisdiction is known as the situs rule.

Business License Tax: Business License Tax is imposed on persons or entities doing business within the city. Business license taxes are most commonly based on gross receipts, but they are sometimes based on the quantity of goods produced, number of employees, number of vehicles, square footage of business or some combination of factors. In the event that a business operates in more than one city, a city may only tax that portion of the business conducted within its incorporated boundaries.

Utility User's Tax: Utility User's Tax may be imposed on the consumer (residential or commercial) of any combination of electric, gas, cable television, water, telephone and other utility services.

Transient Occupancy (Bed) Tax: A Transient Occupancy Tax is imposed on visitors staying 30 days or less in a hotel, inn, or other lodging facility. It is collected by the hotel operator from the guest.

Vehicle License Fee: The Vehicle License Fee (VLF) is really a local tax, originally collected as a personal property tax. In 1935, the legislature provided for a statewide collection and remittance process. The fee was then 1.75 percent of a vehicle's value, approximately equal to the local property 2 percent percent of a vehicle's value. The value is determined based on a depreciation schedule.

Water and Sewer Charges: These are enterprise funds, managed as a separate business, and cannot be used to fund general services. Government Code Section 66013 expressly states that "those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed, unless a question regarding the amount of the fee or charge imposed in excess of the estimated reasonable cost of providing the services or materials is submitted to, and approved by, a popular vote of two-thirds of those electors voting on the issue."

Construction Permit Fees: These are fees charged for plan checks, inspections; electrical, mechanical and structural permits; variances, subdivision maps, environmental documents; and policy changes (rezones, plan amendments). California Government Code Section 66014(a) prohibits those fees from exceeding the estimated reasonable cost of providing the service for which the fee is charged, unless approved by a two-thirds vote.

Sources:

(a) Institute for Local Self Government (2004). *Municipal Finance Quick Reference.*
(b) Lewis, Paul and Barbour, Elisa (1999). *California Cities and the Local Sales Tax*, Public Policy Institute of California.
(c) Institute for Local Self Government (2003). "The Fiscal Condition of California Cities" prepared by Charles Summerell.

Appendix 2
Methodology for Calculating the Business License Tax

Los Angeles
Source: Business Tax Booklet, City of Los Angeles Information, Business and Other Taxes (January 2005).

Businesses are taxed at varying rates based on the type of business activity. For example:

RETAIL SALES Includes grocery stores, drug stores, hardware stores, clothing stores, and restaurants.
Tax Rate: $110.86 for the first $75,000 or less of gross receipts plus $1.48 per $1,000 or fractional part thereof in excess of $75,000.

PROFESSIONS AND OCCUPATIONS BUSINESSES: Includes attorneys, dentists, barbers, and auto mechanics.
Tax Rate: $106.43 for the first $18,000 or less of gross receipts plus $5.91 for each additional $1,000 or fractional part thereof in excess of $18,000.

MULTIMEDIA BUSINESSES: $118.25 for the first $100,000 or less of gross receipts plus $1.18 per $1,000 or fractional part thereof in excess of $100,000.

RENTAL OF DWELLING UNITS: Covers persons who are engaged in the business of conducting or operating a hotel, rooming house, apartment house, or other dwelling units.
Tax Rate: $110.86 for the first $75,000 or less of gross receipts plus $1.48 per $1,000 or fractional part thereof in excess of $75,000.

MISCELLANEOUS SERVICES: Advertising agency, aircraft support contractor, apparel subcontractor, bookbinder, check cashing service, drapery subcontractor, public relations agency, refuse contractor, shoe shining stand or parlor operator, silk screen apparel subcontractor, temporary help agency, ticket sellers, travel agency, typesetter or wire terminator.
Tax Rate: $49.67 for the first $12,000 or less of gross receipts plus $4.14 per $1,000 or fractional part thereof in excess of $12,000.

CONTRACTOR: Persons engaged in the business of constructing, altering, repairing, or demolishing any building, highway, road or other structure.
Tax Rate: $177.38 for the first $60,000 or less of gross receipts plus $1.18 per $1,000 or fractional part thereof in excess of $60,000. In-City Contractor pays an additional $2.96 per $1,000 or fraction of all salaries and fees paid for services rendered in the City in connection with out-of-city projects.

There is a small business exemption for businesses with gross revenues of $50,000 or less. Furthermore, there is a new business exemption (there is no tax for the first year of doing business). The following calculation assumes an ongoing business, not a new business. For the construction company, all construction work is assumed to be conducted within the city (otherwise the tax rate would be higher). There is no cap.

Business License Tax for Sample Businesses in Los Angeles:

Business Description	Calculation	Annual Tax
Retail shop of $1 million sales with two employees	$110.86 + $1.48 x ($1,000,000-$75,000)/$1,000	$1,480
Professional services of $15 million revenue with 60 employees	$106.43 + $5.91 x ($15,000,000-$18,000)/$1,000	$88,650
Restaurant group with $36 million in revenues and 850 employees	$110.86 + $1.48 x ($36,000,000-$75,000)/$1,000	$53,280
Hotel with $50 million in revenues and 600 employees	$110.86 + $1.48 x ($50,000,000-$75,000)/$1,000	$74,000
Large construction company with $500 million in revenue and 800 employees	$177.38 + $1.18 x ($500,000,000-$60,000)/$1,000	$590,107
Multimedia/High Tech company with $6 billion in revenues and 4,500 employees	$118.25 + $1.18 x ($6,000,000,000-$100,000)/$1,000	$7,080,000

San Diego

Source: City of San Diego Municipal Code Article 31.0301

The Business License Tax for the City of San Diego is determined by the number of employees in the business. All businesses pay an application renewal fee of $25. In addition to the renewal fee, businesses with 12 or fewer employees pay a fee of $34. Businesses are charged $125 plus $5 for each additional employee for a business with 13 employees or more. There is no cap on the tax that can be levied on businesses within the city.

Business License Tax for Sample Businesses in San Diego:

Business Description	Calculation	Annual Tax
Retail shop of $1 million sales with two employees	Small business rate ($34)	$34
Professional services of $15 million revenue with 60 employees	$125 + (60-12)x$5	$365
Restaurant group with $36 million in revenues and 850 employees	$125 + (850-12)x$5	$4,315
Hotel with $50 million in revenues and 600 employees	$125 + (600-12)x$5	$3,065
Large construction company with $500 million in revenue and 800 employees	$125 + (800-12)x$5	$4,065
Multimedia/Hi tech company with $6 billion in revenues and 4,500 employees	$125 + (4,500-12)x$5	$22,565

San Jose

Sources:
City of San Jose Office of Economic Development. *Guide to Doing Business in San Jose*;
The City of San Jose, Treasury Division. *Going Into Business in San Jose.*

Like San Diego, San Jose determines the size of the business license tax by the number of employees in the business. Businesses with up to eight employees (including owners) pay $150. In addition, businesses with more than eight employees pay $18 per person (also including owners) for the number of employees exceeding eight. The business license tax cannot exceed $25,000.

Type Of Business	Annual Tax	Additional Tax Increments	Not To Exceed
Residential Landlords	$150 up to 30 units	$5 per unit over 30	$5,000
Commercial Landlords	$150 up to 15,000 sq. ft.	$.01 per sq. ft. over15,000	$5,000
Mobile Home Parks	$150 up to 30 lots	$5 per lot over 30	$5,000
All other Businesses	$150 up to eight (owners + employees)	$18 per person over eight (owners + employees)	$25,000

Business License Tax for Sample Businesses in San Jose:

Business Description	Calculation	Annual Tax
Retail shop of $1 million sales with two employees	Small business rate ($150)	$150
Professional services of $15 million revenue with 60 employees	$150 + $18x(60-8)	$1,086
Restaurant group with $36 million in revenues and 850 employees	$150 + $18x(850-8)	$15,306
Hotel with $50 million in revenues and 600 employees	$150 + $18x(600-8)	$10,806
Large construction company with $500 million in revenue and 800 employees	$150 + $18x(800-8)	$14,406
Multimedia/Hi tech company with $6 billion in revenues and 4,500 employees	$150 + $18x(4,500-8) ($25,000 cap)	$25,000

San Francisco
Source: City and County of San Francisco Office of Treasurer and Tax Collector.

The Business License Tax is based on a company's payroll. Businesses are charged 1.5 percent of their payroll in addition to the registration fee. Businesses with payrolls of less than $66.67 will pay less than $1.00 in payroll tax on top of the $25.00 registration fee. For businesses with payrolls between $66.67 and $666,666.66, the annual tax will range from $1.00 to $10,000 (1.5% of payroll) plus a registration fee of $150. If the payroll ranges from $666,666.67 - $3,333,333.33, then the registration fee is $250 plus 1.5 percent of payroll. If the payroll is $3,333,333.34 or higher, the registration fee is $500 and the annual license fee is 1.5 percent of payroll. There is no cap on the Business License Tax.

ESTIMATED PAYROLL (or no employees)	ESTIMATED TAX DUE ON PAYROLL EXPENSE	REGISTRATION FEE
Less than $66.67	Less than $1.00	$25
$66.67 - $666,666.66	$1.00 - $10,000	$150
$666,666.67 - $3,333,333.33	$10,001 - $50,000	$250
$3,333,333.34 or Higher	$50,001 and over	$500

Business License Tax for Sample Businesses in San Francisco:

Business Description	Payroll (Wages and Salaries from Bizstats.com)	Annual Tax
Retail shop of $1 million sales with two employees	$62,903 (Retailing - Clothing and Accessories)	$943
Professional services of $15 million revenue with 60 employees	$889,329 (Services – Engineering)	$13,340
Restaurant group with $36 million in revenues and 850 employees	$5,554,287 (Retailing – Restaurants & Drinking Places)	$83,314
Hotel with $50 million in revenues and 600 employees	$5,346,127 (Other Services – Hotels and Inns)	$80,192
Large construction company with $500 million in revenue and 800 employees	$16,971,770 (Construction – Residential Buildings)	$254,577
Multimedia/Hi tech company with $6 billion in revenues and 4,500 employees	$139,669,116 (Services – Information & Data Processing)	$2,095,037

Appendix 3
Data for Revenues from Construction Permits

City	Source	Amount	Notes
Los Angeles	CAFR FY2001 p.101	$56,862,000	Expenditures on Building and Safety (revenues not available)
San Diego	CAFR FY2001 p.101	$36,368,000	Charges for Services: Revenues from Development Services Enterprise Fund
San Jose	CAFR FY2001 p.86 Ex III	$22,704,877	General fund revenues from construction permits
San Francisco	CAFR FY2001 p.118	$30,881,000	Revenues of the Building Inspection Fund
Long Beach	Budget FY2004 Section 9 Part 7	$8,118,836	Building Bureau permit license revenue for 2002.
Fresno	CAFR FY1999 p.47	$7,213,307	Operating revenues for development services.
Sacramento	CAFR FY2001 p.14	$13,774,000	Planning and Development Department charges for services
Oakland	Budget FY2001-03	$9,117,360	Construction permits constitute 80.4% (p. D-18) of revenues from $11.34 million in permits (p. D-28).

Data for Anaheim and Santa Ana was not reliable as construction activity is very low, and the permitting function is not easily distinguishable, and therefore was not included.

Appendix 4
Methodology for Computing General Service Expenditures

Functional Activity	Total Expenditures[62]	Functional Revenues	Net Expenditures	Per Capita Net Expenditures per month
Legislative	$38,751,612	-	$38,751,612	$2.64
Management and Support	$115,472,218	$47,681,337	$67,790,881	$4.63
Police	$303,029,471	$79,655,708	$223,373,763	$15.25
Fire	$135,940,901	$20,689,054	$115,251,847	$7.87
Streets, Highways and Storm Drains	$112,906,254	$110,854,709	$2,060,545	$0.14
Libraries	$44,768,280	$6,165,500	$38,602,780	$2.64

Sources: Expenditure data from the 93rd Cities Annual Report, FY2002-03, Statement of Expenditures for San Diego, 433.
Population data is from the 2003 American Community Survey (US Census Bureau).

[62] Total Expenditures include Operating Expenditures and the Capital Outlay.