OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

REVIEW OF MAYOR'S FIVE-YEAR FINANCIAL OUTLOOK FISCAL YEARS 2008 – 2012

Part II. Mayor's Eight Significant Areas

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Report Overview

The Mayor's Five-Year Financial Outlook for Fiscal Years 2008-2012 was presented at the November 29, 2006 Budget and Finance Committee meeting. This Financial Outlook represents a view of the City's long range fiscal condition and fiscal challenges for the next five years. The Financial Outlook identifies the Mayor's priorities that he hopes or plans to address during Fiscal Years 2008-2012. These priorities are identified in the Financial Outlook as the eight significant areas.

This IBA report provides a review of the Mayor's eight significant areas. As stated in IBA Report 07-6, the IBA will examine all areas of the Mayor's Financial Outlook which will include: General Fund revenues and expenditures; the eight significant areas; and possible solutions to balance the budget. The IBA will also be examining possible new and increased fees, which are not contemplated in the Financial Outlook.

Discussion of the Eight Significant Areas

I. Pension System – Annual Required Contribution (ARC) Plus

The Financial Outlook identifies the Retirement System as one of the eight significant areas, reflecting the substantial role the System has played in the City of San Diego's recent financial history. As presented in the Financial Outlook and reinforced in IBA Report 07-6, the base expenditure projections already include the payment of the full ARC, including previously unfunded contingent liabilities. This is consistent with applicable law as well as industry best practices.

However, the Financial Outlook also suggests addressing this liability in a much more aggressive fashion, beyond payment of the ARC. Labeled "ARC Plus," the Financial Outlook proposes to pay additional funds into the system beginning in Fiscal Year 2008 such that there is no negative amortization of the UAAL principal. Thus, the UAAL is fully paid down in 20 years, rather than the 27 years anticipated under the current amortization schedule. This goal requires the infusion of an additional $27 million each year ($20.8 million additional General Fund contribution). According to Attachment I of the Financial Outlook, this infusion of $540 million over 20 years will save the City over $1.1 billion in interest costs. Based on the same proportionate share as above, this represents interest savings of over $847 million in the General Fund over the amortization period.

This plan has clear financial advantages: it saves the City a significant amount of money over 20 years. However, seeking solely to save money through the acceleration of the amortization period is not necessarily a prudent approach. Amortization serves a valuable function in that it enables persons or entities to pay down a debt over an extended, but sensible period of time. Amortizing a debt typically involves additional costs in the form of interest, and a debtor will save money over the long-term by reducing the amortization period. Yet it is neither prudent nor practical to reduce financing costs to zero, which would essentially mean paying for all commodities in cash, and forgoing the benefit of amortization. In the City's case, every step taken to reduce the financing costs will require expenditure reductions in other areas, and may equate to a reduction in other City services. In the proposal presented in the Financial Outlook, the City will have to reduce $20.8 million in the General Fund each year to avoid some of these financing costs. As a point of comparison, $20.8 million is nearly two-thirds of the Library Department or about one-quarter of the Park and Recreation Department. A decision to implement this plan and save on financing costs could come at the expense of reduced services to citizens.

While simply allocating additional funds to the Retirement System in order to reduce financing costs over the long-term may be somewhat arbitrary, the Financial Outlook proposes to achieve a specific policy goal through this plan: the avoidance of negative amortization of the UAAL. The phenomenon of negative amortization in the early years of the schedule is acceptable in pension system practices and by the Governmental Accounting Standards Board (GASB). This is reinforced in SDCERS' June 30, 2005 valuation in which the actuary states, "This expected increase in the UAL in the early years is an acceptable and common method used by many public sector retirement systems, and specifically accepted by GASB in Statement No. 25" (p. 4). Additionally, during the presentation on January 19, 2007 regarding the valuation, the SDCERS' actuary presented projections of the future system liabilities and assets. Based on the adopted assumptions, the UAAL does continue to grow, as anticipated in the Financial Outlook. However, the projection shows that the funded ratio of the trust, the measure of assets as a percentage of liabilities, continues to improve. In fact, the projection shows an improvement of 1-2% each year, if actuarial assumptions are met. The funded ratio is a valuable measure of the trust's ability to meet its obligations, and despite negative amortization, this is expected to improve continuously as shown. Given this, and the statements regarding negative amortization by the actuary, the IBA does not recommend undue focus on this funding phenomenon. Nevertheless, the presence of negative amortization has caused consternation among some members of the public. Thus, while there are no legal requirements or practices that would induce the City to implement this plan, we recognize that it may be desirable to some to "go above and beyond" with regard to paying down the Retirement System UAAL.

In selecting an accelerated payment plan, the IBA finds the 20 year amortization a reasonable goal for consideration, in that it is a prudent amortization period and it achieves a policy goal that may be desirable to the public and elected officials. However, the true value of the ARC Plus plan cannot ultimately be judged until it is apparent what services to the citizens or opportunities to address some of the City's many other pressing needs will be foregone by diverting funds to an optional accelerated UAAL payment plan. Additionally, based on the actuarial valuation for June 30, 2006, the City's ARC will be much lower in FY 2008 than anticipated in the Financial Outlook. Thus, ARC Plus would also be lower, and the remaining deficit projected in the Financial Outlook for FY08 would be essentially eliminated if all of the proposed "solutions" remained intact.

The IBA would not support the restoration of service levels through elimination of the ARC Plus plan and creation of a surplus in FY 2008. However, given the information above, we believe the City Council should consider competing needs, such as taking an even more aggressive funding approach to Storm Water compliance, ADA compliance, and other deferred maintenance above this discretionary plan for the pension liability. Based on the above, as well as the following sections regarding the other seven areas of importance, the IBA believes that the ARC Plus plan is the most discretionary of the funding proposals outlined in the Eight Significant Areas.

II. Reserves

Establishing and maintaining a General Fund Reserve level that is sufficient to address unforeseen contingencies such as natural disasters, catastrophic occurrences, or excess liabilities or judgments against the City has proven challenging given recent fiscal constraints.

Rating agencies view formalized, well-defined operating reserve policies, and the ability to historically adhere to them, as an integral factor in the credit rating process of a governmental entity. Specifically, Standard & Poor's includes "Reserves and Liquidity Policies" as one of its seven financial practices likely to affect credit quality (Financial Management Assessment, August

2006). The evaluation of each of these areas focuses on best practices and policies that are credit-important in most governments. Entities that rank well in the evaluation of these areas are those whose policies help reduce the likelihood of credit deterioration, or enable them to benefit more from changing conditions, whether they are economic, budgetary, statutory, or personnel related.

As stated in the Financial Outlook, the City maintains several reserves for its operations. Reserves supporting General Fund operations include the Allocated Reserve, used to carry forward funds for specific projects, and the Unappropriated Reserve, established to fund major General Fund emergencies. Currently, all unanticipated General Fund expenditures are proposed for funding from the City's reserve, with many items not truly of an emergency nature.

Funding of all reserves (including Public Liability and Workers' Compensation) should be viewed collectively. Adequate funding of the Public Liability and Workers' Compensation reserves would reduce the reliance on the General Fund Unallocated Reserves for these types of expenditures on a regular basis.

Many other government agencies have various types of reserves, including contingency reserves, "deep" reserves, emergency reserves, budget stabilization reserves, etc. Often each reserve may have a targeted level of funding. The City may want to consider creating more than one General Fund reserve, with specific criteria for the funding and use of each.

The City Council adopted a reserve policy in October 2002 providing for a General Fund Reserve at a minimum of three percent of annual General Fund revenues, and defines a goal of a five percent reserve to be achieved by 2014. Although not always adhered to, the Council Policy suggests that when General Fund revenues increase by at least two percent, an increase in the General Fund Reserve equal to ten percent of any General Fund revenue increase in excess of two percent should be included in the budget.

In November 2006, the City's Chief Financial Officer (CFO) provided information to the Budget & Finance Committee for a Proposed Reserve Policy, describing objectives, approaches, and issues related to authority, for various City funds, including the General Fund. It is anticipated that more work will occur in the months ahead to adopt a revised reserve policy. As part of this process, it will be important to determine the types and uses of reserve accounts, appropriate reserve levels, and criteria or conditions for the use of reserve funds.

The Financial Outlook assumes that the City will continue to work towards the goal of reaching a General Fund Unappropriated Reserve level equal to eight percent of the General Fund operating budget by Fiscal Year 2012.

It should be noted that increasing the reserve to the eight percent level is a sound but discretionary action, and a range of options should be considered to determine the appropriateness of increasing the funding to the reserve, possibly at the expense of providing funding for other significant areas.

Shown in the table below are the annual amounts shown in the Financial Outlook to achieve the eight percent level by Fiscal Year 2012, as well as annual amounts needed to instead maintain the reserve at six percent, as an alternative option. Using this alternative, funds varying from $5-7 million annually would be available for programming for other purposes.

	Financial Outlook		Alternative Option		
	% of Gen Fund	Annual Increase	% of Gen Fund	Annual Increase	Approx Available
FY 2008	6.0%	$7.4 million	6.0%	$7.4 million	-
FY 2009	6.5%	$8.5 million	6.0%	$1.5 million	$7.0 million
FY 2010	7.0%	$6.8 million	6.0%	$1.8 million	$5.0 million
FY 2011	7.5%	$7.4 million	6.0%	$1.8 million	$5.6 million
FY 2012	8.0%	$7.7 million	6.0%	$1.9 million	$5.8 million

Based on Fiscal Year 2007 year-end estimates, the total projected ending balance is estimated to reach $61.7 million, which represents 6% of the Fiscal Year 2007 General Fund budget.

The Government Finance Officers Association (GFOA) recommends that cities maintain a General Fund reserve of a least 5 – 15% of general fund revenues, which would include all reserve needs. The Mayor’s proposed level of General Fund reserves of eight percent is well within this range.

The IBA will provide a formal review of the proposed Reserves Policy once it is finalized and submitted to the City Council. In the meantime, the IBA supports efforts to increase funding levels of the General Fund reserves, coupled with the Reserves Policy to govern the appropriate and prudent uses thereof. However, an eye should be kept on what the impact will be of increasing this funding category, on other critical areas.

III. Deferred Maintenance/Capital Improvements

One of the key issues for the City of San Diego to regain strong fiscal health is to fund deferred maintenance. It is also important for the City to address the existing capital improvement needs. According to the Financial Outlook, the City’s deferred maintenance/capital needs, excluding those of Water and Wastewater, is estimated to be at least $800 to $900 million as a result of years of under funding. However, preliminary data from an inventory currently underway indicates the number may be lower. The Mayor has included additional funding for deferred maintenance and capital improvement needs in the Financial Outlook by utilizing a combination of cash and financings. The proposed cash flow requirements for deferred maintenance/capital improvements over the five-year period, using the combined “pay-as-you-go” and financing methods, total $297 million. This will generate $578 million in funding for deferred maintenance/capital improvements over the next five years. The Financial Outlook does not specify the projects that will receive the proposed funding for Fiscal Years 2008-2012.

As previously noted, the Mayor's Office is in the process of completing an inventory of all deferred maintenance/capital improvement needs. The City Council needs the inventory and prioritization list as soon as possible for effective budget decision making. It is important to identify and prioritize all needs to ensure they receive full consideration during the budget process. On January 17, 2007, the City Council adopted a Council Policy for Prioritizing Transportation CIP Projects. It is imperative that the Mayor's Office continue to work towards a prioritization process that addresses City-wide CIP projects.

In addition to establishing a plan that addresses the backlog of deferred maintenance in the City, it is important to address current maintenance needs to avoid "growing" the backlog. Funding for ongoing, systematic preventative maintenance should be seriously considered. The longer maintenance is deferred, the more costly the repairs will be. While the Mayor has begun to address the deferred maintenance backlog in the Financial Outlook by making this a funding priority for the City, there is no strategy to address the ongoing systematic maintenance requirements.

The Financial Outlook also states that there are practical limits on how much work can be handled in any given fiscal year. The City should carefully evaluate and determine how many projects can be logistically accomplished each year. Furthermore, staffing requirements of carrying out projects need to be determined.

As stated in IBA Report 06-36, due to the complexity of the CIP and the difficult decisions that will be necessary during the CIP assessment, prioritization and budget processes, it is suggested that the Mayor's Office consider assigning executive level management oversight of the City's CIP to serve a critical function in overall citywide CIP coordination and management.

Finally, citizen involvement is also an integral part of both the operating and capital budgeting processes. A CIP Budget Hearing will be held as part of this year's budget process to allow for public input. New opportunities for citizen involvement in future CIP processes should also be explored.

IV. Other Post-Employment Benefits (OPEB)

As discussed in IBA Report 07-6, the Financial Outlook includes the minimum required payment of Retiree Health obligations on a pay-as-you-go basis as a baseline assumption. The Financial Outlook also identifies the retiree health liability as one of the eight significant areas for aggressive action. The Fiscal Year 2007 budget established a Trust Fund of $5 million for this purpose. The proposal suggests contributing an additional $25 million and $50 million in Fiscal Year 2008 and 2009, respectively, into a Trust to actuarially pre-fund the expected liability. The Financial Outlook further assumes that the ARC, expected to be $75 million, will be paid in-full beginning in Fiscal Year 2010.

The IBA concurs with a plan to begin pre-funding the retiree health liability. As we emphasized in IBA Report 06-18, it is expected that municipalities will begin to address these liabilities in some manner, not just report them as required by GASB. Since the GASB requirement is just taking effect, and most municipalities have not yet valued their liability, or begun pre-funding it, there is little in the way of best practices, industry standards or advisory recommendations to guide the City of San Diego in implementing a prudent plan to pre-fund this liability. Truly, the City will be a leader in this area.

The plan in the Financial Outlook assumes ramping up the retiree health payment over three years, until the full ARC is paid in 2010 and beyond. This is a very aggressive schedule that is admirable and will reduce interest costs over the long term, as discussed in the section on retirement. Yet there are areas of exposure with the plan as described in the Financial Outlook. First, while the schedule to ramp-up pre-funding of the liability is aggressive, based on the data available to us, we do not agree that the City will be paying the full ARC by 2010. If the City uses a 30 year amortization, the ARC would have been $160 million in Fiscal Year 2006 at an assumed investment rate of return of four percent (the current assumption), or over $128 million in Fiscal Year 2008 at six percent return. While the infusion of $75 million into the Trust in Fiscal Years 2008 and 2009 will enable new investment returns, we question the rate of investment return that must be assumed in the Financial Outlook to reduce the ARC to just $75 million in 2010. The IBA suggests that more actuarial data is necessary to substantiate the assumptions in the Financial Outlook for the Retiree Health ARC.

Secondly, each year the full ARC is not paid, the UAAL for retiree healthcare grows, depending on the actuarial assumptions used. If it is true that this plan does not actually pay the full ARC, the City will have to report this on its financial statements and incur additional interest on the principal that is unpaid. We emphasize again that the City is not required to pay the retiree healthcare ARC, as it is required to do for the retirement system. Yet the IBA suggests that the City place a priority on achieving the retiree healthcare ARC, in order to implement a plan to fully write-down the retiree healthcare UAAL over time, above a plan to reduce the time horizon for paying down the pension UAAL. In other words, we believe it is more valuable to have a plan in place for both liabilities, before pursuing a more aggressive plan for one.

Notwithstanding the actual amount of the ARC in a given year, the aggressive ramp-up in retiree health pre-funding is a critical financial goal and is strongly supported by this office. The IBA suggests that, as the Financial Outlook is updated over time, staff report on practices by municipalities and recommendations by advisory organizations that may be developed in the future to ensure that the City's practices are sensible and prudent.

V. Storm Water Compliance

The Financial Outlook identifies Storm Water Compliance as one of the eight significant areas that are addressed. The City of San Diego, along with other governmental agencies within San Diego County, discharges storm water under the Municipal Storm Water Permit for the San Diego Region. The Storm Water Permit, issued by the San Diego Regional Water Quality Control Board (Regional Control Board), requires that the City comply with certain requirements and adopt best management practices in order to reduce pollution in storm water runoff.

The Financial Outlook includes a cumulative $164.7 million in increased expenditure requirements over the five-year period in order to maintain compliance with the Storm Water Permit. The Storm Water Pollution Prevention (SWPP) Division is responsible for implementing and enforcing the Storm Water Permit and reducing pollution that flows to our beaches and bays through activities such as public education, employee training, industrial and commercial storm water inspections, storm water code compliance and enforcement, water quality monitoring, and watershed planning.

The Storm Water Permit was originally issued in 1990 and subsequently revised in 2001 to include more stringent requirements. The Regional Control Board is currently in the process of renewing the Permit once again, and it is anticipated that the upcoming revision will again add significant new requirements, which will become effective July 1, 2007. The identified funding requirements for the SWPP Division in the Financial Outlook anticipate new and additional requirements under the revised Permit.

We commend the Financial Outlook for identifying and including the estimated Storm Water Permit requirements and costs attributable to the SWPP Division. Previous fiscal years only identified a portion of the funding needed; whereas the Financial Outlook will provide a significant increase in funding that will enable the SWPP Division to implement the necessary requirements. However, there are two issues that we would like to point out.

First, the new Municipal Permit will likely include increased requirements for several departments throughout the City, and it is unclear whether additional cost estimates have been included in the Financial Outlook for these departments. A preliminary assessment indicates that the new Permit will place additional burdens on departments such as Street Division (General Services), Metropolitan Wastewater, Development Services and Engineering and Capital Projects. Further discussion of the requirements under the new permit may be necessary to ensure that the full cost of compliance is included for all impacted departments.

Second, while identification and inclusion of Permit compliance costs is a positive first step, the second – and perhaps more crucial – step is to identify the revenues needed to fund those required costs. The City's Urban Runoff Management Program (URMP) Plan, required by the 2001 revision to the Municipal Permit and approved by City Council in January 2002, provided a comprehensive plan for how the City was to comply with all Permit requirements over a five-year period. However, the URMP was not fully implemented since a sufficient funding source was never identified. Currently, the primary source of funding for permit compliance is the General Fund. With competing priorities for resources (i.e. public safety, deferred maintenance), the identification of a dedicated funding source would ensure long term funding for this significant mandate.

To address the two issues discussed above, the IBA suggests that the URMP be updated to reflect the new requirements imposed by the current revisions to the Municipal Permit. This will ensure that Storm Water Compliance is considered from a more global perspective, including the new and increased Permit requirements for all City departments. Furthermore, it is imperative that a dedicated funding source sufficient to address the City's requirements be identified and implemented.

VI. Americans with Disabilities Act

The **Americans with Disabilities Act of 1990 (ADA)** addresses the right of people with disabilities to obtain equal access to services, programs, buildings, facilities and employment. The law has far reaching impacts on local jurisdictions both architecturally and programmatically. The City of San Diego has utilized Community Development Block Grant Funds (CDBG) as the primary funding source for retrofitting non-compliant public infrastructure. In part, the law requires local jurisdictions to make all public infrastructure physically accessible to people with disabilities.

The ADA originally called for jurisdictions to complete this effort by 1995. However, the federal government recognized that the cost and burden of meeting that deadline could be extraordinarily burdensome for some jurisdictions. As such, all cities are required to have a "Transition Plan" which documents non-compliant facilities and infrastructure and plans for continued progress towards retrofitting those projects. The City is currently reviewing its transition plan to ensure that adequate and timely progress is occurring.

The process for identifying and addressing non-compliant facilities may take some time. Once all non-compliant public facilities have been identified and assessed, the City must design and construct appropriate accommodations for each facility. As the City proceeds to ramp up expenditures and construction, it could be a challenge to have sufficient dedicated project management and construction personnel to address numerous projects in a relatively short time frame. The IBA recommends the planning for the upswing in project activity begin now by clearly identifying staff resources to oversee Transition Plan progress and to also continue the monitoring of new development projects for compliance.

Federal law now states that all city programs, services and activities should have achieved ADA compliance by 2002. However, no major city in the United States has been able to achieve full compliance to date and many have yet to develop transition plans (the City adopted phase 1 of its federally mandated Transition Plan in 1997). Despite these circumstances, the City must expeditiously pursue full compliance. Cities that do not comply face possible investigation by either the Department of Justice (Who has pledged to do 11 investigations in Fiscal Year 2007 and have conducted over 150 investigations to date) or the State Attorney General. Non-compliant cities can also be sued by a citizen or have their federal grant funds withheld.

The Financial Outlook calls for stepping up the pace of ADA compliance. To some extent, the ADA funding need overlaps with the deferred maintenance category (i.e., as deferred maintenance needs are addressed and facilities are improved, ADA requirements will be addressed as well). Total ADA compliance needs are speculated to be in the hundreds of millions of dollars. The Financial Outlook includes $10 million per year for ADA related improvements, in addition to $205 million to address deferred maintenance over the Financial Outlook period. The IBA recommends that ADA improvement projects for the five-year period be identified as soon as possible to allow for advance planning of necessary design and construction activities.

The IBA commends the Mayor for his recommendation to dedicate $50 million over the next 5 years to address ADA compliance obligations. If implemented, $10 million a year represents a significant and consistent increase over the City's previous annual ADA expenditures. While the federal government is likely to view this as a positive development, it is important to note that the City has yet to comply with ADA and must spend considerably more than $50 million to achieve full compliance.

VII. Workers' Compensation Fund

As described in the Financial Outlook, workers' compensation liabilities continue to grow. Presently, the City has $150 million in outstanding workers' compensation claims and $18 million in reserves. Should the City be required to make a large payout on a claim, it would likely be a significant impact to the General Fund.

In November 2006, the CFO provided information to the Budget & Finance Committee for a Proposed Reserve Policy, describing objectives, approaches, and issues related to authority, for various City funds, including Workers' Compensation. It is anticipated that more work will occur in the months ahead to adopt a revised reserve policy. As part of this process, it will be important to determine the types and uses of reserve accounts, appropriate reserve levels, and criteria or conditions for the use of reserve funds.

The CFO has recommended that the Workers' Compensation Fund should maintain a reserve equal to no less than 50% of the value of the outstanding claims. Based on current claim levels the Workers' Compensation reserve should approximate $75 million.

Funding has been included in the Financial Outlook to begin building a Workers' Compensation reserve. Five million has been allocated in Fiscal Year 2009 and $10 million for each year thereafter for Workers' Compensation as follows:

	Financial Outlook	
	Annual Increase	Cumulative
FY 2008	$0	$18 million
FY 2009	$5 million	$23 million
FY 2010	$10 million	$33 million
FY 2011	$10 milli0n	$43 million
FY 2012	$10 million	$53 million

These amounts are in addition to the amounts budgeted each year to cover projected annual costs. The City may want to consider allocating additional resources to safety training in order to reduce annual costs associated with Workers' Compensation claims and related reserve requirements.

Many other government agencies are not self-insured (as is the City), and purchase insurance coverage for this purpose. In those cases, separate City reserves are not necessary as any need for large payouts or funding requirements would be covered by the insurance policies.

It should be noted that increasing these reserves is a discretionary action, and a range of options should be considered to determine the appropriateness of increasing the funding to the reserve, possibly at the expense of providing funding for other needs.

As with General Fund reserves, the IBA supports a sensible financial policy that addresses all of the City's reserves and sets prudent targets for funding levels.

VIII. Public Liability Fund

As described in the Financial Outlook, public liabilities fluctuate each year. Presently, the City has $100 million in potential public liability claims and $4 million in reserves. This is far short of what should be reasonably expected. Should the City be required to make a large payout on a claim, it would likely be a significant impact to the General Fund. By establishing a reasonable reserve level, the City will provide better insulation to other programs and services.

In November 2006, the CFO provided information to the Budget & Finance Committee for a Proposed Reserve Policy, describing objectives, approaches, and issues related to authority, for various City funds, including Public Liability. It is anticipated that more work will occur in the months ahead to adopt a revised reserve policy. As part of this process, it will be important to determine the types and uses of reserve accounts, appropriate reserve levels, and criteria or conditions for the use of reserve funds.

The CFO has recommended that the Public Liability Fund should maintain a reserve equal to no less than 50% of the value of the outstanding claims. Based on current claim levels, the Public Liability reserve should approximate $50 million.

Funding has been included in the Financial Outlook to begin building a Public Liability reserve. In the plan, the Public Liability Reserve will receive $5 million each year for Fiscal Years 2008, 2009, and 2010, increasing to $10 million per year thereafter.

	Financial Outlook	
	Annual Increase	Cumulative
FY 2008	$5 million	$9 million
FY 2009	$5 million	$14 million
FY 2010	$5 million	$19 million
FY 2011	$10 million	$29 million
FY 2012	$10 million	$39 million

These amounts are in addition to the amounts budgeted each year to cover projected annual costs.

Many other government agencies are not self-insured (as is the City), and purchase insurance coverage for this purpose. In those cases, separate City reserves are not necessary as any need for large payouts or funding requirements would be covered by the insurance policies.

It should be noted that increasing these reserves is a discretionary action, and a range of options should be considered to determine the appropriateness of increasing the funding to the reserve, possibly at the expense of providing funding for other needs.

As with General Fund reserves, the IBA supports a sensible financial policy that addresses all of the City's reserves and sets prudent targets for funding levels.

Conclusion

The IBA agrees that addressing each of the Mayor's Eight Significant Areas is critical to regaining fiscal health for the City of San Diego. The Mayor's Five Year Financial Outlook is the most comprehensive of its kind in recent history; and the Mayor, CFO and Financial Management staff are to be widely commended.

The Mayor has recommended funding levels for addressing each of the areas over the five-year outlook period. Each funding recommendation needs to be examined with an eye toward how it impacts the ability to fund one of the other critical areas, as well as how it may impact the provision of City services. Numerous funding scenarios are possible and should be considered. While the Mayor's recommendations are responsible and sound, alternative funding scenarios that are equally sound should be discussed from a policy and practical framework.

For example:

- Is it more important to fund ARC Plus at $199 million (or what is now "ARC Plus Plus" given recent actuarial numbers) than it is to be more aggressive in the funding of storm water compliance and ADA requirements, both of which are legal obligations?

- Should the City consider placing a higher priority on achieving the retiree health care ARC, in order to implement a plan to fully write-down the retiree health care UAAL over time, above a plan to reduce the time horizon for paying down the pension UAAL? Is it more valuable to have a plan in place for both liabilities before pursuing a more aggressive plan?

- Would it be more prudent to invest in proactive strategies to stem rising costs in some areas, e.g. funding safety officers and City-wide safety training to help reduce workers' compensation claims or implementing an ongoing systematic preventative maintenance program to avoid adding to the deferred maintenance backlog? Funding the problem addresses the symptom rather than the cause.

- Should the percentage goal of 8% for the City's reserves be reviewed holistically taking into account the City's other reserves, including the Workers' Compensation fund and the Public Liability Fund?

- Should a new dedicated funding source be considered for the Storm Water Program in order to fully implement this federally mandated program without sacrificing other general funds program and needs?

These questions are just a "snapshot" of the kinds of issues that will need to be weighed and debated over the next several months in order to arrive at the best financial decisions for the City of San Diego.

Ultimately, consensus in final funding recommendations will result from open debate and public input. Final recommendations also will rest heavily on the feasibility and desirability of the Mayor's proposed corrective actions. We will take a closer look at these solutions in our Part III. Report reviewing the Five Year Financial Outlook. In addition, further funding solutions are required to fully balance the General Fund which, when presented by the Mayor in his proposed budget, will give the City Council and the public the complete picture of the opportunity costs of each proposal.

[SIGNED]

Tom Haynes
Fiscal & Policy Analyst

[SIGNED]

Angela Means
Fiscal & Policy Analyst

[SIGNED]

Elaine DuVal
Fiscal & Policy Analyst

[SIGNED]

Jeff Kawar
Fiscal & Policy Analyst

[SIGNED]

Lisa Celaya
Fiscal & Policy Analyst

[SIGNED]

Penni Takade
Deputy Director

[SIGNED]

APPROVED: Andrea Tevlin
Independent Budget Analyst