Review of Mayor's Proposed Fiscal Year 2008 Budget

Analysis by the Office of the Independent Budget Analyst

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IBA

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Table of Contents

I. REPORT OVERVIEW
A. Discussion of Legislative Budget Process 1
B. Summary Review of Mayor's Proposed Budget 7
C. IBA Recommendations 10

II. EIGHT SIGNIFICANT AREAS
A. Pension 14
B. Retiree Health 16
C. Deferred Maintenance 17
D. Reserves 19
E. Storm Water 21
F. Americans with Disabilities Act of 1990 (ADA) 22

III. CORRECTIVE ACTIONS
A. Leveraging City Assets 25
B. Tourism Marketing District 27
C. Position Reductions 30
D. Business Process Reengineering 32
E. Managed Competition 36
F. Budget Clean-up 37
G. Summary Review of Mayor's Corrective Actions 39

IV. OTHER CITYWIDE DISCUSSIONS
A. Financial Policies and Budget Practices 40
B. Revenues 42
C. Debt Capacity 45
D. Structural Budget Deficit 47
E. Vacancies/Salary Savings 49
F. City Remediations 51
G. Service Levels 54
H. Appropriation Ordinance 57

Table of Contents

V. CITY DEPARTMENTS
A. Business and Support Services........ 60
B. City Attorney........ 62
C. City Auditor and Comptroller........ 64
D. City Clerk........ 66
E. City Council........ 67
F. City Planning and Community Investment........ 68
G. City Treasurer........ 70
H. Citywide Program Expenditures........ 71
I. Community and Legislative Services........ 73
J. Customer Services........ 74
K. Debt Management........ 75
L. Development Services........ 77
M. Engineering and Capital Projects........ 79
N. Environmental Services........ 81
O. Financial Management........ 84
P. General Services........ 85
Q. Library........ 92
R. Neighborhood Code and Compliance........ 97
S. Office of the CIO........ 99
T. Office of Ethics and Integrity........ 103
U. Park and Recreation........ 104
V. PETCO........ 109
W. Police........ 110
X. Purchasing and Contracting........ 114
Y. Qualcomm Stadium........ 115
Z. Real Estate Assets........ 116
AA. Risk Management........ 117
BB. San Diego Fire-Rescue........ 118
CC. Special Promotional Programs........ 121
DD. Wastewater........ 122
EE. Water........ 125

Report Overview

Discussion of Legislative Process

The Role of the IBA
One of the key responsibilities of the Office of the Independent Budget Analyst (IBA) is to review and comment on the Mayor's Proposed Budget, conduct analyses of the budget and recommend modifications to the City Council. This first report, which is our Preliminary Report, along with the Mayor's budget, provides a framework for Council deliberations throughout the community hearing process. Our Final Report, to be issued on June 1, 2007, will focus on final recommended changes to the Mayor's Proposed Budget for City Council consideration after we have had an opportunity to carefully consider input from the public; comments from Council members; Mayor's Office responses to various issues; and conduct further IBA review and analysis.

The primary goals of our Preliminary Report are twofold:

To ensure that the residents of our community have the information they need to understand the proposed budget, and be in a position to form opinions and express those opinions, if they so desire.

To ensure that the members of the City Council, as the Legislative branch of this community, have the information they need to make fully informed and responsible decisions relative to the proposed budget.

It is not our intent to duplicate existing information or to recreate information provided by the Chief Financial Officer (CFO). Rather, it is our goal to add value to the budget process by providing new information; clarifying existing information; identifying issues for further discussion; and, in some cases, proposing alternative approaches to the budget. Most importantly, it is our goal to provide an independent voice in the development of the Fiscal Year 2008 budget. **To ensure that independence, our office did not participate in the strategy, the development or decision-making related to the Mayor's Proposed Budget**.

This report is composed of the following sections: Report Overview; Eight Significant Areas; Corrective Actions; Other Citywide Discussions and City Departments. It should be noted that while we reviewed all City departments and programs, we did not find it necessary to include them all in our report.

How Did We Approach Our Review of the Mayor's FY 2008 Proposed Budget?
Our review of the Mayor's Proposed Budget focuses on policy analysis; technical budget accuracy; best budgeting and financial practices; legal requirements; clarity and transparency for the public; documentation and justification of proposals; potential community and employee impacts; and legislative/community priorities.

The following overriding principles guide our work:

- The underlying accounting concept of conservatism.
- Adherence to best budgeting and financial practices.
- Prior legislative review and authorization of significant budget proposals.
- The probability of an outcome of a budget proposal.
- Accurate and honest representation of budget proposals.
- Ensuring that problems are not pushed off to the future.

We applied these principles to our review of all significant issues in the Mayor's Proposed Budget.

As part of our technical review of each City department, we examine the following for accuracy,

Discussion of Legislative Process (cont.)

potential impacts, consistency and possible modification:

- Vacancy Factor
- Mid-year Budget Adjustments
- Business Process Reengineering
- Proposed Reductions
- Proposed Additions
- Restructuring
- Service Levels and Impacts
- Department Revenues
- City Policies

As discussed earlier, our overriding goal is to provide an independent examination of the Mayor's Proposed Budget for the public and the City Council.

Discussion of Service Levels

Over the past year, there has been a significant amount of Council discussion relative to the need for service level information in the budget process. **In numerous public discussions and through the unanimous passage of two resolutions (R-302315 and R-302331), the Council has requested this information and expressed that such information is critical for the public, as well as for management and legislative decision-making.** Additionally, the provision of service level information in the budget is a means by which to protect legislative authority in the budget process by documenting legislative intent for funding specific services and programs.

In a February 22, 2007 memorandum in response to the Council's request, the Mayor indicated that minimal information would be provided this year. **The Mayor noted that he would be rolling out a major performance management initiative, known as the "City of San Diego Management Program,"** and that it is his intent to provide meaningful service level data in time for the FY 2009 budget process. We completely support this new initiative.

That being said, readily available and relevant service level data that we believe could have been provided, is missing from this budget, **including response times for Police and Fire-Rescue; permit application activity for Development Services; miles of streets resurfaced; and miles of water pipes replaced, to name a few.** In the absence of more sophisticated data, this information would be valuable in the budget document. The data that is provided is for the current year only. Information from the prior year and upcoming year would help to provide context relative to the current year. We were also unable to obtain any service level information that was analyzed or developed during departments' BPR processes as called for in the BPR Guidebook.

The biggest concern we have relative to service levels is the Mayor's definitive claims that no service cuts or service impacts will result from his proposed budget. We are skeptical for a number of reasons that are discussed in the chapter on "Service Levels." Despite our skepticism, position reductions are necessary in order to achieve a balanced budget for FY 2008, and we, therefore, do not recommend any restorations. We feel it is important to identify for the community and City Council the potential impacts of these reductions and monitor these areas over the course of the year. **Additionally, we believe that identifying, monitoring and publishing meaningful service levels should be a top priority for this City.**

Without reliable measurements, the honest answer to the question: "Will service levels be impacted as a result of the Mayor's Proposed Budget?" is "It's impossible to know." The focus should now turn to remedying this situation.

Discussion of Legislative Process (cont.)

Budget Authority

The IBA believes that the annual budget is a contract between the City Council and the Mayor. The Mayor proposes the budget on April 15th of each year. The City Council amends or approves the spending policies after more than two and half months of public hearings. While the Mayor can veto Council proposed changes, the Council can override his veto.

What is represented to the public throughout the public hearing process, as being funded or not funded in the budget, is the contract the City has with its citizenry. Once the budget is adopted, it is up to the Mayor to execute that contract in good faith. **We feel that budget and policy changes, made after budget adoption, that affect the public or alter legislative intent should be brought forward to the City Council in a public forum**. Not doing so leaves the citizenry out of what should be a very public process.

The IBA believes that the Annual Appropriation Ordinance should provide the following two assurances to the City Council and the public:

1. That the level of public services represented by the Mayor and approved by the Council will be provided unless unanticipated financial or operational circumstances limit the Mayor's ability to do so.
2. If the Mayor believes that an unanticipated financial or operational circumstance precludes his ability to provide promised and/or budgeted levels of public service, the Mayor should request City Council approval before reducing or eliminating those services.

Our preliminary thoughts on how to approach this in the Appropriation Ordinance for FY 2008 are discussed in the Chapter on "Appropriation Ordinance." We are interested in exploring other thoughts as well that might provide the Council and the public with assurance with respect to budgeted service levels. In order to facilitate this dialogue, the IBA plans to form a task force comprised of representatives from the CFO, Auditor and Comptroller, Financial Management, Office of the City Attorney, and our office to effectively and cooperatively address this issue.

Business Process Reengineering (BPR)

Since the Mayor was elected, he has made BPR a cornerstone of his reforms. **The IBA has and continues to support BPR in the City of San Diego.** The City Council unanimously approved the four completed BPRs to date. The Mayor has included a number of BPRs in his Proposed Budget, with the intention of budgeting and realizing the savings in FY 2008 and simultaneously obtaining City Council approval for the BPRs.

The IBA generally believes that the BPRs should not be included in the budget until they have been brought forward for discussion and approval. **The budget provided little to no information about the BPRs included therein.** The IBA requested back-up reports on each of the BPRs included in the budget in order to provide sufficient analysis to the City Council and the public on this budget. In response, the IBA received high-level summary reports with minimal detail. The back-up received was often inconsistent with the Mayor's press release on BPR and inconsistent with the information provided in the Financial Management Information System.

Further, notwithstanding that two of the primary steps of BPR include identifying performance metrics and specifying changes in service levels, none of the new BPRs in the budget have included this information. **The IBA recommends that, when BPRs are considered sufficiently certain to include in the budget, the back-up**

Discussion of Legislative Process (cont.)

information, including accounting and service level data, should be complete.

We recommend the inclusion and approval in the budget of the new BPRs with the strong caveat that service levels be developed and monitored for all of these areas and the savings be audited and reported on an annual basis to ensure that BPR results meet expectations.

Mayor's Five-Year Outlook Kicked Off FY 2008 Budget Process

The FY 2008 budget process effectively began in November 2006 with the release of the Mayor's Five-Year Financial Outlook for Fiscal Years 2008-2012. While providing a roadmap for the future, the Outlook also laid an early foundation for the FY 2008 budget. In this Outlook, the CFO provided a baseline revenue and expenditure forecast; identified the most significant budgetary pressures facing the City known as the eight significant areas; recommended preliminary funding levels to address each area over the five-year period; and proposed corrective actions to generate savings and resources in an effort to eliminate the sizable deficit projected for each of the fiscal years.

The only significant criticisms of the Outlook were that after accounting for all proposed corrective actions significant deficits remained in each of the five fiscal years and no alternative means to fix the City's structural budget deficit were identified. That being said, **the Mayor's Five-Year Outlook was the most significant financial forecast of its kind in recent history and provided an early look at the Mayor's priorities for FY 2008**. The IBA issued a series of four reports which provided analysis and commentary on the baseline expenditures and revenues, the eight significant areas and the proposed corrective actions, and also presented potential new and increased fees for the Budget and Finance Committee discussion.

City Council Holds First-Ever Strategic Budget Prioritization Process

On January 17, 2007, the City Council participated in a visioning process for the first time to discuss future City budget priorities and provide guidance to the Mayor in advance of the FY 2008 budget process. The two-hour facilitated Strategic Budget Prioritization Process utilized polling technology to quickly and anonymously evaluate Council members' perspectives, in the aggregate, on key City services, critical issues and possible budget solutions.

The strategic assessment of City services allowed Council members to rate the long-term importance and current performance of key General Fund services. The results showed that Police Services and Fire-Rescue Services on average were considered the most important and are seen as performing well. The performance of Trash Collection Services was also rated very well by all members. The performance of other services such as Park and Recreation, Streets, Planning and Neighborhood Code Compliance should be improved based on the results of the polling. It was noted that funding constraints impact the performance of some of these areas.

In assessing the critical issues facing the City, results of the Strategic Budget Prioritization Process indicated that "funding the pension obligation" received the most support for funding followed by "addressing deferred maintenance and capital improvements" and "police officer recruitment and retention." **The Mayor has made each of these a high priority for funding in his proposed budget.**

Based on the results of the polling, on the average, the Council members expressed preferences

Discussion of Legislative Process (cont.)

to pursue alternative revenue enhancement strategies, including "new or renegotiated leases" and "program cost recovery" while indicating "across-the-board percentage reductions," "new or increased taxes" and "land sales" were least preferred options. **The Mayor has relied on two of the Council's least preferred strategies to balance the FY 2008 budget, including across-the-board percentage reductions in City departments and new revenues generated through City property sales.**

City Council's FY 2008 Budget Priorities Resolution

Upon voter approval and implementation of the Strong Mayor form of government, the Mayor-City Council Transition Committee recommended as part of the budget process each year, that the City Council adopt by resolution its budgetary priorities for submission to the Mayor by February 1 of each year. The City Council added this step in the process beginning in 2006. The Budget Priorities Resolution for FY 2008 (R-302331) was approved unanimously by City Council on January 29, 2007.

This resolution was made up of the following key components, each of which provided insight for the Mayor relative to Council and community priorities. Each of these areas is described in greater detail in IBA Report No. 07-14 "City Council Budget Priorities for Fiscal Year 2008."

"Polling Results: City of San Diego City Council Budget Prioritization Process"

The Mayor was asked to consider the results of this process in developing his proposed budget. A brief review is provided in the previous section.

Individual City Council Budget Priorities Memorandum

The Mayor was asked to consider the Budget Priorities Memorandum from individual Council members. Several Council members expressed the need to adequately fund public safety, retirement contributions, deferred maintenance and various park and library services. Additionally, several expressed the desire to, at a minimum, maintain current service levels.

Results of Mayor's "Customer SERVey"

The City offered its first on-line customer satisfaction survey on the City's website in June 2006. One area highlighted as needing improvement and ranking greatest in dissatisfaction was the maintenance of City streets, with 75% of respondents indicating either "dissatisfied" or "very dissatisfied." Other areas of concern included sidewalk maintenance and graffiti control and removal.

City Council Request to Provide Program Service Levels for the FY 2008 Proposed and Final Budgets

This resolution requested that the Mayor as part of his proposed budget each year identify current service levels being provided to the community, as well as any proposed changes to those service levels that will result from programmatic reductions or eliminations. This information was requested in order to ensure transparency in decision-making and allow all parties to understand and agree to what services will be provided with the funds allocated.

Continuation of Fiscally Cautious Approach

This resolution also recommended that the fiscally cautious "time out" approach, that the IBA proposed for FY 2007, continue for FY 2008 given the significant needs already identified that are competing for very limited resources.

City Council Requested the Mayor to Provide Critical Information Related to Five-Year Financial Outlook and Budget Process

Specific information was requested of the Mayor in this Resolution related to corrective actions

Discussion of Legislative Process (cont.)

and budget priorities reflected in the Five-Year Outlook in order to assist the Council in determining their viability. Information requested included the specific projects, cost estimates and schedules for deferred maintenance and Americans with Disabilities Act (ADA) projects; details regarding proposals for position eliminations; business process reengineering; budget clean-up; the Tourism Marketing District, and leveraging City assets (property sales).

Report Overview

Summary Review of Mayor's Budget

The Mayor's Proposed Budget centers around establishing strategic priorities to "restore or preserve the fiscal integrity of the City and/or meet our legal and operational objectives." To this end, the Proposed Budget, consistent with the Five-Year Financial Outlook, proposes to aggressively fund the eight significant areas. The road map laid out in this strategy is followed faithfully throughout the budget, representing a truly strategic budget that will work toward accomplishing the goals laid out over a reasonable period of time. This plan is a new endeavor in the City that reflects a marked departure from the past practice of unsystematic funding proposals**. The IBA strongly supports the implementation of key components of the Mayor's budget strategy.**

Furthermore, the IBA supports the priorities as identified in the Mayor's Proposed Budget. Each of the eight significant areas are areas that have historically been neglected in the City of San Diego. In addition they are all areas that will contribute to a solid financial position for the City (as with funding reserves, pension and OPEB) or contributing to critical quality-of-life services for the taxpayers (as with deferred maintenance, and ADA and Storm Water Compliance). **These eight areas are well-chosen, given the City's current position, and the realization of these goals over time will serve the City well and allow the City to return its focus to other issues of importance to taxpayers in the near future.**

With aggressive funding plans for these priorities comes the need for aggressive reforms to identify resources available in what has, and continues to be, a strained General Fund. **In his Proposed Budget, the Mayor has laid out a series of corrective actions that will allow for the implementation of funding for the significant areas in FY 2008.** Some of these actions will create ongoing savings for the City, which will enable the further implementation of strategic funding in future years, while some of the actions create one-time savings or revenues that will have to be reviewed or replaced in future years in order to allow for continued funding of priorities.

The IBA has reviewed each of these corrective actions in accordance with the principles discussed at the beginning of our report. **We support a host of the Mayor's reforms, many of which are both prudent and necessary, given the City's financial positions.** The IBA also continues to support the Mayor's BPR efforts and the position reductions made across the City as a means to balance the budget. As mentioned, however, we are skeptical about the City's ability to maintain service levels in this environment. We support the inclusion of these fixes in the FY 2008 Budget, but we strongly suggest that service levels be developed and monitored regularly to inform the public and ensure accuracy in tracking. More detail is provided in the Business Process Reengineering section of our report.

Additionally, some actions, such as releasing encumbered funds are prudent actions, but the IBA is concerned about their inclusion in the budget since we have learned that specific encumbrances have not yet been identified to meet the budgeted amounts. Given the assurances of the CFO and the magnitude of the encumbrances identified for review for potential release, we will not recommend their removal from the budget at this time. However, we recommend that specific encumbrances be identified to the City Council over the next month, otherwise we will recommend their removal from the budget, due to a high level of uncertainty.

There are several corrective actions that the IBA cannot support and we must recommend

Report Overview

Summary Review of Mayor's Budget (cont.)

that these actions be removed from the budget. As we stated in our preliminary report on the Mayor's FY 2007 Proposed Budget (IBA Report 06-18) one year ago, there are several concepts to consider when including certain revenues or expenses in the budget:

1. Probability of an outcome
2. City Council authorization
3. Anticipated closing date of bonds (if applicable)
4. Conservatism

Several of the Mayor's reforms do not meet these basic principles. With regard to land sales and the proposed Tourism Marketing District (TMD), the outcome is unknown and cannot be considered probable at this time. Neither has been approved by the City Council or even brought forward to the body for a full policy discussion. Some City Council members have expressed skepticism with regard to supporting the sale of City land to meet budgetary goals. In the case of the TMD, not only is a City Council vote required, but the hoteliers themselves must vote, placing additional uncertainty on the outcome of this proposal. Policy decisions on the TMD should not be influenced by its budgetary treatment.

Finally, with regard to the financing for deferred maintenance, a City Council vote is again required. And while the City's audit situation is certainly improved, there is still some uncertainty regarding the ability to realize bond proceeds in FY 2008, given the long lead time that will be required to prepare a debt issuance upon our initial return to the public financial markets, even if the City's rating is restored in the fall. **A conservative approach to all these proposals requires exclusion from the budget.**

The IBA advises the City Council to remove these uncertain revenues and savings unless the budget principles stated above can be met.

The IBA's recommendation should not be seen as a judgment on the merits of the proposals. Certainly, as mentioned above, the IBA strongly supports funding deferred maintenance and partial financing for these projects is prudent. However, given the issues raised above, the IBA suggests that the Mayor return to the City Council with a mid-year budget adjustment for each of these items when further information is available that would secure their outcomes.

On the other hand, the Mayor has chosen not to include any savings from his health care reforms in this budget, given the uncertainty in enrollment shifts among employees. We agree that potential enrollment shifts leave a great deal of uncertainty about the exact amount of savings that can be realized. The savings itself, however, is certain, unlike the proposals discussed above. In accordance with principles one and two above, we know that the outcomes are not only probable, but definite. In addition, we know that it has City Council authorization. In accordance with the fourth principle, conservatism, and to address the concerns of the Mayor, the IBA suggests that only 50% of the anticipated savings be included in the budget at this time and that staff may return with a mid-year budget adjustment if enrollment as of June 30, 2007 proves that additional savings will be realized.

Finally, the IBA disagrees with the Mayor's proposal to remove hourly FTEs from the budget to be replaced by lump sum dollars. The IBA has not found this to be the practice in any municipality we contacted and will create significant challenges in identifying the true cost of service and benchmarking comparisons across jurisdictions as well as historical tracking within the City. We have not found evidence that this change will create any savings in fringe budgeting or that it will enable the more accurate budgeting of fringe accounts. Thus, we will recommend that the FTEs be reinstated in the

Summary Review of Mayor's Budget (cont.)

budget, for a net zero dollar impact across funds, and be separated out from full-time FTEs for ease of identification.

Report Overview

IBA Recommendations

FINANCIAL BUDGET RECOMMENDATIONS

Based on our review as discussed throughout this report, the IBA will recommend the following financial modifications to the FY 2008 Proposed Budget. Each of these items is illustrated in the chart below and is described in more detail in the respective department sections.

FY 2008 GENERAL FUND		FTE	Expense	Revenue
Report Section	**Proposal**	**7,052.99**	**$ 1,103,966,742**	**$ 1,103,966,742**
Tourism Marketing District	Removal of Tourism Marketing District	-	$ -	$ (7,600,000)
Deferred Maintenance	Maintain removal of bond proceeds for deferred maintenance*	-	$ -	$ -
Police	Add FTE, with 100% offsetting vacancy, for Police Northwestern Station	19.00	$ -	$ -
Position Reductions	Hourly positions FTE reinstatement	177.37	$ -	$ -
City Remediations	Funds for City Council Financial Training	-	$ 15,000	$ -
City Remediations	Funds for Audit Committee professional staff or consultants	1.00	$ 225,000	$ -
Citywide Program Expenditures	Reallocation of excess funds budgeted in Citywide	-	$ (2,370,000)	$ -
Revenues	Accurate budgeting of Tobacco Settlement Revenue	-	$ -	$ 1,145,000
Budget Clean-up/ Purchasing and Contracting	Correction of revenue for Equal Opportunity Contracting/ General Government Services	-	$ -	$ 900,000
Reserves	Savings in allocation to Unappropriated Reserve	-	$ (1,390,944)	$ -
CIO	Remove allocation to ERP Fund; utilize ERP Fund balance	-	$ (458,000)	
Park and Recreation	Replacement of Grant Match Funds	-	$ 446,000	$ -
Report Overview	Recognize 50% of anticipated savings from FY 2008 Health Care Reform	-	$ (1,000,000)	$ -
	TOTAL	**7,250.36**	**$ 1,099,433,798**	**$ 1,098,411,742**
	Surplus/Deficit			**$ (1,022,056)**
OTHER FUNDS		**FTE**	**Expense**	**Revenue**
Leveraging City Assets	Removal of land sale revenue/Capital Outlay Fund	-	$ (15,300,000)	$ (15,300,000)
City Remediations/CIO	Lease proceeds and expense for ERP/ERP Fund	-	$ 21,300,000	$ 21,300,000
	Surplus/Deficit			**$**

* The CFO has indicated that $24.5 million in bond proceeds for deferred maintenance was erroneously left out of the budget. In a recent memo to Council, the CFO indicated this would be added in the Mayor's May Revise.

Report Overview

IBA FY 2008 Recommendations (cont.)

After our proposed modifications, a small deficit of $1.0 million remains. This could mean reducing the deposit into the City's reserves temporarily and adding it back in to the budget mid-year upon receipt of funds. We will of course continue to look for technical budget offsets during the remainder of the process. A budget is not balanced if it includes revenues with a high level of uncertainty, and therefore we must recommend that the City Council modify the Mayor's Proposed Budget to exclude those funds that require surmounting significant hurdles or the development of unlikely outcomes.

With regard to removing the revenue for land sales, a commensurate decrease in expense for capital projects is required only until that time that the revenues are more certain. The projects this money was to be utilized for were the $10 million in ADA projects as well as general deferred maintenance. We suggest that other cash for deferred maintenance be reprioritized for ADA projects in order to ensure the City progresses in this critical area. When and if land sale revenue is authorized and realized, each of the projects should be added back to the budget with the revenue, through a mid-year budget adjustment.

In addition to the items mentioned above, the CFO has already identified several items that will be included in the Mayor's May Revise that will impact the General Fund, including the approval of a contract with POA, additional funding required for Qualcomm Stadium, and other modifications. We expect that the Mayor's May Revise will include these and other items, as well as solutions that will ensure the General Fund is in balance.

The IBA also has a number of Technical Budget Recommendations that should be implemented along with the financial modifications. These are listed below and are also discussed further in the respective department sections.

TECHNICAL BUDGET RECOMMENDATIONS

1. Change the accounting activity title for the internal audit function in the Auditor and Comptroller's Budget from "Accounting Operations" to "Internal Auditing" for greater transparency.
2. Establish a separate object account (line item) to record overtime associated with constant staffing in the San Diego Fire-Rescue Department.
3. Require that a financial plan to balance the Publishing Services Internal Service Fund by year-end be submitted prior to approving the FY 2008 Budget.
4. Require that a list of identified encumbrances be submitted prior to approving the FY 2008 Budget. If such a list is not identified or submitted, remove the $3.0 million included in the Proposed Budget from cancelled encumbrances.
5. Do not include financing proceeds for deferred maintenance until such time as the debt issuance is approved by Council.
6. Reallocate a portion of the cash funding budgeted for deferred maintenance to address ADA projects.
7. A detailed project list for deferred maintenance and ADA should be provided prior to approving the FY 2008 budget.
8. Include language in the FY 2008 Budget Adoption Resolution that explicitly waives Municipal Code §63.30 - Utilization of the Environmental Growth Fund, per the Mayor's recommendation.
9. Include language in the FY 2008 Budget Adoption Resolution that explicitly waives Municipal Code §22.0228 – Preparation of the Annual Budget; Library Appropriation, per the Mayor's recommendation.

Report Overview

IBA FY 2008 Recommendations (cont.)

10. Request additional detail supporting the General Fund increase for information technology costs.
11. Request information related to the "A-List" project fund to determine appropriate levels of funding for FY 2008.
12. Reduce revenue estimates to Information Technology fund, and reduce departmental contributions, by like amount.

POLICY RECOMMENDATIONS

During our review, the IBA identified a number of policy recommendations that will not modify the Mayor's Proposed Budget, but will be avenues for further financial reform or operational effectiveness over time. We have provided those in the subsequent chart, entitled IBA FY 2008 Policy Recommendations. As in FY 2007, we will work to develop or implement these policies and report on their status to the Budget & Finance Committee throughout the year.

1	Present plans for compliance with the FY 2006 labor contract requirements to infuse $600 million into the pension system, and include those plans in the budget, when approved by the City Council. Also, conduct an analysis of the ramifications of non-compliance and present to the City Council at the earliest opportunity.
2	Planning for the upswing in ADA project activity begin now by clearly identifying staff resources to implement projects, oversee Transition Plan progress and to continue the monitoring of new development projects for compliance. Additionally, projects to be funded in Fiscal Year 2008 should be identified as soon as possible for project planning and public information purposes.
3	In BPR Reports, provide a detailed tracking of position and cost information, as well as information about and timeline for Meet and Confer, if applicable.
4	Conduct annual audits of BPRs that are implemented to account for actual savings and impact to service levels.
5	Conduct an overview or presentation of the Managed Competition Process and Schedule at either the Rules or Budget Committee.
6	Complete the development and adoption of the financial policies recommended in this report during FY 2008.
7	Identify, monitor and publish service levels so that the City Council and the public can be apprised of any potential impacts of position reductions.
8	In the City Auditor and Comptroller's Office, identify and assign the remaining two employees to the internal audit function prior to the beginning of FY 2008.
9	Report to the Audit Committee regarding the plan for providing sufficient Auditor and Comptroller staff support to ERP, given current staffing constraints.
10	Consider alternatives to the Library Ordinance.

IBA FY 2008 Recommendations (cont.)

11	Develop and present staffing and/or operational plans for the opening of the North University Community branch to identify possible impacts to other branches.
12	Develop a long-term strategic plan for the Environmental Growth Fund.
13	Explore the issue of Workers Compensation reform further, including a presentation on current and future programs to address this significant liability.
14	Establish a procedure to systematically review citywide encumbrances on an annual basis.
15	Initiate a policy discussion regarding potential options for securing a dedicated funding source for Storm Water requirements.
16	Develop a fiscal recovery plan for the Development Services Fund to avoid General Fund impacts.
17	Finalize a contingency plan for handling unanticipated increases in activity in the Development Services Department.
18	Present a report on costs and savings associated with San Diego Fire-Rescue's constant staffing policy to the PS&NS committee.
19	Consider establishing a fuel reserve in the General Services Department - Equipment Division for the FY 2009 Budget set at 20% of the total budget for fuel.
20	Develop a communication plan to ensure timely and accurate information is shared between the City Attorney and Risk Management departments, and the City Council, on a regular basis regarding litigation issues and related costs.

CONCLUSION

In our final report on recommended modifications to the Mayor's Proposed Budget, due June 1, we will formally request that the City Council adopt our Financial Recommendations as referenced above, and include items from the Mayor's May Revise as appropriate. In addition, we will make recommendations arising from the public and the City Council as a result of the budget hearings held throughout April and May.

Finally, given the extent of the critical modifications we recommend above, as well as the ongoing deficits projected in future fiscal years, **it will be essential that the City Council avoid the addition of further budgetary commitments, unless corresponding reductions or revenues are identified.**

Eight Significant Areas

Pension

Effect of Budget Proposals

The Mayor's Budget proposes a payment of $184.7 million from City funds to the retirement system in FY 2008. The allocations are listed below, and are budgeted across departments and funds citywide, except where noted.

FY 2008 DEPOSIT TO SDCERS	
Purpose	*Budget (in millions)*
ARC	$137.7
ARC Plus	$20.0
Retiree Health Payback	$7.3
IRS Limitations Payback	$0.5
Offset Contribution	$19.2
TOTAL	$184.7

The Annual Required Contribution (ARC) payment for FY 2008 includes liabilities not previously included in past years, since the June 30, 2006 valuation recognizes these liabilities for the first time, and the City is in the process of eliminating the concept of surplus undistributed earnings embedded within the Waterfall from the Municipal Code.

To supplement the ARC and end the current practice of negative amortization of the unfunded liability, the Mayor has proposed the dedication of an additional $20 million to the ARC, known as the ARC Plus. This is a discretionary action for Fiscal Year 2008, although in FY 2009, SDCERS will modify the amortization period and the ARC will no longer allow for negative amortization. Based on the data provided to the IBA, taking this discretionary action in FY 2008 will result in interest savings of over $45 million, for a net savings to the City of over $25 million over the course of 20 years. Going forward, the City's total ARC should be reduced by approximately $1.6 million in the early years and up to $3.2 million in the last years of the amortization period.

In the 1980s and 1990s, the SDCERS fund paid retiree health care benefits out to retirees on behalf of the City. As trust monies were not to be used for this purpose, the City will now pay the SDCERS Trust back $33 million for the cost the fund incurred, including interest. The Mayor has proposed an allocation of $7.3 million for FY 2008 to begin repayment of this obligation.

In addition to the above allocations, funding is proposed in Citywide to repay SDCERS for benefit payments in excess of IRS limits. While these benefits are pension benefits, because they exceed IRS limits, they should not be paid out of the tax-advantaged pension system, and must instead be paid out of the City's operating budget. Based on current estimates, this is expected to cost approximately $500,000 in FY 2008. The total related liability amount that has been transferred to the City is $22.8 million. There is no strategy to fund these apart from making annual allocations.

The City is also paying $19.2 million in contributions to SDCERS on behalf of employees, per negotiated agreements. This allocation is called the Employee Offset Contribution.

We also note that the City is budgeting funds to be set aside per the current labor contracts. These funds are the Employee Pick-up Savings. Per the FY 2006 contracts, the employees have agreed to pay more of their own pension contributions, as long as the City sets aside the savings realized to be used to benefit the pension system as agreed. This allocation is budgeted across departments and funds citywide.

FY 2008 OTHER PENSION RELATED EXPENSES (in millions)	
Employee Pick-Up Savings	$18.8

Pension (cont.)

The City's contributions to the retirement system do not include a plan to leverage a remaining $500 million to pay down the UAAL pursuant to labor negotiations with Local 127. As mentioned in IBA Report 06-51, the City agreed to infuse a total of $600 million into the Retirement System within three years in exchange for certain labor concessions.

On June 21, 2006 the City deposited over $100 million into the Retirement Fund from tobacco bond proceeds, tobacco settlement revenues, and employee pick-up savings. The IBA recommends that the City discuss the status of compliance with this MOU during the upcoming year, as all funds must be leveraged by June 30, 2008.

Labor contracts with each of the City's recognized labor unions will expire at the end of FY 2008. As discussed in IBA Report 06-52, the City has been compelled to discuss revisions to the pension plan for new employees. The IBA is committed to providing more information on pension plan design including revised defined benefit, defined contribution and hybrid pension plans, as requested by the Rules Committee. The IBA is currently working on a forthcoming policy statement on pension plan design based on GFOA's Recommended Practice. The IBA will continue to add value to this discussion in FY 2008.

Items for Legislative Consideration

The Mayor's Proposed Budget for retirement obligations is prudent and complies with legal and contractual requirements and financial best practices. It is important to note that the ARC Plus contribution of $20 million is optional. This allocation could instead be directed toward other critical priorities, such as adding additional funding to the retiree health care trust to address that unfunded liability, which would similarly reduce future interest costs and save the City money. It also could be redirected toward other imperatives such as ADA projects or Storm Water compliance. However, the IBA supports ARC Plus as a practical and prudent proposal for FY 2008.

As the IBA has stated many times, it is critical for the City to meet the employee contractual obligations to infuse $600 million into the pension system by June 30, 2008 and/or to understand and plan for the potential legal and financial ramifications of non-compliance, which are not fully known at this time.

Recommendation

1. Plans for compliance with the labor contract requirements to infuse $600 million into the pension system by June 30, 2008, should be discussed and included in the budget, when approved by the City Council. Also, an analysis of the ramifications of non-compliance should be presented at the earliest opportunity.

Retiree Health

Effects of Budget Proposals
The Mayor's Proposed Budget includes funding for retiree health care expenditures that will be realized during FY 2008. This pay-as-you-go amount is budgeted at $23.1 million, as stated on p. 10 of the Executive Summary, and is budgeted proportionately across all City departments.

In addition, the Mayor has proposed $25 million in funding for a retiree health trust fund that will partially pre-fund these post-employment benefits that are being accrued by active employees. This cost is also budgeted proportionately across departments. This proposal is a $20 million increase over the $5 million that was added into last year's Council-adopted budget to initiate this trust. The total unfunded liability for retiree health benefits is estimated between $700 million and $1.4 billion, depending on assumptions used. More aggressive pre-funding will allow interest to accumulate more quickly, reducing the City's annual cost. Under the provisions of GASB 45, the City must perform an actuarial valuation at least biennially for financial reporting purposes. This valuation will also help the City measure its progress toward funding these benefits and the impact on the unfunded liability.

Review of Other Entities
The California Legislative Analyst's Office (LAO) reports that only a small fraction of California governments have taken action to address these liabilities. Some entities that have begun pre-funding their OPEB are Santa Clara County, the City of Los Angeles, and the Peralta Community College District (using bonds). The LAO also reports that 11 of the 50 states have begun pre-funding their OPEB, but only in small amounts, and that only a few states have conducted actuarial valuations and quantified their annual required contributions (ARC). Ohio is a notable exception, in that their OPEB liability was identified as $19 billion, and they have pre-funded $10 billion. In the private sector, a Kaiser/Hewitt 2006 Survey on Retiree Health Benefits found that only 40% of large employers offering retiree health benefits are pre-funding those liabilities. While no comprehensive survey of other cities' action on OPEB could be located, it would appear that San Diego will be at the forefront of addressing OPEB liabilities, based on the Mayor's plan.

Conclusion
The IBA supports the Mayor's aggressive goals to begin pre-funding OPEB in the City of San Diego. Pay-as-you-go shifts current costs to future taxpayers, which violates best budgeting practices. To fully pre-fund, the City would have to pay the ARC, which was estimated to be in excess of $100 million. Given the costs, it is prudent to begin partially pre-funding this liability and ramp-up to higher funding levels each year. As a reminder, unlike with pension benefits, the City is not required to pay the ARC, but pre-funding will save the City money over time and enhance the City's financial integrity, and secure the benefits promised to employees.

Deferred Maintenance

Effects of Budget Proposals
The Mayor's Proposed Budget includes $13.2 million to cash fund the City's deferred maintenance/capital project needs and $2.4 million for debt service payments. The Mayor's office intends to add the additional $24.8 million in bond proceeds in the FY 2008 Budget as part of the May Revise.

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. The City's deferred maintenance/capital needs, excluding those of Water and Wastewater, are estimated to be at least $800 to $900 million as a result of years of under funding. Additional funding for deferred maintenance and capital improvement needs are included in the Mayor's Proposed Budget by utilizing a combination of cash and bond financings. The proposed cash flow requirements for deferred maintenance/capital improvements over the Mayor's Five-Year Financial Outlook 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 Mayor's office has identified projects scheduled to receive funding for FY 2008, but has not identified the specific projects for Fiscal Years 2009-2012.

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 for budget decision making. It is important to identify and prioritize all needs to ensure they receive full consideration during funding allocations. On January 16, 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 Citywide CIP projects. The Engineering & Capital Projects department through their BPR efforts has reorganized the department to address the City's critical CIP oversight to begin to prioritize City capital improvement 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 and a strategy developed.

Finally, there are also 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, particularly given the staffing reductions throughout the City.

Conclusion
As stated above, The Mayor's office intends to add the additional $24.8 million in bond proceeds in the FY 2008 Budget as part of the May Revise. Given that it is our understanding that the CFO prefers to access the public financial markets, the IBA does not recommend adding the $24.8 million in bond proceeds in the FY 2008 Budget. At the March 19, 2007 Audit Committee, Macias, Gini & O'Connell (MGO) indicated that the Firm has the staffing capacity to devote to the City and complete the Fiscal Years 2004, 2005, 2006, and 2007 audits by December 2007 provided continual cooperation from the City's Office of Auditor & Comptroller. Although this would allow the City

Deferred Maintenance (cont.)

to access the public bond markets at that time, it takes roughly six months to issue bonds in the public markets. The timing of bond issuance is uncertain.

Given this, the $24.8 million in bond proceeds is not recommended for inclusion in the FY 2008 Budget. $2.4 million of the $15.6 million included in the FY 2008 Proposed budget is identified for debt service on the bond repayment for the proposed $24.8 million in bond proceeds. If the bond proceeds of $24.8 million are not added into the Final Budget, the debt service of $2.4 million should be used to fund deferred maintenance projects on a cash basis as currently reflected in the Mayor's Proposed Budget. We suggest that staff return for a mid-year adjustment, should the City be able to realize the proceeds of these bonds in FY 2008.

Recommendations

1. The IBA recommends that other cash for deferred maintenance be reprioritized for ADA projects in order to ensure the City progresses in this critical area.
2. A detailed project list should be included prior to the adoption of the final budget for cash funded projects.

Eight Significant Areas

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. 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.

The IBA has previously recommended that 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.

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 requires 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.

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.

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 Mayor's Five-Year Outlook assumed that the City would work towards the goal of a General Fund Unappropriated Reserve level equal to 6% by FY 2008, and 8% by FY 2012. The Mayor's Outlook included a $7.4 million contribution to the reserve in FY 2008 to bring the total to $64 million, which compared to the Outlook's General Fund budget for FY 2008 of $1.066 million, resulted in a 6% reserve level. Since that report was issued in November 2006, the Mayor's Proposed Budget has increased to $1.1 billion, while current year contributions to the reserve have likely also increased. The Proposed General Fund Budget of $1.1 billion would require a General Fund reserve totaling $66.0 million to achieve a 6% level.

The Mayor's Proposed Budget includes $5.0 million as a contribution to the General Fund Unappropriated Reserve to meet the goal of a 6% reserve for FY 2008. Additionally, the Mayor's

Eight Significant Areas

Reserves (cont.)

Budget Clean-up Corrective Action anticipates $3.0 million from the release of encumbered funds, and $2.1 million from the transfer of inactive fund balances, to be allocated to the Unappropriated Reserve, for a total increase of $10.1 million. This will meet the goal of a 6% reserve for FY 2008.

During the FY 2007 Mid-Year Budget Adjustments, it was requested that $5.4 million be appropriated from the Reserve to fund increased salary needs for several departments. It was determined that this need could be reduced to $4.0 million. This change to the amount required from the reserve was not reflected in the reserve information recently provided to the IBA by the CFO and the IBA recommends the use of the funds for additional FY 2008 budget requirements.

In keeping with the Mayor's Five-Year Outlook, funds have been allocated for the Public Liability reserve in the amount of $5.0 million and no additional funds are programmed for addition to the Workers Compensation reserve, as planned. Annual allocations to both of these reserves are planned in the years ahead, in order to create substantial reserves to shield the General Fund from potential claims.

In viewing these three reserves collectively, the consolidated reserve as a percentage of the General Fund budget will approach 8% for FY 2008, and increase substantially to over 9% and over 15% by FY 2012.

The IBA suggests consideration of a consolidated reserves approach as represented above, in consultation with best practices and rating agency guidelines. A consolidated reserve should in no way be viewed as a way to reduce contributions to the Unappropriated Reserve. The IBA supports bolstering the City's reserve levels, and applauds the Mayor's efforts in making significant headway in this important area.

Recommendation

1. Reprogram $1.4 million that was misallocated in the Mid-Year Budget Adjustment for salary needs.

RESERVES
(in millions)

FY	General Fund Budget	General Fund $ to Reserve	Total Reserve (est.)	**GF Reserve as %**	Public Liability Total	Workers Comp Total	Possible Consolidated Reserve	**TOTAL Reserve as % of Gen Fund**
2007	$ 1,021.2		$ 56.0	**5.5%**	$ 4.0	18.0	$ 78.0	**7.6%**
2008	1,104	10.1	66.1	**6.0%**	9.0	18.0	93.1	**8.4%**
Five-Year								
2009	1,092	8.5	74.6	**6.8%**	14.0	23.0	111.6	**10.2%**
2010	1,121	6.8	81.4	**7.3%**	19.0	33.0	133.4	**11.9%**
2011	1,152	7.4	88.8	**7.7%**	29.0	43.0	160.8	**14.0%**
2012	1,184	7.7	96.5	**8.2%**	39.0	53.0	188.5	**15.9%**

Storm Water

Effects of Budget Proposals
In the FY 2008 Proposed Budget, the Mayor has designated $42.6 million for Storm Water Permit compliance, an $18.4 million increase from FY 2007. Of the total $42.6 million allocated for Storm Water Permit compliance, $19.7 million will go to the Street Division for increased street sweeping and storm drain improvements, while $22.9 million will be allocated to the Storm Water Pollution Prevention Program to enhance programs such as outreach and education, watershed management, water quality monitoring, engineering and enforcement.

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 Storm Water Permit was originally issued in 1990 and subsequently revised in 2001 to include more stringent requirements. The Regional Control Board renewed the permit once again in January 2007. The revised permit once again adds significant new requirements, which will become effective July 1, 2007. The additional funding designated for Permit compliance in the Mayor's Proposed Budget is designed to address these new and additional requirements under the revised Permit.

One of the most critical steps in addressing Permit compliance is updating the City's Urban Runoff Management Program (URMP). The URMP, which was required by the 2001 revision to the Municipal Permit and approved by City Council in January 2002, established 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. With the new and additional requirements of the revised Permit, it is critical that the City update the URMP. The Storm Water Department has indicated that this should be completed by January 2008.

Issues for Legislative Consideration
While the Mayor is to be commended for identifying the costs associated with Storm Water Permit compliance in the Five-Year Financial Outlook and for allocating significant funding for this purpose in the FY 2008 Proposed Budget, a second – and perhaps more crucial – step is to identify the revenues needed to fund those required costs. As previously mentioned, the URMP as approved by the Council in 2002 was never fully implemented due to insufficient funding. 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.

Recommendation
1. Initiate a policy discussion regarding potential options for securing a dedicated funding source for Storm Water requirements.

Eight Significant Areas

ADA Compliance

Effects of Budget Proposals

Americans with Disabilities Act of 1990 (ADA)
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. In part, the law requires local jurisdictions to make all public infrastructure physically accessible to people with disabilities. In the past, the City of San Diego has utilized Community Development Block Grant (CDBG) funds as the primary funding source for retrofitting non-compliant public infrastructure.

The ADA originally called for jurisdictions to achieve compliance by 1995. The federal government subsequently 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.

Proposed Budget Commitment and Five-Year Plan
The Mayor's Five-Year Outlook called for stepping up the pace towards ultimately achieving ADA compliance. Total City ADA compliance needs are speculated to cost hundreds of millions of dollars. The Five-Year Outlook included $10 million per year for ADA related improvements beginning in FY 2008. This $10 million budget pledge was to be in addition to any CDBG or other funds allocated to ADA projects. The Mayor's Proposed Budget allocates $10 million for ADA projects from the Capital Outlay Fund. Page 26 of Volume I of the Proposed Budget indicates that this $10 million will come from the sale of public property.

Pursuant to a mayoral change to the CDBG allocation process which shifted longstanding citywide expense (for social service programs and the Housing Commission) to the Council's discretionary CDBG allocation, the Mayor has budgeted another $2.4 million of CDBG for ADA projects, for a total of $12.3 million which is shown on page 301 of Volume III of the Proposed Budget. Additionally, the Mayor continues the practice of allocating 20% of available citywide CDBG proceeds ($1.1 million) and an ADA Transition Plan contribution of $41,000 for another $1.2 million which is not shown in the Proposed Budget.

Why funding ADA compliance should be a priority.

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 Stated 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). Irrespective of these comparative circumstances, the City must expeditiously pursue full compliance. Cities that do not comply face possible investigation by either the Department of Justice (they've 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 private party or have their federal grant funds withheld.

ADA Compliance (cont.)

In summary, the Mayor proposes to allocate $13.5 million for ADA projects in FY 2008. It is possible that the City Council could make additional discretionary CDBG allocations raising total City funding for ADA projects in FY 2008 to more than $14 million.

The IBA commends the Mayor for his efforts to increase ADA funding in FY 2008 and for the five-year, $50 million plan going forward. This represents a significant and consistent increase over prior year 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.

ADA Project Identification and Implementation
On January 29, 2007, the City Council adopted a resolution requesting that the Mayor provide critical information related to the Five-Year Outlook, including specific project detail related to the proposed increase in ADA funding in FY 2008. The fact sheet released by the Mayor on April 20, 2007 regarding the proposed ADA funding commitment provides a list of the types of ADA projects that could be funded; however, a specific project list is not in the Proposed Budget. The process for identifying and addressing non-compliant facilities takes time. Once 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 increase 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 that planning for the upswing in project activity begin now by clearly identifying staff resources to implement projects, oversee Transition Plan progress and to continue the monitoring of new development projects for compliance.

A related consideration is that the Disability Services Program (charged with the lead role in facilitating ADA compliance to date) has moved from the Community and Economic Development Department to the Office of Ethics and Integrity. In addition to this change, the Program has been without a coordinator for several months. The recruitment for a new coordinator is currently underway and filling this position is important to provide the necessary leadership.

Conclusion
The IBA commends the Mayor and the City Council for their willingness to substantially increase ADA funding. We believe that ADA compliance warrants being a budget priority in FY2008 and for several fiscal years to come. Failure to make substantial annual progress toward ADA compliance could have serious fiscal consequences for the City. The IBA further recommends that those ADA projects to be funded in Fiscal Year 2008 be identified as soon as possible for project planning and public information purposes.

Recommendations
1. The IBA recommends that planning for the upswing in ADA project activity begin now by clearly identifying staff resources to implement projects, oversee Transition Plan progress and to continue the monitoring of new development projects for compliance. Additionally, projects to be funded in Fiscal Year 2008 should be identified as soon as possible for project planning and public information purposes.

2. Because the IBA is recommending the removal of land sales from the Proposed

ADA Compliance (cont.)

Budget, we would alternatively suggest that other cash for deferred maintenance be reprioritized for ADA projects in order to ensure the City progresses in this critical area. When and if land sale revenue is authorized and realized, each of the projects should be added back to the budget with the revenue, through a mid-year budget adjustment.

Leveraging City Assets

Effects of Budget Proposals
The Mayor's Proposed Budget estimates $15.3 million in revenue from leveraging City assets. Leveraging City assets includes the sale and/or lease of City-owned land. The San Diego City Charter § 77 entitled "Capital Outlay Fund" states "Into this fund each year there shall be placed all moneys derived from taxation required or needed for capital outlay expenditures and all proceeds received from the sale of city-owned real property." Because of this, all funds received from the sale of City property are to be deposited in the Capital Outlay fund and expended on capital projects. The $15.3 million land sale proceeds are budgeted for ADA ($10 million) and deferred maintenance projects ($5.3 million) that are capital projects.

As described in the recent Report to the Committee on Land Use and Housing, the City is unique among municipalities in the size and diversity of the real estate portfolio that it owns and manages. The City's assets include 120,000 acres, 3,400 properties, and 680 ground leases. The Real Estate Assets Department (READ) has identified 22 surplus, underutilized real estate assets that can be sold in FY 2008. The sale of these assets are estimated to generate approximately $35 million in FY 2008.

The Mayor's Proposed Budget includes $15.3 million of the $35 million. The 22 General Funded projects identified for sale in FY 2008 include a combination of single family resident, multi-family resident, vacant, and commercial properties. These properties were identified based on the probability of a short escrow. This is the first step in the Mayor's Five-Year Financial Outlook to raise $100 million through the sale of underperforming surplus City-owned properties. READ will be charged with evaluating the City's property assets to determine which properties are surplus and can be offered for sale. This entails properties not needed for municipal use in the foreseeable future or do not benefit the City's core functions. Sale of surplus land could benefit the City by providing revenue to the capital improvement fund, relieve the City of potential liabilities and maintenance costs, return the properties to the tax rolls, and stimulate the economy by providing opportunities for private sector development.

At present, 60 properties have been noticed on the City's website as potential candidates for sale. The 22 identified properties in the Mayor's Proposed Budget are included in the 60 properties noticed on the City's website. Statutory requirements include a sixty-day period which includes notification to other governmental agencies that may have an interest in the properties for a variety of reasons, before the properties can be declared surplus.

Sales of some parcels could be made to other governmental agencies before the properties are declared surplus. The City properties have cleared the statutory requirement. The Real Estate Assets Department has received interest in two of the properties from governmental agencies that include Southeastern Economic Development Corporation (SEDC) and the San Diego Border Patrol.

All sales of City land require City Council action. The land sale proposal is estimated to come before the City Council in June 2007 for preliminary approval of the sale of the appraised real estate assets. On February 7, 2007, the Real Estate Assets Department presented a report to the Land Use and Housing Committee regarding proposed revisions to Council Policy 700-10. The Department was requested to return to the Committee on June 13, 2007 to present revisions to Council Policy 700-10. A policy discussion is needed for changes to Council Policy 700-10 prior to final budget decisions.

Corrective Actions

Leveraging City Assets (cont.)

The use of brokers is proposed for marketing and selling the City assets rather than selling property by auction. The department believes this will increase the properties' exposure to the marketplace and maximize the value of the properties. A pool of venders qualified to handle commercial sales will be selected from the Request for Statement of Qualifications (RFQ) process. Up to four Brokers will be selected and will bid for their commission. The timeframe for Broker selection is estimated in May 2007.

In terms of budget and budget estimates, the probability of an outcome of a particular proposal should govern its budget treatment. If there is a high probability that certain revenues will not be received within the fiscal year, then it is more appropriate to present the most likely scenario in the budget. If there is a high probability that the revenues will be received within the fiscal year, then it is appropriate to include them in the budget. According to GFOA Best Practices in Public Budgeting, the City should decide on a set of tentative actions to be taken if the sale of City property generates revenue lower than projected. The contingency plans should be publicly discussed and used in budget decision making. Although READ estimates the sale of the 22 identified properties between 30 and 180 days, none of the properties are in escrow at this time.

Current policy requires Council authorization for the sale of each property and the potential time needed for the close of escrow, which could vary dramatically for each transaction, may put the receipt of funds within a specific timeframe at risk, particularly given the current real estate market. As stated above, the land sale proposal is estimated to come before the City Council in June 2007 for preliminary approval. The 22 properties that will be presented to Council at that time will include appraised values from an appraiser. To expedite the sales, the Mayor's office will be requesting Council's pre-approval for the sale of the 22 selected properties and the sale price of these properties. If it becomes necessary to accept an offer for a property that is less than the price that was pre-approved by Council, then authorization to complete the transaction will require Council approval. If an offer for the property is received from a qualified buyer, and that offer is equal to or greater than the pre-approved price approved by City Council, the Mayor will be authorized to execute the transaction without further action by Council.

During the City Council's recent Strategic Budget Prioritization Process, the Council members expressed preferences, on average, to pursue alternative revenue enhancement strategies including "new or renegotiated leases" and "program cost-recovery" while indicating "land sales" as the least preferred option. The IBA does not recommend inclusion of land sale revenues in the FY 2008 Budget, unless the Council has had the benefit of a full policy discussion on the land sales matter separate from the budget, and has voted affirmatively in favor of this strategy prior to final budget decisions.

Recommendations

1. We suggest that other cash for deferred maintenance be reprioritized for ADA projects in order to ensure the City progresses in this critical area.
2. The IBA recommends removal of land sale revenues in the FY 2008 Budget, unless the Council has had the benefit of a full policy discussion on the land sales matter separate from the budget, and has voted affirmatively in favor of this strategy prior to final budget decisions.

Tourism Marketing District (TMD)

What is a TMD?

As contemplated, the TMD would be an assessment district created by the City on behalf of larger hotel and motel operators within the City (smaller operators would be exempted). The TMD would raise funds to promote tourism in the City and be established in accordance with new language that is proposed for incorporation into the City's Municipal Code. Formation steps for the TMD would be modeled after assessment districts created pursuant to the State's Property and Business Improvement District Law of 1994.

The establishment of a TMD was first presented in the Mayor's Five-Year Financial Outlook issued in November 2006, although the hotel industry has been working it for some time. In that document, the TMD was referred to as a Property Based Improvement District (PBID) and the associated savings accruing to the General Fund in FY 2008 were estimated to be $6 million. The FY 2008 Proposed Budget estimates annual savings of $10 million for the General Fund could be achieved if a TMD were to be established. The $7.6 million estimate in the FY 2008 Proposed Budget is lower because the TMD is not anticipated to be formed and begin collecting assessments until October or November of 2007.

On April 18, 2007, the CFO informed the Budget and Finance Committee that he will be recommending that the anticipated TOT savings estimate be reduced from $7.6 million to approximately $5 million in FY 2008 when he presents his May Revise. This reduction is based on an anticipated delay in the time required to establish the TMD.

How would a TMD be established?

The City must first receive signed petitions from larger hotel and motel operators, who collectively represent at least 50% of the total proposed assessment, requesting that TMD formation proceedings be initiated on their behalf. All hotel and motel operators who stand to be assessed would then be provided an opportunity to express their support or opposition for the proposed TMD by ballots submitted to the City. The City would subsequently hold a noticed public hearing and count returned TMD ballots at a meeting of the City Council. Provided that TMD ballots opened at the conclusion of the public hearing do not represent a majority protest, the City Council would then have the authority to establish the assessment district on behalf of the petitioning hotel and motel operators.

How are assessments collected and how would the funds be used?

If established, the TMD would assess larger hotel and motel operators 2% percent of gross room rental revenue. It is estimated that this assessment will result in approximately $25 million annually that would be used to market the City to potential visitors. The funds are expected to be overseen by a yet to be established nonprofit corporation controlled by a nine-person board comprised of members of the lodging industry. The current proposal calls for the San Diego Convention & Visitors Bureau to receive approximately 50% of the funds, San Diego North Convention & Visitors Bureau to receive approximately 10% of the funds, with the remaining 40% of the funds (approximately $10 million) being awarded

> We are concerned about the utilization of prospective revenues to balance the FY 2008 Budget when there are several milestones to be achieved, including signed petitions and a ballot vote of the hoteliers. It is premature to anticipate the results of the TMD petition and ballot protest process. The IBA recommends that the TMD revenue be excluded from the FY 2008 Budget and added mid-year once the TMD is established and TOT

Corrective Actions

Tourism Marketing District (cont.)

annually to organizations or events that promote tourism and/or boost hotel room occupancy. The City would collect the assessments for the TMD and review associated expenditures for appropriateness, but would not control the annual allocation of these funds.

How would a TMD generate savings for the City's General Fund?

For over a decade, the City has annually provided TOT funding to a group of organizations categorized under Citywide Economic Development (listed on page 334 of Volume II of the proposed budget) to broadly promote economic development within the City. The FY 2008 Proposed Budget plans to again allocate approximately $11.2 million to support 11 longstanding recipient organizations and events. If the TMD is established, TMD proponents have agreed to relieve the City of their funding commitment to these organizations for the remainder of the fiscal year thereby saving TOT that can be re-directed to the City's General Fund. If the TMD begins collecting revenue in January 2008, it is estimated that approximately $5 million could be saved and returned to the City's General Fund.

The IBA has received the following approximate timeline information from City staff related to the anticipated TMD formation process:

ACTIVITY	TIME / ACTIVITY REQUIREMNTS	DATE RANGE
Request City Council adoption of enabling ordinance.	After ordinance introduction, two weeks for 2nd reading and then 30 days until ordinance effective.	May 2007
Collection of petitions from hotel and motel owners who will pay more than 50% percent of the assessments.	Ongoing until signature threshold achieved.	May – June 2007
Review of petitions to verify adequate support.	2 weeks from date petitions submitted to City.	June – July 2007
Once sufficient petitions received, request City Council adopt a resolution of intention to form TMD.	3-5 weeks to prepare Report to the City Council and docket the item.	June – July 2007
Council meeting to discuss resolution of intention to form TMD, notice the requisite public hearing and mailing of bal-lots.		Late July 2007
City Council meeting for public hearing and tabulation of ballot responses.	In accordance with State law, not sooner than 45 days after ballots are mailed to business owners.	Sept -2007
If a majority of businesses to be assessed returning ballots, as weighted by their share of the proposed assessment, support TMD formation, City Council can adopt resolution to form TMD.	In order for TMD to be established, City would execute an administrative agreement with tourism industry's designated nonprofit corporation.	September or October 2007
Assessment collection begins for initial months of TMD.	City Treasurer to facilitate TMD assessment collection process.	Jan-2008

Tourism Marketing District (cont.)

It is important to note that the following <u>four formation milestones</u> have yet to be achieved:

- City Council adoption of an enabling ordinance that would add necessary TMD establishment language into the City's Municipal Code.
- Receipt of petition signatures from hotel and motel operators, who collectively represent at least 50% of the proposed assessment, requesting that the City initiate TMD formation proceedings on their behalf.
- A noticed public hearing where public comment is received and submitted ballots are counted to determine if a majority protest exists.
- City Council action to establish the TMD following the public hearing and an affirmative ballot process.

The IBA has been informed that the following <u>operational aspects of the TMD</u> have yet to be determined:

- Incorporation of the nonprofit organization that would oversee fund allocation and other TMD administration.
- Exemption criteria establishing those hotel and motel operators within the City that would not be subject to the TMD assessment.
- Completion of the requisite management plan (to be referenced in the ballots) which specifies: district boundaries; proposed activities; method and basis for the assessments; time and manner for collecting assessments; number of years which assessments will be levied; rules and regulations applicable to the TMD, district administrative expenses; any matters required by the City Council; etc.
- City Treasurer methodology and associated expense for facilitating collection of TMD assessments.

Other possible considerations include:

- Potential legal challenges related to the TMD.
- Aside from San Diego Convention & Visitors Bureau and San Diego North Convention & Visitors Bureau, there are no funding guarantees for the other longstanding City TOT recipient organizations beginning in FY 2009. After the first year, funding will be allocated on a competitive "return on investment" analysis which we support. These organizations may return to the City to request funding if denied funding by the TMD.
- Finally, as the Council and hoteliers deliberate the merits of this proposal over the next several months, they should not be influenced by its treatment in the budget.

As noted above, there are several important steps, determinations and decisions that remain to be completed. The City does not control all of these actions. Best budgeting practices dictate that organizations only budget revenue that is reasonably certain to be received. The IBA believes that there is significant interest to form a TMD among key stakeholders (particularly the San Diego County Hotel-Motel Association and the Lodging Industry Association) and that, if formed, there will be TOT savings that can be re-directed to the General Fund for other purposes; however, there is a significant amount of uncertainty associated with actions remaining to be taken.

Recommendations

1. For budgeting purposes, we believe it is premature to anticipate the results of the TMD process, just as it would be to anticipate the results of voter approved bonds by budgeting the expenditure of bond proceeds prior to a public vote. The IBA recommends that the TMD revenue be excluded from the FY 2008 Budget and added to the budget mid-year once the TMD has been established and TOT savings are certain.

Corrective Actions

Position Reductions

The Mayor's Proposed Budget includes the reduction of a 848.90 FTEs. In this section, the IBA provides a detailed analysis of how and what position changes occurred from the Fiscal Year 2007 to Proposed Fiscal Year 2008 Budget. Based on review of supporting documentation, the IBA was able to develop the following table that summarizes the position changes by type.

Position Changes by Type (As shown in FMIS)	
	FTE
Business Process Reengineering	(83.70)
Financial Outlook Vacancies/ BPR	(574.64)
Hourly Conversion	(177.37)
General Fund Savings Plans	(22.00)
Position Adds	30.50
New Facilities/Annualizations	22.36
Other Reductions	(44.05)
Total FTE Changes	(848.90)

The categories for this table were developed utilizing the subcategories in the City's Financial Management Information System. When budget changes are inputted into the system, the user has the ability to select an identifier (previously identified or directed) that can later be used to sort information for various reports.

While the financial system shows only 83.70 FTE reductions directly inputted as BPR, the IBA was able to calculate 256.50 FTEs reduced as part of the Mayor's reengineering efforts. See the "Business Process Reengineering" section for further details. The majority of reductions are identified as "Financial Outlook Vacancies/ BPR" in a budget document The Mayor's Five-Year Financial Outlook had previously identified the reduction of 546.34 FTEs, of which 446.34 FTE were vacant at the time of publication and an additional 125.00 FTE reductions as a result of BPRs for a total reduction of 671.34 FTEs, exclusive of any FTE reductions related to hourly/part-time standardization.

A significant change in policy occurred in the budgeting of hourly employees. In past fiscal years, hourly employees were recorded as full-time equivalents. Most of these classifications were distinguished by a five digit job class number. For example, a full-time Grounds Maintenance Worker I has the job class of 1467 and an hourly/part-time Grounds Maintenance Worker I would have the job classification of 14671. This separated classification for hourly/ part-time employees allowed for the budgeting of considerably less fringe.

Hourly Conversion by Position		
Job Class	Title	FTE
1398	Ranger/Diver	(2.00)
13891	Custodian II	(2.10)
14671	Grounds Maintenance Worker I	(12.28)
14681	Grounds Maintenance Worker II	(0.50)
18341	Sanitation Driver I	(0.50)
15461	Junior Engineer - Civil	(2.50)
15841	Librarian II Hourly	(1.48)
15861	Library Assistant	(2.02)
14801	Golf Starter	(5.50)
15881	Library Aide	(14.01)
15901	Library Clerk	(1.92)
15311	Recreation Leader II	(15.25)
15651	Recreation Leader I	(54.00)
15911	Lifeguard I	(28.89)
17941	Recreation Aide	(6.92)
19051	Swimming Pool Manager I	(5.00)
19361	Pool Guard II	(22.50)
	Total Conversion	(177.37)

Corrective Actions

Position Reductions (cont.)

Based on this current system, the IBA does not understand the need to convert these FTE to dollars. The IBA does agree that if a department were to utilize an hourly/part-time employee in a budgeted full-time position, the department would experience significant fringe savings.

The IBA suggests a policy regulating hourly/part time positions be implemented (or modified if in existence) and audited annually to ensure compliance. The IBA believes that the reduction of these FTEs will not accurately reflect the number of full-time equivalent positions the City employs or how many employees are required to achieve a given service level. Additionally, reductions to part time positions will no longer be shown in the budget. It took several steps for us to learn that part-timers have been cut for FY 2008. In a quick review of other municipalities, the IBA determined that it appears to be common budget practice to account for hourly/part-time employees as full-time equivalent. This practice will allow for more accurate year-to-year comparisons of budget information, as well as allow for easy comparisons with other jurisdictions, and provide valuable data to the public on expected levels of services.

Purely for informational purposes, the IBA also reviewed how the position reductions impacted the various bargaining units in the City and developed the table at the bottom of this page. The City's financial system currently tracks job classes by bargaining unit; the Deputy City Attorney's Union is not reflected separately but is included in the "Unclassified/Unrepresented" category. The IBA further broke down the Municipal Employees Association based on the subcategories identified in their labor agreement and calculated the reduction as a percentage of the workforce for that bargaining unit/subclassification.

Recommendations

1. Reinstate the hourly positions as FTEs. There is no net impact to budgets. The Mayor's proposal converted FTEs with an equivalent amount of dollar; this recommendation would reverse that action.

Position Reductions by Bargaining Unit/Subclassification	FY07 FTE	FY08 FTE	Diff.	Hourly	FTE Changes	% of Category
Municipal Employees Association (MEA)						
Administrative Support and Field Service Unit	1,339.46	1,220.83	(118.63)	(21.43)	(97.20)	-7%
Professional Unit	1,543.55	1,415.75	(127.80)	(6.00)	(121.80)	-8%
Supervisory Unit	976.56	853.04	(123.52)		(123.52)	-13%
Technical Unit	1,388.84	1,163.84	(225.00)	(132.56)	(92.44)	-7%
Local 127	2,219.78	2,011.65	(208.13)	(17.38)	(190.75)	-9%
Police	2,089.45	2,088.75	(0.70)		(0.70)	0%
Local 145 - Fire	1,036.18	1,004.59	(31.59)		(31.59)	-3%
Unclassified/Unrepresented	812.53	799.00	(13.53)		(13.53)	-2%
Officials	10.00	10.00				0%
TOTAL	**11,416.35**	**10,567.45**	**(848.90)**	**(177.37)**	**(671.53)**	**-6%**

Business Process Reengineering (BPR)

Overview
As introduced by the Mayor, Business Process Reengineering focuses on streamlining work processes for substantial improvement, finding more efficient ways of working and getting rid of nonvalue-added activities. BPR is not *reorganization* or *downsizing*. Reorganization may occur as a result of BPR because the process will shift structures from a "task/activity" to "process" focus.

> A business process is a structured, measured set of activities designed to produce a specified output. For example, going grocery shopping is a process; whereas selecting an apple is one of the activities.

The primary steps in a business process reengineering effort are:

- Establishing a team comprised of key staff, stakeholders, subject matter experts, and labor representatives.
- Creating a project charter that documents the BPRs scope and objectives.
- Conducting a situational analysis to determine the processes strengths, weaknesses, opportunities, and threats.
- Performing data gathering, including benchmarking, developing an understanding of customer needs, establishing baseline costs, and developing performance metrics.
- Documenting the existing process, developing the new process and comparing the two.
- Developing the Most Efficient Organization (MEO).
- Forecasting potential results, including a budget that identifies the differences (before/after) and specifies the changes in service levels.
- Developing recommendations.

The Mayor's Proposed Budget proposes significant savings associated with his business process reengineering efforts. To date, four BPRs have been reviewed and subsequently approved by the City Council, but the proposed budget includes these four approved BPRs and six new BPRs. The following chart identifies these BPRs, plus those in progress or planned.

BPR STATUS

Approved by Council	Included in Proposed Budget	In Progress	Future BPRs
Contracts	Fleet Services	Development Services	Real Estate Assets
Human Resources	Streets Division	Reservoir Program	Public Information
Information Technology	Publishing Services	Water	Ethics and Integrity
Environmental Services	Police - Phase I	Fire-Rescue	Dispatch Centers
	Engineering	Police - Phase II	Emergency Operations Center
	Metropolitan Wastewater	Grants and Gifts	Redevelopment
		Facilities Maintenance	Community & Economic Development
		Park Maintenance	Planning - Facilities Financing
		Libraries	IT&C - Communications
		Storm Water	General Services - Station 38, Admin
			Risk Management
			Finance
			Park and Recreation

Corrective Actions

Business Process Reengineering (cont.)

Effects of Budget Proposals
The IBA's preliminary report on the Mayor's FY 2008 Proposed Budget provides specific information on BPRs in the department pages and summarizes global issues for legislative concern in this section.

In the Mayor's April 9th press release, Business Process Reengineering results were responsible for $54.2 million in savings, including the reduction of 488.16 FTEs. The press release provides an overview of ten departments/ functions, including Contracts, Central Warehouse, Environmental Services, Fleet Maintenance, Metropolitan Wastewater, Development Services, Engineering & Capital Projects, Publishing Services, Streets Division, and Police Department.

Upon the release of the Mayor's Budget, the IBA received six BPR reports on Fleet Services, Streets Division, Publishing Services, Police – Phase I, Engineering & Capital Projects, and Metropolitan Wastewater. The BPR report on Development Services was received by the IBA as this document was going to print. Development Services proposes a reduction of 115 positions as a result of reduction in force. Upon review of the documents for the six other BPRs, the IBA discovered difficulty determining what results are actually included in the Proposed Budget, and whether FTE reductions were a result of vacancy elimination reflected in the Five-Year Outlook or reengineering reductions. The IBA had three areas to review information:

- City's Financial Management Information System (FMIS), in which all budget changes are inputted by the responsible department and includes the selection of a specific identifier that can later be used to sort information for various reports;
- High-level summary reports provided by the Business Office to the IBA on April 13th; and
- Mayor's press release.

One of the difficulties we had in the analysis was in determining whether reductions to vacant positions were a result of a BPR. The six reports provided to the IBA identified a total reduction of 349.46 FTE of which 268.80 (or 77%) were reported as vacant by the departments.

MAYOR'S PRESS RELEASE

Department/Function	GF Position Reductions	NGF Position Reductions	Savings
FY07			
Contracts	11		$ 907,000
Central Warehouse	5		$ 1,100,000
Environmental Services		32	$ 2,900,000
Sub-Totals for FY07	**16**	**32**	
	Total FTE	**48**	**$ 4,907,000**
FY08			
Fleet Maintenance	10	25	$ 2,600,000
Metropolitan Wastewater		144	$ 20,000,000
Development Services	6	106	$ 11,000,000
Engineering & Capital Projects	34.25	45.25	$ 8,200,000
Publishing Services	10		$ 600,000
Streets Division	35.66		$ 4,500,000
Police Department	24		$ 2,400,000
Sub-Totals for FY08	**119.91**	**320.25**	
	Total FTE	**440.16**	**$ 49,300,000**
Since BPR Began	**135.91**	**352.25**	
	Total FTE	**488.16**	**$ 54,207,000**

Business Process Reengineering (cont.)

Many of these were identified for reduction in the fall as part of the Five-Year Outlook prior to the initiation of BPRs. It was not possible to discern in the budget document which positions were attributable to BPRs as all reductions were lumped together. Based on what we could document in FMIS, combined with our own review of the reports and discussion with the departments, we recreated a chart of reductions that we have confirmed to be a direct result of a BPR. In comparison with the Mayor's Press Release, the following significant differences are noted:

BPR REDUCTIONS AS CONFIRMED BY THE IBA

Department/Function	GF Position Reductions	NGF Position Reductions
BPR Reductions in Fiscal Year 2007 Budget:		
Central Warehouse	-	5.00
BPR Reductions in Proposed Fiscal Year 2008 Budget:		
Contracts	7.00	4.00
Human Resources	-	-
Information Technology	-	-
Environmental Services	-	32.00
Fleet Services (1)	9.00	16.00
Metropolitan Wastewater (2)	-	134.00
Engineering & Capital Projects (3)	7.75	41.75
Subtotal by Fund	**23.75**	**232.75**
TOTAL BPR		**256.50**

BPR REDUCTIONS NOT CONFIRMED BY THE IBA

Other Reductions as identified as BPR in Mayor's Press Release:		
Development Services (4)	-	112.00
Publishing Services (5)	-	10.00
Streets Division	33.16	-
Police Department (6)	22.00	-
TOTAL NON-BPR	**55.16**	**122.00**
GRAND TOTAL by fund	**78.91**	**354.75**
GRAND TOTAL		**433.66**

1. The Fleet Services BPR identified the total reduction of 35.00 FTEs, but actual reductions in the financial system totaled 25.00 FTEs.
2. The Metropolitan Wastewater BPR identified the reduction of 157.80 FTE, but actual reductions in the financial system totaled 134.00 FTE.
3. Engineering & Capital Projects BPR identified the reduction of 89.50 FTE, but actual reductions totaled 49.50 FTE.
4. Development Services experienced a reduction in force of 112.00 FTEs due to a decline in activity.
5. Publishing Services reduced 10.00 FTEs that have been vacant for multiple years and appear to be as a result of reduced workload.
6. Police Department BPR identified 24.00 FTEs for reduction, but 2.00 FTEs are already accounted for in the Fleet Services BPR reductions (General Fund portion). The other 22 positions are vacancy reductions identified as part I of their BPR.

The IBA also had significant difficulty determining and verifying the amount of actual dollar savings as a result of BPR. Beyond the BPRs already reviewed and approved by the Council, the reports concentrate on position reductions. Also, cost savings is not the only result of reengineering, in some instances improved services could be the outcome. For example, it is anticipated that the Fleet Services BPR will increase service levels to the public safety fleet, including the development of a replacement schedule to reduce the level of over-aged vehicles in the public safety fleet (currently 46%). However, service levels were not a component of the BPR reports and were not available from the departments for our review.

Conclusion/Recommendations

1. The IBA recommends that detailed tracking

Business Process Reengineering (cont.)

of position and cost information be communicated with the results of the BPR reports in the future. Most of the six reports given to us for our review were deficient in communicating what and how processes were improved, what the baseline and revised budgets were, and providing what performance metrics will be monitored. Also, some recommendations may be delayed depending on whether Meet and Confer has occurred. If known, this information and possible timeframe is detailed in the department summaries.

2. The IBA believes in the importance of the Mayor's reengineering efforts and believes the City can achieve significant savings from the complete redesign of existing processes. The IBA recommends that service levels be developed and monitored for all BPR areas and that an annual audit of actual implementation of proposed recommendations and savings achieved be conducted. Accurate tracking of results, including process improvements and service levels as well as position reductions and cost savings, is key to the credibility of the process.

Corrective Actions

Managed Competition

The Recommended Practice, *Managed Competition as a Service Delivery Option*, from the Government Finance Officers Association recommends "that governments systematically identify and evaluate the major factors in considering a managed competition option. Service level, cost, efficiency, effectiveness, quality, customer service, and the ability to monitor the service provider's work should be essential components of any managed competition decision. In addition, governments should clearly define the service parameters in the expected service delivery."

No budget savings related to managed competition are included in the Mayor's Proposed Budget. It is unknown whether there will be additional savings above and beyond the BPRs. In the Mayor's Financial Outlook, the first Request for Proposal (RFP) was identified to be issued in the summer of 2007. The IBA has several questions regarding this timetable. First, to the best of our knowledge, the IBA is unaware of a schedule for the managed competition process, including the finalization of the Managed Competition Guide. In regard to the Managed Competition process, it is our understanding that a consultant is going to be hired to assist in the development of preparing the scopes of work. We have not been able to confirm when this request will be coming forward to Council or whether costs have been included in the FY 2008 budget.

The IBA is also concerned about the approval process for the completed Business Process Reengineering efforts if a function has been identified as a candidate for Managed Competition. When the Environmental Services BPR was presented to Council, the Collection Services portion of the BPR was not available for public review because of the concern about protecting the City's competitive position. Information should be provided to Council on how and when decisions were made identifying candidates for Managed Competition and when BPR results will be made available. Information regarding the schedule for moving forward with Managed Competition should also be provided to Council.

Recommendations

1. The IBA recommends that an overview/ presentation of the Managed Competition Process and Schedule be given to either the Rules or Budget Committee that addresses the above concerns.

Corrective Actions

Budget Clean-up

Effects of Budget Proposals
The Mayor's Proposed Budget relies on several budget clean-up actions to help balance the General Fund budget and allocate additional funding to the Unappropriated Reserve. The Proposed Budget reflects approximately $10.9 million in additional resources from implementing these clean-up actions, which are discussed in greater detail below.

General Government Services Billing (GGSB) - $5.8 million
The City uses General Government Services Billing (GGSB) to recover a proportionate share of the cost associated with General Fund departments that provide centralized support services, such as Auditor and Comptroller, City Attorney, and Financial Management. In the past, the costs for several departments, including the Mayor's Office, the City Council, and more recently the Office of the IBA, have been fully funded by the General Fund. Beginning in Fiscal Year 2008, the cost associated with these departments will be allocated citywide as part of the GGSB, resulting in a $4.2 million increase for the General Fund. It should be noted that these costs will be picked up by other, Non-General Fund departments. Another $1.6 million will be realized due to various adjustments in GGSB that would occur even if these additional central service departments were not incorporated into the process.

It should be noted that during this process, several other departments were considered for inclusion in the GGSB allocations, including Office of Ethics and Integrity, the business offices, Office of the Chief Financial Officer and Equal Opportunity Contracting (EOC). Ultimately, these departments have not been included in the GGSB allocation process in FY 2008. There is continuing discussion as to whether these departments should be allocated via GGSB in the future. However, in the case of EOC, the Department reduced approximately $932,000 in revenue due to the presumed inclusion in the GGSB allocation process. Since EOC is not part of GGSB in FY 2008, $930,000 in revenue should be added back into the Department's budget. See the EOC Purchasing and Contracting, budget review section of this report for additional details.

Release of Encumbered Funds - $3.0 million
An encumbrance essentially refers to a portion of a department's budget that is earmarked and set aside for a particular purpose. Departments may encumber funds for a number of reasons. For instance, if a department enters into a contract for supplies or services, it will create an encumbrance to ensure that the funds are available when payment is due. Departments may set up numerous encumbrances each year, and many of these retain funding after the fiscal year ends. However, there is no formal process for reviewing and closing open encumbrances. As a result, many unnecessary or inactive encumbrances that were established throughout the years remain open, with the encumbered funds sitting idle.

The Mayor's Proposed Budget includes $3.0 million in released encumbrances, which will be transferred directly to the Unappropriated Reserve. Several months ago, the Business Office sent out a list of all open encumbrances and asked departments to provide operational or legal justification for the ones that should remain open. All encumbrances for which sufficient justification was not provided were intended to be closed. This preliminary survey was very cursory, but showed that a total of $12 million in additional resources due to closed encumbrances might be possible, including $8 million associated with General Fund. Based on the potential for $8 million, the CFO built a conservative estimate of $3 million into the Mayor's Proposed Budget.

Budget Clean-up (cont.)

Following this cursory review, the Comptroller has indicated that it will be necessary to take a closer look at the specific projects and contracts that are associated with the identified encumbrances. The Council has also asked for more specific details to determine if there are any policy implications associated with the cancellations. However, such detailed analysis has not yet been completed due to staff constraints, so no backup detail to support the $3 million in the budget is currently available. Such backup will need to be provided within the next couple of weeks, prior to final Council decisions regarding the FY 2008 Budget. If the list of encumbrances cannot be identified and confirmed, and if backup detail cannot be provided to the Council, then the $3 million will need to be removed from the Budget. On the other hand, it may be possible to generate additional revenue in excess of $3 million, pending the detailed review by the Comptroller. However, the specifics related to this revenue source can not be confirmed at this time.

Aside from identifying encumbrances for the FY 2008 Budget, the IBA recommends that a process be established by which encumbrances are reviewed at the end of each fiscal year. This will allow for a more comprehensive tracking of all open encumbrances, and prevent the buildup of unnecessary and inactive encumbrances that contain idle funding.

Transfer of Inactive Fund Balances

The Proposed Budget also includes an additional $2.1 million in inactive fund balances that can be transferred to the Unappropriated reserve. From time to time, various funds are established for specific purposes, many of which were funded by the General Fund. A list of funds identified as being obsolete or inactive was initially generated, and several of the funds that were funded by the General Fund were targeted for closure.

The majority of the estimated $2.1 million in inactive fund balances is due to the GASB 31 fund, which was created a number of years ago to hedge against unrealized losses in the City's investment portfolio. An unrealized loss refers to a situation when the market value of the City's investments is less than the book value, meaning that if the City sold all of its investments it would realize a loss. If the City does not sell its investments, the loss is not realized but still must be recorded in the financial statements as an unrealized loss. While this practice is purely a financial accounting requirement under GAAP, it does impact fund balances. In previous years, specific General Fund carryover targets were established prior to the end of the fiscal year. The GASB 31 fund was established in order to be able to meet these targets should the City have to record an unrealized loss. Since the City has terminated the practice of budgeting carryover in the General Fund, the GASB 31 fund is no longer needed.

Issues for Legislative Consideration

The IBA supports the budget clean-up measures taken in the Mayor's Proposed Budget as described above. However, as mentioned above, specific backup details on the encumbrances targeted for closure must be provided prior to Council approval of the Budget.

Recommendations

1. Increase Equal Opportunity Contracting revenue by $930,000 due to non-inclusion in the GGSB Process;
2. Provide specific backup detail for the $3 million in cancelled encumbrances that are included in the Proposed Budget;
3. Establish a procedure to review encumbrances on an annual basis.

Corrective Actions

Summary Review of Mayor's Corrective Actions

Corrective Action	Probability	Five Year Outlook	Mayor's Budget Proposal	IBA Recommendation 4/27/06	Remarks
Position Eliminations	Certain	$25.1 million	$20 million	No change	Reflects 296.1 GF FTE reductions including 23.75 we have confirmed as BPR reductions.* While we are skeptical about the Mayor's statements regarding no service impacts, we do not recommend any restorations.**
Mandatory Employee Furlough	Uncertain	$4.6 million	$0	No change	We did not support as ongoing remedy and Mayor did not include in budget.
Debt Refinancing	Certain	$3.8 million	$3.7 million	No change	Refinancing is completed.
PBID/TMD	Uncertain	$6.0 million	$7.6 million***	**Remove from '08 Budget**	Numerous action steps remain including hoteliers' vote. Add savings to Budget mid-year if approved.
Budget Clean-Up	$7.9 million Certain $3.0 million Uncertain	$8.3 million	$10.9 million	**GGSB correction to EOC revenue of $0.9 million**	Specific encumbrance clean-up actions are uncertain. Details are needed. Recommend systematic annual encumbrance review and policy with established criteria.
Leveraging City Assets	Timing Uncertain	$15.3 million	$15.3 million	**Remove from '08 Budget pending Council vote**	Receive affirmative vote by Council on strategy prior to final budget decisions or remove from budget and add revenue to budget mid-year when sales are in escrow. Tie specific deferred maintenance projects to sales revenue. Does not diminish ability to do projects.
Managed Competition	Uncertain	$0	$0	No change	Schedule and potential for additional savings are unknown.

* See Chapter on "Business Process Reengineering"
** See Chapter on "Service Levels"
*** CFO will propose to reduce from $7.6 million to $5 million due to revised schedule

Other Citywide Discussions

Financial Policies and Budget Practices

Effects of Budget Proposals
As noted in our report last year, the City lacks comprehensive financial policies. In some cases, the City has written or informal policies on some topics, but the IBA recommends that financial policies be developed and formalized, in accordance with best practices and recommendations by respected professional organizations, including the Government Finance Officers Association (GFOA). The City has made progress on several fronts, but it remains a critical priority that policies be institutionalized, in order to ensure long-term financial goals and strategies are in place, and provide a road map for decision makers to assist in improving and maintaining the City's fiscal health. Adherence to well-developed financial policies also provides credibility with the public, financial institutions, and credit rating agencies. Priority should continue to be placed on the six policies discussed here.

Reserves Policy
The Chief Financial Officer presented a preliminary Reserve Policy to the Budget & Finance Committee on November 29, 2006. Subsequently, the CFO indicated that the Policy would be modified and returned to the Budget Committee for further action. It is anticipated that the revised policy will be finalized and brought back to the Budget Committee in early summer. More information specific to desired reserve levels and policy considerations is described in the Reserves section of this report.

Investment Policy
The Investment Policy is reviewed every year (with oversight and input from the City Treasurer's Investment Advisory Committee, consisting of outside investment experts) and was last approved by the City Council in November 2006.

Debt Issuance Policy
Revisions to the existing debt policy including Special Districts formation and debt issuance are planned for City Council review in May 2007. See section on "Debt Capacity" in this report for specific policy considerations.

Budget Policy
The IBA recommends consideration of the creation and adoption of a Budget Policy, to provide a common understanding of principles to be followed and to serve as a guide for annual budget development efforts. The budget policy could include many of the principles referred to in this report, such as:

- The underlying accounting concept of conservatism
- Adherence to best budgeting and financial practices
- Prior Legislative review and authorization of significant budget proposals
- The probability of an outcome of a budget proposal
- Accurate and honest representation of budget proposals
- Ensuring that problems do not get pushed off to the future
- Incorporation of meaningful service levels as part of the budget decision-making process for use by City staff, management, the City Council and the public

Retirement Plan Design Policy
In January 2007, the IBA presented retirement plan design options to the Rules Committee and suggested that the City develop a policy statement to guide ongoing retirement plan administration and design decisions, in accordance with the recommended practice by GFOA. The policy should address the provision of a sustainable and properly funded retirement plan, which will attract

Financial Policies and Budget Practices (cont.)

employees in a competitive labor market, facilitate effective management of the workforce, and fulfill retirement needs.

The IBA is working with the GFOA, as they finalize and update their recommendations practice, to bring further research and recommendations back to the Rules Committee and City Council this year.

Cost Recovery Policy

The City's Administrative Regulation 95.25 outlines the City's procedures to establish fees to recover the cost of providing City services. Once established by the City Council, the Mayor is authorized to conduct annual reviews of the fees and charges to ensure that all reasonable costs incurred in providing these services are being recouped.

While efforts have been made in the past to identify cost-recovery levels, based on estimated costs and projected revenues, the City does not currently have an updated or accurate analysis of the full cost of many fee-supported services, nor is there a comprehensive list of all cost- recovery fees. In a comprehensive survey on this matter sent out to departments this past fall, managers were readily able to identify the annual revenue collected, but frequently could not denote the specific cost to provide the service and the current level of cost recovery. This information is critical in order to determine whether current cost recovery policies are being met, and in developing recommendations for rate increases, if appropriate. Without this information, any fee increase would simply be tied to known inflation costs rather than the actual costs of providing the service.

Departments currently utilize various mechanisms to develop and determine cost recovery rates. Such analyses should be done uniformly across the City organization, utilizing a full costing accounting model to ensure accuracy and consistency. The development and implementation of the integrated Enterprise Resource Planning (ERP) system (which is currently underway) should consider these needs and additional functionalities to facilitate departments effectively performing these types of analyses on a regular basis, using personnel, accounting, and revenue and expenditure data. An annual systematic analysis of fees and rates is an appropriate part of an Annual Work Plan of an Internal Audit function.

An annual fee cost-recovery analysis should be done each year and the results reported as part of the annual budget process. This will facilitate decision-making and incorporate it into the context of annual budget decisions. Once such a program is put into place, costs can be easily updated each year. Once fees have reached appropriate cost-recovery levels, the City should consider implementing systematic increases in order to keep up with inflation in future years.

Recommendation

1. Complete the development and adoption of these financial policies during FY 2008.

Revenues

Effects of Budget Proposals

The Mayor's Proposed Budget includes $1.1 billion in General Fund revenue, an increase of approximately $82.8 million over FY 2007. Approximately 74% of this increase, or $61.3 million, is due to growth in the City's four major General Fund revenues: property tax, sales tax, transient occupancy tax (TOT) and franchise fees. Together, these major revenues account for over 70% of the entire General Fund revenue budget.

General Fund Revenue

	FY 2007	FY 2008[1]	Change
Major General Fund Revenues			
Property Tax	344,196,284	385,688,853	41,492,569
Sales Tax	234,876,334	239,485,958	4,609,624
TOT	72,862,596	83,382,148	10,519,552
Franchise Fees	64,783,012	69,431,697	4,648,685
Other Local Taxes			
Property Transfer	14,872,876	7,570,860	(7,302,016)
Safety Sales Tax	8,193,840	8,401,528	207,688
Vehicle License Fees	9,255,341	7,938,333	(1,317,008)
Other Non-Departmental	34,555,112	66,469,512	31,914,400
Departmental Revenue	237,607,703	235,597,853	(2,009,850)
TOTAL GENERAL FUND	1,021,203,098	1,103,966,742	82,763,644

1. FY 2008 Projections based on FY 2007 year-end projections

In general, the IBA supports the FY 2008 General Fund revenue projections. Growth rates are based on reasonable assumptions and are generally consistent with current revenue trends and the expected economic outlook. It is important to note that in practice, revenue forecasting is an imprecise science, and projections should not be viewed in terms of being "right" or "wrong." For each revenue source, there is typically a range of projections or growth rates that may be viewed as reasonable. Where in this range an actual budget projection lies depends on how conservative or aggressive the projection is. The key, however, is whether or not a revenue projection falls within the reasonable range. The IBA believes that the Mayor's Proposed General Fund revenue projections fall comfortably within that range.

In the Mayor's Five-Year Financial Outlook, comprehensive General Fund revenue projections were made for FY 2008 through FY 2012. The IBA reviewed these revenue projections and commented extensively on the four major revenue sources in IBA Report 07-6. With a few exceptions, there has been little change to the growth rate assumptions for the major and minor revenue sources in the Mayor's Proposed Budget. This review will primarily address the General Fund revenues for which growth rate assumptions have been changed from the Financial Outlook. For a discussion of revenues for which growth rates have remained consistent, and for a more in-depth discussion of the four major revenues, we invite the reader to review IBA Report 07-6.

Property Tax

The Proposed Budget assumes a 6.0% growth rate for property tax. This projected growth rate has increased from 3.5% in the Financial Outlook. As

Revenues (cont.)

discussed in the Financial Outlook and in IBA Report 07-6, the weakening of the residential real estate market is expected to impact growth in assessed valuation, the basis for property tax growth. Assessed valuation has experienced tremendous growth over the past five years as residential and commercial real estate markets have boomed. While the commercial market remains fairly strong, the residential market has experienced a sustained decline in both sales and prices.

While it is clear that this trend will reduce growth in both assessed value and property tax receipts, the big question is how much. In the Financial Outlook, the Mayor took a more conservative position, projecting just 3.5% growth for FY 2008. Subsequently, new information from the County Assessor's Office has caused a revision in the projected growth rate. Preliminary estimates from the County indicate that assessed valuation growth will be around 6.75% in 2007, providing the basis for property tax receipts in FY 2008.

One interesting point to note: even though the median price of homes in San Diego County has been declining, the market price of a current sale may still be significantly higher than the assessed value of that home on the tax roll. There will be a negative impact to assessed valuation, and therefore property tax revenues, only if a home that was sold at peak price is resold at a lesser price.

Transient Occupancy Tax (TOT)

The Proposed Budget assumes a 6.0% growth rate for TOT. While this growth rate is unchanged from the Financial Outlook, the IBA felt it was important to point out that this growth rate projection is quite conservative. Year-to-date growth in TOT revenue is approximately 11.9%, reflecting robust strength in the local tourism industry. However, we do not suggest increasing the FY 2008 projected growth rate to that level. As discussed in IBA Report 07-6, rapid growth in average daily room revenue and rooms nights sold over the past few years suggests that the tourism industry – and TOT revenue – may be coming to a peak, particularly if the national economy experiences a slowdown. That being said, the IBA believes that there may be capacity to increase the projected TOT growth rate for FY 2008. To provide some idea of magnitude, 1% growth in TOT, based on FY 2007 year-end projections, generates approximately $1.5 million in new revenue.

SDG&E Franchise Fee

The Proposed Budget assumes an 8.5% growth in SGD&E franchise revenue, an increase from the 7.5% growth initially projected in the Financial Outlook. This upward revision in the growth rate is based on higher actual receipts in FY 2007. While the IBA believes that the current projection may be a little aggressive, there is no cause at this point to recommend a downward revision. Growth in SDG&E franchise revenue has historically experienced a high degree of variance from year to year. Actual growth rates have at times been well over 10%; at other times closer to zero. Given this unpredictability, the most prudent course of action would be to hold growth rates constant unless there is clear indication that they should be revised one way or the other. However, the higher than projected revenue in FY 2007, coupled with a forecast for sustained high oil and natural gas prices, keep this revised projection within the acceptable range.

Vehicle License Fees

Vehicle License Fee (VLF) revenues are projected to grow by 3.95% in the FY 2008 Proposed Budget. This is an increase from the Financial Outlook, which projected 0% growth in VLF revenues. The revised growth rate is consistent with the projected growth rate for statewide VLF

Other Citywide Discussions

Revenues (cont.)

revenues in the State of California 2007-08 Proposed Budget. While this projection is somewhat curious given that the State Budget also projects new vehicle registrations to increase by 1.2% in calendar year 2007 and by just 0.1% in 2008, it is legitimate to mimic the State's projected growth. However, this revenue should be closely monitored throughout the year.

Booking Fees

The Mayor's Proposed Budget includes $5.2 million for booking fee reimbursements from the State. Booking fees were originally established in the Budget Act of 1990, whereby counties were given authority to charge local agencies for the cost of booking arrestees into county jails or other local detention facilities. In 1999, the State Legislature appropriated funds to backfill cities and other local jurisdictions for their costs associated with paying booking fees to counties.

As part of the Fiscal Year 2006 State Budget Agreement, a new agreement was reached between sheriffs, police chiefs, cities and counties regarding booking fees, which was codified in AB 1805. Under the new agreement, set to begin on July 1, 2007, counties will no longer charge booking fees to cities, and would instead be reimbursed directly from the State. This agreement is designed to have a net-zero impact for cities, which will no longer pay booking fees to counties or get reimbursed by the State.

The City of San Diego is in a special situation, however. The County of San Diego does not charge the City booking fees. Instead, the City and the County have a Memorandum of Understanding (MOU) whereby the City pays the County an annual amount of $5.2 million in exchange for a guaranteed number of beds in County detention facilities for City misdemeanants. This would mean that under the current booking fee agreement, the City would no longer get reimbursed by the State, yet would still be contractually obligated to pay the County per the terms of the MOU. According to Intergovernmental Relations Department (IRD), the Mayor reached an agreement with the Governor that would address this issue. According to this agreement, special language was to be included in State law that would allow the City of San Diego to continue receiving reimbursements from the State. However, upon review of the relevant State law, it does not appear that such language currently exists. IRD has indicated that further research is necessary on this issue. Since San Diego was supposed to continue receiving a State reimbursement under the original agreement, the IBA does not recommend that booking fees be removed from the budget at this time; however, this issue should be closely monitored and resolved before the final budget is approved.

Tobacco Settlement Revenues

On p. 11 of the Executive Summary, the Mayor describes a change in accounting for the Employee Pick-up Savings, which replaces most of the City's previous Tobacco Settlement Receipts (TSRs), to budget the revenues in the year it is collected. The IBA suggests that the City apply this policy consistently to the remainder of the TSRs to be received. The Master Settlement Agreement projects that the City will receive $1.1 million in TSRs in spring 2008. The IBA recommends that the City budget these funds in the 2008 budget.

Recommendations

1. Increase the General Fund revenue budget by $1.1 million for the excess Tobacco Settlement Revenues that is projected to be received in FY 2008. Begin budgeting excess TSR revenue for the fiscal year in which it is projected to be received.

Other Citywide Discussions

Debt Capacity

Effects of Budget Proposals

Volume I of the Mayor's FY 2008 Proposed Budget (pages 57-61) provides a discussion and summary of the City's debt obligations. This section of the Proposed Budget indicates that the City will use debt to finance approximately $380 million of $500-$600 million of General Fund supported deferred maintenance and capital needs over the next five years. It further estimates that $500 million of capital needs for the City's Wastewater and Water Systems will need to be debt financed through 2010. As the issuance of debt will be the City's primary means of financing needed capital infrastructure over the next five years, this section of our report briefly discusses debt affordability guidelines and related factors that impact credit ratings assigned to debt.

Debt Affordability Guidelines

The IBA understands that the CFO and the Debt Management Department are developing a comprehensive debt issuance/management policy for City Council review and discussion within the next few months. We expect that policy may provide some general commentary related to debt affordability. In advance of discussion about the forthcoming policy, the IBA has reviewed rating agency literature and identified a few affordability measures that can provide a useful means of assessing the level of the City's outstanding debt and gauging our capacity for issuing additional debt.

In a release entitled "To Bond or Not To Bond", Fitch Ratings indicates that debt affordability is best viewed in the context of a comprehensive assessment of capital needs. They recommend that prioritizing and quantifying the amount of debt the tax base can support enables an entity to determine the scope and limits of immediate, medium-term, and long-term capital plans. The above referenced debt financing estimates in the Mayor's Proposed Budget suggests that the CFO has already assessed and prioritized the City's capital needs over the next five years.

Fitch Ratings indicates that debt affordability policies are a set of targets or ranges that measure debt levels against economic and financial indicators. The most common limitations set by governments are on: 1) total debt as a percentage of the market value of taxable property, 2) total debt per capita and 3) total debt service as a percentage of the annual budget. Using local economic data and information from the debt obligation table on page 59 in Volume I of the Proposed Budget, the IBA compares the City's General Fund debt position with typical debt policy limits:

Affordability Guideline	Typical Debt Policy Limit	Current City	Comment
1) Outstanding General Fund debt as a % of the market value of taxable property in the City.	2% to 5%	Approximately 0.3%	Very Low
2) Outstanding General Fund debt divided by the City's population - direct debt per capita.	$2,000 to $3,000 per capita	Approximately $369 per capita	Very Low
3) Total debt service for outstanding General Fund debt as a % of the General Fund budget.	High range: 8% to 12%	Approximately 4.5%	Low to Moderate

Debt Capacity (cont.)

A fourth affordability guideline that is sometimes considered examines the time to maturity of each debt issuance with a preference for more than half of an entity's outstanding debt to be retired within ten years. While the City does not meet this test, it is in part explained by the fact that we have matched the term of our debt issuances to the expected useful life of the assets being financed, which is a recommended practice. The City has primarily financed assets (Convention Center, Ballpark, Water/ Wastewater System improvements, etc.) that have a useful life of more than ten years.

Section 90 of the City Charter limits the City's bonded indebtedness, excepting debt for City water facilities, to not more than 10% of the total assessed valuation of all real and personal property in the City subject to an annual property tax levy. On page 58 of Volume I of the Proposed Budget, it states that the City had $12.7 million of outstanding debt subject to a $9 billion (10%) Charter imposed limit as of July 1, 2006. This means that at the beginning of this fiscal year the City had outstanding debt of less than 1% (actually .14%) of the Charter Section 90 limit. When considered in conjunction with the data in the table on the previous page, it is evident that the City has relatively little debt and is well positioned to assume additional debt for worthwhile capital projects.

Related Factors That Can Impact Credit Ratings

In developing a credit rating for the debt issuance of a municipality, rating agencies will look at numerous factors to ascertain the fiscal health and creditworthiness of an issuer. Fitch Ratings has assigned relative values to best financial practices that positively impact their credit ratings. Some of the practices which receive the greatest weight from the rating agency include debt affordability reviews / policies (discussed above), superior debt disclosure practices (Disclosure Practices Working Group, Debt Management's FCMP compliance tracking system, and citywide disclosure training are examples of the City working toward this objective) and strong fund balance reserve policies (the Mayor's Five-Year Outlook targets an 8% General Fund reserve by 2012 which is considered adequate).

Conclusion

In summary, the IBA believes that the City's outstanding debt position is very conservative and will be favorably evaluated by the rating agencies. The City has developed and recently implemented a number of programs, practices and policies that over time should improve the credit ratings received on future debt issuances. The City has ample capacity to prudently issue debt to address various capital needs going forward.

Other Citywide Discussions

Structural Budget Deficit

Effects of Budget Proposals

Although the City of San Diego has a number of options to ensure that the FY 2008 Adopted Budget will be in balance upon its approval in June, it is clear that a structural budget deficit exists that should be addressed to ensure long-term financial stability. A structural budget deficit exists when ongoing revenues do not match with ongoing expenditures. The Five-Year Financial Forecast shows that, even with aggressive reforms, significant deficits exist in future years that will challenge management and elected officials to keep a balanced budget. In addition, other factors will continue to strain finances, particularly the General Fund. This chart was used at the City Council's Strategic Budget Prioritization Process in January to exhibit the magnitude of the then-projected deficit in FY 2009-2012.

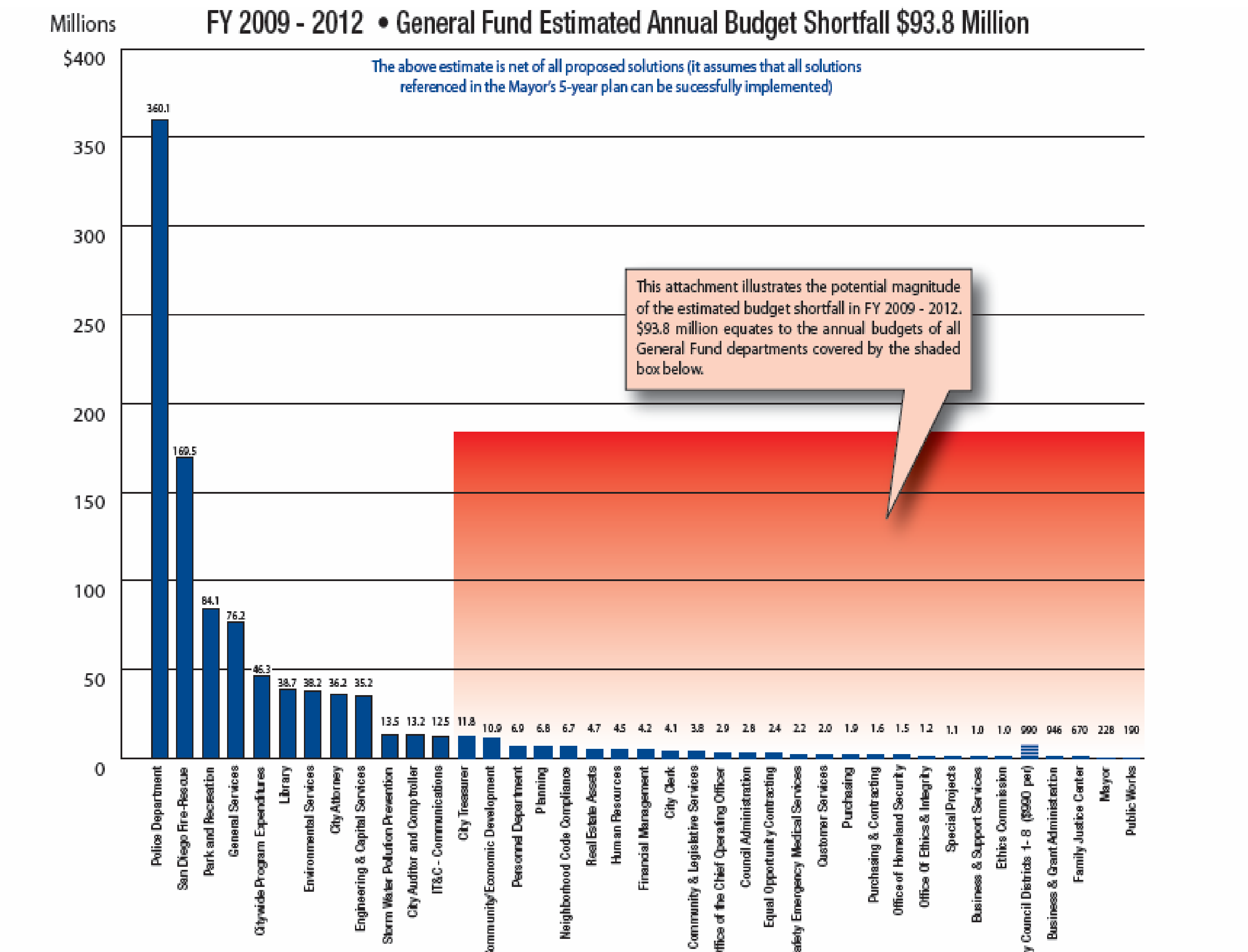


Exhibit 1-2

Structural Budget Deficit (cont.)

Use of one-time fixes

The Mayor's Proposed Budget, as well as many budgets that have gone before it, have used one-time fixes that will not recur in future years. For instance, the release of encumbered funds or outdated fund balances can only be done once, although regular review of these items is warranted and may result in identification of further savings in the future. Nevertheless, this represents savings that must be removed from the budget in FY 2009 and so the underlying structural budget deficit still exists and will resurface each year.

Use of one-time revenues

Again, the proposed and past budgets employ the use of one-time revenues that will not recur in future years. For instance, the correction in recognizing Employee Offset Savings (as a replacement to Tobacco Settlement Revenues) in the year they are received is a prudent action. But, it results in approximately $10 million in revenue that will only occur this year and must be removed from the base budget for FY 2009. Once again, the underlying structural budget deficit will resurface. Another example is the revenue from land sales that could enable enhanced maintenance of City assets. This is not a permanent source of revenue and other resources to address the City's needs will eventually be necessary.

Looking beyond the Five-Year

The concerns raised above are likely to be exacerbated in the years beyond the Five-Year Outlook when the City will stop selling surplus lands and options for one-time fixes are exhausted. This is one reason why it will be critical to continue updating the Five-Year Outlook regularly and adding a new year to the Outlook each time one year drops off. During FY 2008, the Mayor and City Council should begin reviewing the outlook through FY 2013 to recognize new impending challenges.

Service Levels

Notwithstanding the deficits already expected in an environment of questionable service levels in the City, it is incumbent upon the City leadership to explore the taxpayers' desired service levels and develop options to meet those desires. The IBA has long agreed with the current approach to address the City's fiscal security prior to evaluating possibilities for enhanced or expanded services. Yet, we believe that should be an ongoing dialogue with the citizens that begins now. As we have stated, we support the Mayor's strategic plan to increase fiscal stability. We now urge that the City begin a secondary plan that would strategize on how to address the service levels desired by the citizens. As with the fiscal reform plan, this plan would have to be implemented over time and subject to taxpayer support for the corresponding revenues or alternative reductions that may be necessary.

The IBA intends to pursue this topic further in the coming year to provide increased clarity on the structural budget deficit and the themes described above.

Other Citywide Discussions

Vacancies/Salary Savings

Effects of Budget Proposals

In the Mayor's Proposed Budget, a vacancy factor savings was applied to most General Fund departments. The FY 2008 vacancy factor applied to the General Fund departments totaled $37.4 million slightly down from FY 2007 of $38.7 million.

A vacancy factor is intended to reflect normal attrition in an organization. This adjustment is made to department budgets to account for vacant and/or under-filled positions, salary step savings, and recruitment time. It is not an imposed hiring freeze to generate personnel savings throughout the fiscal year. Departments should have the ability to fully staff their departments.

At the beginning of the budget process, the CFO estimated a 3% standard vacancy factor as a baseline reduction for FY 2008. The chart below shows an average vacancy factor of 2.8% that has been proposed for FY 2008 in the General Fund excluding Police, San Diego Fire-Rescue and Storm Water Pollution Prevention departments. The FY 2008 average vacancy factor of 2.8% is similar to FY 2007's average vacancy factor of 2.7%.

The vacancy factor for the Police Department was increased by $2.0 million as a result of the current recruitment and retention problems currently being experienced by the department. The vacancy factor for the San Diego Fire-Rescue Department was decreased by $3.5 million as a result of a vacancy factor that was too high in FY 2007, which subsequently resulted in a salary and fringe deficit.

The Storm Water Division is adding 13.50 positions in FY 2008 related to the new funding allocated for Permit compliance. The vacancy factor is due to the normal delay in the hiring process.

Conclusion

Given Business Process Reengineering adjustments and reduced staffing levels resulting from the Mayor's proposed solutions, the FY 2008 vacancy factor appears reasonable. The Mayor's Proposed Budget states that the vacancy saving estimates will be reviewed throughout the fiscal year and will be modified if needed.

Other Citywide Discussions

Vacancies/Salary Savings (cont.)

Fiscal Year 2008 General Fund Vacancy Savings				
Department	**FY 2007 Vacancy Savings**	**FY 2007 Vacancy Percentage**	**FY 2008 Vacancy Savings**	**FY 2008 Vacancy Percentage**
City Clerk	(22,742)	0.7%	(82,975)	-2.3%
Equal Opportunity Contracting	(182,448)	-8.8%	(57,022)	-2.4%
Community/Economic Development	(383,596)	-8.7%	0	0.0%
City Attorney	(1,284,569)	-3.7%	(831,238)	-2.4%
City Auditor and Comptroller	(704,656)	-6.9%	(477,146)	-4.7%
City Treasurer	(44,765)	-0.7%	(231,276)	-2.2%
Financial Management	(332,522)	-11.3%	(75,644)	-2.4%
Debt Management	(11,064)	-0.7%	(56,707)	-2.4%
Purchasing	(131,102)	-7.5%	(47,256)	-2.4%
Personnel Department	(40,908)	-0.7%	(140,097)	-2.3%
Labor Relations	(19,650)	-0.6%	0	0.0%
City Planning & Community Investment	(634,532)	-10.9%	(467,278)	-4.7%
Real Estate Assets	(24,373)	-0.7%	(92,719)	-2.4%
Mt. Hope Cemetery	(7,232)	-0.8%	0	0.0%
Reservoir Concessions	(7,232)	-0.6%	0	0.0%
Neighborhood Code Compliance	(334,960)	-5.9%	(134,751)	-2.4%
Purchasing & Contracting	(9,507)	-0.8%	0	0.0%
Office of Homeland Security	(7,665)	-0.7%	(29,206)	-2.4%
Business Operations & Administration	0	0.0%	(53,096)	-2.4%
Community & Legislative Services	(17,560)	-0.6%	(80,104)	-2.4%
Office of Ethics & Integrity	0	0.0%	(59,588)	-3.8%
Library	(453,286)	-1.6%	(683,384)	-2.4%
Park & Rec - Administrative Svcs	(194,811)	-23.5%	(48,209)	-2.4%
Community Parks I	(56,587)	-0.6%	(181,666)	-2.1%
Developed Regional Parks	(757,015)	-3.2%	(472,108)	-2.1%
Community Parks II	(82,811)	-0.7%	(237,779)	-1.8%
Park Planning and Development	(169,028)	-4.2%	0	0.0%
Open Space Division	(331,454)	-11.4%	(76,871)	-2.5%
Environmental Protection	0	0.0%	(39,787)	-2.4%
Collection Services	(319,962)	-3.1%	(239,239)	-2.2%
Resource Management	0	0.0%	(29,689)	-2.3%
Facilities	(494,831)	-4.9%	(320,281)	-3.2%
Parking Management	(187,205)	-2.5%	0	0.0%
ECP-Field Engineering	(84,047)	-0.7%	(295,314)	-2.4%
ECP-Architectural Engineering and Contracts	(26,587)	-0.6%	(450,901)	-7.6%
ECP-Transportation Engineering - Design	(45,348)	-0.7%	(212,342)	-3.1%
ECP-Transportation Engineering - Ops	(34,750)	-0.7%	(123,764)	-2.3%
Street Division	(465,897)	-2.0%	(1,164,872)	-5.3%
Customer Services	(6,915)	-0.5%	(40,581)	-2.3%
Police Department	***(19,310,722)***	***-6.2%***	***(21,344,700)***	***-6.7%***
San Diego Fire-Rescue	***(11,473,397)***	***-7.6%***	***(8,000,000)***	***-5.2%***
Storm Water Pollution Prevention	***(10,530)***	***-0.5%***	***(553,264)***	***-14.7%***
Total General Fund	**(38,706,266)**	**2.7%**	**(37,430,854)**	**2.8%**

***** Police, SDFR, & Storm Water were not included in the vacancy percentage.***

Other Citywide Discussions

City Remediations

Effects of Budget Proposals
In the Mayor's memo of August 24, 2006 laying out a plan for implementation of remedial recommendations, fiscal impacts were identified where applicable. The Mayor's Proposed Budget includes funding for these remediations as follows:

Enterprise Resource Planning (ERP) System
The City's Remediation Plan called for implementation of a new financial information system within three years. On February 5, 2007, the City Council adopted Resolution R-302332 which approved, in concept, the ERP described in Report to the City Council No. 07-027 and requested that the Mayor's staff return to the City Council to approve a financing package for the ERP. On April 24, 2007, the Debt Management Department and the Chief Information Officer received approval to enter into a $29.5 million lease-purchase agreement with IBM to finance the implementation of an ERP system.

Although the hardware, software and systems integrator have yet to be selected, the Mayor's staff anticipates spending approximately $6 million in Fiscal Year 2007, $20.5 million in Fiscal Year 2008 and $10 million in Fiscal Year 2009 for a total estimated system implementation cost of $36.5 million. The City has already incurred pre-implementation costs of approximately $191,000. A special revenue fund has been established for the ERP project (pages 305-307 of Volume II of the Fiscal Year 2008 Proposed Budget).

In the Proposed Budget, $843,000 has been budgeted for debt service on funds anticipated to have been borrowed from the IBM lease-purchase facility. Approximately 54% ($458,000) of the debt service is budgeted within the General Fund - Citywide budget with the remaining 46% ($384,000) funded by the non-General Fund departments. We note, however, that the accompanying proceeds from the lease-purchase draw ($21.3 million in FY 2007 and FY 2008 according to Report to the City Council No. 07-027) do not appear to have been budgeted for expenditure. Given that the debt service has been budgeted, the IBA recommends that the borrowed proceeds and the associated expense similarly be budgeted for appropriation in the FY 2008 budget.

Independent Consultant
In January 2007, the City engaged Mr. Stanley Keller to serve as an Independent Consultant to the City, in accordance with the agreement with the Securities and Exchange Commission. At the time, up to $2 million was authorized for associated expenses for the balance of the fiscal year. For Fiscal Year 2008, the Mayor has proposed a $1 million budget, budgeted across City funds. The contract with Mr. Keller is not-to-exceed $4 million and extends through expiration of the contract on March 1, 2010.

Audit Committee
In his original response to the Remediation Plan, the Mayor estimated that funding of $150,000 would be added to the Auditor's budget to support this committee. The Mayor initially recommended that the committee be comprised of private citizens that would serve without compensation. However, the City's Audit Committee was subsequently formed as a committee of the Council due to Charter restrictions and in accordance with best financial practices. No funding was added to the Auditor's budget for support; however, 1.00 FTE and associated expense of almost $108,000 was allocated to the Council Administration budget for a committee consultant to support the Audit Committee, similar to the committee consultants for all other council committees.

Other Citywide Discussions

City Remediations (cont.)

Based on several discussions at the Audit Committee in March and a subsequent discussion at the City Council meeting on March 27, 2007 for the Mid-Year Budget Adjustments, the City Council authorized an addition to the FY 2007 budget for professional level staff or consultant support for the Audit Committee. This position and funding is not reflected in the FY 2008 Proposed Budget and should be added.

Financial Training

The City's Remediation Plan recommends that the CFO, in conjunction with the Internal Auditor and the Audit Committee, develop an adequate and effective training program for finance employees to ensure that they maintain competency and remain current in such areas as financial management, external and internal financial reporting and reliable public disclosure.

Additionally, the Remediation Plan recommended that employees of the Metropolitan Wastewater Department (MWWD) receive special training directed at ensuring the City complies with all contractual requirements, laws and regulations and reporting any noncompliance to the appropriate individuals or entities. Although the details of an annual training program have yet to be developed, the Mayor's Proposed Budget allocates funding for training and training-related travel in each of the financial departments and MWWD as follows:

FINANCIAL TRAINING ALLOCATION		
Auditor & Comptroller	$134,742	$1,361/employee
Debt Management	$44,495	$2,022 /employee
Financial Management	$51,300	$1,710/employee
Treasurer	$69,925	$ 564/employee
MWWD Administration	$44,493	$ 247/employee
Total	**$344,955**	

In his initial response to the City Remediation Plan, the Mayor estimated that an additional annual allocation of $500,000 would be needed to meet citywide training efforts in this area. It should also be noted that the per employee figures (in the chart) cover all employees and that the recommended training would not be necessary or appropriate for all department employees.

The Mayor's Proposed Budget also does not include funding for City Council Financial Training. On December 6, 2006, the City Council adopted resolution R-302243 implementing a plan to provide training to the City Council in accordance with IBA Report 06-59 and as recommended in the City Remediation Plan. IBA Report 06-59 suggested that the program proposed by the IBA and approved by the City Council would be approximately $15,000 per year. The IBA recommends the City Council add these funds to the budget to ensure that monies are available to continue financial training for all City Council members in FY 2008.

Repayment of Retiree Health

In the 1980s and 1990s, the SDCERS fund paid retiree health care benefits out to retirees on behalf of the City. As trust monies were not to be used for this purpose, the City will now pay the SDCERS Trust back $33 million for the cost the fund incurred, including interest. The Mayor's Remediation Plan contemplates paying this back over a five-year period at $8.3 million per year for a total of $41.3 million. The FY 2008 Proposed Budget includes funding of $7.3 million, across City funds, to begin paying this obligation.

City Remediations (cont.)

Because this amount is less than originally anticipated in the Mayor's plan, it may take additional years at a cost greater than $41.3 million to fully repay this obligation, dependent on funding allocated in FY 2009-2012.

Actuary

In his original proposal, the Mayor anticipated the need for an additional $20,000 in FY 2008 for actuarial service related to recommendations in the Remediation Plan. The Mayor's Proposed Budget actually includes an additional $500,000 for actuarial services. Some of these services may extend beyond those suggested in the Remediation Plan.

Recommendations

1. Add funding ($225,000 is suggested) to be used for professional support to the Audit Committee as approved in Mid-Year Budget Adjustments.
2. Given that the debt service for funds borrowed to finance ERP expenditures has been budgeted, the IBA recommends that the borrowed proceeds (estimated to be $21.3 million in fiscal years 2007 and 2008) and the associated expense be similarly budgeted for appropriation in the Fiscal Year 2008 budget.
3. Add $15,000 to the FY 2008 Budget for City Council financial training.

Other Citywide Discussions

Service Levels

A Government Finance Officers Association (GFOA) Best Practice in Public Budgeting recommends that "program and service performance measures be developed and used as an important component of long term strategic planning and decision making which should be linked to governmental budgeting." We have been advocating for the inclusion of service level information and review as a part of the budget process since our formation and included recommendations as such in our Preliminary Report a year ago.

Over the past year, there has been a significant amount of Council discussion relative to the need for service level information in the budget process. The Council has expressed that such information is critical for the public as well as for management and legislative decision making. Additionally, the provision of service level information in the budget is a means by which to protect legislative authority in the budget process by documenting legislative intent to fund specific services and programs.

To reinforce the importance of service levels, on January 29, 2007, the City Council unanimously adopted its Budget Priorities Resolution for FY 2008 (R-302315) requesting as one of its six priorities, that "the Mayor provide the service level impact for programs and services that are recommended for funding reductions in the FY 2008 Proposed and Final Budgets." On February 5, 2007, the City Council unanimously adopted Resolution R-302331 requesting that the Mayor as part of the his Proposed Budget each year identify current service levels being provided to the community as well as any proposed changes to those service levels that will result from programmatic reductions or eliminations.

In March, the Mayor rolled out a major initiative known as the "City of San Diego Management Program"- a performance management initiative which will enable the City "to integrate strategic planning, performance monitoring and budget decision-making." The Mayor has indicated that, from this process, performance indicators focusing on relevant outcomes (how we are doing) rather than simple outputs (what we are doing) will be developed over the next year for all City departments. The intent is to have this process completed in time for incorporation into the FY 2009 budget process. We completely support this effort.

In a February 22, 2007 memorandum to the Council, in response to the City Council's resolutions requesting service level information for the FY 2008 budget process, the Mayor noted that limited output information would be made available for the FY 2008 budget deliberations. The Mayor noted that output information is valuable and interesting, but unenlightened and irrelevant; and, in his opinion, it can not be tied directly to budget decisions.

Our office believed that service levels were going to be an integral part of the business process reengineering and that meaningful service levels would be available, at a minimum for the departments that had completed their BPRs. One of the key steps of the BPR process as noted in the City's "BPR Guide" is to develop three to five performance metrics for the area under review. The intent is to allow for analysis of performance before and after process improvements, and to determine if new measures should be established based on new processes. According to staff, departments that participated in the BPR process have not finalized any service level information and they were not required to incorporate them into their BPR reports. To date we have been not able to obtain any service level information that was reviewed or analyzed during the BPR processes; and we were not able to rely on BPRs

Service Levels (cont.)

at this point for any service level data.

We agree with the Mayor that the City is not at a point of being able to provide sophisticated performance data for this year's budget. In the absence of this data and BPR-related data, we believe that certain output information is valuable and important for FY 2008. The service level information provided by the Mayor in the FY08 proposed budget in response to the Council resolutions is inadequate. This year's budget document provides some output measures for some departments for the current fiscal year but no information is provided for the prior fiscal year or upcoming fiscal year to provide context for the current year data. Also, key service level data that is readily available is missing in several critical areas.

The **Police Department** provides information on the number of calls dispatched, but no information is provided on response times for service or property crime and violent crime rates. Similarly, no response times are reported for **San Diego Fire Rescue**. Response times are of utmost interest to the community and an indicator to management and City Council of possible operational concerns. We have provided this information in the Police and Fire chapters of this report.

No workload indicators such as total permits issued or inspections performed are provided for **Development Services-** a department which is losing 115 employees as a result of reduced construction activity. This information is pertinent to justifying and understanding the budget decisions relative to the significant reductions. We noted that the following common, key service levels were not provided that could shed light on significant activities particularly when compared from fiscal year to fiscal year:

Neighborhood Code Compliance:
- Number of complaints investigated
- Response times to complaints
- Cycle time for processing complaints
- Number of citations issued
- Number of graffiti removal projects

Risk Management:
- Claims received/closed
- Number of settlements
- Lost days (workers compensation)
- Number of industrial claims filed

General Services:
- Miles of streets resurfaced/slurry sealed
- Miles of streets per maintenance employee
- Square feet of facilities maintained

Engineering and Capital Projects:
- Total construction dollars managed

Water:
- Number of customers
- Miles of pipe replaced
- Average gallons of water used per capita per day

Areas where good output data is provided include **Environmental Services, Park and Recreation, Library, Water and Wastewater**.

The biggest concern we have relating to service levels, however, is the Mayor's definitive claims that no service cuts or service impacts will result from his Proposed Budget. The Mayor has indicated that this is due to of business process reengineering, technological improvements and a reduction in vacancies rather than filled positions.

Service Levels (cont.)

Our review shows reductions outside of the BPR process of the following positions that provide direct services to the community and have been priorities in the past:

Position	FY 2007	FY 2008	Net Change	Percent Change
Park and Recreation				
Grounds Maintenance Workers	344.50	313.00	-31.50	-9.1%
Aquatics Staff	8.90	5.90	-3.00	-33.7%
Park Rangers	34.00	29.00	-5.00	-14.7%
Parks Custodians	20.50	18.50	-2.00	-9.8%
Utility Workers	26.60	20.00	-6.60	-24.8%
Library				
Librarians	106.76	100.16	-6.60	-6.2%
Library Aides	62.99	55.99	-7.00	-11.1%
Library Assistants	48.64	40.14	-8.50	-17.5%
Library Technicians	15.00	12.00	-3.00	-20.0%
Library Clerks	106.54	100.54	-6.00	-5.6%
Neighborhood Code Compliance				
Utility Workers: Graffiti Removal	10.50	8.50	-2.00	-19.0%
Code Compliance Officers: Land Development Zoning	25.00	22.00	-3.00	-12.0%
Police				
Police Service Officers	75.00	70.00	-5.00	-6.7%
San Diego Fire-Rescue				
Code Compliance Officer: Brush Management	1.00	0.00	-1.00	-100.0%

We are skeptical of the Mayor's broad statement that no services will be impacted in these areas for the following reasons:

- Some of these areas have not yet undergone Business Process Reengineering to generate process improvements. (Note: The 7 PSO's in Police were reflected in their Phase I BPR but the reductions did not result from new process improvements.)
- There are no significant technology improvements that we can identify which could help offset position reductions. The exception is the Library. The installation of additional self-checking equipment is estimated to offset a reduction of 4.5 Library positions.
- Significant cuts have been made to these areas in the past and, based on anecdotal information, workloads have not declined and possibly increased as new facilities have come on line as new North University Branch Library scheduled to open in the Fall of 2007 with no new funding.
- There has been no significant review of meaningful service levels in these areas that we are aware of that would support this conclusion.
- Many of these positions have been vacant as a result of directives in the past to hold positions vacant to generate savings or provide placement opportunities for other employees. It can not be concluded, that because they are vacant, these positions are not necessary to provide services and programs. **Without reliable data, the honest answer to the question: "Will service levels be impacted as a result of the Mayor's Proposal Budget?" is "It's impossible to know." The focus should now turn to remedying this situation.**

Conclusion

While we are skeptical of the Mayor's broad claims that no services will be impacted by the position reductions noted above, we do agree that position reductions are necessary in order to achieve a balanced budget and, therefore, do not recommend their restoration. We do feel it is important to identify for the community and City Council the potential impacts of certain position reductions. Additionally, we believe that identifying, monitoring and publishing meaningful service levels for all these areas, at a minimum, should be a top priority.

Recommendation

1. Service levels should be identified, monitored and published so that the City Council and the public can be apprised of any potential impacts of these position reductions.

Other Citywide Discussions

Appropriation Ordinance

What is the Annual Appropriation Ordinance?

City Charter Section 71 prescribes that in July of each year the City Council must pass an appropriation ordinance, which becomes the City's legal budget spending authority for the fiscal year. The Appropriation Ordinance should establish a comprehensive framework for management of the budget throughout the fiscal year, including the proper delegation of Council authority, and appropriate specific budget dollars for the

Changes to the Annual Appropriation Ordinance

In recent years, the Appropriation Ordinance had become quite lengthy (81 pages in Fiscal Year 2006), and included a broad delegation of authority to the Auditor and Comptroller and the Financial Management Department to administratively implement budget adjustments to Council-approved appropriations. During the Fiscal Year 2007 budget process, a thorough review of past documents was undertaken. The review placed an emphasis on returning the authority for budget adjustments to the City Council, determining the appropriate delegation of authority, and eliminating unnecessary accounting fund detail within the ordinance. The resulting Fiscal Year 2007 Appropriation Ordinance was less complex and more concise (12 pages in length). Most importantly, the Fiscal Year 2007 Appropriation Ordinance significantly curtailed the ability to modify appropriations without City Council approval.

In Fiscal Year 2007, budget adjustments that were typically handled administratively in the past may now require specific action by the City Council, such as the appropriation of excess revenues for a specific fund, or departmental program or purpose. On the other hand, significant efforts were made to appropriately budget for anticipated departmental expenditures, including categories that may have been historically underfunded. The IBA believes that efforts to budget at more appropriate levels will minimize the need for ongoing budget adjustments throughout the fiscal year. Correspondingly, budget adjustment requests to the City Council should only be for items that were truly unanticipated in the budget process or for situations where unforeseen circumstances impacted key assumptions that were relied upon to develop the budget.

In prior years, balanced budgets were achieved by making numerous adjustments to the budget at the conclusion of the fiscal year. This was done by adjusting revenue and expenditure amounts to align with actual levels, and re-allocating or modifying departmental budgets as needed. As a result, the City Council was presented with a single recommendation to support a myriad of requested adjustments at the end of the fiscal year in order to balance the budget, with limited opportunity for full discussion.

In a change from past practice, efforts have been made in Fiscal Year 2007 (i.e., adoption of the mid-year budget adjustments ordinance in March 2007) to periodically identify needed budget adjustments throughout the fiscal year. This change provides information to the City Council in a more timely manner, when issues arise that may affect the budget. The IBA believes that scheduled opportunities to exchange information during the fiscal year, when necessary, better enables the City Council to become apprised of unanticipated issues and participate in the process of identifying possible solutions.

Budget Authority

The IBA believes that the annual budget is a contract between the City Council and the Mayor. The Mayor proposes the budget on April 15th of

Appropriation Ordinance (cont.)

each year. The City Council amends or approves the spending policies after more than two and half months of public hearings. What is represented to the public throughout the public hearing process, as being funded or not funded in the budget, is the contract the City has with its citizenry.

Once the budget is adopted, it is up to the Mayor to execute that contract in good faith. We feel that budget and policy changes, made after budget adoption, <u>that affect the public</u> should be brought forward to the City Council in a public forum. Not doing so leaves the citizenry out of what should be a very public process.

The City Council is, more times than not, the first line of contact for citizens seeking information or explanations and expressing their opinions and concerns. Therefore, it is critical that the City Council be apprised when changes are being considered to the representations they have made to the public in good faith throughout the budget process. If the City Council is not well-informed, the public is not well-served. Going forward we believe it is critical that all actions that have <u>service level or policy implications</u> be communicated to the Legislative branch and the public in a timely manner and prior to implementation.

In the Strong Mayor form of government, the City Council has the ultimate budget authority per the Charter. The Council can amend the Mayor's budget and override his veto of any change. The budget per the Charter is the controlling document for the preparation of the Annual Appropriation Ordinance. The Mayor has no veto power over the Annual Appropriation Ordinance. It is the Council's prerogative to delegate some of their budget authorities to the Mayor through the Appropriation Ordinance which they do in order to allow for more efficient and effective business operations.

It is only through the Annual Appropriation Ordinance and the Council's agreement, that the Mayor has the budget authority that he does. While the Mayor has full operations authority in the City, it is through the policy objectives set forth in the annual budget. Per the Charter, the manager (Mayor) as the Chief Budget Officer of the City, is responsible for "planning the activities of the City government and for adjusting such activities to the finances available." The IBA believes that there must be an inherent understanding and trust that the Council will at minimum be informed and be included in decision-making when budget and policy issues surface that require changes during the year, particularly when those changes are going to impact the public.

Using the Appropriation Ordinance to Provide Public Service Level Assurances

The IBA believes that the Annual Appropriation Ordinance should provide the following two assurances to the City Council and the public:

1. That the level of public services represented by the Mayor and approved by the City Council will be provided unless unanticipated financial or operational circumstances limit the Mayor's ability to do so.
2. If the Mayor believes that an unanticipated financial or operational circumstance precludes his ability to provide promised and/ or budgeted levels of public service, the Mayor should request City Council approval before reducing, altering or eliminating those services.

In the extreme, it has been suggested that the City Council could request that City departments provide a detailed list of all of their public service levels for inclusion into an expanded Annual Appropriation Ordinance.

Other Citywide Discussions

Appropriation Ordinance (cont.)

This would ensure that any proposed service level change receive City Council discussion and approval in a public meeting. While this approach is possible, it would be a cumbersome, costly and unusual practice. The IBA believes there is a more cost-effective and cooperative way to provide reasonable assurances to the City Council and the public.

The IBA recommends that funding for all City services and programs, and their associated service levels, be continued at the same level provided in FY 2007 unless otherwise modified in the adopted FY 2008 budget.

Additionally, the IBA would identify those explicit service level representations contained within the Mayor's press releases related to the contents of his Proposed Budget and recommend that they also be included in the Appropriation Ordinance as required service levels. The aforementioned public service levels would be covered by language in the FY 2008 Appropriation Ordinance. Any changes to these identified service levels would require City Council approval and opportunity for public comment.

Although we believe the above paragraph is the best approach, we would like to receive constructive feedback and explore other suggestions that might provide the City Council and the public assurance with respect to budgeted service levels. In an effort to facilitate this dialogue prior to the preparation of the FY 2008 Appropriation Ordinance, the IBA plans to form a task force comprised of representatives from the CFO, Auditor & Comptroller, Financial Management, Office of the City Attorney and our office to effectively and cooperatively address this issue.

Business and Support Services

In FY 2008, Business and Support Services has been restructured to include the following departments: Personnel, Labor Relations, Purchasing and Contracting, the CIO, Customer Services, Park and Recreation, Library and Business Operations and Administration. The department was new in FY 2007, comprised of positions previously budgeted in other General Fund and Non-General Fund departments and new positions. This section will include a review of three of the above referenced departments.

BUSINESS OPERATIONS AND ADMINISTRATION

Effects of Budget Proposals

As a new department for FY 2008, Business Operations and Administration provides executive oversight of all departments embedded within Business and Support Services. These new oversight responsibilities were added to the responsibilities of the Business Office delineated in FY 2007, including BPR, Managed Competition and the City Management Program.

A total of 11.25 positions were added to Business Operations and Administration, 10.25 of which were transfers and with two new adds and one reduction. Two positions were transferred from the Chief Operating Officer's office including the Assistant Chief Operating Officer (ACOO) and an Executive Secretary. With the elimination of the Business and Grant Administration department, 7.25 positions were transferred to Business Operations. The Grant Director has indicated that this transition will have no operational impact on grant administration, since this department has been reporting to the ACOO since its creation in FY 2007. The remaining two positions in Grant Administration were transferred to Community and Legislative Services. This transfer reflects the function of these positions, as they do not perform services related to business and grant administration.

Vacancy Factor

The Business Operation and Administration budget includes a vacancy factor of 2.4%. This is consistent with the citywide standard of 3%. This department did not have a vacancy factor in FY 2007.

Business Process Reengineering (BPR)

The new Grants Coordination Team "was established to improve the efficiency and effectiveness of grants and gifts on a citywide basis." The final transfer was one Program Manager from Neighborhood and Customer Services. Two Program Managers represent new position adds that were identified in the Human Resources and IT BPRs: Group HR Manager and Group IT Manager. One Organizational Effectiveness Supervisor was reduced to help offset the cost of one group manager, however, there was a $13,000 difference added to the department's budget.

LABOR RELATIONS

Effects of Budget Proposals

Formerly titled Human Resources, Labor Relations is a new department for FY 2008. This department was reduced by 31.50 positions, 28.50 of which went to Risk Management. An additional three positions were transferred because their activities related to Special Training now located under Customer Services. The remaining positions that comprise the department include one Labor Relations Manager, four Program Managers, and one Executive Secretary. This staff will liaise and negotiate with the City's five labor unions.

Business and Support Services (cont.)

Vacancy Factor
The vacancy factor for labor relations is 0%, since no vacancy factor is applied to departments with under ten positions. A 0.6% was applied to this department in FY 2007; however, it served the function of Human Resources and contained 37.50 FTEs.

Business Process Reengineering (BPR)
Labor Relations is not scheduled for BPR review. Whereas Human Resources underwent a BPR, the Labor Relations division is not currently scheduled to undergo a BPR.

PERSONNEL
Effects of Budget Proposals
The Personnel Department eliminated 3.98 positions as part of Phase I of the Five Year Plan's Position Reductions (1.98) and the Mayor's 4% reductions (2.00). In addition 1.20 FTE was swapped out for an equivalent associated PE dollar amount in Overtime and Temporary Help. This swap represented a net-zero impact to the department. A reduction of $642,000 to department revenues occurred due to a cancellation of SLAs.

Vacancy Factor
The vacancy factor for Personnel in FY 2008 is 2.3%, up from 0.7% in FY 2007, yet consistent with the citywide standard of 3%.

Business Process Reengineering (BPR)
Personnel is not scheduled for BPR review.

Departments

City Attorney

	FTE		PE		NPE		Total		Revenue
Fiscal Year 2007 Budget	335.22	$	34,820,413	$	1,384,745	$	36,205,158	$	8,014,550
Vacancy Factor (07)	-		1,284,569		-		1,284,569		-
Vacancy Factor (08)	-		(831,238)		-		(831,238)		-
Salary and Wage Adjustments	-		(1,210,722)		-		(1,210,722)		-
Increase to OPEB	-		651,536		-		651,536		-
Subtotal	*335.22*	*$*	*34,714,558*	*$*	*1,384,745*	*$*	*36,099,303*	*$*	*8,014,550*
Support for Information Technology	-		-		(583,082)		(583,082)		(1,851,288)
Support for Supplies and Services	-		-		785,331		785,331		-
Subtotal	-	*$*	-	*$*	*202,249*	*$*	*202,249*	*$*	*(1,851,288)*
TOTAL	**335.22**	**$**	**34,714,558**	**$**	**1,586,994**	**$**	**36,301,552**	**$**	**6,163,262**
Difference from 2007 to 2008	-	$	(105,855)	$	202,249	$	96,394	$	(1,851,288)

Effects of Budget Proposals

The City Attorney's budget reflects an increase of $831,000 to various non-personnel accounts over FY 2007. These increases are mitigated by significant decreases in the personnel category (described below), resulting in a net increase of $96,000 for the department. Recently, the City Attorney has discussed the historical underfunding of his department and initiated requests during FY 2007 for additional funds in the amount of $1.25 million to correct the ongoing problem.

As part of the FY 2007 Mid-Year Budget Adjustments, projections for the City Attorney at that time showed an expected overexpenditure of $796,000 in the non-personnel category, which was offset by salary savings of $613,000. The Mayor's Proposed Budget addresses these same issues for FY 2008 by reducing average salaries, and including increases to non-personnel accounts.

Vacancy Factor

The vacancy factor has been reduced from 3.7% to 2.4% of the personnel budget, an increase of $453,000 to the department budget. For FY 2008, the vacancy factor results in a reduction of $831,000 in the personnel category due to expected vacancies, as compared to $1.3 million for FY 2007. The department is expected to achieve this level of savings and approximately $600,000 more (total of $1.8 million). This high level of savings in the current year has been attributed to a higher than necessary average salary for deputy city attorneys, which has been reduced in the FY 2008 budget, contributing to the negative salary and wage adjustment in the table above.

Position Requests

The Department submitted requests for the addition of 25.22 FTEs, at a total cost of $3.4 million, which were not included in the Mayor's Proposed Budget. A portion of these positions were described as supplemental positions that were not included in previous budgets.

In an April 16, 2007 memorandum to the Mayor and City Councilmembers, the City Attorney clarified that the City Attorney's Office has been fully staffed throughout most of 2006 and all of 2007, and is in the process of filling two recent vacancies in the Public Infrastructure Unit.

Departmental Revenues

Departmental revenue estimates have been reduced by $1.85 million due to the elimination of Service Level Agreements (SLAs) with other City departments, consistent with the actions taken during this fiscal year. Information submitted in the budget system shows an initial request to reduce

City Attorney (cont.)

revenues by almost $3.1 million, which was later revised to a reduction of $1.85 million.

Business Process Reengineering (BPR)
As a non-Mayoral department, the Office of the City Attorney is not scheduled for BPR review.

Issues for Legislative Consideration
As described in the KPMG's memo entitled "Independent Auditors' Report on Internal Control Over Financial Reporting", it was noted that limited communications occur between the Risk Management Office and the City Attorney's Office regarding outstanding case reserves and other litigation issues. Because the City is self-insured, the City is required to establish liabilities in its financial records, and develop plans for the payment of possible claims. The lack of communication may have led to the overstatement of estimated amounts for public liability claims in the City's financial statements.

The IBA recommends that a communication plan be developed to ensure timely and accurate information is shared between these departments, and the City Council, on a regular basis regarding litigation issues and related costs.

The City Attorney intends to pursue the request to add 25.22 supplemental positions, plus additional funds for training, tuition reimbursement and case management software, to the FY 2008 Budget. Since average salaries have been reduced for next fiscal year, the department will be unable to absorb expenditures related to unbudgeted positions.

The City included an additional 270.51 positions in the FY 2007 General Fund Budget to correct past practices of allowing supplemental positions to exist outside the budget process. It is unclear how this situation continued to exist in the City Attorney's office.

Complete information regarding the status of the department's filled and vacant positions should be evaluated by the CFO, in order to determine if the requested 25.22 positions are truly supplemental. This request could be included in the Mayor's May Revision to the Proposed Budget for consideration, if the request is determined to be justified. If not, steps will need to be taken to eliminate these phantom positions in order to avoid over expenditures in the office.

Recommendation
1. Develop a communication plan to ensure timely and accurate information is shared between the City Attorney and Risk Management departments, and the City Council, on a regular basis regarding litigation issues and related costs.

City Auditor & Comptroller

Effects of Budget Proposals

What caused department staffing to be reduced from 107 to 99 positions when there has been insufficient staff to perform needed internal audit functions and with other significant responsibilities looming in Fiscal Year 2008?

Although there were other restructuring changes that caused internal position movement, the reduction of positions in this department is primarily explained by the transfer of eight positions to departments that either better matched with their responsibilities or funded their work as noted below:

- **5.00 FTEs** were transferred from the City Auditor & Comptroller to the City Treasurer. These positions conduct audits of hotels, lessees and franchises to ensure revenues due to the City are remitted timely and accurately.

- **3.00 FTEs** were transferred from the City Auditor & Comptroller to Retirement. Retirement was already funding their expense and directly receiving the benefit of their services.

Has the City Auditor & Comptroller position been eliminated in the FY 2008 Proposed Budget?

Yes. The City Auditor & Comptroller position has been eliminated in the Proposed Budget and another Assistant City Auditor & Comptroller was added, for a total of two. One Assistant City Auditor & Comptroller would be for the Deputy Comptroller and the other would be for the Internal Auditor position that is currently being recruited. It may be that the Mayor intends to appoint the CFO, subject to City Council approval, to serve in the dual role of CFO and City Auditor & Comptroller (in title only as the position has been eliminated).

Vacancy Factor

The City Auditor and Comptroller budget includes a vacancy factor of 4.7%, which is above the 3% citywide standard. The vacancy factor was 6.9% in the FY 2007 Budget. The department's vacancy experience through accounting period five was 15%. Although department management has informed the IBA that they currently have between 10 and 20 vacancies out of 99 budgeted positions (10-20%), they also indicate they anticipate filling most of these vacancies by June 30, 2007. We recommend that vacancies be carefully monitored throughout the year. The vacancy factor should be adjusted mid-year if necessary.

The Importance of Auditor Independence

In their recommendation for an independent Auditor General (now referred to as an internal auditor), Kroll makes the following statement: "Currently, the functions of accounting and financial reporting are combined with the function of internal auditing in the Office of the City Auditor and Comptroller; in substance, the auditor audits his own work. Such a structure lacks the requisite level of independence widely viewed as essential for a sound financial reporting system."

City Auditor & Comptroller (cont.)

Business Process Reengineering (BPR)

Dates for BPR analysis for departments within the Department of Finance are yet to be determined.

Issues for Legislative Consideration

Re-Establishment of the Internal Audit Function

In his memorandum dated March 14, 2007 and at the Audit Committee meeting on March 26, 2007, the CFO reiterated his intention to reestablish the internal audit function. The memorandum specified that the CFO expected a "more fully functioning" internal audit work unit by the beginning of FY 2008. The CFO specified that the FY 2008 Budget would include the Internal Auditor and four staff, two who have already been assigned and two that remain to be identified/assigned for the Internal Audit work unit.

In reviewing the Auditor & Comptroller section of the Proposed Budget, it is not explicitly clear what actions were taken to restore the internal audit function or if internal audit expenditures are budgeted. The group activity accounting title of "Accounting Operations" now represents the five internal audit positions. This staff and expenditure line item is shown on pages 118 and 119 of Volume II of the Proposed Budget. In reviewing information available from the budget information system, it appears that internal reorganization and reclassification actions have been taken to isolate these five positions to perform the internal audit function. The detail behind the Significant Budget Adjustment entitled "Re-establish the Internal Audit Division" shows the following five positions will constitute the internal audit work unit beginning in FY 2008: Assistant City Auditor & Comptroller (the Internal Auditor), Principal Accountant, two Accountant IIIs and an Accountant II.

The IBA has emphasized the importance of re-establishing the internal audit division in recent reports (IBA Reports # 07-18, 07-35 and 07-37). IBA Report 07-35 indicates that the Internal Audit Divisions of twelve large cities spend approximately 69% of their staff time, on average, performing internal audit functions other than financial reporting and internal controls related to financial reporting. Of those twelve cities, the four closest in population size to San Diego have audit divisions which range from 19 to 27 employees. The IBA believes that it is important to reestablish a fully functioning audit division over the next fiscal year.

Recommendations

1. Change the accounting activity title for the internal audit function from "Accounting Operations" to "Internal Auditing" for greater transparency to the reader of the budget document.
2. Identify and assign the remaining two employees to the internal audit function prior to the beginning of FY 2008.
3. It is reasonable to expect that the planned implementation of the Enterprise Resource Planning (ERP) System will further strain limited Auditor and Comptroller staff resources. The IBA recommends that the CFO apprise the Audit Committee as soon as possible of his plan for providing sufficient Auditor and Comptroller staff support to ERP given current staffing constraints.

City Clerk

Effects of Budget Proposals

The City Clerk's office took on additional tasks with transition to the Strong Mayor form of government including: docket coordinator duties; development of tracking and follow-up system for resolutions and ordinances to be delivered to Mayor's office with 48 hours of passage by Council; and coordination of the veto process.

The FY 2008 Budget for the City Clerk reflects no change in FTEs and insignificant increases to PE, NPE and revenues. The Clerk's office has alerted City Council that a data entry error occurred in their budget for Council Dockets and Exhibits. The error will free up an additional $37,000 to be budgeted elsewhere.

There are, however, a few noteworthy allocations in the City Clerk's budget. In particular, $50,000 has been allocated for CIP upgrades to the Council Chambers. Projects to be funded by this allocation include upgrades to the Council voting system and ADA required upgrades.

Vacancy Factor

The vacancy factor for the City Clerk's Office in FY 2008 is 2.3%, up from 0.7% in FY 2007.

Business Process Reengineering (BPR)

The Clerk's Office has informed the IBA that it intends to complete a voluntary BPR in Records Management in FY 2008. Currently, $1.8 million in records management information is spread throughout the City. If approved, this BPR will move Records Analysts in City departments into the central location of the Clerk's office. The details of this upcoming BPR were not included in the FY 2008 budget, as this BPR has yet to be finalized.

Departments

City Council

Effect of Budget Proposals

The proposed budget for the City Council includes all eight City Council offices as well as Council Administration. The Office of the Independent Budget Analyst (IBA) was previously included in this section as well. However, as discussed in the section on the Office of the IBA, that office has been reorganized into its own department structure, removing 9.00 FTE and associated expense from the City Council. The budget for each of the eight Council districts remains at the same funding level as in FY 2007, at $990,000 each.

The Mayor's Proposed Budget includes an allocation for a committee consultant for the City's new Audit Committee as part of the Council Administration budget. This is consistent with the recommendations of the Audit Committee and the action taken by the City Council on March 27, 2007 to add this position to the FY 2007 budget during the Mid-Year Budget Adjustments.

The Mayor's Proposed Budget also includes 1.00 FTE and funding for a docket assistant position to be housed in the Council Administration budget, and to work with the Office of the Council President. This position would serve as professional-level staff support to the docketing process and also provide continuity over the course of years as the Council President changes.

Vacancy Factor

Neither Council Administration nor any of the individual Council District budgets include a vacancy factor.

Business Process Reengineering (BPR)

As non-Mayoral departments, the City Council Offices are not scheduled for BPR review.

Items for Legislative Consideration

The Mayor's Proposed Budget does not include funding for City Council Financial Training. In IBA Report 06-59, we suggested that the program proposed by the IBA and approved by the City Council would be approximately $15,000 per year. The IBA recommends the City Council add these funds to the budget to ensure that monies are available to continue financial training for all City Council members in FY 2008.

Recommendation

1. Add $15,000 for City Council financial training.

Departments

City Planning and Community Investment

Effects of Budget Proposals
The Office of Neighborhood and Customer Services was eliminated during 2007 as part of the Mayor's plan to streamline City government. Community Development Block Grants (CDBG) and Homeless Services, originally transferred to Community and Economic Development, are now part of City Planning and Community Investment. To further streamline City government, the Community and Economic Development department is being re-organized into the City Planning and Community Investment department as part of the Mayor's Proposed Budget along with Park Planning from the Park and Recreation department. The Proposed Budget for City Planning and Community Investment is $16.4 million, a 139% increase of over $9.5 million above the FY 2007 Budget, with a net increase of 33.20 positions. The Department of City Planning and Community Investment's budget consists of 93.45 positions.

The net expenditure increase primarily reflects the following changes to the FY 2007 Budget: transfers to the department due to restructuring; the department's savings proposal; loan repayment of the City Heights Urban Village Housing and Urban Development 108 Loan; public use lease adjustment; and funding support for Public Information Services. As part of the Mayor's efforts to streamline City government and reduce City costs, departments were requested to submit either a four or ten percent savings proposal depending upon BPR completion. The City Planning and Community Investment department submitted a reduction of $40,000 in overtime. In the FY 2007 Budget, approximately $108,000 of overtime was added to the department due to the continued reduction in the Planning Department staffing over the past several years. The use of overtime allowed Planners the ability to attend various evening community meetings.

The Mayor's Proposed Budget reduces three Planners from the City Planning and Community Investment department. The staffing reduction in conjunction with the reduction in overtime may affect the department's ability to meet workload expectations. In addition, 46 Community Plans require updating.

The FY 2008 Proposed Budget revenue for City Planning and Community Investment is $3.7 million, a net increase of $684,000 from the FY 2007 budget attributed to revised revenue projections, TransNet revenue transfer to the General Services Department and decrease in development activity.

Vacancy Factor
The vacancy factor applied to the City Planning and Community Investment Department in FY 2007 was 10.9%. The Department is projecting an expenditure savings of 3%, according to the Mid-Year General Fund expenditure monitoring. Although the Department's FY 2008 proposed vacancy factor of 4.7% is higher than the average General Fund vacancy rate, a reduction to the City Planning and Community Investment's vacancy factor to 4.7% is reasonable based on the projected year-end estimates for the Department, primarily due to vacant positions.

Business Process Reengineering (BPR)
City Planning and Community Investment department has not been through BPR review yet. The office is scheduled for BPR at a future date to be determined.

Historical Resources and Mills Act
The City's Mills Act Agreement program grants property tax reductions to qualified designated historical properties. This program provides a public benefit by preserving architecturally significant structures and neighborhood character. City Planning lacks the resources to continue to

City Planning and Community Investment (cont.)

support the increase of submitted designations. Existing fees are inadequate to provide resources to support this workload. The FY 2007 Budget included the addition of 1.00 Sr. Planner for Historical Resources supported by the General Fund, but this has not kept pace with the increases in submissions.

Winter Shelter

The Homeless Services Program in the City Planning and Community Investment department organizes and coordinates activities to assist the homeless community, including the Winter Shelter Program. Funding for the Winter Shelter is not included in the Proposed Budget. The San Diego Housing Commission funded the winter shelter in FY 2007 with reserve funds, which are extremely low. If the Housing Commission is unable to fund the FY 2008 Winter Shelter Program, then the Mayor will need to identify other revenue to fund this program or the shelter may not open. CDBG allocated $145,000 to the Winter Shelter in FY 2007. The Winter Shelter program budget is approximately $590,000.

Community Development Block Grants (CDBG)

In accordance with Council Policy 700-02, 60% of the City's annual funding will be allocated to individual Council Districts and 40% will be allocated on a citywide basis via the Mayor's office. The City's CDBG grant amount for FY 2008 is $15.4 million, a slight reduction from last year. During FY 2007, the Mayor's office reviewed the process and the allocations for FY 2008. A task force was gathered for input to the proposed process. The goals of the Task Force were to recommend a CDBG process that identified core uses of CDBG under the federal guidelines, identify the City's core needs for CDBG, set parameters/criteria as to uses of CDBG, and to leverage CDBG funds to maximize funding resources. The IBA office participated in the Task Force and learned about many of the Mayor's ideas. All Task Force participants offered suggestions and recommendations on a new CDBG process. However, the Task Force ended prematurely and to compound it, this policy discussion never came before Council Committee or City Council in a timely manner. No final proposals or recommendations were made.

The Mayor's FY 2008 CDBG and Social Services memo was distributed on March 26, 2007 with changes to the allocation of City Council's discretionary funds to include social services programs and Housing Commission. In prior years, the allocation to social services programs and Housing Commission came from the 40% citywide allocation. By adjusting these allocations from Citywide to City Council, a city-wide net balance of $2.3 million is available to be allocated to ADA eligible projects for a total Citywide CDBG allocation of $3.5 million. The FY 2008 Budget also includes an additional $10 million for ADA projects. As stated in IBA Report 07-45, the Mayor needs to discuss with the City Council his proposed changes to the CDBG policy. This policy discussion is needed given the potential impact to citizens and should have occurred sooner at Council Committee or/and City Council.

City Treasurer

Effects of Budget Proposals

What caused the department to grow from 86.80 to 124.00 positions (an increase of 37.20 positions)?
Organizational restructuring resulted in the following changes:

- **31.00 FTEs** (inclusive of all costs and associated revenues) were transferred in from the General Services Department: Parking Management and Street Division. As the Office of the City Treasurer is responsible for the receipt, collection and custody of all Citywide revenues, this consolidation transfers positions performing parking meter collection and related administration functions into the department with primary responsibility for this type of activity.
- **5.00 FTEs** were transferred in from the City Auditor & Comptroller department. These positions conduct audits of hotels, lessees and franchises to ensure revenues due to the City are remitted timely and accurately.
- **1.00** vacant unclassified Financial Operations Manager position was transferred in from the City Auditor & Comptroller department to address a Kroll Report recommendation to develop a more automated, documented and complete cash reconciliation process. The position has been filled and, in addition to other responsibilities, works to reconcile the cash general ledger to the bank.
- **0.20** Information System Technician transfer in from Debt Management department.

How will the Business Tax Compliance Program be staffed and funded in FY 08?
The department has requested that five new positions (four Public Information Clerks and a Management Analyst) be carried as limited/hourly in FY 2007 and 2008. These positions will not be shown as additional positions in the Fiscal Year 2008 Proposed Budget because they are temporary positions already funded within the existing budget.

Why is the Financing Services Program no longer grouped with the City Treasurer in the Fiscal Year 2008 Proposed Budget document?
In the Fiscal Year 2007 Budget, the Financing Services Program was represented as an operational division, with a separate appropriation, of the Office of the City Treasurer. Late in Fiscal Year 2006, the Financing Services Program became the Debt Management Department. Although too late to be reflected in the Fiscal Year 2007 Budget, Debt Management operates as an independent department within the larger Department of Finance and is now properly reflected in the Fiscal Year 2008 Proposed Budget.

Vacancy Factor
The City Treasurer budget includes a vacancy factor of 2.2%, which is consistent with the department's vacancy experience through accounting period five and 3% citywide standard. The vacancy factor was 0.7% in the FY 2007 Budget.

Business Process Reengineering (BPR)
Dates for BPR analysis for departments within the Department of Finance are yet to be determined.

Business Tax Compliance Program
In May 2007, the City Treasurer will initiate a program to increase business tax compliance and revenue collection. The City Treasurer has estimated that $7.6 million can be collected from program implementation through FY 2008, with an additional $2.5 million annually in subsequent years. In FY 2008, approximately $5 million has been budgeted from this new program.

Citywide Program Expenditures

Effects of Budget Proposals

Special Promotional Programs
The allocation to Special Promotional Programs from citywide was reduced by $4.7 million, because FY 2008 TOT revenues are expected to negate the need for this subsidy.

Deferred Maintenance
The FY 2008 budget allocation was reduced by approximately $10.6 million due to a transfer of these funds to General Services for street and storm drain repair. $5.0 million for deferred maintenance is proposed to go to the Mission Bay Park and Regional Park Improvement funds in accordance with Municipal Code §22.0229.

Special Consulting Services
Although this expenditure is listed as a single line item in the budget there are a series of specific budget changes which account for the $4.75 million dollar increase to Special Consulting Services. The chart below provides a brief overview of these changes:

Special Consulting Services Budget Changes	
Initial Budget	$324,950
Transfer to CFO Special Contracts and Travel	($268,650)
Payment to Pathfinder Group	($35,000)
Transfer to Financial Management for Training	($21,300)
SEC Independent Consultant and City Remediation	$1,118,630
ERP	$458,434
Meet and Confer	$300,000
Professional Services and Contracts	$2,874,735
Total Increase	**$4,751,799**

The following will shed light on some of the more significant changes to this area of Citywide.

SEC Independent Consultant and City Remediation
A total of approximately $1.10 million was added to Citywide to cover the General Fund portion of expenses related to the cost of the SEC Independent Consultant and actuarial services.

Meet and Confer
$300,000 was added to this line item to cover consultant and contractual expenditures for FY 2008 negotiations with all City bargaining units.

Professional Services and Contracts
An increase of approximately $2.87 million was allocated to Special Consulting Services for "Professional Services and Contracts" in Citywide. The only cost identified at this time for this category is $500,000 to repay SDCERS for benefit payments in excess of IRS limits. We recommend reducing this allocation from $2.87 million to $500,000 accordingly.

Annual Audit
$682,000 was added to Citywide to cover expenses of external audits. This expense was moved to the Auditor and Comptroller's department in FY 2007 and has been placed back in Citywide for FY 2008.

Elections
In anticipation of two citywide elections, four district elections and at least three ballot measures, an additional $718,000 has been added to Citywide Elections. This addition nearly doubles the amount budgeted in FY 2007, $732,000, for a total of $1.45 million.

Public Liability
An additional $8 million was allocated to public liability. A Public Liability Reserve will be established with $5 million and the remaining $3 million will be expended on outside legal

Citywide Program Expenditures (cont.)

counsel. Last year (FY 2007) the department received an expenditure increase of approximately $32.9 million for public liability needs associated with City's financial investigations and costs associated to the right-of-way acquisition for State Route 56. Public liability was increased again during mid-year adjustments in FY 2007 by an additional $3.5 million. These funds have consistently been insufficient, requiring adjustments throughout the year. The IBA would like to highlight the need to more accurately manage public liability.

Recommendation

1. Reduce allocation to Professional Services and Contracts in Special Consulting Services to $500,000.

Community and Legislative Services

Effects of Budget Proposals
The FY 2008 Proposed Budget for Community and Legislative Services is $4.3 million, a 14% increase of $524,000 over the FY 2007 Budget, with a net increase of six positions. The expenditure increase primarily reflects transfers to the department due to restructuring. The FY 2008 Proposed Budget revenue for Community and Legislative Services is $259,000, a reduction of $772,000 from the FY 2007 Budget attributed to revised revenue projections. The FY 2008 revised revenue projections include:

- Reduction in Mayor's Protocol services from Transient Occupancy Tax (TOT)
- Revenue corrections due to restructuring
- Service Level Agreement cancellation with Enterprise departments for lobby contract reimbursement
- Fund transfer from Non-General Fund departments that receive State and Federal Lobby services

The Department's FY 2008 budget consists of 29 positions. The Department Staffing section in the Mayor's Proposed Budget improperly displays the staffing information.

Department Staffing			Budget Document	IBA Corrections
GENERAL FUND	FY 2006 Budget	FY 2007 Budget	FY 2008 Proposed	FY 2008 Proposed
Community & Legislative Services				
Boards and Commissions	0.00	1.00	**4.00**	**1.00**
City TV	0.00	4.00	4.00	4.00
Communications	0.00	6.00	**6.00**	**12.00**
Council Liaison	0.00	4.00	4.00	4.00
Intergovernmental Relations	0.00	4.00	3.00	3.00
Mayor's Protocol	0.00	1.00	1.00	1.00
Policy	0.00	3.00	**7.00**	**4.00**
Total	**0.00**	**23.00**	**29.00**	**29.00**

Vacancy Factor
The vacancy factor applied to the Community and Legislative Services department in FY 2007 was 0.65%. The Department is projecting an expenditure savings of 4%, according to the Mid-Year General Fund expenditure monitoring. The FY 2008 proposed vacancy factor increase to 2.4% is more reasonable based on the projected year-end estimates for the Department, primarily due to vacant positions.

Business Process Reengineering (BPR)
Community and Legislative Services Department has not been through BPR review yet. The office is scheduled for BPR at a future date to be determined. A Program Manager of Bi-National Relations was eliminated from the Department as part of the Information Technology (IT) BPR, adopted by City Council on October 16, 2006, to offset the cost of creating a Group IT Manager for the Public Safety Department. The creation of Group IT Managers enables the Mayor's office to create a consistent application policy and review the City's IT from a citywide view point.

Customer Services

Effects of Budget Proposals

The Office of Neighborhood and Customer Services was eliminated in 2007 as part of the Mayor's plan to reduce City operating costs. The Customer Services Department is under Business and Support Services. The Mayor's Proposed Budget for Customer Services is $2.5 million, a 23% increase of $475,000 over the FY 2007 Budget, with a net increase of one position. The expenditure increase reflects transfers to the department due to restructuring. The FY 2008 Proposed Budget revenue for Customer Services is over $700,000, an increase of $565,000 over the FY 2007 Budget attributed to the current approved Service Level Agreements and passport processing revenues.

The Department of Customer Services' FY 2008 Budget consists of 20 positions. The Chart below reflects the position changes from the Customer Services' FY 2007 Budget:

	FTE	PURPOSE	TRANSFER
Special Training	3.00	Restructuring	***From:*** *Human Resources Dept.*
Community Outreach (Reflected in the Mid-Year)	(3.00)	Restructuring	***To:*** *Community & Legislative Services*
Customer Services Administration	1.00	Restructuring	***From:*** *Community & Economic Development*
TOTAL	1.00		

Vacancy Factor

The vacancy factor applied to the Customer Services department in FY 2007 was 0.5%. The Department is projecting an expenditure savings of 2.8%, according to the Mid-Year General Fund expenditure monitoring. The FY 2008 proposed vacancy factor increase to 2.3% is more reasonable based on the projected year-end estimates for the Department.

Business Process Reengineering (BPR)

The Customer Services Department has not been through BPR review yet. The office is scheduled for BPR at a future date to be determined.

Departments

Debt Management

Effects of Budget Proposals

Is the department sufficiently staffed to perform the City's anticipated debt issuance, management and related financial disclosure responsibilities?

In last year's IBA report on the Mayor's Proposed FY 2007 Budget, we noted the reduction of six financial disclosure positions in the City Treasurer – Financing Services Division (now the Debt Management Department). These positions were added to the Debt Management budget in FY 2006 to begin to address requirements set forth in the City's 2004 Disclosure Ordinance. We cited concern that the department had lost over 50% of its staff to attrition over an 18 month period. Given the loss of technical, knowledgeable staff and the loss of six positions, the IBA recommended that the Mayor and City Council closely monitor their workload and staffing needs in future years.

Anticipating continued capital financing needs and believing that the City will soon be able to borrow again in the public financial markets, the IBA expects the debt issuance and administration workload to increase in FY 2008. In addition to new debt issuances, the department administers the City's outstanding debt issuances, performs unique economic analyses and consults with other departments on financing matters. Authorized department staffing remains unchanged from FY 2007 at 22.00 positions; however, there are currently five vacancies to be filled.

Department management has informed the IBA that hiring processes are in progress and that they believe that the department is sufficiently staffed to handle the anticipated workload, including disclosure-related responsibilities. To the extent possible, department management intends to time debt issuance and administration responsibilities so as not to overload department staff. The IBA recommends that the Mayor and City Council continue to monitor the department's workload and staffing levels in future years to ensure that the City is comprehensively and cost effectively managing its debt.

Why were 6.50 positions transferred from the Special Districts Fund to the Debt Management Department?

Special Districts is a work unit within Debt Management that coordinates the issuance and on-going administration of Community Facilities District and 1913/1915 Act bond issuances. The expense of this work unit is covered by a special districts revenue fund which has been accorded a distinct department number for fund accounting purposes. This transfer simply eliminates the department number for the Special Districts work unit and consolidates it with the Debt Management Department where it has organizationally been located for many years. The expenses of this work unit will continue to be covered by the special districts revenue fund.

Given direction received in the agreement with the SEC and the City's focus on providing thorough financial disclosure, what systems has Debt Management installed to assist with disclosure compliance?

The Debt Management Department has implemented the Formal Centralized Monitoring Program (FCMP) to track the City's compliance with the covenants for all of its outstanding debt issuances. Debt Management maintains a centralized list of the covenants for each bond issuance as determined by a rigorous examination of the bond documents. The details of each covenant (the controlling bond document's title and section, due date, lead time, responsible department, and debt issuance) are loaded in the Mun-ease debt management program. The Mun-ease program generates an e-mail notification to

Debt Management (cont.)

the responsible departments in advance of the covenant's due date. The responsible party replies to the e-mail, after conducting a reasonable inquiry, stating that the City either is or is not in compliance with the covenant. Debt Management aggregates the individual responses and produces a written semi-annual report summarizing the results for the Chief Financial Officer.

The FCMP report serves as an internal financial control and forms part of the City's responses to inquiries related to bond covenant compliance from outside auditors. Funding to support these activities is provided within the Debt Management budget as appropriated. Departments participating in the FCMP include the Auditor & Comptroller, Risk Management, City Attorney, Water, Metropolitan Wastewater, and Real Estate Assets. The outstanding debt obligations covered under FCMP are approximately $2.2 billion.

Vacancy Factor

The Debt Management budget includes a vacancy factor of 2.4%, which is consistent with the 3% citywide standard. It should be noted, however, that the department's vacancy experience through accounting period five was 17%. Although the department currently has five vacancies out of 22.00 budgeted positions (23%), department management indicates that hiring processes are in progress. The vacancy factor was 0.7% in the FY 2007 Budget. A 2.4% vacancy factor may be too low unless current vacancies can be filled and maintained throughout FY 2008.

Business Process Reengineering (BPR)

Dates for BPR analysis for departments within the Department of Finance are yet to be determined.

Now a Distinct Department within the Budget

In the FY 2007 Budget, the Financing Services Program was represented as an operational division, with a separate appropriation, of the Office of the City Treasurer. Late in FY 2006, the Financing Services Program became the Debt Management Department. Although too late to be reflected in the FY 2007 Budget, Debt Management operates as an independent department within the larger Department of Finance and is now properly reflected in the FY 2008 Proposed Budget.

Development Services

Effects of Budget Proposals

The Mayor's Proposed Budget for Development Services Department (DSD) is $60.5 million, a 12% reduction below the FY 2007 Budget of $69 million. The net expenditure reduction primarily reflects transfers to the department due to restructuring and the reduction of 115 positions over half of which are vacant. The FY 2008 Proposed Budget revenue of $45.5 million is a 27% reduction in revenue attributed to a drop in permit application activity across all segments of the department's permit types. The chart below shows DSD's revenue decline over the last three fiscal years.

FY 2006 FY 2008 DSD REVENUE			
	FY 06 Budget	**FY 07 Budget**	**FY 08 Proposed**
Revenue	63,806,414	62,540,157	45,502,453

The chart below shows DSD's activity decline over the last three fiscal years.

DEVELOPMENT SERVICES DEPARTMENT			
	FY 05	**FY 06**	**FY 07 *(as of 3/07)***
Discretionary Applications	1,259	1,121	529
Inspections	137,574	149,034	105,709
Building Permits	10,675	10,203	5,558*
Valuations	$1,963,383	$1,960,092	$919,278

*The number of building permits as of March 2007 is 5,558, tracking 19% below FY 2006 data as of March 2006.

Vacancy Factor

DSD's FY 2008 proposed vacancy factor is 17.8%. Due to a decline in permit application activity, the Development Services eliminated 32 filled positions during FY 2007. Although DSD is reducing 115 positions, the proposed vacancy factor is still substantial reflecting the fact that vacancies will not be filled unless activity improves. Even after the staffing reductions, the Department has over 100 vacant positions.

Business Process Reengineering (BPR)

DSD is undergoing BPR. According to the staff, the BPR study reevaluated the development review process to determine the most efficient way to provide core services. The staff indicated the first phase examined the department's core processes which include regulatory reform, ministerial review, discretionary review, environmental review, records, code compliance and community input. No report on the Phase I BPR is available. The second phase will look at the supporting processes of closeout, review by outside departments and agencies, training, finance, technology, and customer service. The second phase of DSD's BPR is scheduled to be completed in fall 2007. The IBA's office received the Department's Phase I BPR report at the time this report was ready for print. Therefore, our office has not had an opportunity to review the DSD BPR report.

Service Levels

Contingency plans to maintain service levels are currently being developed by DSD. Personnel cuts may result in service level reductions and impact DSD's cash flow as revenue is realized only as projects are completed. DSD is currently tracking their revenues every period very carefully to monitor the current year revenues. Frequently monitoring revenues and activity will allow adjustments to be made in a timely manner. DSD is currently reviewing a fee study to ensure fees balance with costs. DSD anticipates bringing the results of the study to City Council in November 2007.

Development Services (cont.)

Reserve Levels

DSD's reserve levels have been impacted due to the decline in revenues from permit application activity. The Department is expected to deplete their $4.5 million reserves in FY 2008. If no fiscal recovery plan is undertaken, the General Fund may be impacted in future years. Given the City's fiscal condition and other General Fund service priorities, a plan is needed to mitigate the impact to the General Fund.

Recommendations

1. The IBA recommends a fiscal recovery plan be developed for DSD given the condition of their reserves and the potential General Fund impact.
2. It is also recommended that a contingency plan for handling unanticipated increases in activity in the Development Services Department be finalized.

Engineering and Capital Projects

ENGINEERING AND CAPITAL PROJECTS Department Expenditures Fiscal Year 2008 Proposed Budget					
	FTE	PE	NPE	Total Exp	Revenue
General Fund	285.47	30,705,818	4,914,238	35,620,056	28,574,544
Non-General Fund	176.03	18,178,207	8,867,559	27,045,766	71,544,710
TOTAL	**461.50**	**48,884,025**	**13,781,797**	**62,665,822**	**100,119,254**

Effects of Budget Proposals

The Mayor's Proposed Budget for the Engineering and Capital Projects (E&CP) Department is $62.7 million, a slight 0.7% increase of over $457,000 above the FY 2007 Budget, with a net reduction of 49.50 positions.

The net expenditure increase primarily reflects transfers to the department due to restructuring and an offset of savings from Business Process Reengineering (BPR). The chart at the top displays the Engineering and Capital Projects' FY 2008 Proposed Budget by General and Non-General Funds.

The FY 2008 proposed revenue budget for E&CP is a little over $100 million, a net increase of nearly $4.8 million from the FY 2007 Budget attributed to revised revenue projections that include additional TransNet funding to E&CP and Business Process Reengineering.

The Engineering and Capital Projects Department's FY 2008 Proposed Budget consists of 461.50 positions, of which 285.47 are General Fund positions.

Vacancy Factor

The vacancy factor applied to the General Fund divisions of the Engineering and Capital Projects department in FY 2007 was 0.65%. The Department is projecting a General Fund expenditure savings of 8%, according to the Mid-Year General Fund expenditure monitoring. The Department's General Fund FY 2008 proposed vacancy factor of 3.5% is more reasonable based on the projected year-end estimates for the Department, primarily due to vacant positions. This vacancy factor is in-line with the City's 3% vacancy factor average.

Business Process Reengineering (BPR)

The Engineering and Capital Projects FY 2008 proposed budget includes savings identified through the Department's BPR. As part of the Fiscal Year 2008 budget, the City Council will be asked to approve the Business Process Reengineering Study for E&CP. Engineering and Capital Projects conducted a comprehensive assessment of engineering core functions and processes, spread among various City departments, in order to identify operational efficiencies, streamline business processes, and reduce the cost of providing services to citizens.

The E&CP BPR has resulted in fifteen recommended modifications to current business practices, including significant departmental reorganization. The BPR proposes a more effective and streamlined organization with centralized processes and enhanced service levels.

The E&CP BPR study has resulted in a reorganization plan that will consolidate most engineering services and support into a centralized Department. This affects the following departments: E&CP, General Services, MWWD, Park and Recreation, Planning and Water Department. The centralized operations will provide the oversight

Engineering and Capital Projects (cont.)

that is needed to prioritize projects to ensure effective allocation of available resources. The BPR study states that 80.50 positions were reduced as a result of the study in Fiscal Year 2008. The 80.50 position reduction displayed in the BPR study also does not take into account any staffing additions as a result of the Department's reorganization. The net position reduction for E&CP is 49.50. The BPR will result in a plan that will provide improved control and coordination of projects in the City's right-of-way and enhanced transportation system engineering and operations.

CIP Prioritization

It is essential that the City prioritize all City capital improvement projects to ensure efficient and effective allocation of funding. The Mayor is in the process of identifying all City infrastructure requirements and assessing the condition of assets in conjunction with a prioritization process for all capital improvement projects that includes a criteria-based ranking system. A prioritization process for transportation projects was adopted on January 16, 2007 by the City Council with direction to return to Council on May 11, 2007, with additional process information. A similar process is needed for other capital improvement projects such as Library, Park and Recreation, Water, and Metropolitan Wastewater projects.

The City should adopt policies for acquiring, maintaining, replacing and retiring City assets. Oftentimes, there is funding to acquire assets, but no funding available for maintenance. Such policies help to ensure that needed capital assets or improvements receive appropriate consideration during the budget process. This will assist the City in necessary planning for large expenditures and reducing deferred maintenance. Policies may address inventorying capital assets, evaluating their condition, funding for adequate maintenance, and scheduling replacement of capital assets. Plans should be developed to establish ongoing, multi-year replacement and renewal schedules, and should recognize the linkage of capital expenditures with the annual operating budget.

Capacity

According to the Mayor's Five-Year Financial Outlook, the City's deferred maintenance/capital needs, excluding those of Water and Wastewater, is estimated to be at least $900 million.

The Mayor's Five-Year Financial Outlook includes funding for deferred maintenance/capital improvements by using a combination of cash and financings. The total funding for deferred maintenance/capital improvements over the next five years is $578 million as a result of years of underfunding.

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 for carrying out projects need to be considered, particularly in the Engineering and Capital Projects department.

The Mayor's Proposed Budget proposes to eliminate approximately 49 Engineers from the Department. The staffing reduction may affect the department's ability to meet workload expectations. The Engineering and Capital Projects department is considering the use of contracts for additional resources if needed, in order to accomplish the ambitious goals laid out in the Proposed Budget. Throughout FY 2008, updates should be provided in order to advise the City Council and the public of the status of achieving the plans and projects approved in the Adopted Budget.

Environmental Services

GENERAL FUND
Effects of Budget Proposals
The Proposed Budget for the General Fund portion of the Environmental Services Department (ESD) reflects a net increase of 21.46 FTE positions and a net expenditure increase of $2.8 million. The General Fund portion of ESD encompasses three divisions, Collection Services, Environmental Protection and Resource Management. As part of an internal realignment of expenditures to reflect appropriate funding sources, 24.46 positions were transferred from ESD's various Non-General Funds to the General Fund.

The Refuse Disposal Fund transferred 9.10 positions and $1.1 million in expenditures to the General Fund for the Hazmat Internal Program and the Underground Storage Tank Program. The Recycling Fund transferred 4.50 positions and $370,000 to the General Fund for the Lead Safe Neighborhoods Program and the Container Delivery Program. In addition, the Refuse Disposal Fund and Recycling Fund transferred a total of 10.86 FTE and $1.06 million in expense to the General Fund for redistribution of Resource Management costs.

These increases to the General Fund divisions were partially offset by a reduction of 3.00 vacant positions and $410,000 in expenditures in the Collections Division as part of the FY 2008 General Fund Savings Plan.

Vacancy Factor
Overall, the Proposed Budget includes a vacancy factor of $309,000 for the General Fund portion of ESD, or approximately 2.2% of total budgeted personnel expense. Both the Resource Management and Environmental Protection Divisions have a budgeted vacancy factor in FY 2008 as a result of the increased positions. The Collections Division, by far the largest of the three, has a vacancy factor of $239,000, or 2.1% of budgeted personnel expense. This vacancy factor should reasonably be expected to capture regular turnover.

Business Process Reengineering (BPR)
Environmental Services' Business Process Reengineering was approved by the City Council on February 6, 2007. The BPR recommendations focused primarily on the Non-General Fund portion of ESD's budget, and will be discussed in greater detail in the section on ESD's Enterprise Funds.

It should be noted that when the BPR was approved on February 6, the General Fund portion of Collections Division had also undergone a reengineering process. However, the specific details of that effort, and subsequently its implementation, have been withheld pending a decision on managed competition. It is currently unknown when or if the Collections Division will be subject to managed competition, or when the General Fund savings from Business Process Reengineering will be realized.

Issues for Legislative Consideration
The Proposed Budget includes $500,000 for refuse container replacement, unchanged from FY 2007. Current figures indicate that over 12,500 containers have been replaced through April 2007, including refuse containers, recycling containers and greenery containers, at a total estimated cost of nearly $620,000. The Department expects that the number of containers needing replacement in FY 2008 will likely exceed 13,000.

As discussed in IBA Report 07-36 on Potential New or Increased Fees, most of the 317,000 refuse containers are nearing the end of their useful life cycle, and a number of replacements are expected to accelerate in the coming years.

Environmental Services (cont.)

The Environmental Services Department has estimated that it will cost $14.3 million to replace these containers, at a replacement cost of $45 a piece. Preliminary calculations indicate that an annual fee of $12-$13 per automated container would generate sufficient revenue to replace outdated refuse containers on an ongoing basis and recover costs for associated administration and support. Consideration should be given to implementing an automated refuse container replacement fee in order to facilitate the timely replacement of outdated refuse containers without creating additional burdens for the General Fund.

Finally, the Proposed Budget for the Resource Management Division includes the $300,000 that the City Council allocated in the FY 2007 Budget for Alpha Project's Take Back the Streets Program. The Department has indicated that it has not yet been determined how to administer those funds, but that a proposal for a City-run program similar to Take Back the Streets would be forthcoming. No details on such a proposal have been released.

REFUSE DISPOSAL AND RECYCLING FUNDS

Effects of Budget Proposals

The Environmental Services Department has two enterprise funds, the Refuse Disposal Fund and the Recycling Fund. The Mayor's Proposed Budget for the Refuse Disposal Fund reflects a net decrease of 39.47 FTE positions and a net reduction of $2.5 million in expenditures. Of these position reductions, 25.19 are due to the Environmental Services Business Process Reengineering, while the realignment of expenditures to the General Fund accounted for another 12.28 position reductions. Other significant reductions to the Refuse Disposal Fund include $262,000 in expenditure reductions due to cancelled or reduced Service Level Agreements, $527,000 in Information Technology and other non-discretionary reductions, and a $71,000 reduction due to the removal of the Environmental Library. Significant budget additions include $1.2 million due to an increase in the Hawthorne Agreement related to the lease of four Heavy Duty Wheel Traction Push-Pull Scrapers and a $200,000 increase for fuel costs.

The Mayor's Proposed Budget for the Recycling Fund reflects a net reduction of 19.49 FTE positions and a net reduction of $390,000 in expenditures. Of the 19.49 cut positions, 6.81 are due to Business Process Reengineering and 12.18 are due to realignment of program expenditures to the General Fund. The only other significant budget reduction is $668,000 for IT and other non-discretionary adjustments. Significant additions include $673,000 for the purchase of new automated greenery containers, and a $1.15 million revenue increase from curbside recycling revenue.

Vacancy Factor

The Proposed Budget includes a vacancy factor of $254,000 for the Refuse Disposal Fund and $263,000 for the Recycling Fund, or 1.9% and 2.2% of budgeted personnel expenditures, respectively. These vacancy factors have been significantly reduced from FY 2007, both in absolute terms and in terms of percentage of personnel expenditures, and are consistent with the citywide standard. In FY 2007, the Refuse Disposal Fund had a budgeted vacancy factor of $872,000, or 5.7% of personnel expense, while the Recycling Fund's vacancy factor was $838,000, or 7.0% of PE. The reduction in these vacancy factors reflects the elimination of several vacant positions.

Environmental Services (cont.)

Business Process Reengineering (BPR)
The Environmental Services Business Process Reengineering was approved by the City Council on February 6, 2007. As mentioned above, this BPR resulted in the elimination of 32.00 FTE as reflected in the Mayor's Proposed Budget. It is also anticipated that another 2.00 positions will be eliminated over the next two fiscal years as a result of the BPR. The Environmental Services BPR culminated in seven recommendations aimed at reducing costs and enhancing operational efficiency by eliminating obsolete or unnecessary business processes, consolidating operations along functional lines, and streamlining the management functions.

Of the seven recommendations, three are the most significant in terms of changes to the Department's organizational structure:

1. Consolidation of the Energy Conservation & Management and Environmental Protection Divisions into a single Division;
2. Consolidation of the Waste Reduction & Enforcement and Refuse Disposal Divisions into a single Division;
3. Centralization of the administrative functions by moving the Resource Management Division under the Office of the Director.

These recommendations would reduce the Department's six current divisions to three, and generate savings by consolidating activities, reducing administrative staff and reducing management and supervisory overhead. However, due to the timing of the BPRs approval, the consolidation of divisions was not able to be implemented in the Proposed Budget. The Department has indicated that they will reflect the changes of the Division names in the May Revise, and then implement the detailed organizational changes in the FY 2009 Budget.

Service Levels
The Environmental Services Department does not anticipate a reduction in service levels as a result of either Business Process Reengineering or the General Fund Savings Plan for the Collections Division. However, since the City is required by State law to maintain trash collection services, an appropriation adjustment may be necessary if actual tonnage collected exceeds budgeted tonnage.

Issues for Legislative Consideration
The most prominent concern regarding the Recycling Fund is that budgeted revenues are approximately $3.1 million less than budgeted expenditures, resulting in a commensurate draw down of fund balance. Based on figures in the budget document, the fund balance would be drawn down to $1.2 million from a beginning balance of $4.3 million. While there appears to be sufficient fund balance to accommodate this draw in FY 2008, the Fund will likely not be able to sustain another year without an increase in Recycling Fees, otherwise known as AB 939 fees. The Department has indicated that they will be forwarding options to increase Recycling Fees in FY 2008 in order to being the Recycling Fund into balance.

Financial Management

Effects of Budget Proposals

Transfer of the Department Director from the Office of the Chief Financial Officer

The Financial Management Department Director position was originally budgeted in the Office of the Chief Financial Officer and the CFO position was budgeted in the Office of the Chief Operating Officer, as were other deputy chief positions in FY 2007. In an effort to budget deputy chiefs in their associated business centers, the CFO is now budgeted in the Office of the CFO within the Department of Finance. A corresponding budget adjustment transfers the Financial Management Department Director position from the Office of the CFO to the Financial Management Department in FY 2008.

Decrease in staffing from 33.00 FTEs in FY 2007 to 30.00 FTEs in FY 2008

The department transferred 2.00 FTEs (Information Systems Analyst IVs) to the Office of the Chief Information Officer to work on the ERP and Computing Infrastructure Upgrade projects. Additionally, the department eliminated 2.00 FTEs (a Supervising Management Analyst and a Word Processing Operator) to achieve savings in compliance with the Mayor's five-year reduction plan. Adding the reduction of these 4.00 FTEs to the addition of 1.00 FTE for the Department Director position referenced above results in a net reduction of 3.00 FTEs in FY 2008.

Increase in support for Financial Training in FY 2008

The department added $30,000 for training for a total of $51,300 in FY 2008 or approximately $1,700 per budgeted employee. The City's Remediation Plan recommends that the CFO, in conjunction with the Internal Auditor and the Audit Committee, develop an adequate and effective training program for finance employees to ensure that they maintain competency and remain current in such areas as financial management, external and internal financial reporting and reliable public disclosure.

Vacancy Factor

The Financial Management budget includes a vacancy factor of 2.4%, which is roughly consistent with the department's 4% vacancy experience through accounting period five and the 3% citywide standard. The vacancy factor was 11.3% in the FY 2007 Budget.

Business Process Reengineering (BPR)

Dates for BPR analysis for departments within the Department of Finance are yet to be determined.

General Services

STREETS DIVISION
Effects of Budget Proposals
The Mayor's Proposed Budget for the Street Division includes a reduction of 33.16 FTE positions, but a net expenditure increase of nearly $18.3 million. The net increase in funding is due primarily to a $10.6 million increase for deferred maintenance and an $8.6 million increase for Municipal Storm Water Permit compliance. Deferred maintenance and Storm Water Permit compliance are two of the Mayor's eight significant areas, as described in the Five-Year Financial Outlook.

These position reductions reflect the transfer of 17.16 to other departments, including Police, Storm Water, Treasurer, and the General Services Administration Division. Another 14.00 positions are eliminated as part of the Mayor's five year reduction plan, 12.00 of which are currently vacant. The remaining 2.00 positions were supposed to be transferred to Engineering and Capital Projects Department; however, the IBA was unable to confirm that these positions had been added to the E&CP budget, and thus we assume they have also been eliminated.

Vacancy Factor
The Proposed Budget includes a vacancy factor of $1.2 million for the Street Division, or approximately 5.3% of budgeted personnel expenditures. In FY 2007 the budgeted vacancy factor was $466,000, or 2.0% of budget personnel expense. The cause for the significant increase in vacancy savings in FY 2008 is unclear and we are concerned that this vacancy factor is too high, particularly given the increased funding and anticipated ramp-up in service. After the elimination of vacant positions pursuant to the General Fund Savings Plan, and the transfer of positions due to BPR, the Division has just a few vacant positions remaining. The IBA is concerned that the FY 2008 proposed vacancy factor for the Street Division may impose a *de facto* hiring freeze for the remaining vacant positions.

Business Process Reengineering (BPR)
The Street Division Business Process Reengineering is partially implemented in the FY 2008 Proposed Budget. According to a staff report, the Street Division BPR will result in the consolidation of the Division's seven sections into four sections: two Operational and Maintenance sections, one Administration and Support section, and one Services and Contracts section. The staff report indicates that the BPR resulted in the elimination of the 33.16 positions as previously discussed. However, the IBA was unable to confirm that these position reductions were BPR related.

Overall, the BPR focused on strengthening core functions and transferring out non-core functions. The BPR report includes a summary of BPR recommendations and an implementation status. However, no specific details on additional staff or cost reductions have been disclosed at this point, as certain functions within the Street Divisions are being considered for managed competition. The Street Division BPR has not yet been through Meet and Confer.

Service Levels
With increased funding in FY 2008, the Street Division expects to repair in excess of 134 miles of streets, including 41.1 miles of overlay and 93.3 miles of slurry sealing. As contracts will be utilized to perform these street repairs, the Department believes that internal staff will be able to focus more on preventative maintenance and minor repairs. In addition, it is the Mayor's intention to provide additional funding for sidewalk repair and storm drain deferred maintenance (unrelated to Permit compliance). Overall, $33 million in increased funding is intended to be allocated to Street Division for

General Services (cont.)

deferred maintenance, a majority of which will be financed. However, as described in the "Deferred Maintenance" section of this report, only $10.6 million in cash funding has been included in the Proposed Budget. Furthermore, approximately $2.5 million of the $10.6 million was intended for debt service on the financed portion of the $33 million. Should the City be unable to secure financing, this $10.6 million will have to fund all deferred maintenance projects.

The Proposed Budget also includes $8.6 million in increased funding for street sweeping and storm drain improvements related to the revised Municipal Storm Water Permit.

Issues for Legislative Consideration
Adequate funding for preventative street maintenance is critical in addressing the deferred maintenance backlog. While the Street Division is able to perform a significant amount of preventative maintenance, additional funding in this area may be necessary in the future, particularly given the significant cost increases for overlay and slurry sealing over the past several years.

Overlay & Slurry Seal: Cost Per Mile			
	FY 2006 Estimated	**FY 2007 Estimated**	**FY 2008 Proposed**
Overlay	$317,000	$383,000	$450,000
% Change	*N/A*	*20.82%*	*17.49%*
Slurry Seal	$39,000	$68,000	$75,000
% Change	*N/A*	*74.36%*	*10.29%*

These significant annual cost increases suggest that any money the City saves on preventative maintenance today will cost much more in deferred maintenance tomorrow.

EQUIPMENT DIVISION
Effects of Budget Proposals
The Mayor's Proposed Budget for the Equipment Division reflects a net increase of 69.50 FTE positions and a net expenditure increase of approximately $21.4 million. As part of the consolidation of fleet services per Business Process Reengineering (discussed in greater detail below), 73.00 positions have been transferred from the Police Department, and 22.00 from Fire-Rescue. These position adds were partially offset by the transfer of 2.00 positions to the Facilities Division, and the elimination of 7.50 positions, both related to BPR. In addition, Equipment eliminated 16.00 vacant positions as part of the FY 2008 General Fund Savings Plan. Aside from the net increases due to BPR, significant additions to the Equipment Division's proposed budget include $3.9 million for increased fuel costs, $2.3 million for parts and supplies, and $764,000 for the Enhanced Vapor Recovery System.

Vacancy Factor
The Proposed Budget includes a vacancy factor of $459,000 for the Equipment Division, or 2.2% of budgeted personnel expenditures. This compares to an FY 2007 vacancy factor of $429,000, or 3.2%. While the vacancy factor has increased in absolute terms, it has declined as a percentage of personnel expense, reflecting greater personnel expense in FY 2008 due to the consolidation of fleet services and the net increase in budgeted positions. The FY 2008 vacancy factor is consistent with the citywide standard of 3%.

Business Process Reengineering (BPR)
The Equipment Division's Business Process Reengineering is reflected in the Proposed Budget. This BPR, referred to more generally as the Fleet Services Business Process Reengineering, was a comprehensive assessment of the fleet operations in General Services, the Police Department and the Fire-Rescue Department. The most significant operational change as a result of the Fleet BPR is the consolidation of the City's three fleet organizations into one Fleet Services Division within the General Services Department. The

General Services (cont.)

Fleet Services Division will be responsible for the maintenance, operation and procurement of the City's entire fleet, including public safety vehicles. Prior to this reorganization, the Public Safety departments managed their own fleet procurement and maintenance. However, due to limited funding, the Police and Fire-Rescue fleets are significantly over-aged: 42% of patrol sedans are over-aged, while 50% of fire apparatus are in need of replacement. Due to the consolidation of fleet services under one division, Police and Fire-Rescue will become customers of that division beginning in FY 2008, and will be responsible for paying annual assignment and usage charges. Assignment charges are deposited into the Vehicle Replacement Fund and used to replace vehicles at the end of their useful life cycle. Usage charges are deposited into the Internal Service Fund, and are used to fund both operations, including fuel, parts, salaries and underground fuel storage tank upgrades, as well as capital improvements. The assignment and usage charges to the Police and Fire-Rescue Departments in FY 2008 are $17.1 million and $7.8 million, respectively. Over time, it is expected that a reduction in the over-age percentage of the public safety fleets will result in reduced usage charges as a result of reduced maintenance needs.

According to the Fleet Services BPR report, three non-core services will be eliminated as part of the Business Process Reengineering: washing/ cleaning/fueling of Police non-patrol vehicles, the General Services/Equipment Work Order Hauling program, and custodial services. The Work Order Hauling Program has been absorbed by the Street Division and the Water Department's Operations Division, while custodial services will be performed by the Facilities Division as part of the citywide consolidation of the custodial function.
The Fleet Services BPR report states that 37.00 positions will be eliminated as a result of the BPR, 25.00 from Equipment Division, 8.00 from Police and 2.00 from Fire-Rescue. In addition, 2.00 positions will be transferred from the Equipment Division to Facilities. It should be noted that 27.00 of the 37.00 positions scheduled for elimination are vacant, including 20.00 in Equipment Division. Meet and confer with Local 127 and MEA for the Fleet Services BPR has concluded.

Finally, a determination has been made to implement the Fleet Services Most Efficient Organization (MEO) as soon as possible. The BPR report states that a decision will be made regarding managed competition once Fleet Services experiences a full year of consolidation and MEO implementation. This is a marked departure from the MEO implementation procedure for other BPR departments and divisions, such as Streets, Publishing Services, or Collections Division in Environmental Services. It is unclear why Fleet Services will be implementing its MEO immediately while these other Divisions must wait for a determination regarding managed competition. This lends to the impression that Fleet Services is not being considered for managed competition.

Issues for Legislative Consideration

One of the biggest challenges over the past several years for the Equipment Division has been increases in fuel costs. Fuel costs have been consistently underbudgeted over the past several years, causing the Equipment Division to dip into the Replacement Fund in order to fund ongoing fuel expenses. Volatility in fuel prices makes it difficult to accurately budget for fuel expenses. Given the limited General Fund resources over the past several years, it would be imprudent to budget fuel expenses at an artificially high level in order to hedge against price increases. At the same time, being too conservative with fuel budgets may result in underfunding.

General Services (cont.)

The $3.9 million increase for fuel costs in FY 2008 brings the total fuel budget up to $14.0 million. While this increase is a move in the right direction, consideration should be given to establishing a fuel reserve that may be used as a cushion against unanticipated price increases. Industry standards suggest an appropriate fuel reserve would be 20% of the fuel budget, or approximately $2.8 million for FY 2008. While there may not be sufficient funding in FY 2008 to establish such a fuel reserve at this level, consideration should be given in future years to establishing such a reserve.

Recommendation

1. Consider establishing a fuel reserve for the FY 2009 Budget, set at 20% of the total budget for fuel.

FACILITIES DIVISION

Effects of Budget Proposals

The FY 2008 Budget for the Facilities Division reflects a net reduction of 10.50 FTE positions and a net expenditure reduction of approximately $257,000. As part of the General Fund Savings Plan, the Division reduced 8.00 filled positions, eliminating 7.00 Painters and 1.00 Painter Supervisor, for a total expenditure reduction of $642,000. In addition, 5.00 FTE and $1.7 million in expense were transferred out of the Division to create the new Contracts Division in General Services. This new Division will administer and manage general requirement and service contracts related to ADA and tenant improvements for the General Services Department beginning in FY 2008.

These reductions were partially offset by the addition of $1 million in non-personnel expense for operation and maintenance of the San Diego Theatre Concourse and Central Boiler. Other significant additions include a transfer in of 1.00 positions from Engineering & Capital Projects, and a transfer in of 2.00 positions from the Equipment Division related to the Fleet Services BPR. Finally, as one of the Mayor's eight significant areas, the Facilities Division received $5.3 million to begin addressing the backlog of deferred maintenance. More detail on this allocation is provided in the section on the Mayor's eight significant areas.

Facilities also implemented internal restructuring to facilitate a transition from trade-based service to zone-based service. Zone-based service is where employees are responsible for providing a full scope of services to one specific area or zone. This is in contrast to the current structure, whereby employees practicing a certain trade may be sent all across the city on an as-needed basis whenever that particular service is needed. The goal of transitioning to a zone-based service is to enhance responsiveness, productivity and customer service by increasing employee familiarity, knowledge and expertise on particular facilities.

Vacancy Factor

The Proposed Budget for Facilities includes a vacancy savings factor of $320,000 or 3.2% of total budgeted personnel expenditures. In FY 2007 the vacancy factor was $495,000, or 4.9% of total budgeted personnel expenditures, reflecting a greater number of vacant positions in that year. The FY 2008 vacancy factor is consistent with the citywide standard, and should appropriately account for any remaining vacancies as well as standard turnover rates.

Business Process Reengineering (BPR)

Facilities Division is currently undergoing Business Process Reengineering (BPR), and is expected to be completed in September 2007. However, it should be noted that much of the restructuring implemented in the Proposed Budget is indeed a reengineering of business processes. While not officially identified as BPR changes, the restructure to zone-based service and the

General Services (cont.)

creation of the Contracts Division achieves the goal that BPR purports to accomplish – modifying business practices and organization in order to increase efficiency, streamline operations, and maintain or enhance service levels. The Department has confirmed that while these recommendations were developed in the BPR process, it was determined to be in the best interest of the organization to restructure first in anticipation of future BPR recommendations.

Service Levels

Service levels are not expected to be reduced based on the FY 2008 Proposed Budget for Facilities. As previously mentioned, 7.00 Painters and 1.00 Painter Supervisor have been eliminated as part of the General Fund Savings Plan, leaving the Division with just 4.00 Painters and no Painter Supervisors. According to the Division, however, no service impacts are anticipated, as Facilities will increase reliance on service contracts to obtain painting services. Since no additional funding was added for these service contracts, Facilities will either absorb these costs as part of the existing operational budget, or be reimbursed by customer departments for tenant improvement work.

Issues for Legislative Consideration

Looking forward, one of the most pressing needs for the Facilities Division is a greater emphasis on preventative maintenance. While the IBA is certainly supportive of efforts to address the deferred maintenance backlog, we wish to emphasize that such efforts will be limited in effectiveness as long as preventative maintenance is underfunded. Each year that preventative maintenance is not sufficiently funded, the backlog of deferred maintenance continues to grow. If the funding needs for preventative maintenance are not addressed, the City will essentially be trading old deferred maintenance for new deferred maintenance. The hole in the boat must be plugged in order to effectively bail out the water.

It should be noted that the restructuring implemented in the Proposed Budget may provide a significant step in the right direction. According to the department, the creation of the Contracts Division and the transfer of ADA, tenant improvement and service contract responsibilities will allow Facilities staff to focus more on preventative maintenance, while much of the deferred maintenance will be addressed through service contracts administered by the Contracts Division. Furthermore, the restructure to zone-based service may enhance efficiency and productivity in the provision of services. Nonetheless, greater support for preventative maintenance is still greatly needed.

PUBLISHING SERVICES DIVISION

Effects of Budget Proposals

The Proposed Budget for the Publishing Services Division reflects a reduction of 10.00 FTE and a net reduction of $159,000 in expenditures. The 10.00 positions were reduced as part of the Five-Year Reduction, while the reduction in personnel expenditures were partially offset by salary and wage adjustments and a significant reduction in the vacancy factor, discussed in the next section. There were no additions to the Proposed Budget for Publishing Services.

Vacancy Factor

The FY 2008 proposed vacancy factor for Publishing Services was reduced to $40,000 from $403,000 in FY 2007. This reduction is appropriate since the 10.00 positions that were eliminated as part of the General Fund Savings Plan were vacant. The FY 2008 vacancy factor is currently 2.2% of budgeted personnel expenditures, compared to 20.7% in FY 2007. Publishing Services currently has three vacant positions that are in various stages of being filled.

General Services (cont.)

Business Process Reengineering (BPR)
While the Publishing Services Business Process Engineering is complete, it is not implemented in the FY 2008 Budget. The Publishing Services BPR report states that the 10.00 positions were eliminated based on reengineering decision. However, these positions have been vacant for some time, and their reduction appears to be simply vacant position cuts, not eliminations based on reengineered business processes. The BPR report states that emphasis was placed on customer service, multi-functional employees, and the utilization of service contracts where effective.

While the specific details of the BPR are being withheld pending managed competition, the report states that service levels are expected to remain the same, or be enhanced, though certain services may be provided via service contracts with local vendors in the future. The BPR report provides a summary of recommendations and an implementation status.

Issues for Legislative Consideration
It is anticipated that the Publishing Services Internal Services Fund will end the 2008 fiscal year with a deficit. Depending on the efficiencies and cost savings that are derived from the Publishing Services BPR, the Division may need to request an increase in service rates or seek General Fund support to shore up the fund.

Recommendation
1. Establish a financial plan to balance the fund by year-end prior to approval of the FY 2008 Budget for Publishing Services.

STORM WATER POLLUTION PREVENTION DIVISION
Effects of Budget Proposals
The Proposed Budget for the Storm Water Pollution Prevention Program (Storm Water) allocates nearly $9.4 million in additional funding, including a net increase of 16.66 FTE positions. Of these increased positions, 13.50 FTE are directly related to the Mayor's commitment to provide funding for Storm Water Permit compliance, as identified as one of the eight significant areas in the Five-Year Financial Outlook (refer to the section in this report on the Mayor's Eight Significant Areas for additional discussion). The remaining position increases (3.16 FTE) are due to a transfer from the Street Division as a result of that Division's Business Process Reengineering. The Storm Water Division did not take any reductions in the FY 2008 Proposed Budget.

While no major internal restructuring is implemented in the FY 2008 Proposed Budget, the entire Division has been moved from the Metropolitan Wastewater Department (MWWD) to the General Services Department. The Storm Water Division was moved from General Services to MWWD in FY 2006. FY 2008, the budget will reflect this change.

Vacancy Factor
The Proposed Budget includes a $553,000 vacancy factor for Storm Water, or approximately 14.7% of budgeted personnel expense. By comparison, the vacancy factor in FY 2007 was just $10,500, or 0.5% of budgeted personnel expense. While it appears that the intent of budgeting such a high vacancy factor in FY 2008 was to accommodate the lag time in filling new positions, the IBA is concerned that a vacancy factor of nearly 15% is exceedingly high and may result in a *de facto* hiring freeze.

Business Process Reengineering (BPR)
According to a BPR schedule provided by the Business Office, the Storm Water Division was included in the Metropolitan Wastewater Department's BPR, and reflected in the Mayor's Proposed Budget. However, the only discernable

General Services (cont.)

change to the Storm Water Division in the Proposed Budget is the relocation to General Services.

Service Levels

With the significant increase in funding and the addition of 16.33 FTE positions, service levels are expected to be greatly enhanced in FY 2008. The revised Municipal Storm Water Permit, which was adopted in January 2008, requires the Storm Water Division to expand efforts in areas such as inspection and enforcement, water quality monitoring, education, and watershed-based urban runoff management programs. Without additional funding and enhanced service levels the City may be subject to severe penalties, and we commend the Mayor for dedicating significant funding for Storm Water Permit compliance.

Issues for Legislative Consideration

One of the concerns regarding Storm Water's budget is whether the Division has the capacity to actually spend its entire budget in FY 2007 as well as in FY 2008. The Division received a funding increase of approximately $10.8 million in FY 2007, including the addition of 6.99 FTE. However, actual data through period 10 show that the Division has expended only $2.0 million of its $13.5 million budget, while $7.0 million has been encumbered. The Department has explained that since FY 2007 was the first year of the expanded Storm Water program, it took several months to fully establish the program, develop consultant contracts and route the Request for Council Action (1472). While it is expected that most of the FY 2007 budget will be either expended or encumbered by the end of the fiscal year, significant use of encumbered funds essentially means that the Division will be spending FY 2007 funds in FY 2008.

While the lag time in these expenditures is certainly understandable given the ramp up in spending, the IBA is concerned that a similar lag in spending may also occur in FY 2008, particularly given the significant increase in funding and the addition of new positions. We wish to emphasize that we fully support funding the Storm Water program to the extent necessary to comply with the Municipal Permit; however, given current financial conditions, it would be fiscally prudent to budget only what the Division can reasonably expect to spend in FY 2008. The IBA suggest that the Storm Water Division's FY 2008 current year expenditures and actual vacancy savings be closely monitored to determine whether a reduction in appropriations or vacancy factor is necessary.

Library

LIBRARY	FTE		PE		NPE		Total		Revenue
Fiscal Year 2007 Budget	417.36	$	28,957,251	$	9,786,435	$	38,743,686	$	1,834,801
Vacancy Factor (07)	-		453,286		-		453,286		-
Vacancy Factor (08)	-		(683,384)		-		(683,384)		-
Salary and Wage Adjustments	-		1,265,300		-		1,265,300		-
Increase to OPEB	-		677,797		-		677,797		-
Subtotal	*417.36*	*$*	*30,670,250*	*$*	*9,786,435*	*$*	*40,456,685*	*$*	*1,834,801*
Hourly Standardization	(19.43)		(112,883)		112,883		-		-
Additions:	-		-				-		-
Contractual Services	-		-		206,670		206,670		-
Transportation Allowance	-		-		60,000		60,000		-
Reductions:	-		-		-		-		-
Change to Self-Checkout Machines	(4.50)		(283,579)		-		(283,579)		-
Close City Heights Performance Annex	(1.00)		(95,323)		(92,000)		(187,323)		-
Five Year Plan Reduction	(31.10)		(2,077,434)		(562,186)		(2,639,620)		(140,379)
Subtotal	*(56.03)*	*$*	*(2,569,219)*	*$*	*(274,633)*	*$*	*(2,843,852)*	*$*	*(140,379)*
TOTAL	**361.33**	**$**	**28,101,031**	**$**	**9,511,802**	**$**	**37,612,833**	**$**	**1,694,422**
Difference from 2007 to 2008	(56.03)	$	(856,220)	$	(274,633)	$	(1,130,853)	$	(140,379)

Effects of Budget Proposals

In January 2007, the Mayor announced that the Office of Neighborhood and Customer Services was planned for elimination to achieve streamlining, and its component departments would be reassigned throughout the existing City organization. Because of this, the Library Department is now part of Business and Support Services and the Proposed Budget reflects this revised organizational structure.

As stated in the Mayor's press releases, the Library budget is to maintain current service levels, and library hours will remain at FY 2007 levels. However, in November 2006, 31.02 positions were identified as vacant, and targeted for elimination from the Library Department as part of the Mayor's Five-Year Financial Outlook. The budget reflects the elimination of 31.10 FTEs, as shown in the table. Isolating the Librarian classification changes among the functional areas of Library operations, it appears that an effort was made to minimize the impact to each area by distributing the reductions throughout the various areas. The Mayor's press release also describes various technological improvements that may minimize the impact of any proposed reductions, including self-check machines at the branch libraries with the highest activity levels, to

LIBRARIAN POSITION REDUCTIONS				
Function/Area	FY 2008	FY 2007	FTE Change	% change
Administration	1.00	2.00	(1.00)	-50.0%
Central Library	65.92	73.42	(7.50)	-10.2%
Technical Services	32.00	38.00	(6.00)	-15.8%
Branch Libraries	209.66	225.26	(15.60)	-6.9%
Development Program	0.25	1.25	(1.00)	-80.0%
SUBTOTAL	**308.83**	**339.93**	**(31.10)**	**-9.1%**

(Includes Librarian II, III, IV, Supervising, Library Aide, Clerk, Assistant, excluding impact of hourly change)

Library (cont.)

enable the public to check out library materials themselves. The self-check machines allow for the reduction of 4.50 FTEs and $283,000, separate from the vacancy reductions. The City Heights Performing Annex is proposed for closure with the elimination of 1.00 Associate Management Analyst and related costs, for a savings of $187,000.

HOURLY POSITION CHANGES	
Library Assistant	(2.02)
Library Aide	(14.01)
Library Clerk	(1.92)
Librarian II	(1.48)
GENERAL FUND	**(19.43)**

Standardization of Hourly Positions
All hourly positions, previously shown as specific line items in department's budget salary schedules, were removed from the budget system and budget document, and instead, an equivalent amount of dollars were included to fund these costs. This change results in the reduction to affected departments' position counts, while no corresponding reduction should be expected with regard to the level of services to be provided. As a result, no specificity regarding the level or type of positions to be utilized with the funds is provided.

For the Library Department, this change to the budget practice results in the elimination of 19.43 FTEs in its General Fund budget. As many of these positions provide direct services to citizens, and changes to these services are monitored and become immediately apparent, it seems that budget modifications that result in less information or a lack of clarity on the allocation of resources in these areas should be avoided.

The IBA recommends that hourly positions be reinstated in the annual budget document, and shown as part-time budgeted positions, separate from full-time positions, as has been the past practice. This will allow for more accurate year-to-year comparisons of budget information, as well as allow for easy comparisons with other jurisdictions, and provide valuable data to the public on expected levels of services. Possible shortcomings with the current budget practice related to fringe benefits and the inability to budget appropriately with regard to hourly positions should be addressed with the implementation of the City's new integrated financial and accounting system, currently in development.

Vacancy Factor
For FY 2008, the vacancy factor has been increased from 1.6% to 2.4% of the personnel budget, which results in a reduction of $230,000 to the department budget over the prior year. In FY 2007, the vacancy factor resulted in expected savings of $453,000 and the department is expected to achieve this amount, plus approximately $500,000 more. The increased vacancy factor may become more difficult for the department to achieve next year with the elimination of almost 10% of the Librarian and support positions, currently vacant.

Business Process Reengineering (BPR)
The Library BPR is currently underway with a target completion of September 2007. No information specific to the BPR for this department has been provided for evaluation. Because of this, and due to the number of vacancies identified in November 2006 related to the Five-Year Financial Outlook, all reductions reflected in the proposed budget should be considered vacancy reductions, as part of the General Fund savings plan to help balance the budget.

Library Ordinance
The Municipal Code §22.0228 requires the City Manager (Mayor) to propose an appropriation for the Library that is equivalent to 6% of the

Library (cont.)

total General Fund proposed budget. The Municipal Code also allows the City Manager (Mayor) to request that the City Council temporarily suspend compliance with these requirements if revenues are determined to be insufficient to both comply with this provision and provide for City services necessary to preserve the health, safety, and welfare of the citizens. The Proposed Budget assumes the waiver of this requirement. The City Attorney's Office has confirmed that, since this entails a suspension of compliance with the Municipal Code, the City Council must explicitly waive that provision in adopting the FY 2008 Budget.

The proposed Library General Fund budget of $37.6 million is 3.4% of the total General Fund. To comply with the Library Ordinance, a Library General Fund budget of $66.2 million would be needed to achieve the 6% level, an increase of $28.6 million (or 76%) over the proposed budget.

The Library Ordinance has been suspended for four of the five years since its adoption, and given the City's current financial constraints, it is appropriate that the suspension continue. As discussed during last year's budget process, the IBA recommends that the City Council consider alternatives to the Library Ordinance.

State Library Foundation Grants

The State Library Foundation awards funds to qualifying public libraries equal to the proportional share of the total amount appropriated by the Legislature and signed by the Governor each year, based on the population of the library's service. Awards are made only to those libraries that formally apply. To qualify the local governing body must appropriate funds to the library that are at least equal to its appropriation for the immediate preceding year. This requirement ensures grant funds are not utilized to supplant current resources. Based on the Mayor's Proposed Budget, the Library budget decreases by $1.13 million from FY 2007. However, the department staff have indicated that centralized data processing costs can be included to ensure sufficient funds are documented to secure the state grant funds. The proposed budget includes the continued receipt of the State Library Foundation Grant funds in the amount of $733,000, and funds 8.60 FTE.

Service Levels

The "Budget Dollars at Work" provides static data about the Library, its operations, and the public it serves. This same data shown over a multi-year period would provide a reader with valuable information related to the levels of service provided, and how it changes on an annual basis. Trends in the information can provide insight into the usefulness and success of particular programs and functions. The next table was compiled using information easily available on the City's Library Department website. As can been seen from this information, useful data is regularly compiled by departments, and could supplement the City's budgetary data.

Library (cont.)

FACTS ABOUT THE LIBRARY			
Source: City of San Diego Website			
BUDGET	FY 2006	FY 2005	FY 2004
General Fund Budget	36,647,886	35,846,666	35,420,223
Budget per Capita	$27.95	$27.45	$27.37
RESOURCES			
Library Materials Owned:	3,409,831	3,300,086	3,255,735
Book Volumes Added: (Catalogued and Un-catalogued)	270,565	321,591	302,319
Book Titles Added: (Catalogued)	48,044	57,177	57,570
Bound Periodicals (estimated):	89,950	89,800	89,550
Current Periodical Subscriptions:	4,122	4,111	4,124
Government Documents:	1,612,364	1,588,595	1,584,949
Microforms (Magazines, Newspapers, etc.)	615,236	624,887	623,760
LEVELS OF SERVICE			
Circulation:	7,003,040	7,293,262	7,242,394
Circulation per capita:	5.34	5.59	5.60
Reference, Research and Questions Answered:	1,694,801	1,803,178	1,905,844
In-Library Use of Materials:	1,762,090	1,902,137	1,865,777
Central Library Attendance:	603,229	626,446	761,538
Branch Libraries Attendance:	5,467,561	5,805,775	5,758,166
Library Programs Attendance:	165,644	182,755	173,116
Total Attendance, All Libraries:	6,017,790	6,435,446	6,519,704
Users of Public Internet Computers	1,418,525		
Online Searches, by Patrons:		1,238,343	1,132,818
Web Catalog, Total Visits:		537,109	
Web Catalog, Page Views:		21,454,072	

Capital Improvement Program

A new library in the North University community will open next fall and the City will break ground early in FY 2008 on a new library to serve the Logan Heights community. The CIP budget reflects the Logan Heights Branch Library as fully funded, and an expected operating budget impact of 4.95 FTEs at a cost of $819,000 for FY 2009. The Library CIP budget reflects $8.2 million specifically for the Main Library project for FY 2008.

New Facilities

In the FY 2007 budget, additions were made for three new branch facilities, College-Rolando branch, Otay-Nestor branch and Serra Mesa-Kearny Mesa branch. For FY 2008, the new North University Community Branch Library will open in fall 2007, and no additions have been made in the Proposed Budget for this purpose. In FY 2006, the CIP budget indicated that annual operating costs at this location would require the addition of 8.70 FTEs at a cost of $713,000. It appears these costs were included in the FY 2006 operating budget, due to an earlier than expected projection completion, but subsequent reductions to the Library Department have likely negated these prior additions.

The City will have additional operating costs at the same time period we face significant deficits.

Library (cont.)

Issues for Legislative Consideration
As previously stated, the IBA recommends that hourly positions be reinstated in the annual budget document, and shown as part-time budgeted positions, as has been the past practice. Because the Library Ordinance has been suspended for several years, it has become apparent that it is not useful as a way to create a permanent source of funding for future library requirements. The IBA recommends the City Council consider alternatives to the Library Ordinance. Additional funding for new facilities may be needed to appropriately staff and operate the North University Community branch library, scheduled to open during FY 2008, to ensure service levels can be maintained system-wide.

Recommendations
1. Add 19.43 FTEs to reinstate the hourly positions to the Library budget, as has been the past practice, at no additional cost.
2. Include language, in the adoption of the FY 2008 Budget, that explicitly waives Municipal Code §22.0228 Preparation of Annual Budget; Library Appropriation, per the Mayor's recommendation.

Neighborhood Code Compliance

NEIGHBORHOOD CODE COMPLIANCE	FTE	PE	NPE	Total	Revenue
Fiscal Year 2007 Budget	73.00	$ 5,678,979	$ 1,029,058	$ 6,708,037	$ 1,621,088
Vacancy Factor (08)		(134,751)		(134,751)	
Salary and Wage Adjustments		635,655		635,655	
Increase to OPEB		123,219		123,219	
Subtotal	*73.00*	*$ 6,303,102*	*$ 1,029,058*	*$ 7,332,160*	*$ 1,621,088*
Non Discretionary			$ 19,964	$ 19,964	
IT			$ (184,490)	$ (184,490)	
Transportation funding adjustments - TransNet				-	(300,000)
Subtotal	*-*	*$ -*	*$ (164,526)*	*$ (164,526)*	*$ (300,000)*
Additions	-	-	-	-	
Reductions	(8.00)	(586,109)	-	(586,109)	-
Subtotal	*(8.00)*	*$ (586,109)*	*$ -*	*$ (586,109)*	*$ -*
TOTAL	**65.00**	**$ 5,716,993**	**$ 864,532**	**$ 6,581,525**	**$ 1,321,088**
Difference from 2007 to 2008	**(8.00)**	**$ 38,014**	**$ (164,526)**	**$ (126,512)**	**$ (300,000)**

Effects of Budget Proposals

The Mayor's Proposed Budget for Neighborhood Code Compliance (NCC) is $6.6 million, a 2% reduction below the FY 2007 Budget. The net expenditure reduction primarily reflects the reduction of eight positions. The Proposed Budget revenue reduction for NCC is attributed to transportation funding adjustments due to the transfer of operations to the Engineering and Capital Projects and General Services departments.

Vacancy Factor

The vacancy factor applied to Neighborhood Code Compliance in Fiscal Year 2007 was 5.9%. The Department's General Fund FY 2008 proposed vacancy factor of 2.4% is more reasonable based on projected year-end estimates for the Department, primarily due to vacant positions. This vacancy factor is in-line with the City's 3% vacancy factor average.

Business Process Reengineering (BPR)

The IBA's office received the Department's Phase I BPR report at the time this report was ready for print. Therefore, our office has not had an opportunity to review the Development Services Department's Phase I BPR report.

Issues for Legislative Consideration

The City Council has taken substantive steps towards alleviating problems associated with nuisance rental properties/mini-dorms located in the College Area in Council District 7. Residents of the College Area have struggled with problems pertaining to rental properties near San Diego State University (SDSU).

Neighborhood Code Compliance (cont).

The position reduction in the FY 2008 proposed budget eliminates the positions reflected in the chart on the right.

NCC Fiscal Year 2008 Position Reduction		
	FTE	**Classification**
Graffiti Control	(1.00)	Utility Worker I
Graffiti Control	(1.00)	Utility Worker II
Land Development/Zoning	(3.00)	Code Compliance Officer
Field Support	(1.00)	Word Processing Operator
IT Services	(1.00)	Information Systems Analyst II
Director's Office	(1.00)	Executive Secretary
Total	**(8.00)**	

The City Council added two additional Utility Workers to the FY 2007 Budget for a total of eight Utility Workers to expedite the removal of graffiti. The Mayor is now proposing to eliminate the two positions as part of his Proposed Budget.

The City of San Diego Police department created a pilot program that will allow police officers to issue Administrative Citations as an enforcement tool. This will give officers the ability to fine both tenants and property owners responsible for creating disturbances associated with nuisance rental properties. Neighborhood Code Compliance will send citations to property owners each time a tenant causes or contributes to disturbance. Though great efforts have been achieved, Neighborhood Code Compliance's staffing reduction may affect their ability to meet workload expectations.

As discussed in the chapter on "Service Levels", no workload data has been provided on number of complaints investigated, response times, case cycle time, citations issued and number of graffiti removal projects making it difficult to draw conclusions regarding the specific impact of the reductions. This information should be examined as part of their BPR.

Office of the CIO

The Office of the Chief Information Officer (CIO) is comprised of two divisions: Information Technology (IT) and Communications. Positions and activities are budgeted in a Special Revenue Fund, with funding needs allocated proportionally among the various City departments and funds.

The General Fund share of these costs is budgeted, for the most part, in the department also entitled "Office of the CIO". Funds budgeted in the General Fund for this purpose are primarily transfers to support the special revenue fund activities.

Additionally, in the past, a separate City fund was established for "A-List" projects, which accounted for the new development of significant data processing and information technology efforts, some of which spanned multiple years, and/or several departments. Responsible departments contributed funds for "A-List" projects proportionally.

The CIO is responsible for the recently approved Enterprise Resource Planning (ERP) project, which will replace the City's major software systems, including financial, human resource, and procurement applications. This multi-year effort will require assistance from City staff throughout various departments, as the new system is developed and implemented. The City Council authorized the lease-purchase financing of the ERP in an amount not to exceed $29.5 million on May 24, 2007. Cash funding totaling $7.0 million has also been identified, with $3.5 million coming from the "A-List" project fund, and an additional $3.5 million expected from the reserves of the San Diego Data Processing Corporation (SDDPC). A new fund entitled ERP has been established to separately account for costs associated with the project.

Effects of Budget Proposals

Many data processing costs are now centralized, due to recent BPR efforts (described below) and now budgeted within the special revenue fund on behalf of City departments, although department budgets continue to budget for some IT functions. This change for the FY 2008 budget has resulted in the transfer of significant IT costs from individual General Fund department budgets to the Office of the CIO (GF), and can been seen as "Support for Information Technology" on each department's Significant Budget Adjustments in the document. The CIO budget has increased $12.8 million because of this change, though the net impact for the General Fund is lessened, as funds were transferred from other departments. Justification for the increase is not discernible from the information provided in the budget document.

Business Process Reengineering (BPR)

The Information Technology BPR was approved by the City Council on October 17, 2006. Impacts of the BPR are included in the Fiscal Year 2008 Budget. These organizational changes include the addition of 4.00 Group Information Technology Manager positions in Public Safety, Public Works, Land Use and Economic Development and the Customer and Neighborhood Services. Historically the City's Information Technology structure has been decentralized with departments developing their own policies and procedures to accomplish their mission. This environment has required departments to create their own IT organizational structures to accomplish their IT needs. After review by the Mayor's IT BPR team of the various departmental applications, it was found that duplication of applications and systems exist within the City.

Enterprise Resource Planning (ERP)

The Mayor's Proposed Budget assumes the lease-purchase for the ERP is executed and payments in

Office of the CIO (cont.)

the amount of $842,500 are included, with the General Fund's proportionate share of $458,000 budgeted separately in Citywide Program Expenditures.

Given that the debt service for funds borrowed to finance ERP expenditures has been budgeted, the IBA recommends that the borrowed proceeds (estimated to be $21.3 million in FY 2007 and FY 2008) and the associated expense be similarly budgeted for appropriation in the FY 2008 budget.

"A-List" Project Fund

The Mayor's Proposed Budget includes a General Fund allocation of $544,000 from the Office of the CIO for contribution to the "A-List" project fund. This is a reduction of $509,000 from FY 2007 levels. Additionally, non General Fund departments will contribute $970,000, for a total infusion of $1.5 million. No information is contained in the budget document related to the "A-List" project fund, so it is not possible to evaluate the proposed level of funding, or the projects for which the funds are intended. However, it is planned that the current funds within the "A-List" project fund are to be transferred to the new ERP fund, which will be funded with cash and the lease-purchase financing. It is unclear why additional funding would be needed in the "A-List" project fund. Based on information provided by the CIO, all planned enhancements for those systems being replaced with ERP have been suspended.

INFORMATION TECHNOLOGY

Effects of Budget Proposals

Two positions are planned for transfer to the Information Technology Division within the special revenue fund from the Financial Management Department, at a cost of $238,000. Additionally, GIS costs of $144,000 are also planned for transfer to this division, with rent allocations being reduced. The net impact of the budget results in an increase of 2.00 FTEs and $674,000 over FY 2007.

Vacancy Factor

The vacancy factor for FY 2007 was 0.8% and has been increased to 2.4% for FY 2008. This results in a reduction to the division's budget of $45,000.

IT	FTE	PE	NPE	Total	Revenue
Fiscal Year 2007 Budget - IT	19.50	$ 2,301,318	$ 709,570	$ 3,010,888	$ 3,383,343
Vacancy Factor (07)	-	18,002	-	18,002	-
Vacancy Factor (08)	-	(62,495)	-	(62,495)	-
Salary and Wage Adjustments	-	79,124	5,201	84,325	-
Increase to OPEB	-	42,677	-	42,677	-
Subtotal	*19.50*	*$ 2,378,626*	*$ 714,771*	*$ 3,093,397*	*$ 3,383,343*
Transfer Rent Allocation	-	-	(43,872)	(43,872)	-
Transfer of Staffing from Fin Mgmt	2.00	238,524	-	238,524	-
Transfer of GIS from Communications	-	-	143,651	143,651	-
Subtotal	*2.00*	*$ 238,524*	*$ 99,779*	*$ 338,303*	*$ -*
Additions		20,611	233,197	253,808	713,196
Reductions					
Subtotal	*-*	*$ 20,611*	*$ 233,197*	*$ 253,808*	*$ 713,196*
TOTAL	**21.50**	**$ 2,637,761**	**$ 1,047,747**	**$ 3,685,508**	**$ 4,096,539**
Difference from 2007 to 2008	2.00	$ 336,443	$ 338,177	$ 674,620	$ 713,196

Office of the CIO (cont.)

Department Revenues
As discussed above, the division receives funding for its activities from other City funds and departments. As currently budgeted, revenues exceed expenditures by $411,000. Since the source of funding is guaranteed from the City's budget, it seems that budgeting revenues in excess of expenditure needs, which in turn requires City departments to unnecessarily budget excess funds for this purpose is ill-advised. The accompanying Revenue and Expenditure Statement for the special purpose fund reflects a $900,000 balance at the end of FY 2008, due to these inflated revenues. The revenue estimates for this fund could be reduced, and City department budgets could reduce their respective allocations.

COMMUNICATIONS
Effects of Budget Proposals
Position adjustments and the elimination of a vacant position result in the reduction of 2.00 FTEs for the Communications division. Funds included here are dedicated to the second (of seven) annual lease payments to Motorola for 800 MHz Radio System, Paging and Microwave Upgrade, which is currently underway. For Fiscal Year 2008 the lease payment is budgeted at $2.4 million.

Vacancy Factor
The vacancy factor for FY 2007 was 0.7% and has been increased to 2.4% for FY 2008. This results in a reduction to the division's budget of almost $100,000.

Department Revenues
As discussed above, the division receives funding for its activities from other City funds and departments. As currently budgeted, revenues exceed expenditures by $573,000. Since the source of funding is guaranteed from the City's budget, it seems that budgeting revenues in excess of expenditure needs, which in turn requires City departments to unnecessarily budget excess funds for this purpose is ill-advised. The accompanying Revenue and Expenditure Statement for the special purpose fund reflects a $900,000 balance at the end of FY 2008, due to these inflated revenues. The revenue estimates for this fund could be reduced, and City department budgets could reduce their respective allocations.

The CIO budget in the General Fund to fund Communications is currently $6.7 million, and has increased $3.4 million over the FY 2007 levels. In total, the City has budgeted $9.6 million for transfer to Wireless Communications, an increase of $3.9 million over FY 2007.

INFORMATION TECHNOLOGY	FTE	PE	NPE	TOTAL	REVENUE
FY 2007 Budget CIO -Communications	57.88	5,759,498.00	1,132,922.00	6,892,420.00	7,186,001.00
Vacancy Factor (07)		38,545.00		38,545.00	
Vacancy Factor (08)		(138,130.00)		(138,130.00)	
Salary and Wage Adjustments		240,255.00		240,255.00	
OPEB		107,722.00		107,722.00	
Additions	1.00	75,136.00	395,349.00	470,485.00	-
Additions - Public Safety	-	-	2,980,256.00	2,980,256.00	3,690,263.00
Reductions	(3.00)	(288,710.00)	-	(288,710.00)	-
TOTAL	**55.88**	**5,794,316.00**	**4,508,527.00**	**10,302,843.00**	**10,876,264.00**
Difference from 2007 to 2008	(2.00)	34,818.00	3,375,605.00	3,410,423.00	3,690,263.00

Office of the CIO (cont.)

Given the excess funds planned for receipt by the Information Technology special revenue fund, it is possible that any lease payments needed for the ERP lease purchase could be absorbed from funds already budgeted, and could eliminate the need to budget the specific ERP line item in the amount of $842,000, of which $458,000 is to come from the City's General Fund.

Issues for Legislative Consideration

The Mayor's Proposed Budget includes a General Fund allocation of $544,000 from the Office of the CIO for contribution to the "A-List" project fund. Additionally, non General Fund departments will contribute $970,000, for a total infusion of $1.5 million. No information is contained in the budget document related to the "A-List" project fund, so it is not possible to evaluate the proposed level of funding, or the projects for which the funds are intended. It is unclear why funding would be needed in the "A-List" project fund, given the initiation of the ERP system.

The CIO budget has increased $12.8 million because of this change, though the net impact for the General Fund is lessened, due to reductions in the form of transfers from other departments.

Given the excess funds planned for receipt by the Information Technology special revenue fund, it is possible that any lease payments needed for the ERP lease purchase could be absorbed from funds already budgeted, and could eliminate the need to budget the specific ERP line item in the amount of $842,000, of which $458,000 is to come from the City's General Fund.

Recommendations

1. Request additional detail supporting the General Fund increase for information technology costs.
2. Request information related to the "A-List" project fund to determine appropriate levels of funding for FY 2008.
3. Reduce revenue estimates to Information Technology fund, and reduce departmental contributions, by like amount.
4. Eliminate Citywide Program Expenditure allocation of $458,000 for ERP lease payment, and budget transfer of funds from Information Technology fund to ERP fund, for any lease payment which may be required.

Office of Ethics and Integrity

Effects of Budget Proposals

The Proposed Budget for the Office of Ethics and Integrity (OEI) includes significant restructuring, which accounts for the apparent doubling of the OEI budget. The Disability Services Program was transferred to OEI in FY 2007, including 5.00 FTE and associated expense and CDBG revenue for reimbursable positions. In addition, 2.00 FTE and associated expense were transferred from the Chief Operating Officer budget (which was eliminated). No other significant increases, decreases or modifications are proposed in the OEI budget.

Vacancy Factor

The OEI budget includes a vacancy factor of 3.8%, which is consistent with the 3% citywide standard. In FY 2007, OEI did not have a vacancy factor applied and at mid-year, the department was projecting a 1% savings in the Salaries category. In FY 2007, the Disability Services Coordinator position has been vacant for several months and the Assistant position added by the City Council in the FY 2007 Adopted Budget has not been filled to-date. However, both positions are currently in active recruitment, which is consistent with the vacancy rate projected in the budget.

Business Process Reengineering (BPR)

OEI has not been through BPR review yet. The office is scheduled for BPR at a future date to be determined.

Park and Recreation

	FTE	PE	NPE	Total	Revenue
Fiscal Year 2007 Budget	851.10	$ 53,404,502	$ 30,735,857	$ 84,140,359	$ 18,762,167
Vacancy Factor (07)	-	1,606,170	-	1,606,170	-
Vacancy Factor (08)	-	(1,016,633)	-	(1,016,633)	-
Salary and Wage Adjustments	-	2,714,708	-	2,714,708	-
Increase to OPEB	-	1,149,250	-	1,149,250	-
Subtotal	*851.10*	*$ 57,857,997*	*$ 30,735,857*	*$ 88,593,854*	*$ 18,762,167*
Transfers/Swaps	-	25,051	(28,560)	(3,509)	-
Transfer to Engineering & Capital Projects	(18.00)	(2,159,909)	(139,651)	(2,299,560)	(1,458,425)
Transfer to City Planning & Comm Invest	(7.00)	(744,268)	(50,064)	(794,332)	(90,000)
Standardization of Hourly Positions	(118.65)	(766,251)	771,757	5,506	-
Subtotal	*(143.65)*	*$ (3,645,377)*	*$ 553,482*	*$ (3,091,895)*	*$ (1,548,425)*
New Facilities	4.30	319,471	441,771	761,242	-
New Facilities - Annualizations	6.00	334,466	302,530	636,996	35,000
Additions	-	307,199	1,790,242	2,097,441	2,142,213
Additions - Reservoir Recreation	-	-	3,412,015	3,412,015	1,486,833
Reductions	(81.28)	(5,403,958)	(307,760)	(5,711,718)	75,440
Reduction - Grant Match	-	-	(446,955)	(446,955)	-
Subtotal	*(70.98)*	*$ (4,442,822)*	*$ 5,191,843*	*$ 749,021*	*$ 3,739,486*
TOTAL	**636.47**	**$ 49,769,798**	**$ 36,481,182**	**$ 86,250,980**	**$ 20,953,228**
Difference from 2007 to 2008	(214.63)	$ (3,634,704)	$ 5,745,325	$ 2,110,621	$ 2,191,061

Effects of Budget Proposals

In January 2007, the Mayor informed the City Council that the Office of Neighborhood and Customer Services was planned for elimination and its component departments would be reassigned throughout the existing City organization. Because of this, the Park and Recreation Department is now part of Business and Support Services, with the exception of the Park Planning Division, which has been divided among the Engineering and Capital Projects and the City Planning and Community Investment Departments. The Mayor's Proposed Budget reflects a portion of these reorganization changes.

In November 2006, 97.55 FTEs were identified as vacant and targeted for elimination as part of the Mayor's Five-Year Financial Outlook. The Mayor's Proposed Budget proposes the elimination of 81.28 FTEs at a savings of $6.1 million from Park and Recreation's General Fund budget. Separately, additions have been made for the funding for reservoir recreation activities, new facilities, and uncontrollable costs. Together these changes result in a net increase to the Park and Recreation Department of just $749,000, and a loss of 70.98 positions.

Reservoir Recreation Program

The Reservoir Recreation BPR is targeted for City Council review and approval in May 2007. Until the BPR process is completed, the reservoir recreation program continues to be operated by the Water Department, with costs associated with the recreation activities tracked and reimbursed from the City's General Fund. In January 2007, actions were taken by the City Council to approve the allocation of $1.9 million from the General Fund reserves to fund Water Department costs attributable to reservoir recreation activities for FY 2007. Ongoing annual costs for this activity were not included in the Mayor's Five-Year Financial Outlook. The Mayor's Proposed Budget includes the addition of $3.4 million in new expenditures, and $1.5 million in new revenues in the Park and Recreation Department related to the reservoir recreation program. This presumes the General Fund will continue to subsidize these costs that have been determined to be ineligible

Park and Recreation (cont.)

for the water ratepayers to support. Goals of the BPR include determining which department could most effectively and efficiently perform these duties, and assess possible options to achieve cost-neutrality in order to eliminate future General Fund subsidies.

New Facilities

The Mayor's budget includes funding to staff and support ten new Park and Recreation Department facilities. The Department will receive nearly $300,000 in operation funding for two previously partially or unfunded new parks – Camino Ruiz and Charles L. Lewis III Skate Park. The parks had been operating by using existing staff and financial resources within the department. Funding for many new facilities reflect partial funding for the fiscal year dependent on the expected opening date of the facility. Because of this, additional funding will be required in Fiscal Year 2009 to fully fund a complete fiscal year of requirements.

Reductions

The Mayor's Budget eliminates $447,000 in grant matching funds, which typically assists the City in receiving three times the match amount for specific Park and Recreation projects. Park and Recreation staff has indicated that this amount was removed inadvertently and it is anticipated to be reinstated by the Mayor in the May Revise to the budget. The IBA recommends grant matching funds be added back to ensure the City can successfully apply for and receive its share of

New Facilities	FTEs	Amount
Florence Joyner Elementary School Joint Use	0.15	$16,870
Kennedy Porter Elementary School Joint Use	0.10	$12,040
Ocean View Hills Elementary School Joint Use	0.50	$87,461
Citywide Additional Open Space – 200 acres	3.00	$318,404
Park de la Cruz (Phase II)	0.12	$50,378
Rancho Encantada Neighborhood Park	0.00	$64,598
Rodriquez Elementary School Joint Use	0.13	$15,302
Teralta Park Comfort Station and Bike/Pedestrian Corridors	0.30	$23,147
Thurgood Marshall School Joint Use	0.00	$43,964
Torrey Del Mar Neighborhood Park	0.00	$14,947
New Facilities - Annualizations		
Camino Ruiz Neighborhood Park	1.00	$163,126
Edison Elementary School Joint Use	0.02	$2,113
Naval Training Center Phase I	1.13	$132,201
Nobel Athletic Area and Recreation Center	1.70	$172,000
Normal Heights Elementary School Joint Use	0.15	$10,052
Citywide Additional Open Space – 400 acres	0.50	$30,221
Charles L. Lewis, III Memorial Skate Park	1.50	$127,283
TOTAL	**10.30**	**$1,284,107**

Park and Recreation (cont.)

State grant funds.

Following is a description of some of the specific classifications of positions that are proposed for elimination from Park and Recreation.

Grounds Maintenance Workers
The Mayor's Budget proposes the reduction of 31.45 FTEs among various levels of Grounds Maintenance Workers, Managers and Supervisors. This comprises a net reduction of 9.4% of all of the grounds maintenance positions in the Park and Recreation Department, and includes the elimination of two hourly, part-time positions, separate from the standardization of these types of positions.

Aquatics Staff
The Mayor's Budget proposes the reduction of 3.00 FTEs among the Aquatics staff, which includes Aquatics Technicians I, II and Supervisors, from 8.95 to 5.95 FTEs. This comprises a reduction of 33.5% of all of the Aquatics Technician positions in the Park and Recreation Department.

Utility Workers
The Mayor's Budget proposes the reduction of 6.60 FTEs among various levels of Utility Workers, including Seniors and Supervisors, from 26.60 to 20.00 FTEs. This comprises a net reduction of 24.8% of all of the utility worker positions in the Park and Recreation Department.

Custodians
The Mayor's Budget proposes the reduction of 2.00 FTEs among Custodian I and II positions, from 20.50 to 18.50 FTEs. This comprises a net reduction of 9.8% of all of the Custodian positions in the Park and Recreation Department.

Park Rangers
The Mayor's Budget proposes the reduction of 5.00 Park Rangers positions, including 4.00 Park Rangers and 1.00 Senior Park Ranger, all from the Open Space Division. This comprises a net reduction of 26% of the Open Space ranger positions, from 19.00 to 14.00 FTEs. The proposed reduction totals 7.00 FTEs, but increases related to new facilities permitted the addition of 2.00 FTEs due to increases to open space acreage, resulting in a net reduction of 5.00 FTEs. Additional Park Ranger positions are budgeted within Park and Recreation and are specifically dedicated to Balboa Park, Mission Bay Park and Los Penasquitos Canyon Preserve. No ranger reductions are proposed for these particular parks. The proposed budget includes 29.00 FTEs, down from 34.00 FTEs budgeted for FY 2007, resulting in a loss of 14.7% of all ranger positions.

Standardization of Hourly Positions
All hourly positions, previously shown as specific line items in department's budget salary schedules, were removed from the budget system and budget document, and instead, an equivalent amount of dollars were included to fund these costs. This change results in the reduction to affected departments' position counts, while no corresponding reduction should be expected with regard to the level of services to be provided. As a result, no specificity regarding the level or type of positions to be utilized with the funds is provided.

For Park and Recreation, this change to the budget practice results in the elimination of 118.65 FTEs in its General Fund budget, plus an additional 5.75 FTEs in the Golf Course Enterprise Fund. As many of these positions provide direct services to citizens, and changes to these services are monitored and become immediately apparent, it would seem that budget modifications that result in less information or a lack of clarity on the allocation of resources in these areas should be avoided.

Park and Recreation (cont.)

The IBA recommends that hourly positions be reinstated in the annual budget document, and shown as part-time budgeted positions, separate from full-time positions, as has been the past practice. This will allow for more accurate year-to-year comparisons of budget information, as well as allow for easy comparisons with other jurisdictions, and provide valuable data to the public on expected levels of services. Possible shortcomings with the current budget practice related to fringe benefits and the inability to budget appropriately with regard to hourly positions should be addressed with the implementation of the City's new integrated financial and accounting system, currently in development.

HOURLY POSITION CHANGES	
Park and Recreation - FTEs	
Recreation Leader I	(54.00)
Recreation Leader II	(15.25)
Recreation Aide	(6.92)
Custodian II	(2.10)
Grounds Maintenance Worker I	(12.03)
Grounds Maintenance Worker II	(0.50)
Lifeguard I	(0.35)
Swimming Pool Manager I	(5.00)
Pool Guard II	(22.50)
GENERAL FUND	**(118.65)**
Grounds Maintenance Worker I	(0.25)
Golf Starter	(5.50)
GOLF COURSE	**(5.75)**

Vacancy Factor

For FY 2008, the vacancy factor has been reduced from 3.0% to 2.1% of the personnel budget, which results in an addition of $575,000 to the Department's General Fund budget over the prior year. In FY 2007, the vacancy factor resulted in a reduction of $1.6 million and the department is expected to achieve this amount, plus $1.3 million more, as reported during the Mid-Year Budget Adjustments. Given the significance of the reductions proposed for next fiscal year, a reduced vacancy factor seems prudent.

Business Process Reengineering (BPR)

BPRs are currently underway for Park Maintenance and Reservoir Recreation programs. No information specific to the BPRs for this department has been provided for evaluation. Because of this, and due to the number of vacancies identified in November 2006 related to the Five-Year Financial Outlook, all reductions reflected in the budget document should be considered vacancy reductions. The larger Park and Recreation BPR is expected to be available in the Fall. The Park and Recreation restructuring, separate from a BPR, is reflected in the budget including the transfers as discussed above.

Service Levels

The Mayor announced that he will continue his policy, begun last year, of maintaining park and recreation services at current levels. The press releases specifically state that the Park and Recreation Department will maintain recreation center and skate park hours of operations at their FY 2007 levels, continuing to operate an average of 40-hours per week, year-round, and that pool operations will continue at FY 2007 levels, with the City operating four of thirteen pools year-round:

- Vista Terrace (CD8)
- Memorial (CD8)
- Clairemont (CD6)
- Ned Baumer (CD5)

The other nine pools will close on a rotational basis for 3.5 months, the same as was done in FY 2007.

Although the Mayor has committed to maintaining service levels through this budget, the IBA is unable to arrive at this conclusion, based on the reduction of over 80 positions

Park and Recreation (cont.)

throughout the department. As discussed in the section on service levels, we are skeptical of this claim, but see that these position reductions are necessary. Therefore, we recommend that these areas are monitored over the course of the fiscal year and reports made to the City Council should results differ from expectations.

Environmental Growth Fund (EGF)

The Mayor's Proposed Budget includes an increase of almost $2.7 million to reimburse the General Fund for eligible expenses. Nearly $900,000 of this increase derives from the EGF 1/3, while nearly $1.8 million derives from EGF 2/3. Per Charter Section 103.1a., the EGF is to be used for preserving and enhancing the environment only. The General Fund has significant expenses that comply with this Charter provision and it will simultaneously relieve the strained General Fund of these obligations.

With the recent sharp decline in required debt payments for the General Obligation Bonds in combination with strong franchise revenue deposited in the fund, a considerable amount of money is accumulating in the 2/3 portion of the fund, in particular. The Municipal Code §63.30 has a more strict requirement for the use of these funds than does the Charter. It disallows use of those funds for purposes other than debt service on bonds or acquisition of open space. The Code does, however, provide an opportunity for the Council, by majority vote, to suspend compliance with that section for one fiscal year, on the recommendation of the Manager (Mayor), such that the monies can be used consistent with the more flexible provisions of the City Charter. The Mayor has recommended suspension of this section in order to allow for the reimbursement of an additional $1.8 million, or $8.9 million in total, from the EGF 2/3. The City Attorney's Office has confirmed that the City Council must explicitly waive the Municipal Code provision in adopting the FY 2008 Budget.

The IBA supports the use of EGF funds for their purpose as described in the City Charter and recommends waiver of the Municipal Code section consistent with the Mayor's Proposed Budget. As we have suggested over the last year, we continue to recommend the City develop a long-term plan for the EGF. With over $14 million in franchise fees each year, and the imminent retirement of the General Obligation Bonds, the City should ensure that these funds are used strategically in accordance with long-range policies and objectives. If the City decides to use all the proceeds to support General Fund park maintenance and similar functions, as indicated in Report to the City Council 07-073, the City should amend the Municipal Code permanently and seek a Charter amendment, rather than simply using the EGF as a permanent pass-through to the General Fund.

Issues for Legislative Consideration

The Mayor's Budget eliminates $447,000 in grant matching funds, which typically assists the City in receiving three times the match amount for specific Park and Recreation projects. The IBA recommends grant matching funds be added back to ensure the City can successfully apply for and receive its share of State grant funds.

Recommendations

1. Add $446,000 to reinstate grant matching funds.
2. Include language, in the adoption of the FY 2008 Budget, that explicitly waives Municipal Code §63.30 Utilization of the Environmental Growth Fund, per the Mayor's recommendation.
3. Develop a long-term strategic plan for the Environmental Growth Fund.
4. Add 118.65 FTE associated with hourly/ part-time positions.

Departments

PETCO

Effect of Budget Proposals
The Mayor's Proposed Budget for PETCO Park reflects a net expenditure reduction of approximately $3.7 million due primarily to the refunding of the Ballpark Bonds, approved by City Council on January 16, 2007. Due to the advantageous market rates at the time the bonds were refunded, the City will save approximately $3.7 million per year on debt service and interest payments. In addition, 0.50 FTE was reduced for the Ballpark Administrator, effectively making this a half-time position.

These savings are partially offset by a $100,000 increase for police costs, and $116,000 in increased costs related to contractual operations and maintenance expenses. The net result of these budgetary changes is that the Special Promotional Programs allocation to PETCO was reduced by approximately $3.4 million, which provides a direct benefit to the General Fund.

Vacancy Factor
PETCO Park does not have a vacancy savings factor since there are fewer than 10 positions budgeted in that department.

Business Process Reengineering (BPR)
PETCO Park is not scheduled to undergo Business Process Reengineering.

Issues for Legislative Consideration
PETCO Park continues to rely heavily on the General Fund. Even taking into account the reduction, the total allocation to PETCO Park in FY 2008 is still $15.9 million. One of the concerns regarding PETCO Park in FY 2008 is that budgeted expenditures exceed budgeted revenues by approximately $266,000, thereby drawing down the fund balance. While this may be acceptable for the upcoming fiscal year, at some point budgeted revenues will need to equal budgeted expenditures. Unless new fund revenues are identified, this will mean increasing the General Fund allocation via the Special Promotional Program.

Police

	FTE	PE	NPE	Total	Revenue
Fiscal Year 2007 Budget	2,818.00	$ 313,778,455	$ 46,356,270	$ 360,134,725	$ 24,645,141
Vacancy Factor (07)	-	19,310,722	-	19,310,722	-
Vacancy Factor (08)		(21,344,700)		(21,344,700)	
Salary and Wage Adjustments	-	3,182,413	-	3,182,413	-
Increase to OPEB	-	5,488,051	-	5,488,051	-
Estimated POA increase	-	-	13,100,000	13,100,000	-
Subtotal	*2,818.00*	*$ 320,414,941*	*$ 59,456,270*	*$ 379,871,211*	*$ 24,645,141*
Transfer In - Parking Management	70.00	$ 5,675,624	$ 228,251	$ 5,903,875	$ 18,517,599
Transfer In - GSD-Streets	11.00	798,558	78,672	877,230	900,000
Transfer Out - Fleet BPR	(81.00)	(6,538,180)	(9,383,790)	(15,921,970)	(50,000)
Allocation for Fleet Services	-	-	17,054,738	17,054,738	-
Subtotal	*-*	*$ (63,998)*	*$ 7,977,871*	*$ 7,913,873*	*$ 19,367,599*
Additions	5.50	534,370	3,380,870	3,915,240	129,723
Reductions	(22.00)	(1,732,140)		(1,732,140)	(2,500,000)
Subtotal	*(16.50)*	*$ (1,197,770)*	*$ 3,380,870*	*$ 2,183,100*	*$ (2,370,277)*
TOTAL	**2,801.50**	**$ 319,153,173**	**$ 70,815,011**	**$ 389,968,184**	**$ 41,642,463**
Difference from 2007 to 2008	**(16.50)**	**$ 5,374,718**	**$ 24,458,741**	**$ 29,833,459**	**$ 16,997,322**

Effects of Budget Proposals

Between F Y 2007 and 2008 the primary areas of change for the Police Department’s Budget were related to a pay increase for police officers, impacts from restructuring and Business Process Reengineering, and non-personnel increases.

Police Department’s budget is proposed to increase for costs associated with the full year operations of the Northwestern Division Area Station, including 4.50 FTEs. Due to the current recruitment/retention problem in the Police Department, the total positions necessary to operate the station were not included. It is anticipated that an additional 19.00 sworn FTEs will need to be added in future budgets, including 14.00 Police Officers IIs, 4.00 Police Sergeants, and 1.00 Lieutenant. The Police Department’s budget also includes an increase of $1.8 million to cover the expense of the helicopter lease payment. It should be noted that this is not a new payment to the City, but rather a transfer of an expense previously made by another fund. In Fiscal Year 2007, this expense was made utilizing the proceeds from the sale of an old helicopter, both revenue and expense were budgeted in the Seized & Forfeited Assets Fund.

A significant reduction of 22.00 non-sworn FTEs is proposed. These positions were previously identified as part of the vacant position reductions described in the Mayor’s Financial Outlook in November. A majority of the positions have been vacant for over two years, but the list includes 7.00 vacant Police Service Officers whose positions have been vacant since the beginning of the fiscal year. The responsibilities normally performed by the Police Service Officers are currently performed by sworn officers, which results in a net five (two positions were added in support of Northwestern) fewer officers in the field. In FY 2007, the Council added 30 civilian positions for the purpose of returning officers to patrol. The net effect of this action will reverse Council’s FY 2007 direction by reducing seven of the PSOs previously added.

At the time of publication, the Proposed Budget had reserved $13.1 million in personnel expenses for an anticipated pay raise as part of the ongoing

Police (cont.)

labor negotiations with the Police Officers Association (POA). On April 10, 2007, the City Council approved a labor agreement with POA, which included a 6% pay increase in July 2007; a 2% pay increase in December 2007; and a 1% pay increase for POST certification. This agreement results in an estimated total expense of $16.6 million for Fiscal Year 2008. The difference of $3.5 million will be partially offset by an increased vacancy factor (the net increase is anticipated to be $2.0 million).

Vacancy Factor

Although the Mayor stated in the Financial Outlook that vacancy factors would be reduced, this has not occurred for the Police Department. The IBA agrees with this approach considering the situation in the Police Department. The vacancy factor was increased by $2.0 million in Fiscal Year 2008 for a total of $21.3 million, which would average approximately 200 positions. The current vacancy factor is based on Fiscal Year 2007 salaries and should be increased (approximately $1-2 million) during the final budget process as a result of the approved pay increases.

Business Process Reengineering (BPR)

Police Department's budget had significant adjustments as a result of the Mayor's streamlining and business process reengineering efforts. In the beginning of Fiscal Year 2007, the Parking Management Program, budgeted in the General Services Department, had split and transferred to the Police Department and the Treasurer's Office. Parking Enforcement functions are now under the authority of the Police Department; this also includes parking enforcement activities associated with enforcement of street sweeping previously performed in the Streets Division. This has resulted in a total transfer of 81.00 FTEs, total expense of $6.8 million, and revenue of $19.4 million.

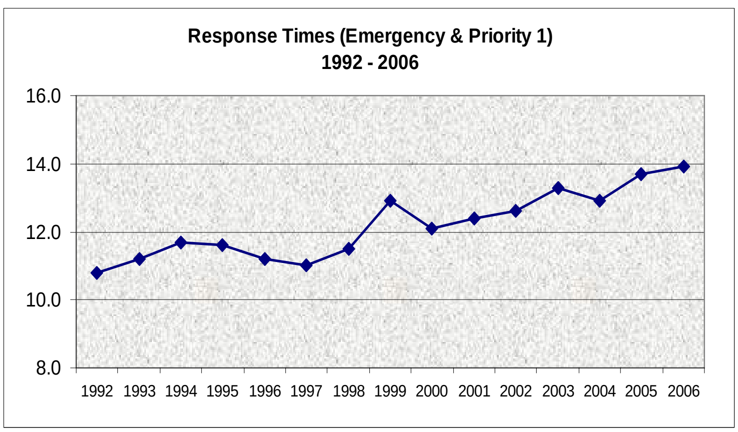
The Fleet Services BPR resulted in the consolidation of the three fleet organizations, Fire-Rescue, Police, and General Services-Equipment Division. The Proposed Budget includes the transfer of 81.00 FTE for a total cost of $15.9 million from the Police Department to the new Fleet Services Division in the General Services Department. Of the 81.00 FTE being transferred, 8.00 FTEs will be reduced. In conjunction with the consolidation, an expansion of the structured Internal Service Fund will now include Police and Fire-Rescue. This action is reflected in the allocation of $17.1 million for usage (costs associated with maintaining the vehicles/equipment) and assignment fees (a set-aside to be used for future replacement costs). The $1.2 million increase is primarily associated with known operational cost increases that would have occurred regardless of the transfer/consolidation and an above-average assignment cost due to the amount of over-aged vehicles (vehicles beyond their useful life). By reducing the percentage of over-aged vehicles, it is anticipated that usage/operating costs will reduce in subsequent years.

Police Department commenced their business processing reengineering study in January 2007. The BPR will be conducted in two phases and focus on evaluating core functions in the department; developing an investigative workload model that establishes acceptable service levels; and maximizing the effectiveness of civilian support staffing. Phase I has been completed and reflected the reduction of 22.00 vacant FTEs that had previously been identified in November. Also, Phase I included the reevaluation of investigative positions that the department needs in a stand-by capacity. Police Department's Phase II BPR is scheduled for completion in November 2007.

Police (cont.)

Service Levels

The Police Department provided the IBA with response time information for the past fourteen years. The chart below depicts the response times for Emergency and Priority 1 calls. Since 1992, the average response time has steadily increased. In 2006, the average response time was 13.9 minutes. It has been previously reported that response time for the first three months of 2007 were quicker than the same time period in 2006. The shortage of police officers has been offset by a decrease in violent crime. Violent crime has decreased by 3.2% from 2005 to 2006 in the city of San Diego, but homicides and robberies have increased. This is also consistent with the crime statistics for the region. In SANDAG's report, *Twenty-Five Years of Crime in the San Diego Region*, they also reported that violent crime is at the lowest in 25 years, but homicides increased from last year and robberies have increased for a fourth year in a row.



Police Decentralization Fund and Booking Fees

The Police Decentralization Fund provides funding to pay for jail services in accordance with a memorandum of understanding (MOU) between the City and the County of San Diego. Since this is a separate fund from the general fund, the revenue to pay for these services is provided by a transfer from the Police Department. In the Proposed Budget, an accumulated fund balance of $1.2 million will be used to offset the transfer from the Police Department. The expense for this transfer has not been reduced in Police's budget, but should be. The Chief Financial Officer has indicated that this reduction will be included in the May Revise. It should be noted that the use of accumulated fund balance may not occur in future fiscal years and that this action may be a one-time reallocation.

The largest expense in this fund is associated with the MOU with the County that guarantees the availability of 180 beds for misdemeanants arrested by City officers and booked in the County jail facility. The MOU also waives the booking fees the City would have otherwise incurred. The City's General Fund has received funds from the State for booking fees, which offset this expense. Beginning in Fiscal Year 2008, change in State legislature would have reallocated these payment directly to the County, but it was the understanding that special language would have exempted the City of San Diego. Due to the existing MOU, the City would still be obligated to pay the County regardless of which municipality receives the fees. This issue is still outstanding and the IBA suggests that this issue be monitored and resolved before the final budget is approved.

Issues for Legislative Consideration

As previously stated, the Police Department's Budget does not include all positions associated with the full-year operations for the Northwestern Division Area Station. Although the IBA agrees that even if the positions were in the budget the department would be unable to

Police (cont.)

hire given the current circumstances, the IBA believes that it would be more transparent to add the FTEs in FY 2008, but not the dollars, by increasing the department's vacancy factor, to ensure that this new facility's commitment is able to be addressed for future years.

The IBA is concerned that a structural underfunding still exists in the area of Information Technology (IT) for the department. Allocation for these resources has changed citywide for Fiscal Year 2008, but the department believes that they may be approximately $500,000 short in this area, which the IBA concurs with. In addition to an adequate level of support for normal IT costs, the department needs approximately $1.0 million to begin replacing patrol officers' Mobile Computer Laptops. These laptops communicate with dispatchers and are used to prepare reports. Identification of this funding would permit the replacement of 20% of the oldest laptops that are now 7-8 years old.

Recommendation

1. Add 14.00 Police Officer IIs, 4.00 Police Sergeants, and 1.00 Lieutenant (total of 19.00 FTE) new Northwestern Station and increase the vacancy factor by the corresponding increase in expense for a net zero impact in order to ensure that this commitment is addressed for the future.

Purchasing and Contracting

Effects of Budget Proposals
In the FY 2008 Budget, the Purchasing and Contracting Department was restructured to house four formerly separate departments including: Equal Opportunity Contracting; Purchasing; Purchasing and Contracting; and Central Stores Internal Service Fund. According to the FY 2008 Budget document, this new structure has expanded the department's charge to include ensuring Equal Opportunity Contract Compliance with federal, state and municipal laws, regulations and procedures, and leading the City's Managed Competition Program.

Vacancy Factors
- Purchasing and Contracting: 0%, not applied to departments with less than 10 FTEs.
- Purchasing: 2.4%
- Central Stores: 2.2%
- Equal Opportunity Contracting: 2.4%

These vacancy factors are consistent with the citywide standard of 3%.

Business Process Reengineering (BPR)
Changes of note took place primarily in Purchasing and Contracting and Equal Opportunity Contracting. In totality, 11 positions were eliminated in these two departments with the approval of the Purchasing and Contracting BPR by City Council. No position reductions or additions and/or budgetary changes in Purchasing are worthy of note. Central Stores Warehouses underwent a BPR at the end of FY 2006 consolidating four warehouses into two. This consolidation resulted in the elimination of 5.50 positions and an estimated savings in FY 2007 of $1.1 million to the General Fund. There were no position changes or reductions for Central Stores in FY 2008.

PURCHASING AND CONTRACTING
Nine positions were reduced within Purchasing and Contracting and transferred to Engineering and Capital Projects as a result of the Purchasing BPR. Four of these transferred positions were eliminated along with associated revenue of $325,674 in Engineering and Capital Projects.

An increase of $30,000 for Training is reflected in the FY 2008 Budget for managed competition, professional certification and cross-training due to the new BPR structure.

EQUAL OPPORTUNITY CONTRACTING
Two positions were reduced in Equal Opportunity Contracting pursuant to the Purchasing and Contracting BPR. In addition, eleven positions were reclassified per the Purchasing BPR. Revenues were reduced by $932,000 due to the move to the General Government Services Billing process.

Recommendation
1. Increase Equal Opportunity Contracting revenue by $930,000 due to non-inclusion in the GGSB process.

PURCHASING AND CONTRACTING BUDGET BY DEPARTMENT					
	FTE	**PE**	**NPE**	**Total**	**Revenue**
PURCHASING/ CONTRACTING	**7.00**	$646,149	$248,633	$894,782	$554,763
PURCHASING	22.00	$1,988,269	$163,965	$2,152,234	$152,393
CENTRAL STORES	22.00	$1,408,929	$22,413,384	$23,822,313	$23,927,238
EO CONTRACTING	23.00	$2,348,166	$239,894	$2,588,060	$669,825
TOTAL	**74.00**	**6,391,513**	**23065876**	**29,457,389**	**25,304,219**

Departments

Qualcomm Stadium

Effect of Budget Proposals
The Mayor's Proposed Budget for Qualcomm Stadium reflects a net increase of approximately $1.0 million. Significant increases include a $370,000 increase for fire insurance, $437,000 for supplies and contractual services, and $185,000 for General Government Services Billing. Significant reductions include $200,000 in repair and maintenance to the Chargers Practice Facility that were performed in FY 2007.

Vacancy Factor
The Proposed Budget includes a $42,000 vacancy factor, or approximately 1.4% of budgeted personnel expense. The vacancy factor in FY 2007 was $20,000, or 0.7% of personnel expense in that year.

Business Process Reengineering (BPR)
Qualcomm Stadium is not scheduled to undergo Business Process Reengineering at this time. However, the department has been analyzing operations over the past year and a half and has been successful in reducing overtime in custodial services. Further options to reduce costs and implement cost-recovery strategies will continue to be examined.

Issues for Legislative Consideration
Currently, the General Fund is supporting the Qualcomm Stadium fund via allocations from Special Promotional Programs. In the Proposed Budget, the allocation to Qualcomm exceeds the budgeted debt service and interest payment by approximately $327,000. It is worth noting that even with this allocation, budgeted expenditures exceed budgeted revenues by over $1 million, forcing the fund to rely on fund balance. Stadium staff is working diligently to attract new special events such as international soccer games in order to reduce the fund's reliance on the General Fund. But presently, all else equal, any increase in expenditures will require an increased transfer from Special Promotional Programs, which in turn will impact the General Fund.

An April 14, 2007 memo from the Chief Financial Officer regarding potential items for the May Revise identified an additional $1.4 million that will need to be transferred to Qualcomm in order to address contractual requirements related to ADA improvements. This transfer will impact the General Fund.

Real Estate Assets

Effects of Budget Proposals
The Proposed Budget for Real Estate Assets Department (READ) is $4.4 million, an 8% reduction below the FY 2007 Budget. The net expenditure reduction primarily reflects the reduction of two Property Agent positions. The FY 2008 Proposed Budget revenue increase for READ is attributed to the revised revenue projections primarily as a result of an increase in Mission Bay Park revenue due to the revitalization and improvement of tourism in the Mission Bay area.

Vacancy Factor
The vacancy factor applied to READ in FY 2007 was 0.7%. The Department's General Fund FY 2008 proposed vacancy factor of 2.4% is more reasonable based on projected year-end estimates for the Department, primarily due to vacant positions. This vacancy factor is more in-line with the City's three percent vacancy factor average.

Business Process Reengineering (BPR)
Real Estate Assets Department has not been through BPR review yet. The office is scheduled for BPR at a future date to be determined.

Land Sales
The Real Estate Assets Department is gearing up to assist the City in selling 22 surplus, underutilized real estate assets that could potentially generate over $30 million in FY 2008, $15.2 million of which has been assumed in the Mayor's Proposed Budget. This is the first step in the Mayor's Five-Year Financial Outlook to raise $100 million through the sale of underperforming surplus City-owned properties. The Department will be charged with evaluating the City's property assets to determine which properties are surplus and can be offered for sale. This entails properties not needed for municipal use in the foreseeable future or that do not benefit the City's core functions. Twenty-two General Funded parcels have been identified for sale in FY 2008, which include a combination of single family resident, multi-family resident, vacant, and commercial properties. The sale of City property provides revenue for the capital improvement fund and relieves the City of potential liabilities and maintenance costs.

The use of brokers is proposed for marketing and selling City assets. For additional information on City land sales, please see the policy discussion on Leveraging City Assets in the "Reforms/ Corrective Actions" section of this report.

Best Practices Methodology for READ
On February 7, 2007, the Grubb & Ellis Company presented a report to the Land Use and Housing Committee on Best Practices methodology for Real Estate Assets Department. The consultant report stated that a successful business model must focus on three areas – real estate investment portfolio performance, operating portfolio planning, and customer service. Adopting this business model presented by Grubb & Ellis Company, will improve customer service, increase financial return from City assets, and position the City to provide superior facilities to City operations.

Departments

Risk Management

Effects of Budget Proposals

What caused department staffing to increase from 58.25 FTEs in FY 2007 to 84.25 FTEs in FY 2008?
In a restructuring effort reflected in the FY 2007 budget, 24.92 FTEs from the Benefits and Safety Divisions of Risk Management Department were transferred to the Human Resources/Personnel Department. After further analyzing the implications of the transfer, a decision was made to return the Benefits and Safety Divisions back to the Risk Management Department in FY 2008. Although the Significant Budget Adjustment on page 159 of Volume II of the Proposed Budget is entitled "Transfer from Labor Relations Department", it more specifically represents the transfer of the following programs with a total cost of $2.5 million (Benefits, Long-term Disability, Employee Assistance, Savings Plans and Safety) from Human Resources (now the Labor Relations Department) back to Risk Management.

28.50 FTEs associated with the above programs were transferred back to Risk Management in the Mayor's Proposed Budget. The department also eliminated 2.50 FTEs (an Employee Assistance Counselor, a Safety Officer and .50 of a Claims Aide) to achieve savings in compliance with the Mayor's five-year reduction plan. The net impact of these changes results in the addition of 26.00 FTEs in FY 2008.

What explains the Significant Budget Adjustments on page 160 of Volume II entitled "Revised Revenue" and "One Time Expenditure Removal"?
In FY 2007, the Risk Management Department, via a fund transfer, funded the above referenced programs that had been transferred to the Human Resources Department. The "One Time Expenditure Removal" line item reflects a $3.7 million reduction of expense associated with the 28.50 FTEs transferring back to Risk Management in FY 2008. That expense reduction, in combination with other expense reductions in FY 2008, reduces the amount of funding needed and as such is reflected in the "Revised Revenue" line item showing a $3.1 million reduction in revenue.

Vacancy Factor
The Risk Management budget includes a vacancy factor of 2.4%, which is consistent with the 3% citywide standard. The vacancy factor was 2.9% in the Fiscal Year 2007 Budget.

Business Process Reengineering (BPR)
Dates for BPR analysis for departments within the Department of Finance are yet to be determined.

Workers Compensation
A 1999 Zero-Based Management Review of the Risk Management Department identified that a "vigorous, joint action" taken by the City "involving all levels of city departments and management and labor is required to make the reduction of accidents and injuries a paramount everyday working condition." Costs associated with workers compensation claims are not completely outside the control of the City. The goal of risk management is to protect the city and its employees from unnecessary loss by managing, preventing, and minimizing risk.

Whereas the Risk Management Department has implemented changes, including an annual safety audit of the larger departments additional reforms in conjunction with raising our reserves (to address existing claims) may be necessary to address this issue.

Recommendation
1. The IBA recommends that the workers compensation issue be explored further, including a presentation on current and future programs to address this significant liability.

San Diego Fire-Rescue

	FTE	PE	NPE	Total	Revenue
Fiscal Year 2007 Budget	1,191.26	$ 150,812,872	$ 18,696,788	$ 169,509,660	$ 14,742,682
Vacancy Factor (07)	-	11,473,397	-	11,473,397	-
Vacancy Factor (08)		(8,000,000)		(8,000,000)	
Salary and Wage Adjustments	-	(640,993)	-	(640,993)	-
Increase to OPEB	-	2,204,751	-	2,204,751	-
Hourly Standardization	(28.54)	(186,384)	189,820	3,436	-
Subtotal	*1,162.72*	*$ 155,663,643*	*$ 18,886,608*	*$ 174,550,251*	*$ 14,742,682*
Transfer Out - HR BPR	(1.00)	$ (164,317)		$ (164,317)	
HR Reclassifications		57,588		57,588	
Transfer Out - Fleet BPR	(23.00)	(1,864,523)	(1,356,917)	(3,221,440)	(2,000)
Allocation for Fleet Services			7,808,711	7,808,711	-
Subtotal	*(24.00)*	*$ (1,971,252)*	*$ 6,451,794*	*$ 4,480,542*	*$ (2,000)*
Additions	7.56	$ 1,425,450	$ 508,101	$ 1,933,551	$ 9,098
Reductions	(1.32)	(116,080)		(116,080)	(5,635,367)
Subtotal	*6.24*	*$ 1,309,370*	*$ 508,101*	*$ 1,817,471*	*$ (5,626,269)*
TOTAL	**1,144.96**	**$ 155,001,761**	**$ 25,846,503**	**$ 180,848,264**	**$ 9,114,413**
Difference from 2007 to 2008	**(46.30)**	**$ 4,188,889**	**$ 7,149,715**	**$ 11,338,604**	**$ (5,628,269)**

Effects of Budget Proposals

The Proposed Budget for the San Diego Fire-Rescue Department incorporates many of the themes found throughout the Mayor's Budget, including the standardization of hourly positions, ensuring operational support of new facilities, and enhancements for public safety.

Fire Station 47 in the Pacific Highlands Ranch area of San Diego is scheduled to open in November 2007 and the Proposed Budget includes a total of 7.56 FTE and related non-personnel expense for a total of $1.1 million. It was previously estimated that Station 47 would open in June 2007 and previous budget's included one month's worth of operational costs; however, the opening is now anticipated to be in November 2007 and the Proposed Budget includes an additional seven months of costs. The department explained that Station 47 would initially house one engine company that is staffed by a four-member crew, including a Fire Captain, Fire Engineer and two Fire Fighters. Since three shifts are needed to operate the engine, a total of 12 crew members are needed plus constant staffing requirements. The additional constant staffing factor is reflected as follows: Fire Captain 3.30, Fire Engineer 3.27, and Fire Fighter 3.20 (6.40 for two fire fighters). In total, a full year's operation will equal 12.97 FTE, an additional 4.32 FTE will need to be added in the Fiscal Year 2009 Budget.

Fire-Rescue also received additional funding for enhancement of the Fire-Rescue Department's operations, including the breathing air filling stations, turnouts, equipment and materials for the Hazardous Materials Incident Response Team program, and lease payments for fire equipment and apparatus.

In conjunction with the Mayor's Financial Outlook, 1.00 Code Compliance Officer and 0.32 Fleet Manager were reduced from the Fire-Rescue Department. These positions are currently vacant. The elimination of the Code Compliance Officer will reduce the Fire Prevention Bureau's ability to perform pro-active brush management by 50%.

Fire-Rescue had significant reductions in revenue, primarily associated with the reduction in reimbursable revenue received from the Emergency Medical Services (EMS) program. This adjustment ($3.7 million) reflects the reduced

San Diego Fire-Rescue (cont.)

level of staffing support by the General Fund to the EMS program experienced for the past several fiscal years. The IBA concurs with this reduction, as it is consistent with information provided during the FY 2007 Mid-Year Budget Adjustments. Also, the department reduced revenues from the federal government ($1.4 million), as this was a one-time reimbursement from FEMA for the Urban Search and Rescue team deployed to hurricanes Katrina and Rita.

Standardization of Hourly Positions

Consistent throughout the budget is the practice of removing all hourly positions from a department's budget and replacing with an equivalent amount of dollars to fund these costs. This will result in the reduction of a department's budgeted positions but no reduction in expenses or services associated with these positions. For the San Diego Fire-Rescue Department, this has resulted in the reduction of 28.54 FTEs associated with hourly, Lifeguard I positions.

Vacancy Factor

San Diego Fire-Rescue Department's vacancy factor was reduced by approximately $3.5 million to $8.0 million in FY 2008; which reflects a vacancy factor of 5.2%. The IBA had raised concerns last fiscal year that the department's vacancy factor may be too high. Subsequently during the fiscal year, the department experienced a deficit in salaries and fringe benefits associated with a vacancy factor that was too high. The IBA believes this reduction is consistent with the previous actions as documented in the Mid-Year Budget Adjustments.

Business Process Reengineering (BPR)

Although, the Fire-Rescue department has not completed their Business Process Reengineering, the Proposed Budget for Fire-Rescue does include impacts from the Human Resources and Fleet Services BPRs. Fire-Rescue BPR is scheduled for completion in July 2007.

A transfer of 1.00 Assistant Fire Chief to Public Safety occurred as a result of the recommendation from the Human Resources BPR. The goal of the Human Resources BPR was to address the inconsistent application of labor and personnel standards and procedures. This position will provide this consistency for the Public Safety departments. The IBA would like to note that subsequent to this transfer, two additional positions were reclassified (for an increased cost of $58,000) to provide support for this function in the Fire-Rescue department.

The Fleet Services BPR resulted in the consolidation of the three fleet organizations, Fire-Rescue, Police, and General Services-Equipment Division. The Proposed Budget includes the transfer of 23.00 FTE for a total cost of $3.2 million from the Fire-Rescue Department to the new Fleet Services Division in the General Services Department. Of the 23.00 FTE being transferred, 1.00 FTE will be reduced. In conjunction with the consolidation, an expansion of the structured Internal Service Fund will now include Police and Fire-Rescue. This action is reflected in the allocation of $7.8 million for usage (costs associated with maintaining the vehicles/equipment) and assignment fees (a set aside to be used for future replacement costs). The $4.6 million increase is primarily associated with known operational cost increases that would have occurred regardless of the transfer/consolidation and an above-average assignment costs due to the amount of over-aged vehicles (vehicles beyond their useful life). By reducing the percentage of over-aged vehicles, it is anticipated that usage/operating costs will reduce in subsequent years.

San Diego Fire-Rescue (cont.)

Service Levels

Overall average response times for the first arriving engine or truck at an incident has increased since FY 2004, but is currently down in FY 2007 (based on information as of March 31, 2007).

INCIDENT RESPONSE TIME	MIN.
Fiscal Year 2004	5.10
Fiscal Year 2005	5.23
Fiscal Year 2006	5.53
Fiscal Year 2007 (ending 3/31/07)	**5.21**

Constant Staffing

In IBA Report 06-18, the subject of constant staffing was discussed and a recommendation was made to separate normal overtime costs, for training, etc., from overtime associated with constant staffing, as two separate line items. The department estimates that 70% of its overtime is attributed to constant staffing, which is Fire Command's operational policy to fully staff fire apparatus. Without separate accounting, it is not possible to verify the department's estimate. Also, Council President Scott Peters requested that a study be conducted which compares the costs and savings of the City's current constant staffing policy versus the hiring of additional full-time, benefited employees to cover the hours currently covered by overtime. The department has indicated that this will be conducted as part of their BPR, but the IBA believes a stand alone report on this subject should be discussed.

Recommendations

1. Reinstate the hourly Lifeguard I positions (28.54 FTEs). Since the original conversion had no net impact on a department's budget, this reinstatement would subsequently not increase the department's budget.
2. Establish a separate object account (line item) to record overtime as associated with constant staffing.
3. Present a report on costs and savings associated with the City's constant staffing policy to the PS&NS committee.

Special Promotional Programs

Effects of Budget Proposals

The Mayor's Proposed Budget for Special Promotional Programs includes several items of note. Allocations for community groups and other non-profits have largely remained unchanged except for the allocation to the Hall of Champions, which has been eliminated, and the allocations to the San Diego Regional Economic Development Corporation (EDC) and the World Trade Center (WTC), which have been significantly reduced.

The savings due to the refinancing of the PETCO Park bonds has been included in the proposed budget. This net savings to the fund was almost \$3.4 million, offset slightly by scheduled debt increases for other projects, for a total savings of approximately \$3.2 million that will benefit the General Fund.

The Mayor also proposed to implement a Tourism Marketing District (TMD) that will shift certain marketing allocations to the TMD, freeing up available resources to be allocated to other priorities in the General Fund. The IBA has noticed that this was budgeted as a revenue increase in the Financial Management Information System, rather than reduced expense. When and if the TMD is approved in the budget, we recommend this be modified. However, it should be noted that the IBA recommends the removal of the TMD from the budget at this time, due to significant hurdles that remain in realizing this proposal. Please see the section on the TMD earlier in this report for more information.

The Special Promotional Programs budget also includes significant additional revenue from TOT based on a strong tourism sector in San Diego. Notwithstanding this increase, the decreases recommended for the Hall of Champions, the EDC and the WTC are said to be "based on reduced availability of Transient Occupancy Tax revenues in Special Promotional Programs." In fact, TOT increases are not available due to the effort to return TOT to the General Fund, as reflected in the Mayor's budget, Volume I, p. 25. The proposal to reduce allocations to the specified groups is a policy recommendation by the Mayor's Office.

Vacancy Factor

The Special Promotional Programs budget does not include a vacancy factor, as there are less than 10.00 FTE in the fund.

Business Process Reengineering (BPR)

The Special Promotional Programs fund is not scheduled for BPR review.

Items for Legislative Consideration

As reflected in the TMD section, the IBA is proposing that the TMD is removed from Special Promotional Programs, which also removes a corresponding amount of revenue in the General Fund.

Recommendations

1. Remove the TMD from the FY 2008 Budget pending more certainty.

Wastewater

Effects of Budget Proposals

The Mayor's Proposed Budget for the Metropolitan Wastewater Department (MWWD) reflects a net increase of approximately $62.4 million, and a net reduction of 134.00 FTE positions. The increase in expenditures is due primarily to a $60.9 million increase in the Capital Improvement Program budget, while MWWD's operating budget increased by a net total of $1.2 million. The position reductions reflect Business Process Reengineering. MWWD has undergone significant restructuring in the Mayor's Proposed Budget, primarily as a result of the BPR. However, based on the way this restructuring was implemented in the budget system, the IBA is unable to ascertain which budgetary changes are due to restructuring and internal transfers, and which are due to true additions and reductions. One significant addition that is identifiable is an increase of 6.00 FTE and $764,000 to support various oversight committees, including 2.00 FTE and $195,000 for the Independent Rate Oversight Committee (IROC).

Vacancy Factor

In somewhat of an anomaly among larger City departments, MWWD does not have a budgeted vacancy factor in the Mayor's Proposed Budget. In FY 2007 MWWD had a vacancy factor of $1.45 million, or approximately 1.6% of budgeted personnel expense. There are several reasons for the elimination of the vacancy factor in FY 2008. First, per BPR, the Department is reducing more positions than the total number of existing vacancies, resulting in a net personnel reduction. Furthermore, the Department has indicated that a list of potential candidates to fill any remaining vacancies is prepared and waiting, which should reduce the vacancy due to turnover. Secondly, the consultant that MWWD worked with in developing its MEO has indicated that as part of the MEO, the Department should assume a baseline vacancy factor of zero. While it would seem that even a modest vacancy factor would be appropriate to capture standard turnover, the Department has decided to take a "wait and see" approach. Since MWWD is an enterprise fund, there are really no practical or budgetary consequences to having no vacancy factor. However, in keeping with best budgetary practices, the Department should prepare to budget a vacancy factor in the future based on actual experience.

Business Process Reengineering (BPR)

The Mayor's Proposed Budget reflects the implementation of MWWD's Business Process Reengineering. According to the Metropolitan Wastewater Business Process Reengineering Report, major changes resulting from the BPR include reorganization and consolidation of Departmental support functions, the relocation of the Storm Water Pollution Prevention Program to the General Services Department, reduction of management and supervisory positions, streamlining of many specific processes to improve efficiency and effectiveness, and modifications to shifts and schedules to decrease overtime and improve efficiencies. As previously mentioned, due to the way in which the restructuring was implemented, the IBA was unable to reconcile all of these changes in the Mayor's Proposed Budget. The Council may wish to request additional clarification on BPR modifications prior to approving MWWD's FY 2008 budget.

The implemented changes from BPR culminate in the elimination of 157.80 FTE, while an additional 30.50 positions are reclassified to better support the Department's MEO. The Department has indicated that from an operational standpoint it is not possible to fully implement the staffing reductions by July 1, 2007. To more accurately reflect the reduction in staff size over the first half of FY 2008, MWWD has included 17.50 FTE, which are intended to reflect 35 employees

Wastewater (cont.)

working through December 2007. These FTEs will be eliminated in FY 2009.

Capital Improvement Program
MWWD's CIP Budget in the Mayor's Proposed Budget is approximately $100.7 million, an increase of $60.9 million. As with the Water Department, MWWD has been unable to access the public bond market in the past several years, thereby sharply curtailing the Department's Capital Improvement Program. On April 9, 2007 the City Council approved short-term private financing as an interim measure for an amount not to exceed $225 million. Proceeds from the private financing will be used for the following purposes: $144.4 million will be used to refund the outstanding Series 2004 Bonds; $41.9 million will be used to reimburse the Department for eligible capital improvement costs previously expended; and $38.2 million will be used to fund new capital project expenditures. Due to the size of this financing, MWWD does not anticipate the need for additional financing until FY 2009.

The private financing described above, and any additional financing over the next few years, will be funded with sewer rate increases that were approved by City Council on February 26, 2007. The Council approved rate increases for each of the next four years: 8.75% in FY 2008 and 2009, and 7.0% in FY 2010 and 2011. In FY 2008, this rate increase is expected to generate approximately $18.5 million in new revenue. With the private financing, MWWD's total outstanding debt is currently $1.1 billion, with annual debt service and interest payments of $94.7 million. Both the outstanding debt and debt service figures include State Revolving Fund loans.

MWWD's Capital Improvement Program in FY 2008 primarily focuses on replacement of sewer mains and pipelines, trunk sewer replacement and rehabilitation, and upgrades and renovations to pump stations. The projects included in the FY 2008 CIP Budget are consistent with those presented in the rate case, and the majority are required per the proposed Final Consent Decree.

MWWD - Major CIP Projects	
Pipeline Rehabilitation	$28.3 million
Sewer Main Replacements	$11.4 million
Trunk Sewer Rehabilitation	$8.9 million
Trunk Sewer Replacement	$8.0 million
Metro Pump Stations Upgrades	$6.3 million

Issues for Legislative Consideration
One of the issues that will have to be addressed in FY 2008 is the Shames settlement. Originally, MWWD intended to factor in the Shames settlement into the rate increases that were approved in February, but due to an error in the Proposition 218 notification, this component of the proposed rate increases was removed. The Department has indicated that the Shames settlement is in final negotiation, and that they expect to come back to Council for a subsequent rate adjustment within a few months. The intent is to combine the Proposition 218 notification process with the Water Department's notification for the anticipated County Water Authority pass-through.

The most significant long-term issue concerning MWWD is the conversion of the Point Loma Wastewater Treatment Plant (PLWTP) to secondary treatment. The PLWTP is currently operating with a modified NPDES permit that does not require full secondary treatment of wastewater prior to discharge through the deep ocean outfall. However, it is anticipated that the City will eventually be required to upgrade the PLWTP to secondary treatment. It is estimated that this upgrade may cost anywhere from $700 million to $1.2 billion, which will result in significant additional sewer rate increases.

Wastewater (cont.)

The current modified permit is set to expire in June 2008, and the Department has indicated that they will be bringing this issue forward to Council sometime in calendar year 2007. It should be noted, however, that while the full Council has not made a decision regarding the PLWTP, the Rules Committee voted unanimously on July 26, 2006 to work toward a Consent Decree that would implement secondary treatment. Until a decision is rendered by the City Council, MWWD is taking steps to prepare the application for a waiver.

Water

Effects of Budget Proposals
The Mayor's Proposed Budget for the Water Department reflects a net expenditure increase of $146.9 million. This increase is primarily due to a $114.5 million increase in the Department's capital improvement budget. Operating expenses increased by approximately $32.3 million, the majority of which is due to a $19.8 million increase in debt service payments. Total debt service is budgeted at $57.5 million. Other significant additions include a $4.5 million increase to the Unallocated Reserve, a $1.6 million increase to the 45-Day Operating Reserve, $2 million for the trench restoration contract, and $2.9 million in increases for OPEB adjustments and General Government Service Billing.

These increases were partially offset by a reduction of 61.16 FTE positions and $5.2 million in personnel expense as part of the Mayor's five year position reduction plan. Of these reduced positions, 50.00 are currently vacant. The Department also reduced $1.5 million due to the cancellation of the Service Level Agreement with Park and Recreation for lakes concessions.

Vacancy Factor
The Mayor's Proposed Budget includes a vacancy factor of $1.7 million for the Water Department, approximately 2.2% of budgeted personnel expense. This represents a significant reduction from the $4.0 million vacancy savings budgeted in FY 2007, which amounted to 5.4% of budget personnel expense in that year. The reduced vacancy factor in FY 2008 is consistent with the elimination of vacant positions, yet still accounts for a few remaining vacancies and standard turnover rates.

Business Process Reengineering (BPR)
The Water Department is currently undergoing Business Process Reengineering. It is anticipated that the BPR will be completed and available for review in June 2007.

Capital Improvement Program
On February 26, 2007, the City Council approved a 6.5% water rate increase per year for each of the next four years. The first increase is scheduled to go into effect beginning July 1, 2007, and is expected to generate $19.8 million in additional revenue in FY 2008. This increased revenue will be used to support the Water Department's CIP program in FY 2008. Over the past several years, the City's financial condition has prohibited the Water Department from issuing new public debt, thereby sharply curtailing capital improvements. The capital improvements that have been performed during this timeframe have been primarily cash funded. On January 16, 2007 the City Council approved $57 million in private financing for the Water Department. Of that amount, $23.3 million was used to reimburse the Department for capital improvement costs already expended, and $33.4 million was to be used for new capital expenditures.

As previously mentioned, the Water Department's proposed CIP budget for FY 2008 is $145.6 million, a $114.5 million increase from FY 2007. Approximately $117.7 million or 80.1% of the FY 2008 CIP Budget will be funded with financing proceeds, while the balance will be cash-funded. In general, capital improvement

Water - Major CIP Projects	
Water Main Replacements (15 miles)	$31.2 million
Alvarado Treatment Plant Expansion & Upgrade	$13.2 million
Miramar Treatment Plant Expansion & Upgrade	$44.6 million
Otay Treatment Plant Expansion & Upgrade	$19.2 million
Otay Second Pipeline Improvements	$7.5 million

Water (cont.)

in FY 2008 will focus on replacement of water mains and upgrade and expansion of water treatment plants. The capital projects planned for FY 2008 are consistent with those presented in support of the rate case in February, and many are required by the Department of Health Services Compliance Order.

Issues for Legislative Consideration

As part of the water and sewer rate increase proposal that was approved in February 2007, the Mayor pledged to establish an oversight committee to ensure that ratepayer funds were being used appropriately, and to perform an oversight and monitoring function for the Water and Sewer Enterprise Funds. On March 20, 2007 the City Council approved formation of the Independent Oversight Rates Committee (IROC) to perform these functions. It was subsequently estimated that the IROC would require $197,000 in support from the Water Department, and $305,000 in support from the Sewer Department. The Water Department anticipates that existing staff will be able to provide support services to the IROC in FY 2008.

Another issue that will be coming forward in FY 2008 is the anticipated increase in water purchase costs due to rate increases by the County Water Authority. In order to continue funding capital improvements at the same level, the Water Department will need to go through another Proposition 218 notification process and request a subsequent rate increase in order to pass this cost on to water customers. As the CWA rates, if increased, will become effective on January 1, 2008, the Water Department expects to bring the Prop. 218 notification to Council around October.

Finally, the Mayor's Proposed Budget does not address the issue of water re-use. On January 13, 2004 the City Council approved a resolution directing the City Manager to conduct a year-long study to evaluate options for increasing the beneficial use of recycled water. The Final Draft Report was released in March 2006, and presented to the Natural Resources & Culture Committee on July 26, 2006. The Report included six potential strategies for water reuse, three pertaining to the North City Water Reclamation Plant (NCWRP) and three to the South Bay Water Reclamation Plant (SBWRP).

For both the NCWRP and the SBWRP, these strategies range from only non-potable projects similar to the City's existing recycled water program, to a mixture of non-potable and small-scale IPR opportunities, to large-scale IPR opportunities. While any combination of these potential strategies would reduce dependency on imported water and decrease water purchases, they would also come with significant capital and operating costs. The City Council may wish to proactively address the issue of water re-use in order to provide policy direction for the future.

Signature Page

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