OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of the Mayor's 2009-2013 Five Year Financial Outlook

OVERVIEW

On January 16, 2008, the CFO presented an updated Five Year Financial Outlook to the Budget & Finance Committee. As with last year's forecast, it includes a projection of the City's financial position for the upcoming five years, including funding for known commitments and policy objectives. The IBA provides this report in order to give additional information and further analysis and spur discussion on important topics. We will address our comments in the following sections:

Our review included an analysis of the following:

- Underlying assumptions for all categories
- Consistency with goals depicted in previous year's Outlook
- Accuracy of data provided
- Completeness and reliability of information
- Consideration of "risks" or changing events
- Accurate portrayal of proposals.

The chart below provides an "at-a-glance" comparison for the Eight Significant Areas and the Corrective Actions for the previous year's and this year's Outlooks.

Comparison of Current and Previous Outlooks

Description	Included in 2008 2012 Outlook?	Implemented in Fiscal Year 2008 Budget?	Included in 2009 2013 Outlook?
EIGHT SIGNIFICANT AREAS			
Pension	✓	**Yes**	✓
Reserves	✓	**Yes**	✓
Deferred Maintenance/ Capital Improvements	✓	**Yes**	✓
Other Post Employment Benefits (OPEB)	✓	**Yes**	✓
Storm Water	✓	**Yes**	✓
ADA	✓	**Yes**	✓
Workers' Compensation Fund	✓	**No**	✓
Public Liability Fund	✓	**Yes**	✓
CORRECTIVE ACTIONS			
Position/Budget Reductions	✓	**Yes**	✓
Business Process Reengineering (BPRs)	✓	**Yes**	
Furlough	✓	**No**	
Debt Refinancing	✓	**Yes**	
TMD/Special Promotional	✓	**Yes**	✓
Budget Clean-Up	✓	**Yes**	
Leveraging City Assets	✓	**Yes**	✓
Managed Competition	✓	**No**	
Health Care Savings		**Yes**	✓
Proposition 1B		**No**	✓

On a very positive note, the Mayor initiated and has continued a strong focus on critical areas of need that have been ignored for years and are crucial to the future fiscal health of this City. On a less positive note, despite a recurring deficit, no new significant solutions for addressing these vital needs have emerged in this Outlook, aside from state funding. Some feasible actions that were included in last year's Outlook, such as results from reengineering and managed competition, are not mentioned in the new Five Year Outlook; and there are fewer corrective actions contemplated in this Outlook than there were last year.

The chart below summarizes the results of our more in depth analysis of this year's Outlook that are described in detail on the following pages. We continue to support all of the Mayor's overarching policies with respect to addressing the Eight Significant Areas, and we concur with taking strong corrective action to provide funding for them. However, in some specific cases, we do not agree with either the underlying assumptions, the data or the characterizations of the proposals. Also, we found there to be less information available this year than last year, making it more difficult to evaluate the validity of the assumptions and the accompanying proposals.

Overview of IBA Analysis

Outlook Topic	Agree with Assumptions	Inaccurate/ Inconsistent Info	More Info Needed	Notes
Revenues - Major	Yes			Risk of recession not discussed
Revenues - Other	No		✓	Unclear how much Employee Offset Savings is included
Expenditures	Neutral		✓	
Terminal Leave	Yes			New to 2009-2013 Outlook
Future Committed Expenditures	Neutral		✓	No specific programs/ facilities provided in Outlook
EIGHT SIGNIFICANT AREAS				
Pension	Yes	✓		See Outlook Table III - portrays money above ARC being paid
General Fund Reserves	No	✓	✓	Need assumptions about significant depletion of 08 reserves
Deferred Maintenance	Neutral		✓	Need information about magnitude of problem
OPEB	No	✓		See Outlook Table III -not consistent with last year's policy
Storm water Compliance	No	✓	✓	Does not match adopted URMP
ADA Compliance	Neutral		✓	Need information about magnitude of problem
Liability Reserve	No	✓		Unclear as to estimated reserve balance at 08 year-end
Workers' Compensation Reserve	Yes			
CORRECTIVE ACTIONS				
Leveraging City Assets	Neutral		✓	Need status of progress of current sales & proposed new properties to be sold
Health Care Reform	Neutral		✓	New to Outlook but included in 2008 budget
Proposition 1B Funding	Yes			
Special Promotional/TMD	Yes		✓	Insufficient detail on how $1million in 2009 is derived. Unclear what happens in future years.
Budget Reductions	Neutral		✓	Magnitude of deficit uncertain; service implications unknown

FISCAL/POLICY DISCUSSION

General Fund Revenue

The Five Year Financial Outlook projects General Fund revenue to grow from $1.106 billion in FY 2008 to $1.314 billion in FY 2013, an increase of over $207 million or 18.7 percent. Annual General Fund revenue growth averages approximately 3.5 percent per year. Four major revenue sources – property tax, sales tax, transient occupancy tax (TOT) and franchise fees – account for over 70 percent of total General Fund revenue. However, as with the previous Outlook, these major revenues account for the vast majority of the total *growth* in General Fund revenue, contributing approximately $188 million over the five year period.

The four major General Fund revenue sources are highly sensitive to economic conditions, and must be carefully monitored to ensure that current projections are consistent with general economic trends. However, due to the large number of unknowns, projecting these major revenues is very difficult, particularly the further out that projections are made. For instance, it is relatively clear that the continuing decline in home prices and sales will impact property tax growth in FY 2009. However, it is much less clear what will happen to the housing market in the future, thereby making it difficult to project property tax growth in outlying years. As such, major revenue projections will be subject to continual revision as new information becomes available. The table below shows the General Fund revenue projections as reflected in the Financial Outlook.

General Fund Revenue, in Millions*

	FY 2008 Budget	FY 2009 Projected	FY 2010 Projected	FY 2011 Projected	FY 2012 Projected	FY 2013 Projected
Property tax	$ 385.7	$ 414.3	$ 430.9	$ 448.1	$ 466.1	$ 484.7
Sales tax	239.5	227.1	235.5	245.8	256.3	266.6
TOT	85.2	91.6	98.0	104.8	112.2	120.0
Franchise fees	69.4	74.0	79.1	84.5	90.3	96.6
Other Revenue	326.5	322.7	327.9	333.6	339.5	345.7
Total General Fund	$ 1,106.3	$ 1,129.7	$ 1,171.4	$ 1,216.9	$ 1,264.4	$ 1,313.6

** Totals may not add due to rounding.*

Overall, the General Fund revenue projections are generally consistent with underlying economic trends, and provide a reasonable foundation for the Financial Outlook. In this section we will touch briefly on the assumptions and growth projections for each of the four major General Fund revenue sources, and take a brief look at some of the other revenue components. The goal of this section is not to make alternative recommendations, but rather, to provide some perspective on the major revenues, including key economic indicators, general economic trends, and future prospects. In addition, this section highlights some possible risks to the forecast.

Property Tax

Property tax is the single largest General Fund revenue source, projected to be nearly $485 million by FY 2013, well over one-third of the entire General Fund. Property tax growth is driven by growth in assessed valuation, or the market value of all property in the City. When a property is sold, it is reassessed at market value, and the total increase in the assessed value of all properties sold within a calendar year provide the basis for growth in property tax. It should be noted that there is a lag time between the point at which properties are sold, and when the reassessment impacts property tax revenue. For example, market activity in calendar year 2007 will impact Fiscal Year 2009 property taxes. The more properties that are sold, and the higher the prices relative to the previous sales price, the higher the growth in assessed valuation and in turn, property tax revenue.

As has been well documented by the local media, home prices and sales in San Diego County have fallen dramatically over the past two years. According to DataQuick Information Systems, the median price of all home sales in calendar year 2007 was $476,000, down 4.8 percent from 2006. Home sales totaled 34,741, a 22.1 percent reduction from 2006. On a monthly basis, the median price in December 2007 was down 13 percent from December 2006, while the number of sales were down 35.4 percent from the same month a year ago, marking the 43rd consecutive month that home sales have declined on a year-over-year basis. It is expected that these declines in sales and prices will negatively impact growth in property tax revenue. This negative outlook is generally reflected in the growth rate assumptions for property tax in the Financial Outlook.

	FY 2008 Budget	FY 2009 Projected	FY 2010 Projected	FY 2011 Projected	FY 2012 Projected	FY 2013 Projected
Property Tax	6.00%	6.00%	4.00%	4.00%	4.00%	4.00%

While growth in assessed valuation and property tax revenue is expected to slow over the next several years, it is not anticipated that either will experience negative growth. Despite the decline in prices, the growth in assessment for a specific property is relative to its prior assessment, not a statistical measurement such as the median price. So while a typical home might sell for less today than it would have two years ago, if the current sale price is greater than the previous sales price, the property will see an increase in assessed value.

While an absolute decrease in total assessed valuation (and hence property tax) would require widespread property sales at prices lower than previously paid, an extreme situation that is unlikely to occur, several factors have the potential to more acutely impact the growth in assessed value in the near future. First, the number of foreclosure in San Diego County has increased dramatically, creating a situation where properties are sold for less than was previously paid due to deflated market prices. According to DataQuick, there were 7,349 foreclosures in calendar year 2007, up from 1,621 in 2006. This trend may continue to increase as adjustable rate mortgages reset. Secondly, under State law, property owners may have their property reassessed if its market value is below the assessed value. However, this will likely only affect property owners who purchased their property at the height of the market. Finally, the commercial real estate sector, which has been very strong over the last several years, may begin to soften as a result of an economic downturn.

The growth rate projections for property tax in the Financial Outlook reflect a continued weakening in residential and nonresidential real estate sectors initially, but then suggest a leveling-off of market activity in later years. However, should the housing market continue to decline into calendar year 2009, or should any of the risk factors discussed above have a larger than expected impact, the City may experience continued declining property tax growth rates in FY 2011 or beyond.

Sales Tax

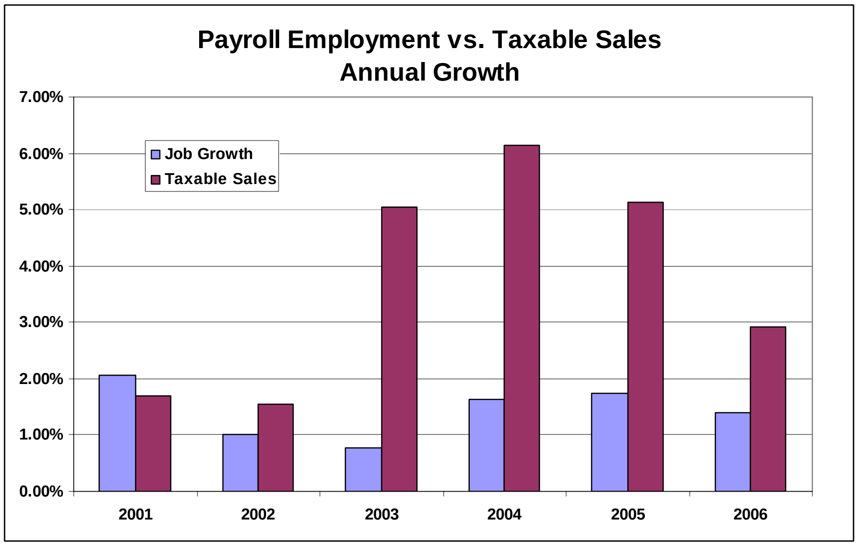
Sales tax is the second-largest revenue source in the General Fund, projected to reach $267 million by FY 2013, or approximately one-fifth of total General Fund revenue. Sales tax revenue is generated through the 1% Bradley-Burns Sales and Use Tax levied on all taxable sales within the City. Tax revenue is collected at point-of-sale and remitted to the State Board of Equalization, which then allocates the revenue to the City in monthly apportionments. The table below shows the projected sales tax growth rates in the Financial Outlook.

	FY 2008 Budget	FY 2009 Projected	FY 2010 Projected	FY 2011 Projected	FY 2012 Projected	FY 2013 Projected
Sales Tax	3.00%	1.25%	3.00%	4.00%	4.00%	4.00%

While these growth rates would seem to reflect a slowdown in FY 2009, the Outlook indicates that sales tax is projected to end FY 2008 approximately $10 million under-budget, or 1.3 percent *less* than in FY 2007. This means that the 1.25 percent growth projected for FY 2009 actually represents a significant *increase* in growth over FY 2008, reflecting improved economic conditions, with more accelerated growth projected for FY 2010 and FY 2011. Sales tax revenue is largely driven by consumer spending, which in turn is highly sensitive to changes in income and the propensity to spend. All else equal, an increase in income will increase consumption, generating higher sales tax revenues. Propensity to spend refers to how much of their income consumers are willing to spend. For example, if interest rates are high consumers may opt to put more money in savings, thereby lowering consumption even if income remains the same.

Over the past several years, consumer spending has largely been propelled by the booming housing market and the dramatic increase in housing prices, despite only modest job growth. This is due to three primary factors. First, the voluminous number of home sales spurred consumer spending at retail outlets such as furniture and home improvement stores. Secondly, low interest rates and the availability of cheap financing caused many existing homeowners to refinance their homes, resulting in either lower monthly mortgage payments or a one-time windfall in discretionary cash. Many homeowners took this opportunity to remodel their homes, injecting additional dollars into the economy. Finally, the dramatic increase in home values may have caused many homeowners to feel wealthier than they actually were, and thus consumer more than they would otherwise. This psychological phenomenon is known as the "wealth effect."

Evidence of the housing market's impact on consumer spending can be seen in the chart below.

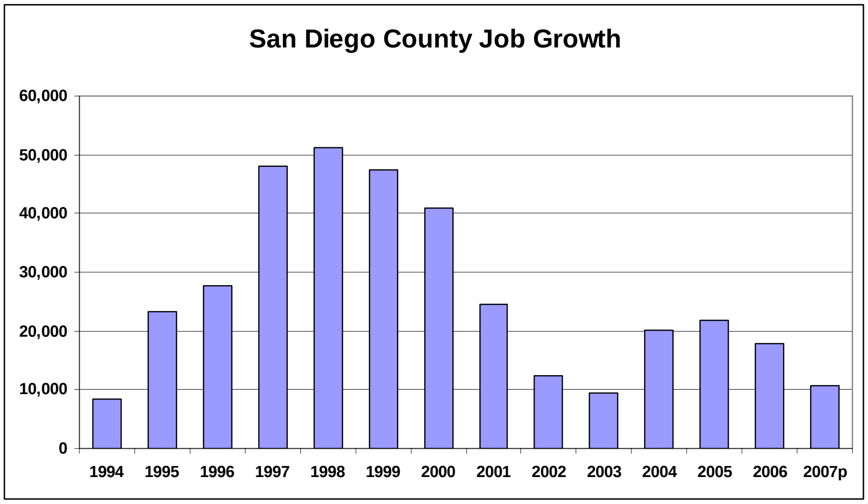


Source: CA Employment Development Department; Board of Equalization

This chart reflects the annual growth in San Diego County payroll employment compared to the annual growth in taxable sales. As mentioned above, consumer spending is largely driven by income. Job growth is a good proxy for income at the local level, suggesting that consumer spending should be highly correlated with job growth. However, as the chart on the following page illustrates, from 2003 through 2006, annual growth in taxable sales far exceeded the growth in payroll employment. This significant discrepancy was likely the result of the booming housing market and the factors described above.

Looking forward, consumer spending is likely to further weaken, especially in the near term. The softening of the housing market and substantial decline in prices will eliminate the stimulus of the past few years, and general economic conditions appear to be weakening at all levels. On January 22, 2008, the Federal Reserve lowered the federal funds rate by three-quarters of a point in an attempt to stimulate national economic activity, stating that the rate was cut "in view of a weakening of the economic outlook and increasing downside risks to growth." Reports from major retailers such as Nordstrom, J.C. Penney, and Target reported a pronounced slowdown in customer spending in December 2007.

At both the state and local levels, job growth is on the decline after several years of increasing growth as shown in the chart below, largely due to declines in housing-related sectors, including construction and finance.



Source: CA Employment Development Department

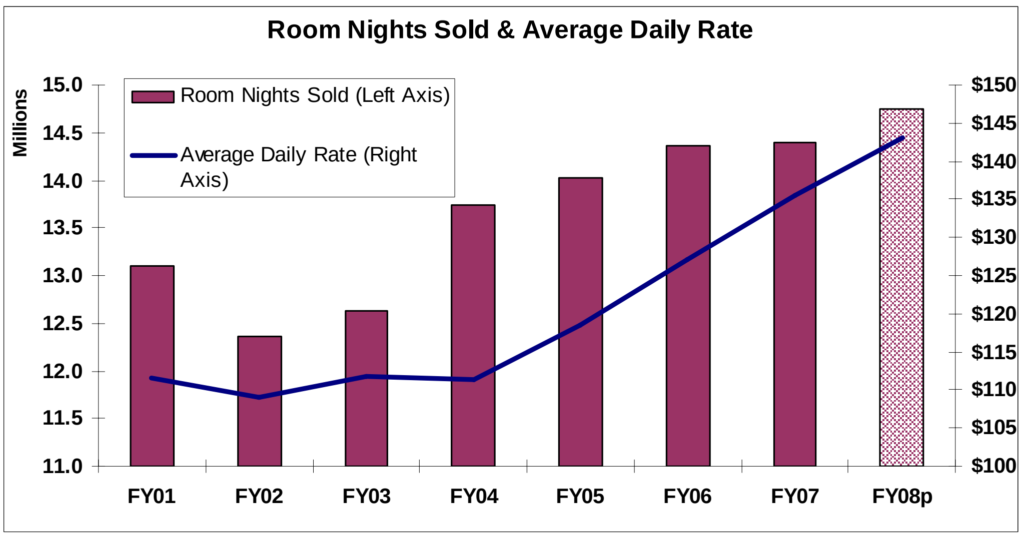
As previously described, the sales tax growth rates in the Outlook reflect improved economic conditions in FY 2009, followed by more accelerated growth in FY 2010 and FY 2011. We are concerned that these projected growth rates may be overly aggressive, particularly in light of the FY 2008 year-end projection. Should the national economy slip into a recession or the decline in the local housing market persist and spill over into other sectors of the economy, not only could sales tax be more adversely affected in FY 2009, but it may take longer than projected to return to normal growth. However, potentially mitigating these downward forces are the aforementioned cut in interest rates by the Federal Reserve, which are likely to continue, as well as a potential economic stimulus package that is currently being developed. It remains to be seen what impact either of these efforts will have on the broader economy, or on City sales tax revenues. Overall, sales tax is likely to be the most volatile major General Fund revenue source over the Outlook period, and should be closely monitored as additional information becomes available.

Transient Occupancy Tax

Transient Occupancy Tax (TOT) is derived from a 10 ½-cent per-dollar levy on the daily room rate charged at lodging facilities within the City. TOT revenue equivalent to 5 ½-cents is deposited directly in the General Fund, while 5-cents is allocated to the TOT Fund for purposes of promoting the City via the Special Promotional Programs budget. General Fund TOT is projected to grow from $91.6 million in FY 2008 to over $120 million in FY 2013. TOT growth rates as projected in the Financial Outlook as shown in the next table.

	FY 2008 Budget	FY 2009 Projected	FY 2010 Projected	FY 2011 Projected	FY 2012 Projected	FY 2013 Projected
TOT	7.50%	7.50%	7.00%	7.00%	7.00%	7.00%

These growth rates reflect continued strength in the City's tourism and lodging industry over the term of the Outlook. TOT revenue is driven by the total number of rooms that are sold throughout the year ("room-nights"), and the rates that are charged for those rooms. These variables are impacted not only by the total demand for tourism (both national and international), but also by the supply of available hotel rooms and the relative attractiveness of the San Diego region as a tourist destination. Over the past several years, the total number of room nights sold has grown modestly; however, growth in the average daily room rate has remained strong. This is reflected in the chart below.



Source: San Diego Convention & Visitors Bureau, Office of the IBA

TOT revenue is more sensitive to national and regional economic conditions than to conditions at the local level. As the national economy begins to slow, it is anticipated that the total demand for tourism will also slow. According to the San Diego Convention & Visitors Bureau's *2008 San Diego County Travel and Tourism Forecast*, tourism began to slow in calendar year 2007, and is expected to continue slowing in 2008 with the anticipated downturn in the national economy. Total room nights sold is expected to grow just 0.6%, down from 0.9% in 2007, while average hotel occupancy is expected to decline 1.9%. The average daily room rate is projected to grow by 5.0%, still strong, but down slightly from 5.2% in 2007.

Despite the forecast for calendar year 2008, a number of factors may work to counteract the anticipated slowdown. First, the depressed value of the dollar relative to other currencies makes travel outside of the United States more expensive. This may cause U.S. travelers to opt for domestic vacations instead of traveling abroad, as well as stimulate international travel into the United States. Secondly, the Tourism Marketing District (TMD), established in December 2007, will provide significant additional funding for marketing and promotion of the San Diego region as a tourist destination. This increased marketing effort may increase San Diego's market share, supporting the tourism industry and the City's TOT revenue in spite of a general decline in tourism nationwide. Essentially, the tourism "pie" may get smaller as the national economy slows, but San Diego's slice of the pie may increase enough to compensate.

Overall, the TOT growth projections in the Financial Outlook may prove to be somewhat aggressive, particularly in the early years as the economy slows. However, given the historical strength of the City's tourism industry and potential counteracting factors such as the declining dollar and the establishment of the TMD, there is little compelling evidence at this time that significantly lower growth rates will be seen in the future.

Franchise Fees

The final major General Fund revenue source is franchise fees, or fees paid by private utility providers for the use of the City's rights-of-way. While franchise fee revenue is commonly discussed as a single revenue source, it is in fact the sum of all revenues generated by the City's various franchise agreements. The largest franchise agreement in terms of revenue generated is with San Diego Gas and Electric (SDG&E), which is charged three percent of gross revenue. The City also has franchise agreements with two cable providers, Cox and Time Warner. The franchise fee pursuant to those agreements is five percent of gross cable revenue. Finally, the City has franchise agreements with private refuse haulers, who are charged based on the tons of waste they collect and dispose of. The table below shows the growth rates projected in the Financial Outlook for franchise revenue from SDG&E and the two cable providers.

	FY 2008 Budget	FY 2009 Projected	FY 2010 Projected	FY 2011 Projected	FY 2012 Projected	FY 2013 Projected
Franchise Fees	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%

Franchise fees are generally one of the most difficult major General Fund revenue sources to project. Since the rates charged to SDG&E and the cable companies are levied as a percentage of gross revenue, projecting franchise revenue essentially amounts to projecting the gross revenues of the various utilities. This can be quite difficult, as the respective markets are complex and the companies are reluctant to reveal sensitive information. As a consequence, projections tend to rely heavily on historical trends. Franchise fees continue to be an area where additional research is needed to better understand the relationship between utility revenue and underlying economic factors.

Other General Fund Revenues

Aside from the four major revenues discussed above, the General Fund revenue projections in the Outlook include other revenue sources such as property transfer tax, safety sales tax, and vehicle license fees, as well as projections for general revenue categories including Licenses & Permits; Fines, Forfeitures and Penalties; Revenue from Money & Property; Revenue from Other Agencies; Charges for Current Services and Transfers from Other Funds. Since revenue from all of these other sources accounts for less than 30 percent of total General Fund revenue, this section only addresses a few key points:

- **Property Transfer Tax.** Property transfer tax is projected to remain constant in FY 2009, followed by a 2 percent growth in FY 2010 through FY 2012, and a 3 percent growth in FY 2013. These projections are significantly increased from the previous Outlook, which projected a 5 percent declines in each of the first three years, and no growth thereafter. We believe that the current projections are more reasonable, reflecting the likelihood that the housing market will begin to stabilize within the five year timeframe.

- **Mission Bay Rents and Concessions.** Revenue from Mission Bay rents and concessions is included in the Revenue From Money and Property category, and is projected to grow 3 percent per year, a reduction from the 5 percent annual growth projected in the 2007 Financial Outlook. The Outlook continues to assume compliance with the Mission Bay Ordinance in all years.

- **Booking Fees.** Booking fee reimbursements from the State continue to be included in the Revenue From Other Agencies category. Under current law, counties can now receive booking fee reimbursements directly from the State instead of charging cities, which previously received the booking fee reimbursement. While the intent of this change was to hold cities harmless, under the terms of the current MOU with the County, the City of San Diego is still liable for an annual payment but will no longer receive reimbursement from the State. It is anticipated that this situation will be remedied to hold the City harmless; however, the status of this effort is unclear.

- **Employee Offset Savings.** The Transfers From Other Funds Category includes $10.1 million in Employee Offset Savings (EOS) used to backfill Tobacco Settlement Revenue, which was securitized in FY 2006. However, language in the Outlook suggests that additional EOS may be included. As stated in the Transfers From Other Funds section:

  "In addition, a total of $19 million in EOS will be budgeted in this revenue category in fiscal year 2009; of that amount, $10.1 million is to backfill the pledged tobacco settlement revenues."

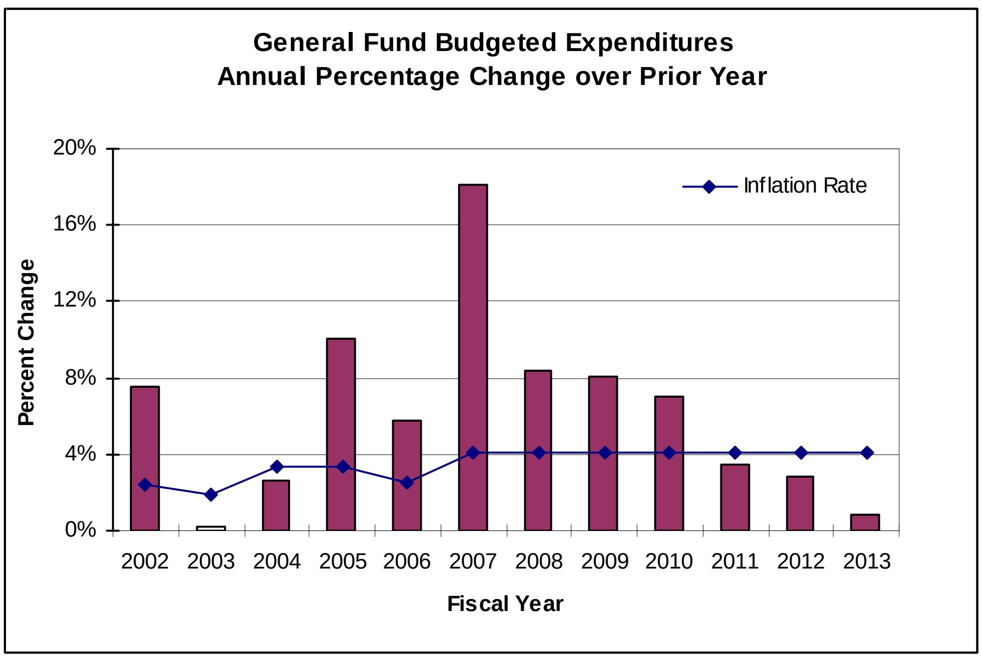
  Despite this language, the IBA was unable to identify this additional EOS revenue. If the full $19 million is in fact included in the Outlook, this would represent a significant change in policy, as only $10.1 million has been pledged for a qualifying purpose. Furthermore, the Outlook includes (at least) $10.1 million in EOS in each fiscal year. This alone presents a serious risk to the Outlook, since it is not clear that employee offsets will continue if the City fails to deposit $600 million into the pension system by June 30, 2008.

- **Transfer from Special Promotional Programs.** The Transfers From Other Funds Category includes a $16.4 million transfer from Special Promotional Programs (Special Promo) in FY 2009, an increase of approximately $5.8 million from that in FY 2008. The transfer from Special Promo is anticipated to grow each year as TOT revenue grows, and reflects the discretionary 1.0-cent that is initially allocated to the TOT Fund. See the discussion of Special Promotional Programs under the Corrective Actions section of this report for additional information.

Overall, the General Fund revenue projections provide a reliable foundation for the Outlook. The assumptions employed are reasonable, and several changes to the growth projections have been made from the previous Outlook that incorporate additional information and more accurately reflect the expected economic outlook. It should again be reiterated that General Fund revenue projections are highly dynamic, and should be updated frequently as part of an ongoing and evolving financial outlook.

General Fund Expenditures

The average percentage change in the General Fund Budget for the past seven fiscal years is approximately 7.5%, with significant variances in 2003 reflecting a downturn in the economy following the events of September 11th and the Mayor's reforms to provide an honest and accurate budget in 2007. These reforms included budgeting for the actual number of existing City employees and increasing expenditures for a number of legal mandates and financial obligations such as the pension fund. During this same timeframe, the Consumer Price Index for the nation has hovered around 3%.



**Source: U.S. Bureau of Labor Statistics, Consumer Price Index for the Nation, Office of the IBA*

For the first two years of the Outlook, the trend of increasing the budget by approximately 7.5% continues. However, in Fiscal Years 2011-2013, the Outlook's projected expenditures are less than the inflation rate (assuming the current rate is maintained). If this were to occur it is expected that service levels would be impacted. For instance, the cost to repair a pothole would increase by a higher percentage than the increase in a department's budget. Therefore, if the department was expected to continue to repair the same number of potholes, the increased costs would need to be absorbed, possibly impacting other programs/services. Alternatively, the department would need to reduce the number of potholes repaired, thereby reducing service levels.

The rest of this section will analyze specific expenditure categories, including Salaries and Wages, Fringe Benefits, and Non-Personnel Expenses.

Salaries and Wages

The Outlook does not assume any new salary increases for City employees. Although not stated, the Outlook does account for the approved pay increase for police officers, including the annualization of the 2% pay increase received in December 2007 and the 1% educational incentive for eligible officers. Current contracts with all labor organizations expire June 30, 2008 and pending results of the labor negotiations, the Outlook may need to be adjusted. The IBA has estimated, based on current salary information, that a 1% increase for all bargaining units and unclassified/ unrepresented employees would increase salaries for the General Fund by approximately $4.5 million annually, as shown. This could significantly impact the Outlook.

Annual Salary Cost for a 1% Increase	
Bargaining Unit	**Projected Increase**
Municipal Employees Association (MEA)	$1.5 m
Local 127	$0.4 m
Local 145-Fire	$0.6 m
POA-Police	$1.5 m
Unclassified and/or Unrepresented*	$0.5 m
Total (General Fund only)	**$4.5 m**

*Includes Deputy City Attorneys

Also, it should be noted that the actual experience for the category of salaries and wages has not matched closely with budgeted allocations in recent fiscal years. For example, at the end of Fiscal Year 2007, the General Fund realized savings of $34.6 million in salaries alone; this represents an additional 6.9% of savings of the adopted salary budget. The IBA recommends increased attention in future fiscal years on revising allocations in this category based on actual experience in order to more accurately allocate the City's resources.

Fringe Benefits

As described in the Outlook, fringe benefits include employee related costs such as workers' compensation, Medicare, unemployment insurance, risk management and savings plan expenses, in addition to payments for pension, retiree health, and the retirement offset. The Outlook assumes inflationary increases of over 3% annually during the five year period. These inflationary increases are in addition to scheduled payments related to pension and retiree health, and impacts due to position adds for specific departmental enhancements. Recent budgets have seen annual increases to the fringe benefits category well in excess of the increases that have been incorporated in the latter years of the Outlook.

General Fund Budget Fringe Benefits (in millions)		
Fiscal Year	Budget	% change
2005	194.88	
2006	238.47	22.36%
2007	252.90	6.05%
2008	271.65	7.41%
2009	274.20	0.94%
2010	299.80	9.34%
2011	309.80	3.34%
2012	319.90	3.26%
2013	329.00	2.84%

Supplies and Services

The Outlook assumes annual inflationary growth of 2.0 percent for the Supplies and Services expenditure category, in addition to changes related to departmental expenditures. As shown in the accompanying chart, past budgets have reflected significant increases over the prior year in this category. However, the amount shown in the Outlook for Fiscal Year 2009 reflects a decrease from the Fiscal Year 2008 budget for this category. Recent increases in Supplies and Services are attributable to the Eight Significant Areas, including allocations made for reserve purposes.

General Fund Supplies and Services (in millions)		
Fiscal Year	Budget	% change
2005	126.49	
2006	125.83	-0.53%
2007	202.26	60.75%
2008	261.83	29.45%
2009	236.10	-9.83%
2010	242.10	2.54%
2011	248.50	2.64%
2012	255.60	2.86%
2013	263.00	2.90%

Information Technology

The Information Technology category costs include data processing, network, hardware, and software costs. This expenditure category reflects annual increases of 4.0 percent to account for inflationary impacts. Recent past budgets reflect significant increases each year, in excess of the annual increases which have been included in the Outlook, as shown in the accompanying chart.

General Fund Information Technology (in millions)		
Fiscal Year	Budget	% change
2005	18.99	
2006	19.78	4.16%
2007	29.72	50.25%
2008	37.16	25.01%
2009	40.70	9.51%
2010	42.30	3.93%
2011	44.10	4.26%
2012	45.80	3.85%
2013	47.80	4.37%

Energy/Utilities

The Energy/Utilities expenditure category of the Outlook reflects inflationary growth of 5 percent, in addition to committed expenditures included in this category. Contributing to the large year-to-year increases is additional funding included for increased fuel costs in the amount of $1.365 million in each year of the five year period in the Citywide Department. The effect of increased fuel costs impacts the City's Equipment Division, which typically factors these impacts into the motive equipment usage rates charged to its customer departments. However, including the impact of these expected costs to the General Fund as a lump sum, versus allocating among separate departments, allows for these costs to be easily accounted for in the Outlook, without working through the mechanics of how the funds are collected and accounted for.

General Fund Budget Energy/Utilities (in millions)		
Fiscal Year	Budget	% change
2005	17.75	
2006	17.79	0.26%
2007	25.69	44.37%
2008	25.65	-0.16%
2009	28.80	12.26%
2010	32.20	11.81%
2011	35.60	10.56%
2012	39.10	9.83%
2013	42.80	9.46%

Equipment Outlay

The Outlook reflects annual inflation growth of 3.0 percent for equipment outlay, in addition to increased costs for departmental expenditures. Recent past budget have reflected large reductions from year-to-year in this category, with Fiscal Year 2009 in the Outlook showing a significant increase of 17 percent for equipment. Based on category detail provided by Financial Management, this large increase is attributable to funds to be budgeted for compliance with emissions regulations of the California Air Resources Board, totaling $1.35 million.

General Fund Budget Equipment Outlay (in millions)		
Fiscal Year	Budget	% change
2005	16.80	
2006	12.96	-22.83%
2007	14.57	12.37%
2008	10.76	-26.15%
2009	12.60	17.08%
2010	13.20	4.76%
2011	13.70	3.79%
2012	14.30	4.38%
2013	14.40	0.70%

Vacancy Factor

A vacancy factor is utilized to capture personnel expense savings that may occur from normal attrition and the hiring of employees who may make less than the average budgeted salary. The Outlook projects a lower vacancy factor than the General Fund has experienced in FY 2007, and what is projected for FY 2008. In the following table, the vacancy factors for the 2008-2012 and 2009-2013 Outlooks and the actual vacancy factors budgeted for 2007 and 2008 are compared. It should be noted that the difference between the FY 2008 vacancy factor and the proposed vacancy factor of 3.4% for FY 2009 is approximately $11 million.

Fiscal Year	Previous Outlook	Current Outlook	Adopted Budget
2007			5.3%
2008	3.5%		4.8%
2009	3.0%	3.4%	
2010	2.5%	3.2%	
2011	2.4%	3.0%	
2012	2.3%	2.5%	
2013		2.4%	

Sufficient detail is not included in the Outlook to determine if and how the following items have been addressed:

- Additional reductions in existing vacant positions;
- IBA's previous concerns about the allocation of the vacancy factor between the salary and fringe accounts;
- Adjustments to the Police Department's vacancy factor ($22.3 million in 2008) given the substantial progress the department has achieved in addressing their recruitment and retention issues.

It is imperative that careful analysis be conducted for the FY 2009 budget on this subject. If the vacancy factor is budgeted too high, additional funding during the fiscal year may need to be identified. However, if the factor is too low, valuable resources could be tied up throughout the fiscal year. Accurately budgeting for salaries is important as, per the Charter, the Council doe not have the authority to transfer funds between salaries and any other expense category.

Future Committed Expenditures

According to the Outlook, additional costs for the staffing of new facilities, and increases as a result of City Council, State, and Federal mandates, have been incorporated. The table below summarizes the future committed expenditures by department, over the five year period of the Outlook.

FUTURE COMMITTED EXPENDITURES Fiscal Year 2009 - 2013				
Department	FTE	Personnel Expense	Non-Personnel Expense	Total
Citywide Program Expenditures	--	--	10,305,630	10,305,630
Library	4.95	369,806	498,528	868,334
Park & Recreation	62.59	3,879,221	2,652,880	6,532,101
Police	--	2,355,971	2,302,887	4,658,858
San Diego Fire-Rescue	43.24	6,579,421	148,705	6,728,126
Other Departmental Adds	43.00	2,127,458	(1,885,601)	241,857
TOTAL OUTLOOK	153.78	15,311,877	14,023,029	29,334,906

Citywide Program Expenditures

Additions included in Citywide Program Expenditures include lease payment costs required for the Enterprise Resource Planning (ERP) project, which the City recently initiated to replace aging financial, personnel and purchasing systems, as well as funding for increased fuel costs and needs that have been identified to comply with California Air Resources Board emissions regulations.

Library

Additions related to new facilities for the Library Department include the Logan Heights branch library in Fiscal Year 2009 at a total cost of $868,000.

Park and Recreation

New facilities and annualizations have been included in the Outlook for the park and recreation locations and sites as follows, over the five year period:

- *Black Mountain Neighborhood Park North*
- *Carson Elementary Joint Use*
- *Mira Mesa Community Park Field House*
- *Scripps Ranch Middle School Joint Use*
- *Torrey Del Mar Neighborhood Park*
- *South Shores Promenade*
- *Fay Elementary School*

- *La Mirada Phase II School Joint Use*
- *39th Street Community Center Phase II*
- *Central Avenue Mini Park*
- *Ocean View Hills Community Park*
- *Torrey Pines City Park General Development Plan*
- *Florence Joyner, Kennedy/Porter, and Rodriguez Joint Use*
- *Park de la Cruz Phase II*
- *Teralta Park Comfort Station*
- *Carmel Valley Community Park, Recreation Center, and Skate Park*
- *Del Mar Mesa Neighborhood Park*
- *Montgomery Middle School Joint Use*
- *Naval Training Center Phase II*
- *West Maple Canyon Mini Park*
- *Sunroad Neighborhood Park*
- *House of Pacific Relations*
- *Myrtle Way Pergola*
- *Balboa Park - Open Space Improvements (Arizona Landfill Reclamation)*
- *West Lewis and Falcon Streets - Mini Park*
- *Pacific Breezes Recreation Center and Community Park*
- *Wightman Street Neighborhood Park*
- *Bay Terraces Community Center*
- *Dennery Ranch Neighborhood Park*
- *Fox Canyon Neighborhood Park Phase II*
- *North Park Senior Community Center/Renaissance Building*
- *Sunset Cliffs' Master Plan*
- *Angier Elementary Joint Use*
- *Wedgeforth Elementary Joint Use*
- *San Diego River Regional Park*
- *North Chollas Community Park Phase 1C*
- *Carroll Neighborhood Park Swimming Pool (Mira Mesa Area)*
- *Black Mountain Community Park Phase II*
- *Torrey Highlands Neighborhood Park*
- *Carroll Canyon Neighborhood Park Phase 1*
- *North Park Mini Park*
- *Fiesta Island Improvements*
- *Sunshine Berardini Fields*
- *Riviera del Sol Neighborhood Park*
- *Home Ave Neighborhood Park*
- *252 Corridor Park (Phase II)*

The Outlook also assumes the addition of 300 open space acres per year, along with the addition of associated park ranger personnel. However, additional resources have not been specifically included to address brush management enhancements.

Police

Two significant increases are forecasted in the Outlook for the Police Department, including

- The addition of personnel expenses associated with the Northwestern Police Station. In the Fiscal Year 2008 Budget, the FTEs were added, but increases in personnel expenses were not budgeted to reflect the existing recruitment and retention problems.

- Approximately $1.4 million in funding for the Police Decentralization Fund is identified in Fiscal Year 2009. In FY 2008, a reduction in the transfer from the Police Department to this fund occurred as a result of an accumulated fund balance. This was a one-time reallocation and the Outlook accurately reflects this readjustment. No additional services are being provided. In fact, this fund, which provides funding to pay for jail services, may be impacted pending resolution of the Booking Fees raised earlier in this report.

The Outlook does not project additional funding to increase the level of sworn or civilian personnel in the department or the replacement of outdated equipment.

Fire-Rescue

Significant increases identified in the Outlook for the Fire-Rescue Department are primarily associated with new facilities, as follows:

- A total of 17.3 FTEs are included for Station 47 that provides service to the Pacific Highland Ranch Community. This reflects the addition of 4.33 FTEs to provide the remaining funding for the full-year's operation of Station 47 and the addition of 12.97 FTEs for a fire truck company at Station 47. In last year's budget discussions, Council raised specific concerns about staffing only the engine company at Station 47, even though the developer had provided an engine and truck per their infrastructure obligations. It was reported that Fire-Rescue's plan was to add the truck company staffing after additional build-out was completed in the area; this was anticipated to be around FY2012. However, the Outlook now includes this staffing in the Fiscal Year 2009 projections. Additional clarity on this has been requested.
- 12.97 FTEs for Fire Station 48 that will provide service to the northern part of the Black Mountain Ranch subdivision.
- 12.97 FTEs for Fire Station 49 that will provide service to the Otay Mesa area. Also, the IBA would like to note that the Outlook does not include projections for additional fire-related expenses, including any increases associated with funding an additional fire helicopter or additional funding to support increases in the brush management program.

Other Departmental Adds

The expenditures included in the Outlook for the Environmental Services Department are based on the Department's FY 2008 General Fund budget. No additional expenditures or reductions have been factored in throughout the five year Outlook period. However, there are several areas that will likely have a financial impact over that time period that have not been factored into the Outlook. First, no expenditure savings are reflected related to the Collection Services Business Process Reengineering. The Environmental Services BPR was approved by City Council on February 6, 2007, but details pertaining to the Collection Services reorganization were withheld pending a decision on managed competition. To date the Collection Services BPR has not been implemented; however, a

September 7, 2007 Report to the City Council stated that all BPR efficiencies would begin implementation after no more than a year.

Second, no additional expenditures have been included for impacts related to the City Recycling Ordinance. It is estimated that this Ordinance could result in additional expenditures ranging from $500,000 to $2.5 million per year for additional recycling trucks, drivers and blue recycling bins to accommodate increased recycling tonnage from single-family customers. Finally, it is currently estimated that the Refuse Disposal Fund and the Recycling Fund will reach a negative fund balance by FY 2010. The Department has indicated that financial mitigation proposals will be forthcoming in FY 2009. It is likely that such proposals will include an increase in disposal fees, which will have a General Fund impact. This impact is not considered in the Outlook.

In the General Services Department, the Outlook reflects an $8.25 million reduction in FY 2009 in Supplies and Services. While it is not clear exactly what this reduction represents, additional information provided by the Financial Management Department suggests that this may be the removal of deferred maintenance funding, which is reflected in the Outlook under the Eight Significant Areas. However, it is unclear whether this reduction is reflected in the Future Committed Expenditures table on page 17. Furthermore, no additional funding has been included in the committed expenditures for ongoing street or facility maintenance. It is unclear whether the General Services Department currently has adequate funding for ongoing maintenance to ensure that the backlog of deferred maintenance does not keep growing.

Funding of Terminal Leave

Annual Leave is a benefit earned by City employees that accrues during each pay period. Any annual leave remaining must be paid out when an employee leaves the City; this becomes terminal leave. Because this benefit is earned during each pay period, employees who have been with the City for a number of years can end up with large leave balances. In general, past practice has been that departments absorb this expense as it occurs. To be more fiscally responsible, the current Outlook incorporates a projected expense of $54 million for the funding of terminal leave over the next five years. The previous Outlook did not address any terminal leave liability and its inclusion in this Outlook is a fiscally responsive approach.

Terminal leave anticipated expenditures are based on the number of employees expected to retire over the next five years. This information is compiled by CAPPS, the City's payroll system. The current Outlook estimates $5.6 million will be needed in Fiscal Year 2009 to adequately fund terminal leave balances. This amount increases to $11 million in Fiscal Year 2010 and ultimately reaches $13 million by Fiscal Year 2012. According to Financial Management, the significant increase from Fiscal Year 2009 to Fiscal Year 2010 is the result of a greater number of employees leaving the City with large leave balances. Of the employees expected to retiree over the next five years, many are public safety personnel with extremely high leave balances, some in excess of 3,000 hours. The table below compares the actual Citywide expenditures for terminal leave with the projected amounts in the current Outlook.

Funding of Terminal Leave Comparison of Past Expenditures with Outlook (in millions)								
Actual Expenditures				Current Outlook Projected Amounts				
FY05	FY06	FY07	FY08*	FY09	FY10	FY11	FY12	FY13
$3.4	$5.9	$4.0	$4.0	$5.6	$11.0	$11.4	$13.0	$13.0
Total: $17.3				Total: $54.0				

*Source: *2007 Year-End Budget Adjustments Report*

Given the high level of salary savings experienced in recent years, the IBA is not confident that additional funds need to be programmed for terminal leave. More accurate budgeting of general salary requirements may free up funding to be re-programmed for this growing need. As we have recommended elsewhere, the IBA suggests close monitoring of the salary and fringe needs in order to more accurately allocate the City's resources.

Eight Significant Areas

As with last year, the Mayor has made it a priority to address eight specific areas of City operations and management. In this section, the IBA will comment on each area, providing context through comparisons to the prior Outlook, budgets and developments over the past twelve months.

Pension

The Mayor's Outlook includes an allocation to the Retirement System of $165 million, the same amount as in the FY 2008 Budget. For the General Fund, this contribution is $123.6 million, as reflected in Attachment 1 of the Outlook. As the Outlook was being published, SDCERS' June 30, 2007 valuation for the City of San Diego was made available and is scheduled for SDCERS Board action at their February board meeting. This valuation, if approved, would set the City's ARC at $161.7 million, or $3.3 million less than projected in the Outlook. As stated therein, this ARC payment will ensure no negative amortization on the unfunded liability of the system, which currently stands at nearly $1.2 billion.

The IBA disagrees with the characterization of pension payments to SDCERS as portrayed in the Outlook. Table III (p. 19 of the Outlook) shows that $9.7 million will be contributed for "ARC Plus" in FY 2009. ARC Plus was created last year by the Mayor as a way to ensure the City paid enough to the pension system to avoid negative amortization on the unfunded liability. Since then, the SDCERS Board took action to require that the City's ARC include all payments necessary to prevent negative amortization. By definition therefore, ARC Plus no longer exists. In fact, the regular

ARC for FY 2009, which is assumed in the Outlook, covers this payment as shown below:

	in millions
FY 2008 ARC	$ 137.7
Change to 20 Year Amortization	$ 13.0
Elimination of any negative amortization	$ 9.4
Change to EAN funding methodology	$ 6.4
Favorable experience gain	$ (4.9)
FY 2009 ARC	$ 161.6

*may not add due to rounding

The current Outlook is double-counting payments to the Pension System by showing payment of the ARC as well as an additional $9.7 million for ARC Plus. The Outlook should discontinue showing that there is an "ARC Plus" in FY 2009 and all future years, or that there are monies above the ARC being contributed to the Pension System, as this is not a correct representation. However, we would also clearly state that the Mayor's policy objectives in creating ARC Plus, and eliminating negative amortization, in FY 2008 are not only being met, but have effectively been institutionalized through the actions of the SDCERS Board.

It is important to note that, notwithstanding the elimination of the need for an allocation to ARC Plus, the Outlook is accurate in its statements that there will be no negative amortization of the unfunded liability in the Pension System, and that the full ARC for FY 2009 is assumed to be paid.

There are several items not addressed in the Outlook that the IBA will mention briefly. In 2004, the voters of the City of San Diego approved Proposition G, which would (among other things) require the liability to be amortized over no more than a 15 year period. There remains significant debate about the application of this requirement to SDCERS, and SDCERS has not changed their amortization period to 15 years for the current unfunded liability. Thus, the ARC, and the amount assumed to be contributed in the Outlook, is not consistent with Proposition G. The IBA recommends that the Outlook include a statement to this effect in order to provide full and accurate information to the public.

The Outlook also does not address the matter of benefits the City must pay in excess of the IRC 415(b) limits. These benefits, inasmuch as they exceed IRS limits, cannot be paid from the SDCERS Trust, and in FY 2008 the City budgeted approximately $500,000 in the General Fund in order to begin funding these benefit payments directly. The Outlook does not make an estimate of future payments for these benefits. Since the Outlook is based on FY 2008, we believe that the Outlook does continue to include $500,000 in future years for this payment. However, the IBA believes this number is likely inaccurate (since it was estimated long before the IRS approved the final methodology that is necessary to calculate which benefits will be in excess of 415(b) limits in future years); and that the Outlook should at minimum discuss the issue and provide revised numbers as soon as is practicable.

General Fund Reserves

On November 13, 2007, the City Council adopted the City Reserve Policy which outlines the policy targets for reserves in the General Fund and enterprise funds, including Water, Metropolitan Wastewater, and Development Services. The Reserve Policy requires a reserve of 6.5 percent of the General Fund budget for Fiscal Year 2009, growing to 8.0 percent by Fiscal Year 2012. For purposes of calculating the reserve target, all three reserves are included: Emergency, Appropriated and Unallocated. Funds in excess of the annual target remain in the Unallocated Reserve, and according to the Outlook, may be available for the City Council to appropriate as required for city priorities.

The Fiscal Year 2008 Adopted Budget totals $1,106,330,952. A General Fund Reserve of 6 percent (as per the policy) amounts to $66.38 million. As of January 17, 2008, the City's General Fund Reserve totals $82.57 million (comprised of the Emergency Reserve, the Appropriated Reserve, and the Unallocated Reserve). The Fiscal Year 2008 Budget allocates an additional contribution of $3.3 million to the General Fund Reserve, which is not yet reflected in the total reported to date. These two amounts together, totaling $85.87 million, represent 7.77 percent of the Fiscal Year 2008 Budget. It should be noted that savings of $40 million were added to the General Fund Reserve at the end of Fiscal Year 2007, increasing the balance significantly.

The Outlook calls for the contribution of an additional $7.0 million in Fiscal Year 2009 in order to reach the policy target of 6.5 percent. However, based on the figures cited above, it appears that the current General Fund Reserve is presently well in excess of the policy target, and it is unclear why additional funds would need to be allocated in Fiscal Year 2009.

The Outlook contemplates that the Fiscal Year 2008 reserves will be reduced significantly to $70 million by year-end therefore requiring another $7 million infusion in Fiscal Year 2009 to reach the 6.5% target as shown in the chart.

This is an extremely aggressive depletion of reserves to assume with five months remaining in the fiscal year. There is not sufficient information provided to understand the underlying assumptions of this scenario. This issue needs to be carefully reviewed during the Fiscal Year 2009 budget development process.

Listed below are the reserve policy annual targets, the estimated annual General Fund Budget, and corresponding annual reserve requirements, based on the figures included in the Outlook.

		Per Outlook		
Fiscal Year	Policy Reserve Target	General Fund Expenses (in millions)	Reserve Amount (in millions)	Change from Prior Year (in millions)
2009	6.5%	$1,195.6	$77.7	n/a
2010	7.0%	$1,279.0	$89.5	$11.8
2011	7.5%	$1,323.6	$99.3	$9.8
2012	8.0%	$1,361.5	$108.9	$9.6
2013	8.0%	$1,373.1	$109.8	$0.9

Deferred Maintenance/Capital Projects

The Outlook has included funding for deferred maintenance and capital improvement needs by utilizing a combination of cash and financing. The proposed funding for deferred maintenance/capital improvements for FY 2008 and the five year Outlook period, using the combined pay-as-you-go and financing methods, is estimated to be $781.0 million. This includes $472.3 million in bond financing and $308.7 million in cash. $80.8 million of the cash will be used to service the debt related to the bonds.

For Fiscal Years 2008 and 2009 the Outlook proposes a total of $145.6 million for deferred maintenance with $102.3 million coming from bond financing. The IBA recently has had discussions with the Mayor's staff and the current plan is to bring the bond financing proposals for both Fiscal Years 2008 ($24.8 million) and 2009 ($77.5 million) forward to the City Council for approval in March. At the January 16, 2008 Budget and Finance Committee, staff indicated that the list of deferred maintenance projects for Fiscal Year 2008 was included in the Annual budget. However, our office was not able to locate the list in the document. For Fiscal Year 2009, staff has indicated that the list of projects will be available when the financing proposals come forward to the City Council in March.

Addressing deferred maintenance/capital needs continues to be an area of emphasis for the Mayor. Staff has stated the City's deferred maintenance/capital needs, excluding those related to Water and Wastewater, at $800 to $900 million. It is unclear what this is based on or if still current. For the past two years the Mayor has committed to providing a comprehensive and prioritized list of all deferred maintenance needs to the City Council. To date, this has not been done. In addition, during discussions on the Outlook at the January 16, 2008 Budget and Finance Committee meeting, staff indicated that the comprehensive list of deferred maintenance projects will not be available until the second half of calendar year 2008. In discussions with the Mayor's staff after the January 16, 2008 Budget and Finance Committee meeting they indicated that a memo will be released in the next couple of weeks to update the City Council on the status of compiling a comprehensive list of deferred maintenance/capital needs.

It is difficult to analyze the Mayor's plan for addressing the City's backlog of deferred maintenance when the scope of the problem has not yet been identified. Without a baseline, how can the Mayor, City Council, or San Diego's citizens ascertain if the projected annual expenditures in the Outlook are acceptable funding levels that will keep the backlog of deferred maintenance from "growing"? Additionally, how can the City Council make an informed decision in March regarding $102.3 million in bond financing to address deferred maintenance/capital needs when a comprehensive list of needs has not been provided?

Finally, as stated earlier in this report, it should be noted that no additional funding has been included in the Outlook's baseline expenditures for ongoing street and facility maintenance. It is unclear whether the General Services Department currently has adequate funding for ongoing maintenance to ensure that the City's past practice of not funding deferred maintenance does not continue in the future.

Other Post-Employment Benefits (OPEB)

The Outlook shows a continued allocation to pre-fund the City's liability for retiree healthcare, also known as Other Post-Employment Benefits, or OPEB. In FY 2008, the City allocated $25 million to pre-fund as well as $23.1 million for the current year costs, or pay-as-you-go amounts (PAYGO). Also in FY 2008, the City executed an agreement with CalPERS to establish a trust fund for this purpose in order to protect the assets and maximize the investment. The current Outlook, consistent with last year, shows the pre-funding for the OPEB stepped up each year until the full ARC is being paid in FY 2010. The IBA continues to support the aggressive funding of the City's OPEB liability through the ramp up to full payment of the ARC.

However, the Outlook has made a significant change to the OPEB funding as compared to the previous Outlook, which is neither pointed out nor portrayed accurately in Table III. Last year, the OPEB pre-funding allocation for FY 2009 was to be $50 million in addition to the PAYGO amounts. This year, the $50 million allocated in FY 2009 includes the pre-funding amount as well as the PAYGO amount. The net result of this change is that approximately $25 million less will be contributed to OPEB funding in FY 2009 than previously planned.

The figures in Table III are inaccurate because it shows only the pre-funding amount in the FY 2008 column. The FY 2009 (and future) columns show both the pre-funding and the PAYGO amounts, thus preventing a true comparison between the years. In order to accurately reflect the total amounts to be paid for OPEB each year, the IBA recommends that both the pre-funding and the PAYGO amounts be shown in each year, as displayed in the chart on the next page. Since the City is now going to contribute all assets to and pay all benefits from the new trust fund, showing one total dollar amount is particularly appropriate.

OPEB (in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
PAYGO	23.1	23.0				
Partial pre-funding	25.0	27.0				
Full ARC			75.0	75.0	75.0	75.0
TOTAL	48.1	50.0	75.0	75.0	75.0	75.0

As portrayed in the Outlook, the reader is led to believe that the FY 2009 budget will increase OPEB funding by $25 million, which is not the case. The Outlook must accurately represent the total amounts that have and will be paid in past and future years. The current Outlook should show a total increase in funding for OPEB in FY 2009 of approximately $2 million over the FY 2008 allocation.

As a final note, the City has recently completed another actuarial valuation for OPEB, which shows that the ARC in FY 2009 would be over $85 million, assuming a 7.75% discount rate. Since we will not pay the ARC in FY 2009 (which is not required under law, unlike the requirement to pay the Pension System ARC), the IBA surmises that the ARC in future years may be even higher. Thus, we believe that the Outlook may be underestimating the OPEB ARC in future years and the City will either have to allocate additional funds in FY 2010 or take additional year(s) to ramp up to the full ARC. This is a matter that should be updated in future editions of the Outlook.

Storm Water Runoff Compliance

The previous Outlook included an additional $164.7 million over the five-year period in order to maintain compliance with the revised Municipal Storm Water Permit, issued by the San Diego Regional Water Quality Control Board (RWQCB) in January 2007. In the current Outlook, this amount has increased to $175.9 million over the next five years for compliance. In total, the current Outlook projects spending $343.9 million for storm water compliance over the next five years. The revised Permit updates and expands existing requirements to improve the City's water quality. Such requirements include enhanced public education, increased business inspection, establishment of minimum private sector Best Management Practices, and the expansion of development planning and monitoring programs. The revised Permit also requires the City to revise Urban Runoff Management Plans (URMP). The Storm Water Division has updated the City's URMP and anticipates the Citywide costs of complying with the Municipal permit to be $320 million over the next five years.

The IBA supports additional funding for storm water compliance and commends the Mayor for highlighting this as one of the eight significant areas. However, the current Outlook funding amounts are not consistent with the anticipated costs identified in the URMP. As depicted in the table on the next page, the current Outlook anticipates nearly $24 million more than URMP estimates for storm water compliance. It is unclear why the figures in the Outlook differ from the URMP.

Storm Water Compliance Funding Outlook vs. URMP (in millions)			
Fiscal Year	**Current Outlook**	**URMP**	**Diff.**
FY08	$43.0	$43.0	$0.0
FY09	$54.5	$54.2	$0.3
FY10	$61.6	$54.2	$7.4
FY11	$61.6	$55.2	$6.4
FY12	$61.6	$56.3	$5.3
FY13	$61.6	$57.3	$4.3
Total	**$343.9**	**$320.2**	**$23.7**

**Totals may not add due to rounding*

In addition, the Outlook continues to assume that the General Fund will be the primary source of funding for Storm Water Permit compliance. As we have discussed in the past, if alternate funding sources are not secured, more stringent requirements associated with the revised Storm Water Permit will continue to increasingly burden the General Fund at the expense of other priorities. The IBA encourages a public discussion at the City Council or appropriate Council Committee to address the possible options and limitations of alternative storm water funding sources.

Americans With Disabilities Act (ADA)

The Outlook includes $10 million per year for ADA-related improvements. In Fiscal Year 2008, $12.3 million was allocated to ADA-related improvements, $10 million of which was to come from the sale of surplus City property assets and $2.3 million from CDBG funds. Unlike the previous Outlook, this updated Outlook does not specify whether the sale of surplus City property will be the source of the $10 million planned to fund ADA projects over the next five years. On October 17, 2007, the Financial Management Director informed the Budget & Finance Committee that targeted land sales had yet to occur in Fiscal Year 2008 and that a year-end fund balance of $6 million (from FY 2007 City land sales) was available to initiate the 38 identified ADA-related projects planned for Fiscal Year 2008. The IBA recently requested, but has yet to receive, an update on the status of those identified projects.

Given the recent downturn in the real estate market and slower than anticipated sales of surplus City property in Fiscal Year 2008, the planned source of funding for ADA-related improvements beginning in Fiscal Year 2009 should be clarified. If the sale of surplus City property continues to be the source for ADA-related project funding, the City Council should request an update from the Real Estate Assets Department on property sales planned for Fiscal Years 2008 and 2009 as suggested in this report. Additionally, the IBA recommends that the City Council be apprised of the specific ADA-related projects planned for Fiscal Year 2009, how projects are identified/ prioritized and any limitations associated with staff’s ability/capacity to complete those projects in Fiscal Year 2009.

The IBA continues to support increased funding to quickly achieve ADA compliance and avoid adverse fiscal ramifications. We believe that ADA-related project funding should be a budget priority for years to come. The IBA is concerned, however, that like deferred maintenance, the total scope of the City's ADA deficiencies has yet to be quantified. The total cost for the City to achieve ADA compliance has been roughly estimated to be in the hundreds of millions of dollars. If so, normal increases in construction costs and materials could mean that the City's total cost to achieve compliance is growing faster than the additional funds being budgeted. The IBA recommends that a more precise estimate of total project costs to achieve ADA compliance be developed.

. . . normal increases in construction costs and materials could mean that the City's total cost to achieve compliance is growing faster than the additional funds being budgeted.

Public Liability Reserve

According to the Outlook, the City has approximately $100 - $114 million in outstanding public liability claims and no reserve funds. In the previous Outlook, the claims level was reported at $100 million, and reserves were $4 million. In the Fiscal Year 2008 Budget, the Public Liability Reserve received funding in the amount of $5 million, bringing the total reserve to $9 million. This was in addition to funding of $13 million for annual claims costs included in the budget. Based on recent reports from the Risk Management Department, it appears the previous 2007 reserve balance of $4 million has been exhausted, and newly allocated reserve funds of $5 million are also on course to be expended this year. On January 11, the $5 million liability reserve was transferred from "contingency" to "new resources" to be "expended", rather than "reserved".

The City's Reserve Policy establishes a goal of funding the Public Liability Reserve at 50% of outstanding claims by Fiscal Year 2014. As stated in the Outlook, it is planned that the Mayor's Proposed Budget for Fiscal Year 2009 will include $5 million annually for the Public Liability Reserve through 2010, increasing to $10 million annually in Fiscal Year 2011 and beyond. Assuming the City's current level of claims is $114 million, the reserve target of 10% for Fiscal Year 2009 would require a total of $11.4 million be maintained on hand. If current reserve funds are expected to be fully expended by year-end, efforts need to be doubled to keep progress on track to meet the reserve policy targets. This would require the allocation of additional funds beyond those currently stated in the Outlook.

The next table reflects the annual Public Liability reserve target, the annual reserve amount, along with the cumulative reserve balance, assuming a current starting balance of $5 million, which is questionable, as noted. The shaded Fiscal Year 2014 extends beyond the current term of the Outlook, but reflects the reserve requirement as shown in the City Reserve Policy, in order to achieve the target of 50% of outstanding claims by 2014.

		Assuming $114 M claims	Per Outlook	
Fiscal Year	Public Liability Reserve Target per Policy	Reserve Needed (in millions)	Annual Reserve Allocation (in millions)	Cumulative Reserve* (in millions)
2009	10%	$11.4	$5.0	$5.0
2010	15%	$17.1	$5.0	$10.0
2011	25%	$28.5	$10.0	$20.0
2012	35%	$39.9	$10.0	$30.0
2013	45%	$51.3	$10.0	$40.0
2014	50%	$57.0	$10.0	$50.0

* This assumes a year-end liability reserve level of $0 for Fiscal Year 2008 based on January 11th information that the 2008 $5.0 million liability reserve has been transferred from "contingency" to "other resources". All funds may not be expended by year-end so this number may vary.

Workers' Compensation Reserve

According to the Outlook and accompanying press releases, the City has $150 - $160 million in outstanding workers' compensation claims and only $20.4 million in reserve balance. In the previous Outlook, the claims level was reported at $150 million, but the reserves at that time were $18 million. The reserve balance has grown by $2.4 million from Fiscal Year 2007 to Fiscal Year 2008, even though no additional funds were budgeted for this purpose in Fiscal Year 2008. Presumably, this can be attributed to Workers' Compensation contributions from all City funds in excess of payments made, allowing the reserve balance to grow, which was not anticipated or discussed in the budget or the Outlook.

The City's Reserve Policy establishes a goal of funding the Workers' Compensation Reserve at 50% of outstanding claims by Fiscal Year 2014. As stated in the Outlook, it is planned that the Mayor's Proposed Budget for Fiscal Year 2009 will include $5 million for the Workers' Compensation Reserve, increasing to $10 million annually in Fiscal Year 2010 and beyond. These amounts are in addition to funds needed to pay annual claims costs, which for Fiscal Year 2008 was budgeted at $26.1 million. Assuming the City's current level of claims is $161 million, the reserve target of 15% for Fiscal Year 2009 would require a total of $24.2 million be maintained on hand.

Workers' Compensation Experience Source: Risk Management Department		
Fiscal Year	# of claims	Cost of all claims (in millions)
2007	1811	$20.17
2006	1947	$21.83
2005	2033	$23.77
2004	1976	$26.24
2003	2025	$25.18

The table below reflects the annual Workers' Compensation reserve target, the annual reserve amount, along with the cumulative reserve balance, assuming a current starting balance of $20.4 million and outstanding claims of $161 million. The shaded Fiscal Year 2014 extends beyond the current term of the Outlook, but reflects the reserve requirement as shown in the City Reserve Policy, in order to achieve the target of 50% of outstanding claims by 2014.

		Assuming $161 M claims	Per Outlook	
Fiscal Year	Workers' Comp Reserve Policy Target	Cumulative Reserve Need	Annual Reserve Amount (in millions)	Cumulative Reserve (in millions)
2008	12%	$19.3	--	$20.4
2009	15%	$24.2	$5.0	$25.4
2010	22%	$35.4	$10.0	$35.4
2011	30%	$48.3	$10.0	$45.4
2012	35%	$56.4	$10.0	$55.4
2013	42%	$67.6	$10.0	$65.4
2014	50%	$80.5	$10.0	$75.4

The First Quarter Budget Monitoring Report (07-184, dated November 8, 2007) stated that a review of Workers' Compensation rates was underway, and that current rates were resulting in the collection of funds in excess of budget levels, causing departments to over expend in this area. Without correction, rates that are higher than needed will cause surplus funds to be collected for Workers' Compensation purposes, possibly at the expense of other departmental needs.

Assuming the current level of claims of $161 million, the Outlook's Workers' Compensation Reserve falls just short of the City's Reserve Policy targets in several years.

Illustrating the Eight Significant Areas

A suggestion made at public comment as well as supported by the IBA is to document the magnitude of these liabilities over time so that the public may understand how they grow or diminish based on the funding policies proposed and implemented. As an example, we have shown a chart on the next page provided by the SDCERS actuary in their June 30, 2007 valuation, which shows the projected pay-down of the unfunded liability over the amortization period, based on assumptions of the system.

Projection Set 2: Pay down of the Unfunded Actuarial Liability (UAL) – City of San Diego

Choice of an amortization period is significant when viewing the projected pay down of the UAL, especially when one is assuming level returns. The chart to the right below demonstrates that varying returns (which always happens) will have a dramatic impact on the annually computed UAL.

Chart 1: 8% return each year

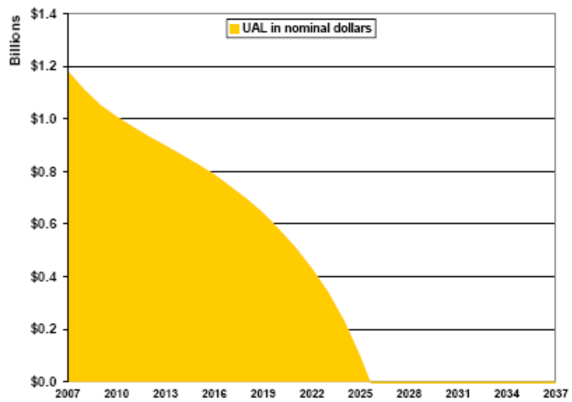
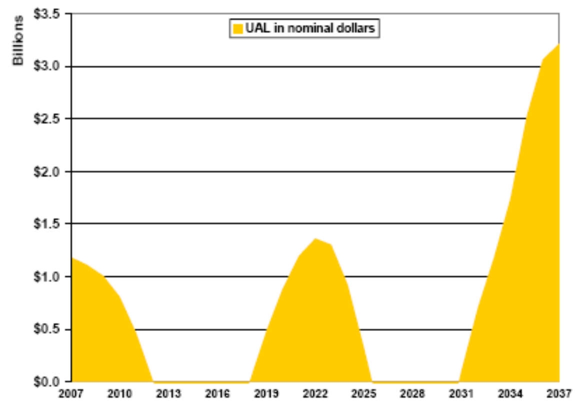


Chart 2: varying returns averaging 8%



*source: SDCERS June 30, 2007 Actuarial Valuation for the City of San Diego

The IBA suggests that staff consider adding a chart similar to this to future editions of the Outlook, to include the magnitude and expected pay-down of all liabilities in the Eight Significant Areas. Before that can be comprehensively completed, certain data must be gathered for a complete and comprehensive picture of these liabilities. For instance:

- The City must report the magnitude of deferred maintenance. This data has been requested a number of times and remains under development at the time of this writing.
- The City must quantify the value of improvements needed under the Americans with Disabilities Act. This may be produced as part of the deferred maintenance inventory.

Corrective Actions

The Corrective Actions are options the Outlook presents for addressing the sizeable deficit that remains after funding of operating expenses and the Eight Significant Areas. The Corrective Actions displayed in the current Outlook differ from those presented in the previous Outlook and although it states in the Executive Summary that the solutions include enhanced revenues to ensure cost recovery of fee-supported services, that is not actually addressed in the Outlook.

Leveraging City Assets
On May 21, 2007 the City Council approved the sale of 17 properties deemed in excess of City needs, five of which are residential. The Fiscal Year 2008 Annual Budget includes $15.3 million in revenue from the sale of public property. The revenue from the sale of public property was budgeted in the Capital Improvements Program to fund ADA related projects ($10.0 million) and capital improvements for City-owned property ($5.3 million). For Fiscal Years 2009 – 2012 the Outlook proposes an additional $21.8 million per year for an estimated total of $102.5 million once all properties sales are completed.

The Real Estate Assets department has informed the IBA that they plan on releasing a memorandum to update the City Council on the status of land sales in the next couple of weeks. The department has stated that it is unlikely that they will be able to close on all of the property transactions previously approved by the City Council by the end of Fiscal Year 2008. The staff has indicated that they should be able to close on enough properties to meet the $15.3 million budgeted amount. The Outlook is unclear on what the impacts would be to the ADA and capital projects if the sale of public properties is not completed or the projected selling prices is lower than expected. In addition, the department will be coming forward to the City Council in the next couple of months with additional properties for possible sale.

Savings from Health Care Reform
The City began the consolidation of the 21 healthcare plans previously administered by employee unions, with the ultimate goal to provide only three plans for all City employees. For the Police Officers Association (POA) alone, this change was estimated to save the City approximately $800,000, assuming current enrollment. By reducing the number of health plans, the City expects to maximize its buying power and slow the increase in health care costs.

While POA and Fire Local 145 agreed to this change for Fiscal Year 2008, the City is now negotiating with MEA, AFSCME Local 127, and the Deputy City Attorneys' Association with hopes to fully implement the health plan consolidation Citywide, and further increase savings.

As stated in the Outlook, savings in the amount of $1 million due to these health care reform measures were included in the Fiscal Year 2008 Budget. This amount was half of the estimated savings determined at the time the budget was developed, in an attempt to conservatively incorporate the potential savings.

Information regarding the status of the health care reform and its related savings for Fiscal Year 2008 has been requested as part of the Mid-Year Financial Report. The Outlook includes savings of $1.2 million for this purpose.

Special Promotional Programs

The Outlook indicates that approximately $1 million will be available in FY 2009 in Special Promotional Programs (TOT Fund) to reimburse TOT-related activities that are currently budgeted in the General Fund. However, the Financial Outlook does not explain how this $1 million figure is derived, nor does it provide any figures for Fiscal Years 2010-2013.

The Special Promotional Programs (Special Promo) budget receives 5.0-cents of the City's 10.5-cent TOT levy. According to the Municipal Code, 4.0-cents must be used for the purpose of promoting the City, while 1.0-cent is discretionary and may be used for any purpose. The Outlook assumes that this discretionary 1.0-cent will be transferred back to the General Fund each year. This is reflected in the Outlook under Transfers From Other Funds section in the General Fund Revenues discussion, and is separate from the $1 million highlighted in the Corrective Actions section. This analysis illustrates how these figures are derived, and shows how they will change in future years.

To begin, it is helpful to look at total projected TOT revenue, and the portion that will be directed to Special Promo. The following table shows total projected TOT over the term of the Outlook, and how this revenue is initially split between Special Promo and the General Fund.

TOT Revenue, in Millions*

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Total City	$ 174.8	$ 187.1	$ 200.2	$ 214.2	$ 229.2
Special Promo	$ 83.3	$ 89.1	$ 95.3	$ 102.0	$ 109.2
General Fund	$ 91.6	$ 98.0	$ 104.8	$ 112.2	$ 120.0

** May not add due to rounding*

Special Promo TOT revenue is allocated for various promotional-related activities, including economic development, arts & cultural programs, special events, capital improvements and safety & maintenance of visitor-related facilities. The next table shows the projected TOT allocations that are built into the Financial Outlook.

TOT Allocations by Category, in Millions

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Economic Development	$ 1.9	$ 1.9	$ 1.9	$ 2.0	$ 2.0
Arts & Culture*	8.3	8.4	8.4	8.4	8.5
Capital Improvements	43.1	41.8	39.1	35.8	36.0
Safety & Maintenance	12.3	12.6	13.0	13.3	13.7
TOTAL**	**$ 65.6**	**$ 64.7**	**$ 62.5**	**$ 59.6**	**$ 60.2**

** Includes Community Festivals*

*** Totals may not add due to rounding*

These allocations reflect changes in debt service levels, and in a few cases modest inflationary adjustments, but do not assume any discretionary increases. As noted above, however, the Municipal Code requires that 4.0-cents of the 5.0-cents deposited in the TOT Fund be used for purposes of promoting the City. An important point is that while the TOT allocations stay relatively fixed, the dollar amount of this 4.0-cent requirement will continue to grow over time commensurate with growth in TOT revenue. This juxtaposition is illustrated below.

TOT Allocations v. Muni Code Requirement, in Millions

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
4-Cent Requirement	$ 66.6	$ 71.3	$ 76.2	$ 81.6	$ 87.3
TOT Allocations	$ 65.6	$ 64.7	$ 62.5	$ 59.6	$ 60.2
Difference	**$ 1.0**	**$ 6.6**	**$ 13.7**	**$ 22.0**	**$ 27.1**

The difference between the 4.0-cent requirement and the baseline TOT allocations reflects the increment by which TOT allocations would have to *increase* in order to stay in compliance with the Municipal Code. In order to comply with the Municipal Code and still benefit the General Fund, the Financial Outlook assumes that the $1 million increment in FY 2009 will be used to reimburse current General Fund expenditures that are promotion-related. This idea was also discussed in IBA Report 07-95 on the Tourism Marketing District.

While we support the use of Special Promo TOT revenues to offset or reimburse current General Fund expenditures that have a nexus with promotion, we have several concerns with how this action is treated in the Financial Outlook. First, the Outlook only discusses the $1 million in FY 2009, and makes no mention of the fact that this increment is projected to grow to over $27 million by FY 2013. Secondly, it does not appear that the strategy of reimbursing promotion-related General Fund expenditures is employed in future years of the Outlook, nor is it clear what will be done with the remaining incremental revenues, as shown in the table above. Finally, as also noted in IBA Report 07-95, there is not currently a precise definition of what constitutes a promotion-related activity, which could be problematic in implementing this strategy in future years.

Impact of TMD on TOT Allocations

On December 3, 2007 the City Council approved the establishment of a Tourism Marketing District (TMD), which will offset several existing Special Promo TOT allocations, as listed below.

TMD-Funded Groups

SD Convention & Visitors Bureau	$ 8,830,411
SD Film Commission	661,817
Holiday Bowl	391,137
San Diego North ConVis	380,903
SD Intl Sports Council	145,800
Hall of Champions	75,000
Rock N Roll Marathon	19,519
California State Games	15,427
San Diego Crew Classic	4,648
TOTAL	**$ 10,524,662**

These allocations are assumed to be fully offset by the TMD in each year of the Financial Outlook, thereby reducing the total baseline TOT allocations from Special Promo. As shown in the table below, without implementation of the TMD the baseline TOT allocations in the Outlook would be approximately $10.5 million higher in each fiscal year of the Outlook, thereby reducing the revenue available for General Fund benefit.

TOT Allocations With and Without TMD

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
5-Year Outlook	$ 65.6	$ 64.7	$ 62.5	$ 59.6	$ 60.2
Without TMD	$ 76.1	$ 75.2	$ 73.0	$ 70.1	$ 70.7

It should be noted that while the Financial Outlook assumes that the full $10.5 million in prior allocations will be fully offset in each fiscal year, the TMD funding is guaranteed only for ConVis and North ConVis after the first 12 months of operation. The remaining groups may return to the City for funding in the future if they are not able to secure TMD funding.

Budget Reductions

Excluding the Police and Fire-Rescue budgets, all other mayoral departments were required to submit a budget reduction plan for Fiscal Year 2009. The Outlook indicates the initial budget reduction target is 10% of the Fiscal Year 2008 operating budget and that departments are identifying the effect of these reductions on operations. The Outlook also specifies that selected reductions will be implemented as permanent solutions that will help reduce projected deficits in future years.

Additionally, the Outlook states that not all of the requested 10% reductions will be taken to balance the budget. The projected Fiscal Year 2009 deficit to be addressed by the 10% budget reductions is currently $32 million; however, the IBA suspects that there may not be much discretion as to which budget cuts to take, particularly if the deficit grows due to other factors. For example, the outcome of upcoming labor negotiations could significantly impact the projected deficit for Fiscal Year 2009.

In addition to public safety, members of the City Council have identified Park & Recreation and Library programs as high priority services that should be maintained or enhanced. Ten percent of the Fiscal Year 2008 General Fund operating budget for all mayoral departments excluding public safety and non-mayoral departments (approximately $474 million) is roughly $47 million. If Park & Recreation and Library programs (approximately $125 million) were also to be excluded from the budget reduction plan, the 10% reduction plan would yield roughly $35 million. This leaves little discretion as to which of the requested 10% reductions should be taken in order to balance the projected $32 million deficit.

	FY08 Budget	**10% Target**
General Fund Total Budget	$1,106,330,952	$110,633,095
Police	$392,336,695	
Fire-Rescue	$179,943,098	
Non-mayoral Departments	$60,046,348	
Subtotal	$632,326,141	
Less Public Safety/Non-mayoral:	$474,004,811	**$47,400,481**
Additional Scenario:		
Park & Recreation	$87,520,141	
Library	$37,630,664	
Subtotal	$125,150,805	
Less Parks and Library	$348,854,006	**$34,885,401**

There are other considerations associated with using across-the-board percentage reductions as a means to balance the budget. In IBA Report 07-5, we acknowledged that the City has historically used this approach to address budgetary shortfalls. We further noted that while an across-the-board percentage reduction approach is arguably equitable, it lacks thoughtful analysis of organizational priorities and associated service impacts. The Mayor's Business Process Reengineering program could be an effective alternative to across-the-board reductions if work process reorganization yields efficiency savings. Unfortunately, there are no future BPR savings reflected in the Fiscal Year 2009 – 2013 Outlook. In the Strategic Budget Prioritization Process conducted by the City Council in January 2007, the across-the-board percentage reduction approach was the least preferred means for addressing the City's critical fiscal issues.

The Governor has proposed using across-the-board reductions to reduce expenditures by $4 billion in an effort to balance the State's projected budget shortfall in Fiscal Year 2009. In analyzing the Governor's proposed budget, the State's Legislative Analyst had the following to say about across-the board reductions:

> "While the administration's approach of across-the-board reductions has the appeal of fairness, it reflects little effort to prioritize and determine which state programs provide essential services or are most critical for California's future. The risk with the administration's approach is that – by attempting to preserve most funding for most programs – many programs end up operating in a less than optimal manner and provide lower quality services to the public."

Business Process Reengineering and Managed Competition

In the previous year's Outlook, total savings of $86.4 million were projected from Business Process Reengineering and Streamlining, including the citywide elimination of 125 positions per year for the three year period of 2008-2010 (75 positions per year were estimated to come from the General Fund). The current Outlook does not address the status or identify any savings from the Mayor's Business Process Reengineering and Streamlining efforts. In fact, there is no mention of the Business Process Reengineering program or its results.

The IBA believes in the importance of an effective reengineering effort and believes the City can achieve significant savings from the redesign of existing processes. It is our understanding that the Business Office will be providing an update on the status of BPRs to the Council by the end of the month. The IBA encourages staff to review the projected savings from ongoing and upcoming BPRs and include those savings in the Outlook. Also, the savings accounted for in BPR can help offset the need for across-the-board savings reductions. Reductions realized from reengineering/streamlining efforts target specific inefficiencies versus spreading the burden across multiple, high priority departments and programs.

Managed Competition was also identified as a corrective action in the previous Outlook, but there is no mention of this program in the current Outlook. No savings were identified in the previous year's outlook, due to timing and the City's lack of experience with the competitive procurement process; however, we believe this strategy should remain in the Outlook as savings should occur within the Outlook's timeframe. Currently, pre-competition assessments have been initiated for sixteen functions whose budgets total approximately $120 million, including 562 positions according to the Mayor's November press release.

Based on the Mayor's revised timeline, shown below, the first process for managed competition could be completed by the end of calendar year 2008 (Council approval). Following a six month transition period, the Fiscal Year 2010 Budget should include the anticipated savings. Also, it should be noted that in connection with Business Process Reengineering, any function identified for managed competition, will have their savings withheld pending the outcome of the managed competition process but not longer than one year. This "withholding" may explain the exclusion of BPR in the current Outlook. However, the savings from concluded BPRs are still expected to occur within the Outlook's five-year period. For instance, the BPR results for the Collection Services Division have been withheld since January 2007 pending managed competition. Whether these services are provided by the private sector or City employees, there should be savings during the Outlook period.

Managed Competition Revised Timeline

Activity	Timeline
Initiate pre-competition assessments	By end of 2007
Complete initial pre-competition assessments	Winter 2007/Spring 2008
Announce functions for initial procurement	Spring 2008
Develop RFP	Spring - Summer 2008
Advertise solicitation	Summer 2008
IRB reviews proposals	Fall 2008
Mayor/Council consider award recommendations	End of 2008
Transition to proposed service delivery process completed	By Summer 2009
Begin performance monitoring	Thereafter

Risks to Outlook

An assessment of risks is a common component of many multi-year financial forecasts. Numerous variables, both internal and external, can dramatically impact current projections and it is important that these risks be assessed and included in future Outlooks. Potential risks that we have identified include:

- Impact of negotiated salary increases
- Resolution of MOU conflict with the County regarding Booking Fees
- Assumed continuation of Employee Offset Savings
- Impact of real estate market on projected revenues from land sales (right term?)
- Construction and raw material costs

- Legal fees and liability costs, including workers compensation
- Impact of a recession on revenue projections

We recommend that future versions of the Five-Year Financial Outlook include a section that addresses potential risks and the impact that these risks could have on revenue and expenditure projections.

Items Not Considered In Outlook

In addition to the risks discussed above, the IBA has identified several items that have not been considered, but will very likely impact the General Fund within the Outlook's five year timeframe. These following items have already been discussed in different sections throughout this report:

- Impact of fiscal mitigations for the Refuse Disposal and Recycling Funds
- Increased funding for ongoing street and facility maintenance
- Revenue from increased cost recovery fees
- Potential savings from BPR/Managed Competition, particularly regarding the Collection Services Division
- Proposition G (15-year amortization) of the pension system liability
- Benefit payments in excess of IRS 415(b) limits.

Other items we identified as a potential liability that were not considered in the Outlook include:

- Long-term refuse management plan
- Impacts of General Plan update
- Additional obligations related to the Mt. Soledad landslide or the October 2007 wildfires
- Potential impact of Chargers relocation
- Impact of Charter reform propositions to be voted on in June 2008
- Service level enhancements and future unfunded needs, such as adequate staffing levels for the Audit Division
- Possible redevelopment of Civic Center
- Fire sprinkler retrofit of CAB.

This is not intended to represent a comprehensive list , but rather, provides a glimpse of some of the things the IBA has identified as not being addressed in the Outlook. While we understand that cost estimates may not be available for several of these items, the Outlook should note items that may present a potential future liability.

Additional Suggestions for Future Five Year Financial Outlooks

In a November 24, 2002 article by Fitch Ratings entitled "The 12 Habits of Highly Successful Finance Officers," Fitch identified multi-year financial forecasting as one of twelve Best Financial Management Practices for Governmental Issuers. The Mayor and his staff are to be commended for initiating last year a financial roadmap for the City's future, and providing an updated version this year. That being said, in comparing this year's Outlook to examples of several other municipal forecasts, we have noted some common features that could add value in future updates.

We believe the following information can be easily incorporated, resulting in more complete documents:

- Provide baseline expenditure and revenue assumptions by including current year, adopted budget information for all categories along with future year projections.

- Identify what specific facilities or other significant expenditures are included in the category of "Future Committed Expenditures."

- Include a discussion of "risks" to Outlook as discussed above.

- Include a discussion of significant departmental challenges/future unmet needs, and major cost drivers for existing services and programs.

- Provide a discussion on community service levels and the administration's vision and goals for the City's future.

- If labor negotiations are pending, quantify potential impact of wage increases at a generic level to show the risk to the projected budget "gap" (e.g. every 1% General Fund increase = $4.5 million).

- Ensure consistency with previous year's major Outlook assumptions and policies, or explain if there has been a change in direction, (e.g. reducing the funding for OPEB and omitting reengineering and managed competition).

- When building on a prior year's "corrective action" such as land sales, provide a brief update on the progress of current year land sales.

- When presenting funding recommendations for "significant areas," such as deferred maintenance and ADA, identify service level targets (e.g. number of streets to be maintained). Also, define the full scope of the problem that needs to be addressed.

Multi-year financial outlooks are not only critical policy and planning documents, but also may impact municipal credit ratings. Rating agencies look for complete forecast assumptions when assessing cities' future financial conditions. For example, in an October 2004 Rating Outlook prepared by Fitch for the City of Philadelphia, Fitch noted concerns with that City's five year forecast including "speculative operating efficiencies," "assumed growth in fund balance attributable to unidentified operating efficiencies" and "the cost of new labor contracts not included." Such information can also assist the legislative body and the public in understanding the forecast's underlying assumptions.

CONCLUSION

The production of a multi-year financial forecast is a critical tool in ensuring prudent fiscal management and charting a course to achieve policy objectives over time. The IBA continues to support the efforts of the Mayor and his financial staff toward this end. It is our expectation that the information, context and suggestions provided in this report can be used to aid City officials and the public in understanding the Outlook, as well as illustrate improvements that may be made to future editions of the Outlook.

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