THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of the Mayor's Five-Year Financial Outlook for FY 2013 – 2017

OVERVIEW

On October 12, 2011 the Mayor released his Five-Year Financial Outlook for FY 2013 – 2017, marking the sixth Financial Outlook under the current administration. Consistent with prior versions of the Outlook, General Fund deficits are projected to continue over the next several years, though declining from $31.8 million in FY 2013 to $5.6 million in FY 2016. However, in contrast with prior versions, the current Outlook projects a General Fund surplus of approximately $22.7 million in the final year of forecast period (FY 2017).

The improvement in the financial outlook is driven primarily by growth in the major General Fund revenues. Total General Fund revenues are projected to increase by approximately $179.6 million or 15.9 percent over the five-year outlook period, while expenditures are projected to increase by $155.2 million, or 13.8 percent.

This report presents the IBA's review and analysis of the Five-Year Outlook for FY 2013 – 2017. The report begins with a review of the General Fund revenue projections, focusing on the major General Fund revenues. General Fund expenditures are then discussed, including significant areas such as salaries & wages, pension, retiree health, non-personnel expense, new facilities and deferred capital. In addition, this section provides an overview of departmental programmatic additions that have been factored into the Outlook. The report then discusses the IBA's Outlook Scenario, which incorporates a number of adjustments to the Mayor's Outlook. Finally, we highlight some of the significant service impacts that have resulted from budget reductions over the past decade, and estimate the cost of modest service restorations in select areas.

It is anticipated the Mayor's Five-Year Outlook and the IBA review and analysis will be presented to the full Council on December 5, 2011.

GENERAL FUND REVENUES

The Five-Year Financial Outlook projects General Fund revenue to increase from the most recent FY 2012 projection of $1.1 billion to $1.3 billion in FY 2017, an increase of $ 156.2 million, or 13.7% over the forecast period. Much of this increase is attributed to growth in four major General Fund revenues: property tax, sales tax, transient occupancy tax, and franchise fees, that in total comprise approximately 65.2% of the total General Fund revenue for FY 2012. The FY 2012 budgeted revenue projections have been updated in the FY 2012 base revenue assumed for the five-year forecast in consideration of additional data regarding FY 2011 year-end performance and some current year performance data. In particular, the Outlook incorporates revisions to the FY 2012 base revenue assumptions for property tax, sales tax, property transfer tax, safety sales tax, TOT, motor vehicle license fees (MVLF), and the Citizens' Options for Public Safety (COPS) grant funding. Overall, the revisions equate to a $9.5 million increase to the FY 2012 revenue projection upon which the Outlook is forecast. The table below summarizes the Five-Year Outlook forecast for General Fund revenues, including a summary of the new FY 2012 projections.

Revenues	FY 2011 Year-End Projection[1]	FY 2012 Budget	FY 2012 Revised	FY 2013 Forecast	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast
Property Tax	$ 384.0	$ 380.9	$ 384.8	$ 388.6	$ 398.3	$ 412.3	$ 430.8	$ 454.5
Sales Tax	$ 208.7	$ 211.6	$ 217.6	$ 227.8	$ 238.3	$ 251.6	$ 266.7	$ 282.7
TOT	$ 72.7	$ 74.8	$ 76.3	$ 79.7	$ 83.7	$ 88.3	$ 93.6	$ 99.2
Franchise Fees	$ 65.8	$ 67.8	$ 67.8	$ 69.1	$ 70.6	$ 72.5	$ 74.8	$ 77.3
Other Revenue	-	$ 391.5	$ 389.6	$ 360.3	$ 364.9	$ 370.4	$ 374.4	$ 378.6
Total General Fund	**-**	**$ 1,126.6**	**$ 1,136.1**	**$ 1,125.5**	**$ 1,155.8**	**$ 1,195.1**	**$ 1,240.3**	**$ 1,292.3**
Growth	-	-	-	-0.9%	2.7%	3.4%	3.8%	4.2%

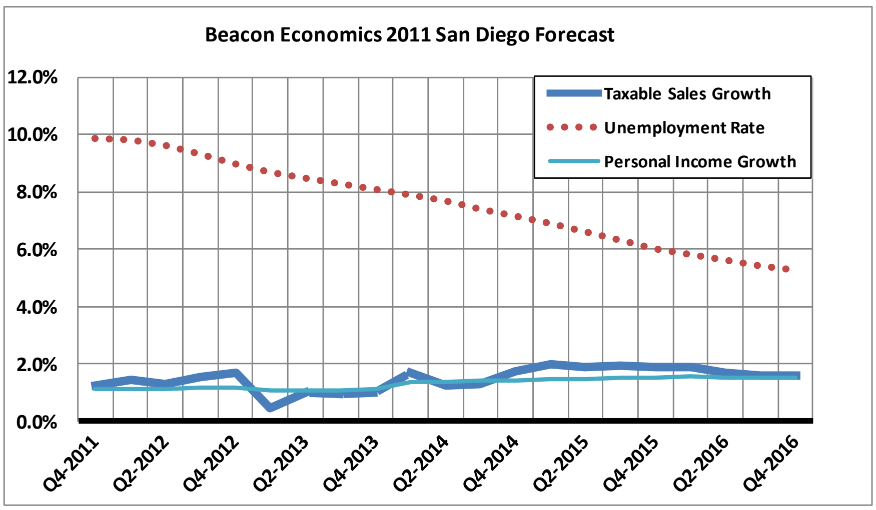
1. Based on updated year-end projections contained in the FY 2013-2017 Forecast. At this time, unaudited preliminary FY 2011 performance amounts for all revenues are not available.

The Five-Year Outlook anticipates a 0.9% decline in FY 2013, with year-over-year growth ranging from 2.7% to 4.2% for the remainder of the forecast period. Overall, the projections are in line with current economic forecasts. In this section we will review the underlying assumptions and growth projections for each of the four major General Fund revenues, while addressing any areas needing consideration.

Economic Forecast

Since the official end of the recession in June of 2009, the economic recovery has been slow, sparking fears of further slowing into another recession. Even so, despite recent setbacks to the momentum of the economic recovery, economic forecasts do not tell the tale of a double dip recession, but rather that of a slow recovery, with potential risks. According to Beacon Economics' 2011 San Diego Economic Forecast, after weak growth for the national GDP in the first two quarters of 2011 (0.40% in the first quarter and 1.00% in the second quarter), it will increase to 2.92% by the fourth quarter of 2011, with continued growth of up to 3.08% by the fourth quarter of 2013.

On the local level, steady improvements are forecast for employment, the real estate market, personal income, and taxable sales through 2016. Health Care, Professional Services, and Leisure and Hospitality sectors are leading the way in job creation in the region, contributing to an increase of 23,000 of the 30,000 jobs created since September 2009. Beacon forecasts that nonfarm employment will show modest, but steady growth of less than 1.0% quarter-to-quarter. The unemployment rate will incrementally decrease throughout the forecast period to 5.3% by the fourth quarter of 2016. Continued growth in highly skilled, high pay jobs in the Professional Services and Technology industries in the region will contribute to personal income growth above the peak in the third quarter of 2008 during the recession. Income growth will support a boost in consumer spending, and thus taxable sales. According to the Forecast, the housing market has stabilized locally, with default and foreclosure activity expected to decline. The chart below details the Beacon Economics forecasted improvements in employment, real capita income, and taxable sales in San Diego County.



The UCLA Anderson San Diego County Economic Outlook for 2012 paints a similar picture of the recovery, but with much more caution regarding its pace, with a particularly more conservative immediate outlook for the local housing market. According to the Forecast, the U.S. economy has "stalled," with national GDP expected to average 0.9% growth from the first quarter of 2011 to the first quarter of 2012. After the beginning of 2012, the forecast anticipates growth of 2.5-3.0% through 2013, fueled by an increase in exports, consumption, and business investments. An unexpected turn in any of these areas would threaten the recovery. Locally, the the San Diego County Gross Metro Product is forecast to exhibit an average growth of 1.2% from the fourth quarter of 2011 to the end of 2013.

Of note, the UCLA Forecast is markedly different than the Beacon Forecast with the immediate outlook for the local housing market recovery. Declines in median home prices are expected until the third quarter of 2012. This contrasts with the Beacon Forecast that median home prices have already hit bottom.

Economically sensitive City revenue streams like property tax, sales tax, and TOT will mimic the forecasted recovery from the recession. Overall, these revenues will continue a recovery trend throughout the forecast period, albeit slower than that of past post-recession recoveries. Beacon cites that factors such as a lack of home equity, the U.S. trade deficit, the federal deficit, inflationary pressures, displaced workers from retracted industries, and struggling economies overseas will continue to slow down the pace of the recovery. UCLA Anderson cautions that any unexpected turn in exports, consumption, and business investments would undermine current recovery trends.

Property Taxes

The Five-Year Outlook anticipates that property tax receipts will experience 1.0% growth in FY 2013, 2.5% growth in FY 2014, with increased growth rates at 1.0% increments thereafter, with 3.5% growth in FY 2015, 4.5% in FY 2016, and 5.5% growth in FY 2017. The forecast assumes continued improvements in the residential real estate market, with declines in foreclosures and notices of default, and an increase in the California Consumer Price Index (CCPI) used to assess property valuation growth.

Property tax revenue in FY 2013 will be based on a valuation of property on or around January 1, 2012, which will reflect market activity in the 2011 calendar year. According to current DataQuick housing data, the average monthly median sales price of homes within San Diego County from January to September is $319,250. This is 3.0% less than the average median sales price of $329,250 for the same period in 2010. Home sales activity in 2011 has declined by 5.3% when compared to the January through September period in 2010. In recent September foreclosure and notices of default data, foreclosures demonstrated year-over-year declines of 32.0%, and notices of default, a decline of 24.2%.

Per the Beacon Forecast, with these recent declines in housing values and sales with improvements in foreclosures, the housing market has reached the bottom, with positive growth in values to resume in the fourth quarter of FY 2012. Per the UCLA Forecast, positive growth will not resume until the second quarter of FY 2013.

The Outlook's forecasted growth of 1.0% for FY 2013 seems optimistic in light of current declines in housing values and sales, but there are a number of factors that are anticipated to contribute to the modest positive growth in property tax revenue in FY 2013 and beyond:

- Despite trending declines in the median sales price for homes in the County in 2011, the County Assessor's Office reports that when properties are changing ownership, there is an average incremental increase in the roll value of the property of approximately $60,000. This compares to the peak of the average incremental increase in the value of properties in 2006 of $230,000, and a low of $16,000 in 2009. This signals that change of ownership activity where properties are sold at a lower price than their current value on the roll is having less of a negative impact since the recession.

- The CCPI adjustment that is applied as assessed valuation growth for properties that have not changed ownership or had structural improvements in the past year is anticipated to be approximately 2.0%, given the current trend in the monthly index that was 2.6% in August. Negative and less than 2.0% growth in this index in the past two years undermined growth in the property tax roll. The CPI adjustment of up to 2.0%, as allowed by Proposition 13, will positively impact approximately 70% of properties within the City on the roll.

- Assessment appeals and resulting refunds increased steadily over the past few years, applying downward pressure to assessed valuation growth. In particular, large commercial property appeals that comprise only approximately one third of the appeals volume are resulting in significant valuation reductions. Although appeals cases are still being processed, resulting in most cases in reassessments at reduced values, the volume of new appeals is declining. Appeals activity is expected to taper off as the real estate market moves further along in the recovery.

- Over the past few years, the County Assessor's Office proactively reviewed the values of properties sold during the peak of the real estate boom for a temporary reduction in assessed valuation based on the current market value. Those properties for which the assessed valuation was temporarily lowered can be automatically increased back up to the original purchase price of the home, plus an allowable Proposition 13 CPI increase of 2%, once their market value increases back to the original sale price. Given the seesawing growth and decline trends seen in 2011 with median housing prices, it is anticipated, that for the majority of temporary reassessments, the assessed valuation will be not be increased in the FY 2013 tax roll. These temporary reassessments will be reviewed on an annual basis by the Assessor's Office and are anticipated to positively impact assessed valuation growth as the real estate market recovery continues in future forecast years.

- Positive movement in new construction will also support growth in the future property tax rolls. Beacon forecasts growth in both residential and commercial permitting activity going forward.

A number of factors are at play in determining growth or declines in the assessed valuation of property values, and thus fluctuations in property tax collections. Current change of ownership activity, CCPI growth, the reversal of temporary reassessments, and new construction will lead to modest improvement in growth in the assessed valuation of properties within the City and mitigate downward pressures related to assessment appeals and foreclosure activity as the real estate market moves toward recovery. With this, the Outlook forecast is appropriate in forecasting modest improvements in year-over-year growth as these factors continue to demonstrate positive trends.

Sales Tax
The Five-Year Outlook forecasts 4.5% growth in sales tax in FY 2013, with an increase in the projected growth rate of 0.5% on an annual basis, until FY 2016, with the growth rate reaching 6.0%, and staying at 6.0% in FY 2017. With this Outlook, sales tax receipts will surpass peak collections seen in FY 2006 by FY 2015. The Outlook assumes that the trend of positive growth in sales tax seen in FY 2011 will continue throughout the forecast period.

The Outlook's growth assumptions align with Beacon and UCLA economic forecasts. Both forecasts predict modest, but steady growth in nonfarm employment and personal income fueled by high skill jobs in the region. Accordingly, this income and employment growth will support a boost in consumer spending, and thus taxable sales.

The Outlook forecast also generally aligns with the City's sales tax consultant MuniServices, LLC's five-year forecast for sales tax performance of 3.6% in FY 2013, 5.1% in FY 2014, 5.9% in FY 2015, 6.1% in FY 2016, and 5.7% in FY 2017. This five-year forecast in based on an analysis of the future performance of the City's economic sectors, business level adjustments, and inflationary assumptions.

Of note, the FY 2012 base for the sales tax forecast, as adjusted based on FY 2011 trends and FY 2012 actuals, assumes 4.0% year-over-year growth in the remaining three quarters of the fiscal year. This assumed growth for the remainder of the fiscal year, is more optimistic than the MuniServices forecast for FY 2012, which assumes growth by a modest adjusted inflationary factor of 1.8% for the remainder of the year. More modest sales tax performance in accordance with the MuniServices forecast would equate to $3.6 million less in the FY 2012 base upon which the Outlook growth rates are applied, which would reduce the revenue forecast for FY 2013, and the outer years of the Outlook. It is expected that forecasted projections will differ, but this particular discrepancy is highlighted here to note a potential vulnerability in the sales tax Outlook.

Since the sales tax forecast does align with economic forecasts of improvements in employment, income, and consumer spending, the IBA ascertains that the sales tax projections in the Outlook are appropriate. A worsening or improvement in any of the indicators outside of current forecasted levels or FY 2012 sales tax performance outside of forecasted expectations would be a cause for a modification in the sales tax forecast.

Transient Occupancy Tax (TOT)

The Five-Year Outlook forecasts growth in TOT of 4.5% in FY 2013, 5.0% in FY 2014, 5.5% in 2015, and 6.0% in FY 2016 and 2017. The TOT 2012 base is increased over the FY 2012 Budget by $1.5 million due to better than expected FY 2011 actuals and year-to-date FY 2012 performance. FY 2011 TOT receipts grew by 4.2% over FY 2010. According to the Outlook, TOT collections will return to its FY 2008 peak by FY 2014.

The Outlook forecast for TOT is consistent with trends cited in the October 2011 San Diego Convention and Visitors Bureau's (CONVIS) Quarterly Travel Forecast of improvements in occupancy rates and the average daily rate. Growth in occupancy rates are forecast to range by 0.43% in 2013 to 0.85% in 2015. Growth in the average daily rate is forecast to range from 5.01% in 2013 to 5.82% in 2015. More accelerated growth in occupancy and average daily rates will be constrained due to slow improvements in the overall economy.

The forecast also aligns with forecasts from UCLA Anderson and Beacon of a steady increase in tourism to the region. Anderson forecasts that travel visits to San Diego will grow annually at an average of 2.5% over the next few years. Beacon assesses that growing incomes and growth in corporate profits will support an increase in recreation and business travel as well.

Franchise Fees

The Five-Year Outlook projects overall franchise fee growth of 1.9% in FY 2013, 2.2% in FY 2014, 2.7% in FY 2015, 3.1% in FY 2016, and 3.4% in FY 2017. The total growth is reflective of separate growth rates for SDG&E franchise fees, cable franchise fees, refuse hauler fees, and all other franchise fees. An assessment of the of the assumed growth rate for each major franchise fee category follows.

In the Outlook, SDG&E franchise fees are expected to increase in growth, with 1.0% growth in FY 2013, 1.5% growth in FY 2014, 2.5% growth in FY 2015, 3.0% growth in FY 2016, and 3.5% in 2017. The SDG&E franchise fees have experienced declines in the in the past two fiscal years due to a substantial increase in refunds and rebates granted by SDG&E. There is uncertainty whether this activity will continue in FY 2012 and beyond. The current FY 2012 base assumes that year-over-year declines will subside, with a relative flat projection over FY 2011 collections. Due to limited information from SDG&E regarding expected performance in FY 2012 and beyond, there is uncertainty regarding the performance of this franchise fee category.

Cable franchise fees are expected to experience 4.0% growth in FY 2013 and FY 2014, and 5.0% growth in FY 2015-FY 2017 in the Outlook. This projection for cable franchise fees is consistent with growth trends over the past two fiscal years averaging 4.7%, with this trend expected to continue in the years of the forecast. Based on information from the Environmental Services Department, refuse hauler franchise fees are projected to grow by 1.0% in FY 2013, 1.5% in FY 2014, -0.3% in FY 2015, 0.3% in FY 2016, and 0.6% in FY 2017. It is assumed that refuse hauler franchise fees will demonstrate this pattern of growth during the years of the Outlook due to stagnant growth in regional tonnage due to the economy and successful waste reduction and diversion efforts. Despite uncertainty regarding the performance of the SDG&E franchise fee, the overall Five-Year Outlook for franchise fees is appropriate given available information.

Other General Fund Revenues
Beyond the four major General Fund revenues, the Outlook includes projections for other revenue sources such as property transfer tax, safety sales tax, vehicle license fees, as well as projections for the general revenue categories that include Licenses & Permits; Fines, Forfeitures and Penalties; Revenue from Money & Property; Revenue from Other Agencies; Charges for Current Services and Transfer from Other Funds. In the forecast, these revenues account for 34.8% of total General Fund revenue. The following revenue forecasts are of note:

- Property transfer tax revenue is forecast to experience a 5.5% increase in FY 2012 over the FY 2011 year-end projection, 7.0% growth in FY 2013, 8.0% growth in FY 2014, and 9.0% growth in FY 2015-2017. The projected growth for the FY 2012 base does not coincide with current housing data regarding declines in the median price of homes and a subtle increase in sales volume during the July-September 2011 period. FY 2012 receipts may come in with minimal growth over FY 2011, unless not as frequent large commercial property transactions boost performance. The magnitude of the Outlook's forecast of continued growth in property transfer tax, increasing from 7.0% in 2013 to 9.0% in FY 2017, does not appear to be supported by economic forecasts. Particularly, the UCLA Anderson forecast predicts a decline in median sales price into the second quarter of FY 2013.

- As noted in the Outlook, State of California actions have resulted in the loss of motor vehicle license fees (MVLF) in FY 2012, and the Outlook assumes that the loss will be permanent through the forecast period. This revenue loss is partially offset by a continuation or increase in State grants that were not included in the FY 2012 Adopted Budget, which include an $800,000 increase in the Citizen's Option for Public Safety (COPS) grant and a continued $2.0 million offset to the City's required annual booking fee payment to the County due to a State subvention. The combined effect of these actions is a loss in revenue in FY 2012 of approximately $800,000 from budgeted levels, which is then carried throughout each fiscal year of the Outlook.

- The FY 2012 Adopted Budget included $31.4 million in one-time revenues, which were removed from the baseline for the forecast period. Largely due to the removal of these one-times, the FY 2013 forecast reflects a 0.1 percent decline from the FY 2012 Adopted Budget and a 0.9 percent decline from the FY 2012 revised projection. If the $31.4 million in one-times are excluded from FY 2012 revised projections used as the base for the Outlook, the change in the FY 2013 forecast over FY 2012 would be a 1.9 percent increase. This implies that there is a 1.9 percent increase in actual year-over-year growth for structural revenues based on updated projections.

GENERAL FUND EXPENDITURES

The Five-Year Outlook projects General Fund expenditures to increase by approximately $155.2 million, or 13.8 percent, over the five year forecast period. The projected increase in General Fund expenditures is largely driven by higher Pension ARC payments based on the June 2010 valuation, and debt service associated with five additional $100 million deferred capital bond issuances. Other notable expenditure increases include contributions to the Public Liability and Workers' Compensation Fund Reserves, salary adjustments related to step increases, and departmental programmatic additions. These and other issues are discussed in greater detail below.

Salaries and Wages

The Outlook reflects a $9.5 million increase in salaries and wages over the five year forecast period. These increases are due to the inclusion of $7.0 million for step increases, as well as $3.3 million in staffing increases which are addressed in the Departmental Additions section. The step and departmental increases of $10.3 million are offset by $800,000 in one-time salary reductions.

Funding for step increases included in the Outlook could be underestimated to some extent. The projected salary step increase for FY 2013 is $3.0 million, which is an approximate 0.6% increase over the FY 2012 budget. The $4.0 million increase over the remaining fiscal years (FY 2014 through FY 2017) translates to a $1.0 million increase each year – which is equivalent to a 0.2% increase each year over the previous year's salaries and wages. If the actual step (and promotion) increases are higher than 0.2% for FY 2014 through FY 2017, salaries could be a few million higher than projected.

Note that there are no general salary increases or restoral of the previous 6% compensation reduction during the Five-Year Outlook. Assuming no salary increases over a five-year period could be considered unrealistic for financial planning purposes. Consideration should be given to assessing the impact of potential salary increases to provide a reasonable forecast of General Fund requirements over the next five years.

Consistent with our last outlook review, the IBA Outlook Scenario shows the impact of potential salary increases[1]. This scenario assumes salary increases of 2% and related variable fringe benefits for all employee groups in FY 2015 and again in FY 2017. The total impact related to this salary increase scenario is approximately $11.1 million in FY 2015 and FY 2016 (as compared to FY 2013). The impact increases by $11.3 million to $22.4 million in FY 2017 (as compared to FY 2013). This does not consider the costs to the pension system associated with wage increases.

Annual Leave Liability

The annual liability associated with accumulated leave balances for DROP participants is calculated based on information provided by the Risk Management Department in addition to assumptions to determine when accumulated balances would be paid. Major assumptions used by the Financial Management Department in calculating this liability are: 1) employees enrolled in DROP will retire at the end of their fifth year in the program; and 2) employees will not utilize any accrued leave during their time in DROP unless it exceeds their total allowable accrued limit. The FY 2012–2016 Outlook utilized these same assumptions, which are employed again based on the difficulty in forecasting retirement dates for any individual employee or habits in utilizing leave balances.

However, the total amount of liability forecasted in FY 2013 and future fiscal years has changed in the current Outlook. The current Outlook forecasts that a percentage of employees currently enrolled in DROP with a planned retirement date of FY 2013 – FY 2015 will retire in FY 2012 due to the change in post retirement benefit options in FY 2012. Effective April 1, 2012, the City of San Diego retiree health benefit will be modified, which reduces future benefit payments to eligible employees. This is discussed further in the section on OPEB/Retiree Health. The Outlook assumes that the following percentage of employees that are scheduled/assumed to retire in the respective fiscal years will opt to retire prior to April 1, 2012 to maintain their current retiree health benefits:

DROP End Date (Original Forecasted Retirement)	***# Employees (Original Forecasted Retirement)***	***Percent Forecasted to Retire in FY 2012***	***# Employees Opting to Retire in FY 2012***
FY 2013	97	50.0%	49
FY 2014	190	30.0%	57
FY 2015	139	10.0%	14
FY 2016	161	0.0%	0
FY 2017	151	0.0%	0

[1] Such salary increases may be precluded by the passage of the Comprehensive Pension Reform ("CPR") Charter amendment ballot initiative and implementation of the related five-year salary freeze.

This assumption reduces the liability in FY 2013 – 2015, and increases the liability in the current fiscal year. The liability figures calculated for these three fiscal years prior to applying this assumption are similar to the FY 2012-2016 Outlook. The amount of liability forecasted in FY 2016 has increased due to an increased number of employees entering DROP in FY 2011 above amounts projected in the previous Outlook (which was completed with four months remaining in the fiscal year).

If projections for early retirement are overstated in the analysis, a potential increase in the deficit for FY 2013 – 2015 may occur. The amount of annual leave accelerated into FY 2012 due to this assumption is $1.2 million for FY 2013 employees, $1.7 million for FY 2014 employees, and $0.4 million for FY 2015 employees.

Retirement/Pension

The retirement figures included in the Five-Year Outlook are based on the most recent actuarial valuation for the City, which is dated June 30, 2010. The valuation revealed that the City's June 30, 2010 Unfunded Actuarial Liability (UAL) is $2.15 billion, up from $2.11 billion at June 30, 2009. The City's FY 2012 Annual Required Contribution (ARC), which is based on the June 30, 2010 valuation, totals $231.2 million. The General Fund portion of the FY 2012 ARC is $178.3 million.

The pension forecast through FY 2017 reflects the most recently provided projections from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, and is presented in the following chart. This chart shows the Citywide ARC increasing by $98.6 million from FY 2012 to FY 2017. These figures are based on the June 30, 2010 valuation and will be updated upon the completion of the June 30, 2011 valuation.

Pension Forecast (in millions)	FY 2012 Budget	FY 2013 Forecast	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast
Citywide Payment	$ 231.2	$ 256.6	$ 276.2	$ 294.7	$ 312.5	$ 329.8
Increase from FY 2012	*N/A*	*$ 25.4*	*$ 45.0*	*$ 63.5*	*$ 81.3*	*$ 98.6*
General Fund Payment	178.3	198.0	213.1	227.3	241.1	254.4
Increase from FY 2012	*N/A*	*$ 19.7*	*$ 34.8*	*$ 49.0*	*$ 62.8*	*$ 76.1*

The June 30, 2011 valuation, which determines the FY 2013 ARC, is anticipated to be released in January 2012. At that time, the actual FY 2013 ARC will be presented, and updated ARC estimates for FY 2014-2017 are expected.

As part of the determination of the FY 2013 ARC, there will be changes in actuarial assumptions which the SDCERS Board approved on September 30, 2011. Those changes include lowering the investment return assumption from 7.75% to 7.50% and lowering the inflation assumption from 4.00% to 3.75% after a two-year freeze on inflationary pay increases. The dollar impact of these and other changes is anticipated to be provided when the June 30, 2011 valuation is released in January 2012.

As noted in the Five-Year Outlook, the actual FY 2013 ARC (and forecasted ARC's in the out-years) could be lower than the current estimate presented in the Outlook, which would reduce the FY 2013 projected deficit. However, because of the complexity of the pension system variables, the total of all effects on the ARC is unknown. It is anticipated that higher than assumed investment returns and the impact of the FY 2012 general salary freeze will reduce the ARC, and the actuarial assumption changes approved by the SDCERS Board on September 30, 2011 will increase the ARC. However, the impact of demographic experience and other pension variables is unknown at this time.

OPEB/Retiree Health

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

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

When the agreement to restructure the retiree health benefit was approved, it was estimated that there would be a cumulative cash flow savings of $714 million over 25 years. Additionally, it was estimated that the June 30, 2010 UAL would be reduced from $1.1 billion to $798 million, and there would be a $33 million ARC reduction (from $96 million).

Actual savings for the retiree health benefit restructuring will depend, in part, upon choices made by eligible employees – including how many eligible employees will retire before April 1, 2012 and maintain the current benefit level, and for those employees not eligible or not choosing to retire before April 1, 2012, which of the available restructured benefit options[2] they will choose. Stated another way, actual savings to the retiree health benefit UAL, ARC and cash flows will depend on actual employee choices as compared to the assumed employee choices incorporated in the savings estimates that were provided during the retiree health benefit restructuring process. It is possible that there could be some increased retirements before April 1, 2012, above the assumed retirement level, which would lock those employees in the current higher retiree health benefit. Employees' actual choices will be reflected in the June 30, 2012 valuation, which is anticipated to be released in November 2012.

The Outlook reflects the estimated fiscal impact of the newly restructured retiree health benefit at $57.8 million for FY 2013. The General Fund portion is $40.5 million. The recently released

[2] There are three options associated with the restructured retiree health benefit: Option A is a defined benefit with a full annual allowance (at 20 years of service) equal to $8,883 per year, with a 2% annual escalator beginning FY 2014; Option B is a defined benefit with a full annual allowance (at 20 years of service) equal to $5,500 per year, with no escalator; Option C is a defined contribution plan for which a full funding level (at 20 years of service) would be approximately $100,000. Options A and B require that employees make nonrefundable contributions.

June 30, 2011 valuation, which establishes the OPEB ARC for FY 2013 shows the ARC at $97.4 million. However, this figure does not reflect the restructured benefit, as it had not been finalized prior to the valuation work. Had the benefit restructure been included in the valuation, it is believed that the ARC would be significantly closer to the $57.8 million OPEB amount shown in the Outlook for FY 2013. Therefore, to compare the FY 2013 ARC to the $57.8 million would not be an "apples-to-apples" approach. Once the restructured retiree health benefit and actual employee choices are incorporated into the June 30, 2012 valuation, which will be the basis for the FY 2014 ARC, it will be more practical to compare the ARC to the anticipated budget amount (for FY 2014).

Non-Personnel Expense

Non-personnel expenditures (NPE) included in the Outlook are categorized as supplies, contracts, information technology, energy/utilities, and "other". Growth in NPE is based on additions from General Fund departments, which are discussed further in the Department Additions section, debt service, and an inflation rate applied to specific expenditure categories. The inflation rates applied in the FY 2013 – 2017 Outlook as compared to the previous Outlook are as follows:

NPE Category	***FY12-16 Outlook***	***FY13-17 Outlook***
Supplies	0.0%	1.0%
Contracts	0.0%	1.0%
Information Technology	0.0%	0.0%
Energy / Utilities	5.0%	5.0%
"Other"	0.0%	0.0%

As mentioned above, departmental adjustments to NPE are noted in the Departmental Additions section. However, some NPE expenses in the "other" expenditure category are not detailed in that section due to their impact occurring City-wide. Approximately 79 percent of budgeted items in FY 2012 in the "other" expenditure category are General Fund transfers to other City funds for reimbursement for services, payment of required debt service, and other required transfers. These additional required transfers include the City's public liability transfer, preservation of benefits payment, and transfer to the park improvement fund. Some additional items of note included in this category are as follows:

- Increasing debt service of $7.2-$7.5 million per fiscal year for each of the five $100 million issuances of deferred capital bonds assumed in the Outlook.
- Elimination of the annual required $7.9 million McGuigan settlement payment in FY 2016 and 2017, as the last of four required payments is scheduled in FY 2015.
- Annual growth of 4.0 percent per year in the property tax administration fee charged by the County of San Diego.
- Addition of $400,000 per fiscal year in operating costs for the repair of deferred items for the City Administration Building.
- A reduction in booking fee expenditures of $2.0 million per fiscal year due to State actions associated with motor vehicle license fee revenues.
- Annual funding for elections as follows:

FY 2012 Budget	FY 2013 Forecast	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast
$2,875,000	$2,875,000	$1,875,000	$2,875,000	$3,575,000	$2,875,000

Forecasting elections costs is difficult due to unknown new requirements, a varying number of new ballot measures, and run-off election costs for local candidates. The total funding for elections in each fiscal year is based on the timing for specific Council District elections (including the new Council District 9) and Mayoral primary and general elections. In addition, every fiscal year includes approximately $1.6 million for other election-related costs, including funding for potential verification efforts related to signature petitions and/or potential ballot measures.

In reviewing the elections funding included in the Outlook, fiscal years 2015-2017 appear to be overstated based on timing for each election and utilizing the same assumed amount for ballot measures. Using consistent assumptions, elections funding for FY 2015 should be the same as for FY 2014 due to only Council District elections occurring, while both FY 2016 and 2017 should equal $2.5 million due to Mayoral primary and general elections. As such, FY 2015 and 2016 costs are overstated by approximately $1.0 million each, while FY 2017 is overstated by approximately by $400,000. These adjustments are made in the IBA Outlook Scenario.

Reserves

The Five-Year Outlook includes funding to meet the revised Reserve Policy targets as presented to the Budget & Finance Committee on October 19, 2011. According to the revised Reserve Policy, the General Fund Reserve shall remain at 8% of General Fund revenue, which was achieved in FY 2012. Additionally, the Public Liability and Workers' Compensation Fund Reserves will meet their reserve targets of 50% of outstanding claims by FY 2019. Finally, the Long-Term Disability Fund Reserve will achieve a reserve target of $12 million by FY 2012. It is anticipated that the revised Reserve Policy will be brought forward for Council approval before the end of the calendar year.

New Facilities

The Outlook includes funding for two branch libraries scheduled to open during the forecast period. These facilities will be the Skyline Hills Branch Library, opening in FY 2015, and the San Ysidro Branch Library, opening in FY 2016. These facilities will be expanding from approximately 4,400 square-feet and 4,090 square-feet to approximately 19,000 square-feet and 17,000 square-feet respectively. The Outlook includes an additional 4.60 FTE to address the staffing and maintenance of the additional square footage for these facilities, as well as increased non-personnel costs of approximately $198,000 for the Skyline Hills library and approximately $163,000 for the San Ysidro library.

The Outlook also includes funding associated with the planned opening of new Park and Recreation facilities and enhancements to several existing facilities for the forecasted period. The Park and Recreation Department anticipates the need to add a net of 18.90 FTEs (addition of 19.30 FTEs for the new facilities and a reduction of 0.40 FTE at the Kumeyaay campgrounds) and $1.6 million in non-personnel expense during the forecasted period to address additional ground maintenance and management of the additional facilities and anticipated added acreage. Attachment III of the Outlook provides a list of the new facilities expected to be completed each year, and the corresponding costs.

In addition, the Outlook includes $4.4 million in funding related to a double fire station at the University of California, San Diego (UCSD). This station is ranked 8 in priority by the Citygate Associates Report. The $4.4 million would cover staffing costs for two companies at the station. The Fire-Rescue department is working with UCSD to determine the funding for the design, construction, and outfitting of this new station. It should be noted that this new facility is not discussed in the Five-Year Outlook, or included in the New Facilities list provided in Attachment III. Further information on this planned new fire station would be beneficial.

New Facilities – Central Library

Phase I construction has begun on the new Central Library which is scheduled to open in FY 2014. Approximately $159 million of the anticipated needed $185 million for the construction of the new Central Library has been secured. The secured capital funding sources include funds from the Redevelopment Agency, San Diego State University, State Grant Funds, and private donations. The remaining $26 million is anticipated to be secured through private donations. The City is not contractually obligated to fund or complete the second construction phase, which is to be funded solely from private donations. However, should the Central Library not be completed, the City may be obligated to re-pay the State Grant of $20 million, as the terms of the grant award contemplates full operation of a library.

The Outlook includes the addition of 6.00 FTE during the forecast period for the Central Library, including 1.00 FTE in the Library Department and 5.00 FTE in the General Services Department to address the increased maintenance of the facility. Additionally, Library staff anticipates increasing non-personnel costs by $2,742,866 and General Services anticipates adding $150,000 in non-personnel costs related to the Central Library.

The Outlook includes approximately $2.8 million in additional revenues to offset the increased expenses. The Library Foundation has confirmed $2 million in annual donations has been secured for five years beginning in FY 2014 to address the increased operational costs. Parking receipts from the parking facility, rental space fees, and other fees are anticipated to generate approximately $825,000 annually in additional revenues. The table below illustrates total General Fund expenditures and revenues associated with the Central Library that have been included in the Outlook. As reflected, the Outlook projects that total expenditures will exceed total anticipated revenues by approximately $364,000 annually.

Five-Year Outlook – Central Library Revenues & Expenditures

Expenditures	FTE	PE[1]	NPE	Total
Library Department	1.00	$ 42,876	$2,742,866	$2,785,742
General Services	5.00	253,249	150,000	403,249
Total	**6.00**	**$ 296,124**	**$2,892,866**	**$3,188,990**

Revenues	Total
Private Donations	$2,000,000
Net Parking Reciepts[2]	600,000
Rental Space Reciepts	150,000
Other	75,000
Total	**$2,825,000**
Net Impact to General Fund	**$ 363,990**

1. PE figure represents salaries plus estimated fringe expenses.
2. Figure represents estimated $800,000 in parking reciepts less estimated $200,000 in management fees.

Storm Water Permit Compliance

The Storm Water Division, which is part of the new Transportation & Storm Water Department, must comply with requirements of the Storm Water Municipal Permit issued by the California Regional Water Quality Control Board. The FY 2012 Budget included $33.8 million to fund programs to comply with the permit including storm water pollution prevention, street sweeping, and storm drain maintenance.

The current Municipal Permit became effective in 2008. It has a five-year life span and a new permit will be issued in FY 2013. However, as indicated by the Division, the new permit will not become effective until FY 2014. Costs to comply with the future Municipal Permit are not known at this time, and therefore were not included in the Outlook. New mandates are currently under review and additional funding for compliance may be required.

While the Outlook does not include costs associated with future permit compliance, additional expenditures within the Division for other costs associated with current permit compliance have been included. These additional costs are discussed in detail in the Department Additions section of this report.

9th Council District Office

The Council Administration department is currently coordinating the build-out of the tenth floor to accommodate the 9th Council Office, whose term will begin December 4, 2012. The FY 2012 Budget included $41,000 for design costs. An additional $430,000 in one-time funding will be required for construction and furnishing of the office. This funding will be required in mid-FY 2012 or early FY 2013. This funding was not included in the Outlook.

In addition to the one-time funding for the 9th Council Office, annual expenses related to staffing and non-personnel expenses for the office will be required. Based on the average FY 2012 Budget for the other eight council offices, $1.1 million would need to be added to future budgets. The Outlook does not include any additional operating costs associated with the 9th Council office and assumes that these costs will be absorbed within existing City Council office budgets. To implement this, each existing Council Office budget would need to be reduced by $137,500. Funding for staffing and operation of the 9th Council District Office is included in the IBA Outlook Scenario.

Civic Center Complex
The Outlook anticipates $40 million in repairs needed to maintain the safety and functionality of the Civic Center facilities. In their May 2009 Facilities Condition Assessment Supplement on the San Diego Civic Center Complex, AECOM stated that it would cost a minimum of $20 million to maintain the buildings for an additional five years and $40 million for ten years.

Staff anticipates funding the majority of the $40 million through future bond funds. The $4.0 million associated with the City Administration Building's sprinkler project will be funded with $1 million from the 2009 deferred capital bonds and $3.0 million from the second bond funding anticipated at the end of FY 2012. The Outlook also includes $400,000 in annual maintenance expenses for the Civic Center Facilities.

It should be noted that the Outlook does not include information related to a long-term plan for the Civic Center Facilities. However, the Outlook reflects a scenario similar to the "Hold-Steady" scenario discussed by the Office of the Mayor in their June 25, 2010 report on the Civic Center Complex to the Rules Committee. The "Hold Steady" scenario assumed the minimum required estimated capital repairs and replacement for safety and functionality during the next ten years. The "Hold Steady" scenario also assumed that existing City leases would be renewed for an additional five years upon their expiration, based upon "best and final" offer proposals received from the City's three landlords.

Deferred Capital
At the Budget & Finance Committee (B&FC) meetings on March 16 and 30, 2011, the City's COO and Public Works staff presented information regarding the total deferred capital backlog for the City's three main asset classes – Facilities, Streets, and Storm Drains. Staff identified $840 million as the total backlog for the three main asset classes. Although the complete elimination of the deferred capital backlog would be the ideal goal, even if funding were available this is not realistic due to the City's existing capacity to manage and complete the number of projects at this level of funding. In response, staff identified two condition levels and funding alternatives (I & II) for each of the main asset classes (Facilities, Streets, Storm Drains). These alternatives (I & II) were based on future funding availability in the context of the City's total budget and capacity for completing projects.

The alternatives are separated into the required "Catch-Up" and "On-Going" expenses. Staff delineated "Catch-Up" as funding required to reach a designated service level and "On-Going" funding as the annual, recurring funding required after "Catch-Up" is achieved to maintain the desired service level. "On-Going" Funding can include both capital expenditures and maintenance (non-capital) expenditures. Examples of capital "On-Going" expenditures include a two-inch overlay of asphalt on streets or a new roof and electrical system for a facility. Items such as slurry sealing of streets and minor repairs of facilities (painting, patching walls, and minor plumbing) are considered maintenance and are non-capital in nature. The following table details the "Catch-Up" and "On-Going" Funding required for the two service level Alternatives:

Required "Catch-Up" and "On-Going" Funding for Alternative Service Levels (in millions)

	Alternative Service Level I	Alternative Service Level II
"Catch-Up" Funding (One-Time Expense)	$192.0	$392.0
"On-Going" Expenses (Annual Expense)[1]	$147.0	$182.0

1. Required after achieving "Catch-Up".

On November 2, 2011 the IBA presented report 11-63 "Deferred Capital" to the B&FC. The following provides an overview of how the Mayor addresses Deferred Capital in the context of the Outlook. IBA report 11-63 includes a more detailed overview of the City's Deferred Capital program and IBA recommendations for moving forward with this program. It is important to note that at the March 2011 B&FC meetings staff stated that the initial goal would be to achieve Alternative Service Level I. Staffed confirmed this at the November 2, 2011 B&FC meeting.

<u>"Catch-Up" Funding</u>

In the Outlook, the Mayor outlines his plan to address the "Catch-Up" funding for the next five fiscal years. As detailed in the Outlook, the Mayor is recommending that the City bond for $100 million per year for the next five years for a total of $500 million over the Outlook period. The debt service for the 2017 issuance would occur in FY 2018 which is outside the scope of this Outlook's time frame. The $500 million projected in the Outlook would be in addition to the $100 million bond issuance scheduled for FY 2012.

It should be noted that the Deferred Capital funding proposal in the Outlook is substantially more than what is required for the "Catch-Up" funding in Alternatives I ($192 million) and II ($392 million) as proposed by the Mayor's staff in their March 8, 2011 report to the B&FC. In fact, the anticipated bond funding in the Outlook exceeds the Mayor's "Catch-Up" funding requirements by $308 million for Alternative Service Level I, and by $108 million for Alternative Service Level II, even before taking into consideration the $100 million bond issuance scheduled for FY 2012.

<u>"On-Going" Funding</u>

As discussed above, in their March 8, 2011 report to the B&FC, Public Works staff presented two alternative funding scenarios for "On-Going" maintenance for the main asset classes with Service Level I being the goal. To reach Service Level I, $147 million in annual funding (Capital and Non-Capital) would be required **after achieving the desired service level for "Catch-Up"**. Staff has stated that it will take at least three to four years to expend the $192 million in "Catch-Up" bond funding to reach Service Level I, and that during that time $58 million in “On-Going” maintenance (Non-Capital) expenditures would be required to ensure that the City does not fall behind. This compares with the Outlook which assumes continuing the FY 2012 funding of $45.4 million in annual “On-Going” maintenance expenses plus an additional $400,000 for maintenance of the Civic Center Plaza facilities for a total of $45.8 million. It should be noted that once the City does achieve Service Level I, the full “On-Going” funding level of $147 million (Capital and Non-Capital) would need to be identified.

Funding Scenario to Achieve Service Level I

The $192 million level of “Catch-Up” funding for Service Level I can be accomplished through the 2009 bond issuance and the planned issuance of $100 million in bonds in FY 2012. Debt service requirements for these two issuances will continue through the Outlook period. While Service Level I can be met through the two bond issuances, the IBA Outlook scenario includes a third $100 million bond issuance in FY 2015 which will allow for continued progress toward Service Level II and funding for assets not currently included in the $840 million estimated backlog. For discussion purposes, the following table shows the required additional debt service payments to achieve “Catch-Up” Service Level I; one additional bond issuance in FY 2015; and the additional funding required to reach the $58 million in “On-Going” annual maintenance funding.

Required Additional Funding to Reach “Catch-Up” Service Level I and Address Other Capital Assets and “On-Going” Maintenance (in millions)

	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017
"Catch-Up" Funding[1]	$7.2	$7.2	$7.2	$14.7	$14.7
"On-Going" Funding[2]	$12.2	$12.2	$12.2	$12.2	$12.2
Total Additional Funding Required:	**$19.4**	**$19.4**	**$19.4**	**$26.9**	**$26.9**

1. Assumes continued debt service funding for the 2009 Bond Issuance (2010A Master Refunding) which is included in the base budget and an additional $100 million bond funding in FY 2012 to reach the $192 million Service Level I "Catch-Up" funding requirement. The debt service payments ($7.2 million) for the 2012 bond issuance would start in Fiscal Year 2013. An additional $100 million debt issuance is proposed for FY 2015 to continue to make progress toward Service Level II and to address deferred capital requirements other than those included for the three main assets. The debt service payment ($7.5 million) for the FY 2015 bond issuance would start in FY 2016.

2. Expenditures reflect a net of the $58.0 million in annual required funding for "On-Going" maintenance (Non-Capital) for Service Level I and $45.8 million ($45.4 million included in the FY 2012 budget and the $400,000 in additional maintenance funding for the Civic Center Facilities assumed for FY 2013-2017).

Departmental Additions

The Five-Year Outlook includes approximately $7.3 million in departmental programmatic additions over the five year period, including the addition of 56.28 full time equivalent (FTE) positions. While a portion of these programmatic additions are related to new facilities as discussed above, there are a number of other departmental additions that are not discussed or highlighted in the Five-Year Outlook. The table below reflects the cumulative position and expenditure additions (including salary and non-personnel expense)[3] that have been factored in to the Outlook projections.

Cumulative Departmental Additions Included in the 5-Year Outlook over FY 2012 Budget

	FY 2013		FY 2014		FY 2015		FY 2016		FY 2017	
Department	FTE	Total Expense	FTE	Total Expense	FTE	Total Expense	FTE	Total Expense	FTE	Total Expense
Personnel	0.00	$10,619	0.00	$31,856	1.00	$75,043	2.00	$135,557	2.00	$135,557
Office of the City Auditor	0.50	$133,684	1.00	$139,774	1.50	$191,264	2.00	$242,754	2.50	$294,244
Business Office	1.00	$49,278	1.00	$47,778	1.00	$47,778	1.00	$47,778	1.00	$47,778
Human Resources	0.00	$100,000	0.00	$100,000	3.00	$359,500	3.00	$359,500	3.00	$359,500
Office of the CIO - IT	0.00	$500,000	0.00	$500,000	0.00	$500,000	0.00	$500,000	0.00	$500,000
Purchasing & Contracting	2.00	$116,674	2.00	$116,674	2.00	$116,674	2.00	$116,674	2.00	$116,674
City Treasurer	2.00	$447,357	2.00	$1,102,357	2.00	$702,357	2.00	$502,357	2.00	$402,357
Development Services	4.00	($158,954)	4.00	($104,390)	7.25	$179,447	7.25	($100,553)	7.25	($450,553)
Real Estate Assets	0.00	($150,000)	0.00	($120,000)	0.00	($120,000)	0.00	($120,000)	0.00	($120,000)
Library Department	0.00	$0	1.00	$2,779,162	3.55	$3,088,456	5.60	$3,323,482	5.60	$3,323,482
Park and Recreation	0.93	$640,338	8.65	$1,495,945	13.46	$2,476,903	17.93	$2,899,898	18.93	$2,960,729
Fire-Rescue	0.00	$3,714,246	0.00	$1,031,627	0.00	$558,095	0.00	$419,166	0.00	$90,237
OHS	0.00	$63,510	0.00	$115,999	0.00	$153,092	0.00	$190,245	0.00	$227,462
Disability Services	0.00	$0	0.00	$0	0.00	($5,000)	0.00	($5,000)	0.00	($5,000)
General Services	(1.00)	$13,222	4.00	$377,608	4.00	$377,608	4.00	$377,608	4.00	$377,608
Transp. & Storm Water	0.00	$233,173	4.00	$770,174	6.00	$856,361	8.00	$959,371	8.00	$957,171
Fleet	0.00	($1,611,292)	0.00	$239,694	0.00	($1,246,066)	0.00	$2,053,416	0.00	($2,316,593)
Citywide	0.00	$273,708	0.00	($441,391)	0.00	($144,840)	0.00	$863,838	0.00	$1,185,140
Other Adjustments	0.00	$1,368,318	0.00	$1,393,704	0.00	$1,824,403	0.00	($5,641,471)	0.00	($766,625)
TOTAL	**9.43**	**$5,743,881**	**27.65**	**$9,576,571**	**44.76**	**$9,991,073**	**54.78**	**$7,124,619**	**56.28**	**$7,319,167**

While not reflected in the table above, it should be noted that certain adjustments in departmental revenues have also factored into the Outlook. The sections below describe some of the more significant departmental adjustments that have been included in the Five-Year Outlook.

<u>City Attorney's Office – Civil Litigation and Community Justice Divisions</u>

- Increased revenue of $135,827 in the Civil Litigation Division beginning in FY 2013 attributable to a realignment and increase in Service Level Agreements.
- Decreased revenue of $917,000 in the Community Justice Division beginning in FY 2013 attributable to a reduction in the availability of Prop. 64 funds, Civil Penalties Enforcement Fund and Able-Disabled Grant.

<u>Office of the City Auditor</u>

- Addition of 2.50 FTE over the five-year period (FY 2013 through FY 2017) to achieve target staff goal of 25.00 FTEs – consultant Jefferson Wells suggested 24.50 positions would be an appropriate staffing level for the Office of the City Auditor in their report to the Audit Committee in 2008. If implemented, the FTE additions built into the Outlook result in the Office of the City Auditor having 25.00 FTEs by FY 2018.

[3] Department additions reflect only salary expense for new positions, as variable fringe expenses were calculated globally in the Outlook based on a percentage of total salaries. As a result, the true cost of department programmatic additions as reflected in the table is understated.

- Reduction of $222,323 in revenue attributable to audit services provided to the Public Utilities Department. The Public Utilities Department now covers these audit costs through the GGSB Citywide cost allocation process.

City Treasurer – Revenue Collections and Treasury Operations

- Addition of 2.00 FTEs (1.00 Associate Management Analyst; 1.00 Public Information Clerk) to assist in the administration of the proposed Centralized Business Regulatory process involving the Business Tax Program. Council approval of the proposed Centralized Business Regulatory process will be sought later in FY 2012.
- A one-time addition of $1 million in information technology expense (FY 2014 - $700,000; FY 2015 - $300,000) to transition Business Tax regulatory and billing processes into SAP.
- Beginning in FY 2013, approximately $161,000 in increased annual miscellaneous contractual expenses.
- Additional Revenue: 1) Beginning in FY 2013, $500,000 in additional Rental Unit Business Tax expected from enhanced billing processes and 2) Beginning in FY 2014, an additional $95,000 due to an expected increase in Parking Card sales related to the installation of new technology meters with the ability to accept Compass Cards.

Development Services – City Planning

- Addition on 3.25 FTE beginning in FY 2015 related to traffic modeling for community plan updates and Mills Act investigations.
- Reduction of $853,854 in contractual funding for community plan updates over five year period.

Development Services – Neighborhood Code Compliance

- Addition of 4.00 Utility Workers and associated NPE in FY 2013 related to graffiti removal. These FTE were slated for reduction in the FY 2012 Budget, but the positions were not eliminated due to Labor Relations issues.

Engineering and Capital Projects

- Reduced revenues under Project Implementation & Technical Services by $500,000 due to department review of actual revenue not supporting currently budgeted amounts in FY 2012.

General Services – Facilities

- Addition of 5.0 FTE in FY 2014 and beyond for staffing of the new central library, including two tradespersons and three technicians. Related NPE for maintenance supplies of $50,000 and contracts of $100,000 for elevator and fire suppression system maintenance is also included.

General Services – Fleet

- Total assignment fees charged to General Fund departments are based on the number of vehicles to be replaced based on their life cycle. Total assignment fees charged are as follows:

FY 2012 Budget	FY 2013 Forecast	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast
$ 15,107,571	$ 13,496,279	$ 15,347,265	$ 13,861,505	$ 17,160,987	$ 12,790,618

- The Outlook continues to include debt financing for vehicle purchases at varying levels in each fiscal year.
- Fleet Services is reviewing their vehicle replacement criteria compared against replacing vehicles based on age, usage (miles and/or hours), maintenance history and condition, which could change the projected fees charged to General Fund departments.
- Usage fee rates in the Outlook have been increased to reflect an increase in unleaded gasoline prices. FY 2013 usage fees in the Outlook increase the unleaded gasoline price incorporated into the FY 2012 Adopted Budget by 23.0 percent based on the current price of gasoline charged to the City. This price is then inflated 5.0 percent per year, similar to the "energy / utilities" section of NPE.
- Projected savings associated with the Fleet Services management competition process have not yet been reflected in the Outlook.

Fire-Rescue – Lifeguard Services

- $369,960 added for salary and related costs for 3.89 FTEs to provide lifeguard services at Black's Beach through FY 2014 per a City agreement with UCSD. UCSD will reimburse the City for the services. The agreement has a 2-year extension beginning in FY 2012 that tentatively ends in FY 2014.
- $644,286 added in FY 2013 to create a Lifeguard Marine Vessel Replacement Fund to fund the replacement of aging marine vessels in the lifeguard fleet. This initial amount is reduced each year in the Outlook as vessels are replaced in the initial years of the forecast, and assignment fees are deposited into the fund to support future replacement costs over the life cycle of replaced vehicles.

Fire-Rescue – Emergency Operations

- $100,000 added annually for additional supplies and operating costs associated with the Bayside Fire station.
- $4.4 million added for funding of a double fire station at UCSD, as discussed in the New Facilities section.
- Removal of $53,625 in revenue for the Air Medical Billing Fee that was approved and adopted as part of the FY 2012 Budget. The City will not be able to charge this fee due to an FAA ruling.

Fire-Rescue-Fiscal and Administrative Services

- Added revenue of $716,008 in FY 2013 to account for annualized revenue related to the department's false alarm fees. This amount is reduced to $465,405 in FY 2014 thorough FY 2017 due to the expectation that penalty and fine collections will decrease with an increase in program compliance.

Fire-Rescue – Communications

- Addition of $2.6 million in capital expenditures related to the replacement of the fire station alerting system. Originally, it was estimated that the project would cost $3.4 million over a two year period, with the cost split evenly between the first and second year. $1.7 million was adopted as a one-time expenditure in FY 2012. The $2.6 million one-time allocation in FY 2013 represents a $900,000 increase in the original estimated cost for the replacement of the station alerting system. The increase is related to additional engineering and contingency costs.

Fire-Rescue – Emergency Medical Services

- Addition of $1.36 million in revenue related to an increase in the operational fee paid by Rural Metro in FY 2013 for the provision of emergency medical services in the City per their interim two-year implementation agreement with the City adopted by Council on June 13, 2011. A $1.57 million reduction in revenues in FY 2014-FY 2017 is due to the end of the agreement term.

Human Resources

- Addition of 2.00 Labor Relations Officers related to the Fire Fighters and Police Officers' Procedural Bill of Rights, and 1.00 Citywide Volunteer Coordinator, for a total salary increase of $250,000.

Library Department (Central and Branches)

- Addition of 1.00 FTE and $2.7 million in non-personnel costs in FY 2014 for operation of the new Central Library.
- Increase of $2.8 million in new revenue in FY 2014 to support operation of the Central Library, including $2 million from private donations to be received for the first five years of operation.
- Addition of 4.60 FTE and $360,746 in non-personnel expense associated with new branch library facilities scheduled to open in FY 2015 (Skyline Hills Branch) and FY 2016 (San Ysidro Branch).

Office of Homeland Security

- In FY 2013, $35,880 in expense is added for the salary of 0.5 FTE Senior Management Analyst that will migrate from grant funding. $35,880 to fund the other 0.5 FTE of the position is added in FY 2015 to fully migrate the position over to the General Fund.
- In FY 2014, $51,344 is added for the salary of 1.00 FTE Administrative Aide II migrating from grant funding to full General Fund funding to support non-grant related workload.

Office of the CIO, Information Technology

- One-time increase of $500,000 in FY 2013 for General Fund PC replacement.

Park and Recreation

- Net increase of 18.90 FTE and $1.6 million in non-personnel expense over the five-year period related to new facilities and acreage, as discussed in the New Facilities section.

Personnel

- Addition of 1.00 Payroll Audit Specialist I to support the SAP HCM system and 1.00 Associate Personnel Analyst to support bilingual retests for Fire and Police, for a total salary increase of $100,901.

Purchasing & Contracting

- The addition of 2.00 Procurement Specialist FTEs beginning in FY 2013 to handle additional IT procurement responsibilities the department is assuming.

Real Estate Assets (READ)

- For the forecasted period, the Outlook anticipates an increase in annual revenues related to Pueblo Lands. READ anticipates an annual additional increase of $122,909. By FY 2017, the annual additional increase will add approximately $646,000 in annual revenue.

Transportation and Storm Water

- Addition of 8.00 FTEs over the five-year period in the Storm Water Division to assist with municipal permit requirements, including 2.00 Parking Enforcement Officers which are reimbursable.
- $600,000 decrease in Storm Drain Revenue in FY 2013 and beyond due to City's ongoing efforts to conserve water.
- Addition of $115,000 in PE and NPE expenses associated with the addition of 1.00 Deputy Director for the Administration and Right-of-Way Coordination Division. This position was approved by the City Council on May 16, 2011.
- Savings of $850,000 per fiscal year from installation of induction lighting systems in City streetlights. Annual savings is based on total savings less required debt service payments on bonds and loans associated with retrofit.
- Addition of $75,000 in one-time NPE expenses to install GPS devices for field vehicles to improve efficiency.

IBA OUTLOOK SCENARIO

As discussed in previous sections of this report, the IBA has identified a number of areas where adjustments to the Mayor's Outlook should be made in order to illustrate potential financial impacts, reflect funding needed to meet policy targets, and to recognize savings or expenditures resulting from known commitments. The IBA Outlook Scenario presented below reflects adjustments related to salary increases, deferred capital, election costs, and the 9th Council District Office. In addition, adjustments have been made to reflect the estimated savings related to the Fleet Services Managed Competition and the Sharp Copier Contract, discussed further below. Savings related to these items were unknown at the time the Outlook was prepared.

Sharp Copier Contract

On November 1, City Council approved a five year contract with Sharp Business Solutions (Sharp) to provide convenience copiers throughout the City at an estimated annual cost of approximately $1.0 million based on Staff estimates. In FY 2011 $2.3 million was expended on the previous contract in place with the City, so an estimated savings of $1.3 million can be reasonably forecasted throughout the Outlook due to the adoption of the new Sharp contract.

Fleet Services Managed Competition

In October 2011, the Mayor's Office announced that city employees won the bid to provide fleet maintenance services under the Managed Competition Program. Annual savings to the General Fund are estimated to be approximately $3 million, beginning in FY 2013.

IBA Outlook Scenario, FY 2013 – 2017 (in millions)

	FY 2013 Forecast	FY 2014 Forecast	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast
OUTLOOK REVENUES	**$ 1,130.7**	**$ 1,162.8**	**$ 1,200.9**	**$ 1,250.2**	**$ 1,306.2**
IBA Adjustments	$ -	$ -	$ -	$ -	$ -
ADJUSTED REVENUES	**$ 1,130.7**	**$ 1,162.8**	**$ 1,200.9**	**$ 1,250.2**	**$ 1,306.2**
OUTLOOK EXPENDITURES	**$ 1,162.4**	**$ 1,199.4**	**$ 1,229.1**	**$ 1,255.7**	**$ 1,283.6**
IBA Adjustments					
July 2011 Pension Valuation	TBD	TBD	TBD	TBD	TBD
Salary Increases[1]	$ -	$ -	$ 11.1	$ 11.1	$ 22.4
Adjustment for Elections Funding	$ -	$ -	$ (1.0)	$ (1.0)	$ (0.4)
Debt Service for Deferred Capital Bonds[2]	$ -	$ (7.5)	$ (15.0)	$ (15.0)	$ (22.5)
Deferred Capital "Ongoing" Funding	$ 12.2	$ 12.2	$ 12.2	$ 12.2	$ 12.2
9th Council District Office	$ 0.5	$ 1.1	$ 1.1	$ 1.1	$ 1.1
Fleet Services Managed Competition	$ (3.1)	$ (3.1)	$ (3.1)	$ (3.1)	$ (3.1)
Sharp Copier Contract	$ (1.3)	$ (1.3)	$ (1.3)	$ (1.3)	$ (1.3)
ADJUSTED EXPENDITURES	**$ 1,174.6**	**$ 1,204.1**	**$ 1,236.4**	**$ 1,263.0**	**$ 1,295.3**
OUTLOOK SURPLUS/(DEFICIT)	$ (31.8)	$ (36.6)	$ (28.1)	$ (5.6)	$ 22.7
ADJUSTED SURPLUS/(DEFICIT)	**$ (43.9)**	**$ (41.3)**	**$ (35.5)**	**$ (12.8)**	**$ 10.9**

1. Reflects a 2% increase in FY 2015 and FY 2017. Salary increases may be precluded by the passage of the Comprehensive Pension Reform ballot initiative and implementation of the related five-year salary freeze.

2. Reflects the decrease in deferred capital bond debt service from what is included in the Outlook. Assumes a $100 million bond issuance in FY 2012 to reach the $192 million "Catch-Up" funding requirement for Service Level 1, and an additional $100 million bond issuance in FY 2015 to continue to make progress toward Service Level II and to address deferred capital requirements that are not currently included in the three main asset classes.

As reflected above, the adjustments made in the IBA Outlook Scenario result in an increase to the FY 2013 deficit of approximately $12.1 million. However, the trend of improving financial conditions remains, with declining deficits through FY 2016 and a projected surplus in FY 2017.

SERVICE LEVELS

With the few exceptions outlined in the Departmental Additions section, it is important to keep in mind that the Mayor's Five-Year Financial Outlook maintains service levels as they are today. Over the past decade a significant number of service reductions have been implemented in order to balance the City's budget. Some of the significant service impacts to the community include a reduction in the number of academy classes for Police and Fire; elimination of 130 Police civilian support positions; reduction of lifeguard beach service; elimination of park maintenance and security positions; reduction in swimming programs; reduction in library hours and staffing; and closure of the remaining 15 community service centers.

Comparing data from FY 2001 and FY 2011 for several key service areas illustrates the decline in services provided to the community:

Significant Service Level Reductions

Department/Service Measure	FY 2001	FY 2011
Library Department		
Annual Operating Hours	86,000	68,000
Average Weekly Operating Hours		
-Central Library	64	44
-Branch Libraries	54[1]	36[2]
Park & Recreation		
Annual Recreation Center Hours	62	40
Average Weekly Recreation Center Hours	163,000	121,000
Aquatics Program Participants	712,000	299,000
After School Sites	37	17
Police Department		
Sworn Police Officers per 100,000 population	166	152
Fire-Rescue		
Sworn Firefighters per 100,000 population	80	67
Customer Service Centers		
Number of Centers throughout City	37	0
Storm Water		
Miles of street swept annually	110,000	88,000

1. Based on weighted average of all branches.
2. Three branches (La Jolla, Poiunt Loma and Serra Mesa) also provide Sunday hours funded through private donations.

It is important to remember that the declining General Fund deficits and FY 2017 surplus projected in the Outlook, while certainly positive signs, have been achieved in part through service reductions over the past decade. And while it is not expected that the Outlook include significant increases in service levels, it is important to note that the Outlook projections assume little to no improvement in service areas over the next five years. In the past, the IBA has recommended that the Financial Outlook include a section on unmet or unfunded needs, which would discuss the highest priority departmental and programmatic funding needs. Such a discussion would be helpful to the Council and the public by providing greater information on the future budgetary requirements needed to maintain and improve critical service levels.

In 2004, the City Manager released an Unfunded Needs Report, which provided a comprehensive overview of basic operating needs that were unmet due to the competing priorities for available funding. The Unfunded Needs Report identified approximately $272.4 million in General Fund unmet needs.[4] Importantly, the Unfunded Needs Report was not a departmental "wish list," but rather an assessment of budgetary resources needed to maintain the existing service levels at that time. While some of the needs identified in the Unfunded Needs Report have been addressed over the years, much has changed since 2004 and no subsequent comprehensive needs assessment has been conducted. Given the general improvement in the City's fiscal outlook, we recommend that a new comprehensive needs assessment be conducted to identify at a minimum the funding needs that would be necessary to maintain existing service levels.

Ideally, over the next several years the City will be able to restore some of the services that have been cut in the last decade, as Mayor and Council did with the elimination of all Fire Station brown-outs in the FY 2012 Budget. However, service increases could impact the bottom-line projections in the Five-Year Outlook unless additional resources are identified. The table below illustrates the additional funding that would be required for the restoration of certain service levels.

Funding Requirements for Select Service Restorations

Service Restoration	Cost
Restore 5 hours per week year-round for all 35 brach libraries	$952,000
Restore 8 hours per week year-round for the Central Library	$923,000
Restore 5 hours per week year-round for all 54 recreation centers	$632,000
Restore 1 Police 40 Recruit Academy Class	$2.2 million
Restore 20 Police civilian support positions	$1.5 million
Restore 1 Fire-Rescue 30 Recruit Academy class	$913,000
Restore Lifeguard services to FY 2008 levels	$744,000

It should be emphasized that we are not advocating for service restorations at this time. In fact, it is likely that additional service reductions may be necessary in the future to mitigate remaining projected deficits. However, given the significant reductions that have occurred over the past

[4] It should be noted that the $272.4 million in General Fund needs did not include needs for street maintenance.

decade, it is important that the Mayor and Council continue to focus on restoring and maintaining critical service levels as the fiscal outlook improves.

CONCLUSION

On October 12, 2011 the Mayor released the Five-Year Financial Outlook for FY 2013 – 2017. Overall, the Outlook reflects general improvement in the City's fiscal condition, with declining General Fund deficits projected through FY 2016, and a General Fund surplus of approximately $22.7 million projected for FY 2017.

The IBA Outlook Scenario included in this report reflects a number of adjustments to the Mayor's Outlook in order to illustrate potential financial impacts, reflect funding needed to meet policy targets, and to recognize savings or expenditures resulting from known commitments. These adjustments include funding related to salary increases, deferred capital, election costs, staffing and operation for the 9th Council Office; and savings related to the Fleet Services Managed Competition and Sharp Copier Contract. Altogether, these adjustments increase the deficits projected through FY 2016, and decrease the surplus projected in FY 2017. However, even with these adjustments, the City's financial outlook remains generally positive.

It is important to remember, however, that the improvement in the Financial Outlook has been achieved in part through significant service reductions over the past decade. Furthermore, with the few exceptions outlined in the Departmental Additions section, the Outlook assumes little to no improvement in service areas over the next five years. It should be noted that due to the continued projected deficits we are not advocating for service restorations at this time. In fact, further service reductions may still be necessary in the future. However, given the significant reductions that have occurred over the past decade, it is important that the Mayor and Council continue to focus on restoring and maintaining critical service levels as the fiscal outlook improves and funding becomes available.

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