THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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FY 2012 Year-End Budget Adjustments and Year-End Budget Monitoring

OVERVIEW

The Financial Management Director issued the Fiscal Year 2012 Year-End Budget Monitoring Report (Year-End Report) on May 23, 2012. The Year-End Report describes the current status of revenues and expenditures, and their year-end projections, based on actual (unaudited) data from July 2011 through March 2012.

The IBA reviewed the Year-End Report and also compared information to the City Comptroller's Financial Performance Report for Period 9, dated May 14, 2012, and the Mid-Year Budget Monitoring Report (presented and approved by City Council on March 12, 2012). The Year-End Report reflects continued trends that were described in the Mid-Year Report; which includes increases in major General Fund revenues in addition to significant reserves above policy levels.

The Year-End Report provides an in-depth summary of changes to the General Fund (and other funds) since the Mid-Year Report. After our Office reviewed the report, we have provided additional information or clarification to the information presented in the Year-End Report. In summary, this report highlights changes to projections and assumptions since the Mid-Year Report, offers suggestions on areas needing further review and discussion, provides updated information from issues brought forward during our Office's review of the Mid-Year Report, and highlights issues that impact assumptions contained in the FY 2013 Proposed Budget.

FISCAL/POLICY DISCUSSION

General Fund Revenues

$ in millions

Revenue Source	Fiscal Year 2012 Adopted Budget	Fiscal Year 2012 Mid-Year Report	Fiscal Year 2012 Year-End Report	$ Change from Adopted Budget to Year End	$ Change from Mid Year to Year End
Property Tax	$ 380.9	$ 386.2	$ 385.4	$ 4.5	$ (0.8)
Sales Tax	211.6	220.7	222.8	11.2	2.2
Transient Occupancy Tax	74.8	78.7	77.5	2.7	(1.2)
Other Revenue	459.3	463.0	451.9	(7.4)	(11.1)
Total GF Revenue	**$ 1,126.6**	**$ 1,148.5**	**$ 1,137.6**	**$ 11.0**	**$ (10.9)**

As noted in the Year-End Report, General Fund revenues have decreased $10.9 million from the Mid-Year Report, due to re-budgeting $11.8 million in Gas Tax funding from the General Fund operating budget to CIP (which correspondingly reduced General Fund expenditure projections). However, total General Fund revenue is projected to exceed the FY 2012 Adopted Budget by $11.0 million. The largest gains in revenue above the Adopted Budget continue to be the three largest General Fund sources: Property Tax, Sales Tax, and Transient Occupancy Tax (TOT). Changes in major revenues from Mid-Year projections net an increase of $181,000. Departmental and other revenues have decreased $7.4 million over the Adopted Budget, which is due to the Gas Tax re-categorization being offset by $4.3 million in tow referral fees discussed in the Mid-Year Report.

The following revenue sections outline the major General Fund revenues and any additional departmental revenue items of note.

Major General Fund Revenues

Property Tax

Property tax is projected to end the fiscal year $4.5 million over the Adopted Budget of $380.9 million, at $385.4 million. This projection is approximately $800,000 less than the amount projected in the Mid-Year Report of $386.2 million. This adjustment is due to an increase in anticipated property reassessments and refunds that have negatively impacted property tax projections.

Sales Tax

Sales tax is projected to end the fiscal year $11.2 million over the Adopted Budget of $211.6 million, at $222.8 million. This projection reflects an increase of $2.2 million over the mid-year projection. This increase is reflective of actual performance for the third quarter, which experienced an approximate 7.0 percent growth over the same period in FY 2011. The increase in revenue is also attributable to an adjustment to the projected growth rate for the fourth quarter.

The Mid-Year Report included a 4.5 percent projected increase, which has been subsequently revised to 6.0 percent in the Year-End Report.

In the IBA's review of the FY 2012 Mid-Year Budget Monitoring Report (12-11), the IBA noted that the Mid-Year projection was relatively conservative in consideration of the demonstrated performance trend for sales tax and indications of a continued local economic recovery. With actual performance for the first, second, and third quarters of the fiscal year demonstrating growth of 8.4 percent, 11.5 percent, and 7.0 percent, respectively, the growth projection of 6.0 percent for the fourth quarter is more modest in comparison, but appropriate given the economic uncertainty inherent in projecting this revenue source.

Transient Occupancy Tax (TOT)
TOT is projected to end the fiscal year $2.7 million over the Adopted Budget of $74.8 million, at $77.5 million. This projection reflects a decrease of $1.2 million from the Mid-Year projection of $78.7 million. This net decline in the TOT projection is due to a reporting error that occurred for TOT revenue distributions in the Mid-Year Report that overstated TOT revenue by approximately $3.3 million at the time. Subsequent to the release of the Mid-Year, the reporting error was discovered and the revenue distributions were corrected. Although the TOT projections in the Mid-Year were inflated, actual year-over-year TOT growth has shown definite improvement, with $2.1 million of growth over the corrected Mid-Year projection. Year-to-date (representing receipts from July-March of FY 2012), TOT has experienced 6.9 percent growth over FY 2011. The Year-End projection assumes growth of 5.5 percent for the remaining months of the fiscal year. This assumed growth rate for the remainder of the fiscal year reflects an increase over the 5.0 percent growth rate assumed in the Mid-Year Report. Given year-to-date TOT performance and projections of continued modest improvements in hotel occupancy and average daily rates, this assumed growth and the resulting TOT projection is appropriate.

Departmental Revenue Issues

Police
As noted in the Year-End Report, the Police Department revenues are projected to exceed budget by $1.5 million, reflecting a $1.8 million increase over the Mid-Year projection. This increase over the Mid-Year projection is primarily related to the inclusion of $1.0 million of Abandoned Vehicle Abatement (AVA) reimbursements and $396,000 in DNA Backlog and Justice Assistance Grant (JAG) grant reimbursements that were not included in the Mid-Year projections. The reimbursements for JAG and the DNA Backlog were not previously budgeted. Additionally, the $1.5 million in Stonegarden Grant revenue reimbursements discussed in the Year-End Report were not included in the Adopted Budget, but were projected in the Mid-Year Report.

Transportation & Storm Water (TSW)
The FY 2012 Year-End Report decreased TSW revenue and expenditures by $11.8 million as a result of the reallocation of Gas Tax funds from the operating budget to the Capital Improvement Program (CIP) budget. This is in-line with Council Resolution 307299 passed on March 15, 2012. The $11.8 million was originally intended to be used for slurry seal, which is considered street maintenance and included in the operating budget. TSW staff updated information on street conditions from the assessment completed in November 2011 into the Department's

Pavement Management System. This system determines the best method to maintain each section of street and analyzes the City's street network to determine the most cost effective plan. As a result, TSW identified a greater need for asphalt overlay which is considered to be a capital project and included in the CIP budget.

Public Works – Engineering & Capital Projects
In our Office's FY 2012 Mid-Year Report (IBA Report 12-11), we noted that E&CP had projected a $1.3 million revenue shortfall due to the methodology used to estimate reimbursements for engineering services from other City departments. The Year-End Report projects revenues to be under budget by $609,000. The projection has increased by approximately $708,000 since the Mid-Year due to: 1.) the department's efforts to improve tracking and billing of reimbursable staff time; 2.) increased billable construction inspections and land surveying services being provided; and 3.) one-time revenue from budgetary adjustments. Some of the one-time revenue may be from charges in previous years, but this could not specifically be determined. For FY 2013, revenue rates have been calculated as a ratio of budgeted salary, and the department believes this methodology will create a budget more in-line with actual revenues.

Fire-Rescue
In our Office's FY 2012 Mid-Year Report, we noted that the mid-year projection for Fire-Rescue Alarm Permit Fee revenue did not reflect up-to-date performance data conveying that the new fee program would not meet budgeted expectations due to a lower number of permits issued than originally estimated, and a delay in penalty billings. The FY 2012 Budget includes $370,440 for permit revenue and $540,000 for penalty billings, totaling $910,000. The Year-End Report projection for Alarm Permit Fee revenue is $193,938 and $410 for false alarm penalties, totaling $194,348; which is a reduction of $715,652 from budget. As of May 29, 2012, 11,511 permits have been issued and 14 penalty billings have been assessed while it was initially assumed that 42,000 alarm systems would be permitted in FY 2012. The FY 2013 Proposed Budget has not been adjusted to reflect a reduction in False Alarm Permit Fee revenue, with the budget remaining at $910,000.

General Fund Expenses

$ in millions

Expenditure Category	Fiscal Year 2012 Adopted Budget	Fiscal Year 2012 Mid-Year Report	Fiscal Year 2012 Year-End Report	$ Change from Adopted Budget to Year End	$ Change from Mid Year to Year End
Personnel Expenditures	$ 504.6	$ 507.3	$ 503.7	$ (0.9)	$ (3.6)
Fringe Benefits	308.9	311.0	312.0	3.1	1.0
Contracts	174.5	169.6	157.4	(17.1)	(12.2)
Energy & Utilities	33.7	34.7	32.8	(0.9)	(1.9)
Information Technology	23.2	23.2	23.1	(0.1)	(0.1)
Supplies	17.9	21.7	22.6	4.7	0.9
Other Expenses	65.5	64.6	68.2	2.7	3.6
Total GF Expenses	**$ 1,128.4**	**$ 1,132.1**	**$ 1,119.8**	**$ (8.6)**	**$ (12.3)**

General Fund expenses have decreased $8.6 million from the FY 2012 Adopted Budget, and have declined $12.3 million since the Mid-Year Report. As previously discussed, the re-categorization of $11.8 million in Gas Tax revenues and expenditures from the General Fund to CIP skewed the change from the Adopted Budget and Mid-Year Report, as shown above.

The following expenditure sections detail any additional city-wide and departmental expenditure items of note.

City-Wide Issues

Personnel Expenditures
Estimated retirements included in the Mid-Year Report from January to June 2012 were approximately 84 FTE and 170 FTE in the Year-End Report. The resulting $4.7 million decrease in projected personnel expenditures (salaries and fringe) is partially offset by increases in overtime, hourly wages, termination pay, pay-in-lieu of vacation, and retiree health expenditures, for a net decrease to projected personnel expenditures of $2.7 million.

Departmental Issues

Park & Recreation
As noted in the Year-End Report, the Park and Recreation Department's projection for utility expenses has decreased by approximately $1.0 million from the Mid-Year Report due to the correction of a water billing issue. The correction was related to the implementation of the new Public Utilities' billing system and the installation and information provided by new meters. Public Utilities' staff has corrected the billing issues and posted the appropriate credits to the Park and Recreation Department for Fiscal Year 2012, resulting in the decrease in projected expenses from the Mid-Year Report. Public Utilities' staff has indicated that they now have a way to detect these types of issues to avoid this type of correction in the future.

Transportation & Storm Water
Transportation & Storm Water Salaries and Wages are projected to be $22.0 million which is $1.2 million under budget. This is an increase from the Mid-Year Budget Monitoring Report of about $450,000 due to higher than anticipated vacancies. Department vacancies are up from 67 at the end of January to 72 currently, including 15 retirements. This represents about 16.2% of TSW's 443.68 total FTEs for FY 2012. A high level of vacancies persist in the Department due to about 26 positions being on hold due to Managed Competitions for Street Sweeping and Storm Water Facilities Operations (7 positions) and Street and Sidewalk Maintenance (19 positions). Additionally, staff report that filling vacant positions in the Department has taken up to 6 months for the Personnel Department's hiring process from initiating the Request-to-Fill Memorandum to clearing personnel. Staff expects to fill about 2 of the vacant positions by the end of this fiscal year.

TSW's projection for Contract expenditures has decreased by $1.1 million from the FY 2012 Mid-Year Report. About $700,000 of this decrease will be used to partially offset increases in both the Supplies and Energy and Utilities categories. Supplies expenditures are projected to be over budget by $1.6 million due to increases in road repairs. The Energy and Utilities category is projected to be over budget by $643,000 due to delayed installation of energy saving street light.

The remaining decrease for Contracts is attributable to delays in awarding a $400,000 contract for sidewalk repairs. Street Division staff prioritized the processing of asphalt overlay contracts funded by TransNet to spend unexpended funding for various CIP projects. This impacted the processing of the sidewalk contract, which is now expected to be awarded in June 2012. The contract will be funded out of the Department's FY 2013 operations and maintenance budget.

Fire-Rescue
In the Mid-Year Report, the Fire-Rescue Department personnel expenses were projected to come in over budget by $4.8 million, due to over budget overtime and other personnel expenses that were not being offset by savings in salary and fringe benefits in accordance with the constant staffing budgeting model employed by the department. With the Mid-Year adjustment to the overtime budget for Fire-Rescue of $4.8 million, personnel expenses now are only projected to be over budget by approximately $728,000 in the Year-End Report. This overage is primarily due to fringe expense reallocations to the department. A year-end budget adjustment for $502,000 is being requested for the department, which is the net amount of the overage that is not offset by savings in other departmental expense categories.

The FY 2013 Proposed Budget includes a net $4.8 million budget adjustment that is intended to address the personnel expense budgetary issues experienced by Fire-Rescue in FY 2012 and meet the department's true operational needs as identified by the department and Financial Management. Of the net increase, $6.6 million is an increase in the department's overtime budget, and $1.8 million a reduction in the salary savings budget.

Status of General Fund Reserve

The following table shows the major changes in FY 2012 General Fund surplus between the Mid-Year and the Year-End Reports.

Changes in Projected General Fund Surplus

FY 2012 Projected Surplus, per Mid-Year Report	$16.5
FY 2012 Mid-Year Council Actions	(5.0)
Retiree Health Increased Expenditure Projection	(1.4)
Personnel Savings Due to Increased Retirements	4.7
Projected Energy/Utilities Savings	1.9
Projected Revenue Increase	0.9
Net Other Expenditure Savings	0.2
FY 2012 Projected Surplus, per Year-End Report	$17.8

FY 2012 Mid-Year Report Projected Surplus - Revised
Included in the Mid-Year Report were the Mayor's FY 2012 recommended uses for $5.0 million of the $16.5 million projected surplus - $2.7 million for the Fire Station Alerting project, $1.0 million for the CIP Emergency Reserve, $1.0 million for an April Police Recruits Academy, and $0.3 million for branch library and recreation center hours for the remainder of FY 2012. These FY 2012 appropriations were approved as part of the Mid-Year Council Actions.

Also, after the release of the Mid-Year Report, it was determined that the retiree health expenditure projection would need to be increased by $1.4 million. Furthermore, our office noted a TOT revenue reporting error of $3.3 million in the Mid-Year Report during our review of the FY 2013 Proposed Budget. These two items, combined with the $5.0 million Mid-Year Council Actions, reduce the Mid-Year Report projected surplus of $16.5 million to $6.8 million. When compared to $17.8 million projected surplus in the Year-End Report, there is an $11.0 million improvement.

FY 2012 Projected General Fund Reserve
Utilizing the FY 2012 projected surplus amounts discussed in the section above, the FY 2012 projected General Fund ending reserve balance is calculated as follows:

FY 2012 General Fund Reserve Projection

	Mid-Year Report	Year-End Report	Difference
FY 2012 Reserve - Beginning Balance	$113.9	$113.9	($0.0)
FY 2012 Projected Surplus - Revised	6.8	17.8	11.0
FY 2012 Reserve - Projected Ending Balance	$120.7	$131.7	$11.0

FY 2013 Projected General Fund Reserve
Based on the FY 2012 projected General Fund reserve discussed in the previous section, the FY 2013 projected reserve balance is shown in the table below. Note that the amounts to be re-budgeted in FY 2013, for expenditures originally budgeted in FY 2012, have increased slightly.

A total of $12.8 million in reserves is anticipated to be utilized in the FY 2013 budget, including the following items (which appear in the Year-End Report column of the table below): $3.7 million for amounts budgeted in FY 2012 that will be re-budgeted in FY 2013; $8.3 million to increase cash funding for FY 2013 deferred capital projects (in order to reach the "Status Quo" funding level); and $0.8 million to fund a portion of the FY 2013 appropriated reserve.

The $12.8 million of General Fund reserve that is anticipated to be budgeted in FY 2013 is $5.0 million less than the projected $17.8 million FY 2012 surplus. The Mayor has recommended, and the IBA concurs, that this $5.0 million remaining amount be kept in reserve for unforeseen circumstances. Note that for FY 2013, the Mayor has also proposed a General Fund Appropriated Reserve of $3.7 million in addition to a projected $10.7 million in TOT fund balance to address potential impacts of unwinding redevelopment.

FY 2013 General Fund Reserve Projection

	Mid-Year Report	Year-End Report	Difference
FY 2012 Reserve - Projected Ending Balance	$120.7	$131.7	$11.0
FY 2012 Amounts Re-budgeted in FY 2013			
Community Projects Programs and Services	(1.3)	(1.4)	(0.1)
Kinder Morgan Litigation	(1.2)	(1.4)	(0.2)
Community Plan Updates & Other Special Projects	(0.7)	(0.9)	(0.2)
FY2013 Deferred Capital Projects*	(3.6)	(8.3)	(4.7)
FY2013 Appropriated Reserve	0.0	(0.8)	(0.8)
FY 2013 Reserve - Projected Ending Balance	$113.9	$118.9	$5.0

* The $3.6M for deferred capital projects in the Mid-Year Report column is the amount of FY 2012 surplus remaining after making all adjustments to the original $16.5 million projected surplus (including the $5.0 million in Mid-Year Council Actions, $1.4 million for the increased retiree health expenditure projection, $3.3 million for the TOT revenue reporting error in the Mid-Year Report, and $3.2 million in FY 2012 amounts re-budgeted in FY 2013).

General Fund Reserve Level

In April 2012, Standard & Poor's and Fitch Ratings reviewed various City of San Diego debt issuances for any potential update on their credit rating. Both agencies affirmed the stable financial outlook of the City of San Diego and maintained or improved the credit ratings for each individual bond issuance they reviewed. Maintenance of a high credit rating for City debt is an important fiscal priority due to the cost savings associated with reduced interest costs and continued access to public debt markets.

Standard & Poor's noted in their comments that they have increased the rating of their reviewed City debt from 'A-' to 'A+' due to "proactive budget adjustments that have contributed to improved reserve levels even as the City managed fiscal pressures related to a sluggish economic cycle and rising pension costs." In the report from Fitch Ratings, they noted "Prudent Policies: the City continues to demonstrate a commitment to conservative financial management policies, multi-year budget planning, and general fund balance and reserves preservation."

Moody's Investors Service also released a rating update in May 2012, assigning the City an Aa3 Issuer Rating, which is the same level as the previous general obligation rating. Additionally, they noted that the rating outlook is stable. Moody's references the City's "below average reserves" as a credit challenge, while noting that "the City has been able to tightly control expenditures and modestly grow general fund reserves."

The General Fund reserve target is 8 percent of annual General Fund revenues, as prescribed by the City's Reserve Policy. Below is a table which shows the projected excess General Fund reserve over 8 percent of General Fund revenues for FY 2013, as well as the total projected General Fund Reserve as a percent of FY 2013 projected revenues. Again, it is recommended that these amounts be kept in reserve for unforeseen circumstances and to mitigate any impacts with respect to former Redevelopment Agency enforceable obligations.

General Fund Reserve as a Percent of General Fund Revenues

	Mid-Year Report	Year-End Report	Difference
FY 2013 Reserve - Projected Ending Balance	$113.9	$118.9	$5.0
8% of General Fund Revenues	92.0	92.0	
FY 2013 Projected Reserve Over 8% of Revenues	$21.9	$26.9	
Total FY 2013 Reserve (Projected Ending Balance) as a Percent of FY 2013 Revenues - Based on May Revision	9.9%	10.3%	0.4%

Note that the projected FY 2013 General Fund Reserve of $118.9 million does not include the potential addition of any unbudgeted revenue received from property tax trust fund distributions that are in excess of the City's required obligations from the Redevelopment Agency's dissolution. For more information on redevelopment dissolution, see the section entitled, "Preserving Funds for Impact of Redevelopment Dissolution" in the IBA's report 12-24 *IBA Review of the FY 2013 May Revise and Recommended Revisions to the Mayor's FY 2013 Budget*.

Requested Appropriation Adjustments

As noted in the Fire-Rescue section, there is a $502,000 requested appropriation adjustment due to fringe expense re-allocations to the department. In addition to this request, there are two small requests detailed in the Year-End Report. First, there is $90,000 requested in Council Administration to be transferred to a CIP account to provide additional funds to complete the construction of the 9th Council District offices. Finally, there is a $5,000 request for an appropriation in the Office of the Assistant COO to cover increased pay-in-lieu expenditures.

After reviewing each appropriation adjustment, our Office supports the requested actions in the Year-End Report.

CIP De-Appropriations

Water & Wastewater Funds

The CIP de-appropriations for the water and wastewater funds total a combined $116.1 million, as detailed in attachment VI of the Year-End Report. It should be clarified that the total $116.1 million will not be returned to the Dedicated Reserve for Efficiency Savings (DRES), per policy, since this total dollar amount represents appropriations and not actual cash funding for the capital projects listed. Approximately 20 percent of this aggregate total amount will be returned to the DRES for future CIP.

Close Out Incomplete Projects

The FY 2012 Year-End Budget Monitoring Report closes 55 abandoned or cancelled CIP project
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reducing the CIP budget by $23.8 million. Remaining project funds, which range up to $8.9 million, will be returned to their original various sources. It is important to note that many funding sources have specific requirements for how they can be used. For example, based on our review about $14.1 million will be returned to the Water Utility CIP Fund or Water Fund and can

be used only for water projects. In addition, about $3.0 million is for appropriated funds not realized from Facilities Benefit Assessment (FBA) revenue as originally anticipated due to the economic slowdown. The FBA will be re-programmed for these projects in the future as funds become available. Of the remaining funds, about $3.0 million will be returned to various community funds, such as Developer Impact Fee and Park Development Funds and may be available for use by the respective communities. Financial Management is reviewing the funds from closed projects and will provide a referral memorandum by June 8, 2012.

CONCLUSION

The FY 2012 Year-End Budget Monitoring Report provides a comprehensive review of the General Fund's financial status through March 2012. The IBA has thoroughly reviewed the revenue and expense information contained in the report and believes the projections included are conservative and appropriate based on current economic information and actual experience to date. Updated information for both revenues and expenses in the Year-End Report have been incorporated into the May Revise and IBA recommendations for the FY 2013 Adopted Budget.

The IBA recommends that the City Council accept the FY 2012 Year-End Budget Monitoring Report from the Mayor and authorize the requested appropriation adjustments.

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