

CITY OF SAN DIEGO  
FISCAL YEAR  
**2008** ANNUAL  
BUDGET

# Fiscal Recovery





# Mayor's Commitment to Fiscal Recovery



In the Fiscal Year 2008 Annual Budget, the City of San Diego will remain focused on achieving fiscal recovery by implementing the initiatives outlined by the Mayor in the Five-Year Financial Outlook. The Fiscal Year 2008 Annual Budget

funds eight significant areas that are the legal obligations of the City. The following significant areas have been discussed for years but have never been fully addressed or adequately funded: pension and retiree health obligations; funding of reserves; deferred maintenance and capital improvements; Americans with Disabilities Act (ADA) improvements; storm water permit compliance; and the Public Liability and Workers' Compensation funds. By establishing a Five-Year Financial Outlook, the Mayor has set forth the framework in the budgeting process for a critical examination of City funding priorities.

The Fiscal Year 2008 Annual Budget reaffirms the Mayor's efforts to restore fiscal health to San Diego by continuing commitments to ensure the protection of core services, implementing a managed competition plan, continuing to carry out Business Process Reengineering, and reorganizing the City's operational structure.

In Fiscal Year 2008, necessary funding continues to be provided for essential services such as parks and libraries, police and fire protection, trash collection, and water and wastewater services. However, given the obligations identified in the Five-Year Financial Outlook, the City has focused on fulfilling primary core responsibilities at optimum funding levels before committing to other non-core services.

## Business Process Reengineering

Through the Business Process Reengineering (BPR) initiative, the Mayor is streamlining the City's business practices and creating efficiencies throughout the City between Fiscal Years 2007 and 2009 with the intent to continue providing a high level of customer service while reducing the costs of providing these services. While positions have not been targeted for elimination through BPR, a large number of positions have been reduced across several departments. The Fiscal Year 2008 Annual Budget reflects additional position reductions Citywide that will be implemented through BPR efforts. Additional savings will be identified in non-personnel expense costs (supplies and services, IT costs, and fringe benefits) as BPR efforts are finalized.

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## Citywide Reorganization

The structure of the City continues to undergo a realignment intended to convert the City into a more manageable and responsive organization. These functional organizational shifts will continue to move the City toward complete fiscal recovery while allowing for better use of resources and promote accountability. The efforts made in Fiscal Year 2007 and continued as part of the Fiscal Year 2008 Annual Budget to streamline the City's organizational structure resulted in a net reduction of 629.71 Full-Time Equivalent (FTE) positions in the Fiscal Year 2008 Annual Budget, including the reductions related to BPR.

In November 2006, the Mayor presented to the Budget and Finance Committee a Five-Year Financial Outlook that outlined the position reductions needed to achieve fiscal recovery. The position reductions are outlined in the Five-Year Financial Outlook; many of these positions are vacant and core City services are not expected to be adversely affected.

## Implementing Managed Competition

In November 2006, voters approved Proposition C, allowing City departments to competitively bid for certain jobs alongside external vendors and contractors. The goals of the managed competition program include, but are not limited to, maximizing the quality of service the City provides to its residents in a cost-effective manner. In addition, it is anticipated that managed competition will reduce the cost of services by having City departments compete with private companies on a level playing field. Managed competition is expected to maximize City resources and serve as a catalyst for positive internal City reforms and savings that will improve the fiscal health of the City. In Fiscal Year 2008, the City plans to complete pre-competition assessments and develop and issue Requests for Proposals (RFP).

## Maintaining Sound Financial Structure

In order to achieve a balanced budget, the Mayor's Five-Year Financial Outlook identified eight significant areas that had been either ignored or severely underfunded. Adequate funding of these eight areas is essential for the City to achieve fiscal strength:

- Employee Pension Plan
- General Fund reserves
- Deferred maintenance and capital improvement needs
- Retiree Health (Other Post Employment Benefits)
- Requirements for Storm Water Runoff Permits
- Obligations under the Americans with Disabilities Act
- Workers' Compensation Fund
- Public Liability Fund



## Funding the Pension Plan

Restoring the integrity of the City's Retirement System is critical for the long-term fiscal health and stability of the City. In November 2006, voters approved the passage of Proposition B, the Mayor's initiative calling for voter approval before allowing any future increases in pension benefits for City employees. On June 2006, the San Diego City Employees' Retirement System (SDCERS) released its 2006 actuarial valuation report for the City of San Diego and determined that the City's Annual Required Contribution (ARC) for Fiscal Year 2008 was \$137.7 million.

The Fiscal Year 2008 Annual Budget provides that the City will contribute \$20 million in addition to the ARC of \$137.7 million. This amount will be used to pay down in part the Unfunded Actuarial Accrued Liability (UAAL) with no negative amortization. In addition, the City has budgeted an additional \$7.3 million to begin paying back the pension plan for assets inappropriately used to pay retiree health benefits. For Fiscal Year 2008, the City's total pension payment is budgeted at \$165 million. The full budgeted amount was advanced in July 2007 to the San Diego City Employees' Retirement System (SDCERS).

## Building Reserves

Building healthy reserves will help insulate City services against periodic swings in the economy and the demands placed on the City to pay the costs from emergencies such as natural disasters. In addition, since the City's reserves are one of several factors considered by rating agencies, a strong reserve balance may help lower the City's cost to borrow money. The City currently maintains several reserves for its operations, including the Emergency Reserve for the General Fund which was established to fund unanticipated liabilities for natural disasters, catastrophic occurrences, and judgments.

The City's proposed reserve policy calls for establishment of adequate reserve levels for an Emergency Reserve, Appropriated Reserve, Capital Reserve, and other types of reserves. The City's current reserve policy (adopted by City Council in 2002) established a General Fund Reserve minimum of 3.0 percent of the General Fund revenues. The policy defined a goal of a 5.0 percent reserve to be achieved by 2014. It is the Mayor's goal to go above and beyond the current policy and increase reserves to 8.0 percent by Fiscal Year 2012. The Five-Year Financial Outlook established a 6.0 percent reserve goal for Fiscal Year 2008, and the Fiscal Year 2008 Annual Budget includes \$3.3 million as a contribution to the General Fund Emergency Reserve to meet this goal. The Fiscal Year 2008 Proposed Budget included \$5 million as a contribution to the Emergency Reserve, but as a result of the Fiscal Year 2008 Budget deliberations, the contribution was reduced from \$5 million to \$3.3 million.

## Funding Deferred Maintenance

Over the years, the City has undertaken several studies to catalogue deferred maintenance needs for which no funding had been identified. Presently, staff is compiling an inventory of all needs and will have a completed list with the estimated projected costs during Fiscal Year 2008. It is estimated that the City's deferred maintenance and capital needs, excluding the Water and Wastewater enterprises, may be at least \$800 to \$900 million.

The forecast for addressing the City's deferred maintenance needs in Fiscal Year 2008 assumes that \$5.3 million will be spent on facility repairs and improvements, all of which will be paid in cash. Additionally, \$33 million will be spent in Fiscal Year 2008 to address the deferred maintenance of the City's storm drains and streets. The City's formula for financing storm drain and streets maintenance assumes that 25 percent of costs will be paid in cash while the remaining 75 percent will be financed.

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In summary, the Fiscal Year 2008 Annual Budget includes \$38.3 million in additional funding to accomplish these projects, of which \$13.6 million will be paid in cash and the remaining \$24.7 million financed.

## Addressing Rising Retiree Health Care Costs

The City continues to experience financial pressure from the rising costs of retiree health care. Under the terms mandated by the Governmental Accounting Standards Board (GASB 45), public agencies across the country, including the City, will be required to report and record this liability on an actuarial basis in its financial statements. The Fiscal Year 2008 Annual Budget continues to include funding for these costs on a 'pay-as-you-go' basis, the base cost being \$23.0 million for the fiscal year. The budget also includes an additional \$25.0 million payment toward a trust fund to cover the future liability for retiree health driven in part by escalating health care costs. It is expected that the trust fund will be established in Fiscal Year 2008.

## Meeting New Storm Water Runoff Requirements

Compliance with new Storm Water Runoff regulations associated with new permits has created a large impact on the City's budget. Preliminary estimates show that it will cost the City an additional \$18.0 million in Fiscal Year 2008 to comply with the public education and monitoring requirements and this amount has been included in the Fiscal Year 2008 Annual Budget. The full impact of these regulations on the City's finances in future years is still being analyzed.

## Compliance with the Americans with Disabilities Act

The Americans with Disabilities Act (ADA) went into effect in 1990, requiring public and private agencies to make facilities and infrastructure universally accessible. ADA improvements are permanent improvements to public sidewalks and facilities and include additional capital projects such as the installation of audible signals at intersections. Similar to the City's deferred maintenance situation, very little funding has been put toward meeting ADA requirements. To address this important obligation, the Fiscal Year 2008 Annual Budget includes an additional \$10 million anticipated from the City's real estate sales for ADA-related improvements, in addition to existing Community Development Block Grant funding or other funding allocated for this purpose.

## Building the Workers' Compensation Reserve Fund

Workers' compensation liabilities continue to grow and the City needs to establish sufficient reserves to cover increases in these liabilities. The City has approximately \$150 million in outstanding workers' compensation claims and \$18 million in reserves. This is far short of what should reasonably be expected for the size of the liability; if the City would be required to make a large payout on a claim, there would be a significant impact on General Fund services. By establishing an acceptable reserve level, the City will provide better protection against adverse impacts to General Fund services as a result of these liabilities. The City will begin to fund reserve levels as outlined in the Five-Year Financial Outlook. The Fiscal Year 2008 Annual Budget includes \$26.1 million to cover only the projected annual costs.

## Building the Public Liability Reserve Fund

Similar to workers' compensation liabilities, the City has public liabilities that fluctuate year over year. Any excessive payouts for public liability claims would create a negative impact on General Fund services. The City has approximately \$100 million in potential public liability claims with no reserves. The establishment of a sufficient reserve would insulate General Fund services from a detrimental payout if the City were found liable in a claim. The Fiscal Year 2008 Annual Budget includes \$5.0 million in new funding for a total of \$18 million that includes \$13 million for projected annual costs.

## Cumulative Budget Impact

The Five-Year Financial Outlook projected that after the City meets the Fiscal Year 2008 funding needs presented in the eight significant areas and continues to support core City services such as public safety, parks, libraries, and other essential services, General Fund expenditures would exceed revenues by \$87 million without any corrective actions. The Five-Year Outlook further outlined corrective actions that have been implemented in the Fiscal Year 2008 Annual Budget along with additional savings achieved through streamlining efforts, position reductions and a lower than expected Annual Required Contribution (ARC) to SDCERS.



The projected cumulative budget impact for all City funds in the Five-Year Financial Outlook from the eight significant areas described above totaled \$108.3 million; the projected impact to the General Fund totaled \$94.1 million. The actual impact in the Fiscal Year 2008 Annual Budget totals \$94.9 million for all City funds and \$66.2 million for the General Fund. One factor that contributes to the decrease in the projected budget impact is the reduction in the legally required pension contribution computed by the SDCERS' actuary. The amount budgeted in Fiscal Year 2008 is \$165 million for the ARC, ARC Plus, and the retiree health payback, compared to the projected amount of \$198.7 million in the Five-Year Financial Outlook. In addition, parts of the City's contributions toward deferred maintenance and the ADA compliance have not changed from the original projections but were budgeted in the Capital Improvements Programs Budget instead of the General Fund.

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**Table 1** compares the original projections in the Five-Year Financial Outlook and the Fiscal Year 2008 Annual Budget.

<b>TABLE 1</b> <b>ToTAL CiTy CuMuLAtivE BuDgET IMPACT</b> <b>FuNDINg FoR ElgHT SlgNIFICANT AREAS</b> <b>(IN MILLIoNS)</b>				
	FY 2008 Projected in Outlook		FY 2008 Annual Budget	
	All Funds	General Fund	All Funds	General Fund
ARC Plus <sup>(1)</sup>	\$ 27.0	\$ 20.8	\$ 20.0	\$ 15.0
Reserves <sup>(2)</sup>	7.4	7.4	3.3	3.3
Deferred Maintenance <sup>(3)</sup>	15.7	15.7	13.6	8.3
OPEB	25.0	17.0	25.0	16.6
Storm Water Runoff Compliance	18.2	18.2	18.0	18.0
ADA Compliance <sup>(4)</sup>	10.0	10.0	10.0	-
Workers' Compensation Fund	-	-	-	-
Public Liability Fund	5.0	5.0	5.0	5.0
<b>Total</b>	<b>\$ 108.3</b>	<b>\$ 94.1</b>	<b>\$ 94.9</b>	<b>\$ 66.2</b>

<sup>(1)</sup> The ARC Plus contribution is less than the original projection due to the updated (lowered) contribution to pay down the Unfunded Accrued Actuarial Liability as computed by the San Diego City Employees' Retirement System actuary.

<sup>(2)</sup> The Fiscal Year 2008 annual contribution to the Unappropriated Reserve is lower than the original projection in the Outlook based on the Fiscal Year 2008 estimated beginning balance for the General Fund Reserves and actions taken in adopting the Fiscal Year 2008 Annual Budget.

<sup>(3)</sup> The cash contribution to deferred maintenance has been budgeted as follows: \$8.3 million in General Fund and the remaining \$5.3 million in the Capital Improvements Program Budget. This amount does not include the \$24.7 million in financed deferred maintenance budgeted in the Capital Improvements Program Budget.

<sup>(4)</sup> \$10 million for ADA compliance has been budgeted in the Capital Improvements Program Budget.

The Fiscal Year 2008 Annual Budget provides funding for seven of the eight significant areas and demonstrates the Mayor's commitment to the implementation of the Five-Year Financial Outlook to restore and maintain the City's sound financial structure.

## Corrective Actions Incorporated into the Fiscal year 2008 Annual Budget

In order to achieve a balanced budget, several solutions from the Five-Year Financial Outlook have been implemented in the Fiscal Year 2008 Annual Budget. **Table 2** shows the description of corrective actions between the original projections in the Five-Year Financial Outlook and the estimates included in the Fiscal Year 2008 Annual Budget.



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<b>TABLE 2</b> <b>FISCAL yEAR 2008 ANNuAL BuDg ET Co RRRECTivE ACTIo NS</b> <b>To TAL CiTy</b>		
	FY 2008 Projected in Outlook	FY 2008 Annual Budget (In Millions)
<b>TOTAL EXPENDITURE SAVINGS*</b>		\$ 48.3
*The savings is the result of the total City net reduction of 629.71 FTEs (Five-Year Financial Outlook Projection - 671.34 FTEs)		
<b>FISCAL YEAR 2008 ANNUAL BUDGET CORRECTIVE ACTIONS</b>		
	FY 2008 Projected (In Millions)	FY 2008 Annual (In Millions)
Net Reduction of 259.69 FTEs (312.8 FTEs in Five-Year Financial Outlook)	\$ 25.1	\$ 16.0
Employee Benefit Adjustments/Furlough	\$ 4.3	\$ 1.0
Debt Refinancing (PETCO Park)	\$ 3.8	\$ 3.7
Reallocation of Transient Occupancy Tax	\$ 6.0	\$ 6.9
<b>Budget Clean-up</b>		
Corrected GGSB (General Government Services Billing)	\$ 3.2	\$ 5.8
Inactive Fund Balances	\$ 2.1	\$ 2.1
Release of Encumbered Funds	\$ 3.0	\$ 3.0
<b>Leveraging City Assets</b>	\$ 15.3	\$ 15.3
<b>Managed Competition</b>	tbd	tbd
<b>TOTAL CORRECTIVE ACTIONS</b>	\$ 62.8	\$ 53.8

## Position Reductions – \$48.3 Million

A total of 629.71 FTE positions outlined in the Mayor’s Five-Year Financial Outlook have been eliminated in the Fiscal Year 2008 Annual Budget for total salary and benefit savings of \$48.3 million. The total net reduction of 629.71 FTE positions in the Fiscal Year 2008 Annual Budget includes the reductions related to Business Process Reengineering as well as reductions of middle management and supervisory positions.

The Financial Outlook targeted a total of 671.34 FTE position reductions: 312.80 FTE position reductions in the General Fund and 358.54 FTE positions in other funds. The Fiscal Year 2008 Annual Budget reflects a total reduction of 629.71 FTE positions: 259.69 FTE positions in the General Fund, for a savings of \$16 million, and 370.02 FTE positions in other funds, for a savings of \$32.3 million in Fiscal Year 2008 and future years. The change from the Financial Outlook target of 671.34 FTE position reductions and the actual FTE reductions is due to positions adjustments recommended by the Mayor and City Council in adopting the Fiscal Year 2008 Annual Budget.

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## Debt Re. nancing (PETCO Park) – \$3.7 Million

On January 30, 2007, the City Council authorized the issuance of lease revenue bonds to refund the previously issued Ballpark Project bonds. The annual debt service on the refunding bonds is \$11.3 million for Fiscal Years 2008–2032, which translates into savings of approximately \$3.7 million annually for the General Fund.

## Reallocation of Transient o ccupancy Tax (To T) – \$10.6 million

The Fiscal Year 2008 Annual Budget allocates \$10.6 million, which is slightly less than the one cent per dollar of the discretionary TOT revenue that is allowable to be redirected to the General Fund. This is in accordance with Council Policy 100-3, which stipulates that up to one cent of every 10.5 cents collected from TOT can be allocated for any purposes approved by the Mayor and City Council. The savings are primarily comprised of the expected savings from the PETCO Park bond refinancing (\$3.7 million) described above, rate stabilization reserve adjustment (\$1.8 million), and TOT revenue growth (\$5.1 million). A total of \$15 million in discretionary TOT revenue was allocated to the General Fund in the Fiscal Year 2008 Proposed Budget and was reduced to \$10.6 million in the Fiscal Year 2008 Annual Budget due to budget adjustments recommended by the Mayor and City Council.



The San Diego Lodging Industry Association (LIA) and the San Diego County Hotel/Motel Association proposed a 2.0 percent assessment on nightly hotel room rentals to the Tourism Marketing District (TMD) with the purpose of creating funding for the marketing of San Diego to potential visitors. If approved, the TMD would raise approximately \$24.0 million annually. The TMD proposal would offset \$10 million annually in funding for organizations that are currently funded by the City for marketing

and tourism promotion. This offset was budgeted in the Fiscal Year 2008 Proposed Budget, but was subsequently removed in adopting the Fiscal Year 2008 Annual Budget. The TMD proposal is expected to be brought before the City Council in the fall of 2007 and, if the ordinance is passed, it is subject to approval by members of the LIA. Any budgetary savings from the passage of the TMD ordinance would be realized in the Special Promotional Programs budget.

## **general government Service Billing (g g SB) – \$5.8 Million**

The City's General Fund pays for basic City services such as public safety, parks, and libraries. In addition, the City allocates the costs associated with central service departments, such as Auditor and Comptroller, City Attorney, City Clerk, and Financial Management to all City departments by means of a rate based on the General Government Services Billing (GGSB) standard. The amounts allocated to Non-General Fund departments are billed and received into the General Fund as revenue to offset the cost of the services provided by these central service departments. In reviewing the allocation of Citywide costs, it was determined that the City's General Fund inappropriately supports the total cost of several departments, including the Offices of the Mayor, City Council, the Chief Operating Officer, and similar support services. Based on the GGSB standard, it was determined that the General Fund is currently paying more annually than its appropriate share. Implementing this corrective action has a net zero effect on the City's total budget; however, the increased revenue to the General Fund provides direct relief to the City's operations funded by taxes. The Fiscal Year 2008 Annual Budget includes \$5.8 million in revenue from the GGSB.

## **Leveraging City Assets – \$15.3 Million**

The Real Estate Assets Department has identified properties for sale that will generate one-time revenue. To comply with the City Charter, revenues generated from the sale of public property will be used for funding of capital improvement projects. The Fiscal Year 2008 Annual Budget includes \$15.3 million in revenue from the sale of public property which has been budgeted in the Capital Improvements Program Budget to fund ADA and capital improvements for City-owned facilities.

## **Other Adjustments**

An estimated \$1 million in savings from the health care reform was added to the Fiscal Year 2008 Budget (the savings were estimated prior to the completion of the employees' health care enrollment). A mid-year budget adjustment will be requested if enrollment proves that additional savings are realized. The health care reform was part of the labor negotiations in Fiscal Year 2007 for the Police Officers' Association (POA), Local 145, and Deputy City Attorneys' Association (DCAA). In addition, the reform also covers unclassified and unrepresented City employees.

The Office of the City Auditor and Comptroller will release inactive fund balances and aged encumbered funds (projected to be \$2.1 million and \$3.0 million, respectively, in the General Fund). As a result, the General Fund Reserve will have a one-time increase to the fund balance of approximately \$5.1 million.

## **Service Level Impacts**

A net total of 629.71 FTE positions citywide have been eliminated in the Fiscal Year 2008 Annual Budget, one of the key corrective actions outlined in the Mayor's Five-Year Financial Outlook. A reduction in service levels is not anticipated since the majority of these positions have been vacant for a significant period of time or they were eliminated as a result of Business Process Reengineering.

A portion of the 629.71 FTE positions being eliminated are a result of reduction in expenditures that General Fund departments were requested to make in order to balance the budget in Fiscal Year 2008. The General Fund departments identified solutions to close the projected General Fund budget gap of approximately \$25 million between projected expenditures and revenues. Departments proposed

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expenditure reduction plans of either 4 percent or 10 percent, depending on whether departments had undergone BPR (4 percent for departments having gone through the BPR process and 10 percent for departments that had yet to begin the BPR process). As a result of this process, 22.00 of the 629.71 FTE positions were eliminated. The full effect of all position reductions are difficult to gauge at this time, although no program or facility closures are expected as a result of these position reductions.

## Funding of Positions for New Facilities

The Five-Year Financial Outlook included funding for several new facilities and the annualization of budgeted staff for existing facilities. These facilities were funded in the Fiscal Year 2008 Annual Budget and include 4.50 FTE civilian positions funded at \$300,000, 19.00 FTE sworn positions (unfunded), and approximately \$1.2 million in non-personnel support for the Northwestern Area Police Station for a total of \$1.5 million of new operating funds. Funding for the 19.00 FTE sworn positions may be included in Fiscal Year 2009 Budget.

The Fiscal Year 2008 Annual Budget achieves the goal of the City's comprehensive Five-Year Financial Outlook. It provides funding for many areas that have been either ignored or under funded in the past. The City's adherence to its Five-Year Financial Outlook demonstrates continued commitment to build a solid fiscal foundation for the provision of core services to the residents of San Diego.