THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA's Review of the Interim Mayor's Financial Outlook for FY 2015 - 2019

OVERVIEW

On November 14, 2013 Interim Mayor and Council President Todd Gloria released his Five-Year Financial Outlook (Outlook) for FY 2015-2019, marking the eighth Outlook issued since formation of the Strong Mayor-Strong Council form of government. This Outlook is the first to be issued under a new Executive Branch administration since Mayor Sanders' term of office ended in December 2012. Since August 2013, the new administration has been led by Interim Mayor and Council President Todd Gloria who will serve in this capacity until a new Mayor takes office in March of 2014. Despite the upcoming change in administrations, this Outlook will likely remain in effect until the new administration releases an updated Outlook anticipated to be no later than November 2014. Principle No. 5 of the City Council-adopted "Ten Principles for an Effective, Cooperative and Efficient Government" calls for the Mayor to present to Council no later than November of each fiscal year a financial outlook that includes projected revenues and committed expenditures for a five-year outlook period. Following are the major themes of our review which are discussed in greater detail in this report.

<u>New Outlook Raises Bar on Transparency and Disclosure</u>

Most importantly, this Outlook is notable for its transparency and full disclosure of relevant and informative budget information, much of which has not been made available in the past to the public, and in some cases, the City Council and Independent Budget Analyst. In this document, the reader will find for the first time the full range of department-identified funding needs for the five-year period rather than an Outlook confined to a Mayoral agenda. Our office has advocated for several years for the Outlook to include a list of priority departmental needs. While it is made clear in the Outlook that funding all of the requests will not be possible based on current revenue projections, it is important for the Council to be aware of what department experts see as the most critical needs facing the City, as budget priority memos are developed and important annual funding decisions are made. This information is also of value to the public as it allows residents to weigh the numerous competing priorities and effectively participate in the annual budget process. This Outlook has raised the transparency and disclosure bar for future Outlooks.

IBA Revised Baseline Budget and Projected Outlook Deficits/Surpluses

The sheer volume of information, however, together with the four levels of priorities, does pose a challenge in that the Outlook could benefit from a clearer policy direction and a course of action for moving forward. Given the vast funding needs and the limited resources available to fund them, clear priorities and solutions for addressing these four levels would be useful. A portion of our review and analysis of the new Outlook focused on reviewing and understanding the categories of funding priorities proposed by the administration. Throughout our review we observed some inconsistencies in the categorization of funding requests between the Outlook's four priority levels which include the Baseline Budget; Mandated Revenues and Expenditures; Critical Operational Needs; and Discretionary Operational Needs.

As a result, we have revised the Outlook's Baseline Budget considerably to incorporate the following non-discretionary items that we believe will need to be or should be funded over the Outlook period:

- Numerous items from the Outlook's Mandates section such as Federal and State mandates
- Operating costs for all new facilities expected to come on line during the Outlook period
- City commitments such as enforcement of recent Council- approved ordinances (e.g. Prevailing Wage) and the Animal Services contract with the County
- General Fund support of the Police Air Support Unit, which cannot rely on outside funding sources
- Items related to community safety such as repairs to playground equipment
- Projects currently underway that need to be completed – such as the public safety interoperable radio system

We have also made adjustments on the resource side including increasing projections for property tax and sales tax revenues as a result of our analysis, and including anticipated office lease savings and information technology (IT) savings from a reduction in capital lease debt service. We believe this realignment of core Baseline expenditures results in a more realistic "bottom line" deficit / surplus projection for each year of the Outlook as shown in the following table:

$ in millions	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Outlook Baseline Budget Surplus / (Deficit)	$ (19.1)	$ 13.1	$ 47.2	$ 73.0	$ 104.0
IBA Revised Baseline Budget Surplus / (Deficit)	$ (34.1)	$ (7.6)	$ 31.8	$ 55.9	$ 80.6

The details of the adjustments we have made to the Baseline are discussed later in our report and can be found in the chart on pages 32 – 33 and in Attachment One.

IBA Recommended Critical Services and Operational Needs, Beyond the Baseline

After revising the Baseline Budget, we reviewed all of the funding needs remaining in the Mandates, Critical Operational and Discretionary Operational categories of the Outlook. Based on this review, we have developed a second priority funding level which includes critical service enhancements, public safety plans from the Mandates section, the infrastructure funding plan, Penny for the Arts, as well as items from both the Critical Operational and Discretionary Operational categories that support the implementation of these service enhancements. An example is including the costs for condition assessments in this funding level, recognizing that they are important for addressing infrastructure needs. For consistency and clarity, we have included all adopted or pending Public Safety plans as well as priority components of the plans on our critical list. In the Outlook, full funding for the Five-Year Police Plan is included in Mandates, while Fire Citygate and Lifeguard plans are spread across three priority categories. The specific funding needs included in our Recommended Critical Services and Operational Needs are discussed in detail later in our report and can be found on the chart on page 35 and in Attachment Two.

What Happened to the Library Appropriation Ordinance

As Council considers the Outlook's inclusion of fiscal impacts of recently adopted operational plans (such as those for Police, Citygate Fire, Lifeguards), adopted funding plans (including Penny for the Arts and Infrastructure plans) and recent ordinances (Prevailing Wage, Neighborhood Parking Protection, Property Value Protection, etc), it may be useful to consider the City's approach to past Council approved plans. As an example, the Library Appropriation Ordinance, approved by Council in 2002, requires the Library Department's budget be equal to 6 percent of the General Fund's budget each fiscal year.

This legislation's intent is clearly well meaning, and emphasizes the importance of funding basic neighborhood services. However, the ordinance's funding requirements have been waived each year since 2004, as the set funding level required by the ordinance is not always appropriate in all fiscal years. Library funding today represents 3.6 percent of the General Fund budget; an additional $29.7 million would be necessary to bring library funding up to the 6 percent 'mandate' in the Library Ordinance.

We note that while the Outlook calls out several other similar legislatively-adopted expenditures as mandates, it does not include the Library Ordinance's requirements; indeed, no Outlook since 2007 has included its funding requirements. Given this, we do not agree that all operational plans, funding plans, and funding requirements prescribed by ordinances should be considered *mandated* funding. While these costs do represent critical needs and services, the overall level of funding dedicated to them each year is discretionary and based on the availability of funding and balancing numerous important and competing community-wide needs. The Public Safety, Penny for the Arts and Infrastructure plans are desired policy goals, and the amount of funding allocated to enforcing those plans and ordinances is ultimately discretionary. As Council reviews the Outlook, it is worth considering the Library Ordinance as an example of how funding needs and priorities change over time, and how earmarking General Funds or mandating specific funding levels for plans is often neither feasible nor desirable.

Identifying a Comprehensive, Long Range Solution for Infrastructure Funding

Our review of this year's Outlook confirms what our office has been discussing for several years, that new revenue sources will soon need to be identified to fund our vast deferred capital and infrastructure needs. The City has critical infrastructure deficiencies (public safety facilities, streets and sidewalks, storm water infrastructure and other facilities) that must be incrementally financed over time. New long-term sources of revenue must be developed in order to satisfactorily address these critical capital needs going forward. Potential new sources of revenue will likely require increased service fees and/or voter approval.

Motivated by a desire to avoid increased service fees and/or assessments to citizens, the City has used General Fund backed lease revenue bonds (which do not require voter approval) as its primary means of financing critical projects for the last 20 years. As discussed later in this report, the continued exclusive use of lease revenue bond borrowing is not sustainable or recommended. Given imminent limitations associated with lease revenue bond financing and the magnitude of critical infrastructure needs on the City's horizon, the IBA believes the City must consider pursuing alternative sources of revenue for projects.

In FY 2015, approximately 26 percent of the City's General Fund is committed to payments on long-term obligations (long-term Annual Required Contribution and Other Post-Employment Benefits payments coupled with the City's other existing debt service obligations). Unless the City can develop other sources of revenue in future years, this percentage will continue to grow and further constrain the City's General Fund. Increased long-term payment obligations will not only reduce the General Fund's ability to fund existing services, but also hamper its ability to address the inevitable array of unanticipated future needs and priorities.

Reassessing the General Fund Reserve Policy

The Outlook raised policy questions relative to the City's General Fund Reserve. While our current policy goal for the General Fund Reserve is 8.0 percent of General Fund revenues, the Outlook shows the reserve far in excess of the 8.0 percent policy for every year of the Outlook period. Beginning in FY 2015 the ending reserve balance as a percent of revenues is 14.6 percent or $80.8 million in excess of the Reserve Policy, and it declines slightly each year to 12.6 percent in FY 2019, $51.5 million over policy requirements. Should the Outlook General Fund Reserve match to our current policy of 8.0 percent? What is an appropriate reserves policy goal for our City? What is the potential impact on our bond ratings? What is the most prudent approach - maintaining fund balance in the reserve in excess of policy or freeing up some of the excess funds for critical one-time infrastructure costs? Alternatively, it has been suggested by the San Diego Municipal Employees Association (MEA) that excess fund balance over current policy could be used to meet other reserve goals now, such as for the Worker's Compensation reserve, which would avoid General Fund contributions over the next several years.

In response to a request from the Committee on Budget and Government Efficiency, we have reviewed MEA's suggestion to utilize excess reserve funds to meet goals for other City reserves. We offer one possible scenario for discussion purposes only based on the following: 1) increasing the policy goal from 8.0 percent of revenues to 12.0 percent and 2) using excess one-time reserve funds to accelerate achieving the Workers' Compensation Reserve policy goal, which would in turn free up future General Fund contributions. We also discuss the alternative of spending one-time funds on critical infrastructure needs for storm water compliance which are currently unfunded. This is discussed in detail later in our report. This policy issue will be considered at the Committee on Budget and Government Efficiency during the first quarter of calendar year 2014.

Retirement/Pension

Questions have also been raised by MEA about the pension ARC numbers reflected in the Outlook and whether they should be reduced to take into account investment gains in excess of the assumed rate of return in FY 2013. After considering this matter, we concur with the approach Financial Management has used to reflect the ARC in the Outlook. While this investment gain in isolation would have the impact of decreasing the ARC, an investment gain or loss is not the only type of experience gain or loss that could occur. The impact of demographic experience (including turnover, retirement, death and disability) is not yet known and could have the effect of offsetting investment experience gains. Since the total of all effects on the ARC is unknown, we believe that the prudent approach is to use the numbers we know at this time, as reflected in the Outlook. The complete June 30, 2013 valuation will incorporate not only the FY 2013 investment result but all experience gains and losses and will determine the FY 2015 ARC. This information will be available in January 2014. This issue is also discussed in greater detail later in our report.

Major General Fund Revenues and Expenditures

In our review of the Outlook's major revenue categories (property tax, sales tax, transient occupancy tax, and franchise fees), we have recommended upward adjustments that have been incorporated into the IBA Revised Baseline for both property tax and sales tax revenues. We have reviewed all other major revenues and agree with the projections included in the Outlook and have specifically identified any items of note for other general fund revenues in the General Fund Revenues section of this report. Additionally, we have reviewed the projections included in the Outlook for major expenditure categories and believe that they are reasonable based on current information. We have also provided additional detail beyond that included in the Outlook for significant programmatic General Fund expenditures.

The following sections discuss all of these matters, and provide a detailed analysis of General Fund Revenues and Expenditures as presented in the FY 2015-2019 Five-Year Financial Outlook.

REVIEW OF GENERAL FUND REVENUES

Economic Overview

Local improvement in economic indicators include both residential and commercial properties, employment, personal income levels, and total consumer spending. The median San Diego County home price has increased 36 percent from the low experienced in 2009 and has increased for six consecutive quarters. Beacon Economics forecasts continued growth in the median home price, averaging approximately 7 percent growth per fiscal year until the end of their outlook period in calendar year 2018 with total residential construction permits averaging approximately 18 percent growth per fiscal year over the same time.

Local and Statewide employment have continued to improve, which has consequently increased consumer spending. This is evidenced by year-over-year increases in both sales tax and transient occupancy tax revenues received by the City. Beacon Economics' latest forecast for San Diego County projects a sustained decline in the unemployment rate, from the current 7.0 percent unemployment rate to 4.6 percent by the end of calendar year 2018. UCLA Anderson's California economic outlook also forecasts a continued decline in the Statewide unemployment rate to 6.9 percent at the conclusion of their outlook period at the end of calendar year 2015.

With both a strong economic improvement over the last number of fiscal years in addition to a forecasted continuation of this progress, growth in major revenues and an overall increase in General Fund revenues can be projected. However, local economic uncertainty still exists with any potential impacts to local military and Federal government employment, which encompasses a significant portion of local jobs and spending, due to sequestration and the continued potential for a temporary government shut down. Other risks such as the invalidation of the Convention Center Financing District or the Tourism Marketing District, the potential for natural disaster in Southern California, impacts due to any State of California actions, or any general economic downturn will have an unknown but potentially significant impact on projections utilized in this Outlook.

General Fund Revenues

Revenue Source *(in millions)*	FY 2013 Unaudited Actuals	FY 2014 Budget	FY 2014 Revised	FY 2015 Forecast	FY 2016 Forecast	FY 2017 Forecast	FY 2018 Forecast	FY 2019 Forecast
Property Tax	$ 412.2	$ 408.0	$ 454.0	$ 424.1	$ 439.2	$ 452.7	$ 466.5	$ 480.7
Sales Tax	232.9	248.1	248.5	255.6	265.3	274.7	283.8	293.2
Transient Occupancy Tax	83.9	87.9	87.6	92.4	97.0	108.5	113.6	118.9
Franchise Fees	67.7	68.4	68.6	70.3	72.3	74.2	76.2	78.2
Other Revenue	387.3	390.6	392.2	373.8	388.3	404.0	416.5	429.4
Total GF Revenue	**$ 1,184.0**	**$ 1,203.0**	**$ 1,250.9**	**$ 1,216.2**	**$ 1,262.1**	**$ 1,314.0**	**$ 1,356.6**	**$ 1,400.4**
% Growth		**1.6%**	**4.0%**	**-2.8%**	**3.8%**	**4.1%**	**3.2%**	**3.2%**

The Five-Year Financial Outlook projects revenues to increase from FY 2014 budget levels of $1.20 billion to $1.40 billion in FY 2019, a total of $197.4 million or 16.4 percent over the Outlook period. Total General Fund growth ranges from 2.2 to 5.3 percent per year in the Outlook. The largest increase in FY 2017 is due to an increase in major revenue growth rates from a projected continuation of economic expansion in the region and revenue growth associated with the Convention Center expansion beginning in that fiscal year. As in previous Outlooks, total revenue growth is generated by increases in the City's four largest major revenues: property tax, sales tax, transient occupancy tax, and franchise fees. Growth in these four major revenues accounts for $158.7 million or 80.4 percent of this total increase in revenues over the Outlook period. Growth in each major revenue source is outlined in the following sections.

The FY 2014 revised forecast incorporates the latest revenue distributions during the current fiscal year to establish an updated year-end projection and base budget utilized in the Outlook. The revised forecast includes updated projections for all four major revenues, with the largest change coming from property tax revenue due to a $34.8 million one-time revenue distribution due to the residual property tax receipts from the City's Non-housing Due Diligence Review (DDR) payment. Additional changes in revenue projections in the base budget include changes in property transfer tax, safety sales tax, and Mission Bay rental revenues, among others. Additionally, the FY 2015 forecast in the Outlook also excludes $21.7 million in one-time revenues that were included in the FY 2014 Adopted Budget and revised forecast.

Property Tax

Revenue Source *(in millions)*	FY 2014 Adopted Budget	FY 2014 Adjusted Base	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Property Tax Included in Outlook	$ 408.0	$ 417.7	$ 424.1	$ 439.2	$ 452.7	$ 466.5	$ 480.7
5 Year Outlook Growth Rate			3.5%	3.5%	3.0%	3.0%	3.0%

The Outlook anticipates that property tax revenue from assessments will grow 3.5 percent in FY 2015 and FY 2016 from an adjusted FY 2014 base (which reflects revenue changes outlined in the First Quarter Budget Monitoring Report), then declining slightly to 3.0 percent growth per fiscal year for the remainder of the Outlook period. The Outlook property tax projection is comprised of two separate revenue sources that have different growth rates for each fiscal year. The growth previously discussed is only utilized in property tax projections for the City's 1.0 percent assessment in addition to the motor vehicle license backfill (MVLF) fee. These growth rates do not apply to property tax revenue receipts due to distributions from the Redevelopment Property Tax Trust Fund (RPTTF). Analysis for property tax growth from the City's 1.0 percent assessment and MVLF backfill is discussed separately from RPTTF revenues below.

1.0 Percent and MVLF Backfill

Assumed in property tax projections is the steady growth in the residential and commercial real estate markets with increases in regional median home prices, home sales, and in the California Consumer Price Index (CCPI) for Proposition 13 assessment growth. According to the October 2013 Beacon San Diego Economic Forecast, median home prices and single family home sales will continue to improve within the County. Beacon forecasts that the growth in both residential and commercial will be robust in FY 2015 and declining marginally in each of the remaining fiscal years of the Outlook period. Projections for FY 2019 continue to show growth; however, the forecast period by Beacon ends at calendar year 2018, which is half-way through the fiscal year. Beacon forecasts the following changes in the County-wide residential and commercial real estate markets for the Outlook period:

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019 *
Nonresidential Permit Values	9.8%	7.3%	8.2%	7.7%	1.6%
Residential Permits	32.0%	26.6%	15.9%	12.4%	2.4%
Single-Family Home Sales	3.8%	2.4%	0.2%	-0.1%	0.1%
Median Home Price	6.7%	5.0%	4.8%	4.7%	2.4%

** First half of FY19 vs. first half of FY18*

This local forecast by Beacon supports continued strong growth for the Outlook period, and perhaps above the forecasted growth rate for this property tax revenue source included in the Outlook. Property tax revenue growth has averaged 5.4 percent per fiscal year from FY 1999 to the adjusted base for FY 2014 property tax projections[1]. This historical period includes both times of significant economic expansion and recession. The Outlook growth rates for property tax revenue are well below this average; however, the potential increase in interest rates during the Outlook period, sequestration cuts, and global economic effects may impact growth in future years. Our office considers it reasonable to increase the annual growth rate of property tax revenues to 4.0 percent per fiscal year to reflect the projected growth in the residential and commercial real estate markets and the historical long-range growth rate of property tax revenue, tempered by the impacts of potential and unforeseen economic conditions. The fiscal impact from this adjustment to the projection is as follows:

Revenue Source *(in millions)*	FY 2014 Adopted Budget	FY 2014 Adjusted Base	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Incremental Revenue from 4.0% Growth Adjustment			$ 1.5	$ 3.1	$ 6.3	$ 9.9	$ 10.2

In addition to increasing the projected property tax growth rate for the Outlook period, our office has made two changes to portions of the projected property tax calculations for each fiscal year. These adjustments include adjusting beginning total secured receivables and payments made by the State for use of City rights-of-way in FY 2014 to reflect figures published by the County of San Diego Assessor's Office (which doesn't significantly impact FY 2014 projections, but affects outer years of the Outlook period) and adjusting growth assumptions for delinquent payments of property tax bills in each year of the Outlook. The fiscal impact from these adjustments to the projection are as follows:

Revenue Source *(in millions)*	FY 2014 Adopted Budget	FY 2014 Adjusted Base	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
IBA Property Tax Projection Adjustments			$ (3.2)	$ (4.0)	$ (4.4)	$ (4.6)	$ (4.8)

RPTTF Payments

Revenue Source *(in millions)*	FY 2014 Adopted Budget	FY 2014 Adjusted Base	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Additional RPTTF Residual Revenue for Outlook	$ 8.2	$ 9.2	$ 5.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0

Per the dissolution of California redevelopment agencies (RDA) in February 2012, the City receives additional property tax revenue from the RPTTF (formerly tax increment), including both tax sharing and residual payments in association with each Recognized Obligation Payment Schedule (ROPS) period. The Five-Year Outlook includes $3.0 million annually for tax-sharing payments which the City is guaranteed to receive; however, Financial Management did not include the residual distributions because these are based on a number of factors and difficult to accurately project. The actual residual distribution to the City was $8.5 million in FY 2013 from ROPS 3 and 4. We are including a conservative projection of $5.0 million annually in residual payments over the five years of the Outlook. These distributions are anticipated to increase over

[1] For the 1.0 percent property tax revenue category since the MVLF backfill was introduced in 2005. MVLF revenue has grown at an average rate of 5.0 percent from the first "normalized" payment in FY 2006 to the actual payment remitted to the City in FY 2014. (City of San Diego reported CAFR revenues)

time as various enforceable obligations are paid off and the total assessed property values in the redevelopment project areas are increased.

The total impact to property tax revenue projections based on these three changes is as follows:

Revenue Source *(in millions)*	**FY 2014 Adopted Budget**	**FY 2014 Adjusted Base**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Property Tax Included in Outlook	$ 408.0	$ 417.7	$ 424.1	$ 439.2	$ 452.7	$ 466.5	$ 480.7
5 Year Outlook Growth Rate			3.5%	3.5%	3.0%	3.0%	3.0%
Incremental Revenue from 4.0% Growth Adjustment			$ 1.5	$ 3.1	$ 6.3	$ 9.9	$ 10.2
IBA Property Tax Projection Adjustments			$ (3.2)	$ (4.0)	$ (4.4)	$ (4.6)	$ (4.8)
Additional RPTTF Residual Revenue for Outlook	$ 8.2	$ 9.2	$ 5.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0
Adjusted Outlook Property Tax Projection			$ 427.3	$ 443.3	$ 459.7	$ 476.7	$ 491.1
IBA Change to Outlook Baseline Budget			$ 3.2	$ 4.1	$ 7.0	$ 10.2	$ 10.4

Sales Tax

Revenue Source *(in millions)*	**FY 2014 Adopted Budget**	**FY 2014 Adjusted Base**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Sales Tax Included in Outlook	$ 248.1	$ 248.5	$ 255.6	$ 265.3	$ 274.7	$ 283.8	$ 293.2
5 Year Outlook Growth Rate			4.5%	4.0%	3.5%	3.5%	3.5%

The Outlook projects that sales tax revenues will grow by 4.5 percent in FY 2015, 4 percent in FY 2016, and 3.5 percent for FYs 2017-2019. Incremental increases of $768,310 are added in FY 2017 through FY 2019 to account for an anticipated boost in sales tax performance related to the Convention Center expansion. The Outlook broadly assumes an improved economy in the San Diego region, with increases in employment, personal income, an improving housing market, and increased spending.

These assumptions are supported by outside forecasts for regional employment and improving market conditions. Beacon Economics is forecasting that local unemployment will fall from its current 7.2 percent rate by 13.5 percent in FY 2015, 13.2 percent in FY 2016, 7.9 percent in FY 2017, and 2.2 percent in FY 2018, at which point the unemployment rate is predicted to remain steady at 4.6 percent. Personal income is also projected to increase by roughly 6 percent per year in FYs 2015-2018. Population is expected to increase by roughly 1 percent per year in FYs 2015-2018. These projections are sufficient to support a growth in taxable sales.

The Outlook's anticipated growth rates are also consistent with projections for increased taxable sales in the region performed by Beacon Economics and the City's sales tax consultant MuniServices, LLC. Beacon projects taxable sales to increase by 6.9 percent in FY 2015, 6.4 percent in FY 2016, 5.5 percent in FY 2017, and 4.6 percent in FY 2018. MuniService's projections of likely growth are slightly more conservative, at 4.7 percent in FY 2015, 3.6 percent in FY 2016, and 4.4 percent in FYs 2017-19. The projections in the Outlook are consistent with those forecast by MuniServices, and while they are slightly more conservative than other forecasts, they limit vulnerability to any slowdown in an improving economy.

We do propose some technical amendments to the model used in the Outlook that impact the actual dollar figures in anticipated sales tax receipts. As we noted in our review of the 2014 First Quarter Monitoring Report, the City will receive roughly $2.2 million less in revenue from the

Sales and Use Tax Compensation Fund (this revenue is commonly referred to as the triple-flip) than it had anticipated in the current fiscal year. That lost revenue will be recouped in FY 2015 during the prior year true-up process, and we include it in our modified projections. Additionally, the model used to create the projected revenues had intended to reflect a 1.35 percent annual increase in the State's costs for administering collection and distribution of sales taxes, which is deducted from the City's total sales tax revenue, beginning in 2015. However, that rate was inadvertently set at 13.5 percent. We have adjusted expected revenues accordingly, as is detailed below.

Revenue Source *(in millions)*	**FY 2014 Adopted Budget**	**FY 2014 Adjusted Base**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Sales Tax Included in Outlook	$ 248.1	$ 248.5	$ 255.6	$ 265.3	$ 274.7	$ 283.8	$ 293.2
5 Year Outlook Growth Rate			4.5%	4.0%	3.5%	3.5%	3.5%
Sales Tax - IBA Adjusted		$ 246.3	$ 258.2	$ 266.1	$ 276.1	$ 285.8	$ 295.8
IBA Baseline Budget		$ (2.2)	$ 2.5	$ 0.85	$ 1.4	$ 2.0	$ 2.6

Transient Occupancy Tax (TOT)

Revenue Source *(in millions)*	**FY 2014 Adopted Budget**	**FY 2014 Adjusted Base**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Transient Occupancy Tax 5.5cent	$ 87.9	$ 87.6	$ 92.4	$ 97.0	$ 101.8	$ 106.9	$ 112.2
Revenue from Conv. Ctr. Expansion (5.5cent only)					$ 6.7	$ 6.7	$ 6.7
Total 5.5cent Transient Occupancy Tax	$ 87.9	$ 87.6	$ 92.4	$ 97.0	$ 108.5	$ 113.6	$ 118.9
5 Year Outlook Growth Rate			5.5%	5.0%	5.0%	5.0%	5.0%

The Outlook projection for TOT includes revenue growth projections of 5.5 percent for FY 2015 and declining moderately to a 5.0 percent growth per year for FY 2016 through FY 2019. The projection for TOT revenue throughout the Outlook is based on an updated FY 2014 year-end forecast, $0.3 million below Adopted Budget levels due to a projected 5.7 percent growth in the current fiscal year as compared to the budgeted growth rate of 6.0 percent. The long-run growth rate for the 10.5 cent TOT rate for the City is 4.0 percent per fiscal year[2] and the FY 2014 year-end projection included in the First Quarter Budget Monitoring Report is only 4.4 percent growth from unaudited FY 2013 actual revenue.

However, as detailed in the Outlook, the Tourism Economics, Inc. forecast for each TOT growth indicator is positive year-over-year through CY 2017, including visitor growth, room demand, occupancy, etc. Additionally, growth over the last three fiscal years has been above both Outlook and historical long-range growth rates for TOT: FY 2011 – 12.5 percent; FY 2012 – 6.6 percent; and FY 2013 – 7.2 percent. Based on this contradictory information, our office is not proposing an adjustment to TOT included in the Outlook; however, we would note the following sensitivity issues to the projected TOT receipts: 1.) additional revenue due to the Convention Center expansion in FY 2017, 2.) San Diego Tourism Marketing District marketing reductions in FY 2013 and 2014; and 3.) a potential reduction in the growth rate of TOT to the long-range growth rate of 4.0 percent.

[2] Based on 1999 CAFR transient occupancy tax as compared to FY 2014 year-end projection

Convention Center Expansion

TOT in the Outlook for FY 2017 through 2019 includes an additional $12.7 million in projected revenues to be received by the City due to the proposed expansion of the convention center. This is the total 10.5 cent TOT projected revenue, so $6.7 million of this total amount is included in the Outlook for each fiscal year for the General Fund's 5.5 cent allocation. The additional revenue in these fiscal years is derived from the November 2010 AECOM report on the estimated financial impact of a comprehensive expansion of the convention center, comprised of new exhibit space, meeting spaces, ballroom expansion, and support spaces, among others. In our Office's sensitivity analysis of the revenue estimate (Report 12-02REV), we noted that the revenue estimate provided by AECOM may potentially be inflated and a lower revenue estimate of $5.2 - $9.7 million annually during these fiscal years may be more appropriate, or $2.7 – $5.1 million for the 5.5 cent General Fund allocation.

San Diego Tourism Market District Reductions

As noted in the Outlook and in IBA Report #13-52, the San Diego Tourism Marketing District (SDTMD), which controls and distributes Tourism Marketing District (TMD) revenues for marketing activities under an agreement with the City, has received only a small portion of total assessments in FY 2014. With the approval of the second amendment to the SDTMD operating agreement, approved by City Council on November 21, 2013 to release the majority of TMD funds, marketing activities will resume. However, it is currently unknown what impacts the delay in expanded marketing activities provided for by TMD funds will have on future TOT receipts, or if any positive impact to TOT receipts will occur due to the recommencement of marketing activities.

Combined Scenario

For illustrative purposes, the following table shows a scenario where the annual growth rate of TOT is reduced to 4.0 percent per fiscal year in addition to utilizing the lower-range for additional TOT from the convention center expansion in 2017. However, no impact for the delay in the release of TMD funding is included due to the difficulty in estimating any impact this may have over the Outlook period.

Revenue Source *(in millions)*	**FY 2014 Adopted Budget**	**FY 2014 Adjusted Base**	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Transient Occupancy Tax 5.5cent	$ 87.9	$ 87.6	$ 91.1	$ 94.7	$ 98.5	$ 102.5	$ 106.6
Revenue from Conv. Ctr. Expansion (5.5cent only)					$ 2.7	$ 2.7	$ 2.7
Total 5.5cent Transient Occupancy Tax	$ 87.9	$ 87.6	$ 91.1	$ 94.7	$ 101.2	$ 105.2	$ 109.3
Adjusted Growth Rate			4.0%	4.0%	4.0%	4.0%	4.0%
Revenue Differential From Outlook - 5.5 cent portion			$ (1.3)	$ (2.3)	$ (7.3)	$ (8.4)	$ (9.6)
Revenue Lost From Total 10.5 cent TOT			$ (2.5)	$ (4.3)	$ (13.9)	$ (16.1)	$ (18.4)

Potential Qualcomm Stadium Impact

The Qualcomm Stadium special revenue fund supports all operations at the stadium with revenue from operating activities such as Chargers football, San Diego State Aztec football, and other special events. However, the revenues from the stadiums operation fall short of operating expenditures, requiring a significant General Fund contribution from transient occupancy tax revenues. The FY 2014 projected required contribution of TOT funds to the Qualcomm Stadium special revenue fund is $10.2 million ($4.7 million in debt service payment and $5.5 million in operating support), which is an increase of approximately $1.7 million from FY 2012 due to increases in operating expenses.

In April 2011, AECOM and Magellan Consulting published a facilities condition assessment for Qualcomm Stadium, which detailed a $80.0 million requirement for facility repairs at that point in time. Over the last two fiscal years, approximately $10.3 million in TOT funds have been transferred to the Qualcomm Stadium special revenue fund to address these repairs. Despite this transfer of TOT revenue, the significant repair backlog at the stadium outlined the AECOM report will require to be addressed. This backlog could potentially require an increased TOT contribution based on needs at the stadium and negatively impact future fiscal year TOT revenue that is transferred back to the General Fund beyond the 5.5 cent allocation.

Franchise Fees

Revenue Source *(in millions)*	FY 2014 Adopted Budget	FY 2014 Adjusted Base	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Combined Franchise Fees in Outlook	$ 68.4	$ 68.4	$ 70.3	$ 72.3	$ 74.2	$ 76.2	$ 78.2
Combined 5 Year Outlook Growth Rate			2.7%	2.9%	2.6%	2.7%	2.6%

Franchise fees in the Outlook consist mainly of payments from San Diego Gas and Electric (SDG&E), cable providers, and refuse haulers. Overall, all combined franchise fees are expected to increase each year of the Outlook, as detailed above; individual rates are discussed in further detail below.

Cable Franchise Fees

Cable franchise fees currently constitute 28 percent of all franchise fees received by the City. The Outlook projects 3.5 percent annual increases in cable franchise fee revenue in each of the next five fiscal years. The projected 3.5 percent growth rate is consistent with the actual average annual growth rate in cable franchise fee revenue of 3.4 percent growth per year since 2008. While anticipating growth in this revenue source is reasonable given expected increases in population, there could be cause to modify this rate should the City experience a decline in the overall proportion of its population that maintains cable subscriptions.

SDG&E Franchise Fees

Franchise fees paid by SDG&E currently represent 52 percent of the total franchise fees received by the City. Projected revenue increases from the SDG&E franchise fee are 2 percent in FY 2015, 3 percent in FY 2016, 2.5 percent in FY 2017, 2.5 percent in FY 2018, and 2.5 percent in FY 2019. As these revenues are ultimately determined by erratic commodity rates and sales in the City, it is difficult to accurately predict any given year's revenue variance – in the past, these revenues have seen large single year increases (10.2 percent in FY 2009) and decreases (12.3 percent in FY 10). While the projected growth in San Diego's population size and the consumer price index are likely to increase demand and energy purchases, the volatility of this revenue source suggests that a conservative projected growth rate should be used.

Refuse Hauler/Sycamore Landfill Franchise Fees

Franchise fees paid by refuse haulers in the City and at the Sycamore Landfill constitute over 16 percent of all franchise revenues collected by the City. The Outlook projects revenues from these sources to increase by 2.7 percent in FY 2015, 0.8 percent in FY 2016, 0.5 percent in FY 2017, 1.5 percent in 2018, and 0.9 percent in FY 2019. In the current fiscal year, revenue from refuse hauler franchise fees is expected to be 2.2 percent above the amount contemplated in the adopted budget. The projections in the Outlook were based on those provided by the Environmental Service Department. Historically, growth and reductions in refuse disposal have broadly tracked overall economic conditions; forecasts by Beacon Economics and MuniServices for the San Diego region discussed previously are broadly indicative of an improving economy, and support the projected increases included in the Outlook.

Other General Fund Revenues

- Safety sales tax revenue continues to support debt service for Fire and Life Safety bonds throughout the Outlook in addition to providing equal support to the Police and Fire Departments. The growth of safety sales tax revenue, and subsequent transfers to departments, is based on the same estimated growth rates throughout the Outlook as mentioned in the sales tax revenue section. As noted in the sales tax section, these growth rates utilized to forecast revenue in the Outlook are appropriate given current economic conditions.

- The forecast for property transfer tax is based on average of approximately 10.0 percent growth per year. Property transfer tax revenue for the City reached a plateau of $12.7 million in FY 2005 and subsequently declined to $5.4 million in FY 2011. Since this low, revenue has averaged approximately 13.8 percent per fiscal year, finishing with an unaudited FY 2013 revenue total of $7.0 million.

  Though the Outlook's growth rate average is less than the average growth over the past two fiscal years, the 10.0 percent growth per fiscal year produces revenue in FY 2019 that exceeds the FY 2005 high. As outlined in the property tax portion of this General Fund revenue analysis, Beacon Economics forecasts continued growth in single-family home sales, the primary driver of transfer tax revenue, but this growth slows considerably in FY 2018. Based on prior General Fund receipts and this Beacon Economics forecast, revenue projections in the outer years of the Outlook may be overstated. Despite this potential overstatement of transfer tax revenue, the impact to overall General Fund projections in these fiscal years is not substantial.

REVIEW OF GENERAL FUND EXPENDITURES

The Outlook's Baseline Budget projects General Fund expenditures to increase by approximately $71.0 million, or 5.8 percent, over the five-year forecast period. The projected increase in General Fund Personnel Expenditures is largely driven by the impact of the five-year agreements with the City's unions for non-pensionable compensation increases, higher pension ARC payments, increasing Workers' Compensation medical and reserve costs, and the negotiated 2.5 percent increases in the retiree health benefits contributions after FY 2015. Note that salaries and wages and the five-year agreements with the City's unions are discussed in the next sections.

For Non-Personnel Expenditures (NPE) the Baseline Budget increases are largely driven by increases in contracts due to an annual 3 percent growth rate assumption, an increase in contracts due to the increase in the Fleet Assignment fees, an increase in energy and utilities due to the 5 percent growth rate assumption, increases in the transfers to the park improvement funds[3], and an increase in the public liability reserve contribution.

A notable decrease in Information Technology expenditures over the five-year period is largely due the reduction in one-time equipment expenditures in FY 2014 and the decline in negotiated contractual expenses. Additionally, the last McGuigan settlement financing payment will be made in FY 2015 and is removed from the remaining Outlook years.

Attachment Three to this report contains a listing of increases and decreases in Baseline Budget expenditures from the FY 2014 Adopted Budget to the FY 2019 Outlook baseline projection.

Lastly, additional expenditures above the Baseline Budget are listed individually in the Outlook under the Mandates and Critical Needs sections. The IBA has provided a Revised Baseline Budget in this report in order to consider certain non-discretionary expenditures that were not included in the Outlook's Baseline Budget. These include certain Federal, State and City mandates, as well as expenditure requirements for new facilities, among other funding needs.

Salaries and Wages

The Outlook reflects a $175,000 decrease in salaries and wages over the five-year forecast period, which excludes the impact of the five-year agreements with the City's unions. This decrease results from the net of the following items: a $1.8 million increase for salary "step increases"; a $1.3 million decrease in the termination pay estimate (which is based on DROP participants' exit dates); and a $700,000 decrease due to one-time expenditure adjustments.

Funding for step increases and promotions could be underestimated in the Outlook. The projected increase is $1.8 million for FY 2015, or approximately 0.4 percent of salaries and wages, with no additional step or promotion increases in the remaining four years of the Outlook. If the actual step and promotion increases are higher than estimated, salaries could be a few million dollars higher than projected.

[3] This is due to increases in estimated Mission Bay revenues, as well as the Charter requirement that a larger portion of revenues be transferred to the Park Improvement Funds beginning in FY 2015.

Note that the total salaries and wages budget for all five years in the Outlook is within a few hundred thousand dollars of the FY 2014 budget amount of $515.9 million. Further, the FY 2014 projection for salaries and wages in the First Quarter Budget Monitoring Report is $6.3 million over budget, at $522.2 million. The difference between the FY 2014 budget and projection is largely due to over budget pay in lieu of annual leave, which is projected to be $7.3 million – $5.4 million higher than the budgeted amount of $1.9 million. Additionally, overtime is a contributing factor in the salaries and wages budget deficit projected for FY 2014.

Although it is difficult to estimate how much annual leave employees will cash out each year, looking at pay in lieu expenditures over the past four years shows similarly large deficits. Each of those four years also had a budget of $1.9 million, but the actual expenditures were $6.3 million, $7.2 million, $6.7 million and 7.7 million for FY 2010, FY 2011, FY 2012 and FY 2013, respectively.

To keep within a department's bottom line budget, the department must monitor hiring, salaries and wages, and all budget expenditures. NPE savings or vacancy savings can offset over budget pay in lieu of annual leave and overtime expenditures. General Fund vacancies at November 5, 2013 were 168 in excess of budgeted vacancies. It may be the case that not all of the positions which are projected to be filled will actually be filled by year-end, generating savings. Nonetheless, for the General Fund as a whole (not including Citywide Expenditures and increased elections costs), projected FY 2014 expenditures are $9.1 million higher than the FY 2014 Adopted Budget.

Five-Year Employee Organization Agreements

A notable increase in the Outlook's Baseline Budget is due to the impact of the five-year agreements with the City's unions which provide for increases in non-pensionable compensation. This impact translates to additional estimated non-pensionable salary and fringe expenditures of $7.3 million in FY 2015, $16.7 million in FY 2016, $18.5 million in FY 2017 and $20.2 million in FY 2018 and 2019.

Within the five-year agreements are reopeners to negotiate over additional non-pensionable compensation for FY 2017 and FY 2018. Though the Outlook does not anticipate any impacts due to these pending negotiations, for reference a one percent non-pensionable compensation increase could total approximately $5.0 million for the General Fund. Note that this estimate assumes non-pensionable compensation increases, such as flexible benefits increases, rather than wage increases.

Lastly, in FY 2014 $2.0 million was budgeted to fund a Police Officer retention program. An increase to the uniform allowance was negotiated with the Police Officers Association for FY 2014. The $2.0 million for the retention program has been removed from all years of the Outlook.

GENERAL FUND SIGNIFICANT PROGRAMMATIC EXPENDITURES AND PRIORITIZATION IN THE OUTLOOK

Police Department

Police Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
Police Department Five-Year Plan	$14,255,451	$20,686,901	$22,404,999	$28,093,897	$28,093,897
CRITICAL					
Animal Services Contract	$422,668	$443,802	$465,992	$489,292	$513,756
Police Air Support	$1,565,478	$1,582,123	$1,657,123	$1,742,123	$1,382,123
DISCRETIONARY					
None	-	-	-	-	-

Police Department Five-Year Plan

The Police Five-Year Plan, as detailed in the Outlook, includes the investment of significant resources in sworn and civilian hiring in an effort to restore Department staffing resources to levels achieved before past budget reductions. Over the course of the Outlook period, the plan includes expenditures necessary to add 142 new sworn positions and 96 new civilian positions at a cost of $16.4 million and $6.5 million, respectively. The plan also outlines significant equipment needs, including $8.4 million in FY 2015.

The Outlook categorizes the Police Department Five-Year Plan, in its entirety, as a City mandate and includes $113 million in funding over the five-year period. The most recent update to the Department's plan was approved by the City Council in November 2013. The plan is included in the IBA Critical Services and Operational Needs as opposed to being classified as a mandate. This is consistent with the IBA practice of including all approved or pending multi-year plans in the Critical Services and Operational Needs list.

From a budgetary perspective, given constraints to the General Fund, it is more realistic to consider the various elements of the Police Five-Year Plan separately rather than as one lump sum, as different priorities are assigned to different expenditures. For example, the plan identifies $6.4 million in needs for replacing outdated equipment. The Outlook classifies this expenditure as a mandate since it is part of the Five-Year Plan. The Department, however, breaks down its equipment needs into three levels of prioritization within the Five-Year Plan, from "mission critical" to "can fund as needed." The plan also includes additional equipment needs separately from this list, such as the Computer Aided Dispatch (CAD) system. Greater detail on true operational priorities would assist the Council in evaluating the needs of the Department as described in the Outlook. The Five-Year Plan is an important planning and prioritization tool rather than a mandate to provide the total requested funds each year of the Outlook.

Officer Retention

The FY 2014 Adopted Budget included an appropriation of $2.0 million for a police officer retention program. The Outlook appropriately classifies the program as a one-time expenditure and does not include continued funding in Outlook years. However, at the time the Council adopted the program, there was discussion of the importance of maintaining an officer retention program in some form over multiple years. As police officer retention continues to be a challenge facing the Department, it may be important to evaluate the need for other retention efforts.

Police Department Air Support

In recent budget years, maintenance and fuel expenditures related to Police Department Air Support have been funded with seized asset and grant funds, which have been inconsistent and difficult to project. The Outlook recommends moving approximately $1.5 million in annual expenditures for helicopter maintenance from seized asset funds to the General Fund, but not in the Baseline Budget. This increased General Fund expenditure is reflected in the IBA Revised Baseline due to its ongoing operational need.

The $1.5 million annual projection for helicopter maintenance in the Outlook represents a significant decrease from the FY14 Proposed Budget, which included expenditures of $3.2 million for this function. According to staff, this is a result of significant maintenance overhauls that took place in FY 2014 that are not anticipated to recur in FY 2015-2019. Additional fuel costs associated with Police Air Support will continue to be supported by seized asset funds. The FY 2013 year-end balance for the Seized Asset Fund was $1.4 million.

Animal Services Contract

The Outlook includes approximately $420,000 in FY 2015, increasing annually by five percent over future years, for additional costs for animal services provided by the County of San Diego. While the Outlook classifies this expenditure as a critical need, the IBA has revised the Baseline Budget to reflect the increased costs as they are mandated by contract. Although animal services operations have been provided out of contract since July 2013, the City and County have continued their relationship under previous contract terms. A new five-year agreement for animal services has been reviewed and approved by the Office of the City Attorney and is anticipated to be considered by the City Council in December 2013.

Fire-Rescue Department

Fire-Rescue Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
3 New Fire Stations (Citygate)*	$3,621,637	$3,483,274	$3,483,274	$3,483,274	$5,224,911
CRITICAL					
Chief Battalion Unit (Citygate)	$363,721	$363,721	$363,721	$363,721	$363,721
Critical Equipment Needs	$826,919	$495,419	$976,479	$403,279	$622,419
Fire Academy	$655,283	$655,283	$655,283	$655,283	$655,283
Wellness Contract	$54,928	$54,928	$54,928	$54,928	$54,928
Exhaust System Replacement	$50,000	$50,000	-	-	-
Skyline Drive Temp. Station	$2,741,637	$1,541,637	$1,541,637	$1,541,637	-
DISCRETIONARY					
Bomb Squad Cross Staffing	$1,214,656	$1,214,656	$1,214,656	$1,214,656	$1,214,656
Code Compliance Officers	$402,784	$402,784	$402,784	$402,784	$402,784
College Avenue Station (Citygate)	-	-	$780,000	$1,741,637	$1,741,637
Fast Response Squad (Citygate)	$889,535	-	-	-	-
Fire Prevention Admin. Support	$129,933	$129,933	$129,933	$129,933	$129,933
Hazardous Waste Removal	$75,000	$75,000	$75,000	$75,000	$75,000
Hazmat Unit Cross Staffing	$1,214,656	$1,214,656	$1,214,656	$1,214,656	$1,214,656
Paradise Hills Station (Citygate)	-	$1,880,000	$3,483,275	$3,483,275	$3,483,275

*Eastside Mission Valley Station (FY15), Home Avenue Station (FY16), Skyline Hills Station (FY19).

Citygate Recommendations

Expenditures for Fire-Rescue, including Citygate recommendations, are spread across the Outlook's three categories of mandates, critical needs, and discretionary items. Several of these expenditures are based on the recommendations of the Citygate Working Group Plan, which was approved by the City Council in November 2011. In contrast to the recommendations of the Police Department Five-Year Plan, however, not all the Citygate Working Group Plan recommendations are categorized as mandates in the Outlook. The table above illustrates the funding categorizations of the Outlook and notes Citygate Working Group Plan recommendations in parentheses.

The IBA has revised the Baseline Budget to include operating costs for the three new fire stations anticipated to open within the Outlook period. To arrive at a more accurate surplus or deficit, we believe the Baseline Budget should include the operating and maintenance costs of new facilities underway and scheduled to come online during the Outlook period. The new stations are Eastside Mission Valley Station, to be opened in FY 2015, Home Avenue Station, to be opened in FY 2016, and Skyline Hills Station, to be opened in FY 2019. Various capital funding sources, including the third Deferred Capital (DC3) bond issuance, have been identified for these three stations; however, they are not fully funded.

The IBA Critical Services and Operational Needs includes all of the remaining Citygate Working Group recommendations that were included in the Outlook and categorized as either critical operational needs or discretionary operational needs. Two of those recommendations are for new fire stations, specifically College Avenue Station and Paradise Hills Station. Capital funding sources for these stations have not been identified. The remaining two Citygate Working Group Recommendations include funding in FY 2015 for one additional Chief Battalion Unit and one Fast Response Squad (FRS) on a pilot basis. The original Citygate recommendation called for two FRS teams. All of these items are included in the IBA Critical Services and Operational Needs list.

Skyline Drive Temporary Fire Station

The Fire-Rescue Department presented an informational funding proposal for a Skyline Drive Temporary Fire Station to the Public Safety and Neighborhood Services Committee in October 2013. The projected expenditures for the temporary station included in the Outlook are consistent with those presented in Committee. However, the funding sources for NPE differ.

The Outlook projects that FY 2015 costs will include $0.8 million for a new fire engine and $0.4 million for demolition and setup costs for the temporary station, to be funded from the General Fund. In its report to Committee, Fire-Rescue raised the possibility of temporarily using an existing fire engine from the reserve fleet, delaying the cost of purchasing a new fire engine. The Department also indicated it would work with Public Works - Engineering and Capital Projects (E&CP) to determine whether a capital resource could be used to fund demolition and setup costs. Ongoing coordination between Fire-Rescue, Fleet, and Engineering and Property Management is needed to clarify potential alternative funding sources for the Skyline Temporary Station. This is also in the IBA Critical Services and Operational Needs list.

Lifeguard Services

Lifeguard Services Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
None	-	-	-	-	-
CRITICAL					
Advanced Lifeguard Academy	$276,462	$276,462	$276,462	$276,462	$276,462
Lifeguard Division Five-Year Plan	$1,667,006	$1,338,650	$1,746,449	$3,046,449	$1,700,615
DISCRETIONARY					
None	-	-	-	-	-

Lifeguard Services Five-Year Plan

The Outlook classifies the entire Lifeguard Services Five-Year Plan as a critical operational need. The IBA Critical Services and Operational Needs also includes the full Lifeguard Plan. The plan was accepted as an information item by the Public Safety and Neighborhood Services Committee in October 2013 but has not been considered by the full City Council. Since being presented in Committee, the plan has been updated to reflect the cumulative effect of ongoing expenditures added in each fiscal year. In the Outlook, the lack of formal Council approval distinguishes the Lifeguard Five-Year Plan from similar plans put forward by the Police and Fire-Rescue Departments, while we considered all three public safety plans to be critical needs but not mandates.

Advanced Lifeguard Academy

Lifeguard Services provides specialized training for Lifeguard I and Lifeguard II positions through its Advanced Lifeguard Academy, which runs five weeks longer than a standard academy. One-time funding for the program was included in the FY 2014 Adopted Budget. Because the Lifeguard Services Five-Year Plan does not include the Advanced Lifeguard Academy, the Outlook lists the Advanced Lifeguard Academy separately as a Critical Operational Need. The IBA Critical Services and Operational Needs includes funding for this program during the Outlook period.

Penny for the Arts

The Penny for the Arts initiative was adopted by City Council in October 2012, which established a funding plan to return the City of San Diego Commission for Arts and Culture (Commission) to previous funding levels for "increasing support for the region's artistic and cultural assets, integrating arts and culture into community life and showcasing San Diego as an international tourist destination." This funding plan would be a phased increase to the Commission's total budget to return funding to a level that would equal one cent (or approximately 9.5 percent) of the City's total 10.5 cent total transient occupancy tax (TOT) revenue. This phased funding would occur until the full one cent was provided to the Commission by FY 2017. The phased funding would occur as follows:

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Penny for the Arts Blueprint % Total TOT Goal	8.1%	8.6%	9.5%	9.5%	9.5%
	(0.85 cent)	(0.9 cent)	(1.0 cent)	(1.0 cent)	(1.0 cent)

Based on this phased funding plan and updated TOT revenue projections included in the Outlook, the required contributions to the Commission based on these latest figures are as follows:

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Total Outlook Transient Occupancy Tax Revenue	$ 176.4	$ 185.2	$ 207.1	$ 216.9	$ 227.1
Penny for the Arts Blueprint % Total TOT Goal	8.1%	8.6%	9.5%	9.5%	9.5%
	(0.85 cent)	(0.9 cent)	(1.0 cent)	(1.0 cent)	(1.0 cent)
Penny for the Arts TOT Goal	$ 14.2	$ 15.8	$ 19.7	$ 20.7	$ 21.6
Funding Included in Five-Year Outlook	$ 8.0	$ 8.0	$ 8.0	$ 8.0	$ 8.0
Incremental TOT Funding for Implementation of Plan	$ 6.2	$ 7.8	$ 11.7	$ 12.7	$ 13.6

Note that these figures differ from the Outlook due to the incremental TOT required to fully fund the Penny for the Arts plan changing since the figures utilized in the plan approved by Council.

Library Department

Library Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
Expansion of Library Branches[1]	-	-	$269,003	$542,290	$542,290
CRITICAL					
Addition of hours to Central and Branch libraries	$1,707,941	$1,707,941	$1,707,941	$1,707,941	$1,707,941
DISCRETIONARY					
Reduction of funding from dedicated donations	-	-	-	-	($2,000,000)
San Ysidro Branch expansion	-	-	-	-	$235,026

1. Expansion of two branch libraries: Skyline Branch Library and Mission Hills Branch Library.

New Branch Libraries

The Outlook includes the requested action to provide staff and funding for the expansion of two branch libraries: the Skyline Branch Library anticipated opening in FY 2017; and the Mission Hills Branch Library anticipated opening in FY 2018. Funding from the City's planned DC3 bond issuance will complete the funding necessary for the Skyline Branch Library and contribute to the funding required to complete the Mission Hills Branch Library. Although these facilities are anticipated to open in the outer years of the Outlook, as these facilities are to receive funding from the DC3 bond issuance and considered fully funded, the additional operational costs are categorized as Mandates. Consistent with our definition of non-discretionary costs, we have incorporated the costs necessary to operate and maintain these new facilities into our Revised Baseline, as the City has an obligation to operate and maintain new facilities coming on line.

Additional Library Hours

The Outlook includes the request for additional hours for the Central and branch libraries. The request is to add three hours of operation per week to the Central Library and add four hours of operation per week for each branch library. The additional hours of operation would increase the Central Library hours from 49 hours per week to 52 hours per week and the branch libraries hours of operation would increase from 48 hours per week per facility to 52 hours per week per facility. The Library Department anticipates the need to add 29.58 FTEs and approximately $1.7 million in annual expenses to fulfill this request. The increase of operational hours at the libraries was considered and approved during the FY 2014 May Revise contingent upon identifying a funding source. Unfortunately, the identified funding source did not materialize and the addition of hours was nullified. Inclusion of this action in the Outlook indicates continued support to increase library hours citywide. Based on recent City Council action and priority memos, we have included this item in our IBA Critical Services and Operational Needs.

Discretionary Operational Needs

There are two items listed in the Discretionary Operational Needs category for the Library Department: 1) the reduction of the pledged $2 million in annual donations from the Library Foundation for the operation of the Central Library, effective FY 2019 and 2) the addition of staff and funding for the opening of the San Ysidro Library in FY 2019. We have included both of these items in our revised IBA Revised Baseline. Based on existing agreements as we know them today, the $2.0 million annual donation will be ending in FY 2018 while the costs for the Central Library will continue. Therefore this revenue reduction should be reflected in the Baseline Budget.

While the exact construction schedule for the San Ysidro Branch Library is yet to be determined since a site has not been identified, at this point in time the Library Department is projecting operating expenditures to be required in FY 2019. This falls within our methodology of incorporating the costs for the new facilities coming on line during the Outlook period to the Baseline Budget. While several factors could impact the actual opening, previous Outlook reports have appropriately included the opening of all planned facilities within the Outlook period. The Library Department anticipates the need to add 2.05 FTEs and approximately $235,000 in annual expense to address the opening of the San Ysidro Branch library in FY 2019.

Service Enhancements Requested for the Outlook Period

The following table illustrates the service enhancements of the total Library funding requests for the Outlook period. Based on the information provided in the Outlook, the Library Department anticipates the need to add 35.25 FTEs and approximately $2.5 million in annual expenses by the end of the Outlook period.

Proposed Ongoing Increases to the Library Department

	FY 2015		FY 2016		FY 2017		FY 2018		FY 2019	
Facility	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses
Central Library										
Additional hours	3.50	214,118	3.50	214,118	3.50	214,118	3.50	214,118	3.50	214,118
Branch Libraries										
Additional hours	26.08	1,493,823	26.08	1,493,823	26.08	1,493,823	26.08	1,493,823	26.08	1,493,823
Additional facilities	0.00	0	0.00	0	2.00	269,003	3.62	542,290	5.67	777,315
Total	**29.58**	**$1,707,941**	**29.58**	**$1,707,941**	**31.58**	**$1,976,944**	**33.20**	**$2,250,231**	**35.25**	**$2,485,256**

Park and Recreation

Park and Recreation Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
Natural Resources Management Plans	$125,179	$125,179	$125,179	$125,179	$125,179
Brush Management Contractual Services	$924,000	$924,000	$924,000	$924,000	$924,000
CRITICAL					
ActiveNet Online Registration	$72,941	$72,941	$72,941	$72,941	$72,941
Memorial Girls Club Building	$600,000	$0	$0	$0	$0
New FY 2015 P&R Facilities	$566,187	$557,675	$557,675	$557,675	$550,609
Playground Repair Staff	$89,195	$89,195	$89,195	$89,195	$89,195
DISCRETIONARY					
Increase of 5 hours per recreation center[1]	$2,315,367	$2,315,367	$2,315,367	$2,315,367	$2,315,367
Expenses related to future new P&R facilities[2]	$0	$387,216	$592,934	$688,238	$680,890
Additional Open Space Acres Maintenance	$104,583	$172,447	$240,310	$308,174	$376,037
Year-round Turf Fertilization of fields and parks	$450,000	$450,000	$450,000	$450,000	$450,000
Vulcan Replacement	$500,000	$0	$0	$0	$0
Citywide Maintenance of New Facilities	$123,486	$123,486	$123,486	$123,486	$123,486
Kumeyaay Campground Restoration[3]	$142,298	$105,578	$105,578	$105,578	$105,578
Memorial Pool Expansion	$130,484	$130,484	$130,484	$130,484	$130,484
Plaza de Panama Enhancements	$44,398	$44,398	$44,398	$44,398	$44,398
Transfer of Property from READ	$12,766	$12,766	$12,766	$12,766	$12,766
San Ysidro/Larsen Field Lighting	$7,500	$7,500	$7,500	$7,500	$7,500

1. Increase of five hours per week per recreation center due to the addition of 55 Assistant Recreation Center Directors at every recreation center citywide.
2. Future new facilities include Salk Neighborhood Park, Franklin Ridge Pocket Park, Phyllis Place Park, Gonzales Canyon Neighborhood Park, Del Sur Neighborhood Park, Torrey Highlands Neighborhood Park, Carmel Valley Neighborhood Park, Del Mar Mesa Neighborhood Park, Rivera Del Sol Neighborhood Park, Pacific Breezes Community Park, Southcrest Trails Mini-Park, and Olive Street Mini-Park.
3. Per the Outlook, the restoration of overnight camping activities will generate approximately $18,000 annually in revenue. The figure in the table represents the net expense to the Park and Recreation Department.

Natural Resources Management Plan

Per the Park and Recreation Department, the City is contractually obligated under the Multiple Species Conservation Program (MSCP) to complete approximately 50 natural resource management plans. Though no specific deadline to complete these plans is provided, regulatory agencies such as the United States Fish and Wildlife Service and the California Department of Fish and Game regularly inquire as to the completion of these plans. The costs for completing the plans vary based upon several factors such as the type of habitat studied and the type of surveying required. The requested funding will allow for the initiation of three plans (listed in the Outlook) and additional plans will be developed as funding is available. Based on our definition of non-discretionary costs, we have incorporated the funds necessary to plan for the protection, development, and maintenance of City assets into the IBA Revised Baseline.

Brush Management Contractual Services

The Brush Management program was developed by the City's Fire-Rescue Department in 2008 as a result of the 2007 Wildfires. The expenses related to the Brush Management Contractual Services only reflect the increased cost per acre (from $2,051 per acre to $5,720 per acre) from the selected service provider to address the clearing of 300 acres of brush within the City limits. The funding request does not support an increase in service levels or any additional staff to manage the program. As a matter of community safety, we have included this item in the IBA Revised Baseline.

New Park and Recreation Department Facilities to Open in FY 2015 – 2019

The Park and Recreation Department has identified multiple new park facilities or expansions to open/occur during the five-year Outlook period. A list of the facilities anticipated to open during this time is provided as Attachment Four. The Park and Recreation Department has requested 3.29 FTEs and $566,000 in FY 2015 to provide service at new facilities projected to open in FY 2015. These cost estimates are categorized as Critical Operational Needs.

Facilities anticipated to open after FY 2015 are categorized as Discretionary Operational Needs in the Outlook. The Park and Recreation Department has requested 5.21 FTEs and $680,000 to address new park facilities projected to open/occur after FY 2015. Past Outlook reports have incorporated the costs of all new facilities anticipated to open during the Outlook period into the Baseline Budget. Though the actual opening dates of these facilities may vary from what is projected, the City has an obligation to plan for the costs of these new facilities. Consistent with our approach of identifying costs related to the opening of new facilities as non-discretionary, we have included the expenditures for operating and maintaining these new facilities in the IBA Revised Baseline.

Expenses Related to Additional Open Space

During the FY 2014 Budget process, the City Council approved additional staffing to support the Park and Recreation Department's goal of establishing a ratio of 648 acres of parkland to one park ranger. Currently the City has a ratio of one park ranger for every 1,193 acres of parkland. This action was intended to provide for the maintenance and management of new trails and help meet the Multiple Species Conservation Program requirements each year. Additional open space costs have been included in past Outlook reports. The Park and Recreation Department has requested 5.00 FTEs and $376,000 in annual expense be added during the Outlook period. Similar to the costs of opening of new facilities, we have incorporated the costs related to the maintenance of additional open space to the IBA Revised Baseline for the Outlook period.

Increased Recreation Center hours

An increase of service hours at the City's recreation centers has been frequently mentioned as a high priority during the City Council's identification of top priorities during the annual budget process. The department has requested increasing operational hours of each recreation center from 45 to 50 per week per facility. The Park and Recreation Department anticipates the need to add 55.0 FTEs and approximately $2.3 million in ongoing expenses related to this action. We have included this item in the IBA Critical Services and Operational Needs.

Demolition of the Memorial Girls Club Building

In October 2012 an facility assessment, completed by outside consultants and managed by the City's Engineering and Capital Projects Department, found the Memorial Girls Club building to be unsafe. The facility is currently maintained by the Park and Recreation Department. Due to the safety and liability risks at hand and the finding of the facility assessment, this item has been included in the IBA Revised Baseline.

Playground Repair Staff

The department has requested 2.00 FTEs and $89,000 to support preventative maintenance, inspection, repair, removal and replacement of playground equipment in response to safety hazards and current public health and safety requirements. Additional staff will allow the department to perform playground site visits and complete written safety inspection forms as recommended in the City Auditor's Performance Audit of the Park and Recreation Department's Playground Maintenance Program. As this item is related to providing continued playground safety, we have included the request in the IBA Revised Baseline.

Storm Water Compliance

As discussed in the Outlook and IBA Report #13-44, the new Municipal Storm Water Permit was adopted on May 8, 2013 which mandates more stringent water quality regulations. The Storm Water Division utilizes their Watershed Asset Management Plan (WAMP) to estimate funding needs for both their operating budget and capital needs in order to address compliance and flood risk management, including the backlog of deferred capital storm drain assets currently estimated at approximately $146 million. We have reviewed the figures included the Outlook, and they are consistent with Storm Water requests and the WAMP.

As also noted in the Outlook and IBA Report #13-44, deferring compliance could lead to costly State and Federal penalties. Although the City must currently adhere to permit standards, the significant ramp up in necessary funding (as shown on page 41 of the Outlook) beginning in FY 2015 is in response to upcoming 2018 compliance deadlines for water quality regulations. This is particularly significant when looking at the storm water capital needs which are estimated at about $642 million for the Outlook period.

The Outlook projections include the increased General Fund storm water operating budget costs; however, they note the significant Capital Improvement Program (CIP) requirements to comply with the permit are not fully funded. Page 41 of the Outlook outlines the additional funding needed in order to fully support capital projects for compliance. None of these costs are included in the Outlook. Storm Water staff have expressed concern that the City will risk non-compliance if these needs are deferred beyond FY 2015. The remaining funding need is summarized as follows.

Capital Improvements Program (CIP) Needs for Storm Water Compliance					
	FY 2015	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**
Total Need	80,901,958	94,815,311	120,899,939	162,770,345	182,159,545
CIP Funding from Storm Water Operating Budget	2,850,000	2,850,000	2,850,000	2,850,000	2,850,000
CIP Bond Funding (Authorized/Planned)	27,889,734	26,080,000	26,080,000	TBD	TBD
Remaining Funding Needed	**$ 50,162,224**	**$ 65,885,311**	**$ 91,969,939**	**$ 159,920,345**	**$ 179,309,545**

The planned bond funding that is outlined in the preceding table reflects the storm water portion of the total bond amount. Due to the lack of funding available for storm water compliance infrastructure needs, and the importance of complying with State and Federal regulations, the City may want to consider dedicating a larger portion of the planned deferred capital bonds for storm water infrastructure. As shown in the table on the following page, 31 percent of funds from the last three bond issuances for the Five-Year Deferred Capital Funding Plan are planned for storm water capital projects.

Storm Water Portion of Future Planned Deferred Capital Bonds			
	DC 4 (FY 15)	**DC 5 (FY 16)**	**DC 6 (FY 17)**
Planned Storm Water Funding Amount	27,889,734	26,080,000	26,080,000
Total Bond Amount	90,000,000	84,160,000	84,160,000
Portion of Bond for Storm Water	**31.0%**	**31.0%**	**31.0%**

Weighting storm water infrastructure needs more heavily in future bonds would help provide extra funding needed for infrastructure compliance needs. In FY 2018 and FY 2019 note that there is no plan to fund a majority of the necessary storm water infrastructure.

The IBA Revised Baseline includes storm water compliance funding for the General Fund operating budget as well as estimated storm water portion of debt service for the planned/authorized deferred capital bonds. "Storm Water Compliance O&M" incorporates funding needs for the the Comprehensive Load Reduction Plan (CLRP) and flood risk management as shown in the "Federal Mandates" section of the Outlook, as well as the storm water portion of Deferred Capital Maintenance & Repair (M&R) shown under "City Mandates". The figures included in the IBA Revised Baseline are consistent with storm water compliance needs as shown in the WAMP and on page 41 of the Outlook. "Storm Water Compliance Debt Service" shows the estimated debt service based on the proportion of the bonds that are dedicated for storm water capital projects in previous and planned deferred capital bonds. This was included in the IBA Revised Baseline since it helps to fund mandated capital projects that address compliance. These debt service estimates are based only on currently planned/authorized deferred capital bonds, and do not address significant remaining capital needs (as outlined in the previous table "CIP Needs for Storm Water Compliance"). Since the IBA Revised Baseline includes storm water's portion of M&R and debt service, related figures in the Infrastructure section of the IBA Critical Services and Operational Needs have been adjusted accordingly.

Storm Water Funding

As discussed in IBA Report #13-44, the General Fund is the primary source of funding for the Division and its activities. The magnitude of these cost increases for compliance illustrates the need for alternative funding sources to alleviate the impact to the General Fund. The City of San Diego currently collects a storm drain fee from water and sewer utility customers for the purpose of partially reimbursing the General Fund for storm water activities, however, the revenue from this fee is drastically short of full cost recovery. Currently, the storm drain fee is projected to collect approximately $5.7 million, which represents about 16.2 percent of the Division's FY 2014 operating budget, or 9.2 percent of total storm water funding inclusive of capital needs that were bond funded in FY 2014. If the General Fund continues to be the primary source of storm water funding, increased funding contributions will need to be made in order to remain in compliance, reducing funding for other priorities and services.

IBA Reports #10-29 and #13-44 discuss the possibility of storm drain fee increases based on a variety of assumptions, and the impact that the additional funding would have on the General Fund. Although these reports help to illustrate the magnitude of storm water compliance costs, the next step for increasing the storm drain fee would require a cost of service study. This study is necessary in order to determine an appropriate fee calculation. Storm Water staff anticipate to perform a cost of service study in FY 2015.

In addition to initiating a cost of service study, the Storm Water Division also plans to explore the idea of a region-wide revenue approach for funding storm water activities and infrastructure, such as through a parcel tax. Although the funding needs reflected in the Outlook only depict the City of San Diego's portion of compliance costs, other municipalities are affected by increased storm water mandates as well, since the regulated watersheds span over multiple jurisdictions. Los Angeles County has been working towards approval for a revenue source such as this, which could potentially provide increased countywide funding of about $290 million annually.

Changes to Technology and Regulations

Looking beyond the Outlook period, the Division has stated that estimates will continue to be revised and could potentially decrease from currently projected levels. Regulations and technology are constantly evolving, and the Division continues to negotiate for more favorable standards which will be easier to attain and more cost effective in the future. For example, if the Regional Water Quality Control Board agrees to consider the Water Effects Ratio analysis, this could result in approximately an $880 million decrease to projected capital costs. Although a future possibility, upcoming regulations in the near future still remain costly and any decrease in cost estimates would likely not occur until after the Outlook period.

Infrastructure

Funding for the City's infrastructure, including deferred capital, Asset Management, annual maintenance and repair (M&R), and needed new infrastructure assets, will continue to be a top priority over the next five years and beyond. The City Council approved the Five-Year Deferred Capital Funding Plan (FY 2013-2017) known as Enhanced Option B in March 2012 to begin to address the estimated $898 million backlog for streets, facilities, and storm drains. Although the plan did not provide the level of funding desired by Council or necessary to stop the deterioration, it was determined to be the most realistic and fiscally sound approach to address much needed capital projects, such as street resurfacing. Over the five-year period, this level of investment including bond and cash funding (for M&R) is anticipated to slow the rate of deterioration of the assets to 5-10 percent.

The FY 2014 Budget delayed the plan's third capital bond issuance (known as DC 3). However, based on the Outlook, the City plans to authorize an issuance of $120 million in FY 2014 for DC 3 and to remain on track with future planned issuances. The following table compares funding in the Outlook with the Status Quo Option for preventing further deterioration of assets and the Council-adopted Enhanced Option B. Funding in the Outlook will put the City within about $800,000 of the Council-adopted Enhanced Option B and within about $106.8 million of the Status Quo Option by the end of FY 2017.

$ in millions	FY 2012	FY 2013	FY2014	FY 2015	FY 2016	FY 2017	TOTAL
Preventing Further Deterioration (Status Quo Option) (Staff analysis reported in March 2012)							
Deferred Capital Net Bond (Capital Projects)	$ 105.5	$ 105.2	$ 105.2	$ 105.2	$ 105.2	$ 105.2	$ 631.5
Maintenance & Repair (previously called O&M)	59.1	53.8	54.9	56.0	57.1	58.2	339.1
Total	**$ 164.6**	**$ 159.0**	**$ 160.1**	**$ 161.2**	**$ 162.3**	**$ 163.4**	**$ 970.6**
Council-Approved Plan (Enhanced Option B) (March 20, 2012)							
Deferred Capital Net Bond (Capital Projects)	$ 75.0	$ 80.0	$ 81.0	$ 90.0	$ 84.2	$ 84.2	$ 494.4
Maintenance & Repair (previously called O&M)	59.1	54.1	50.0	62.0	66.0	79.0	370.2
Total	**$ 134.1**	**$ 134.1**	**$ 131.0**	**$ 152.0**	**$ 150.2**	**$ 163.2**	**$ 864.6**
Difference (Enhanced Option B minus Status Quo)	**$ (30.5)**	**$ (24.9)**	**$ (29.1)**	**$ (9.2)**	**$ (12.1)**	**$ (0.2)**	**$ (106.0)**
Five-Year Outlook (FY 2015-2019)							
Deferred Capital Net Bond (Capital Projects)	$ 75.0	$ 35.0	$ 120.0	$ 90.0	$ 84.2	$ 84.2	$ 488.4
Maintenance & Repair (previously called O&M)	59.1	54.1	55.2	62.0	66.0	79.0	375.4
Total	**$ 134.1**	**$ 89.1**	**$ 175.2**	**$ 152.0**	**$ 150.2**	**$ 163.2**	**$ 863.8**
Difference (Five-Year Outlook minus Status Quo)	**$ (30.5)**	**$ (69.9)**	**$ 15.1**	**$ (9.2)**	**$ (12.1)**	**$ (0.2)**	**$ (106.8)**

The Outlook places a high priority on the Five-Year Deferred Capital Funding Plan by including both the debt service for the planned bond issuances and M&R costs as a City mandate.[4] However, we have some concerns that the Outlook does not place a high priority on some significant infrastructure-related items. For example, the facilities and street condition assessments critical for identifying deferred capital and maintenance needs are included in the Outlook as a second-tier priority (Critical Operational Needs). In addition, Public Works - Engineering & Capital Projects positions required to meet the growth of the Capital Improvement Program (CIP) based on the increased funding for deferred capital projects are included as Discretionary Operational Needs, the lowest priority funding level. This is concerning given that E&CP and other applicable departments need to have sufficient capacity to effectively implement the increased workload. Additionally, E&CP positions are essentially considered to be cost neutral since they are reimbursed from project delivery costs. The following table shows infrastructure-related needs as categorized in the Outlook as well as some important additional needs which have not been included.

[4] Note that the M&R costs do not reflect new information, such as the level of funding needed to meet the Facilities M&R standard (which are included in the Outlook as a Discretionary Operational Need).

Infrastructure Five-Year Outlook by Category FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
MANDATES					
Deferred Capital - Maintenance & Repair/Capital	$5,891,631	$9,891,631	$22,931,631	$24,512,431	$26,124,847
Deferred Capital - Debt Service	4,400,000	13,900,000	19,500,000	25,100,000	25,100,000
Total Cash Funding	$10,291,631	$23,791,631	$42,431,631	$49,612,431	$51,224,847
Bond Issuance Authorization	$90,000,000	$84,160,000	$84,160,000	TBD	TBD
Storm Water M&R (excluding Deferred Capital M&R for Flood Risk Management which is included in the M&R line above)	6,845,744	10,601,933	6,795,731	10,848,121	13,048,358
CRITICAL					
Facilities Condition Assessment (contractual expense)	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 500,000
New Central Library Maintenance	891,310	861,310	861,310	861,310	861,310
Street Condition Assessment (contractual expense)	560,000	-	-	-	-
Street Condition Assessment Video Hosting (storage of video data)	15,000	15,000	15,000	15,000	15,000
DISCRETIONARY					
Engineering & Capital Projects Positions (required to address CIP)	$3,447,547	$4,992,449	$6,611,764	$8,231,080	$9,850,395
Facilities Maintenance Positions and NPE (required to meet low end of industry standard)	6,328,641	8,397,122	10,407,322	12,472,670	14,378,675
Citywide Maintenance of New Park & Rec Facilities	123,486	123,486	123,486	123,486	123,486
Maintenance for Harbor Drive Pedestrian Bridge (contractual expense)	38,500	38,500	38,500	38,500	38,500
SAP Enterprise Asset Management System (General Fund)	539,800	256,600	206,600	206,600	206,600
Support for Community Plan Updates and Amendments	2,786,243	2,950,883	2,950,883	2,950,883	2,950,883
Park Designer (to meet increased plan review of CIP projects)	90,064	90,064	90,064	90,064	90,064
Reimbursable CDBG Positions (to meet increased number of projects funded)	129,933	129,933	129,933	129,933	129,933
NOT INCLUDED					
Additional CIP Funding Needed for Storm Water Compliance	$50,162,224	$65,885,311	$91,969,939	$159,920,345	$179,309,545
Asset Management Coordinator	150,000	150,000	150,000	150,000	150,000

Facilities M&R

We are concerned that the Outlook does not place a high priority on critical facilities M&R. Chronic underfunding of M&R has been a significant contributing factor to the facilities backlog of deferred maintenance and capital projects. Facilities Division staff currently conduct about 90 percent breakdown, reactive maintenance compared with only 10 percent preventative maintenance. In 2012, the Division developed a sustainability model to recommend appropriate funding levels based on the premise put forward by the National Research Council that annual routine M&R should be between 2-4 percent of the current replacement value of an organization's facilities. For the City's facilities supported by the General Fund, annual funding at the low end of 2 percent would yield a requirement of $47 million annually—a $30 million deficiency. Facilities Division proposed a ramp up of $6 million over five years beginning with the FY 2014 budget request; however, due to tight financial constraints, the Division received only $1.2 million in FY 2014. Continuing to underfund annual M&R could significantly increase the backlog. As assets continue to deteriorate, significant damage can occur resulting in exponentially higher repair costs. We have included this funding in the list of IBA Critical Services and Operational Needs.

Funding for 5.00 FTEs and associated costs required for M&R of the Central Library have been included in the Outlook as Critical Operational Needs. However, as a result of maintenance calls that have been received in the last couple of months since the library opened, Facilities Division staff believe that a minimum of 7.00 FTEs are needed to sufficiently maintain the new library. Further, it is important to note that the square footage of the library was not included in the sustainability model calculations; therefore, these positions cannot be counted toward the needed facilities M&R funding.[5] These items are included in the IBA Revised Baseline since they are necessary to support the new facility.

SAP EAM

We believe that the General Fund portion of the SAP Enterprise Asset Management (EAM) system, which has been included as a Discretionary Operational Need in the Outlook, is a high-priority need related to implementation of citywide Asset Management. Public Utilities started an effort to replace its three existing maintenance management systems with SAP EAM over five years, and these preliminary operating costs are included in the FY 2014 Baseline Budget. This system is particularly important given the large number of assets and significant amount of information that must be collected and analyzed to implement cost-effective Asset Management strategies. This also provides an opportunity for General Fund departments to replace existing legacy systems and leverage their own SAP EAM roll out in the future.

The SAP EAM Governance Committee determined that merging the SAP legacy system (Synergy)[6] with the SAP EAM Project will save the General Fund about $1.1 million over the project duration and provide enhanced business services two years earlier than separate phased projects. Further, the Information Technology Business Leadership Group recommended that the City should proceed with a unified citywide SAP EAM solution. The Outlook includes all General Fund department impacts that have been identified to date, but notes that about $2.1 million in additional capital costs will be needed. Finally, the Outlook does not include funds for an Asset Management Coordinator to support General Fund departments' efforts. The SAP EAM Project Management Office recommends that this position be funded in order for the project to be successful. We have included this funding in our IBA Critical Services and Operational Needs list.

Community Plan and PFFP Updates

We are concerned that the Outlook includes Community Plan Updates and Amendments as Discretionary Operational Needs. Many of the 42 Community and Public Facilities Financing Plans (PFFP) are considered to be significantly out of date. 12 community plans and 13 PFFPs are currently in various stages of the update/amendment process. We believe community plan and PFFP updates are very important since, among other things, they identify and prioritize needed public infrastructure. PFFPs also identify funding sources for public facilities. Generally PFFPs are funded through Development Impact Fees (DIF) or Facilities Benefits Assessments (FBA) which are fees assessed on developers to mitigate the impact of new development. As costs have increased over time, many of these plans are underfunded and updates will help to bring these fees in line with current costs of facilities. These costs have also been incorporated into our list of IBA Critical Services and Operational Needs.

[5] The new Central Library was not operational when sustainability model calculations were made. Recent updates to include the library in the model show a requirement of $48.4 million annually for Facilities M&R.
[6] Synergy is currently utilized by Transportation & Storm Water, Communications, and Publishing Services.

Information Technology

The Outlook includes information technology (IT) related expenditure additions and reductions as part of the Critical Operational Needs section. Over the Outlook period an overall reduction in expenditures is shown which is attributable to the reduction in debt service payments on two capital leases for communication equipment that retire during FY 2014 and a reduction of IBM Capital Lease expense related to the OneSD Citywide allocation. Other critical needs such as P25 Radio System Infrastructure and other IT operating needs offset these savings, as shown in the chart below. These expenditures are described in more detail in the Outlook on pages 53-55.

Information Technology Five-Year Outlook Critical Operating Needs FY 2015-FY 2019

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
CRITICAL					
Capital Lease Reductions					
Communication Equipment	(575,269)	(1,358,368)	(1,420,175)	(1,429,580)	(1,429,580)
SAP	(136,841)	(498,938)	(1,844,210)	(2,657,225)	(2,657,225)
Subtotal	$ (712,110)	$(1,857,306)	$ (3,264,385)	$ (4,086,805)	$(4,086,805)
Public Safety					
P25 Radio System Infrastructure	613,200	949,200	1,058,400	1,100,400	1,142,400
Subtotal	$ 613,200	$ 949,200	$ 1,058,400	$ 1,100,400	$ 1,142,400
IT Operating Needs					
Citywide Software Assets	260,000	260,000	260,000	260,000	260,000
Consultant for RFP for IT Sourcing	-	-	-	260,000	-
Email Archiving Appliance	-	260,000	-	-	-
Laptop Full Disk Encryption	52,000	52,000	52,000	52,000	52,000
Required Training for SAP/Security	20,800	20,800	20,800	20,800	20,800
Subtotal	$ 332,800	$ 592,800	$ 332,800	$ 592,800	$ 332,800
TOTAL IT EXPENDITURES	$ 233,890	$ (315,306)	$(1,873,185)	$(2,393,605)	$(2,611,605)

The IBA Revised Baseline includes the anticipated savings from the capital lease reductions for communication equipment and OneSD SAP software in the amount shown above. As discussed on pages 53 and 54 of the Outlook, this reduction is a result of a planned decrease in debt service payments for communication capital leases and a reduction in expenditures as a result of the IBM Capital Lease for the OneSD SAP software implementation that is expected to be fully paid in FY 2017.

The Public Safety Communications Project (P25) Radio System Infrastructure expenditures were also incorporated into the IBA Revised Baseline. This project was approved by Council in 2011 and has reached approximately 60 percent project completion as of December 2013. To expedite completion of the project before the current system's end-of-life date in 2016, $4 million in debt financing was included as part of the FY 2014 Equipment and Vehicle Financing Program.
Other IT related operating needs that were included in the Outlook, ranging from $300,000 - $600,000, are included in the IBA Critical Services and Operational Needs, as shown in the previous table.

REVISED BASELINE BUDGET BASED ON IBA REVIEW

The IBA Revised Baseline is comprised of recommended revisions to the Outlooks' baseline revenue and expenditure budget based on an updated methodology for determining specific projections or a greater certainty that these impacts will occur and impact General Fund operations.

Revenue revisions include adjustments to property tax and sales tax revenue projections as outlined previously in addition to State and City mandates, the impact when Central Library donations are exhausted, and DMV collection referral increases that were outlined in this report and in the Outlook. Expenditure revisions include known Federal and State mandates, spending to address community safety issues, City commitments (such as the public safety radio system upgrade currently underway), required O&M to properly operate new facilities, and anticipated expenditure savings not reflected in the Outlook. The combination of these revenue and expenditure adjustments to the Outlook Baseline Budget constitute the IBA Revised Baseline that we believe better represents the financial operating projection of the General Fund in future fiscal years.

General Fund Five-Year Outlook 2015-2019
IBA Revised Outlook Baseline Budget*
($ in millions)

General Fund Revenues	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019
Financial Mangement Baseline Budget	$ 1,216.2	$ 1,262.1	$ 1,314.0	$ 1,356.6	$ 1,400.4
IBA Revisions to Major Revenues					
Sales Tax Adjustment	2.5	0.9	1.4	2.0	2.6
Property Tax Adjustment	3.2	4.1	7.0	10.2	10.4
State & City Mandates					
Enterprise Zone Dissolution Revenue Reduction	(0.4)	(0.7)	(0.7)	(0.7)	(0.7)
Neighborhood Parking Protection Ordinance	2.8	2.8	2.8	2.8	2.8
Property Value Protection Ordinance	0.1	0.1	0.1	0.1	0.1
Central Library O&M Donations Ending	-	-	-	-	(2.0)
DMV/Collection Referral Fee Increase	0.3	0.3	0.3	0.3	0.3
IBA Revised Revenues	$ 1,224.7	$ 1,269.6	$ 1,324.9	$ 1,371.3	$ 1,413.9

Non-Discretionary General Fund Expenditures	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019
Financial Management Baseline Budget	$ 1,235.3	$ 1,249.0	$ 1,266.9	$ 1,283.6	$ 1,296.5
IBA Additions to Baseline:					
Federal Mandates:					
Storm Water Compliance O&M[1]	9.9	13.8	10.2	14.6	17.2
Storm Water Compliance Debt Service[2]	1.0	3.6	5.4	7.1	7.1
Natural Resource Management Plans	0.1	0.1	0.1	0.1	0.1
Subtotal	11.0	17.5	15.7	21.8	24.4
State Mandates:					
Mobile Home Park Code Enforcement	0.1	0.1	0.1	0.1	0.1
Caltrans Reimbursement	1.2	-	-	-	-
Subtotal	1.3	0.1	0.1	0.1	0.1

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Non-Discretionary General Fund Expenditures	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019
City Commitments:					
Tipping and AB939 Fee Increase	1.0	1.7	2.0	2.0	2.4
Neighborhood Parking Protection Ordinance	1.5	1.3	1.3	1.3	1.3
Property Value Protection Ordinance	0.1	0.1	0.1	0.1	0.1
Prevailing Wage Compliance	0.6	0.6	0.6	0.6	0.6
P25 Radio System Infrastructure (R-306793)	0.6	0.9	1.1	1.1	1.1
Police Department Air Support	1.6	1.6	1.7	1.7	1.4
Animal Services Contract	0.4	0.4	0.5	0.5	0.5
Subtotal	5.8	6.6	7.3	7.3	7.4
Community Safety Issues:					
Brush Management	0.9	0.9	0.9	0.9	0.9
Memorial Girls Club Demolition	0.6	-	-	-	-
Playground Equipment Repair	0.1	0.1	0.1	0.1	0.1
Subtotal	1.6	1.0	1.0	1.0	1.0
New Facilities O&M Obligations:					
3 New Fire Stations (Citygate)	3.6	3.5	3.5	3.5	5.2
3 New Branch Libraries	-	-	0.3	0.5	0.8
New Central Library Maintenance	0.9	0.9	0.9	0.9	0.9
200 New Open Space Acres Annually	0.1	0.2	0.2	0.3	0.4
New Park & Rec Facilities	0.6	0.9	1.1	1.2	1.2
Subtotal	5.2	5.5	6.0	6.4	8.5
Anticipated Savings:					
Lease Savings	(0.7)	$ (0.6)	(0.6)	(0.5)	(0.5)
IT Capital Lease Reductions in Debt Service	(0.7)	(1.9)	(3.3)	(4.1)	(4.1)
Subtotal	(1.4)	(2.5)	(3.9)	(4.6)	(4.6)
IBA Revised Expenditures	$ 1,258.8	$ 1,277.2	$ 1,293.1	$ 1,315.6	$ 1,333.3

IBA REVISED OUTLOOK SURPLUS/(DEFICIT)	$ (34.1)	$ (7.6)	$ 31.8	$ 55.7	$ 80.6

**Reflects FM baseline budget plus federal and state mandates, new City Ordinances, O&M for new facilities coming on line, and IBA revenue revisions*

[1] *Includes CLRP and flood risk management activities, related M&R, and code compliance officer in DSD*

[2] *Estimated debt service for planned/authorized Deferred Capital Bond funding for CIP needs as outlined in Enhanced Option B only. Does not address unfunded CIP needs.*

IBA RECOMMENDED CRITICAL SERVICES AND OPERATIONAL NEEDS, BEYOND THE BASELINE

After revising the Baseline Budget, we reviewed all of the funding needs remaining in the Mandates, Critical Operational and Discretionary Operational categories of the Outlook. Based on this review, we have developed a second priority funding level which includes critical service enhancements, public safety plans from the Mandates section, as well as items from both the Critical Operational and Discretionary Operational categories that support the implementation of these service enhancements. An example is moving the costs for condition assessments up to this funding level, recognizing the importance of addressing infrastructure needs. For consistency and clarity, we have included all adopted or pending Public Safety plans as well as priority components of the plans on our critical list. In the Outlook, full funding for the Five-Year Police Plan is included in mandates, while Citygate Fire and Lifeguard plans are spread across three priority categories.

We have also identified in this category some critical operational needs that would support policy objectives of the Council such as Small Local Business Enterprise Certification positions, Personnel recruitment positions to assist with departmental hires and priority Information Technology projects and operational needs.

The items in this category are discretionary annual funding decisions which are based on the availability of resources and the need to balance numerous competing needs throughout the City. Because they are discretionary they are not appropriate in the Baseline Budget, and from our perspective, nor are they funding mandates. However, they are critical services or critical operating needs.

General Fund Five-Year Outlook 2015-2019 IBA Recommended Critical Services and Operational Needs ($ in millions)	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019
Public Safety					
Police Five-Year Plan	$ 14.3	$ 20.7	$ 22.4	$ 28.1	$ 28.1
Fire Citygate Report[1]	1.3	2.2	4.6	5.6	5.6
Fire Academy	0.7	0.7	0.7	0.7	0.7
Fire Critical Equipment	0.8	0.5	1.0	0.4	0.6
Fire Cross-Staffing for Hazmat Unit	1.2	1.2	1.2	1.2	1.2
Skyline Drive Temp. Fire Station	2.7	1.5	1.5	1.5	-
Lifeguard Five-Year Plan	1.7	1.3	1.7	3.0	1.7
Advanced Lifeguard Academy	0.3	0.3	0.3	0.3	0.3
Subtotal	23.0	28.4	33.4	40.8	38.2
Infrastructure					
Debt Service[2]	3.4	10.3	14.1	18.0	18.0
Maintenance & Repair[2]	3.0	6.8	19.5	20.8	22.1
Condition Assessments (Facilities and Streets)	1.6	1.0	1.0	1.0	0.5
Engineering Staff Support[3]	-	-	-	-	-
Community Plan Updates	2.8	3.0	3.0	3.0	3.0
SAP Enterprise Asset Management System	0.5	0.3	0.2	0.2	0.2
Facilities Maintenance & Repair Standard	6.3	8.4	10.4	12.4	14.4
Subtotal	17.6	29.8	48.2	55.4	58.2
Community Services					
Penny for the Arts[4]	6.2	7.8	11.7	12.7	13.6
Increases to Library Hours	1.7	1.7	1.7	1.7	1.7
Increases to Recreation Center Hours	2.3	2.3	2.3	2.3	2.3
SLBE/ELBE Certification Positions	0.2	0.2	0.2	0.2	0.2
Open Data	0.1	0.1	0.1	0.1	0.1
Subtotal	10.5	12.1	16.0	17.0	17.9
Operational Needs					
City Reorganization (Net)	0.7	0.7	0.7	0.7	0.7
Personnel / Recruitment	0.6	0.6	0.6	0.6	0.6
Information Technology	0.3	0.6	0.3	0.6	0.3
Subtotal	1.6	1.9	1.6	1.9	1.6
TOTAL PRIORITY SERVICES/PROGRAMS OPERATING EXPENDITURES	$ 52.7	$ 72.2	$ 99.2	$ 115.1	$ 115.9

[1] *Includes Citygate Working Group Plan items in Five-Year Outlook (Chief Battalion Unit, Fast Response Squad, College Avenue Station, Paradise Hills Station) in addition to 3 new stations included in IBA Revised Baseline.*

[2] *Excludes portion of funding for storm water which is incorporated into IBA Revised Baseline.*

[3] *These positions are cost neutral as they are revenue reimbursable and funded through project delivery costs charged to capital projects.*

[4] *On a budgetary basis this is a reduction to the TOT 4 Cent General Fund Revenue which would no longer be available as a resource for other General Fund TOT-related services.*

OTHER ISSUES IDENTIFIED IN OUR OUTLOOK REVIEW

General Fund Reserves

Reserve Status

The unaudited FY 2013 year-end total General Fund reserve was reported by the Office of the Comptroller as $181.9 million, which is subject to change based on completion of the FY 2013 CAFR. With $18.0 million in FY 2014 projected surplus, the projected June 30, 2014 General Fund reserve balance is $199.9 million, which is the estimated reserve balance presented in the Outlook.

However, as presented in the First Quarter Budget Monitoring Report, $21.1 million of the total reserve was approved by City Council on November 21, 2013 for a loan to the City's Successor Agency for the clawback related to the Non-Housing Fund DDR. After adjusting for this loan, the FY 2014 projected General Fund reserve is $178.8 million.

The $178.8 million is 14.2 percent of the FY 2014 General Fund projected revenue (from the First Quarter Budget Monitoring Report). This is 6.2 percent, or $77.9 million higher than the current City Reserve Policy target of 8.0 percent .

$ in millions	Estimate	% GF Projected Revenue
FY 2013 Ending Reserve Balance	$ 181.9	14.4%
FY 2014 Projected Surplus	18.0	
Sub-Total FY 2014 Projected Reserve	$ 199.9	15.8%
Non-Housing DDR "Clawback"	(21.1)	
Net FY 2014 Projected Reserve	$ 178.8	14.2%

Reserve Policy Considerations

As identified in the City Reserve Policy, the Emergency Reserve is a component of the General Fund reserve. The Reserve Policy states that the Emergency Reserve is to be used in cases of catastrophic events or natural disasters, and not to meet operating shortfalls or fund new programs. Spending from the Emergency Reserve may only be "in the event of a public emergency, as determined by a two-thirds vote of the City Council, when such expenditures are necessary to ensure the safety, lives, and property of the City and its inhabitants." As reported in the First Quarter Budget Monitoring Report, the current Emergency Reserve is $63.1 million or 5.0 of projected year-end General Fund revenues.

The Reserve Policy also states that "The Emergency Reserve target level will be 8.0 percent of annual General Fund revenues" and that "at no time will the balance in the Emergency Reserve fall below 5 percent, unless such requirement is specifically waived through an action of the City Council due to an unforeseen emergency requiring the use of the Emergency Reserve."

Funding the Emergency Reserve at an 8.0 percent policy level would necessitate designating $37.8 million in addition to the $63.1 million currently in the Emergency Reserve – for a total of $100.9 million. Specifically designating 8.0 percent of the City's fund balance as Emergency Reserves would necessitate the consideration of an additional reserve cushion for operating shortfalls or unforeseen events. These and other topics should be addressed as part of a larger discussion on the City's Reserve Policy. The Reserve Policy is anticipated to be brought forward to the Committee on Budget and Government Efficiency in the first quarter of calendar year 2014 for discussion and possible revision.

"Clawback" Risk

For initial discussion purposes, this report contemplates a total reserve level, including the 8.0 percent Emergency Reserve, of 12.0 percent moving forward. At FY 2014 year-end, this would be equal to $151.4 million, of which the amount above the 8.0 percent Emergency Reserve would be $50.5 million. This $50.5 million could be used to cover any risk to the General Fund from redevelopment dissolution that may occur, such as a future "clawback".

Based on the State Department of Finance's (DOF) adverse determinations on Recognized Obligation Payment Schedules (ROPS) 3 through 5 and the Due Diligence Reviews (DDR), it is clear that there continues to be a high level of risk to the City's General Fund. Many of these risks are based on factors that are not fully known, such as future DOF rulings, the outcome of ongoing and future litigation, and any potential clean-up legislation. While the City satisfied $21.1 million of the anticipated clawback as part of the Non-housing Fund DDR payment, the State Controller can be expected to claw back up to an additional $23.4 million from the City as part of a future asset transfer review to be completed about two years from now.

A significant and unexpected risk relates to the Community Development Block Grant (CDBG) agreement with the former RDA to repay $78.8 million over 10 years.[7] The repayment agreement was executed in June 2010, long before any proposal emerged for the dissolution legislation. Although previous payments were approved by the DOF in ROPS 1 and 3, the DOF clawed back the payment of $3.3 million made in June 2011 as part of the Non-housing Fund DDR. In addition, in its November 8, 2013 preliminary determination on ROPS 5, the DOF rejected line items relating to the CDBG repayment agreement totaling about $4.4 million. This determination would disallow the funding source that the City is relying on to allocate a large portion of the CDBG program income in the annual action plan for FY 2014-2015 and potentially in future years. Since the annual payments escalate significantly in the latter half of the 10-year term, about $59.7 million has not yet been repaid. Successor Agency staff recognize the significance of the DOF's determination and are proactively working with both HUD and the DOF to identify a resolution. It will be important to continue to preserve funds in the General Fund to mitigate potential future impacts of redevelopment dissolution given the ongoing high level of risk.

[7] This agreement was part a negotiated settlement with the U.S. Department of Housing and Urban Development (HUD) to resolve adverse findings from a December 2008 HUD Office of the Inspector General Audit report.

Excess Reserve

Based on this scenario of a 12.0 percent total reserve level, the Outlook requirement for the General Fund reserve (utilizing IBA revised total base-line revenues) in FY 2015 is $147.0 million. This makes the estimated reserve balance of $178.8 million $31.8 million over the 12.0 percent reserve level. This excess reserve could remain in the General Fund reserve, be utilized as a one-time resource for one-time expenditures (such as infrastructure), or transferred to other reserves to expedite funding goals as outlined in the Reserve Policy, among other uses. The following table shows each fiscal year's General Fund 12.0 percent proposed reserve requirement and current reserve level if this FY 2015 projected excess reserve were to be utilized.

$ in millions	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
IBA Revised Revenues	$ 1,224.7	$ 1,269.6	$ 1,324.9	$ 1,371.3	$ 1,413.9
Beginning FY Reserve Level	$ 178.8	$ 147.0	$ 152.4	$ 159.0	$ 164.6
12% Reserve Requirement (IBA Revenues)	$ 147.0	$ 152.4	$ 159.0	$ 164.6	$ 169.7
Excess Above Five Year Outlook Reserve Level	**$ 31.8**	**$ (5.4)**	**$ (6.6)**	**$ (5.6)**	**$ (5.1)**

Note: this scenario does not take into account any IBA Revised Baseline Budget projected surplus or deficit on total reserve levels.

Note that if the excess reserves of $31.8 million were utilized in FY 2015, the beginning reserve balance for FY 2016 would only be $147.0 million, as shown in the table above. At the end of FY 2016, the 12.0 percent reserve requirement would be $152.4 million, necessitating a General Fund reserve contribution of $5.4 million in FY 2016. Required General Fund reserve contributions for the remaining Outlook years would be $6.6 million in FY 2017, $5.6 million in FY 2018 and $5.1 million in FY 2019 to maintain the proposed 12.0 percent reserve requirement.

Scenarios for Use of Excess Reserves

On November 21, 2013 the Budget and Finance Committee requested our office to review a suggestion from MEA to use reserve in excess of the 8.0 percent Reserve Policy to accelerate policy goals of other General Fund reserves (i.e. public liability, worker's compensation, and long-term disability). In response, a potential scenario for use of the excess reserves would be to accelerate funding for City Reserve Policy requirements for the Workers' Compensation, Long-Term Disability and/or Public Liability Fund reserves. The following is a table showing the effect of funding the Workers' Compensation reserve to the full policy requirement. This would entail contributing $33.0 million from the General Fund in FY 2015 (as well as $7.5 million from non-General Funds). The $33.0 million would come from the excess General Fund reserves of $31.8 million and a $1.2 million contribution from the FY 2015 General Fund operating budget.

Fully funding the Workers' Compensation policy requirement in FY 2015 would save $5.4 million in expenditures that were included in the Outlook's original FY 2015 projection. Additionally, fully funding the Workers' Compensation reserve would eliminate the need for $6.6 million in annual General Fund contributions in FY 2016-2019 that were also included in the Outlook. These savings would offset the annual contributions to maintain the 12.0 percent

General Fund proposed reserve level, as previously outlined. This scenario is illustrated in the following table.

$ in millions	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
IBA Revised Revenues	$ 1,224.7	$ 1,269.6	$ 1,324.9	$ 1,371.3	$ 1,413.9
Beginning FY Reserve Level	$ 178.8	$ 147.0	$ 152.4	$ 159.0	$ 164.6
12% Reserve Requirement (IBA Revenues)	$ 147.0	$ 152.4	$ 159.0	$ 164.6	$ 169.7
Excess Reserve/(Required General Fund Contribution)	**$ 31.8**	**$ (5.4)**	**$ (6.6)**	**$ (5.6)**	**$ (5.1)**
Use of Excess Reserves to Fund Workers' Comp Reserve	$ (31.8)	$ -	$ -	$ -	$ -
Reduced Workers' Comp Reserve Contributions	$ 5.4	$ 6.6	$ 6.6	$ 6.6	$ 6.6
Adjusted Excess Reserve	**$ 5.4**	**$ 1.2**	**$ -**	**$ 1.0**	**$ 1.5**

Note: this scenario does not take into account any IBA Revised Baseline Budget projected surplus or deficit or adjusted excess reserve availability on total reserve levels.

Another alternative is to use about $9.1 million of the $31.8 million excess reserve for one-time infrastructure projects, which would leave sufficient excess reserves to avoid the need for General Fund contributions in future years of the Outlook. In particular, the City has about $50.2 million in unfunded capital projects needed for storm water compliance in FY 2015 which are critical for meeting interim compliance deadlines in 2018. If these deadlines are not met, they carry financial penalties and the risk of lawsuits against the City. The $9.1 million could help to address those projects while the City identifies a future dedicated source of funding for its significant infrastructure and storm water needs. It is important to note that any potential major reductions to needed storm water funding as a result of favorable changes to regulations would not occur in FY 2015 and would most likely be in future years beyond the Outlook period.

<u>Retirement/Pension</u>

The pension forecasts through FY 2019 are based on the most recently provided ARC projections from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, adjusted for Cheiron's estimates for impacts of events which occurred subsequent to those projections.

Those subsequent events include five-year agreements with the City's unions (FY 2014-2018), which include a five-year pensionable pay freeze (excluding merit increases and promotions). Additionally, the SDCERS Board approved a reduction in the actuarial discount rate from 7.5 percent to 7.25 percent, as well as a reduction in the long-term wage inflation rate from 3.75 percent to 3.3 percent (which would be applied after the 0 percent inflation rate through FY 2018 that is associated with the pensionable pay freeze). The impact of these subsequent events is preliminarily estimated to reduce the projection for the FY 2015 ARC by a net $12.0 million. Financial Management included the estimated $12.0 million net decrease to the former ARC projections at the same level for each of the five years in the Outlook, which we believe to be reasonable.

In addition, for FY 2013 the pension system experienced higher than assumed investment returns. The assumed investment rate of return for FY 2013 was 7.5 percent, whereas the actual FY 2013 return was 13.6 percent. This investment experience gain in isolation would have the impact of decreasing the ARC. However, an investment experience gain or loss is not the only type of experience gain or loss that could occur. The impact of demographic experience (including turnover, retirement, death and disability) is unknown at this time. Further, the potential for offsetting demographic experience losses is significant enough that considering the FY 2013 investment experience gain without the ability to consider potential demographic and other experience losses would not be fiscally prudent, for both the coming and future years. Because of the complexity of the pension system variables, the total of all effects on the ARC is unknown at this time.

The complete June 30, 2013 valuation that incorporates not only the FY 2013 investment results but all FY 2013 experience gains and losses will be available in January 2014. This valuation will determine the FY 2015 ARC and is anticipated to include updated ARC estimates for FY 2016-2019.

Identifying a Comprehensive, Long-Term Solution for Infrastructure

Council's adoption of Enhanced Option B in March 2012 was very important since it was the first Five-Year Deferred Capital Funding Plan in the City and provided a significant new investment and source of funds for capital projects. However, a more comprehensive, long-term solution is needed to address infrastructure, because the deferred capital backlog far exceeds the current estimate; infrastructure needs go beyond deferred capital; and lease revenue bonds are not a sustainable solution to address these significant needs. It is evident from the Outlook that the City continues to face significant financial constraints and competing priorities. Ultimately, a financing strategy with new revenue sources is needed to comprehensively address infrastructure needs over the long term, and we believe this is an opportune time for policy makers and staff to begin those discussions.

The Deferred Capital Backlog Far Exceeds the Current Estimate

City staff agree that the City's deferred capital backlog far exceeds the current $898 million estimate which only includes three types of assets (streets, storm drains, and facilities) and was based on limited, outdated assessments of facilities. Staff plan to revise the estimated backlog when condition assessments for facilities, sidewalks, and park assets currently being conducted are completed in early FY 2015. This information will be critical to better understanding the magnitude of the problem and establishing priorities for limited funds.

The City's Infrastructure Needs Go Far beyond Deferred Capital

In addition to deferred capital, the City's infrastructure needs include annual M&R for existing assets as well as new assets, such as critical fire stations identified in the Citygate report and infrastructure identified in community plan and PFFP updates. In addition, the new public input process for the annual CIP budget has identified extensive community needs and priorities. Staff are developing the City's first Multi-Year Capital Improvements Plan in conjunction with the FY 2015 CIP Budget to provide an overall, transparent view of where the City is with regard to infrastructure. We believe this plan is an important tool for comprehensively assessing needs, determining existing funding, and ultimately identifying a strategy for financing priority unfunded needs.

The Lease-Revenue Bond Model Is Not Sustainable

Over the long-term, lease-revenue bonds are not a sustainable solution to address significant infrastructure needs.[8] This is due to limitations on the lease burden; availability of leasable properties; and more importantly the 30-year obligation placed on the General Fund which essentially locks down a large portion of the Fund and significantly limits discretionary spending over the long-term.

- *Limitations on Lease Burden* – Total General Fund backed debt service as a percentage of available revenue, known as lease burden, is one metric for determining how much debt that the City can take on without impacting its financial health and ratings. Rating agencies consider lease burden percentages over 10 percent to be above average or high. Based on information received from the Debt Management Department, the City's lease burden (inclusive of all planned borrowings) is estimated to increase from 5.0 percent in FY 2015 to approximately 5.5 percent in FY 2019. While the City could issue several additional lease-revenue bond tranches based on the lease burden, we believe the focus should be on the more significant limitations discussed below.

- *Limitations on Available Leasable Properties* - In simple terms, lease-revenue bonds involve creating a lease between the City and the Public Facilities Financing Authority for a nominal rent, for example $1. The Authority subsequently leases back those same facilities to the City, at a rate sufficient to cover the debt service. However, there is a limit to the essential unencumbered properties available to the City to pledge for these bonds. Debt Management staff indicated that pledge able assets are most likely available for the remaining three deferred capital bond issuances of Enhanced Option B, but beyond that there is a concern regarding both available properties and whether the City would want to pledge all of its assets. **We recommend that Debt Management and Real Estate Assets conduct a study of critical infrastructure/properties that may be suitable for future lease-revenue bonds.**

- *The Bigger Issue: Long-term Obligations on the General Fund* - Revenue bonds place a 30-year obligation on the General Fund which essentially locks down a large portion of the fund. As shown in the following table, deferred capital bond debt service is about $160 million over the five-year period of the Outlook. But it is important to note that the City's debt service is only one component of the City's non-discretionary long-term obligations. When combined, these long term obligations—including OPEB and the ARC coupled with the City's other existing outstanding debt —will account for 26 percent of General Fund revenues in FY 2015. Rating agencies are beginning to look more broadly at cities' fixed obligations as a percentage of total revenues to measure financial health, rather than narrowly focusing on debt obligations metrics, such as lease burden. It is

[8] Lease revenue bonds are commonly used in California because the debt instrument is structured as a lease and not classified as debt for purposes of debt limit or voter approval.

apparent that continuing to layer on debt service obligations over 30 years will significantly reduce financial flexibility and limit discretionary spending over the long term.

DEBT SERVICE RELATED TO DEFERRED CAPITAL						
$ in millions	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	TOTAL
Existing Debt Service						
DC 1 (2009A/2010A) ($103.3 million)	$ 7.4	$ 7.4	$ 7.4	$ 7.4	$ 7.4	$ 37.0
DC 2 (2012) ($75 million)	4.6	4.6	4.6	4.6	4.6	$ 23.0
DC 2a (2013) ($35.0 million)	2.2	2.2	2.2	2.2	2.2	$ 11.0
Projected Issuances						
DC 3 part 1 (March/April 2014) ($66.4 million)	4.4	4.4	4.4	4.4	4.4	$ 22.0
DC 3 part 2 (March/April 2015) ($53.6 million)	-	3.5	3.5	3.5	3.5	$ 14.0
DC 4 (2016) ($90.0 million)	-	6.0	6.0	6.0	6.0	$ 24.0
DC 5 (2017) ($84.2 million)	-	-	5.6	5.6	5.6	$ 16.8
DC 6 (2018) ($84.2 million)	-	-	-	5.6	5.6	$ 11.2
Total	**$ 18.6**	**$ 28.1**	**$ 33.7**	**$ 39.3**	**$ 39.3**	**$159.0**

This model is not sustainable and addressing the City's significant infrastructure needs will ultimately require various funding sources, such as increasing Storm Drain fees, public-private partnerships, and/or a GO Bond Program. A stable and united leadership among the Mayor, City Council, business groups, public interest groups, and citizens is required to successfully identify and implement new revenue sources to finance infrastructure needs. We believe that this is an opportune time to begin those discussions.

Revenue and Other Funding Sources

As both the Outlook and our Revised Baseline project that the City will be unable to pay for all of its ongoing mandates and critical needs in the next several years, Council may wish to consider investigating new potential revenue sources. We include a brief discussion of some potential future revenue sources below.

Storm Drain Fee

As discussed in the Storm Water Compliance section of this report, storm drain fee revenue collected for the purpose of offsetting the General Fund contribution is significantly short of full cost recovery. IBA Reports #10-29 and #13-44 discuss the possibility of storm drain fee increases based on a variety of assumptions, the impact that the additional funding would have on the General Fund, and challenges for implementing a fee increase. The completion of a cost of service study would help to identify an appropriate fee increase, and Storm Water staff anticipate to perform this study in FY 2015.

Refuse Collection Fee for Trash

San Diego is the only major California city that does not recover at least a portion of its refuse collection expenses, all costs are currently borne by the General Fund. The People's Ordinance (Municipal Code section 66.0127) adopted by San Diego voters in 1919, requires the City of San

Diego to collect, transport and dispose residential refuse, and prohibits the City from charging a fee for this service.

For FY 2014, the cost of City-provided trash collection is budgeted at $32.3 million, which is borne by the General Fund. A refuse collection fee could be structured to recover all or a portion of the cost of providing collection services. Based on maintaining status quo for the refuse collection services and an estimated 290,000 households receiving weekly trash collection services, $32.3 million would translate into a monthly fee of approximately $9.28. These estimates are very preliminary for discussion purposes, as no cost of service study has been conducted to determine potential refuse collection fees.

Majority voter approval would be needed to amend the People's Ordinance. In addition, assuming voters approve the amendment, a Proposition 218 notification process would be required (similarly required for increases in water and sewer rates). As part of the Proposition 218 process, if less than a majority of impacted property owners files a written protest, the fee will pass subject to City Council approval. A cost of service study is not required to amend the People's Ordinance. However, justification for the proposed refuse collection fee is required as part of the Proposition 218 process.

Sales Tax Increase

Currently, San Diego imposes a 1.0 percent sales tax levy on all taxable goods within City limits, which is utilized for the support of any General Fund expenditures. This revenue source is estimated to yield the General Fund $248.5 million in FY 2014. Any sales tax increase would be subject to Proposition 26 requirements of approval by a supermajority vote. However, the sales tax increase could be specifically "ear-marked" in the ballot language to be set aside in a special revenue fund to be utilized only for use in City-wide infrastructure. Additionally, the benefit with a sales tax increase would be the compounding growth in infrastructure investment funds with increases in taxable sales.

If City of San Diego voters approved a one-half-cent taxable sales increase for infrastructure uses, the annual amount of revenue generated in each year of the Outlook based on our revised IBA sales tax revenue projections would be the following:

$ in millions	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
1/2 Cent Sales Tax Increase - New Infrastructure Funding	$ 129.1	$ 133.1	$ 138.0	$ 142.9	$ 147.9

General Obligation (GO) Bonds

GO bonds are backed by the full faith and credit of the issuing municipality, including the ability to raise taxes to make debt financing payments. GO bonds require two-thirds voter approval and are typically the least expensive type of debt available to municipalities. Lower rates will significantly reduce the final costs of capital improvements projects as the bonds are paid off over a 20 to 30 year period. A number of cities and states are financing infrastructure and affordable housing projects through voter-approved GO Bonds. Given the significant backlog of both deferred capital projects and needed new infrastructure, the City of San Diego is beginning to develop a Multi-Year Capital Improvements Plan to identify priority unfunded needs. It is anticipated that the City will begin to assess options for financing these needs, including considering a GO Bond Program.

Innovative Public-Private Partnership Funds

Several cities have developed public private partnership funds to finance affordable housing and other services. For example, the Bay Area Transit Oriented Housing Fund is a $50 million public-private financing resource that provides up-front funding for the development of affordable housing and other community services near transit lines throughout the nine-county San Francisco Bay area. Through the fund, which was started with $10 million in seed capital from the Metropolitan Transportation Commission, experienced non-profit and for profit developers, municipal agencies, and joint ventures of these entities can access flexible, affordable capital to purchase and/or improve available property near transit lines.

Note that Civic San Diego has identified public-private investment funds as a potential viable new funding source for neighborhood revitalization, economic development, and affordable housing.

CONCLUSION

The Five-Year Financial Outlook for fiscal years 2015 through 2019 is a useful tool for long-term fiscal planning. This Outlook is to be commended for its transparency in identifying the City's foreseen needs even though the forecast indicates there will be insufficient funds to address many of these needs. The document can begin to help Council Members prioritize and plan for difficult budget decisions with a better understanding of competing needs and resource constraints.

In an effort to further assist the Council in evaluating the Outlook, the IBA has endeavored to reorganize identified needs into a more realistic Baseline Budget that includes items we believe will need to be or should be funded over the Outlook period. With a revised Baseline Budget bottom line established, we then identify a second priority level IBA Critical Services and Operational Needs. This extracts items that we have been identified as Council priorities from the Outlook's Mandates, Critical Operational Needs and Discretionary Operational Needs categories. Everything else falls into a broader third tier of discretionary need even though they too have been identified as valid needs of the organization.

This report also comments on the need for new sources of revenue going forward to address the City's critical infrastructure deficiencies. Given the magnitude of these deficiencies and limitations associated with the continued use of lease revenue bond financings, the IBA believes the City must consider pursuing alternative sources of revenue for projects.

In response to requests from MEA and direction from the Budget & Finance Committee, our report also discusses the Outlook's forecast for property taxes, the pension ARC and reserves. For these items, we have either made modifications to the forecasts in the Outlook or made recommendations for Council consideration. Finally, we have commented on all major General Fund revenues and on critical expenditure needs.

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Attachments:

1. General Fund Five-Year Outlook 2015-2019 IBA Revised Outlook Baseline Budget
2. General Fund Five-Year Outlook 2015-2019 IBA Recommended Critical Services and Operational Needs
3. Increases / (Decreases) from the FY 2014 Adopted Budget to the FY 2019 Outlook Baseline Projection
4. New Facility Annual Costs Included in Revised IBA Baseline Budget