THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA's Review of the Mayor's Financial Outlook for FY 2016 - 2020

OVERVIEW

On November 14, 2014 Mayor Faulconer released his Five-Year Financial Outlook (Outlook) for FY 2016-2020, the first Outlook to be issued under his administration. To arrive at projected surpluses/deficits for each year of the Outlook, the Mayor established the baseline projection for current operations for FY 2016-2020, and then identified his Priority Initiatives and the costs associated with carrying out those initiatives over the Outlook period. The four Priority Initiatives are Infrastructure and Neighborhoods, Public Safety, Technology Improvements, and Transparency and Open Data. Not surprisingly, Infrastructure and Neighborhoods, and Public Safety make up roughly 98 percent of the total five-year funding projected for the Priority Initiatives.

As shown in the table below the Mayor's Outlook shows surpluses for each year of the Outlook, ranging from $2.9 million in FY 2016 to $61.8 million ***after*** fully funding the baseline projection as well as his four Priority Initiatives. Surpluses for the baseline only, ***before*** accounting for the Priority Initiatives, range from $58.5 million in FY 2016 to $164.1 million in FY 2020.

General Fund Amounts *($ in millions)*	FY 2015*	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Baseline General Fund Revenues	$ 1,188.5	$ 1,241.4	$ 1,279.2	$ 1,316.0	$ 1,361.8	$ 1,404.2
Baseline General Fund Expenditures	(1,202.4)	(1,182.9)	(1,189.9)	(1,206.5)	(1,229.8)	(1,240.2)
Subtotal Surplus/(Deficit)	**$ (13.9)**	**$ 58.5**	**$ 89.3**	**$ 109.5**	**$ 132.0**	**$ 164.1**
Net Priority Initiatives	n/a	(55.6)	(68.2)	(83.7)	(94.2)	(102.3)
Surplus/(Deficit)	n/a	**$ 2.9**	**$ 21.1**	**$ 25.8**	**$ 37.8**	**$ 61.8**
Additional Discretionary Operational Needs not Included in the Outlook Surplus/(Deficit)	n/a	$ 35.0	$ 30.7	$ 33.1	$ 35.7	$ 39.9

**FY 2015 budgeted amount. Updated FY 2015 projections are included in the First Quarter Budget Monitoring report and the IBA's review of that report.*

Is There Really a Surplus? No…

The issue of ***projected budget surpluses*** was discussed by the Budget and Government Efficiency Committee on November 19, 2014 following the staff presentation of the Outlook. As discussed at Committee, it is important to note that while there are surpluses projected for each year of the Outlook, they are based on funding ***existing service levels*** and the addition of new funding for the ***Mayor's Priority Initiatives*** only. While many, if not most, of his priorities will overlap with those of the community and the City Council, neither have yet weighed in on the priorities in this Outlook. Additionally, the Mayor has ***not included*** an additional $174.4 million in funding requests from City departments, for the Outlook period, that he has identified as "discretionary requests". The net dollar amounts for these requests are shown by fiscal year in the previous table.

The City still has many unfunded needs, including infrastructure and service level enhancements for Police and Library, that have been reduced over the last decade and have not yet been brought back to previous levels. While this Outlook is decidedly more positive than previous years, the City does not have enough resources to meet all of the needs of the community. It will be difficult to prioritize which areas receive additional funding, if available, during the FY 2016 budget process and beyond.

Savings Opportunities, Potential User Fee Increases Not Reflected in Outlook

While not discussed in the Outlook, we would note that as part of the FY 2016 budget process, General Fund departments are required to submit operational efficiency reductions totaling 3 percent (1.5 percent for Public Safety) to Financial Management by January 9, 2015 for consideration in the Mayor's FY 2016 Proposed Budget. This could result in budget savings in FY 2016 and beyond if proposals are determined feasible and are accepted. Additionally, results of the "San Diego Works" program, where employees are invited to submit their own proposals for achieving efficiency savings, are still under review and are not reflected in the Outlook.

The City's User Fee Policy calls for fees, charged for use of certain City facilities, programs and services, to be reviewed comprehensively every three years to determine if the revenues from these fees are meeting cost recovery goals. If the revenue is falling short of the costs of the service, revenue adjustments can be made by the Council based on this information. The required three year review is currently underway including a comprehensive study of all Park and Recreation user fees. The results are expected to be available for FY 2016 budget deliberations.

IBA Approach to Reviewing the Outlook

Each year, our review of the Outlook is comprehensive and in-depth. We review and analyze revenue assumptions and line-item projections in the Outlook for reasonableness. We review the baseline projections for funding accuracy, as well as for the inclusion of programmatic and policy decisions made previously made by the Council (e.g. Enhanced Option B, ongoing restoration of library materials, brush management contract, etc.). We are also looking for the inclusion of certain commitments (e.g. annual pension contributions, operating costs for new facilities, reserve levels, Police Air Support, etc.) and funding of mandates (e.g. stormwater permit requirements, employee organization agreements, enforcement costs for existing ordinances, etc.) – to name a few. We have also reviewed the Mayor's Priority Initiatives and Discretionary Requests in the context of priorities identified by the Council and community during past budget deliberations. Through our review, we have identified items and raised issues for Council's awareness, that we feel warrant further discussion or are not sufficiently addressed in the Outlook.

In recent years we have developed alternative Outlook scenarios which have resulted in differences in the bottom line; and we often have projected more substantial deficits than the Outlook due to revising revenues or addressing various omissions. Each year a significant number of these revisions have come to pass.

This year we have chosen to focus our report on a discussion of key issues of importance to the Council and the community as well as concerns identified by our office, rather than developing an alternative scenario. While in past years we felt it necessary to revise certain revenue projections in the Outlook, we believe the revenue projections in this Outlook are appropriate. While there is likely to be some disagreement on certain funding priorities, the Mayor's Priority Initiatives are clearly spelled out in the Outlook and they line up with many of the Council's priorities.

The Outlook also provides a list of items, totaling $174.4 million, requested by the departments that the Mayor has designated as "Discretionary Requests". This provides transparency for the Council and the public regarding the Mayor's less important priorities. The Outlook provides Council with an early look at where the Mayor will be focusing funding in the future. In February 2015 the Council will be developing and adopting its FY 2016 Budget Priorities Resolution to guide the Mayor's upcoming budget decisions. The Outlook, together with our review and analysis, will assist the Council in shaping this important message to the Mayor. While the Outlook is not a "Budget", it warrants a similar, thorough review as it is the key indicator of the Mayor's funding priorities for FY 2016.

In the next section of this report we present a high level review of key programmatic and funding issues. The sections that follow discuss these issues in greater detail and provide a more in-depth review of how Council priorities and overall departmental needs are treated in the Outlook.

<u>Significant Funding Increases Included in Outlook for Key Areas</u>

- <u>Police Sworn and Civilian Positions (Pages 32-33)</u>

The Outlook includes the addition of $27.4 million and 96.0 FTEs over the Outlook period for increased police officer positions and related equipment, and $11.1 million and 54.0 FTEs for civilian positions.

- <u>Storm Water Permit Requirements (Pages 30-31)</u>

The Outlook forecasts funding an additional $111.0 million and 66.0 FTEs for Storm Water Operations and Maintenance over the Outlook period, in order to ramp up for compliance with more stringent water quality regulations established by the Regional Water Quality Control

Board in May 2013. The Outlook also includes new capital funding of $95.4 million. Even with this significant amount of additional funding, the Outlook falls short of what staff has estimated is needed to ensure compliance with new mandates and regulations by FY 2018.

- POA Compensation (Page 22)

This is the first Mayoral Outlook that has included any funding for compensation increases for City employees (in excess of current agreements with all labor organizations), although the IBA Alternative Scenarios often included them. $46.5 million over five years has been included for compensation increases for Police Officers based on the first proposal to the San Diego Police Officers Association. Negotiations are currently underway.

- Enterprise Asset Management (EAM) (Page 27)

The Outlook includes an additional $7.0 million over five years to implement the EAM project that, when completed, will facilitate and enhance the management of the City's infrastructure assets when completed. The project originated as a Public Utilities project and has been expanded to a Citywide initiative in the last year.

- Police and Fire CAD Replacement (Page 33)

A total of $9.5 million ($7.2 million for Police and $2.3 million for Fire) has been included over the five year period to fully fund the Computer Aided Dispatch System replacement project. $5.1 million of the total has been programmed in FY 2016.

- Central Library Donation Replacement Funding (Page 41)

Library Foundation funding of $2.0 million annually in future years, for the Central Library operations and maintenance costs, ends in FY 2018. The baseline projection of the Outlook assumes General Fund replacement of these funds beginning in FY 2019.

Risks (Possible Impacts) to the Outlook

- Outcome of POA Negotiations (Page 22)

As discussed above, negotiations are underway for compensation increases for Police Officers. Funding has been included in the Outlook based on the first proposal. However, the final outcome of negotiations will determine the actual fiscal impact which could change the Outlook.

- Reopeners for Other Employee Groups (Page 22)

In the five-year agreements with the City's other employee organizations, there are reopeners allowing for negotiations 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 would total approximately $3.3 million for the General Fund.

- Possible Retirement ADC Changes (Page 22-23)

The Outlook's defined benefit pension forecasts through FY 2020 are based on the most recently provided Actuarially Determined Contribution (ADC) projections from SDCERS' actuary, Cheiron, from the June 30, 2013 actuarial valuation. Impacts of FY 2014 investment gains, estimated at 16.6 percent, are projected to decrease the FY 2016 ADC for the General Fund by $8.3 million ($11.4 million all funds). These changes have not been factored in the Outlook's pension figures which we believe is appropriate. The SDCERS Board is anticipated to consider various options for changes in actuarial assumptions that may be included in the calculation of the FY 2016 ADC. Some of the options include the following:

1. Reducing the discount rate assumption from 7.25 percent to 7.00 percent is estimated to increase the General Fund ADC by $10.4 million ($14.4 million all funds).
2. Fully implementing a new actuarial standard related to administrative expenses is estimated to increase the FY 2016 General Fund ADC by $9.4 million (all funds $12.9 million).

- <u>Qualcomm Potential Impact (Pages 14-15)</u>

Revenues from Qualcomm Stadium operations fall short of operating expenditures requiring a significant General Fund contribution each year from transient occupancy tax (TOT) revenues. In April 2011, AECOM and Magellan Consulting published a facilities condition assessment for Qualcomm Stadium, which detailed an $80.0 million requirement for facility repairs at that time. This backlog has not been addressed in any substantial fashion since this estimate was prepared. This deferred maintenance backlog could potentially require an increased TOT contribution based on needs at the stadium, and could negatively impact future fiscal TOT revenues that are transferred back to the General Fund, beyond the 5.5 cent allocation.

- <u>Zero Waste (Pages 46-47)</u>

The City Council adopted a Zero Waste objective for the City of San Diego with an initial goal of diverting 75 percent of waste generated in the City from landfill disposal by 2020 and a goal of zero waste by 2040. Due to significant revenue generating limitations within the Environmental Services Department, proposed changes to the funding mechanism supporting the Zero Waste Program could impact the General Fund in the future.

- <u>Future Fire Stations, Not Included in Outlook, That May Become Operational (Pages 37-38)</u>

In our discussion of infrastructure issues below, we note that the Outlook includes operations funding for six new fire stations, four of which lack identified capital funding for facilities. Conversely, two future developer-funded fire stations are expected to open during the Outlook period but no funding for operations is included in the Outlook. These stations, North University City Fire Station (FS 50) and Black Mountain Ranch Fire Station (FS 48) are discussed in detail later in this report.

<u>Infrastructure Issues</u>

- Lease Revenue Bonds (Pages 24-25)

The Outlook indicates the City will have issued a total of $398 million of lease revenue bonds by FY 2017 as compared to Council-adopted Enhanced Option B which called for $494.4 million in lease revenue bonds to be issued by this time. This is $96.4 million short of the plan. While this has been attributed to the delay in the current year due to Court action, we had expected to see a "catch-up plan" of $96.4 million lease revenue bonds in FY 2018 or, alternatively, a discussion of other infrastructure funding sources beyond FY 2017. We recommend the Infrastructure Committee consider evaluating and updating Enhanced Option B to address the $96.4 million shortfall in FY 2018 in order to provide guidance to the Mayor for future Outlooks- provided that sufficient staff capacity will exist to effectively execute this additional project funding. The issue of staff capacity is discussed below and in greater detail in this report.

- Condition Assessments (Pages 26-27)

Significant funding ($4.4 million) was included in the FY 2014 and FY 2015 budgets for condition assessments for streets, sidewalks, facilities and park and recreation assets. The Outlook includes an additional $3.5 million over the next five years for more condition assessments for facilities and park and recreation assets, a total of $7.9 million. These assessments are critical to identifying the magnitude of our deferred backlog for these asset types. However, results of condition assessments, funded and completed in FY 2014 and FY 2015, should be provided to Council before additional funding is considered.

- Departmental Staffing Capacity (Pages 27-30)

In order to develop a comprehensive long-term financing strategy to address priority unfunded needs indentified in the upcoming Multi-Year Capital Plan, it is important that Council be provided with information to better understand what is needed to develop and sustain staffing capacity in the Public Works – E&CP Division and other departments. This is crucial to the effective and timely execution of projects and key to planning for future infrastructure funding. There are many facets to this issue some of which we discuss in this report. It is our understanding that the Deputy Chief Operating Officer (DCOO) for Infrastructure / Public Works and the Public Works Director are in the process of developing a comprehensive business case on how best to develop sufficient staff capacity to handle a potentially higher volume of projects going forward. This will be an important discussion for the Infrastructure Committee.

- New Fire Stations (Page 36)

The Outlook includes a total of approximately $43.0 million in increased funding and the addition of 84.0 FTEs over the Outlook period to support the operation of six new fire stations. For four of these facilities, capital funding has not yet been identified to fully fund the associated design, land acquisition, and construction costs. It is atypical to include operational funds in Outlook projections prior to capital funding and completion schedules being determined.

Priority Issues that Warrant Further Discussion

- Library Materials (Page 40)

During final FY 2015 budget actions, the City Council fully restored a $500,000 reduction in library materials proposed by the Mayor in his FY 2015 Proposed Budget. The Mayor proposed this reduction as a funding source for a new after school homework program at the libraries. In their action, the Council identified $291,000 in ongoing revenue and $209,000 in one-time revenue to restore the book materials. In the Outlook, the Mayor has projected $291,000 in each year of the Outlook for materials restoration, however, the $209,000 reduction in materials is continued throughout the Outlook period and funding is included in the list of unfunded discretionary requests. It is our understanding that Council had intended the materials be fully restored for FY 2015 and beyond, and that an alternative funding resource would be found for the homework program.

- Facilities Maintenance and Repair (Page 51)

The Outlook does not include any increase in funding for facilities maintenance and repair (M&R) for any year of the Outlook. Historical underfunding of maintenance and repair to the City's facilities has been a contributing factor to the existing backlog of deferred maintenance in our facilities. The Department requested 153.0 new FTEs and $16.9 million over the Outlook period, none of which are included in the Outlook projections. They are, however, included in the list of Discretionary Requests.

- Police Attrition (Pages 32-33)

The Police Department continues to experience sworn attrition rates in excess of budgeted assumptions for FY 2015. Currently, the attrition rate is approximately 11 departures per month compared to the budgeted assumption of 9 per month. Should attrition rates continue to exceed budgeted levels in future years during the Outlook period, the net effect of added resources for expanded academies on Department staffing levels will be diminished.

- Police Five Year Plan (Pages 31-32)

The Outlook includes as Priority Initiatives significant investments in sworn and civilian hiring in all five Outlook years, but does not fully fund the staffing portion of the Five-Year Plan. Of note is the inclusion, as a Priority Initiative, of $7.2 million over five years to fund the Police Department's share of the CAD Replacement Project.

- Fire-Rescue Department Citygate Working Group Implementation Plan (Page 35)

The Outlook includes as a Priority Initiative the addition of operational expenses for six new fire stations anticipated to open during the outlook period (four of which are Citygate-recommended sites,) and the continuation of increased fire academies to augment recruitment. Additionally, the Fast Response Squad program is continued and expanded from one to two units as a Priority Initiative.

- Lifeguard Five-Year Needs Assessment (Pages 38-39)

The Outlook includes funding for the vessel replacement plan for each year of the Outlook consistent with the Lifeguard Plan. Several (but not all) other items from the plan, totaling $2.7 million and 9.0 FTEs over the Outlook period, are included in the list of Discretionary Requests.

- <u>Penny for the Arts (Pages 49-50)</u>

The Penny for the Arts Blueprint's goal for funding in FY 2016 is 8.6 percent of total transient occupancy tax (0.9 cent of 10.5 cents TOT rate) and 9.5 percent from FY 2017-2020 (1.0 cent of 10.5 cents). Funding for Penny for the Arts in the Outlook averages 1.9 percent of total TOT (0.2 cent of 10.5 cents) per fiscal year.

- <u>Library Ordinance</u>

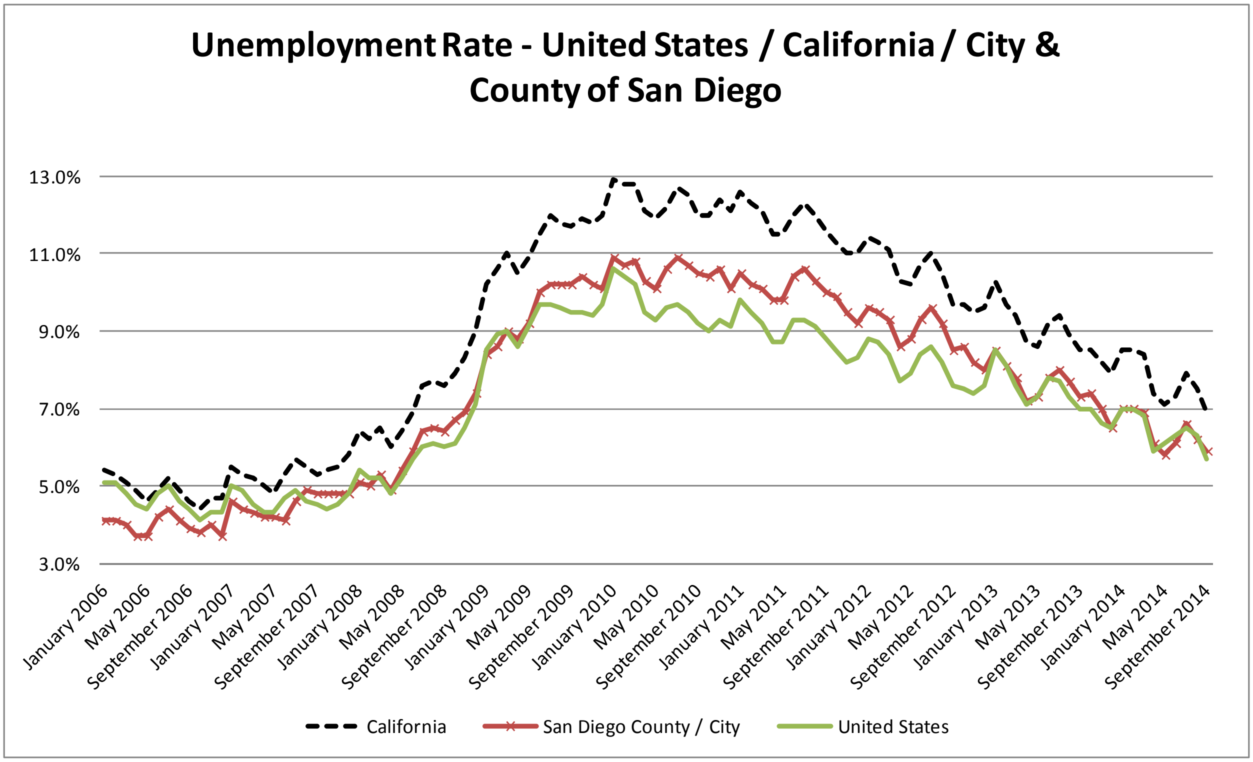
The Library Appropriation Ordinance, approved by Council in 2002, requires the Library Department budget to equal 6 percent of the General Fund's budget each fiscal year. Library funding today represents 3.8 percent of the General Fund budget. While this legislation is well meaning, the ordinance's funding requirements have been waived each year since 2004. The projections for the Outlook period for the Library Department budget would again require waiver of this ordinance for FY 2016-2020.

REVIEW OF GENERAL FUND REVENUES

<u>Economic Overview</u>

Most current economic indicators are continuing to improve on a national, state, regional, and local level. Both consumer spending (both from local residents and tourists) and the local residential real estate market, which are the largest drivers of economic activity in the region, are projected to continue their growth; albeit at a more modest pace as compared to recent years.

Local and state-wide employment have continued to improve, as shown in the following chart, 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 6.0 percent unemployment rate to 4.2 percent by the end of calendar year 2019. UCLA Anderson's California economic outlook also forecasts a continued decline in the state-wide unemployment rate to 5.7 percent at the conclusion of their outlook period at the end of calendar year 2016.



The indicators for the local residential real estate market, as forecasted by Beacon Economics, also show continued growth in single family home sales, the total value of residential construction permits issued, the total value of non-residential construction permits issued, and the median home prices through CY 2019.

Calendar Year	Quarterly Non-Residential Permit Values	Quarterly Residential Permit Values	Single-Family Home Sales	Median Home Price
CY 2015	4.3%	22.2%	15.8%	5.3%
CY 2016	4.4%	20.9%	4.7%	4.7%
CY 2017	4.7%	15.8%	1.5%	5.0%
CY 2018	5.0%	5.2%	0.7%	5.4%
CY 2019	4.7%	1.9%	1.0%	5.6%

The current economic information available shows that the improvement in the local economy will continue at a pace that is more in-line with long-term growth trends. Our opinion after reviewing the Outlook is that growth rates included for major revenues and most other revenues that are dependent on economic activity are appropriate based on this economic outlook. However, local economic uncertainty still exists with potential impacts to local military and federal government employment, which accounts for 20 percent of San Diego's regional economic activity (as reported by Point Loma Nazarene's Fermanian Business & Economic Institute), due to any potential defense budget cuts and troop drawdown. Other risks, such as the recent invalidation of the Convention Center Financing District, the potential for natural disaster or sustained extreme drought conditions 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 2014 Unaudited Revenues	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Property Tax	$ 460.6	$ 445.4	$ 443.7	$ 462.0	$ 479.6	$ 495.6	$ 512.1	$ 526.5
Sales Tax	245.9	257.1	259.1	287.9	292.2	294.0	305.4	316.1
Transient Occupancy Tax	89.7	92.3	94.2	99.4	104.9	110.1	115.6	120.8
Franchise Fees	72.0	72.0	71.1	73.4	73.7	74.1	74.3	74.4
Property Transfer Tax	8.3	9.2	8.7	9.6	10.5	11.5	12.5	13.5
Other Revenue	399.9	312.6	314.2	310.5	320.0	332.4	343.6	354.6
Total GF Revenue	$ 1,276.4	$ 1,188.6	$ 1,191.0	$ 1,242.8	$ 1,280.9	$ 1,317.7	$ 1,363.5	$ 1,405.9
Growth Rate		-6.9%	-6.7%	4.3%	3.1%	2.9%	3.5%	3.1%

The Outlook projects revenues to increase from FY 2015 budget levels of $1.19 billion to $1.41 billion in FY 2020, a total of $217.4 million or 18.3 percent over the Outlook period. Total General Fund growth ranges from 2.9 to 4.3 percent per year in the Outlook. The largest increase in FY 2016 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 end of the sales tax triple flip and continued strong growth in property tax revenues (described in the major revenue section of this report). 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 $171.0 million, which is a 19.7 percent increase in total major revenues from the FY 2015 Adopted Budget. Growth in each major revenue source is outlined as follows:

The FY 2015 First Quarter Budget Monitoring Report (First Quarter Report) is the basis for future fiscal year’s projections for major General Fund revenues. These major revenue projections incorporate the latest revenue distributions during the current fiscal year to establish an updated year-end projection and base budget utilized in the Outlook. The First Quarter Report projections for major revenues are marginally different than the Adopted Budget, while total General Fund projected revenues are also only marginally different. Additional changes in revenue projections in the base budget, outside of major revenues, include changes in property transfer tax and safety sales tax; however, base revenues for most Outlook projections are formulated using Adopted Budget estimates. Additionally, the FY 2016 forecast in the Outlook also excludes $6.4 million in one-time revenues that were included in the FY 2015 Adopted Budget and revised forecast

Property Tax

Revenue Source ($ in millions)	FY 2014 Unaudited Revenues	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Property Tax	$ 460.6	$ 445.4	$ 443.7	$ 462.0	$ 479.6	$ 495.6	$ 512.1	$ 526.5
5 Year Outlook Growth Rate				4.0%	3.5%	3.0%	3.0%	2.5%

The Outlook property tax projection is comprised of two separate revenue sources that have different growth rates for each fiscal year; first for the City’s 1.0 percent assessment in addition to the motor vehicle license backfill (MVLF) fee, and second for 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 as follows.

- 1.0 Percent and MVLF Backfill

Revenue Source ($ in millions)	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
1% Property Tax	$ 314.3	$ 313.9	$ 326.3	$ 337.8	$ 348.2	$ 358.9	$ 368.2
MVLF Backfill	114.0	115.3	119.9	124.1	127.9	131.7	135.0
Total	$ 428.3	$ 429.2	$ 446.2	$ 461.9	$ 476.1	$ 490.6	$ 503.2
Growth			4.0%	3.5%	3.0%	3.0%	2.5%

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[1]. According to the November 2014 Beacon San Diego Economic Forecast, median home prices and single family home sales will continue to improve within the County. Beacon forecasts that growth in home sales and new construction will be strong in the first few years of the Outlook period, then remaining at a long-run and stable growth rate through CY 2019. They also forecast that median home price growth will be consistent throughout their forecast period, averaging approximately 5.2 percent growth per calendar year. Beacon forecasts the following changes in the County-wide residential and commercial real estate markets for the Outlook period:

	CY 2015	CY 2016	CY 2017	CY 2018	CY 2019
Non-Residential Permit Values	4.3%	4.4%	4.7%	5.0%	4.7%
Residential Permit Values	22.2%	20.9%	15.8%	5.2%	1.9%
Single-Family Home Sales	15.8%	4.7%	1.5%	0.7%	1.0%
Median Home Price	5.3%	4.7%	5.0%	5.4%	5.6%

Additionally, the City of San Diego's property tax consultant, HdL Coren & Cone (HdL), has provided information to support a higher growth rate in FY 2016 and then declining to a more normalized growth rate in the outer years of the Outlook period. The First Quarter Report's year-end 1.0 percent property tax revenue projection represents 5.0 percent growth over FY 2014 unaudited actual revenue. This growth is a result of the City's total assessed valuation (AV) growing approximately 6.0 percent this fiscal year, with the majority of this change based on Proposition 8 recaptured value. Proposition 8 is a constitutional amendment that allows a *temporary* reduction in assessed value when real property suffers a decline in value. When the local residential real estate market declined due to the economic recession, a large number of properties received a Proposition 8 reduction in AV[2], which reduced the City of San Diego's property tax revenue receipts.

In property tax roll year 2014 (which determines FY 2015 property tax revenue), due to the economic recovery and increases in the residential real estate market, the number of parcels that were subject to Proposition 8 declined from 83,462 to 58,315, or a decrease of 30.1 percent. This decline in Proposition 8 assessments added approximately $4.4 billion in AV back to the City of San Diego. However, as can be seen in the following table, the City still has 58,315

[1] The CCPI that will be utilized to determine FY 2016 property tax Proposition 13 increases will be released in the first quarter of CY 2015, but is anticipated by HdL to be "on track" for 2 percent, the maximum allowable increase
[2] Total parcels with a Proposition 8 reassessed value grew 214 percent from 2008 to 2012

parcels subject to Proposition 8, which represents $7.7 billion in AV. This is over 30,000 parcels and approximately $4.7 billion in AV higher than the pre-recession level in 2008. As the local economy continues to improve, these Proposition 8 reductions will decline to more normalized levels, which would increase property tax revenue growth.

Property Tax Roll Year	Prop 8 Parcels	% Of All Parcels	Potential AV Recapture ($ in millions)
2008	28,165	8.8%	$ 2,955.5
2009	74,415	23.1%	$ 9,817.6
2010	72,889	22.7%	$ 10,217.2
2011	66,849	20.8%	$ 9,703.7
2012	88,573	27.5%	$ 12,809.2
2013	83,462	25.9%	$ 12,114.8
2014	58,315	18.1%	$ 7,674.2

* Source HdL via County of San Diego Assessor's Office

- Redevelopment Property Tax Trust Fund (RPTTF) Payments

Per the dissolution of California redevelopment agencies (RDA) in February 2012, the City receives additional property tax revenue from the Redevelopment Property Tax Trust Fund (RPTTF) (formerly tax increment), including both tax sharing and residual payments in association with each Recognized Obligation Payment Schedule (ROPS) period. The Outlook includes tax sharing payments of $4.4 million in FY 2016, $4.4 million in FY 2017, $4.5 million in FY 2017, $4.7 million in FY 2018, $4.8 million in FY 2019, and $4.9 million in FY 2020. Financial Management also included residual distributions based on anticipated ROPS periods. Distributions are anticipated to increase over time as various enforceable obligations are paid off and the total assessed property values in the redevelopment project areas are increased. The Outlook includes $11.4 million in residual payments in FY 2016, $13.1 million in FY 2017, $14.9 million in FY 2018, $16.7 million in FY 2019, and $18.4 million in FY 2020.

<u>Sales Tax</u>

Revenue Source ($ in millions)	FY 2014 Unaudited Revenues	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Sales Tax	$ 245.9	$ 257.1	$ 259.1	$ 275.3	$ 282.7	$ 294.0	$ 305.4	$ 316.1
5 Year Outlook Growth Rate				4.5%	4.5%	4.0%	4.0%	3.5%

The Outlook projects that sales tax revenues will grow by 4.5 percent in FY 2016 and FY 2017, 4.0 percent in FY 2018 and FY 2019, and 3.5 percent in FY 2020. The Outlook assumes a continuing decrease in unemployment and a corresponding increase in consumer confidence over its five years.

These assumptions are supported by outside forecasts for regional employment and improving market conditions. Beacon Economics is forecasting that unemployment in San Diego County will steadily fall from its current rate of 6.0 percent to 4.2 percent in 2019. Personal income is also projected to increase by roughly 5 percent per year in FYs 2016-2019. Population is expected to increase by roughly 1.5 percent per year in FYs 2016-2019. 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 HdL. Beacon projects taxable sales to increase by 5.6 percent per year through FY 2019. HdL's projections of likely growth are more conservative, at 4.3 percent growth each year through FY 2019.

We also note that Outlook's sales tax projections include the end of the 'triple flip,' which was enacted by the State in FY 2005. The elimination of the triple-flip is expected to result in a one-time increase in sales tax revenue recognized in 2016 of $12.6 million. The Outlook also assumes that in FY 2017 the City will be made whole on $9.5 million in sales tax revenue that it did not receive due to initial implementation of the triple-flip in FY 2005.

<u>Transient Occupancy Tax (TOT)</u>

Revenue Source ($ in millions)	FY 2014 Unaudited Revenues	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Transient Occupancy Tax 5.5 cent	$ 89.7	$ 92.3	$ 94.2	$ 99.4	$ 104.9	$ 110.1	$ 115.6	$ 120.8
Transienct Occupancy Tax 10.5 cent	$ 171.2	$ 176.3	$ 179.9	$ 189.8	$ 200.2	$ 210.3	$ 220.8	$ 230.7
5 Year Outlook Growth Rate				5.5%	5.5%	5.0%	5.0%	4.5%

The Outlook projection for the 5.5 cent General Fund portion of TOT includes revenue growth projections of 5.5 percent for FY 2016 and FY 2017, declining moderately to a 5.0 percent growth per year for FY 2018 and FY 2019, and finally ending at a 4.5 percent growth rate for FY 2020. The projection for TOT revenue throughout the Outlook is based on an updated FY 2015 year-end forecast, $1.9 million above Adopted Budget levels due actual revenue receipts in FY 2015 exceeding the budgeted 5.5 percent growth rate.

Growth in TOT revenue over the last four years has been robust: FY 2011 – 12.5 percent; FY 2012 – 6.6 percent; and FY 2013 – 7.2 percent; FY 2014 – 6.9 percent. However, the long-term TOT growth rate over the last 10 years has been 4.2 percent. The growth rates included in the Outlook of 5.5 percent, decreasing to 4.5 percent by FY 2020 reflects a higher than average growth rate. However, as detailed in the Outlook, the Tourism Economics, Inc. forecast for each TOT growth indicator is positive year-over-year through CY 2018, including visitor growth, room demand, occupancy, average daily rate, etc (also shown in the following table). Based on recent revenue trends, the projected continual increase in hotel stays and room rates, and general overall positive economic information (as outlined for other major revenues, including property tax and sales tax), the growth rates for TOT revenue in the Outlook are considered reasonable.

Calendar Year	Visitor Growth	Room Demand	Occupancy	Average Daily Rate
2014	2.4%	5.7%	74.6%	$ 141.7
2015	2.3%	2.0%	75.4%	$ 150.3
2016	2.5%	1.8%	75.7%	$ 159.1
2017	1.9%	1.5%	76.0%	$ 166.6
2018	1.6%	0.9%	76.0%	$ 174.0

- Convention Center Expansion

We would note that this Outlook does not include any incremental revenue from the potential Phase III expansion of the City's Convention Center. In the FY 2015-2019 Five-Year Financial Outlook, there was $12.7 million in additional revenue per fiscal year starting in FY 2017 generated from the expansion. However, in August 2014, the Convention Center Financing District (the funding mechanism for the expansion project) was invalidated by the State of California Fourth District Court of Appeals. The City Council voted to not appeal this decision and the potential, funding source, and timing for a Phase III expansion project is currently undetermined.

Transient Occupancy Tax Special Promotions Fund

Per the San Diego Municipal Code, 5.5 cents of the City's 10.5-cent TOT levy are deposited into the General Fund, while the remaining 5.0 cents are deposited into the TOT Fund and allocated for various purposes via the Special Promotional Programs (Special Promo) budget. Of the 5.0 cents deposited into the TOT Fund, the Municipal Code requires that 4.0 cents be used solely for the purpose of promoting the City, while the remaining 1.0 cent can be used for any purpose as directed by the City Council. As in the FY 2015 Adopted Budget and in previous fiscal years, the 1.0 Council discretionary cent is returned to the General Fund for support of operations (less $400,000, which is used for Mayor / City Council directed arts and culture funding). This use of returning the 1.0 cent to the General Fund for support of operations is carried throughout the Outlook period.

The following section highlights funding activities utilizing the remaining 4.0 cents of TOT in the Special Promo fund.

- 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 2015 Adopted Budget projected required contribution of TOT funds to the Qualcomm Stadium special revenue fund is $10.3 million ($4.8 million in debt service payment and $5.5 million in operating support). The Outlook assumes this TOT contribution then increases to approximately $12.8 million in FY 2016 and increases to $14.5 million in FY 2020. These increases are due to operating support for increased janitorial, cleaning costs, and debt service expenses; however, they are not increases due to a more proactive approach in dealing with the deferred maintenance at the stadium.

In April 2011, AECOM and Magellan Consulting published a facilities condition assessment for Qualcomm Stadium, which detailed an $80.0 million requirement for facility repairs at that point in time. This backlog has not been addressed in any substantial fashion since this estimate was prepared, and the backlog may potentially have grown since that time. This deferred maintenance backlog could potentially require an increased TOT contribution based on needs at the stadium and may negatively impact future fiscal year TOT revenue that is transferred back to the General Fund beyond the 5.5 cent allocation.

- Penny for the Arts

The Penny for the Arts is discussed in further detail in the expenditure section of this report.

- Utilization of TOT Fund Balance

In the FY 2015 Adopted Budget, there is a utilization of $7.8 million in TOT fund balance that was generated in prior fiscal years due to actual revenue growth exceeding projected amounts. We would note that in FY 2016, there is a use of $3.9 million in remaining TOT fund balance. This use of fund balance in FY 2016 is anticipated to exhaust the remaining fund balance and is not anticipated to be available in future fiscal years.

<u>Franchise Fees</u>

Revenue Source ($ in millions)	FY 2014 Unaudited Revenues	FY 2015 Adopted Budget	FY 2015 1st Quarter Report	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Franchise Fees	$ 72.0	$ 72.0	$ 72.8	$ 73.4	$ 73.7	$ 74.1	$ 74.3	$ 74.4
5 Year Outlook Growth Rate				1.9%	0.4%	0.5%	0.3%	0.1%

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 slightly each year of the Outlook, as detailed in the previous table; individual rates are discussed in further detail as follows.

- Cable Franchise Fees

Cable franchise fees currently constitute 25 percent of all franchise fees received by the City. The Outlook projects decreases in cable franchise fees each year in the Outlook, with cable franchise revenue decreasing by 0.5 percent in FY 2016, 1.0 percent in FY 2017 and FY 2018, 1.5 percent in FY 2019, and 2.0 percent in FY 2020. The Outlook notes that fable companies have been experiencing declining television subscriptions as demand for internet and telephone services has increased.

This decline is consistent with current trends. In FY 2011, cable franchise revenue growth was 2.8 percent. This declined to 1.1 percent in FY 2012, 0.5 percent in FY 2013. FY 2014 experienced declines in overall cable franchise fee revenue.

- SDG&E Franchise Fees

Franchise fees paid by SDG&E currently represent 56 percent of the total franchise fees received by the City. Projected revenue increases for SDG&E franchise fees are 2.0 percent for each year of the Outlook. This amount represents the average growth over the last 10 years and the forecast for energy prices and consumptions.

SDG&E franchise fee revenue is 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 and tip fees at the Sycamore Landfill total 17 percent of all franchise revenues collected by the City. The Outlook projects revenues from refuse hauler franchise fees to increase by 1.0 percent in FY 2016, 2.1 percent in FY 2017 and FY 2018, 2.0 percent in FY 2019, and 2.1 percent in FY 2021. Historically, growth and reductions in refuse disposal have broadly tracked overall economic conditions; forecasts by Beacon Economics and HdL for the San Diego region discussed previously are broadly indicative of an improving economy, and support the projected increases included in the Outlook.

<u>Other General Fund Revenues</u>

- 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 in FY 2016 is based on 10.0 percent growth above the FY 2015 First Quarter Report projection, decreasing by 0.5 percent each year of the Outlook, ending in a projected growth rate of 8.0 percent for FY 2020. 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. Property transfer tax revenue growth since this trough averaged approximately 16.0 percent per fiscal year through FY 2014. However, we would note that the First Quarter Report projection was $8.7 million, or approximately $0.5 million below Adopted Budget levels due to lower than anticipated actual revenue distributions during the first quarter.

  Additionally, residential property sales (which make up the majority of property transfer tax revenue) remained flat in September 2014 and, according to DataQuick services, home price appreciation leveled off to "historical averages" during this same time period. This continues a trend of positive, but more restrained growth as compared to the last two years. The FY 2020 projection for property transfer tax revenue is $13.5 million, which is $0.8 million greater than the peak revenue experienced during the residential boom period experience by the City in 2005. Based on this recent economic information and historical revenue amounts during times of greater economic expansion, we would note that the projections included in the Outlook for this revenue source may be too optimistic;

however, the total impact of this potential overstated revenue as a percent of total General Fund revenue in each year of the Outlook is minimal.

REVIEW OF RESERVES IN OUTLOOK

General Fund Reserve

GENERAL FUND RESERVE	FY 2015 (estimated)	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
FY 2015 YE Estimated Reserve	$ 166.2	$ 166.2	$ 166.2	$ 166.2	$ 166.2	$ 166.2
Three Year Avg. GF Revenues Subject to Policy	$ 1,124.0	$ 1,125.2	$ 1,149.8	$ 1,158.8	$ 1,199.0	$ 1,234.9
14% Reserve Requirement	$ 157.4	$ 157.5	$ 161.0	$ 162.2	$ 167.9	$ 172.9
Excess Equity / (Required Contribution or Amount of Projected Surplus To Be Put Toward Reserves)	$ 8.8	$ 8.7	$ 5.2	$ 4.0	$ (1.7)	$ (6.7)

As outlined in our review of the FY 2015 First Quarter Report (IBA #14-45), the projected FY 2015 year-end total General Fund reserve is $166.2 million. Of this, $157.4 million is projected to be required to meet the City's 14 percent total reserve requirement[3], leaving $8.8 million in excess equity. The City's 14 percent reserve requirement is based on the past three fiscal years' General Fund operating revenues; and the three-year average and corresponding 14 percent reserve requirement are shown in the previous table for each fiscal year of the Outlook.

In the Outlook, each fiscal year has a projected surplus based on baseline General Fund operations and the Mayoral Priority Initiatives. Based on the assumption that these projected surpluses are used in their entirety for additional discretionary operational needs (to be determined in the future), no General Fund reserve contributions would need to be made to maintain the 14 percent reserve requirement until FY 2019. Because there are no forecasted General Fund reserve contributions in the Outlook, if these contributions were to take place in FY 2019 and FY 2020, the Outlook's projected surplus available to meet additional discretionary operational needs would be slightly reduced as shown in the following table.

$ in millions	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Projected Surplus	$ 2.9	$ 21.1	$ 25.8	$ 37.8	$ 61.8
Incremental Amount Required to Maintain 14% Reserve	-	-	-	(1.7)	(5.0)
Remaining Surplus to be Re-Programmed	$ 2.9	$ 21.1	$ 25.8	$ 36.1	$ 56.8

By FY 2019, $1.7 million would be required to be transferred to the General Fund reserve to maintain the 14 percent policy. This grows to $6.7 million in FY 2020 if no transfer occurs in FY 2019 (or, if $1.7 million is transferred in FY 2019, an additional $5.0 million will be required in FY 2020 to maintain policy levels).

[3] Based on FY 2015 unaudited General Fund operating revenues.

Risk Management Reserves

- Public Liability Reserve

After prefunding the $3.2 million FY 2015 Public Liability Reserve contribution in FY 2014 and budgeting for the utilization of $12.8 million in excess equity, it was anticipated during the FY 2015 budget process that the Public Liability Reserve would have a balance of 40 percent of outstanding liabilities – in excess of the FY 2015 target of 37 percent of outstanding liabilities. However, several large liabilities are currently outstanding; and the current estimate indicates that the Public Liability Reserve balance will be 37 percent at the end of FY 2015, which equates to $35.1 million (shown in the "Projected Reserve Balance – Updated" column). It is important to note that Public Liability claims/payouts can be volatile, and this estimate could change, perhaps significantly.

The goal for the Public Liability Reserve per the City Reserve Policy is that the overall reserve target of 50 percent of the outstanding actuarial liability be reached by FY 2019. The Outlook includes reserve contributions to meet that goal, beginning with $2.8 million in FY 2016, as shown under the "Target Contribution – Updated" column. Note that the Public Liability Reserve is paid entirely from General Fund contributions.

Public Liability Reserve Fund Targets
($'s in millions)

	Target Contribution		Projected Reserve Balance		Balance as % of Total Outstanding Actuarial Liability *
Target Date	Reserve Policy	Updated	Reserve Policy	Updated	
June 30, 2015	$3.2	**	$35.4	$35.1	37%
June 30, 2016	$3.2	2.8	38.6	37.9	40%
June 30, 2017	$3.2	2.8	41.8	40.8	43%
June 30, 2018	$3.2	3.8	45.0	44.6	47%
June 30, 2019	$3.2	$2.8	$48.3	47.4	50%

**Based on the average value of the annual actuarial liability for the three fiscal years 2011 through 2013, or $96.5 million, for the current City Reserve Policy, and for the three fiscal years 2012 though 2014, or $94.8 million, for the Updated Target Contribution and Updated Projected Reserve Balance.*
*** $3.2 million reserve contribution was prefunded in FY 2014*

Also, during the FY 2015 budget process, Council had expressed the desire to fully fund the overall target level for the Public Liability reserve prior to FY 2019 by utilizing General Fund Excess Equity. Council may wish to again consider this approach, or alternatively, to fund the overall target in accordance with the established City Reserve Policy – the approach utilized in the Outlook.

- Workers' Compensation Reserve

For FY 2014, the Workers' Compensation Reserve had met the overall target level of 25 percent of the outstanding liability for Workers' Compensation. The outstanding liability is based on the average of the annual actuarial liabilities for the most recent three fiscal years. For FY 2014, that liability was $172.2 million (based on the average of liabilities for FY 2011 through 2013). The corresponding 25 percent target was $43.0 million.

With the June 30, 2014 valuation completed, the average of the outstanding liabilities for the three fiscal years 2012 through 2014 has increased to $193.8 million. Thus, the 25 percent reserve target has now increased to $48.5 million. The current reserve balance is approximately $47.5 million, or $1.0 million less than the target.

The FY 2015 First Quarter Report indicates that City will increase FY 2015 contributions to the Workers' Compensation Fund, which will provide the $1.0 million needed to bring the Workers' Compensation Reserve to the 25 percent reserve target. Therefore, no reserve contributions are forecasted in the Outlook.

Note that the FY 2015 contribution increase addressed in the First Quarter Report is estimated to be in excess of the $1.0 million for the reserve, at $2.8 million citywide ($2.2 million for the General Fund). The balance over the $1.0 million for reserves will be needed for claims costs.

- Long Term Disability Reserve (LTD)

Similar to the Workers' Compensation Reserve, with the June 30, 2014 valuation completed, the average of the outstanding Long-Term Disability liabilities for the three fiscal years 2012 through 2014 has increased to $18.3 million. The City Reserve Policy's LTD reserve target for FY 2015 is 91 percent of the outstanding liability, or $16.7 million. The current LTD reserve balance is $14.7 million, or $2.0 million less than the target.

The FY 2015 First Quarter Report indicates that City will increase FY 2015 contributions to the LTD Fund, which will provide the $2.0 million needed to bring the LTD Reserve to the 91 percent target. Note that $2.0 million will be the citywide contribution, with $1.4 million from the General Fund. Additionally, there is no additional need related to claims costs at this time.

The goal for the LTD Reserve per the City Reserve Policy is that the overall reserve target of 100 percent of the outstanding actuarial liability be reached by FY 2016. In order to reach the 100 percent target, the Outlook forecasts a $1.6 million contribution in FY 2016 ($1.1 million General Fund), which is anticipated to bring the reserve balance from $16.7 million to $18.3 million.

REVIEW OF GENERAL FUND EXPENDITURES

The Outlook's baseline projection shows a net $37.8 million General Fund expenditure increase (or 3.1 percent) from the FY 2015 Adopted Budget through the five-year forecast period. Note that this $37.8 million increase includes the reversal of $35.7 million in one-time expenditures for FY 2015. Removing the impact of these one-time expenditures from the $37.8 million increase yields a net increase in expenditures of $73.5 million. This projected increase in General Fund expenditures is largely driven by a $28.7 million increase in contracts due to a 3.5 percent assumed annual growth rate; a $21.8 million increase in energy and utilities due to a 9.0 percent assumed annual growth rate; a $13.7 million increase in Fleet Assignment Fees; and $12.7 million in non-pensionable compensation increases resulting from five-year agreements with the City's employee organizations. One of the largest declines is due to the completion of the McGuigan settlement financing payments in FY 2015 – a reduction of $8.0 million.

Increases/(Decreases) from the FY 2015 Adopted Budget to the FY 2020 Outlook Baseline Projection ***(in millions)***		
FY 2015 Adopted Budget	**$1,202.4**	
Salaries & Wages		
Step Increases		1.2
Termination Pay (for Annual Leave)		1.4
Reversal of One-Time Expenditures		(1.3)
Subtotal Salaries & Wages	**1.3**	**1.3**
Fringe Benefits		
Pension/SDCERS		(3.6)
Workers' Compensation		3.4
Net Other Adjustments to Fringe Benefits		0.1
Reversal of One-Time Expenditures		0.5
Subtotal Fringe Benefits	**0.4**	**0.4**
Five-Year Labor MOU's - Non-Pensionable Compensation Increases	**12.7**	
Supplies		
3.5% Annual Growth Rate Over the Five-Year Outlook		4.1
Reversal of One-Time Expenditures		(5.0)
Subtotal Supplies	**(0.9)**	**(0.9)**
Contracts		
3.5% Annual Growth Rate Over the Five-Year Outlook		28.7
Fleet Assignment Fees		13.7
Transfer of Emergency Shelter Budget from Transfers Out		1.3
Transfer of Civic SD Contribution from Transfers Out		0.3
Net Other Adjustments to Contracts		(0.3)
Reversal of One-Time Expenditures		(7.7)
Subtotal Contracts	**36.0**	**36.0**
Information Technology	**0.5**	
Energy & Utilities - 9.0% Annual Growth Rate Over the Five-Year Outlook	**21.8**	
Other		
Transfer to Park Improvements Funds		2.2
Completion of McGuigan Settlement Financing Payments		(8.0)
Delay of DC3 Issuance (DC3 anticipated for FY 2016 and included in Priority Initiatives)		(2.5)
Debts Service Payment Reductions (per debt service schedules)		(0.9)
Transfer of Emergency Shelter Budget to Contracts		(1.3)
Transfer of Civic SD Contribution to Contracts		(0.3)
Net Other Adjustments		(1.0)
Reversal of One-Time Expenditures		(22.2)
Subtotal Other	**(34.0)**	**(34.0)**
FY 2020 Outlook Baseline Projection	**1,240.2**	
Change from FY 2015 Adopted Budget to FY 2020 Outlook Baseline Projection	**37.8**	

Additional expenditures above the baseline projections are listed in the Priority Initiatives section of the Outlook. The five years of surpluses calculated in the Outlook are net of these Priority Initiatives. Also, there are additional Discretionary Operational Needs included in the Outlook report, but these needs are not included in the calculation of the Outlook surpluses – see the following table for the total amounts included for each year in the Outlook.

General Fund Amounts *($ in millions)*	FY 2015*	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Baseline General Fund Revenues	$ 1,188.5	$ 1,241.4	$ 1,279.2	$ 1,316.0	$ 1,361.8	$ 1,404.2
Baseline General Fund Expenditures	(1,202.4)	(1,182.9)	(1,189.9)	(1,206.5)	(1,229.8)	(1,240.2)
Subtotal Surplus/(Deficit)	**$ (13.9)**	**$ 58.5**	**$ 89.3**	**$ 109.5**	**$ 132.0**	**$ 164.1**
Net Priority Initiatives	n/a	(55.6)	(68.2)	(83.7)	(94.2)	(102.3)
Surplus/(Deficit)	n/a	**$ 2.9**	**$ 21.1**	**$ 25.8**	**$ 37.8**	**$ 61.8**
Additional Discretionary Operational Needs not Included in the Outlook Surplus/(Deficit)	n/a	$ 35.0	$ 30.7	$ 33.1	$ 35.7	$ 39.9

**FY 2015 budgeted amount. Updated FY 2015 projections are included in the First Quarter Budget Monitoring report and the IBA's review of that report.*

The issue of "surplus" projections contained in the Outlook was discussed by the Budget and Government Efficiency Committee on November 19, 2014. Although there are surpluses projected for each year of the Outlook, these are based on the City's funding needs with respect to the current baseline of City services, with additions for the Mayoral Priority Initiatives only.

The City still has many unfunded needs, including infrastructure and service level enhancements for Police and Library etc. that have been reduced during the last decade and have not been brought back to previous levels. The City does not have enough resources for all of those needs, and it will be difficult to prioritize which areas receive any additional funding that may be available during the FY 2016 budget process and beyond.

Lastly, we would note that in the FY 2016 budget process guidelines, General Fund departments (and other departments whose funds affect the General Fund) are required to submit operational efficiency reductions totaling 3 percent (1.5 percent for Public Safety). This is not reflected in the Outlook. Furthermore, requests for new expenditures must be limited to four percent of the FY 2015 Adopted Budget.

Salaries and Wages

The Outlook baseline projection reflects a $1.3 million increase in salaries and wages over the five-year forecast period, which excludes the impact of the five-year agreements with the City's employee organizations that occurs after FY 2015. This increase results from the following items: a $1.2 million increase for salary "step increases"; a $1.4 million increase in the termination pay estimate (which is based on DROP participants' exit dates); and a $1.3 million decrease due to one-time expenditure adjustments, largely related to the Fire Academy and Fast Response Pilot.

Funding for step increases and promotions could be underestimated in the Outlook. The projected increase is $1.2 million for FY 2016, or approximately 0.2 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 higher than projected.

The First Quarter Report indicates that the FY 2015 overall projection for salaries and wages is only $0.6 million higher than the budget. The FY 2015 component projections show that over budget overtime, termination pay and pay in lieu of annual leave roughly offset salary savings, which are largely due to vacancies. Even though salaries in the Outlook are based on updated staffing configurations, depending on the number of additional vacancies filled during FY 2015, there could be deficits in the Outlook years if overtime, termination pay and pay in lieu of annual leave continue to be over budget.

Five-Year Employee Organization Agreements

As mentioned previously, one increase in the Outlook's baseline projection is due to the impact of the five-year agreements with the City's employee organizations which provide for increases in non-pensionable compensation of $9.3 million in FY 2016, $11.0 million in FY 2017 and $12.7 million in FY 2018-2020.

The Outlook contemplates a General Fund impact within the Mayoral Priority Initiatives for a Police Officer retention program. For each year in the Outlook, the Priority Initiatives include $3.2 million above the baseline projection related to the holiday pay side letter agreement with the Police Officers Association (POA). Also, the Priority Initiatives include additions above the baseline projection of $1.7 million in FY 2016 and FY 2017; $5.2 million in FY 2018; $8.7 million in FY 2019; and $13.1 million in FY 2020. These increases are subject to negotiations with the POA; and the results of negotiations could impact the figures presented in the Outlook.

Lastly, in the five-year agreements with the City's other employee organizations, there are reopeners allowing for negotiations 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 $3.3 million for the General Fund. Note that this estimate assumes non-pensionable compensation increases, such as flexible benefits increases, rather than wage increases, and includes unrepresented employees.

Pension / SDCERS

The Outlook's defined benefit pension forecasts through FY 2020 are based on the most recently provided Actuarially Determined Contribution (ADC) projections from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, from the June 30, 2013 actuarial valuation. The estimated ADC for FY 2016 is $261.0 million citywide ($189.3 million for the General Fund); and the annual ADC estimates included in the baseline projections, over the five-year period vary by relatively small amounts each year, with an estimated citywide ADC of $258.6 million for FY 2020 ($187.5 million General Fund portion).

These amounts are ***not*** adjusted for any of Cheiron's estimates related to impacts of events which have occurred or may occur subsequent to those projections. For example, independent of other effects on the ADC, FY 2014 investment gains – estimated at 16.6 percent, compared to the assumed rate of return of 7.25 percent – have been estimated to decrease the FY 2016 ADC by $11.4 million ($8.3 million General Fund portion). However, other potential gains or losses (for example those related to turnover, retirement, death and disability) to the FY 2016 ADC have not been determined. There could also be potential changes in actuarial assumptions, such as the discount rate, that we anticipate the SDCERS Board of Administration will consider before the 2016 ADC is determined.

During the September 2014 Board meeting there was discussion regarding the impacts of reducing the actuarially assumed discount rate and for implementing a new Actuarial Standard of Practice related to administrative expenses. There are a number of options that could be considered by the Board; and the Board has yet to make the determination regarding any approaches to be taken. Examples of possibilities include the following:

- Reducing the discount rate assumption from 7.25 percent to 7.00 percent is estimated to increase the FY 2016 ADC by $14.4 million ($10.4 million General Fund portion). A lesser discount rate change would produce a lesser impact.
- Fully implementing the new actuarial standard related to administrative expenses is estimated to increase the FY 2016 ADC by $12.9 million ($9.4 million General Fund portion). Phased-in options would increase the ADC by lesser amounts.

Again, the Board has not made a decision on which of these approaches or whether these approaches will be incorporated into the June 30, 2014 actuarial valuation, which determines the FY 2016 ADC. Due to the uncertainty of future Board decisions and other unknown factors, the ADC amount in the Outlook is based on the latest projections contained in the June 30, 2013 actuarial valuation. We concur with this approach. The complete June 30, 2014 valuation that incorporates not only the FY 2014 investment results, but all FY 2014 experience gains and losses, as well as updated information on potential assumption changes, is expected to be available in January 2015. In addition to providing the FY 2016 ADC, the FY 2014 valuation is also anticipated to include updated ADC estimates for FY 2017-2020.

Retiree Benefits (OPEB)

The City provides a retiree health defined benefit plan for employees hired before July 1, 2005. At the end of FY 2011, the City reached agreement with its six employee organizations regarding a restructured benefit level for employees retiring on or after April 1, 2012. The duration of the agreement with the employee organizations is 15 years, and it can be modified after June 30, 2014.

The agreement provides that the City does not anticipate paying more than $57.8 million annually for the retiree health benefit through FY 2015, and thereafter does not anticipate increasing the payment by more than 2.5 percent annually. The last three Five-Year Financial Outlooks have forecasted for the 2.5 percent increases for years subsequent to FY 2015. However the FY 2016-2020 Outlook does not include the 2.5 percent increases after FY 2015; and FY 2016 through FY 2020 are held steady at a citywide forecast of $57.8 million in the baseline projection.

During subsequent annual budget processes beginning with FY 2016, the City will need to analyze whether the funding needs to be increased above the $57.8 million citywide level budgeted in FY 2015. The financial impact of 2.5 percent increases in the near term is approximately $1.5 million annually citywide.

DEFERRED CAPITAL AND INFRASTRUCTURE

Bonding Portion of the Capital Investment Plan

Between FY 2009 and FY 2012, the City issued three series of lease revenue bonds totaling $213.0 million, known as DC 1, DC 2 and DC 2A. As of June 30, 2014, all DC 1 bond proceeds ($103.3 million) were expended. Approximately $40.9 million of the DC 2 bonds ($75.0 million) and $7.4 million of the DC 2A bonds ($35.0 million) has been spent to date. This leaves approximately $61.2 million in unspent DC 2 and DC 2A bond proceeds. Staff indicates that approximately $35.2 million of the unspent $61.2 million has been encumbered for capital projects.

On March 20, 2012, the Council took a significant step towards providing infrastructure funding when it approved a multi-year capital expenditure plan known as Enhanced Option B. Enhanced Option B called for the annual issuance of lease revenue bonds to fund capital projects totaling $494.4 million, as well as to provide annual maintenance and repair expenditures totaling $370.0 million over a six year period through fiscal year 2017.

Based on the original infrastructure backlog estimate of $898 million, full implementation of the Enhanced Option B Plan was designed to slow the rate of deterioration of streets, facilities, and storm drains, so that infrastructure would only deteriorate by 5 to 10 percent over the life of Enhanced Option B. Due to unanticipated legal challenges, the timing of planned lease revenue bond borrowing has been significantly delayed.

The Outlook includes debt service for planned lease revenue bond issuances of $120.0 million in FY 2015, $84.2 million in FY 2016 and another $84.2 million in FY 2017. There are no other bond issuances planned beyond FY 2017 in the new Outlook. As shown in the table below, if bonds are issued as planned through FY 2017, the City will be <u>$96.4 million behind the amount called for in the Enhanced Option B Plan</u>.

$ in millions	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**	**FY 2016**	**FY 2017**	**TOTAL**
Council Approved Enhanced Option B Plan (March 20, 2012)	$ 75.0	$ 80.0	$ 81.0	$ 90.0	$ 84.2	$ 84.2	$ 494.4
Bonds Issued or Planned in the FY 2016-2020 Outlook	$ 75.0	$ 35.0	$ -	$ 120.0	$ 84.0	$ 84.0	$ 398.0
Enhanced Option B Plan: Bonding Shortfall							**$ (96.4)**

Understanding the nature of the unanticipated delays, the IBA is not overly concerned that $494.4 million of bonds will not be issued by FY 2017 as planned. We believe the $96.4 million shortfall amount could reasonably have been scheduled for FY 2018 in the Outlook thereby completing Enhanced Option B in one more year. Our larger concern is that the Outlook does not reflect a funding plan beyond FY 2017. In order to effectively address the City's infrastructure problem and simultaneously develop/maintain staff project management capacity, it is imperative that the City have a reliable annual funding plan for each year in the foreseeable future.

With regard to the $120.0 million of bonds planned for issuance in FY 2015 (DC 3), the Outlook indicates the first installment or series of the DC 3 bonds ($71.0 million) is expected to be issued in December 2014. However, staff has since decided to wait for resolution of a second legal challenge before issuing any of the DC 3 bonds. City staff is hopeful that this litigation will be resolved in favor of the City and anticipates a final decision on or before the end of February 2015.

Given this latest delay, it is our understanding that staff are currently discussing the appropriate size of the first series of the DC 3 bonds based on project needs and bond market conditions. There is some uncertainty about whether the DC 3 bonds will now be issued in one bond series or two, and whether the $120.0 million of authorized bonds will be issued in FY 2015 or partially deferred into FY 2016. If a portion of the $120.0 million is pushed back into the next fiscal year, it is possible that it could delay or have timing implications for the planned FY 2016 ($84.2 million) and FY 2017 ($84.2 million) bond issuances.

Mayor's Commitment to Allocate 50 Percent New Revenue Growth to Infrastructure

The Mayor has committed to allocate at least half of new revenue growth (based primarily on the four Major Revenue categories) to infrastructure and neighborhood repair efforts through FY 2020. This commitment resulted in an additional $22.0 million being dedicated to infrastructure related projects in the FY 2015 Budget. The annual amount of the commitment projected in the Outlook is shown in the table below.

$ in millions	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook	TOTAL
Commitment in Outlook - 50 Percent Major Revenue Growth	$ 28.8	$ 14.8	$ 12.6	$ 17.9	$ 16.2	$ 90.3

While this represents a noteworthy commitment toward infrastructure funding, it should be noted that the amount of this commitment is relatively small compared to total needs. Additionally, the annual commitment is not cumulative or guaranteed as it will fluctuate annually with the economy. There will not be an annual allocation pursuant to this commitment if there is no year-to-year growth in the City's four Major Revenue categories.

Maintenance and Repair (M&R)

The Five-Year Enhanced Option B Funding Plan for deferred capital, which was adopted by Council in March 2012, included both lease revenue bond proceeds for capital projects as well as annual General Fund allocations for Maintenance & Repair (M& R). This mix of funding was projected to slow the rate of deterioration of streets, facilities, and storm drains to 5-10 percent over the five-year period based on data available at that time. The M&R category of funding for Enhanced Option B was intended to set funding goals for maintenance projects, such as roof repairs and painting, which can only be funded with cash and are not eligible for bond funding.

The following table compares the M&R funding requirements to actual expenditures for FY 2013, FY 2014 and to the budget for FY 2015; also shown is a comparison of future years' M&R funding requirements for Enhanced Option B to the funding levels included in the Outlook.

MAINTENANCE & REPAIRS (M&R) ($ in millions)	FY 2013	FY 2014	FY 2015	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Enhanced Option B	$ 54.1	$ 50.0	$ 62.0	$ 66.0	$ 79.0	$ -	$ -	$ -
Previous Budgets / Outlook Period[1]	54.1	56.1	70.3	66.0	79.0	80.6	82.3	83.8

1 - Includes M&R and cash funding for FY 2013-2015. According to the Outlook, the split between M&R and cash funding in future years will be determined during the budget process.

In the past three budgets a portion of the M&R cash funding has been used for capital projects potentially eligible for bond proceeds, such as asphalt overlay of streets. This has been done transparently and is clearly shown in the Outlook:

M&R vs. CAPITAL EXPENDITURES ($ in millions)	FY 2013	FY 2014	FY 2015
Maintenance & Repair	$ 45.8	$ 52.6	$ 53.0
Capital Expenditures	8.3	3.5	17.3
TOTAL	$ 54.1	$ 56.1	$ 70.3

Condition Assessments

As shown in the following table, the City continues to invest significant General Funds to more accurately identify the magnitude of our deferred maintenance and capital backlog as well to assist in determining funding priorities based on service level goals. It is widely acknowledged that current backlog figures are outdated and understated. Some facilities were assessed in 2008 and 2009, the streets assessment was done in 2011, and sidewalks and park facilities have never been comprehensively assessed.

CONDITION ASSESSMENTS Asset Type ($ in millions)	FY 2014	FY 2015	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Streets	$ -	$ 0.6	$ -	$ -	$ -	$ -	$ -
Sidewalks	1.0	0.1	-	-	-	-	-
Citywide Facilities	1.0	1.0	1.0	0.5	0.5	-	-
Park and Recreation Assets	0.3	0.4	0.3	0.3	0.3	0.3	0.3
TOTAL	$ 2.3	$ 2.1	$ 1.3	$ 0.8	$ 0.8	$ 0.3	$ 0.3

While approximately $4.4 million was budgeted and is expected to be largely expended between FY 2014 and FY 2015, the Outlook projects that an additional $3.5 million will be needed for assessments during the Outlook period (FY 2016-2020). In IBA Report No 14-43 “Revenue Options to Address Critical Infrastructure and Affordable Housing Needs”, issued November 14, 2014, we discuss the status of condition assessments in much greater detail and note that, while we attempted to provide a more comprehensive estimate of the City’s backlog, it proved extremely difficult as the results from the FY 2014 and FY 2015 assessments are not yet available. It is our understanding that some of the results will be provided as part of the Multi-Year Capital Plan when presented to the Infrastructure Committee on January 15, 2015.

In recent Outlooks and budgets, we have strongly advocated for the inclusion of adequate funding for these condition assessments since the results are vital to understanding the extent of our deferred maintenance and capital backlog, determining future funding requirements, communicating the needs to our residents and more comprehensively addressing the backlog. Hence, the results of all condition assessments, that are completed or underway, should be made available to the City Council and the public as soon as possible. While this is a five-year Outlook and not a budget, we would caution the Council about allocating any additional funding in FY 2016 as projected, until the Council has the results from the assessments that were funded in FY 2014 and FY 2015.

Infrastructure Enterprise Asset Management (EAM)

The Enterprise Asset Management (EAM) project is a citywide strategic initiative for implementation of a unified SAP EAM system that integrates data and business processes to facilitate the effective and efficient management of the City's infrastructure assets. This system is required to implement citywide Asset Management, a critical component of the City's infrastructure program. It is particularly important given the large number of assets the City owns and the vast amount of information that will need to be collected and analyzed to implement the most cost effective asset management strategies. The new position of Program Manager for EAM was funded in the current year, and was recently hired, to provide leadership and oversight over all aspects of this multi-department project.

Originally initiated and funded by the Public Utilities Department (PUD), the project is now a citywide strategic initiative and includes the participation of five departments (PUD, Environmental Services, Transportation and Storm Water, Public Works and Department of Information Technology) and the replacement of various legacy maintenance management systems. This expanded project scope is reflected in the FY 2016-2020 Outlook by significantly increasing Non-Personnel Expenses (NPE) CIP funding, over last year's Outlook, as shown in the following table:

EAM FUNDING IN CURRENT OUTLOOK vs. PREVIOUS OUTLOOK					
$ in millions	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	TOTAL
FY 2016-2020 Five-Year Outlook Funding	$ 3.7	$ 3.0	$ 0.1	$ 0.1	$ 6.9
FY 2015-2019 Five-Year Outlook Funding	$ 0.3	$ 0.2	$ 0.2	$ 0.2	$ 0.9

The funds included in the Outlook, both General and Non-General Funds, are anticipated to fully fund the NPE part of the budget. Note that the Personnel Expenditures (PE) portion of the project is already being funded as part of departmental budgets. The total EAM project budget is $39.7 million with $27.8 million (70 percent) of the project funded by PUD's enterprise funds.

Staff Capacity for Infrastructure

On November 15, 2014, the IBA issued Report # 14-43 to discuss potential revenue options that could be considered to address the City's significant infrastructure needs including affordable housing. Given the magnitude of the City's needs and a worsening of the problem over time, our office has continued to discuss the need to identify a substantial new revenue source (or sources) to finance our deferred capital backlog and infrastructure in a greater way. It is important to note that most new revenue sources will require voter approval, time to develop a critical projects list, and community support. Additionally, the City will need to coordinate in advance with other jurisdictions (e.g., San Diego Unified School District) who may also be seeking voter approval for their own capital needs.

It is critical to understand that any successful plan of finance requires a thoughtful Multi-Year Capital Improvements Plan, project management staff (and the contractors they rely on), and other citywide support staff from such departments as Equal Opportunity Contracting and Real Estate Assets, to execute the plan. A key question that may not have received adequate discussion in recent years is "What is necessary for the City to develop and maintain staff capacity and industry capacity (e.g. contractors, vendors, and consultants) to efficiently manage a greater volume of infrastructure projects going forward?" Based on our discussions with staff, we understand that numerous factors impact staff capacity and these factors need to be addressed in developing an effective long-term financing strategy.

- Staff Capacity Maximized When Funding is Predictable

In discussing what is needed to better develop and sustain project management capacity, the Public Works Director has emphasized the importance of a predictable and reliable source of funding (for at least five years in the future). Over the past several years, the Public Works – E&CP Division department has ramped staff up or down, or reassigned them to enterprise funded projects where projects and revenues are predictable, to adjust to changes in the financing plan (primarily delays in deferred capital bonds issuances for Enhanced Option B). A review of recent Outlooks shows substantial changes in the City's infrastructure financing plan. These changes have been largely attributed to unanticipated circumstances like legal challenges to lease revenue bonds and changes in the administration. It is expected that the Multi-Year Capital Plan scheduled for release in January 2015 will help the City to better understand priority capital needs and identify revenue funding. This will serve as a basis for development of an effective, long-term financing strategy.

- Impacts of Transition to Internal Service Fund

The unpredictability of future funding impacts the Public Works – E&CP Division's ability or capacity to execute planned projects in a variety of ways. As an internal service fund, which was put into place in FY 2015, the department relies entirely (100 percent) on project funding to pay for staff. When non-enterprise funding (such as lease revenue bond proceeds) is not available as planned, management shifts existing staff to work on enterprise projects (such as Public Utilities where funding is available) in order to keep staff engaged and stay within budget. When this happens, the staff expertise or experience needed to execute General Fund projects is often transferred to the enterprise funded projects.

Additionally, when project funding is not available as planned, budgeted positions may be left vacant. As an internal service fund, the Public Works – E&CP Division may opt to leave positions vacant when a project funding source cannot be identified. Currently, the Department has 55 vacancies, 31 of which were authorized in the FY 2015 budget, to address capacity issues. However, in developing their request for the Outlook, the department requested an additional 90 positions (representing 20 percent annual project growth) over the five-year period that they anticipate needing to execute a combination of General Fund, enterprise fund and lease revenue bond projects over the Outlook period.

- Design May be Hindered by Uncertainty of Construction Funding

The lack of predictable funding may also hinder moving forward with the design of projects due to the uncertainty of construction funds being available to complete the projects in the future. Project design takes roughly 70 percent of a project's time and 30 percent of its total cost whereas construction takes 30 percent of the time and 70 percent of the cost. When future funding is uncertain, staff often will redirect funds away from project design in order to finish other projects that have already been designed. When this happens, it adversely impacts long-term project readiness and, importantly, the City's ability to expend future funds in a timely manner because projects are not designed and ready for construction.

- Reliable Funding Allows for Better Use of Efficiency Processes

The use of some streamlining and efficiency programs as recommended by City staff and approved by City Council, such as Multiple Award Construction Contracts (MACC), is also hindered by the lack of a significant and reliable funding source. Since Council approval of the process, MACC has only been utilized once and, very successfully, for pipeline projects where reliable funding exists. This is because the use of MACC requires full funding up front for the projects, in contrast with a design-bid-build approach, where funding can be phased for design and construction. It should also be noted that contractors (who must also manage their workforces) care about the certainty of available work. More contractors will plan to be available to bid City infrastructure projects when they have reason to believe the City has a long-term plan with reliable funding.

- "Start and Stop" of Lease Revenue Bonds Impacts Staff Capacity

The City has lacked a robust non-enterprise capital funding plan for many years and the condition of the City's infrastructure is deteriorating. Unanticipated delays in the funding coupled with the absence of a Multi-Year Capital Plan have made it difficult for Public Works – E&CP Division as well as other City departments and offices involved in project delivery to properly develop staff capacity or establish a rhythm to their annual workload. For example, it was initially determined that $120 million of lease revenue bonds to be issued FY 2015 should be divided into two series. The first bond series of $71 million was to be issued late in 2014 with a second bond series of approximately $49 million to be issued sometime in the spring of 2015.

By splitting the bond into two series, staff would have been able to accommodate projects according to their capacity to manage them. Staff would not have been able to efficiently utilize the entire $120 million in 2014, so they alternatively planned for a $71 million mix of projects that could reasonably be initiated late in 2014. However, the decision to wait for resolution of yet another legal challenge delayed the first bond series and the planned receipt of $71 million for projects in 2014. Staff must now endeavor to recalibrate their plans for a different funding/project mix in order to be ready to proceed when/if bond proceeds become available in the spring of 2015.

- Better Understanding of Staff Capacity is Key to Effective Program Execution

In order to develop a comprehensive long-term financing strategy to address priority unfunded needs identified in the upcoming Multi-Year Capital Plan, it is important that Council be provided with information to better understand what is needed to develop and sustain capacity in the Public Works – E&CP Division and other departments (Real Estate Assets, Development Services, City Attorney, etc.) to effectively deliver projects in a timely manner. An effective long-term financing strategy must be complemented by sufficient City staff and consultant capacity and a contractor workforce that can reliably anticipate an increased volume of work, preferably in pre-determined infrastructure project areas (streets, facilities, etc).

Before the City can reasonably ask voters to approve a new funding source to address our infrastructure needs, the City needs to better demonstrate its ability to efficiently expend existing resources (lease revenue bond proceeds and other infrastructure revenue sources) in a timely manner. It is our understanding that the DCOO for Infrastructure/Public Works and the Public Works Director are in the process of developing a comprehensive business case on how to best develop sufficient City, consultant, and contractor capacity to handle a higher volume of critical infrastructure projects going forward (related to levels of funding from new revenues), in order to have a full discussion at the Infrastructure Committee in early 2015. Additionally, we recommend the Infrastructure Committee consider requesting the remaining bond portion of the Enhanced Option B plan ($96.4 million) be included for FY 2018 in the next Outlook - provided that sufficient staff capacity will exist to effectively manage the selected projects in FY 2018.

STORM WATER COMPLIANCE INFRASTRUCTURE

As noted in the Outlook and in IBA Report #13-44, the Municipal Storm Water Permit adopted by the Regional Water Quality Control Board (RWQCB) in May 2013 established more stringent water quality mandates and regulations that the City is required to meet. The Storm Water Division prepared and uses a Watershed Asset Management Plan (WAMP) to estimate funding requirements for both operating and capital needs in order to address permit compliance, flood risk management, and the deferred capital storm drain assets. The stormwater compliance figures included in the Outlook's priorities are consistent with the WAMP.

The regulations have a compliance deadline of 2018, which requires significant increases in operating and capital expenditures throughout the Outlook period. The Outlook forecasts providing additional funding and positions in the following amounts over the course of FY 2016 through FY 2020:

Funding for Storm Water Compliance Included in Priority Initiatives					
$ in millions	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
FTEs	29.00	44.00	57.00	62.00	66.00
Expenditures	$ 14.7	$ 25.0	$ 21.6	$ 23.9	$ 25.9

These amounts represent significant increases in both positions and funding for stormwater permit compliance activities, and are consistent with an increased ramping up of compliance efforts. We do note that additional capital needs continue to exist. These needs are recognized in the Outlook, which includes the following needs and funding levels associated with stormwater permit compliance:

$ in millions	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Total Need	$ 158.1	$ 194.4	$ 233.0	$ 254.6	$ 215.1
Operations and Maintenance Priority Needs Included in Outlook	48.1	58.3	55.0	57.3	59.3
CIP Funding Planned	28.9	28.9	2.9	2.9	2.9
Remaining Funding Needed	$ 81.1	$ 107.2	$ 175.1	$ 197.4	$ 155.8

The Outlook anticipates using $2.9 million from the Department's Operations and Maintenance budget for capital projects in each year of the Outlook, and an additional $26.0 million from DC3 bond revenues in both FY 2016 and FY 2017. These amounts do not meet the total funding needed to ensure compliance with the new stormwater permit. As our office has noted in past reports, and as is noted in the Outlook itself, the City may incur significant penalties if it is unable to meet the required stormwater regulations by 2018. Such penalties could include $10,000 per day violations from the RWQCB and $27,500 per day federal EPA penalties, as well as an increased risk of third party lawsuits.

It will become increasingly important for the City to identify funding sources necessary to comply with the new stormwater permit if it is to avoid fines and litigation. At present, the City collects a storm drain fee from water and sewer utility customers for the purpose of partially reimbursing the General Fund for storm water activities. That fee, however, only provides $5.7 million annually, which is well short of the total capital and ongoing needs of the stormwater program (the total unfunded needs in the Outlook total $716.5 million). IBA reports #10-29, #13-44, and #14-43 all discuss the possibility of a storm drain fee increase, though before any increase could go forward, the City would need to prepare a cost of service study detailing the calculations necessary to determine an appropriate fee level.

The Outlook does note that the City is currently working with the RWQCB and the State Water Board to encourage reasonable implementation of stormwater regulations, which could reduce projected compliance needs. While these discussions may reduce the total needs identified in the Outlook, it is likely that additional funding beyond that included in the Outlook's baseline and Priority Initiatives will still be necessary to ensure compliance.

GENERAL FUND DEPARTMENT AND PROGRAM PROJECTIONS IN OUTLOOK

Police Department

Significant Items Funded in Mayor's Priority Initiatives

- Comparison of Outlook to Police Department Five-Year Plan

The Police Department Five-Year Plan was first presented to the former Public Safety and Neighborhood Services Committee in July 2012, and was most recently updated and approved by the City Council in November 2013. The Police Five-Year Plan 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. The plan also identifies significant equipment needs, including the replacement of the Computer Aided Dispatch (CAD) System.

A comparison of the Police Department Five-Year Plan and the Outlook is provided in the following table. Information is presented for FY 2016 through FY 2018, as FY 2018 is currently the last year of the Five-Year Plan. A discussion of key items included as Priority Initiatives in the Outlook (whether part of the Five-Year Plan or not) follows.

Police Department Five-Year Plan FY 2016-2018

Identified Needs	Cost*	Status
FY 2016		
Addition of 36.0 Sworn Positions	$ 6,372,000	Partially included in Outlook as a Priority Initiative. Outlook does not add FTEs but does include approximately $1.1 million in added expenditures to support the continuation of four expanded police academies per year. Current vacancies are sufficient to be filled with new recruits in FY 2016.
Addition of 24.0 Civilian Positions	$ 2,424,000	Partially included in Outlook as a Priority Initiative. Outlook adds 13.5 FTEs and $853,048 in expenditures in FY 2016.
New Recruit Equipment	$ 244,000	Included in Outlook as a part of the Priority Initiative for Police Officer Positions and Equipment.
New Police Vehicles	$ 847,000	Not funded in Outlook. Although the Police Department funded the purchase of nine vehicles in FY 2015 using FY 2014 Justice Assitance Grant (JAG) funds, the Department currently does not have a funding plan for vehicles.
Restoration of ABLE and Canine Hours	$ 402,000	Discretionary Need of $412,500 identified in FY 2016, not funded in Outlook.
Replace Outdated Equipment	$ 1,837,000	Discretionary Need of $2,854,210 identified in FY 2016, not funded in Outlook.
CAD Replacement Project	$ 5,200,000	Included in Outlook as a Priority Initiative in FY 2016 (updated cost of $4,975,902).
Maintenance of Existing Facilities	$ 750,000	Discretionary Need of $1,000,000 identified in FY 2016, not funded in Outlook.
FY 2017		
Addition of 35.0 Sworn Positions	$ 6,195,000	Partially included in Outlook as a Priority Initiative. Outlook adds 32.00 FTEs and $1,727,292 in expenditures in FY 2017.
Addition of 24.0 Civilian Positions	$ 2,424,000	Partially included in Outlook as a Priority Initiative. Outlook adds 13.5 FTEs and $751,528 in expenditures in FY 2017.
New Recruit Equipment	$ 237,200	Included in Outlook as a part of the Priority Initiative for Police Officer Positions and Equipment.
New Police Vehicles	$ 962,000	Not funded in Outlook.
Restoration of ABLE and Canine Hours	$ 407,000	Discretionary Need of $458,267 identified in FY 2017, not funded in Outlook.
Replace Outdated Equipment	$ 1,876,000	Discretionary Need of $3,536,193 identified in FY 2017, not funded in Outlook.
CAD Replacement Project	$ 1,200,000	Included in Outlook as a Priority Initiative in FY 2017 (updated cost of $950,768).
Maintenance of Existing Facilities	$ 750,000	Discretionary Need of $1,000,000 identified in FY 2017, not funded in Outlook.
FY 2018		
Addition of 35.0 Sworn Positions	$ 6,195,000	Partially included in Outlook as a Priority Initiative. Outlook adds 32.00 FTEs and $2,980,916 in expenditures in FY 2017.
Addition of 24.0 Civilian Positions	$ 2,424,000	Partially included in Outlook as a Priority Initiative. Outlook adds 13.5 FTEs and $751,529 in expenditures in FY 2017.
New Recruit Equipment	$ 237,200	Included in Outlook as a part of the Priority Initiative for Police Officer Positions and Equipment.
New Police Vehicles	$ 1,077,000	Not funded in Outlook.
Restoration of ABLE and Canine Hours	$ 402,000	Discretionary Need of $509,901 identified in FY 2018, not funded in Outlook.
Replace Outdated Equipment	$ 1,789,000	Discretionary Need of $2,227,858 identified in FY 2018, not funded in Outlook.
CAD Replacement Project	$ 1,300,000	Included in Outlook as a Priority Initiative in FY 2018 (updated cost of $850,769).
Maintenance of Existing Facilities	$ 750,000	Discretionary Need of $1,000,000 identified in FY 2018, not funded in Outlook.

*Costs in this table reflect estimates provided in the October 2013 update to the Police Department Five-Year Plan and may not match costs used in the Outlook.

- Sworn and Civilian Staffing Increases

The Outlook includes as Priority Initiatives significant investments in the civilian and sworn hiring needs identified by the Police Department in its Five-Year Plan, but does not fully fund this portion of the plan. For example, in FY 2016 the Department's Five-Year Plan identifies the need for 24.0 FTEs for additional civilian positions, while the Outlook includes 13.50 FTEs. On the sworn side, the Five-Year Plan calls for 36.0 additional FTEs for police officer positions in FY 2016. The Outlook does not increase positions but does add approximately $1.1 million in funding for equipment and other non-personnel expenses. Based on current staffing levels that have changed since the last Five-Year Plan update, the Department has indicated it has sufficient sworn vacancies to support the continuation of expanded police academies in FY 2016 without adding positions. This is reflected in the Police Department Priority Initiatives section of the Outlook.

As we have highlighted in previous reports, the Police Department continues to face sworn attrition rates in excess of those assumed in the FY 2015 Adopted Budget. While the FY 2015 budget assumed a sworn attrition rate of nine departures per month, the current rate is approximately 11 departures per month. Should attrition rates continue to exceed assumed budgeted levels, expanded police academies in FY 2015 and future fiscal years will not significantly improve staffing levels. This will hinder the Department's ability to meet the staffing goals identified in its Five-Year Plan.

- CAD Replacement Project

The CAD replacement project is an essential component of the Police Department's Five-Year Plan. The Outlook includes as a Priority Initiative approximately $7.2 million in expenditures over five years for the Police Department's share of the replacement CAD system. This is in addition to approximately $2.3 million in expenditures over five years for the Fire-Rescue Department's share of the cost of the system.

The most significant CAD-related cost included in the Outlook is a projected expenditure of approximately $5.0 million in FY 2016 from the Police Department General Fund budget. In past reports, our office had raised the possibility of utilizing a lease purchasing option via the City's Master Lease Agreement as an alternative to cash funding this major investment. Given the Outlook's projection of future available General Fund support and the critical importance of the CAD replacement project, we believe cash funding is also reasonable.

The Police Department has indicated that the funding included in the Outlook should be sufficient to fully fund the CAD replacement project and that the Department will require, and be prepared to expend, the funds in FY 2016. The RFP evaluation panel is currently reviewing proposals for the project. The panel is expected to select a vendor in March 2015, to be approved by the City Council in April 2015. After Council approval, configuration and installation of the system would begin shortly thereafter and take approximately 12-18 months to complete. The Department anticipates that the testing and training phase of the project could start in the summer of 2016, with full system operation possible by September 2016.

- Police Department Air Support

The Outlook includes as a Priority Initiative the addition of approximately $1.2 million in additional expenditures for Air Support maintenance and engine overhauls in FY 2016, with funding continuing and increasing slightly each subsequent year. This funding is in addition to the $1.5 million in ongoing General Fund expenditures added to the Police Department budget in the FY 2015 Adopted Budget. The combined ongoing funding of approximately $2.7 million annually is expected to fully fund maintenance of the Air Support Unit.

Previously, Seized Assets Funds were used for this purpose and were considered unpredictable. In past reports, our office had raised concerns about the uncertainty of funding for this critical service and the need to identify General Fund resources when available. The Outlook now includes full General Fund support for Air Support maintenance. Annual fuel expenses are anticipated to continue to be funded by Seized Assets Funds. Based on a review of past fuel expenditures, revenue from Seized Assets will likely be sufficient for this purpose. For example, in FY 2014 actual Air Support fuel expenditures were approximately $480,000 while Seized Assets revenue was approximately $1.5 million. The Department has expressed that a conservative estimate for Seized Assets revenue is generally $1.0 million per year.

Fire-Rescue Department

Significant Items Funded in Mayor's Priority Initiatives

- Fast Response Squad (FRS) Expansion

The FY 2015 Adopted Budget included approximately $600,000 in one-time funding for one FRS unit on a pilot program basis. The Outlook includes the continuation of the first FRS and the addition of a second FRS unit for all five years of the Outlook as a Priority Initiative. The cost of operating two FRS units is approximately $1.5 million per year.

The City's first FRS (Squad 55) is currently assigned to the Encanto community. The Department is currently evaluating the impact the pilot program has had on response times since it began operation in July 2014. Based on preliminary data from the pilot, the Department has reported response time improvements. A comprehensive six-month report on the FRS pilot will be completed by Fire-Rescue by January 9, 2015. Should the FRS program continue and a second unit be added in future years, the location of future FRS deployments could be determined during the annual budget process. Options include expanding the current 12-hour FRS deployment in Encanto to 24 hours, or deploying a second 12-hour FRS to a different community identified as FRS-eligible by the Citygate report.

- Continuation of Additional Fire Academies

The Outlook includes approximately $1.3 million annually in FY 2016 through FY 2020 as a Priority Initiative to continue the FY 2015 practice of funding two additional fire academies above the baseline of one academy per year. This would fund a total of three fire academies per year for every year of the Outlook period. The additional funding includes personnel and non-personnel expenses related to conducting the academies, but does not increase salaries and wages for Fire-Rescue recruits. It is likely that this accelerated hiring could outpace attrition and result in an increase in filled firefighter positions, therefore increasing personnel costs. The Outlook accounts for this by adding new funded positions each year in FY 2016-2020 (for a total of 84.0 additional FTEs by FY 2020) as part of a Priority Initiative for new fire station facilities.

- Citygate Working Group Five-Year Implementation Plan

Based on the recommendations of the 2011 Citygate report, the City Council approved the Citygate Working Group Five-Year Implementation Plan (CWG Plan) in November 2011 to outline a plan to address the most critical Fire-Rescue Department needs. The most recent update to the CWG Plan was presented to the Public Safety and Livable Neighborhoods Committee in January 2014, and included the status and details of the Department's needs for Year 1 through Year 3 of the plan. The following table summarizes the CWG Plan and indicates whether Plan items have been included in the Outlook.

Citygate Working Group Implementation Plan - Years 1 through 3

Identified Needs	Cost* (In Millions)	Status
	Year 1	
Adopted revised deployment (response time) measures	$ -	Completed
Adopt revised fire station location measures and create revised fire station CIP projects	$ -	In Process
Adopt aggregate population definitions	$ -	Completed
Add back (restore) the 8 browned out fire engines	$ 11.5	Completed
Adopt Citygate priorities for adding needed resources	$ -	Completed
Review and adopt dispatch process improvements	$ -	In Process
Fast Response Squad Pilot Program	$ 0.6	Completed - One FRS funded in FY 2015 Adopted Budget; Second FRS included in Outlook as a Priority Initiative in FY 2016-2020.
Replace fire station alerting system (Phase 1)	$ 1.7	In Process
Purchase of ladder truck for East Mission Valley Fire Station 45	$ 1.1	Included in Outlook as a Priority Initiative in FY 2016.
Design and planning for Home Ave. Fire Station	$ 2.0	In Process - DC3 funds for design identified for FY 2015.
	Year 2	
Funding for one Battalion Chief Unit	$ 0.5	Not Completed - Discretionary Need identified for FY 2016-2020 not funded in Outlook.
Replace fire station alerting system (Phase 2)	$ 2.6	In Process
Completion of Eastside Mission Valley Fire Station 45	$ 11.0	In Process - Opening July 2015.
Staffing of Eastside Mission Valley Fire Station 45 for double-house	$ 2.2	Included in Outlook as a Priority Initiative in FY 2016-2020.
Construction of Home Ave. Fire Station	$ 8.0	Not Completed - No funds identified for construction.
Purchase of fire engine for Home Ave Fire Station	$ 0.8	Included in Outlook as a Priority Initiative in FY 2018.
Design and planning for Paradise Hills Fire Station	$ 0.8	Not Completed - No funds identified for capital costs.
	Year 3	
Staffing of Home Avenue Fire Station	$ 2.2	Included in Outlook as a Priority Initiative in FY 2019.
Construction of Paradise Hills Fire Station	$ 8.0	Not Completed - No funds identified for capital costs.
Purchase of fire engine for Paradise Hills Fire Station	$ 0.8	Included in Outlook as a Priority Initiative in FY 2018.
Purchase of ladder truck for Paradise Hills Fire Station	$ 1.1	Included in Outlook as a Priority Initiative in FY 2018.
Funding for land, design, and planning of College Ave. Fire Station	$ 2.0	Not Completed - No funds identified for capital costs.
Total Project Costs	**$ 56.9**	
Projects Completed, In Process, or Included in Outlook	**$ 37.6**	
Outstanding Costs	**$ 19.3**	

*Costs in this table reflect estimates provided in the January 2014 Citygate Implementation Plan Annual Status Report and may not match costs used in the Outlook projection. For the purposes of this table, funds provided in the Outlook for specific items are assumed to fully fund the Department's request.

<u>Department Requests Categorized as Discretionary, Funding Not Included in Outlook</u>

- Elimination of Cross-Staffing

During the Budget and Government Efficiency Committee's consideration of the Outlook, a concern was raised regarding the desire to eliminate cross-staffing of certain specialized units within the Fire-Rescue Department. Currently, the Department's Bomb Squad and HAZMAT units are staffed using cross-staffing. Under this arrangement, the deployment of either of these units results in out-of-service time for the responding firefighters and fire engines and/or trucks. The Outlook projection does not include costs for eliminating cross-staffing for these units but identifies them as Discretionary Operational Needs. Eliminating cross-staffing for one unit would require the addition of 12.0 FTEs and $1.7 million in ongoing expenditures. Eliminating cross-staffing for both units would double the required resources. The Department has expressed that its preferred priority order in eliminating cross-staffing would be to augment the HAZMAT unit first, followed by the Bomb Squad.

Significant Potential Impacts to Outlook

- Future Fire Stations – Operations Funded Without Identified Capital Funding for Facilities

The Outlook includes a total of approximately $43 million in increased funding and the addition of 84.0 FTEs over the Outlook period to support the operation of six new fire stations. Operational expenses include personnel expenditures and non-personnel expenditures such as new fire engines and/or trucks and related equipment. These expenses are included as Priority Initiatives.

It is important to note that although the Fire-Rescue Department may anticipate these stations becoming operational by FY 2020, capital funding has not yet been identified to fully fund the design, land acquisition, and construction costs associated with these facilities. It is unusual to include operational funds prior to capital funding being identified and completion schedules being determined. Remaining capital needs could be funded by future anticipated deferred capital debt issuances of $84.2 million each in FY 2016 and FY 2017, or new alternative sources of capital funding in FY 2018 or beyond. However, the Outlook projects no additional infrastructure bonding past FY 2017. Details are provided as follows for new stations with operational funding included in the Outlook, according to their assumed operation year:

Capital Needs for Fire Stations Included as Priority Initiatives in Outlook

Fire Station Name	Remaining Capital Needs (in Millions)	Status
FY 2016		
Eastside Mission Valley Station (FS 45)	$ -	Construction of this double-house station is fully funded and Fire-Rescue anticipates that the station will open in July 2015.
FY 2017		
Bayside Fire Station (FS 2)	$ -	Construction costs for this station are anticipated to be fully funded by the Successor Agency to the former Redevelopment Agency. The station is expected to be operational in September 2016.
Skyline Hills Permanent Fire Station (FS 51)	$ 11.0	$1.0 million in DC3 bond funds has been identified for the design of the station out of a total estimated construction cost of $12.0 million. Funding for the Skyline Temporary Fire Station was provided in FY 2014 and the station is anticipated to open in March 2015. The FY 2015 Adopted Budget included $951,000 for a half-year of operations funding. The Outlook includes that ongoing funding in the Baseline for FY 2016 and includes an additional $951,000 in FY 2016 as a Priority Initiative to fully fund operations. In FY 2017-2020, the Outlook continues to fully fund operations but classifies Skyline as a permanent fire station.
FY 2019		
Home Avenue (No FS#)	$ 10.1	$1.9 million in DC3 bond funds has been identified for land purchase and design of the station out of a total estimated construction cost of $12.0 million.
Paradise Hills Fire Station (FS 54)	$ 11.1	No funding has been identified in the CIP for this station. Estimated construction costs are $11.1 million.
FY 2020		
College Avenue Fire Statoin (No FS#)	$ 10.8	No funding has been identified in the CIP for this station. Estimated construction costs are $10.8 million
Total Remaining Capital Needs	**$ 43.0**	

- Future Fire Stations – New Stations Not Included in Outlook That May Become Operational During Outlook Period

In addition to the new fire stations included in the Outlook, two additional fire stations are anticipated to become operational during the Outlook period as early as FY 2017. These stations are developer-funded and will not require additional capital investment from the City for facilities. However, once operational, they will require continued General Fund support for personnel and operations. Details for these stations are provided as follows:

- **North University City Station (FS 50) –** Construction of this station is fully developer-funded using Facilities Benefits Assessments (FBA) funds. The total estimated project cost is approximately $14.0 million. Fire-Rescue has indicated that this station may be operational in FY 2017. Generally, a new fire station requires the addition of 12.0 FTE and ongoing annual operational costs of approximately $1.9 million. Additionally, a one-time expenditure of $780,000 to $1.1 million is typically required to purchase the appropriate fire apparatus (engine or ladder truck) for the station.

- **Black Mountain Ranch (FS 48) –** Construction of this station is also fully funded by an FBA. The total estimated project cost is approximately $11.8 million. Fire-Rescue has indicated that this station could potentially open as early as FY 2017. As stated previously, a new fire station requires the addition of 12.0 FTE and ongoing annual operational costs of approximately $1.9 million. Additionally, a one-time expenditure of $780,000 to $1.1 million is typically required to purchase the appropriate fire apparatus (engine or ladder truck) for the station.

Lifeguard Division – Fire-Rescue Department

Significant Items Funded in Mayor's Priority Initiatives

- Vessel Replacement Plan

The Outlook includes as a Priority Initiative approximately $1.4 million in new expenditures over the next five fiscal years for a Lifeguard Services Vessel Replacement Plan. The Plan would set aside funding each year to be used for future vessel replacement needs. This item is included in Year 1 of the Lifeguard Services Five-Year Needs Assessment, which was presented to the City Council in March 2014 and is described later in further detail. The Fire-Rescue Department has indicated that according to the most recently updated replacement plan, the first purchase would occur during FY 2017 for a surf patrol boat.

- Lifeguard Services Five-Year Needs Assessment

The City Council approved the Lifeguard Services Five-Year Needs Assessment in March 2014. The following table summarizes the Needs Assessment and indicates whether requested items have been included in the Outlook. As shown in the table, the Vessel Replacement Plan is the only new item from the Needs Assessment included in the Outlook as a Priority Initiative in FY 2016-2020. Other items in the table listed as funded were approved as part of the FY 2015 Adopted Budget and were either one-time expenditures (Lifeguard Headquarters facility improvement) or are ongoing expenditures included in the Outlook baseline (additional lifeguard positions for Boating Safety Unit and at Windansea Beach). Remaining items from the Needs Assessment are not funded in the Outlook; items are either identified as Discretionary Needs or do not appear in the document.

Lifeguard Services Five-Year Needs Assessment

Identified Needs	Cost*	Status
Year 1		
Convert carpenter garage at headquarters to facility for Boating Safety Unit	$ 500,000	Funded in FY 2015 Adopted Budget.
Addition of 4.0 lifeguard positions for Boating Safety Unit	$ 460,656	Funded in FY 2015 Adopted Budget.
Addition of 2.0 lifeguard positions at Pacific Beach year-round on weekdays	$ 270,000	Not funded in Outlook; Discretionary Need identified in FY 2016-2020.
Addition of 1.0 Senior Management Analyst	$ 124,120	Does not appear in Outlook.
Plan for presumptive medical coverage	$ -	Does not appear in Outlook.
Lifeguard Vessel Replacement Plan	$ 1.4M total over 5 years	Included in Outlook as a Priority Initiative in FY 2016-2020.
Planning for Jr. Lifeguard Headquarters and Aquatic Safety Education Center	$ -	Does not appear in Outlook.
Reclassify Motive Service Technician to Marine Mechanic	$ 2,100	Completed in early FY 2015 using existing resources.
Year 2		
Addition of 1.0 Special Operations Sergeant	$ 143,581	Not funded in Outlook; Discretionary Need identified in FY 2016-2020.
Addition of 2.0 lifeguard positions at Windansea Beach for summer months and at Boating Safety Unit in non-summer months	$ 277,406	One position funded in FY 2015 Adopted Budget; Second position identified as a Discretionary Need in FY 2017-2020, not funded in Outlook.
Addition of 1.0 Clerical Assitant II position	$ 66,848	Not funded in Outlook; Discretionary Need identified in FY 2016-2020.
Addition of 2.0 lifeguard positions at Ocean Beach	$ 277,406	Not funded in Outlook; Discretionary Need identified in FY 2016-2020.
Year 3		
River Rescue Team expansion	$ 49,668	Not funded in Outlook; Discretionary Need identified in FY 2017-2020.
Lifeguard Dive Team expansion	$ 45,472	Not funded in Outlook; Discretionary Need identified in FY 2017-2020.
Addition of 1.0 lifeguard position for training at Mission Bay	$ 138,703	Not funded in Outlook; Discretionary Need identified in FY 2018-2020.
Addition of 1.0 lifeguard position for South Mission Beach in summer months and relief guard in non-summer months	$ 125,826	Not funded in Outlook; Discretionary Need identified in FY 2018-2020.
Conversion of Boating Safety Unit to Specialty Team	$ 222,992 (Outlook est.)	Not funded in Outlook; Discretionary Need identified in FY 2018-2020.
Addition of lifeguard overtime for training	$ 95,375	Not funded in Outlook; Discretionary Need identified in FY 2016-2020.
Increase seasonal lifeguard hours	$ 74,676	Not funded in Outlook; Discretionary Need identified in FY 2018-2020.
Evaluate Paramedic Battalion Medical Officer Program	$ -	Does not appear in Outlook.
Construction of Jr. Lifeguard Headquarters and Aquatic Safety Education Center	N/A	Does not appear in Outlook.
Year 4		
Evaluate assigning Lifeguard Paramedics in Operations	$ -	Does not appear in Outlook.
Year 5		
Evaluate expanding Lifeguard Heaquarters to create Mission Bay maritime public safety hub	N/A	Does not appear in Outlook.
Addition of second fire boat	$ 1,100,000	Not funded in Outlook; Discretionary Need identified in FY 2020.

*Costs in this table reflect estimates provided in the February 2014 Lifeguard Division Five-Year Needs Assessment and may not match costs used in the Outlook.

Library Department

Significant Items Funded in Mayor's Priority Initiatives

The Outlook includes two items of note within the Mayor's Priority Initiatives for the Library Department including new library facilities and support for the Radio Frequency Identification (RFID) Conversion program. Brief highlights of these items are presented as follows.

- Branch Library Expansions

Within the Infrastructure and Neighborhood Investment Priority Initiative category, the Outlook includes operational costs associated with the expansion of two libraries within the Outlook period. These libraries are the Skyline Branch library projected to be completed in FY 2017 and the Mission Hills Branch library anticipated to be completed in FY 2019. In last year's FY 2015 – 2019 Outlook, the San Ysidro Branch Library was anticipated to be expanded and open in FY

2019. However, this project has been removed from the Outlook projections as the project timeline is under consideration. The exact location of this facility has yet to be determined. Due to the uncertainty related to the timing of the San Ysidro Branch library, $2.0 million in funding earmarked for this facility has been reallocated to the Mission Hills Branch library. Funding for the San Ysidro Branch library will be reallocated to the project from a future capital bond issuance. Including the recent reallocation of funding from the San Ysidro Branch library, the Skyline Branch and Mission Hills Branch libraries are now considered to be fully funded. Attachment One lists all the City facilities, including the branch libraries, anticipated to open or be expanded during the Outlook period. It should be noted that while the Department is working on expanding or replacing existing branch libraries, no new libraries are currently under consideration.

- RFID Conversion Program

The RFID technology offers enhanced security, increases automation and self-service capabilities, expedites inventory tasks, and allows staff to provide increased customer service to library patrons. This technology has been implemented at the new Central Library and the Rancho Bernardo Branch Library (funded via private donations). The Outlook includes a total of approximately $950,000 from FY 2017 through FY 2019 to implement this technology throughout the branch library system. Remaining funding that was allocated to implementing this program in the new Central Library will be utilized in FY 2016 to initiate the system-wide roll out. Branches with the largest circulation levels will be the top priority for the initial implementation.

<u>Department Requests Categorized as Discretionary, Funding Not Included in Outlook</u>

- Restoration of Library Materials budget

The original funding proposed to support the pilot after school program was a one-time $500,000 reduction in the Library Materials budget for FY 2015. The City Council’s final budget actions fully restored this reduction through the identification of $290,000 in ongoing revenues and approximately $209,000 from a one-time funding source. The $290,000 in funding has been continued throughout the Outlook for the Library Materials budget. However, the $209,000 in costs, funded with one-time funding in FY 2015, has not been included in the Outlook projections. Full restoration of the materials budget was a top priority for the City Council for FY 2015. Per the Mayor’s priorities, the General Fund’s library materials budget would be reduced by $209,000 from $1.8 million in FY 2015 to $1.6 million throughout the Outlook period. The Department has recently hired a Collection Development Manager to undertake a comprehensive evaluation of the library materials collection. The scope of work and project timelines are currently being developed by staff.

- Replacement of Public Use Computers

Historically, the Library Department has replaced the public access computers with recycled computers previously used by City staff or new computers on an as-needed basis. However in FY 2014, due to an update to the City’s computer operating software, the Department needed to replace all the public access computers in a short period of time. There are approximately 800 public use computers within the Library System. The Department request is an attempt to establish a consistent schedule for the computer replacement. The Department's goal is a five-year replacement schedule as this would include the warranty coverage plus several additional year of use for each computer. The Department projects needing to replace these computers beginning in FY 2019 and has included $400,000 in FY 2019 and FY 2020 to plan for the replacement of these computers. This funding is currently not included in the Outlook projections.

Other Items of Note

- Central Library Foundation Funding

Library Foundation funding of $2.0 million annually for the Central Library ends in FY 2018. Prior to the opening of the new Central Library, the Library Foundation donated $10 million toward the additional operational costs of the new Central Library, with $2.0 million to be used annually for the first five years of operation. The additional costs are related to the increased size of the new facility and need for additional services such as security and maintenance. The new Central Library opened in September FY 2014. The funding from the Library Foundation is included in financial projections as a revenue source from FY 2014 (opening of facility) through FY 2018. The baseline projection of the Outlook assumes General Fund replacement of these funds beginning in FY 2019.

- Continuation of Do Your Homework @ The Library Program

The FY 2015 Adopted Budget included the addition of 6.9 FTEs and approximately $500,000 in expenditures for a new after-school pilot program (Do your Homework @ the Library) to supplement informal volunteer drop-in homework programs in place throughout the library system. The Do your Homework @ the Library program was implemented at four branch libraries (Logan Heights, Pacific Beach, San Carlos, and Scripps Miramar Ranch) and the Central library in November 2014. The implementation at 13 additional branch libraries (reaching full implementation) is anticipated to occur by January 2015. The costs of the full implementation level of service have been continued throughout the Outlook in the baseline projections. An evaluation of this pilot program is expected to be provided at the end of the current fiscal year. Any necessary adjustments based on this evaluation can be made during the FY 2016 budget deliberations.

Park & Recreation Department

Significant Items Funded in Mayor's Priority Initiatives

The Outlook includes several items for the Park and Recreation Department within the Infrastructure and Neighborhood Investment Priority Initiative category. Two of the critical programs identified in the Outlook are: the continued funding of park condition assessments throughout the Outlook period; and operating and maintenance cost for new/expanded park facilities anticipated to open during the Outlook period.

- Continuation of Park Condition Assessments

In FY 2014, the Park and Recreation Department hired an outside consultant, Kitchell and Associates, to a Five-Year As-Needed Facility Assessment Agreement (Agreement) to assess the condition of Park and Recreation assets (including but not limited to playgrounds, parking lots, play courts, athletic fields, lighting, and turf) within the Park System. The Park System includes more than 340 parks. Although the Department's goal is to complete assessments for every park within the Park System, the Department's top priority is to assess community parks (Community, Neighborhood, and Mini-Parks) and developed regional parks (Balboa Park and Mission Bay) as these locations are highly used and contain a variety of assets. Other park assessments will be pursued as funding is available. The number of assessments undertaken and completed each year will vary due to factors such as the type and size of park, the assets located within the park, and available funding. The Department anticipates the number of assessments undertaken each year may increase due to the establishment of an assessment process/routine. Upon the completion of the assessments, the review of the assessment reports, and the duration of the entire assessments process, the Department will evaluate the need to re-initiate the condition assessments.

Initially, 30 Community parks throughout the City were selected for inspection. Approximately $300,000 was allocated in the FY 2014 Budget to complete the 30 initial inspections. The initial 30 assessments were completed by the end of FY 2014 and the drafted assessment reports are being reviewed by staff. It is anticipated that these results will be brought forward in January 2015 along with the results of other City facilities assessments.

The FY 2015 Budget included approximately $400,000 ($150,000 for limited staff and $250,000 for non-personnel expenses) for the continuation of the park condition assessments, with the goal of 30 additional site inspections to be completed within the fiscal year. The Department anticipates achieving this goal by the end of the fiscal year. The Outlook includes $300,000 annually throughout the Outlook period to continue these efforts.

Completion of the assessments will also be used to support the development of an updated Park System Master Plan (Master Plan), which was last completed in 1956. Within the Discretionary Department Requests of the Outlook, the Planning Department requested $350,000 annually from FY 2016 through FY 2018 to develop and complete the Master Plan. The complexity of the Master Plan will be based upon the funding available. Initiating the development of the Master Plan in FY 2016 will allow for several years of park assessments to either be completed or undertaken. These assessments will serve as a good sample for planning purposes within the Master Plan.

- New Park and Recreation Facilities to Open in FY 2016-2020

The Park and Recreation Department has identified multiple new park facilities/joint use agreements to be opened/executed during the Outlook period. A list of the facilities and joint use agreements is provided as Attachment One to this report and includes the fiscal year in which the facility is anticipated to open, and the projected costs and staff needed for each facility. Additionally, Attachment One includes information as to whether the facility was presented in the FY 2015 – 2019 Outlook or is a newly added project.

The following identifies the projected additional annual costs for the new facilities per fiscal year. The actual opening dates of these facilities may vary from what is projected in Attachment One due to factors such as available capital funding, staff capacity, and prioritization of infrastructure needs.

Proposed Ongoing Costs Related to New/Expanded Park Facilities

	FY 2016		FY 2017		FY 2018		FY 2019		FY 2020	
Facility	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses	FTE	Expenses
Parks	2.55	$ 285,461	8.93	$ 1,205,582	3.61	$ 379,141	2.14	$ 232,585	2.40	$ 270,360
Joint-Use Agreements	0.97	$ 259,447	0.28	$ 39,792	1.03	$ 128,806	0.77	$ 118,588	-	$ -
Total	**3.52**	**$ 544,908**	**9.21**	**$ 1,245,374**	**4.64**	**$ 507,947**	**2.91**	**$ 351,173**	**2.40**	**$ 270,360**

<u>Department Requests Categorized as Discretionary, Funding Not Included in Outlook</u>

- Brush Management Contractual Services

The Discretionary Requests section of the Outlook includes additional funding for the City's brush management contract to address recent significant increases in the cost per acre. The Discretionary Requests list also includes one position (Biologist III) to support the Brush Management Program; and the transfer of brush management responsibilities, for approximately 50 additional acres of undeveloped streets, from the Streets Division of the Transportation and Storm Water Department.

The Department's Brush Management Program targets thinning 450 acres of open space brush each year with the combination of using non-profit companies and City forces to thin 150 acres annually and a contract with a for-profit vendor to thin 300 acres annually.

The City recently re-bid the brush thinning service contract after the previous vendor declined the contract option. Based upon the new vendor cost schedule, the brush thinning service cost per acre for FY 2016 is to be $6,012 per acre and will increase to $7,308 per acre in FY 2020. The total cost per year (based on thinning 300 acres) would increase from approximately $1.8 million in FY 2016 to approximately $2.2 million in FY 2020. In the proposed new agreement, the cost per acre is eligible to increase annually by the Consumer Price Index.

The Outlook projects the cost for contracted brush management services to be $5,268 per acre in FY 2016 increasing to $5,929 per acre in FY 2020 based on the previous vendor. A one-year contract (with four one-year options to renew) for the new vendor will soon be considered by Council. If approved, future budgets and Outlooks will need to be adjusted accordingly.

- Assistant Recreation Center Directors/Increased Recreation Center hours

The FY 2015 Adopted Budget maintained the core operational hours for each recreation center at 45 hours per week. An increase in the service hours at the City's recreation centers has been an item of interest in prior budget processes. No citywide core operational hours have been added to all the recreation centers since FY 2012. In FY 2012, the core citywide operational hours for the recreation centers increased from 40 hours per week to 45 hours per week.

In discussion with the Department, the addition of weekly hours to each recreation center would require the addition of 53 Assistant Recreation Center Directors in order to add 5 hours per week for all the recreation centers throughout the City. The Department request is for approximately $690,000 in FY 2015 increasing to approximately $2.3 million by FY 2020. The Department request phases in the additional positions throughout the Outlook period, with the initial priority of increasing customer service and cash handling support to the larger recreations centers.

- Additional Park Ranger for Open Space

During the FY 2015 Budget process, the City Council approved additional staffing to support the Park and Recreation Department's goal of a ratio of 648 acres of parkland to one park ranger. Currently the City has a ratio of one park ranger for every 1,143 acres of parkland. Within the Discretionary Department Requests, the Department has requested the addition of one park ranger per year during the Outlook period. For planning and budgeting purposes, the Department projects the addition of approximately 200 acres of open space per year. Based on the approval of adding one open space park ranger per year during the Outlook period and the increase of 200 acres of open space per year, the ratio of parkland acres to park ranger would decrease from 1,143 to 964 by the end of the Outlook period. The Department request would add approximately $100,000 in FY 2016 and increase to approximately $380,000 by FY 2020.

Planning Department

Significant Items Funded in Mayor's Priority Initiatives

- Community Plan Update Support

The Outlook includes the addition of 3.0 FTEs and $550,000 in ongoing funding for all Outlook years to support the completion of additional Community Plan Updates (CPUs) as a Priority Initiative. The additional positions include one Park Designer, one Senior Management Analyst, and one Traffic Engineer. The increased expenditures are intended to fund these positions and also include $300,000 for consultant expertise to assist with technical and specialized tasks. The Planning Department has indicated that the new positions are needed to support the full range of Department work programs, not just the CPU program.

The City has 52 community planning areas with 42 Community Planning Groups (CPGs). Nine CPUs are currently underway and are anticipated to be complete by the end of calendar year 2016: Grantville Master Plan, Southeastern, Encanto, Uptown, North Park, Golden Hill, San Ysidro, Old Town, and Midway-Pacific Highway.

In addition to these nine CPUs, the Ocean Beach Community Plan was recently adopted by the City Council but is awaiting Coastal Commission approval before taking effect. Additional transit-oriented development community plan amendments that are underway include Chollas Triangle, Clairemont/Morena, and Clairemont/Balboa. A focused amendment regarding the transportation network of the University Community Plan was initiated by the City Council in September 2014. The Mission Valley CPU is expected to begin the update process in March or April of 2015.

A CPU for Barrio Logan was approved by the City Council in FY 2014 but was overturned by referendum. Since that time, a new recognized CPG has been formed in Barrio Logan. The Planning Department has indicated that as staff becomes available, they will work with the newly formed Barrio Logan CPG and other stakeholders to develop a revised Barrio Logan CPU to bring forward to the City Council.

The Planning Department anticipates starting six additional CPUs in calendar year 2016. Completion dates would be staggered, based on timelines that range from 18-36 months depending on the level of complexity of the update. According to the Department, decisions on which plans to update would be based on a number of factors including the age of the plan, number of privately initiated amendments, opportunities for transit-oriented development, park needs, and jobs and housing potential.

<u>Department Requests Categorized as Discretionary, Funding Not Included in Outlook</u>

- Citywide Parks Master Plan

The Outlook identifies support for a Citywide Parks Master Plan (PMP) as a Discretionary Operational Item but does not include funding for it in the Outlook projection. Estimated costs for contractual services to develop a PMP are $350,000 per year in FY 2016, FY 2017, and FY 2018. The Planning Department’s funding request would not meet the full cost of developing a PMP, but would allow the Department to begin the PMP process at a strategic level. The Department’s original funding request was for $2.0 million annually from FY 2018-2020, for a total of $6.0 million. The Discretionary Operational Item, as identified by the Outlook, would instead fund a total of approximately $1.1 million over three years, but beginning two year earlier. Requested funds would be used to hire a consultant to complete inventory and condition assessments, conduct public outreach, develop a menu of park equivalency options for public review, and review the City as a whole to determine where parks and equivalencies could be shared. The PMP development process is anticipated to take three to four years to complete. The Planning and Park and Recreation departments have indicated that they will continue to seek grant funding to supplement any potential General Fund support. The complexity of the Master Plan will be based upon the funding available.

<u>Environmental Services Department (ESD)</u>

<u>Significant Items Funded in Mayor’s Priority Initiatives</u>

- Addition of Code Enforcement Officers

In August 2014, the Office of the City Auditor released a performance audit report of ESD’s Waste Reduction and Recycling Programs. Within this report is a recommendation that ESD should allocate additional resources to enforcement of the Citywide Recycling Ordinance for City-serviced residential properties. In support of this recommendation, the Department has requested the addition of two code enforcement officers in FY 2016 with annual expenses of approximately $140,000. These positions would be continued throughout the Outlook period.

Items of Note

The baseline projections of the Outlook include several items supporting the Zero Waste objection of the City and the financial health of funds within ESD. These items include a reduction of a discount provided to the General Fund on tipping fees; a transfer of funding received related to the Sycamore Canyon Landfill Facility Franchise Agreement; and the transfer of responsibility of the Illegal Dumping Program.

- Reduction of Discount provided to the General Fund on Tipping Fees

Currently the General Fund receives a discount on tipping fees. This discount amounts to approximately $1.8 million annually. To support the Refuse Disposal Fund in its continuation of waste reduction programs, the General Fund discount will be reduced by approximately $600,000 annually for three years beginning in FY 2016 to eliminate this discount.

- Transfer of Funding from the Sycamore Canyon Landfill Facility Franchise Agreement

Currently the General Fund receives approximately $3.0 million in revenue annually from the Sycamore Canyon Landfill Facility Franchise Agreement. This funding to the General Fund will be transferred to the Recycling Fund to support recycling efforts throughout the City. The General Fund allocations will be reduced by $600,000 annually for five years beginning in FY 2016 for a cumulative reduction of approximately $3.0 million annually by FY 2020.

- Transfer of Financial Responsibility for Code Enforcement of the Illegal Dumping Program

Currently the Refuse Disposal Fund is financially responsible for the code enforcement of illegal dumping. As ESD strives for financial sustainability, the Department is evaluating certain service levels for existing programs. To continue code enforcement service at current levels, it is recommended that the General Fund support these efforts. The Outlook includes the transfer of approximately $800,000 annually beginning in FY 2016 to support the code enforcement efforts of the Department.

These recommendations and others strategies related to the Zero Waste Plan are scheduled to be presented to the City Council in early 2015 for consideration. The financial impacts to the General Fund resulting from these recommendations have been incorporated into the Outlook baseline projections for planning purposes.

Significant Potential Impacts to Outlook

In December 2013, the City Council adopted a Zero Waste objective for the City of San Diego with an initial goal of diverting 75 percent of waste generated in the City from landfill disposal by 2020 and a goal of zero waste by 2040. This reduction in waste is to occur through the elimination of waste from landfill disposal and the diversion and conversion of recyclable materials into usable forms with minimal transport, energy use, and harm to society and the environment. The ESD has been directed to develop a Zero Waste Plan, which establishes a framework for the City's planning and decision-making process as to achieve the City's Zero Waste objective. ESD staff has been working with the appropriate stakeholders to develop the draft Zero Waste Plan and anticipates bringing the draft Zero Waste Plan to the City Council for consideration in early 2015.

It is important to note that revenues from both AB 939 fees assessed on disposal tonnage and a portion of disposal fees collected at the Miramar Landfill fund waste diversion programs. As existing programs continue to increase waste diversion and new programs are initiated from the Zero Waste Program, landfill tonnage and revenues are expected to decline, which will in turn reduce funding for these programs. The People's Ordinance (San Diego Municipal Code §66.0127) states that the City must collect residential refuse without charging customers for the collection, transportation, or disposal of that refuse. Due to current financial limitations, significant changes to the way programs are funded need to occur in order for the City to achieve the goals within the Zero Waste objective. ESD will need to balance the financial stability of the Department while pursuing the Zero Waste goals. Any proposed changes to the funding mechanisms supporting the Zero Waste program may impact the General Fund as the program progresses forward.

Department of Information Technology

Significant Items Funded in Mayor's Priority Initiatives

In the Outlook, there are new costs associated with the General Fund transfer to the Information Technology (IT) Fund and the OneSD Support Fund throughout the Outlook. The IT Fund supports the operational budget for Department of IT staff that provide a variety of information technology related activities for the City. Departments who use IT services are assigned a budgetary allocation each year based upon their prior-year IT spending in order to reimburse the IT Fund for costs incurred to provide citywide IT support (as outlined in IBA report #14-15, pg. 102). The OneSD Support Fund supports staff that manage and support the City's Enterprise Resource Planning (ERP) Systems, or SAP. Revenues for this fund are collected based on an annual allocation to departments that use SAP.

- Information Technology Fund

The costs included in the Outlook for the IT Fund are as shown as follows:

INFORMATION TECHNOLOGY FUND					
Item	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
SIRE Replacement	$ 500,000	$ 50,000	$ 50,000	$ 50,000	$ 50,000
Consultant Cost for IT Sourcing Strategy	300,000	200,000	-	-	-
Email Archiving Expenditure	200,000	200,000	200,000	200,000	200,000
SAP and Cyber Security Consulting	200,000	200,000	200,000	200,000	200,000
Microsoft Office 2013 Upgrade	300,000	20,000	20,000	20,000	20,000
Additional Personnel Costs	469,275	469,275	469,275	469,275	469,275
Other Items	481,044	393,698	393,698	393,698	393,698
Total IT Fund Requirements in Outlook	$ 2,450,319	$ 1,532,973	$ 1,332,973	$ 1,332,973	$ 1,332,973
General Fund Portion - 51%	$ 1,249,663	$ 781,816	$ 679,816	$ 679,816	$ 679,816

- SIRE Replacement: The City's docketing system, SIRE, will no longer be supported by its vendor and needs to be replaced. City staff is current working on a request for proposal to replace the system.
- Consultant Cost for IT Sourcing: The current contracts with the City's three outside vendors (Atos, CGI, and Xerox) will expire in FY 2017 and these funds will be utilized to engage a consultant to help determine the City's IT strategy for the future. If the City were to determine that a transition from these contracts was the optimal strategy, there would be one-time transition costs incurred in FY 2017 that are not included in the Outlook.
- Email Archiving: Currently, the Department of IT is developing the policy and strategy for email retention and archiving. These costs are the projected annual maintenance costs associate with archiving expenses.
- SAP and Cyber Security: Costs for consultant services to ensure secure systems.
- Microsoft Office 2013 Upgrade: Costs to upgrade City to Office 2013 due to Microsoft ending support in 2017.
- Personnel Costs: Support for IT security, project management, and other areas of need identified in FY 2014 Department of IT internal performance review.

These costs are shared amongst Enterprise Funds and the General Fund, with 51 percent of these additional costs for future fiscal years beyond what was included in the FY 2015 Adopted Budget allocated to General Fund departments.

- OneSD Support Fund

The costs included in the Outlook for the OneSD Support Fund are as shown as follows:

OneSD SUPPORT FUND					
Item	**FY 2016 Outlook**	**FY 2017 Outlook**	**FY 2018 Outlook**	**FY 2019 Outlook**	**FY 2020 Outlook**
PBF Module Upgrade	$ 1,000,000	$ -	$ -	$ -	$ -
SAP Success Factors Module	234,000	109,000	109,000	109,000	109,000
P&C Module Enhancements	900,000	-	-	-	-
Accounts Receivable Roadmaps	500,000	600,000	600,000	-	-
Other Items	586,308	92,308	92,308	92,308	92,308
Total OneSD Fund Requirements in Outlook	$ 3,220,308	$ 801,308	$ 801,308	$ 201,308	$ 201,308
General Fund Portion - 46%	$ 1,481,342	$ 368,602	$ 368,602	$ 92,602	$ 92,602

- PBF Module Upgrade: The City's Public Budget Formulation (PBF) component of SAP is the key program utilized by all departments to prepare and monitor the City's annual budget. SAP completed an assessment of the PBF system and recommended a number of upgrades that are necessary to continue supporting the City's PBF environment.
- SAP Success Factors Module: This module is envisioned to be used as a Citywide performance evaluation solution to automate and streamline employee evaluations and significantly reduce the labor hours currently spent preparing employee performance evaluations.
- P&C Module Enhancements: The SAP purchasing module has been a consistent complaint from users and this cost is to upgrade the system to enhance its functionality.
- Accounts Receivable Roadmaps: Support for the creation of One Customer San Diego

which would allow City customers to create one unique identifier when interacting with the City.

Personnel Department (Hiring Process)

Over the past couple years, three City Council Committees have explored issues surrounding vacancies and the hiring process. The IBA has released three related reports (reports 13-14, 13-30 and 14-01), and the City Auditor released an audit in November 2013.

The Personnel Department had indicated that Personnel staffing increases were necessary in order to continue to make improvements in the hiring process and keep up with the increased workload that has been experienced over the past few years. During the FY 2015 budget process, Personnel had requested eight positions that were not funded in the Proposed Budget. As part of the FY 2015 Budget Priorities memos, a majority of Councilmembers recommended that two additional positions for the Personnel Department be considered as priorities for additional funding. These two positions were approved in the Adopted Budget and were filled by the end of September 2014.

Of the remaining six requested positions in the FY 2015 budget process that were not funded, four were related to a potential “Outstation Program,” which would have been implemented to provide greater assistance to hiring departments. Since the FY 2015 budget process, City management has continued working to address hiring issues with the Personnel Department. Rather than implement an Outstation Program through the Personnel Department, management has initiated a more intense focus on hiring department process issues.

For the remaining two requested positions, Personnel has indicated that they intend to defer any additional budget requests as they continue to implement process and technical efficiencies. Thus, there has been no request for additional staffing in the Outlook. A pilot program related to hiring departments’ direct access to the Online Hiring Center in NEOGOV is estimated to be implemented by May of 2015. Depending on the outcome of the pilot program, Personnel may need additional staff to assist departments in the use of NEOGOV. However, it is currently unknown whether this will be the case.

Additionally, the City staff workgroup studying potential electronic workflow enhancements related to Personnel processes has been meeting; and select processes have been mapped for study and costing by Enterprise Resource Planning (ERP). As the Personnel Department continues to work on these and other potential process improvements, they will be further evaluating their staffing needs. Additionally, Personnel has agreed to provide quarterly updates on the hiring process and process improvements to the Budget and Government Efficiency Committee.

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 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 2016	FY 2017	FY 2018	FY 2019	FY 2020
Penny for the Arts Blueprint % Total TOT Goal	8.6%	9.5%	9.5%	9.5%	9.5%
	0.9 cent	1.0 cent	1.0 cent	1.0 cent	1.0 cent

Based on this, the difference from the amount of funding for the Penny for the Arts program included in the Outlook and what is outlined in the Blueprint is as follows:

$ in millions	FY 2015	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
Penny for the Arts TOT Blueprint Goal (%)	8.1%	8.6%	9.5%	9.5%	9.5%	9.5%
Penny for the Arts TOT Blueprint Goal (1.0 cent)	0.9 cent	0.9 cent	1.0 cent	1.0 cent	1.0 cent	1.0 cent
Penny for the Arts TOT Blueprint Goal ($)[1]	$ 14.2	$ 16.2	$ 19.0	$ 20.0	$ 21.0	$ 21.9
Penny for the Arts Funding Included in Outlook	$ 10.0	$ 10.6	$ 11.2	$ 11.8	$ 12.4	$ 13.0
Variance from the Blueprint	$ (4.2)	$ (5.6)	$ (7.8)	$ (8.2)	$ (8.6)	$ (8.9)

[1]The Penny for the Arts TOT Goal ($) is based upon the TOT Goal (%) of the total 10.5 cent Transient Occupancy Tax projection included in the Outlook. The total TOT projection for fiscal years 2015-2020 are as follows: FY 2015 - $176.3; FY 2016 - $189.8; FY 2017 - $200.2; FY 2018 - $210.3; FY 2019 - $220.8; FY 2020 - $230.7

Funding for Homeless Programs and Services

In FY 2014, approximately $1.9 million was budgeted in the General Fund for homeless programs and services including the extension of the Single Adult Emergency Winter Shelter and Veterans Shelter to year-round operations for FY 2014. In FY 2015, the General Fund budget redirected the same $1.9 million towards outcome-focused services and critical program enhancements that are believed to be a more effective use of resources and result in a coordinated operation. In addition to the $1.9 million, an additional $150,000 was added to fund 25 triage beds to be utilized by the Police Department's Homeless Outreach Team. The Winter Shelter and the Veterans Shelter have reverted back to a five-month program scheduled from November 2015 to April 2015. The Winter Shelter opened on November 1, 2014 and the Veterans Shelter opened November 9, 2014 (delay from originally planned opening date of November 1, 2014 due to contracting issue). The FY 2015 funding for homeless programs includes $400,000 being allocated to one-time costs for the development of a regionally coordinated intake and assessment system.

The Outlook has incorporated $1.5 million in funding for homeless programs into the baseline projections. The one-time funding of $400,000 in FY 2015 for the development of a regionally coordinated intake and assessment system has not been included in the Outlook projections as no specific project has been identified for this funding. It is the intention of the Mayor to continue the core funding amount of $1.9 million for homeless programs, however additional programs will need to be identified in future years in order to include additional funding in planning documents. Specific funding and programmatic allocations will be addressed during the annual budget deliberations.

<u>Public Works - Facilities Maintenance & Repair</u>

The Outlook does not include any increase for facilities maintenance and repair (M&R) for any future fiscal year. Underfunding of M&R for facilities and other City assets has been a significant contributing factor to the facilities division's backlog of deferred maintenance and capital projects. 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 approximately $47 million annually, which is over $30 million higher than the current level of M&R invested in City facilities[4].

Discretionary Requests in the Outlook, which are not part of the baseline projections or the Mayor's Priority Initiatives, include department requested increases to facilities M&R to aid in closing the gap between current City investment and the 2 percent industry standard. The costs associated with closing this gap as requested by the department is shown in the following table:

FACILITIES M&R REQUESTED, NOT INCLUDED IN OUTLOOK PROJECTIONS					
($ in millions)	FY 2016 Outlook	FY 2017 Outlook	FY 2018 Outlook	FY 2019 Outlook	FY 2020 Outlook
FTE's	37.00	66.00	96.00	125.00	153.00
Total Expense	$ 4.2	$ 7.4	$ 10.8	$ 14.0	$ 16.9

This requested increase would not bring the total M&R to the National Research Council low standard of 2 percent, though it would help to slow the deterioration of City owned assets. We would note that the FY 2015 Adopted Budget includes $1.0 million for the first round of facility condition assessments (which are anticipated to be presented in the January 2015 with the Multi-Year CIP) that will aid in determining required annual M&R in future fiscal years. Additionally, the Outlook does include additional funding for facilities condition assessments - $1.0 million in FY 2016 and $0.5 million for both FY 2017 and FY 2018.

CONCLUSION

The Mayor's FY 2016-2020 Outlook provides the Council with an early look at where the Mayor plans to focus funding in the future. Furthermore, it is a key indicator of the Mayor's funding priorities for FY 2016. In February 2015, the Council will develop and adopt its FY 2016 Budget Priorities Resolution to help guide the Mayor's upcoming budget decisions. The Outlook, together with our review and analysis, will assist the Council in shaping this important message to the Mayor. In this report we have raised issues for the Council to consider and

[4] This did not include the new Central Library

possibly explore at Committees over the next several months in preparation for the FY 2016 budget process.

Our review of the Outlook, as in the past, provides analysis and commentary on a wide range of issues identified in the Outlook; and typically we do not include specific recommendations at this point in the process. However, in this report and as a result of our review, we have identified the following recommendations regarding infrastructure funding and planning:

1. We recommend the Infrastructure Committee evaluate and update the Enhanced Option B Plan adopted by Council in March 2012, and consider a "catch-up" plan for FY 2018 (and beyond) to address what we see as a funding gap of $96.4 million in lease revenue bonds in the Outlook.

2. We strongly support the DCOO's and the Public Works Director's efforts underway to develop a comprehensive plan on how best to develop sufficient City, consultant, and contractor capacity to handle a higher volume of infrastructure projects in the future; and recommend that this plan be heard at the Infrastructure Committee in early 2015.

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Attachment: 1. New or Expanded Facilities – Annual Costs