

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: May 11, 2006

IBA Report Number: 06-24

City Council Agenda Date: May 15, 2006

Item Number: 200

Item: Overview of Citywide Issues Presented in IBA Report No. 06-18, "Mayor's Proposed Fiscal Year 2007 Budget"

Summarized below are significant Citywide budget issues that were identified in our April 28, 2006 review of the "Mayor's Proposed Fiscal Year 2007 Budget." The Council meeting on Monday, May 15, 2006, is dedicated to Council budget deliberations. This information is provided in summary format to facilitate these discussions, and reflects the more comprehensive information provided in IBA Report No. 06-18, "Mayor's Proposed Fiscal Year 2007 Budget." Corresponding page numbers from that report are noted by each subject.

General Fund Revenue and Earmarking of Funds (IBA 06-18, pp. 15-17)

The table below presents General Fund revenue growth FY 2007 over FY 2006 that was presented in the Mayor's Proposed Budget, excluding pension obligation bond proceeds.

General Fund Revenue – FY06 to FY07 (No POB Receipts)	
FY 2006 General Fund Revenue	\$ 864,919,912
<i>Restructuring</i> ¹	37,718,800
<i>Supplemental Revenue</i> ²	<u>22,303,222</u>
FY 2007 Base General Fund Revenue	\$ 924,941,934
FY 2007 Revenue Adjustments	
<i>Major Revenue Growth</i> ³	\$ 151,150,368
<i>Other Non-Departmental Adj.</i> ⁴	(65,136,447)
<i>Departmental Revenue Adj.</i>	<u>2,151,033</u>
FY 2007 Proposed Budget	\$1,013,106,888
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<i>1. Reflects Street Division, Diversity, Special Training, and the Benefits and Safety activities of Risk Management moving to the General Fund.</i>	
<i>2. Associated with supplemental positions.</i>	
<i>3. Includes property tax, sales tax, TOT and franchise fees.</i>	
<i>4. Primarily reflects removal of FY 2006 on-time revenue (\$12.4m) and elimination of TOT transfer (\$39.1m) and budgeted carryover (\$9.9m).</i>	

As the table shows, over \$60 million of the net increase is due to restructuring and supplemental revenue. The significant increase in major General Fund revenue growth is partially attributable to a more transparent budget practice regarding sales tax revenue. In prior years, sales tax revenue was allocated to other non-General Funds before being budgeted in the General Fund. In the FY 2007 proposed budget, the entire amount of projected sales tax is budgeted in the General Fund, while General Fund transfers are made to support the recipient non-General Funds. In addition, the budget also includes a one-time boost of approximately \$17 million in property tax revenue due to the elimination of a two-year ERAF shift.

Our report noted that the Fiscal Year 2007 proposed budget employs reasonable growth estimates for major General Fund revenues. Property tax growth is projected to slow substantially from the projected growth in FY 2006 as a result of a slowing housing market, while sales tax growth is on par with statewide estimates made by the California Department of Finance. Growth in TOT revenue reflects continued strength in the city's tourism market. One point of uncertainty however, as noted in our report, is in regard to the FY 2007 state booking fee revenue of \$5.2 million that is included in the Mayor's Budget. Our report also discussed the concerns regarding the earmarking of general revenues.

Pension Obligation Bonds (IBA 06-18, pp. 4-5, 20)

The Mayor's Budget included \$374 million in pension obligation bond proceeds to pay down the UAAL.

In our report, the IBA proposed that the City Council discuss/consider an Alternative Budget A for Fiscal Year 2007. Alternative Budget A would propose including the \$162.5 million for retirement contributions in next year's budget, while holding off on including the \$374 million in pension obligation bonds proceeds in the budget. This approach would not limit the City's ability to pursue the pension obligation bonds during the course of the year.

This recommendation is based on the high degree of uncertainty relative to this potential transaction and is discussed in greater detail in our April 28, 2006 report.

Other Pension Issues (IBA 06-18, pp. 6, 20-24)

Our report raised the following pension related issues:

Fiscal Year 2007 Payment Calculation

When Board approved rates are applied to the payroll in the proposed budget, the contribution is calculated at between \$168 million and \$174 million, depending upon the timing of the payment. The Mayor's Budget reflects a payment of \$162.5 million.

On May 19, the SDCERS Board is expected to discuss the full actuarial valuation report. The IBA expects at that time to have written clarification on the required contribution for FY 2007. Once that information is provided, our office will analyze this with respect to the FY 2007 Proposed Budget.

Timing of Payment

Timing of the payment should be clarified per the Gleason settlement by the CFO.

Waterfall

“The Waterfall,” the mechanism by which retirement fund assets are diverted to other “contingent” uses, is still codified in the City’s Municipal Code. This will continue to occur in Fiscal Year 2007 without additional infusions outside of the required contribution and without necessary revisions to the Municipal Code.

Tobacco Securitization (IBA 06-18, pp. 5, 25)

The IBA confirmed that those programs historically funded through these revenues are reflected in the Fiscal Year 2007 Proposed Budget, as in past years, with the exception of the “6 to 6” program. In addition, no tobacco securitization revenues are budgeted as is appropriate. However, the IBA could not identify the final step in the process, which is to make the General Fund revenues whole through the receipt of the employee offset savings.

The employee offset savings, which are estimated at \$10.4 million, were not included in the Mayor’s Budget and are available as a resource in final Council budget modifications. We recommended a contribution to the unallocated reserves as a desirable option in our April 28 report.

Retiree Health (IBA 06-18, pp. 7, 26)

The Mayor’s Proposed Budget stated that funding in Fiscal Year 2007 to pay for current retiree healthcare premiums was provided at nearly \$21 million. However, we were unable to confirm that this level of funding was provided in the budget. Our research showed that only \$17.2 million was provided in the budget. The Mayor has confirmed this and has stated that it may be corrected through overages in other accounts. This information should be detailed to the City Council and the IBA for evaluation and possible inclusion in the budget.

Establishment of Retiree Health Trust Fund (IBA 06-18, pp. 7, 26)

The Mayor’s Proposed Budget stated that an additional \$5 million is included in the budget to establish a trust to pre-fund the City’s retiree healthcare obligation. We were unable to confirm that this \$5 million allotment is provided in the budget. Our research did not show any funding allocated for the establishment of this trust. As above, the Mayor has confirmed this and has stated that it may be corrected through overages in other accounts. Again, this information should be detailed to the City Council and the IBA for evaluation and possible inclusion in the budget.

Deferred Maintenance (IBA 06-18, pp. 6, 27-28)

The Mayor has stated that the City will allocate approximately \$20 million in FY 2007 to the backlog of deferred maintenance. The Fiscal Year 2007 Proposed Budget includes funding a portion of the City's backlog of deferred maintenance of \$10.6 million. The remaining \$9.4 million of the \$20 million for deferred maintenance is contingent upon issuance of pension obligation bonds (POBs).

On April 13, 2006, the Mayor released a deferred maintenance backlog fact sheet totaling \$20 million in priority projects. The Council may wish to know which of these projects the Mayor would propose to fund in FY 2007 given that, without the pension obligation bonds, only \$10.6 million remains in his proposed FY 2007 budget. The Council should identify their top priority needs for final budget adoption.

General Fund Reserve (IBA 06-18, pp. 7, 29-30)

The Fiscal Year 2007 budget as submitted did not provide for a contribution to the General Fund reserve without the inclusion of the pension obligations bonds. While the Mayor's plan is to contribute \$22.4 million to the reserve in Fiscal Year 2007, this plan is contingent upon issuing pension obligation bonds. No additional contribution to the reserve was budgeted.

As stated in our report, without an additional contribution, the reserve as proposed for FY 2007 would constitute 3.25% of the General Fund compared to 4.2% for the current fiscal year. It should be noted, however, that since our report was released the General Fund reserve was accessed several times to pay for over-budget expenditures, including \$10.4 million needed to comply with a court order regarding State Route 56. These subsequent extractions will result in a lower reserve balance and a lower percentage of the General Fund if the reserve is not replenished at the end of FY 2006. Given the frequency with which the reserve has been accessed, we reiterate our position that the policy governing reserves should be updated as soon as possible in order to establish clear guidelines regarding the use and replenishment of the General Fund reserve.

New Facilities (IBA 06-18, pp. 43-44)

A number of new City facilities will be completed in FY 2007 requiring funding for operations and maintenance. The chart below shows the facilities by department, the requested funding and the status of the request in the Mayor's Budget.

<u>Dept.</u>	<u>Facility</u>	<u>Funding Request</u>	<u>Status</u>
Library	3 new branches *	\$1.2 M	Funded
Park & Rec	11 new facilities **	\$2.0 M	Not Funded
Police	Northwestern Station	\$12 M	Not Funded

* 2 of 3 branches were completed in FY 2006
** New Park & Recreation facilities completed in 2006 did not receive \$3.8 M in requested operating funds

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The Mayor's CFO has stated that he plans to discuss with the Council at the May 15, 2006 meeting his recommended budget changes to address the issues noted above. As of the time this report was issued, our office had not had an opportunity to evaluate the proposed changes for this report. We will do so prior to the issuance of our final report on May 19, 2006. The IBA recommends that the Council take no action on the CFO's proposed changes until the IBA has had the opportunity to evaluate them and incorporate all recommended changes into our final report.

Other Citywide Issues

IBA Report No. 06-18 also discussed the following financial issues that if not addressed during budget deliberations, we recommend be docketed for future Budget and Finance Committee agendas over the next several months:

- Long Term Planning
- Financial Policies
- Prior Year General Fund Encumbrances
- Public Liability Fund/Legal Expenses
- The City's Structural Budget Deficit
- Fees for Services
- Core Services
- Business Process Reengineering
- Appropriation Ordinance

[SIGNED]

Andrea Tevlin
Independent Budget Analyst