City of San Diego

Five-Year Financial Outlook

Fiscal Years 2008 – 2012

November 29, 2006

Presentation to the City Council Through The Budget and Finance Committee

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Executive Summary

Introduction

This document and the accompanying attachments represent the City of San Diego's first true examination of its long range fiscal condition and financial challenges. For years the City operated on a year-to-year basis and ignored or never attempted to identify the long-term affects of its decisions or how they might pay for them. As a result, paying down the City's long-term liabilities have not been addressed and setting aside funding to maintain City physical and financial assets has not been a priority.

The City of San Diego's Five-Year Financial Outlook (Financial Outlook) breaks this practice. The Financial Outlook will stimulate discussion and allow the City to take a long-range perspective regarding the City's true fiscal conditions in order to achieve balance, stability and economic competitiveness. By incorporating this perspective into the City's annual budget process, it will allow the City to make decisions today that will minimize the risk of future budget gaps.

The Financial Outlook includes revenue and expenditure forecasts which are based on various assumptions such as economic conditions or previous policy decisions. The Financial Outlook serves as a tool which identifies the priorities, long-term trends, risks and opportunities and will be valuable to guide the City in the development of future budgets.

This Report is divided into two primary Sections. The first section covers the development of the projections and the identification of the unmet needs. It includes a brief introduction, a discussion on the more global economic assumptions that affect the San Diego's economy and a more detailed discussion of each assumption used and its impact on specific revenues and expenditures. The Financial Outlook starts out with the assumption of no new programs or services, no restoration of services cut in previous years, and no new revenues except through the natural growth that comes from economic expansion. It reflects the continuation of the full payment of the Annual Required Contribution (ARC) as calculated by the San Diego City Employees' Retirement System (SDCERS) and the pay-as-you-go approach for the post-employment medical benefits provided by the City. It does include funding for the General Fund's pro-rata share of the projected costs to fully implement the Kroll Remediation Plan as well as funding to repay SDCERS principal and interest associated with the past use of Pension Plan Assets to pay for the retiree health care benefit (1982 to 1992). Incorporated into the Financial Outlook is funding to pay for negotiated salary increases, consistent with each Memorandum of Understanding (MOU), for both the Municipal Employees' Association (MEA) and Local 127's only. Aside from this, no funding has been incorporated into the forecast to provide for any other employee salary increase. Finally, in anticipation of the elimination of a number of vacant positions and the filling of critical public safety positions, funding has been included in the Financial Outlook to reduce the vacancy factor that was used in fiscal year 2007. Each of these areas will be discussed in greater detail below.

In addition to the above, the first Section of the Financial Outlook discusses funding for eight significant areas that must be addressed in order to restore or preserve the fiscal integrity and/or meet the legal obligations of the City. Many of these areas have been discussed for years but never addressed. The rationale used in developing the approach and recommendation to each area is elaborated upon below. The eight areas are:

1. Properly funding the City's Pension Plan.
2. Properly funding the City's General Fund reserves.
3. Funding deferred maintenance and capital improvement needs.
4. Properly funding the City's Post Employment Medical Program.
5. Funding the City's new obligations under Storm Water Runoff Permits.
6. Funding the City's ADA obligations.
7. Adequately funding the City's Workers' Compensation Fund.
8. Adequately funding the City's Public Liability Fund.

The second Section of the Financial Outlook will focus on some of the possible solutions to bring future budgets into balance, including both reductions in costs as well as possible revenues. A number of the possible solutions require further analysis, but will serve as the basis for developing the fiscal year 2008 budget. Since most of these solutions represent ongoing savings, nearly every solution to fiscal year 2008 represents the start towards solving the projected budget deficits in fiscal year 2009 and beyond.

Revenue Forecast

The General Fund Revenue portion of this Report provides a detailed description of the revenue categories, including background information, a description of the method of allocation, growth trends, and economic factors affecting the revenue source. The four major revenue sources, property tax, sales tax, transient occupancy tax and franchise fees, generate approximately 70% of the General Fund revenue. Changes in the local, State, and national economic environments can impact each of these revenue sources. Other General Fund revenue sources are influenced by economic conditions as well as a myriad of non-economic factors. These factors may include a change in an existing fee or the implementation of a new policy in existing programs.

Expenditure Forecast

The Salaries and Wages category represents 48.6% of the General Fund budget. Total compensation, including retirement and other benefits, represents about 73.3% of the fiscal year 2007 General Fund budgeted expenditures. The Financial Outlook assumes a 4.0% growth in salaries in fiscal year 2008 for the Municipal Employees' Association and Local 127 bargaining units only followed by no growth thereafter. Since there are no negotiated salary increases for any other bargaining unit, no salary increases have been factored into the Financial Outlook for any other employee group. Given that the MOUs with each bargaining group provides for normal salary step increases, some funding has been included in the Financial Outlook to take this into account. In addition, the Mayor formally introduced the use of a vacancy factor when preparing the fiscal year 2007 budget. The average vacancy factor used in fiscal year 2007 was 5.3%. The Financial Outlook assumes the vacancy factor will be reduced to 3.5%, 3.0%, 2.5%, 2.4%, and 2.3% for fiscal years 2008, 2009, 2010, 2011, and 2012, respectively.

Pension Payments have been incorporated into the Financial Outlook based upon projections prepared by the Retirement System's actuary. These projections started with the June 30, 2005 actuarial valuation and then were modified to incorporate such factors as the $108 million supplemental contribution the City made to the System prior to June 30, 2006. These projections do not assume any changes to the amortization schedule as contemplated in Proposition G. Based upon an opinion issued by the State Attorney General, the voters cannot impose actuarial assumptions on the Retirement Board. This, of course, does not preclude SDCERS from changing the amortization schedule beginning in fiscal year 2009. While the City may issue pension obligation bonds, leverage lease revenues, complete the leveraging of the employee pick-up, etc., the Financial Outlook does not factor any of these possible future actions into the funding schedule of the Unfunded Actuarial Accrued Liability (UAAL). Funds have been added to the Financial Outlook to increase the projected Annual Required Contribution (ARC) by approximately $8 million per year in order to discontinue the use of "surplus earnings" (the Waterfall) to pay for the Corbett settlement or 13th Check. Based upon SDCERS' recent direction to its actuary, future ARCs will take this into consideration.

In addition to the ARC and the Waterfall, in order to eliminate the negative amortization that accrues to the City over the projected next ten years, the Financial Outlook includes an additional $27 million per year (of which $20.8 million is the General Fund's portion) to be paid to SDCERS each year. This is projected to reduce the amortization schedule by seven years.

Retiree Health Care Cost (OPEB) traditionally has been funded on a pay-as-you-go basis. Given how fast this component of the budget is projected to grow, if the City continues with this practice, it will experience similar issues it now faces with the Pension costs. In addition, beginning with the City's fiscal year 2008 Comprehensive Annual Financial Report (CAFR), the City will have to officially calculate its OPEB liability, establish an ARC payment and either budget the ARC at its full level or record the difference as a liability on its financial statements.

As such, the Financial Outlook continues the practice of pay-as-you-go to fund the OPEB benefits for fiscal years 2008 and 2009. In addition, the funds are included for a Trust Fund and for an actuarially calculated Annual Required Contribution. Included in the Financial Outlook is an additional $25 million in fiscal year 2008 budget on top of the pay-as-you-go amount and an additional $50 million in fiscal year 2009. Both amounts are on top of the projected pay-as-you-go amounts. Both incremental amounts will be deposited into a Trust Fund that is expected to be established in fiscal year 2007. Beginning in fiscal year 2010, the City would discontinue the pay-as-you-go approach all together and pay its full ARC. At this point in time, it is difficult to calculate what that exact number would be; however, the Financial Outlook assumes a $75 million ARC in fiscal year 2010 that would grow each year as payroll costs increase.

Flexible Benefits and other fringe benefit costs include the cost of providing employee health care and other benefits as part of the flexible benefit program. The category of Other Fringe Benefits includes general employee benefits such as workers' compensation and unemployment insurance, which is projected to increase by inflation and will be paid by the City. The Financial Outlook assumes an increase of $500 in flexible benefits for MEA employees in fiscal year 2008 followed by no growth in fiscal years 2009-2012 for all bargaining units.

Other Committed Expenditures have been included in the Financial Outlook. The "committed" expenditures category includes contractual services obligations; new facilities; additional staffing for new facilities; the City Council-mandated and other obligations. The "committed" expenditures category also includes inflationary increases to various expense items such as supplies and services, energy and utilities, and information technology.

Projected **Kroll Remediation** costs have also been included in the Financial Outlook. On August 8, 2006, Kroll provided its findings and remedial recommendations to the City Council. On August 24, 2006, the Mayor presented his response to the report. The projected cost of implementing the numerous recommendations is estimated at $45 million. These costs have been allocated between the General Fund and other City funds as appropriate.

Eight Significant Areas

As mentioned above, the Financial Outlook includes funding for eight specific areas that require immediate City attention.

ARC Plus: Under the current funding approach, the City is paying down its UAAL over a 30 year time horizon. Under the Gleason Settlement, the City is currently in year 28. Given how virtually every public pension plan is funded (i.e. level percentage of payroll), the City's current ARC is projected not to fully cover the 8.0% interest charged by SDCERS on the UAAL for the next ten years (negative amortization). As salaries grow over time, so does the ARC, and the negative amortization eventually disappears. In order to eliminate this negative amortization beginning with fiscal year 2008 and continuing each year thereafter, the Financial Outlook includes an additional $27 million payment each year to SDCERS. The General Fund portion of this amount is $20.8 million. This will also shorten the amortization period by seven years. **ATTACHMENT 1** reflects two amortization schedules. The top schedule continues to current amortization approach, while the bottom schedule eliminates all negative amortization. In aggregate, after paying the ARC, covering the Waterfall and adding an additional $27 million per year, the City's pension payments for all funds will be $198.7 million, $202.1 million, $206.6 million, $212.1 million, and $218.0 million in fiscal years 2008 through 2012, respectively. Again, this does not include any leveraged financing that the City is currently exploring.

General Fund Unappropriated Reserve (Reserve): The forecast assumes that the City will continue to work towards the Mayor's goal of reaching the General Fund Reserve level equal to 8.0% of the General Fund operating budget by fiscal year 2012. Staff is preparing a new Reserve Policy and will present it to the City Council for review and approval. The Financial Outlook includes Reserve levels of 6.0%, 6.5%, 7.0%, 7.5%, and 8.0% for fiscal years 2008, 2009, 2010, 2011, and 2012, respectively.

Deferred Maintenance/Capital Improvements: Deferred Maintenance/Capital Improvements includes all needed repairs to City facilities, including roof replacement, heating and cooling system upgrades, painting, floor covering repair, structural repairs, as well as repairs and improvements to storm drains and streets. It is estimated that the City's deferred maintenance/ capital needs, excluding those of Water and Wastewater, may be at least $800 to $900 million. Presently staff is compiling an inventory of all needs and will have a completed list plus projected costs sometime in fiscal year 2008. Until then, several assumptions had to be made which have been incorporated into the Financial Outlook.

First of all, a portion of the deferred maintenance/capital improvements can be financed over time and a portion should be cash funded each year. Given the lack of detailed information, it has been assumed that 50% of the improvements done to facilities will be on a pay-as-you-go basis and 50% will be financed. As it relates to streets and storm drain projects, 25% of the improvements will be on a pay-as-you-go basis and 75% financed. These proportions will be updated as new information becomes available. In addition, regardless of the amount of funding made available for these projects, there are practical limits on how much work can be handled in any given fiscal year. The forecast assumes that $5 million can be spent on facility repairs and improvements in fiscal year 2008 (which will be 100% paid for with cash) and $50 million each year thereafter which will be 50% paid for with cash and 50% will be financed. With respect to storm drains and streets, the forecast assumes that $33 million can be spent in fiscal year 2008, $70 million in fiscal year 2009 and $90 million each year thereafter. These projects will be funded on a 25%/75% ratio as described above. **ATTACHMENT 2** reflects the total amount of projects that will be undertaken each year as well as the cashflow required to either pay for the project or the debt service related to financing the projects.

Both because the annual cost of the benefit is projected to increase substantially over the next five to ten years and Governmental Accounting Standards (GASB 45) will require the City to begin reporting this liability on its financial statements, **Retiree Health Care (Other Post-Employment Benefits – OPEB)** needs to be more appropriately funded. The Financial Outlook continues to include funding for this benefit on a pay-as-you-go basis for fiscal years 2008 and 2009. In addition, $25 million and $50 million, respectively, have been added to the projections in order to begin building a Trust Fund to cover the escalating costs. Beginning in fiscal year 2010 and continuing until this liability is fully funded, the Financial Outlook assumes that the City will pay the full OPEB ARC. The Financial Outlook assumes that this will be around $75 million in 2010 and grow slightly each year thereafter.

Compliance with new **Storm Water Runoff Regulations** associated with new permits will impact the City's budget. Based upon preliminary estimates, this will cost the City $18.2 million in fiscal year 2008 and $36 to $37 million each year thereafter. Some of this cost could be offset by increased storm drain fees, but this is still under review. As such, the Financial Outlook only includes the projected costs associated with the permits.

The **Americans with Disabilities Act (ADA)** went into affect in 1990. Since that time, public agencies and private companies have been required to make facilities and infrastructure accessible to persons with physical challenges. Just like deferred maintenance, the City of San Diego has put very little funding towards this effort. At this point, it cannot be determined how much of the City's ADA improvements will be addressed with the deferred maintenance/capital improvement spending. As such, in addition to the funding budgeted for deferred maintenance/capital improvements, the Financial Outlook includes $10 million per year to be allocated to ADA related improvements. This is on top of any CDBG or other funds allocated for this purpose.

Workers' Compensation liabilities continue to grow and reserves need to be put in place to cover this exposure. Presently, the City has approximately $150 million in outstanding workers' compensation claims and only $18 million in reserves. This is far short of what should be reasonably expected. Should the City be required to make a large payout on a claim, it would most likely be a significant impact to the General Fund. By establishing a reasonable reserve level, the City will provide better insulation to other programs and services. Funding has been included in the Financial Outlook to begin building a Workers' Compensation reserve. While no additional funding has been included in fiscal year 2008, $5 million has been allocated in the fiscal year 2009 budget and $10 million for each year thereafter. This amount is in addition to the amount budgeted each year to cover projected annual payments.

As with the **Workers' Compensation Fund,** the City has **Public Liabilities** that fluctuate from year to year and also place the City's General Fund at risk. Presently, the City has approximately $100 million in outstanding public liability claims and only $4 million in reserves. This too is far short of what should be reasonably expected. Should the City be required to make a large payout on a claim, it would most likely be a significant impact to the General Fund. By establishing a reasonable reserve level, the City will provide better insulation to other programs and services. Included in the Financial Outlook for fiscal years 2008, 2009 and 2010 is $5 million each year. This amount is increased to $10 million per year thereafter. This amount is on top of the amount budgeted each year to cover projected annual payment.

ATTACHMENT 3 provides on overall recap of the financial challenges facing the City over the next five years. It reflects the revenue and expenditure projections for each year and incorporates funding for the priorities discussed in this Report.

THE FIVE YEAR FINANCIAL OUTLOOK

Introduction

The City of San Diego new Five-Year Financial Outlook has a purpose of serving as a planning tool in order to bring a long-range perspective to the City's budget process and spending priorities and securing fiscal and structural balance. The Financial Outlook provides the analytics designed to communicate the key assumptions and conclusions of the City's General Fund Financial Outlook.

By providing a forecast of revenues and expenditures over a five-year period and incorporating a variety of known and assumed factors that drive each revenue and expenditure line item, the Financial Outlook will assist the City in annually assessing its ability to meet the following key goals:

- ✓ Preservation of City services
- ✓ Commitment to fund new public facilities; meet contractual obligations; and fund mandated programs
- ✓ Reduction of the Pension Unfunded Actuarial Accrued Liability (UAAL)
- ✓ Establishment and maintenance of adequate General Fund reserves
- ✓ Address other financial obligations with a longer term strategy

The Financial Outlook is consistent with the best practice recommendations of the Government Finance Officers Association (GFOA) which recognizes the importance of combining the forecasting of revenues and expenditures into a single financial model which should extend at least three to five years beyond the budget period and be regularly monitored and periodically updated. GFOA recommends that local governments have a financial planning process to assess the long-term financial implications of current and proposed policies, programs, and assumptions and to develop appropriate strategies to achieve the established goals.

Scope of the Forecast

The Financial Outlook primarily focuses on the City's General Fund which is the City's main operating fund used to pay for public safety services, refuse collection, libraries, parks and recreation. Most of the City's tax revenues are deposited into the General Fund, as well as revenues from licenses, permits and fines. The Financial Outlook forecasts the General Fund revenues and expenditures for five years beginning fiscal year 2008 through fiscal year 2012.
The Financial Outlook is designed to reflect the General Fund Unappropriated Reserve level equal to 8.0% of revenues by fiscal year 2012 and also assumes that the City complies with the Mission Bay Ordinance.

I. General Fund Revenue

Revenue Forecast

The Revenue Forecast combines an analysis of the economic factors driving the City's revenue base and the specific revenue sources available to the City. The City's revenues are increasingly affected by decisions made by the State regarding the allocation of local revenue. Three of the City's largest historical General Fund revenues - property tax, sales tax, and motor vehicle license fees - are all subject to State legislative actions, and have been significantly impacted by past State budget decisions resulting in tremendous revenue loss to the City. While Proposition 1A has gone a long way in providing greater security for local revenues, it does not mean that the State will not look for other ways to balance its budget on the backs of local governments when economic times become tough.

Economic Assumptions

The Financial Outlook reflects various assumptions about the future economic environment which were developed after analyzing several national, State and local economic forecasts. Because of San Diego's strong and diverse economy, local economic growth is anticipated to continue to outpace the rest of the State and nation. The revenue forecast takes into consideration the following economic assumptions:

- San Diego Gross Regional Product is expected to grow by 2.5% in calendar year 2007 to reach approximately $159.2 billion, up from the estimated $149.9 billion in 2006.[1]

- Local inflation is anticipated to decrease by 0.3% in calendar year 2007 from 3.6% in calendar year 2006. The decrease is partially due to moderating home prices and lowering gas prices. [1]

- The County unemployment rate is expected to be lower than the State and the U.S. rates to be approximately 4.1% in calendar year 2007, up from the estimated 4.0% in calendar year 2006. The number of employed people is expected to grow by 1.1% or 16,000 jobs to reach 1,471,500. [1]

- Total taxable sales in calendar year 2007 are projected to increase 1.1% from calendar year 2006; per capita retail sales are projected to grow 0.4% to reach $12,000, up $400 from $11,600 in calendar year 2006. [1]

- A median price of single-family homes in San Diego is expected to drop approximately 8.0% to $550,000 in calendar year 2007, down from $579,000 in calendar year 2006. [1]

- Personal median household income is expected to increase by 3.6%; per capita income is forecasted to increase by 3.7% in calendar year 2007. [1]

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[1] San Diego Regional Chamber of Commerce. San Diego Economic Bulletin Forecast 2007. Volume 55. No.2.

- The City's population is estimated to increase by 13,338 people, from 1,311,162 on January 1, 2006 to 1,324,500 on January 1, 2007. [1]

The following summarizes the General Fund's major revenue sources as reflected in the Financial Outlook. In comparing year-to-year changes, it is important to note that General Fund revenues from many of these sources will reflect both economic activity and the allocation of these revenues between the General Fund and various special funds.

Major General Fund Revenue Estimated Growth
Fiscal Years Years 2007 - 2012

Revenue Category	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
Property Taxes	*3.5%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
Sales Tax	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
Transient Occupancy Tax	*6.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Franchise Fees	*7.5%*	*7.5%*	*7.5%*	*7.5%*	*7.5%*

PROPERTY TAX REVENUE

Property tax is the City's largest revenue source representing 33.7% of the total General Fund revenue. The City of San Diego receives property tax revenue based upon a 1.0% levy on the assessed value of all real property. Property tax revenue is collected by the County of San Diego, which allocates the revenue to a number of agencies within the City's geographic area, including the County itself, the City of San Diego, school districts, and special districts. The basis for allocation under State law is the average tax rate levied by the taxing agency for the three years before Proposition 13 was adopted (referred to as "the AB 8 formula".) This formula has been modified by the State over the years. The City of San Diego receives a relatively smaller allocation of the 1.0% (approximately 17% of the 1.0%) than other cities in the State due to a lower tax rate at the time of the passage of Proposition 13.

Since the early 1990s, the City's property tax revenue has undergone many changes. First, in fiscal year 1993, the State of California faced a serious deficit. In order to meet its obligations to fund public education at specified levels under Proposition 98, the State enacted legislation that shifted partial financial responsibility for funding education to local governments. These revenue shifts, otherwise known as the Educational Revenue Augmentation Fund (ERAF) shifts, have resulted in an estimated cumulative loss of over $468.3 million in property tax revenue for

[1] City of San Diego Planning Department. The City population figure reflects the projection as of January 1, 2007; subject to revision.

the City through fiscal year 2006. In addition, in order to collect and distribute property tax, the State authorized counties to charge cities for administrative fees, which further reduces the City's annual property tax receipts by approximately $2.1 million per fiscal year.

Another two-year ERAF shift (ERAF III) was enacted in fiscal year 2005, which mandated local agencies to contribute $1.3 billion per year to the State. This contribution was "offered" by the State in exchange for Proposition 1A (approved by voters in November 2004), which was designed primarily to protect local governments from future revenue losses resulting from the State actions. For the City of San Diego, this contribution has resulted in approximately $16.9 million property tax loss in fiscal years 2005 and 2006. Any increases in assessed valuation in redevelopment areas do not increase the General Fund's share of property tax revenue, as any increase in property tax due to redevelopment must stay in the redevelopment zone.

Beginning in fiscal year 2005, Vehicle License Fee backfill was eliminated by the State and was replaced dollar-for-dollar with property tax, resulting in a property tax revenue increase by approximately $69.1 million in fiscal year 2005 and $74.3 million increase in fiscal year 2006. Beginning in fiscal year 2006, this "property tax in-lieu of VLF" revenue will grow annually at the rate of growth in assessed valuation. It should be noted that the property tax revenue in-lieu of VLF should be considered as a permanent increase in property tax revenue, unless other State actions take place in future, with annual growth being based on the growth in assessed valuation.

Over the past few years, the base property tax revenue experienced a tremendous growth, which was primarily due to a robust growth in the local housing values. This trend, however, is projected to experience a downturn, in part due to a slowdown in the appreciation of housing prices, rising interest rates as well as other economic factors such as local unemployment rate and the overall health of local, State and national economies. The fiscal year 2007 property tax budget is $344.2 million, which consists of $254.5 in base property tax (Proposition 13), the estimated property tax in-lieu VLF payment of $72.8 million, and the reinstated $16.9 million of the City's ERAF III contribution to the State.

Based on the year-to-date data received, the fiscal year 2007 base property tax is projected to be $272.4 million, a net change of approximately $17.9 million over the adopted fiscal year 2007 property tax budget; and $92.7 million for in-lieu VLF and ERAF III repayment, a net change of $3.0 million over the adopted fiscal year 2007 property tax budget. The projected property tax revenue was used when developing the Financial Outlook.

The projection for fiscal years 2008-2012 assumes a 3.5% growth in fiscal year 2008 followed by 2.0% growth thereafter as depicted in the following table.

	Forecast 2008	**Forecast 2009**	**Forecast 2010**	**Forecast 2011**	**Forecast 2012**
			(in millions)		
Property Tax	$ 378.0	$ 385.5	$ 393.2	$ 401.1	$ 409.1
Forecasted Growth	***3.5%***	***2.0%***	***2.0%***	***2.0%***	***2.0%***

The lower growth in fiscal year 2008 and in the following fiscal years is mainly due to the anticipated slowdown (which may, in fact, be considered as a return to normal market conditions) in the local housing market, projected to last at least a few years. The latest statistics from the DataQuick Information Systems (local company which collects San Diego's housing market data) indicates that the median home price continues to decline throughout San Diego. The September 2006 report shows a decline of 4.4% for all types of homes, including condominiums and new and existing houses, over the same period last year; the August, July and June 2006 reports also indicate that all types of homes experienced a decline of 2.2%, 1.8% and 1.0%, respectively, compared to the same period in 2005.

Another factor contributing to a lower growth in the property tax revenue for fiscal years 2008-2012 is the growth in the total building permit valuation for residential and nonresidential units. During fiscal year 2005, the value of permits issued totaled $1.963 billion or 1.0% more than the prior fiscal year. For fiscal year 2006, the value of permits issued totaled $1.960 billion, a 0.2% decrease from 2005. New residential construction is an indicator of trends in both the construction industry and the overall economy. For single family dwelling units, 1,290 permits were issued in fiscal year 2006, up 1.0% from fiscal year 2005. Multifamily dwelling units decreased by 39.0%, from 5,334 in fiscal year 2005 to 3,260 in fiscal year 2006. [1]

The UCLA Anderson Forecast projects a statewide slowdown or "leveling off" of the home sale prices stating that the cooling off of local housing markets would result in a slowdown in spending and some job losses in construction and other real estate related industries. Economists expect an increase in delinquencies and foreclosures from today's historically low levels.

All of the above mentioned economic assumptions have been built in the property tax revenue forecast for the next five fiscal years.

SALES TAX REVENUE

Sales tax is the City's second largest revenue source representing 23.0% of the total General Fund revenue. Collected at the point of sale, sales tax receipts are remitted to the State Board of Equalization, which allocates tax revenue owed to the City in the form of monthly payments. According to the Bradley-Burns Sales and Use Tax law, San Diego receives one cent (or 13.0%) of the total 7.25 cent statewide sales tax levied on each dollar of taxable sales. In addition to the Bradley-Burns sales tax, San Diego County voters approved a half-cent supplemental sales tax in 1987 to fund the San Diego Transportation Improvement Program (TransNet), resulting in a total countywide sales tax of 7.75%. This tax rate includes a ½-cent tax that was passed by California voters in 1993 for the purpose of funding local public safety expenditures.

The fiscal year 2007 sales tax budget is $234.9 million. The fiscal year 2007 sales tax budget includes the property tax reimbursement that the City receives as a result of the triple-flip. Based on the latest receipts, the fiscal year 2007 adopted sales tax budget is being revised downward to $229.7 million, a decline of $5.2 million. The projections for fiscal years 2008-2012 assume a 3.0% annual growth as depicted in the following table.

[1] City of San Diego Planning Department.

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Sales Tax	$ 240.7	$ 247.0	$ 254.4	$ 262.1	$ 270.0
Forecasted Growth	***3.0%***	***3.0%***	***3.0%***	***3.0%***	***3.0%***

The growth in sales tax revenue is dependent on the state of the economy which includes such factors as taxable sales, unemployment, consumer confidence, per-capital income and business investment. The forecast assumes a sustained growth in local taxable sales, though there are some concerns among economists related to the performance of taxable sales in San Diego County for 2007. The concerns are the result of a projected increase, though not significant, in the unemployment rate related to the job losses in the real estate industry. The unemployment rate is forecasted to increase by 0.1% in calendar year 2007; the employment rate is projected to increase by 1.1% in calendar year 2007. The UCLA Anderson Forecast stated that incomes in San Diego have been rising over the last two years but not at the same level as spending which is largely due to increases in new housing wealth.[1] In addition, employment related to real estate remains a significant contributor to overall job growth. If there is less spending related to new housing wealth, and if there is a job loss in the real estate industry, the local economy may be negatively affected unless this loss is made up in other high wage industries. The weakness in the real estate sector, however, may be offset by continued growth in tourism and professional services. Despite a projected growth in personal income (3.7% in 2007), taxable sales are not projected to follow the growth of personal income pace as the consumption driven by a home equity wealth factor keeps declining. All of these economic assumptions have been built in the sales tax revenue forecast for the next five fiscal years.

SAFETY SALES TAX REVENUE

Safety sales tax revenue is derived from a half-cent sales tax that resulted from the passage of Proposition 172 in 1993 and must be used solely for local public safety purposes. The State Controller's Office disburses safety sales tax revenue to the County Local Public Safety Fund for distribution to local governments. Cities receive 5.0% of the amount in the fund, which is allocated among cities based upon their proportionate loss of property tax revenue in the 1993-94 ERAF shift. Subsequent legislation (Senate Bill 8) changed the allocation system for Proposition 172 revenue and lifted the cap on the share that the City of San Diego and other cities within the County could receive. Total revenues reflect additional funds received by the City as a result of this legislation.

Safety sales tax revenue is sensitive to economic conditions, particularly factors that influence taxable sales, such as employment levels, per-capita income and business investment. Safety sales tax, however, is allocated first to counties in proportion to their share of taxable sales and then to the cities within the county. As result, the City of San Diego's share of total countywide

[1] The housing wealth was built through home price appreciation; it allowed homeowners to tap into this wealth at favorable interest rates to finance other forms of investment and consumption.

safety sales tax revenue depends not on taxable sales with the City, but rather on San Diego County's share of total statewide taxable sales.

The fiscal year 2007 safety sales tax revenue budget is $8.1 million. The fiscal year 2007 safety sales tax budget has not been revised since it is projected that the actual revenue will come in on budget. The projection for fiscal years 2008-2012 assumes a 3.0% annual growth as depicted in the following table.

	Forecast 2008	Forecast 2009	Forecast 2010 (in millions)	Forecast 2011	Forecast 2012
Safety Sales Tax	$ 8.5	$ 8.7	$ 9.0	$ 9.3	$ 9.5
Forecasted Growth	***3.0%***	***3.0%***	***3.0%***	***3.0%***	***3.0%***

TRANSIENT OCCUPANCY TAX

San Diego's Transient Occupancy Tax (TOT) is levied at 10.5 cents per dollar of the daily room price in hotels and motels used by visitors staying in San Diego for less than one month. The allocation of TOT is at the discretion of the Mayor and City Council with guidelines provided by Council Policy 100-3. This Policy stipulates that of the 10.5 cents, 4.0 cents shall be applied toward promotional activities of the City as a tourist destination, 5.5 cents shall be applied toward general government purposes, with the remaining 1.0 cents to be allocate for any purpose the Mayor and City Council may direct. Currently, an equivalent of 5.0 cents of the TOT or approximately 48.0% is allocated to Special Promotional Programs for the promotion of tourism and other purposes designated by City Council, while the remaining 5.5 cents is allocated directly to the General Fund to pay for general government purposes.

The fiscal year 2007 General Fund TOT budget was $72.9 million. Staff is now revising this number to $78.6 million, a $5.7 million increase, based on higher than expected receipts. For the forecast period, San Diego tourism performance is projected to have a moderate growth. It is estimated by industry experts that in calendar year 2007:

- Annual room supply will increase by 1.9%;
- Number of occupied rooms will increase by 2.0%;
- Market occupancy will increase by 0.1%;
- Average daily room rate will increase by 5.0%;
- Revenue per available room will increase by 5.2%.

This trend of moderate growth is reflected in the forecast for fiscal years 2008-2012 as depicted in the following table.

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
TOT	$ 83.4	$ 87.5	$ 91.9	$ 96.5	$ 101.3
Forecasted Growth	***6.0%***	***5.0%***	***5.0%***	***5.0%***	***5.0%***

PROPERTY TRANSFER TAX REVENUE

The property transfer tax is levied on the sale of real estate property. Under State law, the County can and does impose a tax of $1.10 per $1,000 of the sale price when any real property is transferred. Under the same State law, the City of San Diego can and did impose a tax of $0.55 per $1,000, which is credited against the County's portion, so that the City and the County each receive $0.55 per $1,000. The funds are collected by the County for property transfers that occur within City limits and are transferred to the City in 13 apportionments throughout the year.

Property transfer taxes are highly reflective of the housing market and are generally more volatile than overall property taxes. Appreciation or depreciation in property values and sales volume in the local real estate market specifically affect property transfer tax revenues. Property transfer tax revenue is being impacted by a slowdown in construction and in the long term by a reduction in the supply of City land that may be developed. The fiscal year 2007 property transfer tax budget was $14.9 million. Based upon the receipts to date, however, the staff is revising the property transfer tax budget downward to $8.8 million, a decline of $6.1 million. This is mainly attributed to a slowdown in the local real estate market, higher interest rates and the modest growth in the overall economy. This trend is expected to continue for the next few years and has been factored into the Financial Outlook as indicated in the table below:

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Property Transfer Tax	$ 8.4	$ 8.0	$ 7.6	$ 7.6	$ 7.6
Forecasted Growth	***-5.0%***	***-5.0%***	***-5.0%***	***0.0%***	***0.0%***

LICENSES AND PERMITS

The Licenses and Permits category reflects revenue generated to recover costs associated with performing regulatory functions. Major budgeted revenues in this category include general business license taxes, rental unit taxes, parking meter collections, and the refuse collection business license tax. The fiscal year 2007 Licenses and Permits budget is $30.7 million. The forecast for fiscal years 2008-2012 is based on the historical performance of this revenue category and assumes a 2.0% growth for Business License Tax, 2.0% for Parking Meter revenue and 1.0% for Other Licenses and Permits as follows:

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Licenses and Permits	$ 31.2	$ 31.7	$ 32.3	$ 32.8	$ 33.4
Forecasted Growth	***1.6%***	***1.6%***	***1.9%***	***1.5%***	***1.8%***

FINES, FORFEITURES AND PENALTIES

Fines, Forfeitures and Penalties (FFP) include revenue generated from monetary sanctions associated with the violation of a law or regulation such as California Vehicle Code violations, City parking and ordinance violations, and litigation awards. Parking violations represent approximately half of this revenue category. The fiscal year 2007 FFP budget is $34.9 million. The forecast for fiscal years 2008-2012 is based on the historical performance of this revenue category and assumes a 2.0% growth for Vehicle Code Violations, 2.0% growth for City Parking Violations and 5.0% for Other FFP as follows:

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Fines, Forfeitures and Penalties	$ 35.8	$ 36.8	$ 37.8	$ 38.9	$ 39.9
Forecasted Growth	***2.6%***	***2.8%***	***2.7%***	***2.9%***	***2.6%***

REVENUE FROM MONEY AND PROPERTY

This category includes revenue from franchises fees collected for the use of the City's rights-of-way, rents and concessions from Mission Bay and other City properties, and interest earnings.

Franchise Fees are set through franchise agreements that are negotiated with individual utility companies. San Diego Gas & Electric (SDG&E), the single largest generator of Franchise Fee revenue, is charged 3.0% of gross sales from gas and electricity within the City. Three-fourths of the total SDG&E franchise revenue is allocated to the General Fund, while one-fourth is allocated to the Environmental Growth Fund as required by the City Charter.

The Rents and Concessions category includes General Fund revenue generated from Mission Bay Park (the largest component), Balboa Park, Torrey Pines Golf Course and lease agreements on City Pueblo lands.

The fiscal year 2007 budget for this revenue category is $98.4 million. The forecast for fiscal years 2008-2012 is based on the historical performance of this revenue category with the exception of revenue from SDG&E. The Mission Bay revenue is projected to grow at 5.0%; SDG&E and cable revenue is projected to grow at 7.5%; no growth is projected for other rents and concession as can be seen in the following table.

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Revenue From Money & Property	$ 104.1	$ 110.1	$ 116.5	$ 123.2	$ 130.4
Forecasted Growth	***5.8%***	***5.8%***	***5.8%***	***5.8%***	***5.8%***

REVENUE FROM OTHER AGENCIES

The Vehicle License Fee (VLF) was historically the largest revenue in this category levied by the State at 2.0% of depreciated vehicle value. Beginning in 1999, the VLF underwent a series of offsets, first initiated by the State legislature as part of the fiscal year 1999 budget agreement. These offsets ultimately resulted in a 67% reduction in the effective VLF rate, from 2.0% to 0.65%. To compensate cities and counties for the tax offset, the State began providing General Fund revenue to cities and counties on a dollar-for-dollar basis, otherwise known as the VLF backfill. As part of the fiscal year 2005 budget agreement, the VLF rate was statutorily reduced to 0.65%, thereby eliminating the VLF backfill. Cities were compensated for this loss with increased property tax revenues. In fiscal year 2005, approximately $69.1 million was shifted from VLF to property tax. As a result of this revenue shift, VLF is no longer considered a major General Fund revenue source for the City. The fiscal year 2007 budget for VLF is $9.3 million. The forecast for fiscal years 2008-2012 includes the following projection:

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Vehicle License Fee	$ 9.1	$ 9.0	$ 9.0	$ 9.1	$ 9.2
Forecasted Growth	***0.0%***	***-1.0%***	***0.0%***	***1.0%***	***1.5%***

Other revenue sources in this category include State Grants, the projected surplus from a securitized tobacco revenue (to be received by the City), and employee pick-up savings. (The City leveraged $10.1 million of the employees' contribution to the Retirement System, via the securitization of tobacco settlement revenues the City receives under the Master Settlement Agreement with the tobacco companies. The infusion of $100 million and the $8.3 million in employee pick-up savings from fiscal year 2006 contributed to paying down the UAAL).

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Other Revenue From Money & Property	$21.0	$21.8	$22.0	$22.2	$22.3

CHARGES FOR CURRENT SERVICES

This category includes revenue generated by General Fund departments from services provided to other City funds, including water and wastewater funds. In addition, a number of departmental charges for public services are included in this category, the most significant are the Fire-Rescue and Police departments.

The fiscal year 2007 Charges for Current Services budget is $88.3 million. The fiscal year 2007 budgeted figure is being revised in the Financial Outlook to $85.1 million due to a reduction in the Fire department's Emergency Medical Services (EMS) revenue. The forecast for fiscal years 2008-2012 is based on the historical performance of this revenue category and assumes a 2.0% annual growth.

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Charges For Current Services	$ 86.8	$ 88.5	$ 90.3	$ 92.1	$ 94.0
Forecasted Growth	***2.0%***	***2.0%***	***2.0%***	***2.0%***	***2.0%***

TRANSFERS FROM OTHER FUNDS

Revenue in this category reflects transfers to the General Fund from various other funds, such as Capital Improvement Programs, Storm Drain, Environmental Growth, and TransNet funds.

The fiscal year 2007 Transfers from Other Funds budget is $62.2 million. The fiscal year 2007 adopted budget has been revised to $59.7 million due to a reduction in Service Level Agreement (SLA) revenue for the City Attorney department. The forecast for fiscal years 2008-2012 does not include a growth in this revenue category beginning in fiscal year 2008.

	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
			(in millions)		
Transfers from Other Funds	$ 58.1	$ 56.1	$ 56.1	$ 56.1	$ 56.1

II. General Fund Expenditure

The primary costs to most cities are its employees. Salary and wages represent 48.6% of the fiscal year 2007 General Fund budget. Total compensation, including retirement, and other benefit compensations, represents 73.3% of fiscal year 2007 General Fund budgeted expenditures.

For purposes of the Financial Outlook, the fiscal year 2007 adopted budget has been adjusted to reflect current year-end expenditure projections. While we are still in the first half of the fiscal year and projections may change as additional data are collected, staff believes these are reasonable projections for the purpose of developing the Financial Outlook at this time. All revenue and expenditure projections will be reviewed and updated accordingly as the fiscal year 2008 budget is put together. The table below shows the adjustments incorporated in the Financial Outlook as compared to the adopted fiscal year 2007 General Fund budget.

Expenditure Adjustments to Fiscal Year 2007 Adopted Budget

Adjustment	Amount (in millions)
Fire-Rescue (EMS Staffing)	$ 3.0
General Fund Special Promotional S	$ (4.7)
Other Expenditures	$ 5.0
General Fund Reserve	$ 6.5
Total Adjustment	**$ 9.8**

As discussed during the 1st Quarter Report, it is currently estimated that the Fire-Rescue department will require an increase to its appropriations because the department did not include in its fiscal year 2007 budget expenditures that were reimbursed in previous fiscal years by the Emergency Medical Services department (that is, supplemental positions.)

As with General Fund revenues, because Transient Occupancy Tax revenue is estimated to be $11.0 million higher than budget, there will be approximately $5.3 million more allocated to the TOT Fund. The adopted fiscal year 2007 General Fund budget called for a General Fund subsidy of $4.7 million to the Special Promotional Programs budget, primarily because of the debt service cost to the City associated with Qualcomm Stadium and Petco Park. Since it is estimated that an additional $5.3 million will be allocated to the TOT Fund from surplus revenue, the General Fund subsidy will no longer be required.

In addition to the above adjustments, it is anticipated that there will be approximately $5.2 million in unanticipated expenses. This includes a $1.1 million payback to the Water and Wastewater Enterprise departments for the unsubstantiated charges found during the Audit of 2003 transactions and $4.1 million to cover other unanticipated expenditures in fiscal year 2007. Finally, the adjusted projection for fiscal year 2007 assumes that any surplus revenue will be allocated to the General Fund Unappropriated Reserve. At this time, it has been estimated that an additional $6.5 million will be allocated to the reserve, the net result of increased revenues and expenditures.

SALARIES

The Financial Outlook for personnel costs is based on the fiscal year 2007 year-end estimated General Fund expenditures, which estimates an additional increase in appropriations of $3.0 million to the Fire-Rescue department and the continuation of positions that have been already approved. An annual salary adjustment is added in fiscal year 2008 to account for the step increases provided to employees over time and the effect of turnover.

In addition, the Municipal Employees' Association and AFSCME Local 127 have labor agreements that expire on June 30, 2008, while the International Association of Firefighters Local 145, and the Deputy City Attorney Association (DCAA) have agreements that will expire on June 30, 2007. The Police Officers Association has a year long imposed term which also expires on June 30, 2007. The Financial Outlook assumes a 4.0% increase in salaries in fiscal year 2008 for the MEA and Local 127 bargaining units only (consistent with their respective MOUs) and no increase thereafter. There is no salary increase included in the Financial Outlook for any other City employee. Pending conclusion for successor MOU negotiations, any increase will need to be factored into the Financial Outlook.

The vacancy factor for the General Fund is also being adjusted to 3.5%, 3.0%, 2.5%, 2.4%, and 2.3% for fiscal years 2008-2012, respectively. This is a reduction from the 5.3% average used to develop the fiscal year 2007 budget.

Assumed Salary Increases by Bargaining Unit
Fiscal Years 2008 - 2012

Bargaining Unit	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
Municipal Employees' Association	*4.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Local 127	*4.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Local 145	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Police Officer Association	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Deputy City Attorney Association	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Unclassified/Unrepresented	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*

PENSION AND OTHER POST-EMPLOYMENT BENEFITS

One of the greatest challenges facing the City is the Unfunded Accrued Actuarial Liability (UAAL) of the San Diego City Employees' Retirement System (SDCERS). Based on the June 30, 2005 Actuarial Valuation for the City of San Diego the UAAL is estimated at $1.39 billion. This growth in UAAL represents a combination of underfunding by the City, improved benefits, net actuarial losses, the use of SDCERS earnings for contingent benefits, and average investment performance below expectations. One of the Mayor's commitments is to develop a strategy to both lower the obligations facing the system and begin paying down the UAAL. Prior to the end of fiscal year 2006, the City contributed an additional $108 million into the Retirement System to pay down a portion of the UAAL. The fiscal year 2007 budget includes $162 million to pay the City's Annual Required Contribution (ARC), which is composed of both the normal cost ($82 million) and the unfunded liability cost ($80 million). The ARC for fiscal year 2007 was computed by the San Diego City Employees' Retirement System's actuary. The forecast assumes that the City will make its full payment obligations consistent with the provision of the Gleason Settlement, as described below.

Gleason Settlement

Since July 1996, the City started making annual contributions to SDCERS in accordance with a funding method that permitted contributions to be made at specified rates that were below the actuarially required contribution rates. In response to litigation alleging that the City violated the City Charter and the Municipal Code by failing to contribute to SDCERS at rates determined by the SDCERS actuary, the City entered into the "Gleason Settlement" in July 2004. The settlement provided that the City would contribute a fixed amount of $130 million for Citywide contributions in fiscal year 2005. In addition, beginning with the June 30, 2004 Annual Actuarial Valuation, the UAAL amortization period should be reset to a new 30-year fixed amortization period; for fiscal years 2006, 2007 and 2008, the City's contribution should be based on the actuarially determined funding level with the new 30-year fixed amortization period commencing with fiscal year 2005.

Proposition G

Proposition G, a Charter amendment approved by San Diego voters on November 2, 2004, would require that the amortization period for the UAAL be reduced to a maximum of 15 years beginning in fiscal year 2009. Shortening the amortization period from 26 years (the remaining term under the 30-year amortization established by the Gleason Settlement) to 15 years will have the effect of increasing the annual cost to amortize the liability by approximately $47 million annually. An opinion from the State Attorney General suggests that the voters cannot impose an amortization schedule on SDCERS; however, there is nothing to prevent the SDCERS's Board from adopting a shorter amortization schedule beginning in fiscal year 2009. The Financial Outlook assumes that the remaining term under the 30-year amortization established by the Gleason Settlement through fiscal year 2012. In other words, it assumes a 26, 25, 24, and 23 years amortization period for fiscal year 2008-2012, respectively.

Based upon the above information, staff requested that the SDCERS's actuary develop an estimated ARC for the next five years. The actual ARC for fiscal year 2008 will be available in December 2007 and will be based upon the assumptions recently adopted by the SDCERS's Board. Until that time, the following table represents the most current information available.

Total Citywide Annual Required Contribution

SDCERS's Actuary Projections [1,2]

Fiscal Year	Contribution Amount (in millions)
2008	$156.10
2009	$159.30
2010	$163.60
2011	$168.80
2012	$174.50

(1) Based on the actuarial assumptions or methods used in the June 30, 2005 Annual Valuation and that contributions are made at the beginning of the fiscal year.

(2) Projections assumed the 30-year fixed amortization schedule throughout the forecast and the infusion of the $108.3 million, above and beyond the ARC, in Fiscal Year 2006.

Corbett Settlement and 13th Check Liabilities

The June 30, 2005 Actuarial Valuation for the City of San Diego does not reflect other liabilities such as the Corbett and the 13th Check in the determination of the ARC. Since the projections are based on this valuation, an additional estimated payment of these liabilities has been incorporated into the Financial Outlook. In the past, payments toward the Corbett and 13th Check benefits were made as part of the distribution of book reserve earnings referred to as the Waterfall. Payment of the Corbett benefits were deemed "contingent" and could only be made each year if there were sufficient "Surplus Undistributed Earnings" to pay them. If the payment is not made one year due to the lack of earnings, the payment carries over and becomes payable in the next year when there are sufficient earnings. The payment does not, however, accumulate interest. Payment of the 13th Check, also deemed contingent, can only be made if there are sufficient surplus undistributed earnings available. In years where there are no earnings, the 13th Check is not payable. Each year stands on its own and there is no forward accumulation of this liability. The additional estimated payment for the Corbett and 13th Check liabilities is approximately $8.3 million, of which $6.4 million would be the General Fund share.

Retiree Health Benefits

Another area of financial pressure on the City is the rising cost of retiree health care. Under Governmental Accounting Standards Board 45, public agencies across the country will have to begin reporting and recording this liability. Based upon a recent actuarial valuation, the City's UAAL for OPEB is estimated to be approximately $1.38 billion. This assumes that the City does not establish a Trust Fund to pay for these benefits and continues the pay-as-you-go method. As such, the assumed rate of return used in this calculation is 4.0%. Should the City establish a Trust Fund, it will be able to change this assumption to somewhere in the 7.0% to 8.0% range and the UAAL would drop to an estimated $600 to $750 million. The Financial Outlook assumes the continued pay-as-you-go approach.

Retiree Health Payback to SDCERS
The Financial Outlook incorporates into the projection the estimated payback to the SDCERS for previous fiscal years retiree health care cost paid from the health care trust which were taken from the Retirement System assets. The estimated General Fund amount for fiscal years 2008-2012 is $5.6 million.

Retirement Offset/City "Pick-Up"
This line item of expenditure in the Five-Year Financial Outlook represents a portion of the employees' contribution that the City has agreed to pay under current labor agreements. Agreements with labor unions resulted in the reduction of City "pick-up" of the employee pension contribution by 3.0% for the Municipal Employees' Association (MEA), the International Association of Fire Fighters Local 145, and the Deputy City Attorney Association (DCAA) and a unilaterally imposed reduction of 3.2% for the San Diego Police Officers Association (POA). In addition, AFSCME Local 127 negotiated a 1.9% salary reduction in lieu of additional employee pension contribution and a benefit freeze. All subsequent fiscal years assumes no change to the Offset Rate applied to the fiscal year 2007 estimated year-end salaries, except for fiscal year 2008 where City-paid employee contribution will be reduced by an additional 1.0% for all MEA employees.

Retirement Liability
This line item of expenditure in the Five-Year Financial Outlook represents the savings or leveraged amount that the City of San Diego must use to address the Retirement System's unfunded liability within the timeframe of the respective contracts. All subsequent fiscal years assumes no change to the rate applied to the fiscal year 2007 year-end estimated salaries, except for fiscal year 2008 where this amount will be increased as a result of the 1.0% MEA City's offset savings. Per labor union agreements, the retirement liability funds shall be used to support a leveraged mechanism to increase the funding ratio of the Retirement System.

OTHER FRINGE

Fringe Benefits
This category refers to costs associated with various employee-related costs, other than the Flexible Benefits Program. The primary components of this line item are workers' compensation, Medicare, unemployment insurance, risk management, and compensated time off. This rate is adjusted annually for inflation at 3.0% for fiscal year 2008, 3.09% for fiscal year 2009, 3.18% for fiscal year 2010, 3.28% for fiscal year 2011 and 3.38% for fiscal year 2012.

Flexible Benefits
This category includes the City's cafeteria benefits plan, of which the highest cost component is health insurance. The forecast assumes that expenditures in this area will be increased for fiscal year 2008 by $500 for all MEA employees according to the current MOU. Beginning with fiscal year 2009, no increases are forecasted for all labor unions and unrepresented and unclassified employees.

VACANCY FACTOR

A new component incorporated into the fiscal year 2007 budget was the use of a vacancy factor to more accurately budget salary and benefits. This reflects the estimated savings in personnel expenses attributable to vacancies, attrition, leaves of absences, turnover, etc. All authorized positions are generally not filled throughout the fiscal year, resulting in savings from short term vacancies, under-filled positions and newly hired employees who may start at a lower salary than the average budgeted salary for a given position. The estimated vacancy factor for the fiscal year 2007 adopted budget is 5.3% of total personnel expenses. The Financial Outlook assumes vacancy factors at 3.5%, 3.0%, 2.5%, 2.4%, and 2.3% for fiscal years 2008, 2009, 2010, 2011, and 2012, respectively.

SUPPLIES, SERVICES, INFORMATION TECHNOLOGY AND ENERGY/UTILITIES

These line items capture most of the City's non-personnel expenses supported by the General Fund. The Five-Year Financial Outlook assumes that these expenditures will generally grow by inflation at an annual rate of 2.0% for supplies and services, 3.0% for information technology and equipment outlay and 5.0% for energy/utilities. The fiscal year 2007 adopted budget serves as a baseline for the five year projection, except for the Supplies and Services category which was adjusted to reflect a $4.7 million reduction in subsidy to the TOT Fund.

FUTURE COMMITTED EXPENDITURES

The Five-Year Financial Outlook incorporates the cost impacts associated with the staffing of new facilities and increases resulting from Council, State, and federal mandates. A major budgetary challenge facing the City in recent years has been the long-term costs of staffing and maintaining public facilities constructed by non-City funds. Since these new facilities and their related operational costs are phased in over a period of time, their future fiscal impacts, including the capacity of forecasted revenues to support the increased costs, are highlighted by the Five-Year Financial Outlook.

IMPLEMENTATION OF THE KROLL REMEDIATIONS

On August 24, 2007, Mayor Sanders presented his response to the Kroll remediation recommendations. Based upon preliminary estimates, the City would need to spend nearly $45 million over the next seven years to fund the costs of the remediations. The largest single item is the implementation of a new ERP system which would provide the City with improved and more timely financial information. The costs of implementing the remediation plan has been allocated across all funds, with the General Fund portion incorporated in the Financial Outlook.

III. The Eight Significant Areas

In addition to achieving a balanced budget that at least comes close to maintaining existing levels of service, the City has identified other financial and service objectives that are critical to the City's continuing goals of providing critical City services, maintaining a favorable business climate, and maintaining a sound financial structure.

1. PENSION SYSTEM – ARC PLUS

Restoring the integrity of the City's Retirement System has arisen as a top priority for the long-term fiscal health and stability of the City. Reaching that goal is a major driver of the Financial Outlook, which includes full funding of all requirements. Given how virtually every public pension plan is funded (i.e. level percentage of payroll), even with the payment of the entire ARC and the elimination of the Waterfall, the City still experiences a negative amortization for the next ten years (estimated). What this means is that the ARC does not even cover the 8.0% interest expense charges against the UAAL. As salaries grow over time, so does the ARC and the negative amortization eventually disappears. In order to eliminate this negative amortization immediately, beginning with fiscal year 2008 and continuing each year thereafter, the Financial Outlook includes an additional $27 million payment to SDCERS. The General Fund portion of that is $20.8 million. This will also shorten the amortization period of the UAAL to 20 years.

The following table represents the total amount of Citywide funds that are projected to be included in each budget over the next five fiscal years.

	Forecast 2008	Forecast 2009	Forecast 2010 (in millions)	Forecast 2011	Forecast 2012
Citywide Pension Payment	$ 198.7	$ 202.1	$ 206.6	$ 212.1	$ 218.0

2. RESERVES

The City maintains several reserves for its operations. These include reserves for the General Fund, as well as reserves for various Debt Service and Tax Funds, Special Revenue Funds, Enterprise Funds, Capital Improvement Funds, and Internal Service Funds that can only be used for their intended purpose. Reserves supporting General Fund operations include the Allocated Reserve, used to carry forward current year funds for projects that could not be completed prior to the end of the fiscal year, and the Unappropriated Reserve, established to fund major General Fund emergencies. Recognizing the importance of maintaining adequate reserves to address unforeseen contingencies such as natural disasters, catastrophic occurrences or excessive liabilities or judgments, the City Council adopted a policy in October 2002 providing for the establishment of a General Fund Reserve at a minimum of 3.0% of annual General Fund revenues. The current policy further defines a goal of a 5.0% reserve, to be achieved by 2014. To ensure progress toward this goal, the Council Policy provides that when General Fund revenues increase by at least 2.0%, there be a corresponding increase in the General Fund Reserve equal to at least 10% of any General Fund revenue increase in excess of 2.0%. This policy and the future funding of the reserve is currently being reexamined and an updated recommendation will be presented by the end of 2006. Suggested changes will be brought before the City Council for consideration. It is the goal of the Mayor to go above and beyond this policy and increase reserves to 8.0% by fiscal year 2012.

The budgeted increase in the Unappropriated Reserve for fiscal year 2007 is $7.2 million. In addition, based on the fiscal year 2007 year-end estimates, an additional $6.5 million will be allocated to the reserve from surplus revenues in property tax and transient occupancy tax, making the total projected ending balance for fiscal year 2007 $61.7 million. The Financial Outlook assumes the following rates for the Unappropriated Reserve with a goal to achieve 8.0% contribution by fiscal year 2012:

- Fiscal Year 2008 6.0%
- Fiscal Year 2009 6.5%
- Fiscal Year 2010 7.0%
- Fiscal Year 2011 7.5%
- Fiscal Year 2012 8.0%

3. DEFERRED MAINTENANCE/CAPITAL IMPROVEMENTS

Over the years, the City has undertaken several exercises to account for needs for which no funding has been identified. This total inventory is daunting. While the Baseline Five-Year Financial Outlook does not attempt to solve this funding challenge, it is important that policy makers do not lose sight that demand on the City resources extend beyond the annual operating budget.

Deferred Maintenance/Capital Improvements includes all needed repairs to the City facilities, including roof replacement, heating and cooling system upgrades, painting, floor covering repair, structural repairs, as well as repairs and improvements to storm drains and streets. It is estimated that the City's deferred maintenance/ capital needs, excluding Water and Wastewater, may be at least $800 to $900 million. Presently staff is compiling an inventory of all needs and will have a completed list with the estimated projected costs sometime in fiscal year 2008. Until then, several assumptions were made which have been incorporated into the Financial Outlook.

First of all, a portion of the deferred maintenance/capital improvements can be financed over time and a portion should be cash funded each year. Given the lack on detailed information, it has been assumed that 50% of the improvements to facilities will be on a pay-as-you-go basis and 50% will be financed. As it relates to streets and storm drain projects, 25% of the improvements will be on a pay-as-you-go basis and 75% will be financed. These proportions will be updated as new information becomes available. In addition, regardless of the amount of funding made available for these projects, there are practical limits on how much work can be handled in any given fiscal year. The forecast assumes that $5 million can be spent on facility repairs and improvements in fiscal year 2008 (which will be 100% paid for with cash) and $50 million each year thereafter which will be 50% paid for with cash and 50% will be financed. With respect to storm drains and streets, the forecast assumes that $33 million can be spent in fiscal year 2008, $70 million in fiscal year 2009 and $90 million each year thereafter. These projects will be funded on a 25%/75% ratio as described above.

	Forecast 2008	**Forecast 2009**	**Forecast 2010**	**Forecast 2011**	**Forecast 2012**
			(in millions)		
Deferred Maintenance/Capital	$ 38.0	$ 120.0	$ 140.0	$ 140.0	$ 140.0
Related Cashflow Requirements	***$15.725***	***$52.725***	***$66.975***	***$76.225***	***$85.475***

4. OTHER POST-EMPLOYMENT BENEFITS (OPEB)

Both because the annual costs of the benefits are projected to increase substantially over the next five to ten years and Governmental Accounting Standards (GASB 45) will require the City to begin reporting this liability on its financial statements, the City needs to establish a plan to pay for retiree health care before the costs get too large. The Financial Outlook continues to include funding for this benefit on a pay-as-you-go basis for fiscal years 2008 and 2009. In addition, $25 million and $50 million, respectively, are added to the projections in order to begin building a Trust Fund to cover the escalating costs. Beginning in fiscal year 2010 and continuing until fully funded, the Financial Outlook assumes that the City will pay the full OPEB ARC. The Financial Outlook assumes that this will be around $75 million in 2010 and growing slightly each year thereafter.

5. STORM WATER COMPLIANCE

Compliance with new Storm Water Runoff Regulations associated with new permits will impact the City's budget. Based upon preliminary estimates, this will cost the City $18.2 million in fiscal year 2008, $37.2 million in fiscal year 2009, $37.1 million in fiscal year 2010, and $36.1 million each year thereafter. Some of this cost could be offset by increased storm drain fees, but this is still under review. As such, the Financial Outlook only includes the projected costs associated with the permits; however, the possible revenues to pay for all or a portion of the cost will be further analyzed.

6. AMERICANS WITH DISABILITIES ACT

The Americans with Disabilities Act (ADA) went into affect in 1990. Since that time, public and private agencies have been required to make facilities and infrastructure accessible. Just like deferred maintenance, San Diego has put very little funding towards this effort. At this point, it cannot be determined how much of the City's ADA improvements will be addressed with the deferred maintenance/capital improvement spending. As such, in addition to the funding budgeted for deferred maintenance/capital improvements, the Financial Outlook includes $10 million per year to be allocated to ADA related improvements. This is on top of any CDBG or other funds allocated for this purpose.

7. WORKER'S COMPENSATION FUND

Workers' Compensation liabilities continue to grow and there are reserves put in place to cover this exposure. Presently, the City has approximately $150 million in outstanding workers' compensation claims and only $18 million in reserves. This is far short of what should be reasonably expected. Should the City be required to make a large payout on a claim, it would most likely be a significant impact to the General Fund. By establishing a reasonable reserve level, the City will provide better insulation to other programs and services. Funding has been included in the Financial Outlook to begin building a Workers' Compensation reserve. While no additional funding has been included in fiscal year 2008, $5 million has been allocated in the fiscal year 2009 budget and $10 million for each year thereafter. This amount is in addition to the amount budgeted each year to cover projected annual costs.

8. PUBLIC LIABILITY FUND

As with the Workers' Compensation Fund, the City has Public Liabilities that fluctuate from year to year and also place the City's General Fund at risk. Presently, the City has approximately $100 million in potential public liability claims and only $4 million in reserves. This too is far short of what should be reasonably expected. Should the City be required to make a large payout on a claim, it would most likely be a significant impact to the General Fund. By establishing a reasonable reserve level, the City will provide better insulation to other programs and services. Funding has been included in the Financial Outlook to begin building a Public Liability reserve. Included in the Financial Outlook for fiscal years 2008, 2009 and 2010 is $5 million each year. This amount is increased to $10 million per year thereafter. This amount is in addition to the amount budgeted each year to cover projected annual costs.

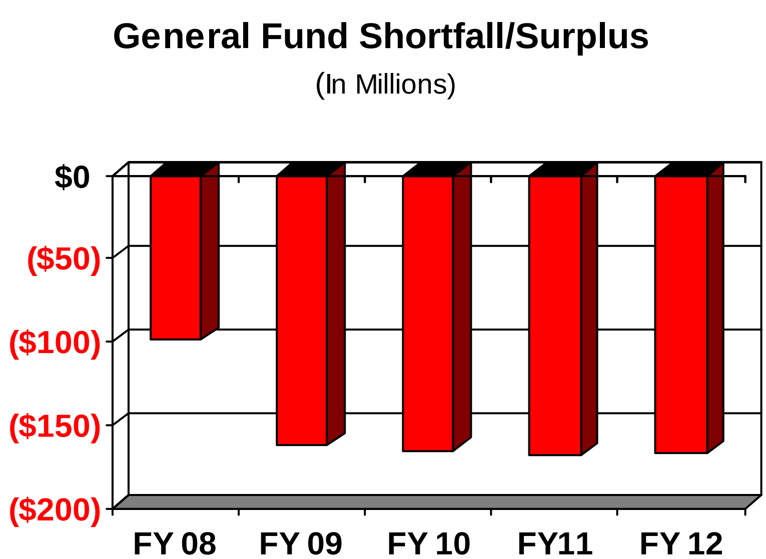
Financial Outlook • Conclusion

In summary, the following chart reflects the recommended level of funding for each of these eight areas. These figures represent the General Fund portion only. In many areas, the General Fund will be the only fund impacted.

ACCUMULATIVE – BUDGET IMPACT

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
ARC Plus	$ 20.800M	$ 20.800M	$ 20.800M	$ 20.800M	$ 20.800M
Reserves	$ 7.400M	$ 8.500M	$ 6.800M	$ 7.400M	$ 7.700M
Mtce/Cap.	$ 15.725M	$ 52.725M	$ 66.975M	$ 76.225M	$ 85.475M
OPEB	$ 17.000M	$ 34.100M	$ 28.750M	$ 30.600M	$ 32.400M
Stormwater	$ 30.000M	$ 30.000M	$ 30.000M	$ 30.000M	$ 30.000M
ADA Compliance	$ 10.000M	$ 10.000M	$ 10.000M	$ 10.000M	$ 10.000M
W/C Fund	$ 0.000M	$ 5.000M	$ 10.000M	$ 10.000M	$ 10.000M
P/L Fund	$ 5.000M	$ 5.000M	$ 5.000M	$ 10.000M	$ 10.000M
Total	**$105.925M**	**$166.125M**	**$178.325M**	**$195.025M**	**$209.975M**

Adding these amounts into the Financial Outlook, the five-year projection looks as shown below:



FY 2008 – ($ 87M)
FY 2009 – ($174M)
FY 2010 – ($176M)
FY 2011 – ($179M)
FY 2012 – ($178M)

IV. Restoring Financial Stability (Identifying the Solutions)

The figures reflected in the Financial Outlook demonstrate that without immediate reductions in the cost of doing business and/or finding additional revenue sources, the City will continue to struggle financially. This could result in further service reductions, canceled programs and closed facilities. By combining the elements of the recovery program, immediate and permanent multi-year funding reductions and responsible labor agreements, the forecast for a more solid future could become a reality. Each component of the recovery program stands alone, yet the strength of the combined elements provides the structural integrity that will be the hallmark of the City's fiscal recovery.

A series of solutions to restore San Diego's organizational and financial strength is currently being developed. Some of the options presented below have been analyzed more carefully than others. While staff is currently still identifying and analyzing various solutions to close the projected budget gap, the Mayor will submit a budget in April 2007 that is financially balanced. **ATTACHMENT 4** provides the reader with a recap of these proposals.

General Fund Corrective Actions

There are a number of actions that can be immediately implemented. The amounts reflect the projected savings to the fiscal year 2008 budget, if these recommendations are fully implemented. The Full Time Equivalent (FTE) count represents the Citywide number of positions that would be eliminated, while the dollar value represents the projected General Fund savings.

POSITIONS – Elimination of 671 FTE's

Elimination of 546 FTE's ($17.9 MILLION)

The Mayor committed to reducing 500 positions when he took office. In developing the fiscal year 2007 budget, 38 FTE's were eliminated as part of the fiscal year 2007 budget restructure. At this time, 446 additional FTE's (presently vacant) have been identified and will be eliminated as part of the fiscal year 2008 budget. This reduction includes the elimination of 81 middle management/ supervisory positions. Of the 446 FTE's, 168 will be eliminated from the General Fund departments and 278 from the Non General Fund departments. Services should not be affected since most of the positions have been vacant for more than a year. The total estimated General Fund savings over the five year period from these reductions are projected to be $55.5 million.

Additionally, 100 middle management/supervisory positions will be identified and eliminated from the fiscal year 2008 budget. Of the 100 positions, approximately 70 positions will be eliminated from the General Fund departments and 30 from the Non General Fund departments. The total estimated General Fund savings over the five year period from the elimination of these positions are projected to be $34 million.

Business Process Reengineering and Streamlining – Reduces 125 positions per year for three years ($7.2 MILLION)
Through the Business Process Reengineering (BPR) initiative, the Mayor is streamlining business practices and creating efficiencies throughout the City over the next three years. The intent is to continue to provide a high level of customer service while reducing the costs to provide these services. While positions have not been targeted for elimination through BPR, based on best practices in governmental re-engineering, it is estimated that the number of positions will be reduced through this initiative. The assumed position reductions from citywide BPR are estimated to result in the elimination of 125 positions per year for each of the next three years, for a total of 375 positions: 225 from the General Fund departments and 150 from Non-General Fund departments. Additional savings are also projected for the non- personnel budget (such as supplies and services, IT costs, and fringe.) The total estimated General Fund savings over the five years from the elimination of these positions are projected to be $86.4 million.

Employee Benefit Adjustments Furlough ($4.3 MILLION)
The Mayor has identified a number of potential areas of savings through changes to existing employee benefits. All of these items are subject to meet and confer and will be incorporated with negotiations scheduled to take place in 2007. The City of San Diego has previously used an employee furlough program to achieve expenditure reduction goals. The Mayor will recommend that a mandatory employee furlough program be incorporated in the Meet and Confer process with the City labor unions. The total estimated General Fund savings over the five years from this area are projected to be $21.5 million.

SUMMARY OF POSITION REDUCTION
(Expressed as Full-Time-Equivalent Positions)

	Totals		Fiscal Year 2008		Fiscal Year 2009		Fiscal Year 2010	
	All Funds	General Fund	All Funds	General Fund	All Funds	General Fund	All Funds	General Fund
Vacant Positions	446.34	167.80	446.34	167.80	0.00	0.00	0.00	0.00
Mid-Mgmt/Supv. Positions	100.00	70.00	100.00	70.00	0.00	0.00	0.00	0.00
Result from BPR	375.00	225.00	125.00	75.00	125.00	75.00	125.00	75.00
Total	921.34	462.80	671.34	312.80	125.00	75.00	125.00	75.00

DEBT REFINANCING ($3.8 MILLION)
Upon completion of the City's 2003, 2004 and 2005 audits, the City of San Diego will return to the bond market. Staff is currently actively working to refinance the PETCO Park bonds. The total estimated General Fund savings over the five years are projected to be $19 million.

BUDGET CLEAN-UP

Allocation of General Fund Expenditures ($3.2 MILLION)
The City's General Fund pays for basic City services such as Fire and Police protection, Parks, and Libraries. In addition, the City allocates the costs associated with the central service departments, such as Auditor and Comptroller, City Attorney, City Clerk and Financial Management to all City departments by means of a rate based on the General Government Services Billing (GGSB) standard. The amounts allocated to Non-General Fund departments are billed and received into the General Fund as revenue to offset the cost of the services provided by these central service departments. In reviewing the allocation of Citywide costs, it was determined that the City's General Fund inappropriately supports the total cost of several departments, including the Offices of the Mayor, City Council, the Chief Operating Officer, and similar support services. Based on the GGSB standard, staff has determined that the General Fund is currently paying $3.2 million more annually than its appropriate share. Implementing this corrective action results has a net zero effect on the City's total budget; however, the savings to the General Fund provide direct relief to the City's operations funded by taxes. The total estimated General Fund savings over the five year period are projected to be $24.4 million.

Release of Encumbered Funds ($3.0 MILLION)
The City creates encumbrances to reserve funds for specified purposes in order to assure that funds are available for future payment. It has been determined that these expenditures will not take place and the encumbrances can be released. Eliminating encumbrances has the effect of reducing the City's financial obligations, effectively increasing the City's reserves. The realized savings from the release of encumbered funds has a one-time-only affect on the City's financial outlook.

Transfer of Inactive Fund Balances ($2.1 MILLION)
The City establishes distinct funds for specific funding purposes. Staff have identified several funds with a value of $2.1 million that no longer have funding requirements. The money in these funds was previously provided by the General Fund, thereby allowing this one-time cash to be returned to the General Fund. The transfer will improve the General Fund reserve amount by $2.1 million and advance the City further toward the goal of an 8% General Fund reserve. As with the release of encumbrances, the realized savings from the transfer of inactive fund balances has a one-time-only affect on the City's financial outlook.

ESTABLISH A PROPERTY BASE IMPROVEMENT DISTRICT ($6 MILLION)

Members of San Diego's Lodging Industry Association (LIA) have proposed the formation of Property Based Improvement District (PBID) modeled after several successful programs in other cities in California. A PBID is an assessment district which allows hotel/motel business owners to self assess a fee which is then managed by lodging industry representatives to promote tourism and increase the City's hotel/motel occupancy rate.

The PBID proposal would offset $10 million annually in funding for organizations that are currently underwritten by the City's General Fund for marketing and tourism promotion. The Mayor will recommend revisions to existing Council policies in order to re-direct these funds back to the General Fund to be used to support other city services. The City would be relieved of supplying $10 million of organizational support to entities such as the Convention and Visitors Bureau ($8.8 million), the San Diego Film commission ($662,000), the Holiday Bowl ($390,000), and others.

Similar to many of the PBIDs already created in California, the assessment will be based on a percentage of the gross room rental revenue. The lodging industry is proposing that the rate be set at 2.0%. The California law allows, at the discretion of the individual business owner, for the assessment to be passed on to the hotel/motel room occupants so long as it is a separately itemized expense. The proposed annual PBID budget of approximately $25 million would be used exclusively to market San Diego as a tourist destination.

The proposed PBID, like other assessment districts in the City of San Diego, would be formed pursuant to State statutes and City ordinances. The City is proposing that the PBID be formed by an ordinance modeled after the 1994 Property and Business Improvement District Act, which requires a majority approval of assessed businesses. In this case, the formation process is initiated with the collection of the requisite number of signatures of assessed hotel/motel operators. The City will conduct a mailed ballot to verify support once petition signatures are submitted.

It is anticipated that the PBID formation process would take six to eight months with the first assessments being collected in fiscal year 2008. Should the timeline be able to be accelerated, the first year financial benefits would be higher. The total estimated General Fund savings over the five year period are projected to be $46.0 million.

LEVERAGING CITY ASSETS ($15.3 MILLION)

The Real Estate Assets Department (READ) has identified properties including vacant land that could be sold to generate significant one-time revenue. In accordance with the City Charter, any revenues derived from the sale of public property will be directed toward capital projects. READ will determine which City properties will be designated for sale after completing its assessment. In addition, the City presently has 45 pending lease agreements for telecom sites and is examining other strategies to better leverage assets owned by the City. The total estimated General Fund benefit over the five year period are projected to be $102.5 million.

MANAGED COMPETITION (<u>savings to be determined</u>)

Managed competition is a process that forces public employees to bid against private companies or nonprofits for the right to do certain jobs. City of San Diego voters approved Proposition C on November 7, 2006, amending the City's Charter to allow the City to accept bids on services from nonpublic sources. The amendment allows outside firms to compete with the City employees for work traditionally performed by civil service employees. Proposed benefits to the City are cost savings and increased efficiency in service performance.

Prior to passing Proposition C, the City Charter limited the City's ability to contract out public services traditionally performed by City employees. This restriction in most cases prevented the City from entering into contracts with private companies even if doing so was shown through the bidding process to save the City money or create improved services or greater efficiencies. The City plans to issue the first Request for Proposal (RFP) in the summer of 2007.

With the exception of public safety members, all other City functions are subject to competition.

Finally, the reason the projected savings are yet to be determined is because the City has no previous experience in the area of managed competition.

TOTAL CORRECTIVE ACTIONS ($394.4 MILLION)

The financial solutions proposed by the Mayor end the piece-meal approach to budget management and past failures to identify and implement plans that would address the City's significant long-term financial shortfalls and budgetary structural problems. The Mayor's Plan represents a diversified approach to mitigating the City's projected five-year financial shortfall. San Diego can achieve financial recovery within a five-year timeframe.

V. Conclusion

This Financial Outlook is a tool to help produce a comprehensive, long-range analysis of its General Fund revenues and expenditures. The financial picture presented in the Financial Outlook will be analyzed on a regular basis. The Financial Outlook will be used to help analyze major decisions as they are being considered and will be used to assist with the preparation of the City's annual budget.

This long-term forecast demonstrates serious structural challenges to the City. Even with all of the savings discussed above, the City still will have a projected deficit of $24.6 million in fiscal year 2008 and nearly $100 million each year thereafter. This gap will be closed and it will take a combination of factors. These will focus on further reductions to the workforce, making government work in a smarter, leaner and more efficient manner and possibly reductions in services. It would be irresponsible to suggest that services would not be impacted given the magnitude of the obligations we are now trying to address. For too long the City has tried to be all things to all people and we just cannot afford to continue to kid ourselves. The money is just not there.

Again, while outlines of a recovery plan are suggested, the specifics will require deliberation of and feedback from elected officials, staff, labor representatives and the public. As alternative approaches to the City's challenges are identified, they will be incorporated into subsequent versions of the Financial Outlook in order to forecast their long-term impact. This project is intended to be an on-going planning tool and not a static report at one point in time.

There will be a number of opportunities to improve this planning tool as future generations of the Financial Outlook are developed and new schedules added to provide additional information and analytic results and more alternative scenarios developed to further explore the various opportunities available to the City to meet the needs of its citizens within available resources.

PENSION PAYMENT AMORTIZATION SCHEDULE

ATTACHMENT 1

Incremental Payment 0 **GF Portion = 0**

Projected Salary Increase 4.25%

Year	Years Remaining	Fiscal Year	UAAL Payment	Additional Payment	Total UAAL Payment	Interest	Net Payment	Remaining UAAL
								1,390,000,000
1	28	2007	83,000,000	0	83,000,000	111,200,000	(28,200,000)	1,418,200,000
2	27	2008	86,527,500	0	86,527,500	113,456,000	(26,928,500)	1,445,128,500
3	26	2009	90,204,919	0	90,204,919	115,610,280	(25,405,361)	1,470,533,861
4	25	2010	94,038,628	0	94,038,628	117,642,709	(23,604,081)	1,494,137,942
5	24	2011	98,035,270	0	98,035,270	119,531,035	(21,495,765)	1,515,633,707
6	23	2012	102,201,769	0	102,201,769	121,250,697	(19,048,928)	1,534,682,635
7	22	2013	106,545,344	0	106,545,344	122,774,611	(16,229,267)	1,550,911,902
8	21	2014	111,073,521	0	111,073,521	124,072,952	(12,999,431)	1,563,911,333
9	20	2015	115,794,146	0	115,794,146	125,112,907	(9,318,761)	1,573,230,094
10	19	2016	120,715,397	0	120,715,397	125,858,408	(5,143,011)	1,578,373,105
11	18	2017	125,845,801	0	125,845,801	126,269,848	(424,047)	1,578,797,152
12	17	2018	131,194,248	0	131,194,248	126,303,772	4,890,476	1,573,906,676
13	16	2019	136,770,004	0	136,770,004	125,912,534	10,857,470	1,563,049,206
14	15	2020	142,582,729	0	142,582,729	125,043,936	17,538,793	1,545,510,413
15	14	2021	148,642,495	0	148,642,495	123,640,833	25,001,662	1,520,508,751
16	13	2022	154,959,801	0	154,959,801	121,640,700	33,319,101	1,487,189,650
17	12	2023	161,545,593	0	161,545,593	118,975,172	42,570,421	1,444,619,229
18	11	2024	168,411,281	0	168,411,281	115,569,538	52,841,743	1,391,777,486
19	10	2025	175,568,760	0	175,568,760	111,342,199	64,226,561	1,327,550,925
20	9	2026	183,030,432	0	183,030,432	106,204,074	76,826,358	1,250,724,567
21	8	2027	190,809,225	0	190,809,225	100,057,965	90,751,260	1,159,973,307
22	7	2028	198,918,617	0	198,918,617	92,797,865	106,120,752	1,053,852,555
23	6	2029	207,372,658	0	207,372,658	84,308,204	123,064,454	930,788,101
24	5	2030	216,185,996	0	216,185,996	74,463,048	141,722,948	789,065,153
25	4	2031	225,373,901	0	225,373,901	63,125,212	162,248,689	626,816,464
26	3	2032	234,952,292	0	234,952,292	50,145,317	184,806,975	442,009,489
27	2	2033	244,937,764	0	244,937,764	35,360,759	209,577,005	232,432,484
28	1	2034	251,027,083	0	251,027,083	18,594,599	232,432,484	0

Incremental Payment 27,000,000 **GF Portion = 20,800,000**

Year	Years Remaining	Fiscal Year	UAAL Payment	Additional Payment	Total UAAL Payment	Interest	Net Payment	Remaining UAAL
								1,390,000,000
1	28	2007	83,000,000	0	83,000,000	111,200,000	(28,200,000)	1,418,200,000
2	27	2008	86,527,500	27,000,000	113,527,500	113,456,000	71,500	1,418,128,500
3	26	2009	90,204,919	27,000,000	117,204,919	113,450,280	3,754,639	1,414,373,861
4	25	2010	94,038,628	27,000,000	121,038,628	113,149,909	7,888,719	1,406,485,142
5	24	2011	98,035,270	27,000,000	125,035,270	112,518,811	12,516,459	1,393,968,683
6	23	2012	102,201,769	27,000,000	129,201,769	111,517,495	17,684,274	1,376,284,409
7	22	2013	106,545,344	27,000,000	133,545,344	110,102,753	23,442,591	1,352,841,818
8	21	2014	111,073,521	27,000,000	138,073,521	108,227,345	29,846,176	1,322,995,642
9	20	2015	115,794,146	27,000,000	142,794,146	105,839,651	36,954,495	1,286,041,147
10	19	2016	120,715,397	27,000,000	147,715,397	102,883,292	44,832,105	1,241,209,042
11	18	2017	125,845,801	27,000,000	152,845,801	99,296,723	53,549,078	1,187,659,964
12	17	2018	131,194,248	27,000,000	158,194,248	95,012,797	63,181,451	1,124,478,513
13	16	2019	136,770,004	27,000,000	163,770,004	89,958,281	73,811,723	1,050,666,790
14	15	2020	142,582,729	27,000,000	169,582,729	84,053,343	85,529,386	965,137,404
15	14	2021	148,642,495	27,000,000	175,642,495	77,210,992	98,431,503	866,705,901
16	13	2022	154,959,801	27,000,000	181,959,801	69,336,472	112,623,329	754,082,572
17	12	2023	161,545,593	27,000,000	188,545,593	60,326,606	128,218,987	625,863,585
18	11	2024	168,411,281	27,000,000	195,411,281	50,069,087	145,342,194	480,521,391
19	10	2025	175,568,760	27,000,000	202,568,760	38,441,711	164,127,049	316,394,342
20	9	2026	183,030,432	27,000,000	210,030,432	25,311,547	184,718,885	131,675,457
21	8	2027	115,209,494	27,000,000	142,209,494	10,534,037	131,675,457	0
22	7	2028	0	0	0	0	0	0
23	6	2029	0	0	0	0	0	0
24	5	2030	0	0	0	0	0	0
25	4	2031	0	0	0	0	0	0
26	3	2032	0	0	0	0	0	0
27	2	2033	0	0	0	0	0	0
28	1	2034	0	0	0	0	0	0

DEFERRED MAINTENANCE PROJECTIONS

ATTACHMENT 2

100% PAY-AS-YOU-GO ALTERNATIVE

		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	TOTAL
Buildings & Facilities	436,000,000	5,000,000	50,000,000	50,000,000	50,000,000	50,000,000	205,000,000
Streets & Storm Drains	400,000,000	33,000,000	70,000,000	90,000,000	90,000,000	90,000,000	373,000,000
Sub-Total	836,000,000	38,000,000	120,000,000	140,000,000	140,000,000	140,000,000	578,000,000
Less: Funding Already in Forecast		0 *	0 *	0 *	0 *	0 *	0
		38,000,000	120,000,000	140,000,000	140,000,000	140,000,000	578,000,000

PAY-AS-YOU-GO/BONDING ALTERNATIVE (assumes 50% of b&f, & 75% of street & storm drain projects can be financed)

		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	TOTAL
Buildings & Facilities	436,000,000						
Pay-Go		5,000,000	25,000,000	25,000,000	25,000,000	25,000,000	105,000,000
Debt Service		0	2,500,000	5,000,000	7,500,000	10,000,000	25,000,000
Total Cashflow Bldgs & Facilities		5,000,000	27,500,000	30,000,000	32,500,000	35,000,000	130,000,000
Streets & Storm Drains	400,000,000						
Pay-Go		8,250,000	17,500,000	22,500,000	22,500,000	22,500,000	93,250,000
New Debt Service		2,475,000	5,250,000	6,750,000	6,750,000	6,750,000	27,975,000
Plus Previous D/S			2,475,000	7,725,000	14,475,000	21,225,000	45,900,000
Total Cashflow Streets		10,725,000	25,225,000	36,975,000	43,725,000	50,475,000	121,225,000
Sub-Total Cashflow	836,000,000	15,725,000	52,725,000	66,975,000	76,225,000	85,475,000	297,125,000
Less: Funding Already in Forecast		0 *	0 *	0 *	0 *	0 *	0
		15,725,000	52,725,000	66,975,000	76,225,000	85,475,000	297,125,000
Total Pay-Go		13,250,000	42,500,000	47,500,000	47,500,000	47,500,000	198,250,000
Total Debt Service		2,475,000	10,225,000	19,475,000	28,725,000	37,975,000	98,875,000
Less: Funding Already in Forecast		0	0	0	0	0	0
Total Cashflow		15,725,000	52,725,000	66,975,000	76,225,000	85,475,000	297,125,000

* Note: FY 2007 Budget includes $10.3 million for deferred maintenance which has been removed in the baseline 5-year forecast.

GENERAL FUND

FIVE YEAR FINANCIAL OUTLOOK

	Accum. Total	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
REVENUES						
Property Tax	2,006.1	386.4	393.5	400.8	408.7	416.7
Sales Tax	1,319.2	249.2	255.7	263.4	271.4	279.5
TOT	460.6	83.4	87.5	91.9	96.5	101.3
Franchise Fees	396.5	69.2	73.9	79.0	84.3	90.1
Other Revenues	1,431.7	277.8	281.1	285.9	290.8	296.1
Total Revenues	5,614.1	1,066.0	1,091.7	1,121.0	1,151.7	1,183.7
EXPENSES						
Salary & Wages	2,670.1	524.1	532.6	537.0	537.7	538.7
Employee Benefits	591.8	113.5	116.5	118.6	120.5	122.7
Pension Payments to SDCERS	804.5	154.4	156.9	160.2	164.3	168.7
Retiree Health Care	248.4	33.4	52.7	49.7	54.0	58.6
Services and Supplies	1,026.3	191.8	200.2	205.9	211.5	216.9
Implementation of Kroll Recommendations	20.2	4.5	4.5	4.0	3.6	3.6
Information Technology	170.0	31.9	33.0	34.0	35.0	36.1
Energy/Utilities	153.6	27.3	29.1	30.8	32.3	34.1
Equipment Outlay	104.9	18.8	20.3	20.7	21.9	23.2
Reserves	36.7	4.8	9.8	6.9	7.4	7.8
Deferred Maintenance/Capital	297.1	15.7	52.7	67.0	76.2	85.5
Storm Water Runoff Compliance	164.7	18.2	37.2	37.1	36.1	36.1
ADA Improvements	50.0	10.0	10.0	10.0	10.0	10.0
Workers' Compensation Fund	35.0	0.0	5.0	10.0	10.0	10.0
Public Liability Fund	35.0	5.0	5.0	5.0	10.0	10.0
Total Expenses	6,408.3	1,153.4	1,265.5	1,296.9	1,330.5	1,362.0
Surplus/(Deficit)	(794.2)	(87.4)	(173.8)	(175.9)	(178.8)	(178.3)

RETIREMENT BENEFIT PAYMENT RECAP

Pension	**All Funds**	**Total**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**
Annual Required Contribution		640.5	121.6	124.1	127.4	131.5	135.9
Elimination of Waterfall Fall		32.0	6.4	6.4	6.4	6.4	6.4
Retiree Health Care Payback		28.0	5.6	5.6	5.6	5.6	5.6
ARC Plus		104.0	20.8	20.8	20.8	20.8	20.8
Total Pension Payments	1037.5	804.5	154.4	156.9	160.2	164.3	168.7
Retiree Health Care (OPEB)							
Pay-as-You Go		35.0	16.4	18.6	0.0	0.0	0.0
Payment Towards ARC		51.1	17.0	34.1	0.0	0.0	0.0
Payment of ARC		162.3	0.0	0.0	49.7	54.0	58.6
Total OPEB Payments	363.2	248.4	33.4	52.7	49.7	54.0	58.6
Total Retirement Benefit Costs	1,400.7	1,052.9	187.8	209.6	209.9	218.3	227.3

GENERAL FUND CORRECTIVE ACTION STEPS

ATTACHMENT 4

	Total	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
SURPLUS/(DEFICIT) ***(1)***	(794.2)	(87.4)	(173.8)	(175.9)	(178.8)	(178.3)
CORRECTIVE ACTIONS						
Positions						
Elimination of 446.34 FTE's (167.80 GF, 278.54 NGF) ***(2)***	55.5	11.1	11.1	11.1	11.1	11.1
Elimination of 100 FTE's (70 GF, 30 NGF) (Mid-Mgmt/Supervisory ***(2)***	34.0	6.8	6.8	6.8	6.8	6.8
BPR Streamlining (125 FTE's/yr for 3 years (75*.00/yr GF*) estimated FY 08-10)						
Salary & Wages ***(2)***	63.6	5.3	10.6	15.9	15.9	15.9
Non-Personnel Expenses	22.8	1.9	3.8	5.7	5.7	5.7
Employee Benefit Adjustments/Furlough ***(3)***	21.5	4.3	4.3	4.3	4.3	4.3
Debt Refinancing						
Petco Ball Park	19.0	3.8	3.8	3.8	3.8	3.8
Reallocation of Transient Occupancy Tax	46.0	6.0	10.0	10.0	10.0	10.0
Budget Clean-up						
Corrected GGSB (General Government Services Billing)	24.4	3.2	5.3	5.3	5.3	5.3
Inactive Fund Balances	2.1	2.1	0.0	0.0	0.0	0.0
Release of Encumbered Funds	3.0	3.0	0.0	0.0	0.0	0.0
Leveraging City Assets	102.5	15.3	21.8	21.8	21.8	21.8
Managed Competition	tbd	tbd	tbd	tbd	tbd	tbd
Sub-Total Corrective Actions (b)	**394.4**	**62.8**	**77.5**	**84.7**	**84.7**	**84.7**
NET SURPLUS/(DEFICIT) (a+b=c)	**(399.8)**	**(24.6)**	**(96.3)**	**(91.2)**	**(94.1)**	**(93.6)**

PENSION EXPENSES						
Pension Payments	(804.5)	(154.4)	(156.9)	(160.2)	(164.3)	(168.7)
Retiree Health Care	(248.4)	(33.4)	(52.7)	(49.7)	(54.0)	(58.6)
Sub-Total Pension Expenses (d)	**(1,052.9)**	**(187.8)**	**(209.6)**	**(209.9)**	**(218.3)**	**(227.3)**

Notes:

(1) Includes previously negotiated salary increases for MEA and Local 127 in fiscal year 2008 only. There are no other salary increases included in these figures.

(2) The reduction of 671.34 FTE in FY 2008, coupled with the 38.8 FTE reduction included as part of the fiscal year 2007 budget, brings the **total FTEreduction to 710.14**, since January 1, 2006. The dollars assoicated with these FTE's reflect salary and fring costs only.

(3) Savings to be achieved is dependent upon the outcome of the Meet and Confer process.