BUDGET MAR 2 6 2008 #2

THE CITY OF SAN DIEGO
MAYOR JERRY SANDERS

MEMORANDUM

DATE: March 21, 2008

TO: Council Member Toni Atkins, Chair, Budget and Finance Committee
Councilmembers, Budget and Finance Committee

FROM: Mary Lewis, Chief Financial Officer

SUBJECT: General Fund Major Revenue Update

This memorandum discusses the projections for the FY 2008 major General Fund revenues that comprise 73% of General Fund revenues. Revenue projections were revised in the FY 2008 Mid-Year Budget Monitoring Report presented in January 2008. The report below incorporates additional actual revenue information to provide the most recent projection of revenues for this fiscal year and the expected growth rates for FY 2009. The next budget monitoring report will be issued in May 2008 and will include an assessment of all revenues and expenditures in the General Fund. The projections included in this memorandum are based on actual (unaudited) revenue data as of March 2008.

Table I displays the FY 2008 Annual Budget, the FY 2008 mid-year projection, the FY 2008 year-end projections as of March 2008, and the change between the mid-year and March 2008 projections. The following sections discuss the revised estimates for the major revenues and explain the potential variances. These projections are based on the review of actual revenues;

TABLE I

FY 2008 Major General Fund Revenues Projections

(in millions)

Major General Fund Revenues	FY 2007 Unaudited Actuals	FY 2008 Final Budget	FY 2008 Mid-Year Projection	Change (FY 2008 Budget/FY 2008 Mid-Year)	FY 2008 Year-End (March) Projection	Change (FY 2008 Mid-Year/March 2008)	Change (FY 2008 Budget/FY March 2008)
Property Tax	$ 360.4	$385.7	$391.8	$6.1	$389.1	($2.7)	0.9%
Sales Tax	$ 225.8	$239.5	$229.1	($10.4)	$226.6	($2.5)	-5.4%
Property Transfer Tax	$ 9.4	$7.6	$9.6	$2.0	$8.5	($1.1)	11.8%
Safety Sales Tax	$ 7.9	$8.4	$8.0	($0.4)	$7.9	($0.1)	-6.0%
Transient Occupancy Tax	$ 80.7	$85.2	$85.4	$0.2	$85.2	($0.2)	0.0%
Franchises	$ 77.7	$69.4	$68.5	($0.9)	$64.9	($3.6)	-6.5%
Motor Vehicle License Fees	$ 8.7	$7.9	$7.5	($0.4)	$7.1	($0.4)	-10.1%
Interest Earnings	$ 2.0	$7.8	$7.8	$0.0 *	$12.6	$4.8	61.5%
TOTAL	$ 772.6	$811.5	$807.7	($3.8)	$801.9	($5.8)	-1.2%

**The projection was not available during the preparation of the FY 2008 Mid-Year Report.*

County and State tax data and projections, and include the information gathered from monitoring economic conditions in the local and regional economy. These are projections, however, and as such may undergo future revision. It should be noted that these latest projections will serve as underlying assumptions for the development of the FY 2009 proposed budget for major revenues.

The eight General Fund revenue sources listed above account for approximately 73% of all General Fund revenues. The notable changes in the forecast amounts from the mid-year projections are in the following categories: interest earnings (increase of $4.8 million); franchise fees (decrease of $3.6 million); property tax (decrease of $2.7 million); sales tax (decrease of $2.5 million); and property transfer tax (decrease of $1.1 million).

As of March 2008, the FY 2008 year-end projection for these eight major General Fund revenues is $801.9 million, which is $9.6 million or 1.2% less than the FY 2008 Annual Budget.

DISCUSSION OF VARIANCES: FY 2008 MID-YEAR ADJUSTMENTS TO PRESENT

Interest earnings revenue is from the City's pooled investment and is influenced by the size of the investment pool, borrowings, terms and market conditions. The price of fixed income securities are inversely related to their yield, which means as bond yields decline, the price of these securities rise. Since August 2007, general interest rates have declined by nearly 3%, causing the City's fixed income securities to significantly appreciate in price. For FY 2008, interest earnings were budgeted at $7.8 million and are projected to be $12.6 million by year-end, primarily reflecting the increase in the size of the investment pool and an increase in capital gains income resulting from a decrease in interest rates.

A decrease of $2.7 million compared to the mid-year projection in **property tax** is due to a technical correction in the assessed valuation calculations made by the County of San Diego.

Year-end projections of **property transfer tax** revenues are expected to be higher than initially budgeted. The FY 2008 Mid-Year Budget Monitoring Report revised the projection upward; however, the review of the March data resulted in an adjustment to the mid-year projection. At this time staff project that the property transfer tax revenues will be approximately $0.9 million higher than the FY 2008 budgeted amount.

The projection of **franchise fees** revenue has changed, resulting in a decrease in projected revenue of $3.6 million since the mid-year projection mainly due to a lower than expected payment from SDG&E received in February 2008.

A decrease in **sales tax** of $2.5 million since the mid-year projection reflects weak performance in taxable sales activity during fourth quarter 2007.

There have been no significant changes to the mid-year forecast for other major revenues. Transient occupancy tax is projected to be at the budgeted amount and safety sales tax and motor vehicle license fees are projected to be slightly under budget at the end of the current fiscal year.

MAJOR REVENUE PROJECTIONS

TABLE II

Major General Fund Revenue Growth Rate Projections

Major General Fund Revenues	Five-Year Financial Outlook (01/08)	FY 2008 Final Budget	FY 2008 YE Projection Actual Growth[1]	FY 2009 Projected (%)
Property Tax	6.0%	6.0%	7.0%	6.0%
Sales Tax	1.25%	3.0%	-0.8%	1.25%
Transient Occupancy Tax	7.5%	7.5%	7.5%	7.5%
Franchise Fees	7.5%	8.0% [2]	-2.2% [3]	7.5%

[1]FY 2008 Year-End projected actuals compared to FY 2007 Year-End projected actuals.

[2]Average: budget growth rate for SDG&E is 8.5%, cable fees - 7.5%.

[3]SDG&E growth is estimated to be (-1.3%) over FY 2007 Year-End projections; cable fees are estimated to be 5.8% over FY 2007 Year-End projections.

- **Property Tax.** The FY 2008 property tax budget is $385.7 million. This figure assumed a 6.0% growth rate over FY 2007 year-end estimated revenues. Based on the data and receipts received through March 2008, it is forecasted that the property tax revenue will be approximately $3.4 million over budget by year-end. The projected surplus is mainly due to a higher than anticipated appreciation of all local taxable properties assessed by the County. The property tax projection for FY 2009, however, assumes another year of slowdown in the housing market, and the latest projection as of March 2008 will be reflected in the FY 2009 property tax budget at 6% growth.

- **Sales Tax**. The FY 2008 sales tax budget is $239.5 million based on a 3% growth rate over FY 2007 year-end estimated revenues. As of March 2008, the sales tax projection has changed by $2.5 million from the mid-year projection due to a weaker performance of the taxable sales in the local retail sector (mainly construction and auto sales). The FY 2008 projection for sales tax revenues has been adjusted downward by $12.9 million from the FY 2008 budget. As a result, the FY 2009 sales tax budget will be adjusted accordingly to a 1.25% growth rate.

- **Transient Occupancy Tax (TOT).** The FY 2008 General Fund TOT budget is $85.2 million. This was based on a 7.5% growth rate over FY 2007 year-end estimated revenues The TOT revenue received as of March 2008 shows that the TOT projection is on track to meet budget by the end of the year. This trend of a modest growth in the local hotel industry will be incorporated into FY 2009 TOT budget.

- **Franchise Fees.** The FY 2008 franchise fees budget is $69.4 million which was based on an 8.5% growth for SDG&E and 7.5% growth for the cable companies. The projected revenue for FY 2008 for the franchise fees is $ 64.9 million, representing a $3.6 million decrease from the mid-year projection (the major decrease is due to lower than anticipated payment from SDG&E received in February 2008). The FY 2009 franchise fees budget will reflect the latest projection as of March 2008.

- **Property Transfer Tax.** The FY 2008 property transfer tax budget is $7.6 million which reflects the continued slowdown in local real estate market activity and a reduction in the median house price. As of March 2008, the property transfer tax projection has declined by $1.1 million compared to the mid-year projections. The property transfer tax budget for FY 2009 will assume the continued slowdown in the local housing market and will be based on the latest projection as of March 2008.

- **Safety Sales Tax.** The FY 2008 safety sales tax budget is $8.4 million and is based on a projected 3.0% growth rate over FY 2007 year-end estimated revenues. As of March 2008, the safety sales tax projection has not changed significantly compared to the mid-year projections. This trend will be built into the FY 2009 budget for safety sales tax.

- **Motor Vehicle License Fees (MVLF).** The FY 2008 vehicle license fees budget is $7.9 million based on a 3.95% growth rate over FY 2007 year-end estimates. As of March 2008, the actual vehicle license fees projection has changed since the mid-year projection by $0.4 million and is projected to end the fiscal year by approximately $0.8 million below the budgeted amount. The change in the FY 2008 year-end projection will be incorporated into the FY 2009 budget for MVLF.

- **Interest earnings.** The FY 2008 budget for interest earnings is $7.8 million; however, based on the latest projections, it is expected that the interest earnings will be higher than budgeted by approximately $4.8 million mainly due to an increase in the size of the investment pool and an increase in capital gains income resulting from a decrease in interest rates. The change in the FY 2008 year-end projection will be incorporated into the FY 2009 budget for interest earnings.

Please note that revenue projections budgeted by General Fund departments are not included in this analysis and will be presented later this year as part of the 4th Quarter Year-End report.

SUMMARY

In considering the General Fund major revenues and the variances that have been identified, it should be noted that the largest drop in revenues compared to the FY 2008 budget is in sales tax (a decline of $12.9M); this shortfall represents approximately 5.4% of the sales tax budget or 1% of the entire General Fund revenue budget. The net variance between the FY 2008 adopted budget and the March 2008 projections for the eight major General Fund revenues discussed in this report is approximately $9.6 million, which is 1.2% of these budgeted revenues and less than 1% of the total General Fund revenues. Other General Fund revenues have not been evaluated in this report but will be included in the year-end report for a complete revenue analysis and final year-end projection.

The full analysis of the General Fund will be included in the FY 2008 Year-End Budget Monitoring Report to be issued in May 2008. As was noted in the FY 2008 Mid-Year Budget Monitoring Report, if the expenditures related to the wildfires and the Mt. Soledad slide are excluded, the City Departments are operating within their approved budgets. The significant spending variances that have occurred are in the areas of public safety (Fire and Police Departments) and Environmental Services for debris removal. The FY 2008 mid-year budget adjustments addressed the need for additional appropriations in these departments related to the

City's unexpected emergencies. Additionally, the City expects to receive reimbursements from State and federal agencies to offset many of the disaster related expenditures; however, those revenues are not expected in this fiscal year and will be included in the FY 2009 revenue budget to the extent they can be reasonably projected to be received.

CC: Honorable Mayor Jerry Sanders
Jay M. Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst