THE CITY OF SAN DIEGO

REPORT TO THE CITY COUNCIL

DATE ISSUED: January 29, 2007 REPORT NO: 07-031

ATTENTION: Budget and Finance Committee
Agenda of January 31, 2007

SUBJECT: Fiscal Year 2007 Mid-Year General Fund Revenue Monitoring Report

REFERENCE: Fiscal Year 2007 Period 1-4 Budget Monitoring Update Report, 06-191
Fiscal Year 2007 Period 1-2 Budget Monitoring Report, 06-148

REQUESTED ACTION:

1. Accept the Report from the Mayor on Fiscal Year 2007 Mid-Year General Fund Revenue Monitoring.

STAFF RECOMMENDATION:

1. Accept the Report from the Mayor on Fiscal Year 2007 Mid-Year General Fund Revenue Monitoring.

SUMMARY:

The Mid-Year Report for fiscal year 2007 presents the status of General Fund revenues and projects year-end results compared to the fiscal year 2007 budget. These projections are based on actual (unaudited) revenue data for accounting periods 1 through 6 (July 1, 2006 through December 15, 2006) for the major revenues, and periods 1 through 5 (July 1, 2006 through November 17, 2006) for the departmental revenues.

Attachment I displays the fiscal year 2007 budget for each major revenue category and General Fund department and the year-end revenue projections. The following sections of the report present the major variances between the fiscal year 2007 revenue budgets and projected revenues, discuss the revised estimates for the major revenues, and explain the potential departmental revenue variances.

These projections are based on extensive review of actual revenues, County and State tax data and projections, and by monitoring economic conditions in the local and regional economy. In addition, departments have reviewed their operations and reported best estimates of year-end departmental revenues. These are projections, however, and as such are subject to future revision.

GENERAL FUND REVENUE

Overview

In fiscal year 2007, the total General Fund revenue budget is $1.02 billion. Four major revenue sources – property tax, sales tax, Transient Occupancy Tax (TOT) and franchise fees – account for 70.2%, or $716.8 million, of the total General Fund revenue budget. As of December 2006, property tax, transient occupancy tax and franchise fees are projected to increase over the fiscal year 2007 Budget, while sales tax is projected to be under budget by the end of the current fiscal year. Property tax revenue is projected to increase by nearly $18.8 million over the budget; TOT revenue (General Fund portion only) is projected to be $5.5 million over budget; and franchise fees are projected to exceed budget by $0.3 million. Sales tax revenue, on the other hand, is projected to be under budget by $6.3 million. The mid-year status of all four major revenue sources, including the fiscal year 2007 year-end projections, is described below.

The following table summarizes the projections for non-departmental General Fund revenues.

Fiscal Year 2007 Major General Fund Revenue Projections

Revenue Source	FY 2007 Budget[1] (in millions)	FY 2007 Projection (in millions)	Change (in millions)
Property Tax	$344.2	$363.0	$18.9
Sales and Use Tax	234.9	228.6	-6.3
Transient Occupancy Tax[2]	72.9	78.4	5.5
Franchise Fees	64.6	64.9	0.3
Property Transfer Tax	14.9	8.4	-6.5
Safety Sales Tax	8.2	8.2	0.0
Vehicle License Fees	9.3	9.4	0.2
Other Revenue	36.8	41.7	4.9
Total	**$785.7**	**$802.6**	**$16.9**

[1] Numbers may not add due to rounding.

[2] Total City Transient Occupany Tax budget for Fiscal Year 2007 is $139 million and the revised projection is $149.6 million. The balance is budgeted in the Transient Occupancy Tax Fund.

Property Tax

The fiscal year 2007 property tax budget is $344.2 million. This figure assumed a 7.25% growth rate over fiscal year 2006 year-end estimated revenues. The fiscal year 2007 property tax budget was built on the assumption of a slowdown in the local real estate market, a softening of the housing market, a reduction in the housing median price, and a reduction in the number of home sales. The property tax revenue received as of accounting period six (December 15, 2006) shows revenue higher than budgeted for the period. Based on the data and receipts received through the first half of fiscal year 2007, it is forecasted that the property tax revenue should be approximately $18.8 million or 5.5% over budget by the end of the fiscal year. The projected surplus is mainly due to more rapid appreciation of all local taxable properties which were assessed by the County Assessor's Office on January 1, 2006. (At the time of the fiscal year 2007 budget preparation, the County assessed valuation report was not available to the City.) Based upon this information, staff is projecting that property tax revenue will exceed budget by approximately $19 million.

Sales and Use Tax

The fiscal year 2007 sales tax budget is $234.9 million. This figure was based on a 4.75% growth rate over fiscal year 2006 year-end estimated revenues. The projection for the budget assumed the following: a moderate increase in the creation of new jobs in the San Diego region; a stable, low unemployment rate; weakened consumer spending; and a sustained growth in overall taxable sales. The State Board of Equalization disburses funds approximately once a month, with four payments per quarter (three advances and a cleanup payment.), which reflect the sales of the previous quarter. As of accounting period six (December 15, 2006), the sales and use tax receipts were below the period to date budgeted amount due to a lower than expected cleanup payment received in September. Weaker performance of the taxable sales in the local retail industry explains the lower than expected payment. The actual year-to-date growth is 3.1% compared to a budgeted rate of 4.75% as stated above. As such, staff is projecting that the fiscal year 2007 overall growth rate will be approximately 3.5% and as a result staff is revising the sales tax revenue projection downward by $6.3 million to $228.6 million. Of course, it should be noted that sales tax information received to date does not reflect the results of the holiday season. Staff will be closely monitoring this information and will report the results in the third quarter monitoring report.

Transient Occupancy Tax (TOT)

The fiscal year 2007 General Fund TOT budget is $72.9 million. This was based on a 6.0% growth rate over fiscal year 2006 year-end estimated revenues and only reflects the General Fund portion of TOT receipts (approximately 52.4% of all TOT revenues). The budget projection assumed a moderate increase in hotel occupancy, higher room demand at higher daily rates, and an increase in the number of leisure travelers. Hotels/motels remit TOT on a monthly basis directly to the City Treasurer. Each hotel/motel collects its own TOT and remits payments by the end of the following month. Recent data published in the Smith Travel Research's Lodging review, a publication of Smith Travel Research, shows that for San Diego County the year-to-date (January - November 2006) average occupancy rate was 75.1%, a 1.8% increase over the same period in calendar year 2005. (The average daily rate was $131.95 per night, a 7.2% increase over the same period in calendar year 2005.)

The TOT revenue received as of accounting period six (December 15, 2006) shows revenue lower than budget for the period due to the timing of the posting of receipts. Recent information shows that the TOT revenue is projected to be higher than anticipated, demonstrating a strong growth in the San Diego visitor market and contrary to moderate projections forecasted by industry analysts. As of December, the timing analysis for the TOT receipts to date demonstrated a growth rate of 11% compared to 6% that was projected in the budget. However, we expect that in the second half of the fiscal year, the TOT revenue growth will decline from 11% and will return to the estimated rate of approximately 6-8%. This projection is based on a lower historical performance of the local tourism market during the second half of the fiscal year compared to the first half of the year.

As a result, staff is projecting the General Fund TOT revenue to be approximately $5.5 million greater than budget by the end of the fiscal year-end. The Non-General fund portion of TOT will realize a similar growth in revenue. This projected surplus revenue creates potential expenditure savings of approximately $4 million in the Citywide General Fund department due to the budgeted subsidy not being required to be transferred to the TOT non general fund.

Franchise Fees

The fiscal year 2007 franchise fee budget is $64.6 million. This is based on a 7.0% growth for San Diego Gas & Electric (SDG&E) revenue and a 7.5% growth for cable fees. Franchise fees from SDG&E and the two cable companies, Cox Communications and Time Warner, are collected on a quarterly basis. Based on the latest data received from SDG&E (after period 6 ended), it is expected that the February franchise fee payment may be higher by $900,000.

On September 29, 2006, the Governor signed into law the Digital Infrastructure and Video Competition Act of 2006 (AB2987,) which became effective January 1, 2007. The law transferred authority for franchise approval from local governments to the State governed entity, the California Public Utilities Commission (CPUC.) After debate on whether local entities would lose these revenues, the bill was amended so that municipalities should be able to keep a 5% fee received from cable TV companies for using public rights of way. Staff will continue to research and monitor the implementation of AB 2987.

Refuse haulers revenue for fiscal year 2007 budget is $10.6 million; however, as of December 2006, the projection for the refuse collection revenue account is below the budget by approximately $600,000. This reduction is due to a discontinuation of operations by one of the commercial accounts.

The total fiscal year 2007 projection for franchise fees, including revenue from SDG&E, cable fees and refuse haulers, is estimated to be $300,000 above budget.

Property Transfer Tax

The fiscal year 2007 property transfer tax budget is $14.9 million and is based on a 7.0% growth rate over fiscal year 2006 year-end estimated revenues. This is down from 10% growth budgeted a year earlier. The budget assumed a slowdown in local real estate market activity and a reduction in the housing median price. Unlike property taxes, property transfer taxes are highly reflective of the housing market and are more volatile to current market conditions. The property transfer tax is disbursed by the County of San Diego in thirteen apportionments. In fiscal year 2006, property transfer tax receipts were below expectations because actual receipts for the year were not available and staff was not able to factor a lower revenue baseline into the fiscal year 2007 Budget projection. As of accounting period 6 (December 15, 2006), the revenue received from the property transfer tax is significantly below budgeted amounts mainly due to a reduction in the number of home sales in San Diego. As a result, staff is adjusting the property transfer tax projected growth rate downward by approximately -30% for the remainder of the fiscal year and projects a revenue shortfall of $6.5 million (43% of budget) in this revenue category.

Safety Sales Tax

The fiscal year 2007 Safety Sales Tax budget is $8.2 million and is based on a projected 4.0% growth rate over fiscal year 2006 year-end estimated revenues. As of December 2006, the safety sales tax revenue was received according to the period to date budgeted amount. It is projected that this revenue category will remain unchanged in the second half of the fiscal year and the City will receive the $8.2 million budgeted amount by year-end. No adjustments to this revenue category are recommended at this time.

Vehicle License Fees (VLF)

The fiscal year 2007 vehicle license fees budget is $9.3 million. This was based on a 3.5% growth rate over fiscal year 2006 year-end estimated revenues. As of accounting period 6 (December 15, 2006), the actual vehicle license fees revenue received was below the budgeted amount by $800,000. However, the City received approximately $1.0 million in Motor Vehicle License Excess fees, which were not budgeted. Staff is projecting that VLF revenue will be at or close to budget by the end of the fiscal year.

Other Revenue

The other revenue category includes revenue sources such as reimbursement for booking fees, revenue received from employee pickup savings resulting from the tobacco revenue securitization, reimbursements from the State-mandated programs and interest from investments and dividends. While as of accounting period six (December 15, 2006), the revenue in this category is on budget, staff is projecting that by year-end the interest and dividends subcategory will realize a surplus of $4.9 million due to a projected increase in overall City interest earnings.

Staff will continue to monitor and analyze these General Fund revenues as more date becomes available and will revise projections as required and report findings to Council in future reports.

Department Revenues

The fiscal year 2007 Budget for General Fund department revenues is $237.6 million, representing 23.2% of the total General Fund revenues. Year-end projections, based upon period five actual data, reflect an estimated shortfall of $10.7 million or 4.5% from this category. The primary contributor to the shortfall is a change in billing practices for Service Level Agreements (SLAs). Departments are now charging based upon actual work performed and many SLAs have been cancelled. In addition, due to the inability to bond for Capital Improvements Program projects, the Water and Metropolitan Wastewater Departments have a reduced need for legal services. These two factors lead to a projected revenue shortfall of $3.8 million for the City Attorney, although the net departmental revenue shortfall is projected to be $2.5 million due to litigation award revenues exceeding the estimated budget. In addition, the Personnel Department will receive $0.6 million less revenue, representing 99% of the department's revenue budget, due to the cancellation of Service Level Agreements (SLAs).

Several other departments project revenue shortfalls as well. As previously discussed with the Budget and Finance Committee, the San Diego Fire-Rescue Department will realize $2.2 million less in revenue than budgeted due to reduced services being provided to the Emergency Medical Services program. Even with this, however, the net departmental revenue shortfall is projected to be only $312,000. This is primarily due to excess revenues being realized from Urban Area

Security Initiative revenues. The General Services Department projects that revenues will be $1.7 million under budget due to vacant parking enforcement positions and reduced requests for as-needed facilities work from other City departments.

Special Projects Department's revenues for major gifts and planning, corporate partnerships, and other special projects revenues are projected to be $600,000 under budget. This department's budget may have been established based on historical revenues and needs to be re-evaluated. The Debt Management Department projects that revenues will be $0.5 million under budget due to vacant reimbursable positions. There will be a corresponding savings of expenditures due to these vacancies. The Community and Legislative Services Department projects $200,000 less in revenues due to the cancellation of SLAs and lower than anticipated City TV 24 revenue.

The Equal Opportunity Contracting and Purchasing and Contracting Departments project that revenues will be $1.1 million and $0.8 million, respectively, less than budgeted; however, an accurate projection and the overall net impact on the General Fund is difficult to determine at this time because the Business Process Reengineering (BPR) recommendations have not been fully implemented. These projections will be revised in future reports and will reflect more accurate revenue estimates once the BPR recommended budgetary adjustments have been applied.

Other contributing factors to the General Fund projected shortfall in department revenues are reductions in grant funding, fee reductions, reduced pool revenues, and decreased land and building permit reviews. Additionally, contributing to the revenue shortfalls in some departments are revenue budgets that were established at high levels in the past and not revised as operations changed. Departmental revenues will be closely reexamined and adjusted as part of the fiscal year 2008 budget. A listing of department revenue projections can be found in Attachment I: General Fund Projected Revenues.

Conclusion

Major General Fund revenues are projected to be over budget by approximately $16.9 million at the end of the fiscal year while the General Fund departmental revenues are projected to be under budget by $10.7 million. This results in a projected total fiscal year 2007 General Fund net revenue surplus of approximately $6.2 million.

Staff reviewed General Fund expenditures through period five compared to period to date budgets and project expenditure savings of approximately $9 million at year-end. These projected savings are primarily due to the large number of vacancies throughout the City; projected salary savings account for 90% of total projected savings. Although the General Fund is projecting savings overall, certain departments are projecting over budget expenditures in non personnel expenditures (NPE). Requested budget adjustments will be brought forward in February to address these and other needs. Included in the budget adjustments will be a request to appropriate $1.1 million to repay the Water and Metropolitan Wastewater Departments for 2003 charges as indicated in the Mayer Hoffman McCann audit.

Staff will continue to monitor General Fund revenues and will present revised estimates to Council in future reports.

FISCAL CONSIDERATIONS: None, this is an information report.

PREVIOUS COUNCIL and/or COMMITTEE ACTION: None.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: None.

KEY STAKEHOLDERS AND PROJECTED IMPACTS: None.

Mary Lewis Financial Management Director	Jay M. Goldstone Chief Financial Officer

Attachment: I. General Fund Projected Revenues