# Management's Discussion and Analysis

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This section of the County of San Diego's (County) Comprehensive Annual Financial Report provides a narrative overview and analysis of the basic financial activities of the County as of and for the year ended June 30, 2007.

The intent of the information presented here, in conjunction with the Letter of Transmittal is to provide the reader with a clearer picture of the County's overall financial status. Unless otherwise indicated, all amounts in this section are expressed in thousands of dollars.

## Financial Highlights

- The assets of the County exceeded liabilities at the close of the fiscal year 2006-07 (2007) by $2.95 billion (net assets). Of this amount, $2.52 billion is invested in capital assets, net of related debt; $162 million is restricted for specific purposes (restricted net assets); and the remaining portion represents unrestricted net assets of $263 million.
- Total net assets increased by $374 million. For governmental activities, revenues exceeded expenses by $355 million. For business type activities, revenues exceeded expenses, before transfers, by $19.6 million.
- General revenues for governmental activities were $1.37 billion. Of this amount, property taxes and property taxes in lieu of vehicle license fees accounted for $838 million or 61 percent; other taxes, sales and use taxes for roads, sales and use taxes for public protection, sales and uses taxes, interest and other general revenues accounted for $530 million or 39 percent.
- Program revenues for governmental activities were $2.3 billion. Of this amount, $1.8 billion or 80 percent was attributable to operating grants and contributions while charges for services accounted for $453 million or 20 percent.
- The total expenses for governmental activities were $3.29 billion. Public protection accounted for $1.08 billion or 32.8 percent of this amount, while public assistance accounted for $1.04 million or 31.7 percent. Additionally, health and sanitation accounted for $580 million or 17.6 percent.

## Overview of the Financial Statements

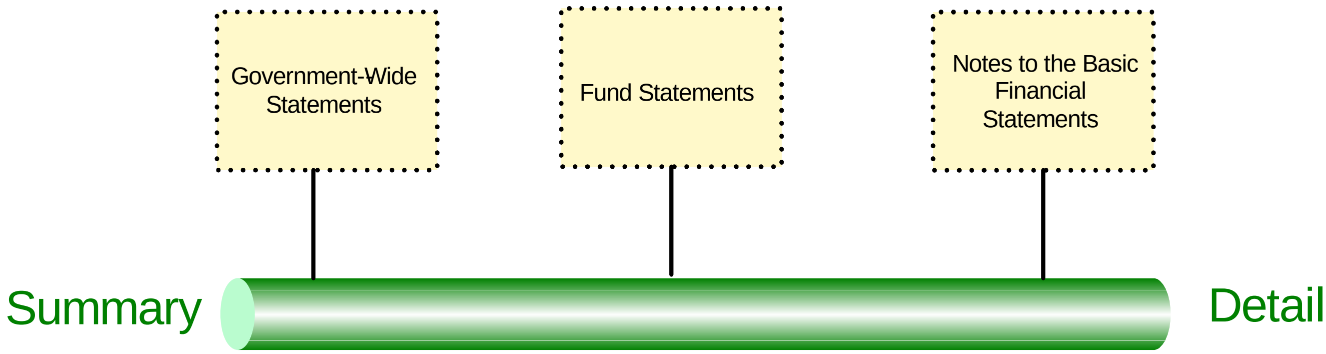
This discussion and analysis is intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements comprise three components: 1) *Government-wide* financial statements 2) *Fund* financial statements, and 3) *Notes* to the basic financial statements. Required supplementary information is included in addition to the basic financial statements.

*The Government-wide financial statements* are designed to provide readers with a broad overview of County finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all County assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.

The *Statement of Activities* presents information showing how the County's net assets changed

The illustration below depicts the required components of the basic financial statements.




during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the aforementioned government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the County include general government, public protection, public ways and facilities, health and sanitation, public assistance, education and recreation and cultural. The business-type activities of the County include airport operations, wastewater management and sanitation districts.

*Fund financial statements* are groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

*Governmental funds* are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a county's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains twenty-seven individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for the General Fund and the Tobacco Securitization Special Revenue Fund, both of which are considered to be major funds. Data from the other twenty-five governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the combining financial statements and supplemental information section in this report.

*Proprietary funds* are generally used to account for services for which the County charges customers - either outside customers, or internal departments of the County. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The County maintains the following types of proprietary funds:

*Enterprise funds* are used to report the same functions presented as business-type activities in the government-wide financial statements. The County uses enterprise funds to account for sanitation services, wastewater management and airport operations. These nonmajor enterprise funds are combined and aggregated. Individual fund data for each nonmajor enterprise fund is provided in the combining financial statements and supplemental information section in this report.

*Internal service funds* are an accounting device used to accumulate and allocate costs internally among the County's various functions. Internal service funds are used to account for the financing of public works and communications equipment; the financing of materials and supplies (purchasing); for start up services for new and existing county service districts; for the County's public liability and employee benefits activities; the financing of fleet services; for facilities management activities; for the financing of information technology services; and for the financing of clothing and personal sundry items for persons institutionalized at various County facilities. Because all of these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

The County's *nine internal service funds* are combined into a single, aggregated presentation in the proprietary funds financial statements. Individual fund data for the internal service funds is provided in the form of combining statements in the combining financial statements/schedules and supplemental information section in this report.

*Fiduciary funds* are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the County's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

*Notes to the basic financial statements* provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

*Required supplementary information (RSI)* is also presented. It provides budgetary comparisons for the General Fund and the Tobacco Securitization Special Revenue Fund (a major fund) in separate Schedules of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual. Additionally, the *RSI* provides trend information on the County's funding progress of its pension system, the San Diego County Employees Retirement Association (SDCERA), for the last three actuarial evaluations.

*Combining financial statements/schedules and supplemental information* section of this report presents combining and individual fund statements and schedules referred to earlier that provide information for nonmajor governmental funds, enterprise funds, internal service funds and fiduciary funds and are presented immediately following the required supplementary information section of this report.

## Government-wide Financial Analysis

## Table 1

**Net Assets**
**June 30, 2007**
**(In Thousands)**

| | Governmental Activities | | Business Type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| ASSETS | | | | | | |
| Current and other assets | $ 2,888,810 | 2,610,156 | 87,186 | 84,646 | 2,975,996 | 2,694,802 |
| Capital assets | 2,755,506 | 2,710,793 | 115,100 | 100,174 | 2,870,606 | 2,810,967 |
| Total assets | 5,644,316 | 5,320,949 | 202,286 | 184,820 | 5,846,602 | 5,505,769 |
| LIABILITIES | | | | | | |
| Long-term liabilities | 2,385,188 | 2,396,272 | 2,893 | 3,134 | 2,388,081 | 2,399,406 |
| Other liabilities | 509,529 | 530,516 | 2,065 | 3,349 | 511,594 | 533,865 |
| Total liabilities | 2,894,717 | 2,926,788 | 4,958 | 6,483 | 2,899,675 | 2,933,271 |
| NET ASSETS | | | | | | |
| Invested in capital assets, net of related debt | 2,409,050 | 2,367,442 | 112,549 | 97,212 | 2,521,599 | 2,464,654 |
| Restricted | 162,318 | 224,635 | | | 162,318 | 224,635 |
| Unrestricted | 178,231 | (197,916) | 84,779 | 81,125 | 263,010 | (116,791) |
| Total net assets | $ 2,749,599 | 2,394,161 | 197,328 | 178,337 | 2,946,927 | 2,572,498 |

## Analysis of Net Assets

*Net assets* may serve over time as a useful indicator of a government's financial position. In the case of the County, assets exceeded liabilities by $2.95 billion at the close of fiscal year 2007.

The largest portion of the County's net assets (85 percent) reflects its investment of $2.52 billion in capital assets (e.g. land, infrastructure, buildings, and equipment); less any related outstanding debt used to acquire those assets. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the County's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be liquidated for these liabilities.

An additional portion of the County's net assets, $162 million, represents resources that are subject to external restrictions on how they may be used. External restrictions include those imposed by grantors, contributors, laws and/or regulations of other governments. The remaining portion of the County's net assets includes $263 million in unrestricted net assets.

At June 30, 2007, changes in net assets before transfers (revenues minus expenses) equaled $374 million, a $13.7 million or 3.5% decrease from the previous year. Principal revenue sources contributing to the change in net assets were operating grants and contributions of $1.83 billion and taxes of $1.072 billion (including: property taxes; sales and use taxes for public protection; and property taxes in lieu of vehicle license fees.) These revenue categories accounted for 78% of total revenues. Principal expenses were in the following areas: public protection, $1.08 billion; public assistance, $1.04 billion; and health and sanitation, $580 million. These expense categories accounted for 81% of total expenses.

## Table 2

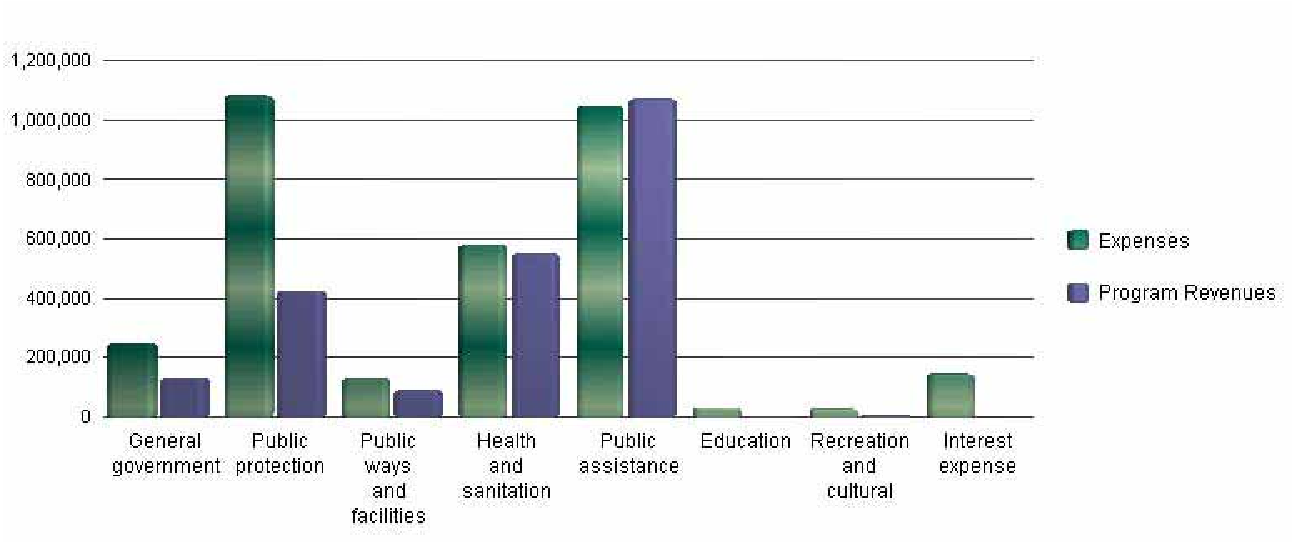
**Changes in Net Assets**
**June 30, 2007**
**(In Thousands)**

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Revenues: | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | $ 453,414 | 455,559 | 32,024 | 29,006 | 485,438 | 484,565 |
| Operating grants and contributions | 1,821,349 | 1,792,663 | 8,257 | 9,994 | 1,829,606 | 1,802,657 |
| Capital grants and contributions | 7,559 | 5,283 | 464 | 58 | 8,023 | 5,341 |
| General revenues: | | | | | | |
| Property taxes | 559,726 | 516,569 | | | 559,726 | 516,569 |
| Other taxes | 26,760 | 34,219 | | | 26,760 | 34,219 |
| Sales and use taxes for roads | 57,439 | 38,702 | | | 57,439 | 38,702 |
| Sales and use taxes for public protection | 234,797 | 236,438 | | | 234,797 | 236,438 |
| Property taxes in lieu of vehicle license fees | 277,930 | 261,695 | | | 277,930 | 261,695 |
| Sales and use taxes | 26,534 | 23,475 | | | 26,534 | 23,475 |
| Interest | 88,974 | 63,810 | 4,189 | 7,048 | 93,163 | 70,858 |
| Other | 95,343 | 78,651 | 2,909 | 160 | 98,252 | 78,811 |
| Total revenues | 3,649,825 | 3,507,064 | 47,843 | 46,266 | 3,697,668 | 3,553,330 |
| Expenses: | | | | | | |
| Governmental Activities: | | | | | | |
| General government | 249,993 | 240,158 | | | 249,993 | 240,158 |
| Public protection | 1,079,320 | 1,021,464 | | | 1,079,320 | 1,021,464 |
| Public ways and facilities | 133,148 | 128,268 | | | 133,148 | 128,268 |
| Health and sanitation | 580,384 | 559,709 | | | 580,384 | 559,709 |
| Public assistance | 1,043,454 | 1,015,481 | | | 1,043,454 | 1,015,481 |
| Education | 33,223 | 32,488 | | | 33,223 | 32,488 |
| Recreation and cultural | 28,469 | 23,376 | | | 28,469 | 23,376 |
| Interest expense | 146,997 | 116,692 | | | 146,997 | 116,692 |
| Business-type Activities: | | | | | | |
| Airport | | | 8,209 | 7,699 | 8,209 | 7,699 |
| Wastewater Management | | | 4,422 | 4,733 | 4,422 | 4,733 |
| Sanitation Districts | | | 15,620 | 15,133 | 15,620 | 15,133 |
| Total expenses | 3,294,988 | 3,137,636 | 28,251 | 27,565 | 3,323,239 | 3,165,201 |
| Changes in net assets before transfers | 354,837 | 369,428 | 19,592 | 18,701 | 374,429 | 388,129 |
| Transfers | 601 | 1,090 | (601) | (1,090) | | |
| Change in net assets | 355,438 | 370,518 | 18,991 | 17,611 | 374,429 | 388,129 |
| Net assets at beginning of year | 2,394,161 | 2,023,643 | 178,337 | 160,726 | 2,572,498 | 2,184,369 |
| Net assets at end of year | $ 2,749,599 | 2,394,161 | 197,328 | 178,337 | 2,946,927 | 2,572,498 |

## Analysis of Changes in Net Assets

The County's total net assets increased by $374 million during fiscal year 2007. The increase of $374 million was attributed to: increases of $341 million in total assets (includes an increase of $281 million in current and other assets and a $60 million increase in capital assets); and a decrease in total liabilities of $33 million (includes a decrease of $22 million of other liabilities and a decrease in long-term liabilities of $11 million).

**Chart 1**
**Expenses and Program Revenues - Governmental Activities**
**(In Thousands)**




**Governmental activities**:

Governmental activities increased the County's net assets by $355 million, accounting for 95% of the total increase in net assets (Business-type activities accounted for the remaining 5%, $19 million).

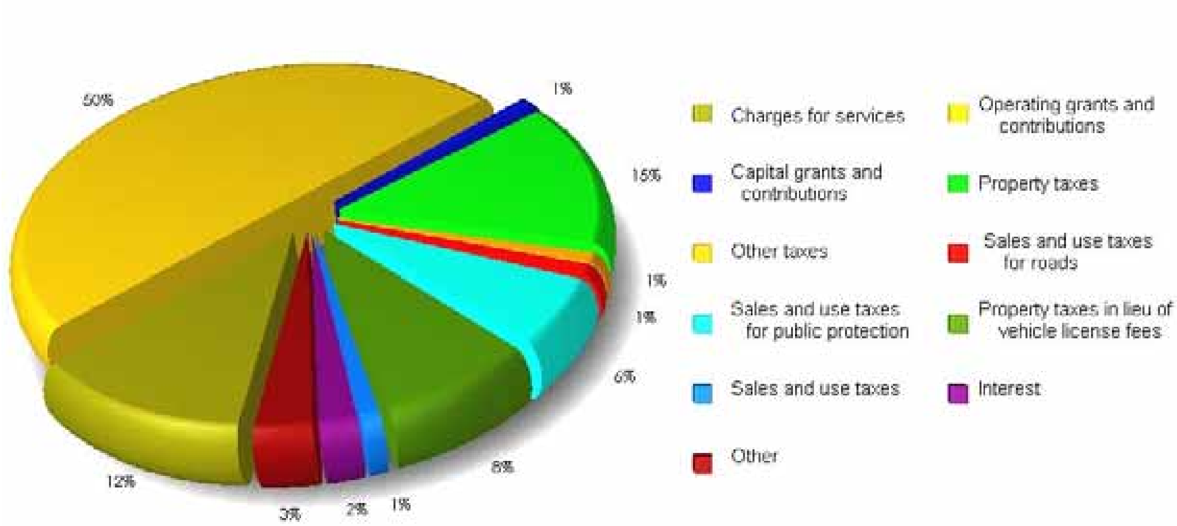
**Expenses:**

- Total expenses for governmental activities were $3.29 billion, an increase of $157 million or 5% ($127 million in functional expenses and $30 million in interest expense) over the prior year. Public protection was the largest functional expense (32.8 percent), followed by public assistance (31.7 percent) and health and sanitation (17.6 percent).

Increases in program expenses were attributed to the following:

- $82 million was due to an increase in contracted services including: $48 million in public protection activities principally due to an increase in Sheriff adult detention and police protection activities of $37 million and Planning and Land Use fire protection activities of $11 million; and $34 million in health and sanitation activities due in large part to increases in mental health and other assistance activities of $19 million and $15 million, respectively.
- $46 million was attributable to an increase in salaries and benefit costs of approximately 3% over the previous year. As a service delivery entity, the County's major cost component is salaries and benefits, which accounts for approximately 46% of the total expenses. The County's overall strategy of deleting, freezing and temporarily funding positions has minimized the impact of negotiated salary increases and increased benefit costs.
- A $30 million increase in interest expenses principally occurred as a result of new debt issued during the current fiscal year, and increased amortization of debt issuance related costs such as issuance discounts and deferred amounts on refundings.

**Chart 2**
**Revenues by Sources - Governmental Activities**
**(As a percent)**




**Revenues:**

Total revenues for governmental activities were $3.65 billion, an increase of 4 percent or $143 million from the previous year.

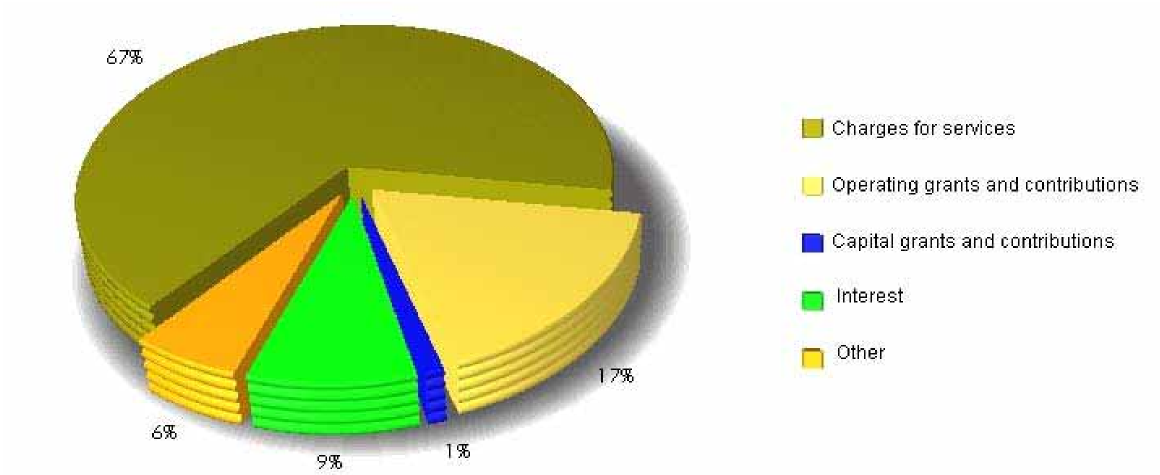
Program revenues increased by $29 million due primarily to increases in operating grants and contributions.

General revenues increased by $114 million. This increase was primarily due to the following:

- $43 million of the increase was due to increases in current and delinquent property taxes chiefly because of the growth in assessed property values.
- $25 million of the increase was attributable to an increase in interest earnings as the annual pool investment earnings rate increased to 5.00% from the prior year of 3.47%.
- $19 million of the increase was due to an increase in sales and use taxes for roads, principally due to an increase in the one-half percent TransNet taxes received by the County.
- $16 million of the increase was due to property taxes in lieu of vehicle license fees. This revenue source replaced the previous distribution of vehicle license fees to local governments.
- $3 million of the increase was due to an increase in general sales and use taxes.

The County's governmental activities rely on several sources of revenue to finance ongoing operations. As shown in **Chart 2** above, operating grants and contributions of $1.8 billion accounted for 50%, the largest share of this revenue. These monies are received from parties outside the County and are generally restricted to one or more specific programs. Examples of operating grants and contributions include State and Federal revenue for public assistance programs and health and sanitation programs. Property taxes and property taxes in lieu of vehicle license fees are not shown by program, but are effectively used to support program activities County-wide.

**Chart 3**
**Revenue By Source - Business Type Activities**
**(As a percent)**




Combined, these general revenues of $838 million account for 23% of governmental activities. Additionally, $453 million applicable to charges for services accounted for 12%, while sales and use taxes for public protection of $235 million accounted for 6% of these revenues.

At the end of fiscal year 2007, total revenues for the governmental activities were $3.65 billion, while total expenses for governmental activities were $3.29 billion.

Other factors concerning the finances of the County's major governmental funds are discussed in the governmental funds section of the "Financial Analysis of the County's Funds."

**Business-type Activities:**

Business-type activities are intended to recover all or a significant portion of their costs through user fees and charges. As shown in **Chart 3**, charges for services represent $32 million or 67% while grants ($8 million) and interest earnings ($4 million) represent 17% and 9% of total revenues respectively.

## Financial Analysis of the County Funds

The County uses fund accounting to demonstrate and ensure compliance with finance-related legal requirements.

**Governmental Funds:**

The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of resources that are available for spending. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Types of major governmental funds reported by the County include the General Fund and the Tobacco Securitization Special Revenue Fund. Nonmajor governmental funds include special revenue funds, debt service funds, and capital project funds.

As of the end of fiscal year 2007, the County's governmental funds reported combined ending fund balances of $2.13 billion, an increase of $251 million in comparison with the prior year fund balance. Of the total June 30, 2007 amount, $1.44 billion constitutes unreserved fund balance, which is available for spending at the County's discretion. The remaining $684 million of fund balance is reserved to indicate that it is not available for new spending because it has already been committed. These reservations include: (1) $253 million in encumbrances for existing contracts and purchase orders; (2) $253 million in Special Fund reserves, see **Table 32,** "Reserved for Other Purposes" in Notes to Financial Statements for details; (3) $113 million reserved for debt service, (4) $55 million reserved for loans, advances and prepaids; and $10 million reserved for: inventories ($9 million); and landfill closure costs ($1 million).

Revenues for governmental functions overall totaled $3.59 billion representing a 5% increase. Expenditures for governmental functions, totaled $3.4 billion, a 5% increase from the fiscal year ended June 30, 2006.

- *General Fund:*

The General Fund is the chief operating fund of the County. At the end of fiscal year 2007, the unreserved fund balance of the General Fund was $745 million, while total fund balance was $1.16 billion, an increase of $256 million from fiscal year 2005-06 (2006).

This was primarily attributed to a $273 million increase in Aid from other governmental agencies - State (principally realignment monies); a $43 million increase in Aid from other governmental agencies - Federal (principally Title 19 Medi-cal); partially offset by a $59 million increase in public protection expenditures, due in large part to increases in Sheriff police protection and adult detention. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 27 percent of total General Fund expenditures of $2.81 billion, while total fund balance represents 41 percent of that same amount.

- *Tobacco Securitization Special Revenue Fund:*

This special revenue fund is used to account for the $411 million the County received from the Tobacco Asset Securitization Corporation (Corporation) related to the sale of 25 years of tobacco settlement revenue in fiscal year 2002; and an additional $123 million the County received from Corporation resulting from the issuance of the San Diego County Tobacco Asset Securitization Corporation refunding bonds in fiscal year 2006. The County will continue to invest these funds in investment products to maximize the sustained long-term use of these dollars. At the end of fiscal year 2007, fund balance was $431 million, a decrease of $9 million from fiscal year 2006. This decrease was attributable to interest earnings of $15 million; and transfers out of $24 million to support health related program expenditures.

- *Other Governmental Funds*:

Other governmental funds consist of twenty-five nonmajor funds, which include special revenue funds, debt service funds, and capital project funds. Individual fund data for each of these nonmajor governmental funds is provided in the combining financial statements and supplemental information section of this report. As of the end of fiscal year 2007, the fund balance of the other governmental funds totaled $542 million, an increase of $4 million over the prior year. This $4 million net increase to fund balance was primarily due to the following.

Increases to fund balance were principally due to the activity in the following funds: The $10 million Road fund's increase in fund balance represents $137 million of revenues from taxes, the State and other revenue sources offset by $70 million of costs incurred for road related activities, $55 million in capital outlay, and $2 million in transfers made out of the road fund to the Pension Obligation Debt Service Fund; $10 million of the increase is related to SANCAL debt service ($6 million) and capital related activities ($4 million); $7 million increase in the Flood Control Districts Fund (Flood) is for transfers made into Flood in to be used for flood related expenditures; $7 million increase to the Housing Authority's fund balance consists of expenditures of $97 million, principally $88 million in tenant assistance offset by Federal grants of $99 million and other revenue of $5 million; $5 million increase in Edgemoor development capital project activities; $4 million increase due to air pollution related activities; $2 million increase in County Library related activities; $1 million for County Service District activities; and, $1 million for Tobacco Securitization Joint Special Revenue Fund activities.

Decreases to fund balance were due to the activity in the following funds: $23 million in Pension Obligation Bond Debt Service Fund's decrease in fund balance is due primarily to debt service payments of $99 million offset by transfers in of $67 million and other revenue of $9 million; $17 million decrease in the Public Safety fund balance represents $234 million in 2007 tax revenues offset by a transfer out to other governmental funds of $251 million to be spent on public protection activities; and, $3 million decrease in the Inactive Wastesites fund balance of represents expenditures in inactive wastesite management costs of $10 million offset in part by interest income of $5 million and tonnage fee and other revenues of $2 million.

**Proprietary Funds**:

The County's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. The nonmajor enterprise funds and the internal service funds are combined into single, aggregated presentations in the proprietary fund financial statements. Individual proprietary fund data is presented in the combining financial statements/schedules and supplemental information section of this report.

The net assets of business-type activities Enterprise Funds increased by $19 million or 11%, indicating that these activities generated revenues sufficient to cover the costs of operations. $4 million of this increase represents operating income. The remaining $15 million increase is primarily due to $8 million in Airport Enterprise Fund grant revenue; $4 million in interest and dividends ($1 million Airport Enterprise Fund and $3 million in the Sanitation Districts Fund); and, a $3 million gain on disposal of assets in the Sanitation Districts Fund.

Net Assets of the internal service funds totaled $106 million, an increase of $23 million from the prior year. This increase was primarily due to net asset increases of $11 million in the Employee Benefits Fund and $11 million in the Public Liability Insurance Fund.

**Fiduciary Funds:**

The County maintains fiduciary funds for the assets of the *Specific Investments - Investment Trust Fund*, the *Pool Investments - Investment Trust Fund*, and the *Agency Funds*.

- *Specific Investments - Investment Trust Fund:*

The Specific Investments - Investment Trust Fund was created in 2007 for the purpose of reporting individual investments which are offered as an alternative to a pooled position. In general, external entities include school districts, independent special districts and various other governments. The Specific Investments - Investment Trust Fund 's net assets totaled $344 million, a decrease in net assets of $513 million, primarily due to distribution from investments of $571 million offset by contributions on investments of $37 million and investment earnings of $21 million.

- *Pool Investments - Investment Trust Fund:*

This fund was established to account for the external portion of the County Treasurer's investment pool. This fund consists of school districts, special districts, and funds held for other governments. The Pool Investments - Investment Trust Fund's net assets totaled $2.62 billion, an increase in net assets of $179 million, primarily resulting from contributions on pooled investments of $17.052 billion and investment earnings of $134 million offset by distribution from pooled investments of $17.007 billion.

- *Agency Funds:*

Agency funds maintain assets held in an agent capacity for other governments, organizations and individuals. These assets do not support the County's programs or services. Any portion of the agency funds' assets held at fiscal year end for other County funds, are reported in those funds rather than in the agency funds.

## General Fund Budgetary Highlights

The County's final budget differs from the original budget (see Notes to required supplementary information) in that it contains supplemental appropriations approved during the fiscal year for various programs and projects, as well as transfers of appropriations, budget corrections, re-budgets, and account reclassifications offset by the amount of budget carried forward to the subsequent fiscal year. At June 30, 2007 net expenditure appropriations increased by $7.6 million and appropriations for transfers-out decreased $132.2 million for a net decrease of $124.6 million. (The net appropriation decrease included $130.9 million in net budget amendments offset by $255.5 million for the amount of budget carried forward to the subsequent fiscal year.)

Appropriation increases of note to the original adopted budget were the following:

- $10.0 million in the Office of Emergency Services for the purchase of equipment to enhance the response to chemical, biological and radiological incidents, to conduct exercises and for emergency planning and administration, based on revenue from the California Office of Homeland Security.
- $9.5 million for the payment of costs related to the transition of information technology from Computer Sciences Corporation to Northrup Grumman Information Technology, Inc., funded by fund balance.
- $6.9 million in the Sheriff to upgrade the County's Wireless Data System based on Proposition 172 revenue and Asset Forfeiture funds.
- An additional $5.4 million in Proposition 172 funding for various projects within the Public Safety Group. This includes $2.5 million in the Probation Department for maintenance projects at the various detention facilities, a new document management system and continuation of the global positioning and home supervision contracts to monitor and track high-risk sex offenders, $1.5 million in the District Attorney's Office for Continuity of Operations Planning (COOP) for information technology enhancements and equipment, $1.0 million in the District Attorney's Office for costs associated with the design and development of the new document management and $0.4 million for various other projects in the Public Safety Group.
- $21.1 million for salaries and benefits for incentives earned through the County's Fiscal Year 2006 Quality First program, funded by fund balance.
- $5.4 million in the District Attorney's Office for salary and benefits costs related to temporary help, graduate law clerks and student workers, the purchase of equipment to support employees' health and safety needs, equipment for the Regional Law Enforcement Training Center and the District Attorneys' training division and information technology upgrades, funded by fund balance.
- $7.2 million in the Health and Human Services Agency to enhance Child Welfare Services as described in the Board approved State-mandated System Improvement Plan and augment staffing needs to address recent state and federal Mandates. The funding source is State Child Welfare funding and Adoptions Basic Funding.
- $3.0 million in the Health and Human Services Agency for alcohol and drug services funded through a California Screening, Brief Intervention, Referral and Treatment Services Grant from the State Department of Alcohol and Drug Programs.

- $2.5 million in the Registrar of Voters to fund the additional costs of the November, 2006 General Election and March, 2007 Special Elections based on elections services revenues received from jurisdictions that participated in the elections and November, 2005 Special Statewide Election reimbursements from the Secretary of State.
- $4.0 million for the renovation and remodeling of existing structures in Heritage Park, funded by fund balance.
- $3.9 million in the Assessor/Recorder/County Clerk for remodeling and facilities maintenance in the County Administration Center and various other departmental maintenance projects, ergonomic workstations and for application services which include the development and upgrade of information technology services and the replacement of microfilm/printers based on funding from the Property Tax Administration, Modernization and Vital Statistics Trust Funds.

Actual revenues fell short of the final budgeted amounts by $49.5 million, while expenditures fell short of the budgeted amount by $380.4 million. The combination of the revenue and expenditure shortfalls resulted in a net favorable operating variance of $330.9 million. Other financing sources and uses of funds resulted in a favorable variance from budget of $17.6 million and there was no variance in the increase to the reserve for inventories of materials and supplies. These combined amounts resulted in a variance in the net change in fund balance of $348.5 million.

Highlights of actuals compared to budgeted amounts are discussed below:

- *Health and Human Services Agency:*

Funded by a combination of State, federal, and County revenues, most agency programs are carried out in the functional areas of health and sanitation and public assistance, with favorable expenditure variances of $58.1 million and $82.2 million respectively. The expenditure variances result from demand for services being less than the budgeted level. This includes Child Care payments, CalWORKS and Welfare to Work and Refugee Assistance payments. These lowered expenditures were offset by corresponding reductions in federal and State revenue.

- *Salaries and Benefits:*

In the continuing environment of uncertainty over State and federal funding, many County functions have deferred hiring staff for ongoing programs in anticipation of future budget constraints. In addition, the Sheriff's department is having recruiting difficulties due to a nationwide shortage of peace officers. The total favorable variance across all functions in this category is $55.7 million of which $15.3 million is attributable to the Sheriff's department.

- *Delayed expenditures:*

Many County projects such as maintenance and information technology take place over more than one fiscal year. However, at inception they are budgeted at full expected cost, resulting in favorable expenditure variances that are re-budgeted in the new fiscal year. For example, in the Department of Planning and Land Use, re-budgets include: $1.0 million for the removal of dead, dying and diseased trees; $1.0 million for the Fire Prevention Program to provide funding to fire districts and County Service Areas; $1.7 million for costs related to the completion of the General Plan 2020 and subsequent Zoning ordinance revisions and $0.8 million for various projects related to the Multiple Species Conservation Program. The Department of Parks and Recreation has re-budgeted $1.6 million for various projects in local parks and community centers. The District Attorney has rebudgeted $4.0 million for approved information technology projects to be completed in the upcoming year. Additional rebudgeted amounts include $0.5 million in the Public Safety Group for various projects including the California Multi-Jurisdictional Methamphetamine Team and for information technology enhancements in the Probation Department and $0.2 million for the relocation of the Purchasing and Contracting Property Disposal warehouse to a new facility.

*Appropriated Management Reserves:*

The County annually appropriates management and contingency reserves based on both ongoing general purpose revenues and prior years' fund balance for a variety of one-time capital and operating expenditures as well as potential emergencies. Unexpended reserves resulted in a positive variance of $54.7 million. In addition, in fiscal year 2007, the County set aside $36.3 million for economic uncertainty with the intent that it not be spent unless unusual needs arose; of that amount, $32.5 million was unexpended at year end.

## Capital Assets and Commitments

### Capital Assets

At June 30, 2007, the County's capital assets for both governmental and business-type activities was $2.76 billion and $115 million, respectively, net of accumulated depreciation. Investment in capital assets includes land, construction in progress, structures and improvements, equipment, and infrastructure (including roads, bridges, flood channels, and traffic signals). The significant capital asset activity in fiscal year 2007 was as follows:

*Governmental Activities:*

- $54.4 million towards the construction and improvement of County maintained roads, bridges, and other road related infrastructure. An additional $15.1 million in infrastructure was donated by developers.
- $30.1 million towards the construction of the Edgemoor Skilled Nursing Facility in Santee. Total project costs are estimated at $118.8 million.
- $9.1 million towards the construction of flood control drainage channels.
- $4.1 million towards the construction of a new Medical Examiner Building in Kearny Mesa. Total project costs are estimated at $85.4 million.
- $4.1 million towards the construction of a Sheriff station in Alpine. Total project costs are estimated at $6.0 million.
- $3.8 million for expansion of the Public Health Laboratory. Total project costs are estimated at $4.3 million.
- $2.9 million for acquisition of real property in Lakeside for a future sports park.
- $1.6 million towards the construction of the Spring Valley Gymnasium. Total projects costs are estimated at $2.6 million.
- $1.2 million for open space habitat restoration at the Goodan Ranch Compound. Total projects costs are estimated at $1.7 million.
- $8.3 million towards the construction of numerous other Capital Outlay Fund projects.

*Business-Type Activities:*

- $2.1 million to complete the rehabilitation of the taxiway at Gillespie Field Airport in El Cajon.
- $1.8 million towards improvements in the Spring Valley Sanitation District including outfall manhole replacement. Total project costs are estimated at $2.2 million.
- $1.5 million towards the construction of the Palomar Airport North Ramp. Total project costs are estimated at $8.8 million.

For government-wide financial statement presentation, governmental fund depreciable capital assets were depreciated from the acquisition date to the end of the current fiscal year. Governmental fund financial statements record capital asset purchases as expenditures.

More detailed capital assets information, including depreciation as of June 30, 2007, can be found in Note IV-D of the notes to the basic financial statements.

**Capital Commitments**

As of June 30, 2007, capital commitments included the following:

- $80 million for the construction of Edgemoor Skilled Nursing Facility, Valley Center Road, Wildcat Canyon road, route 54/94, Central Avenue Flood Control System, and Resurfacing/Culvert Replacement on various county roads.
- $2 million for the Jamacha Boulevard Sewer Improvements and the Flow Monitoring Systems in Alpine, Lakeside, and Spring Valley Sanitation Districts.

More detailed capital commitments information, including depreciation as of June 30, 2007, can be found in Note IV-D.2 of the notes to the basic financial statements.

## Long-Term Obligations

At June 30, 2007, for governmental activities, the County had outstanding long-term obligations of $2.385 billion. Of this amount, $364 million pertained to outstanding certificates of participation, and the remaining $2.021 billion pertained to the following obligations: $1.207 billion of taxable pension obligation bonds; $584 million of San Diego County Tobacco Asset Securitization Corporation Bonds; $15 million of Redevelopment Agency bonds; $8 million for loans; $7 million of unamortized issuance premiums; $(21) million of unamortized issuance discounts; $(27) million of unamortized deferred amounts on refundings; $30 million for capital leases; $111 million for claims and judgments; $83 million for compensated absences; and, $24 million for landfill closure and postclosure costs.

Long-term obligations for business-type activities totaled $2.9 million and consisted of $2.6 million for capital loans and $342 thousand for compensated absences.

During fiscal year 2006, the County's total principal amount of bonds, loans and notes payable for governmental activities decreased by $24 million, before giving affect to the unamortized issuance, issuance premiums, unamortized issuance discounts and unamortized deferred amounts on refundings. The $24 million decrease was due to the following debt issuances, offset by debt service payments discussed below:

Increases - $50 million

The County's issued $42.4 million in certificates of participation for the 2006 Edgemoor Completion Project; $344 thousand Landavo Zone PRD #1015 Capital Loan; and a $118 thousand El Sereno Way Zone PRD #1016 Capital Loan.

Additionally $7 million of principal was accreted (added) to the outstanding CAB principal balances outstanding. These issuances and the accredited amount totaled $50 million.

Decreases - $74 million

Decreases to debt included $74 million in principal debt service payments.

The long-term obligations for business-type activities decreased by $241 thousand due to $194 thousand debt service payments on capital loans, and a decrease of $47 thousand in compensated absences.

More detailed long-term obligation activity, including interest rates and maturity dates, can be found in Note IV-I through IV-I-5 of the notes to the basic financial statements.

The County's issuer and credit ratings on its bonded program are as follows:

### Table 3

| Credit Ratings | Moody's | Standard & Poor's | Fitch Ratings |
|---|---|---|---|
| Issuer Rating | Aa2 | AA | AA+ |
| Certificates of Participation | A1 | AA- | AA |
| Pension Obligation Bonds | Aa3 | AA- | AA |

In May 2007, Fitch Ratings upgraded the County's ratings on its outstanding Certificates of Participation and Pension Obligation Bonds from AA- to AA and assigned the County an

AA+ Issuer rating. According to Fitch Ratings credit research report issued in May 2007, "The rating upgrade is based on the County's positive financial trend, marked by consistent operating surpluses and resulting high fund balances, disciplined pension system funding, and positive actions to limit other post-employment benefit costs, sound underlying economy, and conservative debt management"

## Economic Factors and Next Year's Budget and Rates

- The fiscal year 2007-08 (2008) General Fund budget utilized as funding sources for one-time expenditures $123.3 million out of $561.4 million in unreserved undesignated fund balance and $1.5 million out of $183.4 million unreserved designated fund balance. In addition, $55.5 million in unreserved designated fund balance was shifted to a general reserve.
- The development of the fiscal year 2008 budget was based on current expectations for demand for services and availability of funding to support those services. The fiscal year 2008 General Fund budget contains total appropriations of $3.521 billion. This is an increase of $231.4 million or 7.0% from the fiscal year 2007 General Fund budget. A number of risk factors continue to be tracked: the U.S. economy, the State of California's projected budget imbalance for fiscal year 2009, 2010 and beyond; significant weaknesses in the housing sector; uncertainty in short and long-term interest rates; continued pressure of high energy prices; and the impact of legislation and propositions on the State of California's budget particularly in the areas of Health Care and Corrections Reform.
- The U.S. economy's Gross Domestic Product (GDP) for 2006 showed an increase of 2.9% versus a revised growth rate of 3.1% in 2005. The projected GDP growth for 2007 is approximately 1.9%.
- The State of California's economy has been doing well for the last two years. Overall, 2006 was another good year for California: payroll jobs experienced healthy growth at 1.9%; the job growth also contributed to real personal income growth of 2.9%; but taxable sales grew by only 1.9%.
- The San Diego economy continues to show positive growth (i.e., gross regional product at 6.1% for 2004, 3.9% in 2005, 4.1% in 2006, but slowing growth is forecasted at 2.5% for 2007 and 3.1% for 2008).
- The State's budget outlook continues to be strained by an ongoing structural imbalance between revenues and expenditures. According to a review of the Governor's budget by the State of California's Legislative Analyst (August 2007), the state will again face projected operating shortfalls of more than $5.0 billion in both fiscal years 2009 and 2010.
- The 2006 Budget Act required counties to transfer undesignated fees to the local trial court. This transfer was to occur for only 2004 and 2005, but was extended for four more years, albeit at declining amounts. The County's share was $2.1 million for 2004 and 2005, $0.8 million in 2006, and $0.6 million in 2007. For fiscal years 2008 and 2009, the County's share is $0.4 million and $0.2 million, respectively. One-time resources will be used to fund this requirement.
- Since fiscal year 1996, the State Property Tax Administration Grant program supported counties' maintenance of timely property assessments. The 2008 Budget Act did not include funding for counties' property tax

administration programs. For fiscal year 2008, general purpose revenues continue to replace the loss of these grant funds.

The County's general purpose revenues continue to perform well overall. Specifically:

- The largest source of general purpose revenues is property taxes ($511.4 million in fiscal year 2008), representing 53.1% of the total. The housing boom that had been driving the California and U.S. economies has faded, and the "housing construction/real estate" slowing will contribute to slowing in the growth of the State economy in 2007 and 2008. For the last seven years, property tax growth has been high (9.7% average annual growth) due to the County's strong overall economy and healthy real estate market. Current property taxes consist of three components: current secured property taxes, current supplemental property taxes, and current unsecured property taxes.
- The budgeted amount of current secured property tax revenues ($474.6 million) assumes a net assessed value growth of 7.5% over the prior year and includes an allowance for tax increment allocations to redevelopment agencies and an allowance for delinquent property tax payments. Actual gross assessed value growth exceeded 9.0%, meaning that actual current secured property tax revenues in fiscal year 2008 will likely exceed budget. The demand for housing in the County is also slowing, as evidenced by a reduction in residential building permits, marginally declining housing prices, and increases in foreclosures and defaults. These factors are offset by relatively low interest rates and the area's population growth. Overall, property tax growth is expected to decelerate over the next two years.
- Current supplemental property taxes ($20.8 million in Fiscal Year 2008) are derived from additions to the tax roll during the budget year and are therefore more difficult to predict. The actual amount of these revenues in Fiscal Year 2007 was 26.3% less than budgeted ($23.4 million actual versus $31.7 million budgeted) as a result of weakness in assessed value growth from the slowing in the real estate market. The budget assumes that this weakness will continue through the next two fiscal years with the Fiscal Year 2008 amount being less than the actual for Fiscal Year 2007 followed by a small recovery in Fiscal Year 2009.
- Current unsecured property taxes ($16.0 million in Fiscal Year 2008) do not build on a prior year base. The roll is forecasted based on trends and available information at the time the budget is developed. Growth of 4.3% is budgeted for Fiscal Year 2008 over the Fiscal Year 2007 adopted budget.
- Property taxes in lieu of vehicle license fees (VLF) comprises 30.8% (an estimated $297.1 million) of general purpose revenues in fiscal year 2008. This revenue source was established by the state in fiscal year 2005 to replace the previous distribution of vehicle license fees to local governments. Growth in this revenue source is based on the growth in the County's gross taxable assessed value. The certified growth rate for 2008 is 9.2525%, but as for current secured property tax revenue, the rate of growth is expected to decline over the next two years.
- Real Property Transfer Tax Revenue (RPTT) for fiscal year 2008 was budgeted at $21.5 million, which is 2.2% of general purpose revenues. RPTT is paid when any lands, tenements, or other realty exceeding $100 in value are sold and granted, assigned, transferred or conveyed to the purchaser. The tax rate set by the State is $1.10 per $1,000 of assessed valuation. The County collects 100% of the revenues from all transactions in the unincorporated area and 50% of the revenues from transactions in the incorporated areas.

- Sales & use tax revenue & in lieu local sales & use tax ($24.7 million in fiscal year 2008) represents about 2.6% of general revenues and is derived from taxable sales by businesses located in unincorporated County areas. Its growth is generally impacted by population and income, but is primarily due to economic development and new business formation in the County. These amounts reflect both the Sales Tax revenues and the in lieu local sales & use tax replacement funding that will be transferred from ERAF. Again, effective July 1, 2004, provisions of AB7 X1, one of the 2004 State budget bills referred to as the "triple flip", took effect. It enabled the state to redirect one-quarter cent of the local sales and use tax to the state to repay up to $15 billion in bonds authorized by Proposition 57 (March 2004) to help the state refinance its past debt. In turn, the lost revenues are replaced on a dollar-for-dollar basis with countywide property tax revenues shifted back from the ERAF. Retail sales show moderate growth in the unincorporated area with a projected before-triple-flip-adjustment sales tax growth of $1.2 million (5.2%) over the fiscal year 2007 budget.
- Other revenues budgeted for fiscal year 2008 total $108.9 million. Various revenue sources make up this category including interest on deposits, fines, fees and forfeitures, redevelopment agency tax increment, prior year adjustments on property taxes, franchise revenue, aid from the City of San Diego in lieu of booking fees, and other miscellaneous revenues. The fiscal year 2008 budget represents an increase of 39% over the fiscal year 2007 budget. The increased revenues are primarily due to growth in redevelopment agency tax increment, prior year secured supplemental property taxes, penalties and costs related to delinquent taxes, and interest on deposits, and to a shift in the budgeting and accounting for delinquent property tax revenues associated with the Teeter Plan.

The County's *Operational Plan for Fiscal Years 2008 and for Fiscal Year 2009 can be found on the internet at http://www.sdcounty.ca.gov/ auditor.*

## Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to demonstrate the County's *accountability* for the money it receives. If you have questions about this report or need additional financial information, please contact the Auditor and Controller's Office, County of San Diego, located at 1600 Pacific Highway, San Diego, California 92101.