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, 2008.

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 2007-08 (2008) by $3.22 billion (net assets). Of this amount, $2.59 billion is invested in capital assets, net of related debt; $181 million is restricted for specific purposes (restricted net assets); and the remaining portion represents unrestricted net assets of $444 million.
- Total net assets increased by $273 million. For governmental activities, revenues exceeded expenses by $251 million. For business type activities, revenues exceeded expenses, before transfers, by $22 million.
- General revenues for governmental activities were $1.15 billion. Of this amount, property taxes and property taxes in lieu of vehicle license fees accounted for $941 million or 81%; other taxes, sales and uses taxes, investment income and other general revenues accounted for $214 million or 19%.
- Program revenues for governmental activities were $2.66 billion. Of this amount, $2.15 billion or 81% was attributable to operating grants and contributions while charges for services accounted for $486 million or 18%.
- The total expenses for governmental activities were $3.57 billion. Public protection accounted for $1.18 billion or 33% of this amount, while public assistance accounted for $1.11 billion or 31%. Additionally, health and sanitation accounted for $639 million or 18%.

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 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.

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

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 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, Public Safety Special Revenue Fund and the Tobacco Securitization Special Revenue Fund, all of which are considered to be major funds. Data from the other 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/schedules 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 *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, Public Safety Special Revenue Fund and the Tobacco Securitization Special Revenue Fund (all major funds) in separate Schedules of Revenues, Expenditures, and Changes in Fund Balance- Budget and Actual.

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, 2008 and 2007 (In Thousands)	Governmental Activities		Business Type Activities		Total	
	2008	2007	2008	2007	2008	2007
ASSETS						
Current and other assets	$ 2,680,527	2,888,810	98,107	87,186	2,778,634	2,975,996
Capital assets	2,821,553	2,755,506	128,492	115,100	2,950,045	2,870,606
Total assets	5,502,080	5,644,316	226,599	202,286	5,728,679	5,846,602
LIABILITIES						
Long-term liabilities	2,224,194	2,385,188	2,645	2,893	2,226,839	2,388,081
Other liabilities	277,220	509,529	5,031	2,065	282,251	511,594
Total liabilities	2,501,414	2,894,717	7,676	4,958	2,509,090	2,899,675
NET ASSETS						
Invested in capital assets, net of related debt	2,468,142	2,409,050	126,237	112,549	2,594,379	2,521,599
Restricted	181,198	162,318			181,198	162,318
Unrestricted	351,326	178,231	92,686	84,779	444,012	263,010
Total net assets	$ 3,000,666	2,749,599	218,923	197,328	3,219,589	2,946,927

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 $3.22 billion at the close of fiscal year 2008, an increase of $273 million or 9% over fiscal year 2007. This included an increase of $200 million in the County's restricted and unrestricted net assets (a 47% increase over fiscal year 2007) and an increase of $73 million in capital assets, net of related debt (a 3% increase over fiscal year 2007).

The aforementioned increase of $273 million in net assets was composed of the following changes in total assets and liabilities:

- Total assets decreased by $118 million. This included a decrease of $197 million in current and other assets and a $79 million increase in capital assets. The $197 million decrease in current and other assets was primarily attributable to an increase in property taxes receivable of $60 million and a decrease in restricted investments with fiscal agents of $279 million, offset by an increase in other current and other assets of $22 million. (The decrease in restricted investments with fiscal agents was chiefly due to the reduction of a $220 million guaranteed investment contract outstanding at June 30, 2007 which was used to pay down the tax and revenue anticipation notes discussed below.)
- Total liabilities decreased by $391 million. This included a decrease in long-term liabilities of $161 million and a decrease in other liabilities of $229 million. The decrease of $161 million in long-term liabilities was primarily attributed to reductions in long-term debt (see Long-Term Liabilities discussion). The decrease in other liabilities of $229 was primarily due to the liquidation of $220 million in the amount due for tax and revenue anticipation notes.

The largest portion of the County's net assets (81%) reflects its investment of $2.59 billion in capital assets, net of related debt (which includes: 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, i.e. restricted net assets equaled $181 million and represent 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 $444 million in unrestricted net assets.

Table 2

Changes in Net Assets For the Years Ended June 30, 2008 and 2007 (In Thousands)	Governmental Activities		Business-type Activities		Total	
	2008	2007 (1)	2008	2007	2008	2007
Revenues:						
Program revenues:						
Charges for services	$ 485,618	483,395	41,475	32,024	527,093	515,419
Operating grants and contributions	2,152,380	2,113,585	7,725	8,257	2,160,105	2,121,842
Capital grants and contributions	24,474	22,682		464	24,474	23,146
General revenues:						
Property taxes	637,491	559,726			637,491	559,726
Other taxes	20,374	26,760			20,374	26,760
Property taxes in lieu of vehicle license fees	303,348	277,930			303,348	277,930
Sales and use taxes	24,872	26,534			24,872	26,534
Investment Income	87,554	88,974	4,113	4,189	91,667	93,163
Other	80,804	95,343	105	2,909	80,909	98,252
Total revenues	3,816,915	3,694,929	53,418	47,843	3,870,333	3,742,772
Expenses:						
Governmental Activities:						
General government	298,607	295,097			298,607	295,097
Public protection	1,180,114	1,079,320			1,180,114	1,079,320
Public ways and facilities	144,452	133,148			144,452	133,148
Health and sanitation	638,869	580,384			638,869	580,384
Public assistance	1,114,453	1,043,454			1,114,453	1,043,454
Education	36,355	33,223			36,355	33,223
Recreation and cultural	33,941	28,469			33,941	28,469
Interest expense	119,138	146,997			119,138	146,997
Business-type Activities:						
Airport			8,848	8,209	8,848	8,209
Wastewater Management			5,320	4,422	5,320	4,422
Sanitation Districts			17,574	15,620	17,574	15,620
Total expenses	3,565,929	3,340,092	31,742	28,251	3,597,671	3,368,343
Changes in net assets before transfers	250,986	354,837	21,676	19,592	272,662	374,429
Transfers	81	601	(81)	(601)		
Change in net assets	251,067	355,438	21,595	18,991	272,662	374,429
Net assets at beginning of year	2,749,599	2,394,161	197,328	178,337	2,946,927	2,572,498
Net assets at end of year	$ 3,000,666	2,749,599	218,923	197,328	3,219,589	2,946,927

(1) Note: 2007 Reclassifications for Comparative Purposes

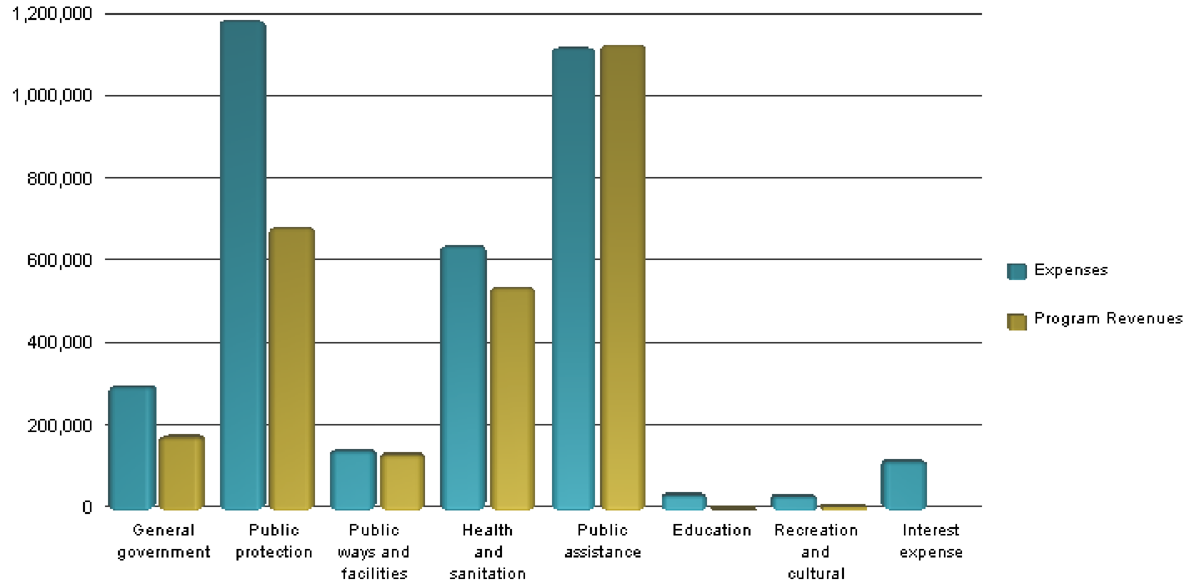
Certain fiscal year 2007 balances were reclassified to conform to the proper current year presentation. As a result, adjustments were made in Table 2, 2007 line items for comparative purposes as indicated below:

- Transfers of $45 million were reclassified to General Government expense to reflect lease payments from the General Fund to the SANCAL Debt Service Funds and lease revenue (charges for services) in the SANCAL Debt Service Fund. In 2007, these transactions were treated as Transfers.
- Charges for services of $15 million were reclassified to Capital grants and contributions to reflect assets donated to the County.
- Intergovernmental restricted: Sales and use taxes of $292 million were reclassified to Operating grants and contributions to reflect shared revenues from the State.

Analysis of Changes in Net Assets

At June 30, 2008, changes in net assets before transfers (revenues minus expenses) equaled $273 million, a $102 million or 27% decrease from the previous year. Principal revenue sources contributing to the change in net assets were operating grants and contributions of $2.15 billion and taxes of $941 million (including: property taxes and property taxes in lieu of vehicle license fees.) These revenue categories accounted for 81% of total revenues. Principal expenses were in the following areas: public protection, $1.18 billion; public assistance, $1.11 billion; and health and sanitation, $639 million. These expense categories accounted for 82% of total expenses.

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



Governmental activities

Governmental activities increased the County's net assets by $251 million, accounting for 92% of the total increase in net assets (Business-type activities accounted for the remaining 8%, $22 million).

Expenses:

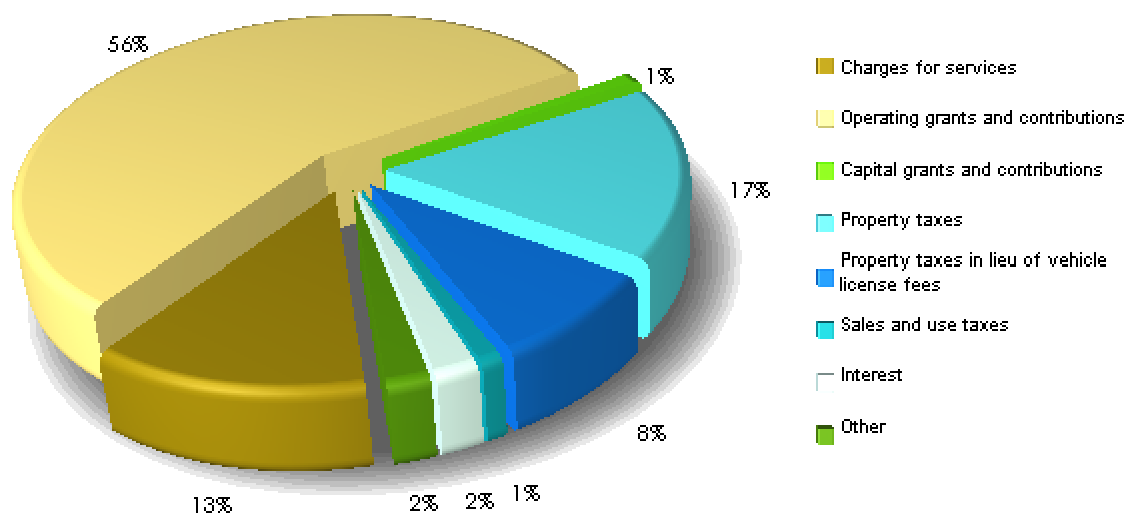
- Total expenses for governmental activities were $3.57 billion, an increase of $226 million or 7% ($254 million increase in functional expenses and $28 million decrease in interest expense) over the prior year. Public protection was the largest functional expense (33%), followed by public assistance (31%) and health and sanitation (18%)).

Increases in program expenses were attributed to the following:

- $133 million was due to an increase in contracted services including the following items: 1) $30 million in public works activities attributable to the costs of the 2007 County Firestorm debris removal in fiscal year 2007-08; 2) $26 million in mental heath activities including: a) $16 million for the expansion of mental health services associated with the Mental Health Services Act funding; b) $5 million was for Medi-Cal/EPSDT services (Children Medi-Cal mental health services); c) $1 million was for firestorm related services, and d) $4 million for various other mental health program services provided; 3) $23 million in increased individual provider costs in the In-Home Supportive Services program; 4) $22 million in information technology related activities; 5) $14 million in aid to families with dependent children activities due in part to the growth in the Health and Human Services Agency's (HHSA) CalWorks program related expenditures including assistance payments and unemployed parent assistance payments; 6) $6 million due to increased costs for the County's Medical Services program; 7) $5 million attributable to the growth in the aid to adoptive children case levels growth and costs per case; 8) $3 million in HHSA participation benefits; 9) $2 million in HHSA Aid for severely emotionally disturbed persons; and 10) $2 million in support and care of persons: a) $1million HHSA and b) $1 million Sheriff's department.

- $96 million was attributable to an increase in salaries and benefit costs of approximately 7% over the previous year. As a service delivery entity, the County's major cost component is salaries and benefits, which accounts for approximately 42% 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.
- $10 million in depreciation due to an overall increase in depreciable capital assets.
- $9 million increase in various other County program activities.
- $4 million in equipment rentals related to various activities.
- $2 million in fuel costs due to the rising costs of gasoline.
- $28 million in interest expense decreases primarily occurred as a result of decreased amortization of debt issuance related costs such as issuance discounts and deferred amounts on refundings, and decreased interest accrued on outstanding debt.

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



Revenues:

Total revenues for governmental activities were $3.82 billion, an increase of 3% or $122 million from the previous year.

Program revenues increased by $43 million. This increase was primarily due to increases in operating grants and contributions in public assistance (Health and Human Services Agency social administration and other assistance).

General revenues increased overall by $79 million. This increase was primarily due to the following:

- $15 million decrease in other revenues primarily due to a decrease in Tobacco Settlement Revenues (TSR) as a result of the County's implementation of Governmental Accounting Standards Board Technical Bulletin 2004-01, "Tobacco Settlement Recognition and Financial Reporting Entity Issues" paragraph 15, in fiscal year 2007, which changed the way in which the County estimated its accrued TSR, thus resulting in additional revenues recognized in fiscal year 2007.
- $7 million decrease in real property transfer tax attributable to the decline in real estate sales.
- $2 million decrease in general sales and use taxes.

- $2 million decrease in investment income due to a decrease in the annual County pool investment earnings rate from 5% to 4.61%.
- $78 million increase in current and delinquent property taxes attributable to the growth in assessed property values.
- $25 million increase in property taxes in lieu of vehicle license fees attributable to an increase in the gross taxable property assessed values.

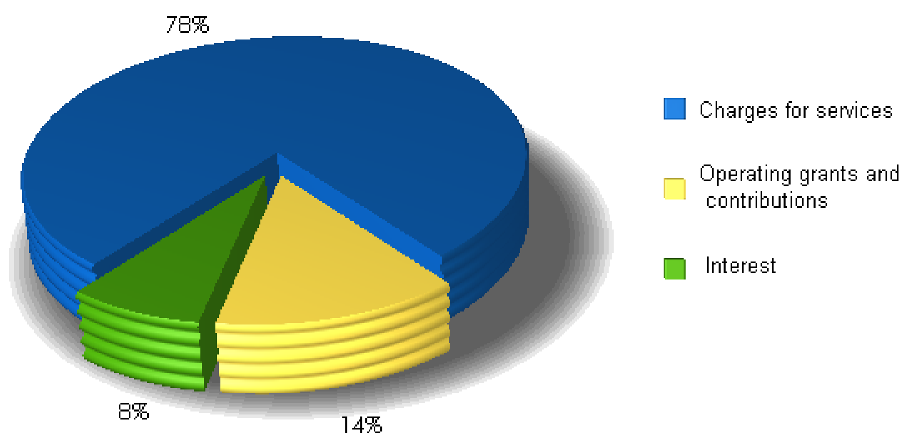
The County's governmental activities rely on several sources of revenue to finance ongoing operations. As shown in **Chart 2**, operating grants and contributions of $2.15 billion accounted for 56%, the largest share of this revenue. These monies are received from parties outside the County and are generally 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. Combined, these general revenues of $941 million account for 25% of governmental activities. Additionally, $486 million applicable to charges for services accounted for 13%.

At the end of fiscal year 2008, total revenues for the governmental activities were $3.82 billion, while total expenses for governmental activities were $3.57 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."

Chart 3
Revenue By Source - Business-type Activities
(As a Percent)



Business-type Activities:

Business-type activities, which are exclusively comprised of enterprise funds, 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 $41 million or 78% while grants ($8 million) and investment income ($4 million) represent 14% and 8% of total revenues respectively.

Net assets of business-type activities increased by $21 million or 11%. This increase primarily included: a) an $11 million increase in current and other assets due to: i) a $6 million increase in airport receivables, chiefly as a result of reversionary interest and leasehold improvement income and ii) a $5 million increase in pooled cash and investments; b) a $13 million increase in capital assets principally due to airport and sewer improvements; and c) a $3 million increase in other liabilities, due to increases primarily in accounts payable.

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, the Public Safety Special Revenue 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 2008, the County's governmental funds reported combined ending fund balances of $2.12 billion, a decrease of $5 million in comparison with the prior year fund balance. Of the total June 30, 2008 amount, $1.65 billion constitutes unreserved fund balance, which is available for spending at the County's discretion. The remaining $472 million of fund balance is reserved to indicate that it is not available for new spending because it has already been committed. These reservations of fund balances include: (1) $312 million reserved for other purposes; (2) $92 million reserved for debt service; (3) $58 million reserved for loans, advances and prepaids; and $10 million reserved for: inventories ($9 million); and landfill closure costs ($1 million).

Governmental revenues overall totaled $3.76 billion representing a 4% increase. Governmental expenditures totaled $3.77 billion, a 10% increase from the fiscal year ended June 30, 2007.

General Fund:

The General Fund is the chief operating fund of the County. At the end of fiscal year 2008, the unreserved fund balance of the General Fund was $947 million, while total fund balance was $1.22 billion, an increase of $65 million from fiscal year 2007.

- This was primarily attributed to: a $66 million increase in current, delinquent and other property taxes principally due to the growth in assessed property values; an $81 million increase in Aid from other governmental agencies - Federal, attributable to the increase in Welfare-to-Work contracts and reimbursements for the costs incurred for CALWORKs Assistance payments and In-Home Support Services; a $7 million decrease in Aid from other governmental agencies - Other related to Sheriff police protection; offset by increased expenditures including, $30 million in public works activities attributable to the costs of the 2007 County Firestorm debris removal in fiscal year 2007-08; $15 million in Sheriff police protection activities; $13 million in District Attorney judicial expenditures; $11 million in Sheriff adult detention expenditures; and $6 million in Probation detention and correction activities. 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 31% of total General Fund expenditures of $3.04 billion, while total fund balance represents 40% of that same amount.

Public Safety Special Revenue Fund:

This fund was established to account for Proposition 172 half-cent sales taxes collected and apportioned to the County by the State Board of Equalization to fund public safety activities. Per Government Code 30052, a "maintenance of effort" (pre-Proposition 172 public safety funding level) must be maintained by the County to comply with the statute's spending requirements. In accordance with the Code, funds are allocated to the Sheriff, District Attorney and Probation departments. Transfers-out of this fund subsidize the following types of public safety activities: juvenile detention services; facilities maintenance and support; capital projects, equipment and other one-time expenditures; on-going technology initiatives; and various region-wide services. As of June 30, 2008, the total (unreserved) fund balance in the Public Safety Special Revenue Fund was $4 million, a decrease of $3.9 million from the prior fiscal year attributed to a decrease in State allocation of one-half sales and use tax due to the slowing economy during fiscal year 2008.

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 2008, fund balance was $428 million, a decrease of $2 million from fiscal year 2007. This decrease was attributable to investment income of $22 million; offset by transfers out of $24 million to support health related program expenditures.

Other Governmental Funds:

Other governmental funds consist of 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/schedules and supplemental information section of this report. As of the end of fiscal year 2008, the fund balances of the other governmental funds totaled $470 million, a net decrease of $64 million over the prior year. This $64 million net decrease to these fund balances was primarily due to the following:

Decreases to the Other Governmental Funds' fund balances totaling $69 million were principally due to the activity in the following funds: an $11 million decrease in SANCAL Debt Service fund other financing sources' face value of bonds issued (in fiscal year 2007 SANCAL issued certificates of participation to finance the completion of the new Edgemoor Skilled Nursing Facility for which there were no new debt issuances in fiscal year 2008) offset by a $2 million decrease in principal and bond issuance costs; a $48 million decrease in the SANCAL Capital Projects fund resulting from a $31 million decrease in other financing sources' face value of bonds related to the aforementioned completion of the Edgemoor Skilled Nursing Facility for which there were no new debt issuances in fiscal year 2008, coupled with an approximately $20 million increase in Transfers Out attributable the accelerated schedule for payment of construction costs in fiscal year 2008 offset by investment income of $2 million and $1 million Transfers In; $12 million net decrease in Pension Obligation Bonds Debt Service fund due to the increase in principal debt service payments attributed to a $100 million prepayment for the Series 2002C PINES and a $20 million prepayment attributed to the Series 2002 B Pension Obligation Bonds, offset by a $95 million Transfer In from the General Fund to fund the aforementioned prepayments, and an overall decrease in other debt service payments of approximately $13 million.

The $5 million increase to the Other Governmental Funds' fund balance was principally attributable to the Road Fund. The increase to its fund balance resulted from tax revenues, intergovernmental revenues from the State and other revenue sources totaling $120 million, offset by $71 million of expenditures incurred for road related activities, $42 million in capital outlay expenditures, and $2 million transfers to the Pension Obligation Debt Service Fund for its share of pension obligation bond payment costs.

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.

Enterprise Funds:

See previous discussion above regarding Business-type activities "Revenues by Source."

Internal Service Funds:

Net Assets of the internal service funds (ISF) totaled $104 million, a net decrease of $2 million from the prior year. This decrease included a combined decrease of $23 million which included $19 million and $4 million decreases in the Information Technology Fund and Public Liability Insurance Fund respectively. This decrease was offset by increases of $21 million which were attributable to increases of $19 million in the Employee Benefits Fund and a net increase of $2 million in various other ISF funds.

The $19 million decrease in the information Technology Fund net assets was essentially due to increases in expenses for contracted services while the $19 million increase in Employee Benefits Fund net assets was due in large part to decreases in claims and judgment expenses.

Fiduciary Funds:

The County maintains fiduciary funds for the assets of the *Investment Trust Fund* and the *Agency Funds*.

Investment Trust Fund:

This Fund was established for the purpose of reporting pooled and specific investments. The Investment Trust Fund 's net assets totaled $3.62 billion, an increase in net assets of $657 million, primarily due to contributions on investments of $6.492 billion and investment earnings of $169 million offset by distribution from investments of $6.004 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. For the fiscal year ended June 30, 2008 net expenditure appropriations increased by $104.1 million and appropriations for transfers-out increased by $33.3 million for a net increase of $137.4 million.

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

- $42.1 million in the Department of Public Works to fund a comprehensive debris management program for Firestorm 2007 based on $35.1 million in revenue from the State Office of Emergency Services, the Federal Emergency Management Agency (FEMA) and $7.0 million in fund balance. The funds were used for debris removal contracts and contract administration to remove hazardous materials and debris from private property to eliminate further risk to public health and safety.
- $4.4 million in the Department of Public Works for erosion control services related to Firestorm 2007, funded by fund balance.
- $6.6 million for the County Operations Center and Annex Redevelopment project for environmental review, planning and design, Disposition and Development Agreement and relocation site searches, funded by fund balance.
- $6.6 million for Homeland Security in various departments including the Office of Emergency Services, Sheriff, Health and Human Services and the Medical Examiner for emergency planning, continued development of an exercise program, equipment purchases regional projects and grant administration based on revenue from the California Office of Homeland Security.
- $11.2 million for the construction of the Ramona Library, funded by fund balance. The total cost for the project is projected to be $11.6 million.
- $7.0 million for the construction of the Fallbrook Library, funded by fund balance. The total cost for the project is projected to be $10.3 million.
- $25.2 million for salaries and benefits for incentives earned through the County's Fiscal Year 2006-07 Quality First program, funded by fund balance.
- $2.9 million in the Probation Department to increase staffing which will enable the department to open additional units and alleviate overpopulation in the detention facilities to comply with State mandated programs and regulations, based on $1.5 million in revenue from the Youthful Offender Block Grant and $1.4 million in fund balance.
- $2.8 million in the Land Use and Environment Group Executive Office for software licensing and implementation and source selection services for a Business Case Management System, funded by fund balance.

- $3.0 million for increased design and construction costs for the Edgemoor Skilled Nursing Facility, funded by fund balance.
- $2.2 million in the District Attorney's Office for the purchase of IT equipment to support the upgrade and enhancement of the department's network infrastructure, funded by fund balance.
- $2.0 million for completion of the environmental documentation and to begin the programming/design phase for the replacement of the Las Colinas Detention Facility, based on fund balance available in the Sheriff Capital Projects fund balance designation.

Actual revenues fell short of the final budgeted amounts by $45.2 million, while actual expenditures were less than the budgeted amount by $417.8 million. The combination of the revenue and expenditure shortfalls resulted in a revenue over expenditure operating variance of $372.6 million. Other financing sources and uses of funds resulted in a net sources versus uses variance from budget of $153.2 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 $525.8 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 budget over expenditure variances of $89.6 million and $43.5 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. It also includes aid payments for Severely Emotionally Disturbed, Foster Care, Aid to Adoptive Parents and KinGap in Child Welfare Services. 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 budget over expenditures variance across all functions in this category is $46.2 million of which $9.3 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 budgeted over expenditure variances that are rebudgeted in the new fiscal year. For example, in the Department of Planning and Land Use, re-budgets include: $1.1 million for consultant and acquisition costs related to the Fire Prevention Program to continue to supplement fire services and apparatus in the unincorporated area of the county; $0.5 million for the Dead, Dying and Diseased Tree removal program; $1.8 million for costs related to the General Plan Update and subsequent Zoning Ordinance revisions and $0.6 million for various projects related to the Multiple Species Conservation Program. The Department of Parks and Recreation has rebudgeted $0.6 million for various projects in local parks. The Sheriff has rebudgeted 5.5 million for various law enforcement grants, including $3.8 million for Homeland Security and $0.9 million in Department Of Justice grants for violent and gang related crime. The District Attorney has rebudgeted $3.0 million for the purchase and installation of IT network equipment to refresh and support current business requirements and the County Technology Office has rebudgeted $2.0 million, also for IT initiatives, including Server Consolidation and the Integrated Property Tax System.

Management and Contingeny Appropriations:

The County annually set up management and contingency appropriations 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 appropriations resulted in a budget over actual variance of $38.4 million. In addition, in Fiscal Year 2008, the County set aside $56.2 million for economic uncertainty with the intent that it not be spent unless unusual needs arose; of that amount, $49 million was unexpended at year end.

Capital Assets and Commitments

Capital Assets

At June 30, 2008, the County's capital assets for both governmental and business-type activities was $2.82 billion and $128 million, respectively, net of accumulated depreciation (See Note IV-D of the Notes to the Financial Statements for more detailed information). 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 2008 was as follows:

Governmental Activities:

- $50.1 million towards the construction of the Edgemoor Skilled Nursing Facility in Santee. Total project costs are estimated at $121.8 million.
- $41.6 million towards the construction and improvement of County maintained roads, bridges and other road related infrastructure. An additional $16.6 million in infrastructure was donated by developers.
- $12.4 million towards the construction of the Medical Examiner Building at the County Operation Center in Kearny Mesa. Total project costs are estimated at $85.4 million.
- $10.6 million for the acquisition of real property for the multi species conservation program.
- $6.2 million towards construction of improvements at the County Operations Center. Total project costs are estimated at $308.5 million.
- $4.4 million towards the construction of Lakeside Baseball Park. Total project costs are estimated at $10.6 million.
- $3.8 million towards the construction of flood control drainage channels.
- $3.2 million towards improvements at the Otay Valley Regional Park. Total project costs are estimated at $10 million.
- $2.1 million towards the construction of the Sheriff station in Alpine. Total projects costs are estimated at $6.5 million.
- $1.4 million towards the San Elijo Nature Center Expansion. Total project costs are estimated at $5.7 million.
- $8.6 million towards the construction of numerous other Capital Outlay Fund projects.

Business-type Activities:

- $6.0 million towards improvements at the Palomar Airport Terminal, parking lot and road. Total project costs are estimated at $18.2 million.
- $2.5 million towards improvements at the Gillespie Field Airport parking lot. Total project costs are estimated at $3.7 million.
- $1.1 million towards improvements at the Spring Valley Outfall Sewer.

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.

Capital Commitments:

As of June 30, 2008, capital commitments included the following:

- $70 million for the construction of the Medical Examiner building, Valley Center Road, Edgemoor Skilled Nursing Facility, Lakeside Sports Complex, San Elijo Nature Center, and the acquisition of 2,827 acres of real property.
- $15.7 million for the construction of improvements at Palomar Airport Terminal, Jamacha Boulevard Sewer Improvements and the Flow Monitoring Systems at Alpine, Lakeside, and Spring Valley Sanitation Districts.

Long-Term Liabilities

At June 30, 2008, for governmental activities, the County had outstanding long-term liabilities of $2.22 billion (See Note IV-I of the Notes to the Financial Statements for more detailed information). Of this amount, $330 million pertained to outstanding certificates of participation, and the remaining $1.89 billion pertained to the following obligations: $1.07 billion of taxable pension obligation bonds; $581 million of Tobacco Settlement Asset-Backed Bonds; $15 million of Redevelopment Agency bonds; $7 million for loans; $7 million of unamortized issuance premiums; $(20) million of unamortized issuance discounts; $(19) million of unamortized deferred amounts on refundings; $28 million for capital leases; $106 million for claims and judgments; $98 million for compensated absences; $22 million for landfill closure and postclosure costs; and $500 thousand for arbitrage.

Long-term liabilities for business-type activities totaled $2.65 million and consisted of $2.26 million for capital loans and $390 thousand for compensated absences.

During fiscal year 2008, the County's total principal amount of COPs, bonds, and loans for governmental activities decreased by $177.4 million, before giving effect to arbitrage, unamortized issuance premiums, unamortized issuance discounts and unamortized deferred amounts on refundings. The $177.4 million net decrease was due to the following:

Increases - $7.6 million

$7.6 million of principal was accreted (added) to the outstanding CAB principal balances outstanding.

Decreases - $185 million

Decreases to debt included $185 million in principal debt service payments.

The long-term liabilities for business-type activities decreased by $248 thousand due to $296 thousand debt service payments on capital loans, and a net increase of $48 thousand in compensated absences.

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

Table 3

Credit Ratings

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

There were no changes to the previous year's credit ratings issued by Moody's and Fitch, while the credit ratings issued by Standard and Poor's increased in each category as compared to the previous fiscal year. The prior year's Standard and Poor's ratings were as follows: AA Issuer rating; AA- Certificates of Participation rating; and, an AA Pension Obligation Bonds rating.

Economic Factors and Next Year's Budget and Rates

- The fiscal year 2008-09 (2009) General Fund budget utilizes as funding sources for one-time expenditures $214.7 million out of $571.4 million in unreserved undesignated fund balance and $0.2 million out of $375.9 million unreserved designated fund balance.
- The state of the economy plays a significant role in the cost of and demand for County services and the resources available to provide them. The fiscal year 2009 General Fund budget contains total appropriations of $3.679 billion. This is an increase of $158.6 million or 4.5% from the fiscal year 2008 General Fund budget. A number of risk factors continue to be tracked closely: the U.S. economy, the State of California's ability to operate within its 2009 budget and its projected budget imbalances for fiscal year 2010, 2011 and beyond; the slump in the housing sector; credit tightening; the weakening labor market; high energy and commodity prices; and a widening federal budget deficit.
- The U.S. economy's Gross Domestic Product (GDP) for 2007 showed an increase of 2.0% versus an adjusted growth rate of 2.8% in 2006. GDP growth for 2008 is projected to be weak, with projections ranging from 1.2% to 1.5%.
- The State of California's economy has deteriorated. In 2007, leading indicators have shown mixed results, payroll job growth dropped to 0.7%, real personal income growth came in at 2.7%, and adjusted taxable sales declined by 2.3%. California's economy in 2008 is expected to remain weak. Gross State Product (GSP) is projected to drop to 1.1%, the number of jobs is expected to improve marginally by 0.1%, taxable sales will continue to decline by 2.4%, and personal income is anticipated to grow by 1.5%.

- The San Diego economy continues to show positive growth (i.e., gross regional product at 6.1% for 2004, 3.3% in 2005, 3.6% in 2006, and 2.1% in 2007). Growth is forecasted to be 2.5% in 2008.
- A weakened real estate market affects the operations and program revenue of a number of County departments including the Assessor/Recorder/County Clerk in the area of document recordings. It challenges the Department of Planning and Land Use to balance construction activity fluctuations with fiscal and customer service stability. It impacts the Library's ability to maintain service hours and provide a collection that meets the needs of patrons. Other economic impacts can be seen in Parks and Recreation where a slowdown in land development delays the provision of park facilities slated to be funded from parkland dedication ordinance fees. A weakened real estate market also negatively affects general purpose revenue growth which is relied upon to sustain core local discretionary services and to provide new or expanded services in response to County residents' needs.
- The State's budget outlook continues to be strained by an ongoing structural imbalance between revenues and expenditures exacerbated by the housing slump and overall economic volatility.

The County's general purpose revenues continue to grow (with budgeted revenue anticipated to grow at 5.3%) but at a slower rate compared to recent trends of 6.2%. Specifically:

- The largest source of general purpose revenues is property taxes ($543.1 million budgeted in fiscal year 2009), representing 53.5% of the total. 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. In 2009, a more modest growth rate of 6.2% is based on the slowed demand for housing in the county as evidenced by the reduction in residential building permits, year over year decline in the median price of homes in the county, a significant increase in notices of default and foreclosures and slowing in total deeds recorded. 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 ($511.8 million) assumes a net assessed value growth of 6.0% 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 fell short of the assumed net assessed value growth coming in at 4.5%. The actual current secured property tax revenues in fiscal year 2009 will likely come in lower than budget. Overall, property tax growth is expected to be low over the next two years.
- Current supplemental property taxes ($15.0 million budgeted in Fiscal Year 2009) are derived from additions to the tax roll based on new construction and changes in ownership. The actual amount of these revenues in Fiscal Year 2008 was 32.7% less than budgeted ($14.0 million actual versus $20.8 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 2009 budgeted figures remaining well below the higher amounts realized in fiscal years 2005 and 2006.
- Current unsecured property taxes ($16.2 million budgeted in Fiscal Year 2009) 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 1.1% is budgeted for Fiscal Year 2009 over the Fiscal Year 2008 adopted budget.
- Property taxes in lieu of vehicle license fees (VLF) comprises 31.6% (an estimated $320.9 million) of budgeted general purpose revenues in fiscal year 2009. 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 2009 is

4.4757%, 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 2009 is budgeted at $17.7 million, which is 1.7% 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 is entitled to 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 ($24.8 million in fiscal year 2009) represents about 2.4% of budgeted general purpose 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 revenue has been growing moderately over the past few years in concert with population growth and new retail business formation in the unincorporated area. Currently, however, retail sales in the unincorporated area are following statewide flattening to marginally declining trends. The amount of budgeted revenue in 2009 is approximately $0.03 million (0.1%) above the 2008 budgeted revenue.
- Other revenues budgeted for fiscal year 2009 total $108.2 million. Various revenue sources make up this category including investment income on deposits, fines, fees and forfeitures, redevelopment agency tax increment, prior year adjustments on property taxes, franchise revenue, payment from the City of San Diego in lieu of booking fees, and other miscellaneous revenues. The decrease in revenues is primarily due to anticipated lower investment income on deposits as a result of a decline in interest rates that is partially offset by growth in redevelopment agency tax increment.

The County's Operational Plan for Fiscal Year 2009 and for Fiscal Year 2010 can be found on the internet at http://www.sdcounty.ca.gov/auditor/budinfo.html.

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.