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, 2014.

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 and deferred outflows of resources of the County exceeded liabilities and deferred inflows of resources at the close of the fiscal year 2014 by $4.59 billion (net position). Of this amount, $3.19 billion represents net investment in capital assets (capital assets net of related debt); $670 million is restricted for specific purposes (restricted net position); and the remaining portion represents unrestricted net position of $734 million.
- Total net position increased by $348.1 million. For governmental activities, current and other assets, capital assets, and deferred outflows of resources increased by $169.8 million, $151.6 million, and $4.9 million respectively; long-term liabilities decreased by $33.5 million, while other liabilities and deferred inflows of resources increased by $4.2 million and $9.3 million, respectively. For business-type activities, capital assets increased by $4.2 million, offset by a decrease in current and other assets of $3.9 million, while other liabilities and long-term liabilities decreased by $1.3 million and approximately $200 thousand, respectively.
- General revenues for governmental activities were $1.14 billion. Of this amount, property taxes and property taxes in lieu of vehicle license fees accounted for $942 million or 83%; while transient occupancy tax, real property transfer tax, miscellaneous taxes, sales and use taxes, investment earnings and other general revenues accounted for $198 million or 17%.
- Program revenues for governmental activities were $3.1 billion. Of this amount, $2.52 billion or 81% was attributable to operating grants and contributions while charges for services accounted for $510 million or 16%.
- Total expenses for governmental activities were $3.93 billion. Public assistance accounted for $1.42 billion or 36%, while public protection accounted for $1.31 billion or 33% of this amount. Additionally, health and sanitation accounted for $632 million or 16%.

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 Position* presents information on all County assets and deferred outflows of resources, offset by liabilities and deferred inflows of resources, with the difference reported as net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position 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).

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

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, jail stores commissary operations 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 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 Endowment 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 and individual fund information and other supplementary 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 airport operations, jail stores commissary operations, and sanitation services. These nonmajor enterprise funds are combined and aggregated. Individual fund data for each nonmajor enterprise fund is provided in the combining and individual fund information and other supplementary 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; and for the financing of information technology services. 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 and individual fund information and other supplementary 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 Endowment 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 supplementary 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 Position

June 30, 2014 and 2013
(In Thousands)

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
ASSETS						
Current and other assets	$ 3,451,265	3,281,461	80,628	84,566	3,531,893	3,366,027
Capital assets	3,364,716	3,213,097	172,677	168,476	3,537,393	3,381,573
Total assets	6,815,981	6,494,558	253,305	253,042	7,069,286	6,747,600
DEFERRED OUTFLOWS OF RESOURCES						
Total deferred outflows of resources	4,883				4,883	
LIABILITIES						
Long-term liabilities	1,990,919	2,024,442	1,204	1,470	1,992,123	2,025,912
Other liabilities	479,411	475,185	1,643	2,957	481,054	478,142
Total liabilities	2,470,330	2,499,627	2,847	4,427	2,473,177	2,504,054
DEFERRED INFLOWS OF RESOURCES						
Total deferred inflows of resources	9,343				9,343	
NET POSITION						
Net investment in capital assets	3,015,405	2,861,061	171,911	167,430	3,187,316	3,028,491
Restricted	669,832	619,855			669,832	619,855
Unrestricted	655,954	514,015	78,547	81,185	734,501	595,200
Total net position	$ 4,341,191	3,994,931	250,458	248,615	4,591,649	4,243,546

(Note that the 2013 columns have not been restated.)

Analysis of Net Position

Net position may serve over time as a useful indicator of a government's financial position. In the case of the County, assets and deferred outflows of resources of the County exceeded liabilities and deferred inflows of resources by $4.59 billion at the close of fiscal year 2014, an increase of $348.1 million or 8.2% over fiscal year 2013. This included an increase of approximately $189.3 million in the County's restricted and unrestricted net position (a 16% increase over fiscal year 2013) and an increase of $158.8 million in net investment in capital assets (a 5% increase over fiscal year 2013).

The aforementioned increase of $348.1 million in net position was composed of the following changes in total assets, deferred outflows of resources, liabilities and deferred inflows of resources:

- Total assets increased by $321.6 million. This included an increase of $165.8 million in current and other assets and a $155.8 million increase in capital assets. The net increase of $165.8 million in current and other assets was primarily attributable to an increase in cash and investments (including restricted and unrestricted cash and investments with fiscal agents) of $228.8 million, a decrease of $39.7 million in receivables, net (excluding property taxes), a $9.2 million decrease in property taxes receivables, net, a decrease in deferred charges of $11.6 million and a $2.5 million decrease in other assets. The $228.8 million net increase in cash is principally due to a $39.7 million decrease in receivables, net (excluding property taxes), a $9.2 million decrease in property taxes receivables, net, a $1.6 million decrease in lease receivable, a $13.1 million decrease in accounts payable, an $8 million increase in accrued payroll, an $8.7 million increase in unearned revenue, all of which have the net effect of increasing cash; coupled with increases to cash mainly attributable to $86 million in state aid for corrections from the State principally to reimburse the County for construction costs incurred for the Las Colinas Detention and Reentry Facility, $58.4 million in the sale of capital assets, principally consisting of the $57.2 million proceeds from the sale of the County Operations Center Annex, $43.6 million one-time payment from the Successor Agency of the City of

San Diego attributable to a due diligence review - all other funds obligation, offset by a $13.3 million increase of various cash outlays. The $39.7 million decrease in receivables, net is principally due to a decrease of $45.6 million in amounts due from other governments, coupled with a $1.3 million decrease in investment earnings receivable and a $9 million decrease in other accounts receivable, offset by a $16.2 million increase in loans receivable for affordable housing development loans. The $9.2 million decrease in property taxes receivables, net was principally attributable to a decrease in delinquent secured taxes. The $11.6 million decrease in deferred charges was the result of the fiscal year 2014 implementation of Governmental Accounting Standards Board Statement No. 65, "*Items Previously Reported as Assets and Liabilities*" which requires that such costs be expensed in the period incurred. The $155.8 million increase in capital assets was due in part to $98.5 million towards construction of the Las Colinas Detention and Reentry Facility in Santee; $28.9 million towards the construction of the County Administration Center Waterfront Park Development Project, $25.8 million for the acquisition of equipment, and $2.6 million in various other capital asset increases.

- Deferred outflows of resources (unamortized loss on refunding of long-term debt) increased by $4.9 million attributable to the fiscal year 2014 implementation of Governmental Accounting Standards Board Statement No. 65, "*Items Previously Reported as Assets and Liabilities*". This item was previously required to be reported as a portion of long-term liabilities.
- Total liabilities decreased by $30.9 million. This included a decrease in long-term liabilities of $33.8 million offset by an increase in other liabilities of $2.9 million. The decrease of $33.8 million in long-term liabilities was mainly due to a $54.8 million decrease in long-term debt (see Long-Term Liabilities discussion), offset by a net $21 million increase in other long-term liabilities (including a $28.1 million increase in claims and judgments, offset by a $4.5 million decrease in pollution remediation liabilities, and a $2.6 million decrease in other long-term liabilities). The increase in other liabilities of $2.9 million was primarily due to a $13.1 million decrease in accounts payable ($10.2 million decrease in vendors payable, coupled with a $2.9 million decrease in due to other government agencies and other payables), and a $700 thousand decrease in accrued interest, offset by an $8.7 million increase in unearned revenue coupled with an $8 million increase in accrued payroll.
- Deferred inflows of resources increased by $9.3 million attributable to the fiscal year 2014 implementation of Governmental Accounting Standards Board Statement No. 65, "*Items Previously Reported as Assets and Liabilities*". These deferred inflows of resources include $9.1 million in property taxes received in advance (previously required to be reported as unearned revenue), and $200 thousand in other deferred inflows of resources.

The largest portion of the County's net position (69%) reflects its investment of $3.19 billion in capital assets, net of related debt (which includes: land, easements, buildings and improvements, equipment, software and infrastructure; 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 position (restricted net position), equaled $670 million and 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 position includes $734 million in unrestricted net position.

Table 2

Changes in Net Position

For the years ended June 30, 2014 and 2013
(In Thousands)

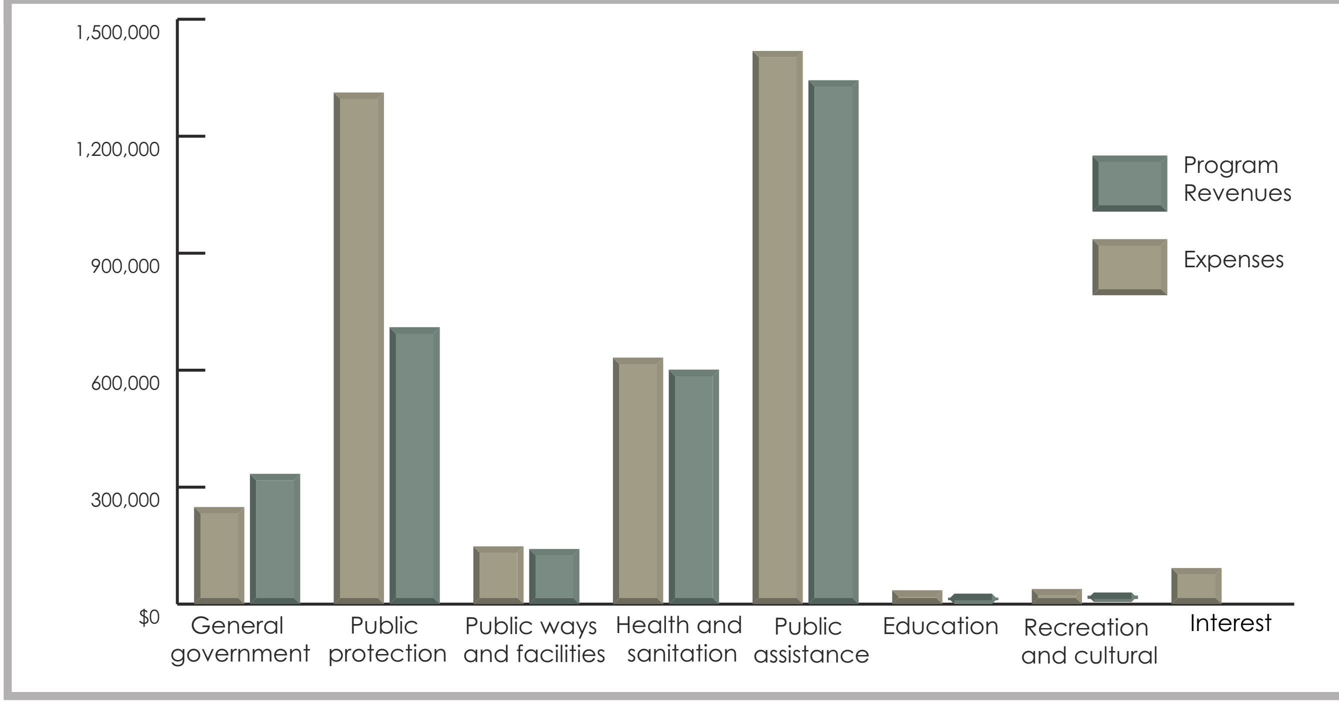
	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
Revenues:						
Program Revenues						
Charges for services	$ 510,452	496,775	43,343	36,202	553,795	532,977
Operating grants and contributions	2,519,619	2,467,966	3,793	4,933	2,523,412	2,472,899
Capital grants and contributions	114,310	32,728			114,310	32,728
General Revenues						
Property taxes	627,709	587,145			627,709	587,145
Other taxes		20,912				20,912
Transient occupancy tax	3,404				3,404	
Real property transfer tax	20,074				20,074	
Miscellaneous taxes	14				14	
Property taxes in lieu of vehicle license fees	313,844	303,646			313,844	303,646
Sales and use taxes	24,871	24,809			24,871	24,809
Investment earnings	16,635	3,504	502	46	17,137	3,550
Other	132,612	90,789	2,565	123	135,177	90,912
Total revenues	4,283,544	4,028,274	50,203	41,304	4,333,747	4,069,578
Expenses:						
Governmental Activities:						
General government	249,066	240,409			249,066	240,409
Public protection	1,312,074	1,236,708			1,312,074	1,236,708
Public ways and facilities	148,209	135,432			148,209	135,432
Health and sanitation	631,543	851,246			631,543	851,246
Public assistance	1,418,703	1,183,923			1,418,703	1,183,923
Education	35,647	34,104			35,647	34,104
Recreation and cultural	38,903	34,204			38,903	34,204
Interest	92,709	95,801			92,709	95,801
Business-type Activities:						
Airport			14,118	14,107	14,118	14,107
Jail stores commissary			4,816		4,816	
Sanitation district			28,291	22,936	28,291	22,936
Wastewater management				5,754		5,754
Total expenses	3,926,854	3,811,827	47,225	42,797	3,974,079	3,854,624
Changes in net position before transfers	356,690	216,447	2,978	(1,493)	359,668	214,954
Transfers	7,086	114	(7,086)	(114)		
Change in net position	363,776	216,561	(4,108)	(1,607)	359,668	214,954
Net position at beginning of year (restated)	3,977,415	3,778,370	254,566	250,222	4,231,981	4,028,592
Net position at end of year	$ 4,341,191	3,994,931	250,458	248,615	4,591,649	4,243,546

(Note that the 2013 columns have not been restated.)

Analysis of Changes in Net Position

At June 30, 2014, changes in net position before transfers equaled $359.7 million, a $144.7 million or 67% increase from the previous year. Principal revenue sources contributing to the change in net position were operating grants and contributions of $2.52 billion and taxes of $942 million (including: property taxes and property taxes in lieu of vehicle license fees.) These revenue categories accounted for 80% of total revenues. Principal expenses were in the following areas: public assistance, $1.42 billion; public protection, $1.31 billion; and health and sanitation, $632 million. These expense categories accounted for 85% of total expenses.

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



Governmental activities

At the end of fiscal year 2014, total revenues for the governmental activities were $4.28 billion, while total expenses were $3.93 billion. Governmental activities increased the County's net position by $363.8 million, while the business-type activities' change in net position equaled $(4.1 million).

Expenses:

Total expenses for governmental activities were $3.93 billion, an increase of $115 million or 3% ($118 million increase in functional expenses and $3 million decrease in interest expense). Public protection (34%), and public assistance (37%) were the largest functional expenses, followed by health and sanitation (16%).

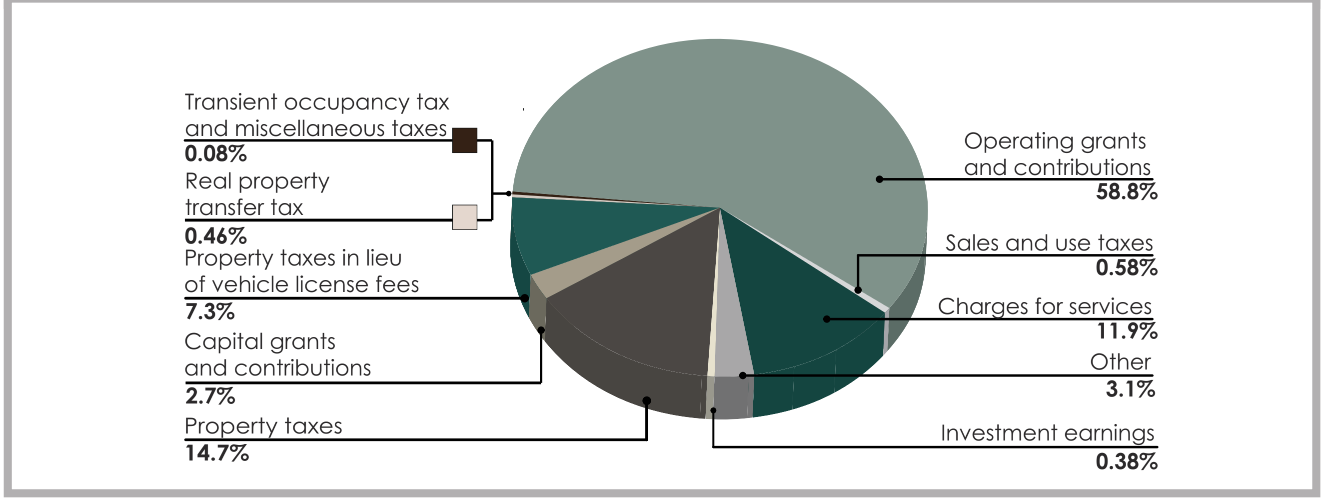
The $118 million net increase in functional expenses consisted of the following:

- $114 million increase in overall salaries and benefit costs principally due to approximately $58 million in overall increases in salaries and wages, of which approximately $49 million is attributed to one-time and ongoing negotiated labor agreements and position changes and $9 million in increased overtime incurred in various departments; while retirement costs increased $40 million, coupled with a $10 million increase in flexible benefits and $6 million increase in workers compensation;
- $12 million net decrease in contracted services including: a $59 million decrease in the Low Income Health Program (LIHP) due to the conclusion of the program in December 2013, offset by increases in various other contracted services, including: $9 million attributable to caseload and wage increases for the In-Home Supportive Services providers, $6 million in Support and Care of Persons contracts, $5 million due to California Healthcare Eligibility, Enrollment and Retention System (CalHEERS) costs to provide access to health care coverage under the federal Affordable Care Act (ACA), $5 million in Cedar-Kettner 2012 Development Project contract costs, $4 million in Flood Control contracted road services, $4 million due to

increased contract spending in the Supplemental Nutrition Assistance Program Education (SNAP-Ed) project, Community Transformation Grant, San Diego Beacon and Black Infant Health programs, $3 million in AFDC - unemployment parent contract costs, $3 million in polygraph services contract for high risk offenders and residential re-entry for other offenders, $2 million in inactive waste site management contracts, $2 million in Planning and Development Services advance planning contracts, $2 million Probation adult field services contract costs, $1 million in Sheriff law enforcement support contracts, and, $1 million in temporary contract help contracts;

- $7 million increase in depreciation and amortization;
- $4 million increase in equipment rentals;
- $2 million increase in utility costs;
- $1 million increase in maintenance costs;
- $1 million increase in medicines, drugs and pharmaceuticals; and,
- $1 million increase in printing and postage costs.

Chart 2
Revenues By Source - Governmental Activities
(As a Percent)



Revenues:

Total revenues for governmental activities were $4.28 billion, an increase of 6.3% or $255 million from the previous year. This increase consisted of an increase in program revenue of $147 million and an increase in general revenues of $108 million as follows:

The $147 million increase in program revenue was chiefly due to increases of $182.6 million and decreases of $35.6 million noted below:

Increases in program revenues of $182.6 million were principally composed of the following:

- $86 million in state aid for corrections from the State principally to reimburse the County for construction costs incurred for the Las Colinas Detention and Reentry Facility;
- $43.6 million one-time payment from the Successor Agency of the City of San Diego attributable to a due diligence review - all other funds obligation;
- $20 million in Assembly Bill (AB)109 public safety realignment revenues;
- $17 million in CalWORKs assistance revenues due to AB 85 Redirection of 1991 State Health Realignment;
- $15 million in Proposition 172 revenues; and,
- $1 million in emergency medical services penalty assessment revenues.

Decreases in program revenue of $35.6 million were principally attributable to:

- $22 million in behavioral and mental health State revenues primarily due to lower eligible expenses and one-time prior year audit and accrual adjustments;
- $3 million in behavioral and mental health federal revenues primarily due to one-time prior year audit and accrual adjustments offset (mitigated) by higher eligible expenses;
- $2.6 million in federal aid mental health Medi-Cal care;
- $2 million in federal American Recovery and Reinvestment Act;
- $2 million in the State revenue allocation of the county's share of the statewide juvenile population and juvenile felony dispositions;
- $2 million in federal HUD Section 8 choice vouchers revenue; and,
- $2 million in public health emergency preparedness revenues.

General revenues increased overall by approximately $108 million. This increase was the result of increases of approximately $112 million and decreases of $4 million noted below.

Increases in general revenues of approximately $112 million were mainly due to the following:

- $44 million gain on sale of disposal of capital assets;
- $23 million in current secured property taxes attributable to the countywide growth in assessed valuation;
- $13 million in investment earnings principally attributed to earnings on the Tobacco Securitization Joint Special Revenue Fund investments;
- $11 million in current secured unitary – qualified electric attributable to the Sunrise Power Link which became operational in fiscal year 2014;
- $10.2 million in property taxes in lieu of vehicle license fees;
- $4.3 million in supplemental property tax collections, attributable to the sale, construction, or ownership transfers of property;
- $2 million in real property transfer taxes;
- $1.5 million in third party recovery revenues;
- $1 million in transient occupancy taxes;
- $1 million in flexible benefit plan forfeitures; and,
- $1 million in Section 8 fraud recovery.

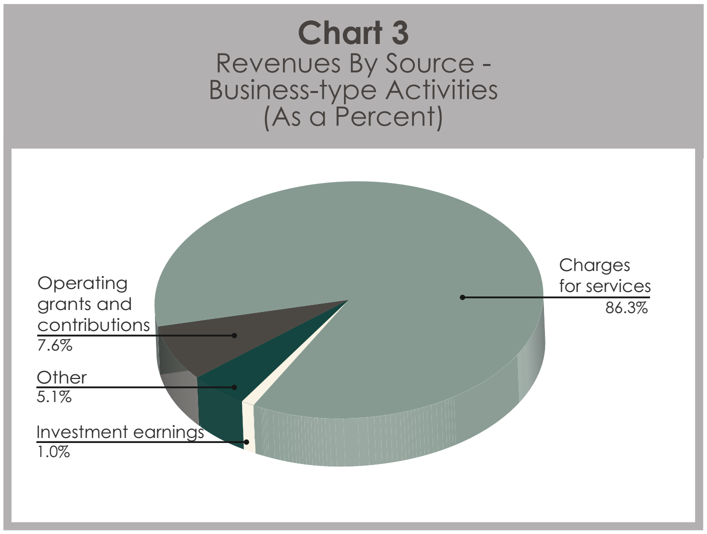
Decreases in general revenues of $4 million were primarily due to the following:

- $3 million in delinquent Teeter property taxes; and,
- $1 million in unsecured property taxes.

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 $2.52 billion accounted for 58.8%, 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 equaled $942 million and accounted for 22% of governmental activities. Additionally, charges for services were $510 million and accounted for 11.9% of revenues applicable to governmental activities.

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



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 $43.3 million or 86.3% of total revenues, while operating grants and contributions ($3.8 million) represent 7.6% of total revenues and other revenues ($2.6 million) represent 5.1% of total revenues.

Net position of business-type activities increased by $1.8 million (.7%). This net increase primarily included the following:

- $5.9 million increase as a result of the reclassification of the Jail Stores Commissary Fund to the Enterprise Funds from the Internal Service Funds;
- $5.6 million of charges for services earned in the Jail Stores Commissary Fund during fiscal year 2014;
- $4.7 million decrease in internal balances primarily as a result of a $4.6 million increase in operating transfers out mainly due to a transfer from the Jail Stores Commissary Fund to the Inmate Welfare Special Revenue Fund;
- $2.3 million of contracted services incurred in the Jail Stores Commissary Fund during fiscal year 2014;
- $2.3 million of cost of materials incurred in the Jail Stores Commissary Fund during fiscal year 2014;
- $1.5 million increase in charges for services for the Airport Fund;
- $1.1 million decrease in Airport Fund operating grants;
- $550 thousand increase in Sanitation District Fund repairs and maintenance;
- $300 thousand increase in salaries and benefits ($223 thousand for the Airport Fund and $77 thousand for the Sanitation District Fund); and,
- $50 thousand decrease in contracted services for the Airport Fund.

Financial Analysis of 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, unassigned 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 Endowment Special Revenue Fund. Nonmajor governmental funds include special revenue funds, debt service funds, and capital projects funds.

At June 30, 2014, the County's governmental funds had combined ending fund balances of $2.59 billion, an increase of $137 million in comparison to the prior fiscal year. Of the total June 30, 2014 amount, $713.05 million constituted unassigned fund balance, which is available for spending at the County's discretion. $217.6 million of fund balance is assigned, $887.5 million is committed, $756.1 million is restricted, and $17.1

million is nonspendable. (Please refer to Note 1 in the notes to the financial statements for more details regarding fund balance classifications.)

Governmental revenues overall totaled $4.18 billion representing a 5.2% increase. Governmental expenditures totaled $4.10 billion, a 5.1% increase from the fiscal year ended June 30, 2013.

General Fund:

The General Fund is the chief operating fund of the County. At the end of fiscal year 2014, its unassigned fund balance was $713 million, while total fund balance was $1.73 billion, an increase of $130.3 million from fiscal year 2013.

This $130.3 million increase in fund balance was composed of $270.9 million in increases and $140.6 million in decreases as follows:

Increases to fund balance of $270.9 million were composed of:

- $58.2 million in the sale of capital assets, principally consisting of the $57.2 million in proceeds from the sale of the County Operations Center Annex;
- $56 million in administration revenues primarily due to implementation of the Affordable Care Act (ACA) and passage of Assembly Bill (AB) 12, the California Fostering Connections to Success Act;
- $43.6 million one-time payment from the Successor Agency of the City of San Diego attributable to a due diligence review - all other funds obligation;
- $20 million in AB 109 public safety realignment revenues;
- $18 million net decrease in contracted services including: a $59 million decrease in the Low Income Health Program (LIHP) due to the conclusion of the program in December 2013, offset by increases in various other contracted services, including: $9 million attributable to caseload and wage increases for the In-Home Supportive Services providers, $6 million in Support and Care of Persons contracts, $5 million due to California Healthcare Eligibility, Enrollment and Retention System (CalHEERS) costs to provide access to health care coverage under the federal Affordable Care Act (ACA), $5 million in Cedar-Kettner 2012 Development Project contract costs, $4 million due to increased contract spending in the Supplemental Nutrition Assistance Program Education (SNAP-Ed) project, Community Transformation Grant, San Diego Beacon and Black Infant Health programs, $3 million in AFDC - unemployment parent contract costs, $3 million in polygraph services contract for high risk offenders and residential re-entry for other offenders, $2 million in Planning and Development Services advance planning contracts, $2 million Probation adult field services contract costs, $1 million in Sheriff law enforcement support contracts, and, $1 million in temporary contract help contracts;
- $17 million in CalWORKs assistance revenues due to Assembly Bill (AB) 85 Redirection of 1991 State Health Realignment;
- $17 million in current secured property taxes attributable to the county-wide growth in assessed valuation;
- $11 million in current secured unitary – qualified electric attributable to the Sunrise Power Link which became operational in fiscal year 2014;
- $10.2 million in property taxes in lieu of vehicle license fees;
- $9.1 million increase in Proposition 172 ½% sales tax revenue transferred in from the Public Safety Special Revenue Fund to be used for public safety activities;
- $4.3 million in supplemental property tax collections, attributable to the sale, construction, or ownership transfers of property;
- $2 million in real property transfer taxes;
- $1.5 million in construction permits;
- $1 million in transient occupancy taxes;
- $1 million in hazardous material base fees; and,

- $1 million in emergency medical services penalty assessment revenues.

Decreases to fund balance of $140.6 million were composed of:

- $120 million increase in salaries and benefit costs;
- $5 million increase in equipment rental expenditures;
- $3 million in Behavioral and Mental Health revenues primarily due to one-time prior year audit and accrual adjustments offset by higher eligible expenditures;
- $3 million increase in repairs and maintenance expenditures;
- $2.6 million in federal aid mental health Medi-Cal care;
- $2 million in federal American Recovery and Reinvestment Act;
- $2 million in the State revenue allocation of the county's share of the statewide juvenile population and juvenile felony dispositions;
- $1 million increase in safety clothing and uniform allowance expenditures;
- $1 million in medicines, drugs and pharmaceuticals; and,
- $1 million in printing and postage costs.

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 Section 30052, a "maintenance of effort" (pre-Proposition (Prop) 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, 2014, the total (restricted) fund balance in the Public Safety Special Revenue Fund was $66.2 million, a $10.8 million increase from the previous fiscal year. This increase was mainly due to a $10.3 million increase in Prop 172 revenues due to improvements in the local economy in fiscal year 2014.

Tobacco Endowment 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 the Corporation resulting from the issuance of the San Diego County Tobacco Asset Securitization Corporation refunding bonds in fiscal year 2006. At the end of fiscal year 2014, fund balance was $325 million, a decrease of $22 million from fiscal year 2013, principally due to investment income of $2.3 million offset by $24.2 million in transfers out to the General Fund for the support of health related program expenditures.

Other Governmental Funds:

Other governmental funds consist of nonmajor funds, which include special revenue funds, debt service funds, and capital projects funds. Individual fund data for each of these nonmajor governmental funds is provided in the combining and individual fund information and other supplementary information section in this report.

As of the end of fiscal year 2014, the fund balances of the other governmental funds totaled $468 million, a net increase of $18 million from the prior year. This $18 million net increase consisted of $45 million in increases, offset by decreases of $27 million as follows:

$45 million increase to Other Governmental Funds' fund balance:

- $17 million increase in the Road Special Revenue Fund's fund balance as a result of the receipt of $20 million in the highway user tax revenue; offset by a $1 million decrease in Federal aid for construction, a $1 million decrease in Federal Housing and Urban

Development community development block grants, and a $1 million decrease in Indian Gaming Special Distribution Fund grants;

- $10 million increase in the Tobacco Securitization Joint Special Revenue Fund's fund balance primarily resulting from an $11 million increase in revenue from the sale of an investment contract;
- $5 million increase in the Inmate Welfare Program Special Revenue Fund's fund balance chiefly due to an increase in profits transferred to this fund from the Jail Store Commissary Enterprise Fund;
- $4 million increase in the Inactive Wastesites Special Revenue Fund's fund balance due to a $1 million increase in State aid from reimbursable costs received from a 50% matching grant for the Fallbrook Mitigation Project coupled with a one-time $9 million transfer from the General Fund for the operation and maintenance of inactive waste sites and burn sites, offset by $6 million in San Marcos landfill postclosure project expenditures;
- $3 million increase in the County Library Special Revenue Fund's fund balance resulting from a $1 million increase in post dissolution redevelopment revenue from Successor Agencies including residual payments, one-time payments, assets sales and pass-through payments, coupled with a $2 million increase in transfers from the General Fund for library enhancements and additional monies for the Neighborhood Reinvestment Program for Bonita Library and the new Imperial Beach Library;
- $2 million increase in the Air Pollution Special Revenue Fund's fund balance resulting from a $9 million decrease in revenue related to State reimbursements for the Air Quality GMERP Heavy Duty Trucks Program (Proposition 1B) offset by a $10 million decrease in expenditures related to the Air Quality GMERP Heavy Duty Trucks Program (Proposition 1B), coupled with a $1 million increase in revenue from Air Pollution fine and penalty payments;
- $2 million increase in the County Service District Special Revenue Funds' fund balance resulting from a $2 million decrease in operating transfers out to the General Fund for expenditures incurred for the 4S Ranch Artificial Turf and Sweetwater Lane Turf projects;
- $1 million increase in the Housing Authority - Other Special Revenue Fund's fund balance resulting from the incurrence of $1 million in contracted services expenditures for maintenance, utilities and management fees, coupled with a $2 million decrease in Federal Aid for Section 8 Housing Choice Vouchers, offset by a $4 million decrease in Housing assistance payment expenditures due to suspension of the leasing process of new tenants; and,
- $1 million increase in the Parkland Dedication Special Revenue Fund's fund balance mainly due to an increase in park land dedication fees.

$27 million decrease to Other Governmental Funds' fund balance:

- $18 million decrease in the San Diego County Capital Asset Leasing Corporation Capital Projects Fund's fund balance resulting from the incurrence of $13 million in capital outlay expenditures for the construction of the County Administration Center Waterfront Park Development Project and $5 million in capital outlay expenditures for the 2012 Cedar and Kettner Development Project;
- $5 million decrease to the Edgemoor Development Special Revenue Fund's fund balance principally attributable to the decrease in the sale of capital assets; and,
- $4 million decrease in the Flood Control Special Revenue Fund's fund balance resulting from a $4 million increase in capital outlay chiefly due to construction costs incurred for the Pepper Wing project which began in fiscal year 2014.

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.

Internal Service Funds:

Net positions of the internal services funds (ISF) totaled $83.7 million, a net decrease of $19.6 million from the prior year. This $19.6 million net decrease was partially the result of the reclassification of the Jail Stores Commissary Fund ($5.9 million) to the Enterprise Funds. The remaining decrease of $13.7 million consisted of $5.5 million of increases, offset by decreases of $19.2 million as follows:

$5.5 million increases to internal service funds' net positions were comprised of:

- $2.3 million increase in the Fleet Services Fund chiefly due to an increase of $900 thousand in operating revenues, a $500 thousand increase in capital contributions, a $700 thousand decrease in fuel costs and a $200 thousand decrease in depreciation;
- $1.4 million increase in the Road and Communication Equipment Fund primarily due to approximately $1 million in transfers in from other nonmajor funds coupled with a gain on the disposal of assets of $400 thousand;
- $1.3 million increase in the Purchasing Fund consisting of a $1.5 million decrease in other operating expenses offset by a $200 thousand increase in contracted services; and,
- $500 thousand increase in the Facilities Management Fund primarily due to a $2.6 million increase in charges for services, a decrease of $800 thousand in grants and an increase of $1.3 million in repairs and maintenance.

$19.2 million of decreases to internal service funds' net positions were comprised of:

- $13 million decrease in Employee Benefits Fund's net position principally due to an $8 million increase in cash principally attributed to an increase in charges for services along with an increase in total claims and judgments liability for reported and unreported workers' compensation claims of $21 million as calculated by an actuary for the reporting period ending June 30, 2014;
- $6 million decrease in the Public Liability Insurance Fund primarily due to a $6 million increase claims liability as prepared by an actuary for the fiscal year ending June 30, 2014; and,
- $200 thousand decrease in the Information Technology Fund primarily due to a $7.0 million increase in charges for services, offset by a $7.2 million increase in professional and special contracted services.

Fiduciary Funds

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

Pooled Investments - Investment Trust Funds:

These funds were established for the purpose of reporting pooled investments. The Pooled Investments - Investment Trust Funds' net position totaled $4.41 billion, an increase of $370 million, from the previous year. This increase was substantially due to contributions to investments of $8.23 billion coupled with investment earnings of $20 million, offset by distributions from investments of $7.88 billion.

Private Purpose Trust Fund:

The private purpose trust fund reports the assets, liabilities, and activities of the County of San Diego Successor Agency formed pursuant to

California Assembly Bill x1 26 on February 1, 2012 upon dissolution of the San Diego County Redevelopment Agency (SDCRA). The County of San Diego Successor Agency Private Purpose Trust Fund's net position had a deficit balance of approximately $14.8 million at June 30, 2014, an increase of $200 thousand. This increase was mainly due to $1.8 million of property taxes - Successor Agency Redevelopment Property Tax Trust Fund distribution; offset by contributions to other agencies and interest charges of approximately $1.3 million, coupled with a $300 thousand decrease in deferred charges. This decrease in deferred charges was the result of the fiscal year 2014 implementation of Governmental Accounting Standards Board Statement 65, "Items Previously Reported as Assets and Liabilities" which requires that such costs be expensed in the period incurred.

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, 2014, net expenditure appropriations increased by $72.3 million and appropriations for transfers-out increased by $7.0 million for a net increase of $79.3 million.

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

- Increases in all Groups resulting from negotiated one-time salary and benefit payments.
- $10.5 million appropriation increase in the Health and Human Services Agency for the implementation of the Patient Protection and Affordable Care Act (ACA).
- $5.3 million appropriation increase in the Registrar of Voters for special elections funded by the City of San Diego and City of Solana Beach.
- $3.8 million increase in the Sheriff's Department for implementation of the Operation Stonegarden grant.
- $2.0 million increase in Capital Outlay for the CAC Waterfront Park Development Project.

Actual revenues fell short of the final budgeted amounts by $78.8 million, while actual expenditures were less than the budgeted amount by $454.6 million. The combination of the revenue and expenditure shortfalls resulted in a revenue/expenditure operating variance of $375.8 million. Other financing sources and uses of funds resulted in a net sources versus uses variance from budget of $272.6 million. These combined amounts resulted in a variance in the net change in fund balance of $648.4 million.

Highlights of actual expenditures compared to final budgeted amounts are as follows:

Salaries and Benefits:

The final budget over expenditure variance across all functions in this category was $54.8 million. A significant portion of these savings were in the Public Safety Group and the Health and Human Services Agency but also in the Land Use and Environment Group, Community Services Group and Finance and General Government Group from lower than budgeted salaries and employee benefit costs due to staff turnover and department management of vacancies.

Health and Human Services Agency Programs:

Funded by a combination of State, federal, and County revenues, most Health and Human Services Agency programs are carried out in the functional areas of health and sanitation and public assistance, with final budget over expenditure variances of $67.4 million and $110.2 million, respectively. Overall, these expenditure variances primarily resulted from a lower demand for services than budgeted levels in the following areas:

- Un-awarded Mental Health Services Act contracts and other unspent service contracts;
- Lower than estimated growth in In-Home Supportive Services Individual Provider costs and in the Community Based Care Transitions Program; and,
- Lower than anticipated caseload levels, growth trends and service utilization.

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. Examples of rebudgets include a positive expenditure variance of approximately $1.85 million for Purchase of Agriculture Conservation Easements (PACE) and $1.46 million associated with the General Plan Amendment for Property Specific Requests.

Management and Contingency Appropriations:

The County annually sets 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 Management and Contingency Reserve appropriations resulted in budget over actual variances of $29.4 million and $15.0 million, respectively. Note that the Management Reserves are included within various functional activities.

Capital Assets and Commitments

Capital Assets

At June 30, 2014, the County's capital assets for both governmental and business-type activities were $3.36 billion and $173 million, respectively, net of accumulated depreciation/amortization. Investment in capital assets includes land, construction in progress, buildings and improvements, infrastructure (including roads, bridges, flood channels, and traffic signals), equipment, software and easements. Significant increases to capital assets in fiscal year 2014 included:

Governmental Activities:

- $98.5 million towards construction of the Las Colinas Detention and Reentry Facility in Santee. Total project costs are estimated at $303.6 million.
- $30.1 million towards the construction of the East Mesa Detention Facility. Total project costs are estimated at $38.8 million.
- $28.9 million towards construction of the County Administration Center Waterfront Park. Total project costs are estimated at $49.4 million.
- $27.5 million towards the construction and improvement of County maintained roads, bridges and other road related infrastructure.
- $25.8 million towards acquisition of equipment.
- $20.2 million towards the construction of the Registrar of Voters Building. Total project costs are estimated at $74.1 million.
- $18 million in infrastructure donated by developers.
- $10.5 million towards development of various software applications.
- $8.1 million towards various land acquisitions.
- $8.1 million towards improvements of various capital projects.
- $7 million towards the construction of the County Operations Center Phase 1B. Total project costs are estimated at $113 million.
- $5.2 million towards the construction of the Rancho San Diego Sheriff Station. Total project costs are estimated at $15.4 million.
- $5 million towards construction of the parking garage at Cedar and Kettner. Total project costs are estimated at $36.1 million.
- $3.1 million in donated structures.
- $2.6 million towards construction of the Pine Valley Sheriff's Substation. Total project costs

are estimated at $3.7 million.

Business-type Activities:

- $2.4 million towards improvements at the Jamacha pump station.
- $2.1 million towards improvements of sewer pipelines.
- $1.9 million towards improvements at Borrego Airport runway.
- $1.4 million towards construction of an access road at Gillespie Field Airport.

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

Capital Commitments

As of June 30, 2014, capital commitments included the following:

Governmental Activities:

- $166 million for the construction of: Women's Detention Facility, parking garage at Cedar & Kettner, East Mesa Detention Facility, Registrar of Voters Building, Boulevard Fire Station, San Vicente Road, Regional Communications System, Conventional Radio System, development of the Integrated Property Tax System and development of Re-entry Case Management System.

Business-type Activities:

- $2.8 million for improvements at various Airports and Sanitation District sewers.

(Please refer to Note 7 in the notes to the financial statements for more details concerning capital assets and capital commitments.)

Long-Term Liabilities

Governmental Activities:

At June 30, 2014, the County's governmental activities had outstanding long-term liabilities of $1.99 billion.

Of this amount, approximately $1.69 billion pertained to long-term debt outstanding. Principal debt issuances included: $732 million in taxable pension obligation bonds; $564 million in Tobacco Settlement Asset-Backed Bonds; $384 million in certificates of participation (COPs) and lease revenue bonds (LRBs); and, $5 million in loans.

Other long-term liabilities included: $185 million in claims and judgments; $98 million in compensated absences; $19 million for landfill postclosure costs; $4 million in pollution remediation; and, $119 thousand in capital leases.

During fiscal year 2014, the County's total principal amount of COPs and lease revenue bonds, other bonds, and loans for governmental activities decreased by $54.510 million.

The $54.510 million decrease was due to the following increases and decreases:

Increases to debt were $12.892 million and included:

- $5.257 million of principal was accreted (added) to the outstanding Tobacco Settlement Asset-Backed Bonds' Capital Appreciation Bonds principal;
- $1.575 million of principal was accreted (added) to the outstanding Taxable Pension Obligation Bonds' principal balances outstanding;
- $4.828 million due to the effects of unamortized issuance premiums, unamortized issuance discounts, and the reclassification of the unamortized deferred amounts on refundings to deferred outflows of resources (unamortized loss on refunding of long-term debt) attributable to the fiscal year 2014 implementation of Governmental Accounting Standards Board Statement No. 65, "*Items Previously Reported as Assets and Liabilities*"; and,
- $1.232 million of San Diego Gas and Electric On-bill Financing loans.

Decreases to debt were due to $67.402 million in debt service payments.

Business-type Activities:

Long-term liabilities for business-type activities totaled $1.204 million and consisted of $766 thousand for capital loans and $438 thousand for compensated absences.

Long-term liabilities for business-type activities decreased by $266 thousand. This was due to a combination of $280 thousand in debt service payments on capital loans and a net increase of $14 thousand in compensated absences.

(Please refer to Notes 14 through 16 in the notes to the financial statements for more details concerning long-term debt; changes in long-term liabilities; and funds used to liquidate liabilities.)

Credit Ratings

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	Aa1	AAA	AAA
Certificates of Participation San Diego County Capital Asset Leasing Corporation (SANCAL)	Aa3	AA+	AA+
Certificates of Participation San Diego Regional Building Authority (SDRBA) Metropolitan Transit System Towers	Aa3	AA+	AA+
Lease Revenue Bonds SDRBA County Operations Center 1A	Aa3	AA+	AA+
Refunding Lease Revenue Bonds SDRBA San Miguel	A2	AA+	not rated
Pension Obligation Bonds	Aa3	AA+	AA+
Tobacco Settlement Assets-Backed Bonds - Series 2006A1 (Senior)	Ba3	BBB	not rated
Tobacco Settlement Asset-Backed Bonds - Series 2006A2 (Senior)	B2	BB+	not rated
Tobacco Settlement Asset-Backed Bonds - Series 2006A3 (Senior)	B2	B+	not rated
Tobacco Settlement Asset-Backed Bonds - Series 2006B (First Subordinate)	not rated	CCC+	not rated
Tobacco Settlement Asset-Backed Bonds - Series 2006C (Second Subordinate)	not rated	CCC	not rated
Tobacco Settlement Asset-Backed Bonds - Series 2006D (Third Subordinate)	not rated	CCC	not rated
San Diego County Redevelopment Agency Bonds	not rated	not rated	not rated

The County's ratings, assigned by three of the major rating agencies, Moody's Investors Service (Moody's), Standard and Poor's Ratings Services (Standard & Poor's), and Fitch Ratings (Fitch), remained the same through Fiscal Year 2014.

Effective August, 2014, the County of San Diego's Issuer Rating was upgraded to a triple A from Aa1 by Moody's, which also then performed the attendant upgrade on the County's individual financings from Aa3 to Aa2. The County now holds triple A Issuer Ratings from Moody's, Standard & Poor's, and Fitch. All three rating agencies noted the County's strong financial management, which effects a very strong fiscal position, and large and diverse tax base, which bolsters the County's strong economy.

Economic Factors and Next Year's Budget and Rates

- The fiscal year 2015 General Fund adopted budget utilizes as funding sources for one-time expenditures $168.1 million out of $713.045 million in unassigned fund balance and $1.4 million out of $492.175 million committed fund balance.
- The fiscal year 2015 General Fund adopted budget contains total appropriations of $3.86 billion. This is an increase of $10.6 million or 0.3% from the fiscal year 2014 General Fund adopted budget. Although there are indicators that the economy is recovering from the great recession, a number of risk factors continue to be tracked closely: employment growth, continued recovery in the housing market, and the effect of the Affordable Care Act implementation.
- The U.S. economy's revised Gross Domestic Product (GDP) for 2013 increased by 1.9% compared to 2.8% increase for 2012. The Federal Open Market Committee met on July 29 - 30, 2014 and according to the minutes of the meeting, real GDP projection would expand at a faster pace in the second half of the year and over the next two years than 2013. The contributing factors to the acceleration include: further anticipated waning of the restraint on spending growth from fiscal policy changes; continued improvement in credit availability; increases in consumer and business confidence; and, a pickup in foreign economic growth. Staff viewed the second quarter rebound in GDP and the ongoing improvement in labor market conditions as supporting their expectations for continued moderate expansion of the economy. According to Moody's Analytics, economic recovery has kicked into higher gear mainly due to the wind-down of fiscal austerity as situations are improving especially among state and local governments. Private companies are growing, as evidenced by additional jobs. Jobs are being added fast enough to eliminate slack in the labor market, estimated at 1.5% to 2.0%, by late 2016. (Source: Moody's Analytics: U.S. Macro Outlook: Back in Stride, August 5, 2014). However, the June 2014 UCLA Anderson Forecast indicated that these are not signs of recovery but rather they are normal growth. UCLA forecasted real GDP to grow 3.6% in the second quarter with a 3% economy that gets a little healthier in 2016. They project that unemployment would continue to trend downward to 5.4% in 2016.
- California's economy continues to recover from the impact of the recession. California is on a more solid footing and is back on track to reclaim its status as the Golden State according to The Kyser Center for Economic Research. The recovery is accelerating in just about every part of the State. Despite the recovery being slow, more people are finding jobs, there is improvement in housing and the State budget situation is improving. In 2013, California had regained about 70% of jobs lost during the recession. The steep decline of the California economy during the recession was worsened by the fiscal challenges that began well before the downturn. Although the recovery continues to be very slow, the unemployment rate is falling, more people are finding jobs, the housing market is improving and for the first time in years, budget surpluses are in sight. (Source: Los Angeles County Economic Development Corporation, The Kyser Center for Economic Research: 2014-2015 Economic Forecast and Industry Outlook, February 2014). The State unemployment rate continued to improve and fell modestly from

10.5% in 2012 to 8.9% in calendar year 2013. (Source: California Employment Development Department, News Release, August 15, 2014). In 2009, real personal income declined 3.7%, but since that time real personal income grew by 1.5% in 2010 and is forecasted to grow by 1.3% in 2013. Taxable sales are estimated to grow by 3.7% in 2013 and by 2.7% in 2014. The June 2014 UCLA Anderson Forecast anticipates total employment growth (payroll, farm and self-employed) of 1.8%; and 2.4% and 2.1% for 2015 and 2016 respectively. Non-farm payroll employment will grow similarly, at 2.1%, 2.3% and 2.1% for the three forecast years. Real personal income growth is forecast to be 3.1% in 2014. Unemployment will decline through 2014, averaging approximately 7.7% for this year. In 2015 the unemployment rate is expected to drop to 6.8% on average, a percent higher than the U.S. forecast, and then to 5.9% in 2016.

- San Diego's economic outlook continues to be moderately positive. The region's economic stability is based on federal spending, innovation clusters, tourism and real estate. Government operations account for 18% of the region's GDP. Since the end of the Cold War, the military's presence has diminished but remains an important driver of the region's economy. San Diego is a thriving hub for the technology-oriented industries and an important manufacturing center as well as a popular travel destination. The quality of life attracts a well-educated, talented workforce and well-off retirees which contribute to a positive outlook in consumer spending. An indicator of economic health is county taxable sales. Taxable sales began to decline overall in the county in 2007 through 2009 and improved in 2010 and 2011. 2012 has shown continued improvement although not as great as 2011. Moderate growth in taxable sales is expected to continue in 2013 and 2014 in the region. San Diego's median household income has remained relatively flat in recent years, after declines in 2009 through 2010 due to high unemployment and constrained consumer spending. There was a slight increase in 2011 then a slight decrease in 2012. Median household income for 2013 is estimated to be 0.6% lower than 2012.
- The state of the economy plays a significant role in the County's ability to fund and provide many of the services that county residents have come to expect. The real estate market which impacts the County's general purpose revenue (GPR) is expected to show moderate improvement in June 2013 compared to June 2012. GPR is relied upon to fund local discretionary services, as well as to fund the County's share of costs for services that are provided in partnership with the State and federal government.

As discussed below, the County's GPR is projected to increase by 5.7% (with budgeted revenue of $1.03 billion in fiscal year 2015 compared to $978.0 million budgeted in fiscal year 2014).

- The largest source of general purpose revenue is property taxes ($563.6 million budgeted in fiscal year 2015), representing 54.5% of the total. In 2015, property taxes are expected to increase by $40.0 million, or 7.6%, from 2014. The budgeted property tax revenue factors in the current commercial and residential real estate conditions as evidenced by the improving level of building permits; improving median price of homes; the relatively low level of foreclosures; and, the improvement in total deeds recorded. Current property tax revenue consists of four components: current secured property taxes, current supplemental property taxes, current unsecured property taxes and current unsecured supplemental property taxes.
- The budgeted amount of current secured property tax revenue ($543.9 million) assumes a net local assessed secured property value increase of 4.0% from the actual local assessed secured property value figure for 2014, and makes certain assumptions regarding the County's share of countywide property tax revenues, the delinquency rate, and the amount of tax roll corrections and

refunds on prior year assessments. In fiscal year 2016, the projected amount of revenues from current secured property taxes assumes a 3.0% increase in local assessed secured property values.

- Current supplemental property tax revenue ($2.5 million budgeted in fiscal year 2015) is derived from net increases to the tax roll from either new construction or changes in ownership that occur subsequent to the January 1 lien date and are, therefore, more difficult to predict. The slowdown in new construction and the decline in real estate prices have been acutely felt in supplemental property tax revenues. In many change of ownership transactions, instead of a property owner being billed for an additional amount of property tax because the value of the property after the transaction is higher than the value as of the lien date, the property owner receives a refund because the value is lower than it was on the lien date. In fiscal year 2006, supplemental refunds countywide totaled $4.0 million. They began increasing in fiscal year 2007 to $6.2 million until it reached $38.3 million in fiscal year 2009. In fiscal year 2010, supplemental refunds decreased to $21.6 million then to $15.3 million in fiscal year 2011. In fiscal year 2012, they increased to $18.3 million and went back down to $13.9 million in fiscal year 2013. They are anticipated to continue to decline gradually over time as residential and commercial assessed values improve.
- Current unsecured property tax revenue ($17.1 million budgeted in fiscal year 2015), increased slightly from fiscal year 2013. Based on trends and most up-to-date information, projection is relatively flat for the next two fiscal years.
- Current unsecured supplemental property tax revenue ($0.1 million budgeted in fiscal year 2015) remains unchanged from fiscal year 2014. It is derived from supplemental bills that are transferred to the unsecured roll when a change of ownership occurs and a tax payment is due from the prior owner. Or, there may be a subsequent change in ownership following the initial change in ownership which occurs prior to the mailing of the initial supplemental tax bill. Historically, this revenue category has not been budgeted because the actual amount of revenue received has been low.
- Property tax in lieu of vehicle license fees (VLF) comprises 31.6% (an estimated $326.3 million) of budgeted general purpose revenue in fiscal year 2015. This revenue source was established by the State in fiscal year 2005 to replace the previous distribution of vehicle license fees to local governments. The annual change in this revenue source is based on the growth or decline in the net taxable unsecured and local secured assessed value. A 4% increase is projected in the combined taxable unsecured and local secured assessed value in fiscal year 2015 which is $19.8 million higher than budgeted for fiscal year 2014.
- Teeter revenue represents 1.8% (an estimated $19.1 million) of budgeted general purpose revenue. In fiscal year 1994, the County adopted the alternative method of secured property tax apportionment available under Chapter 3, Part 8, Division 1, of the Revenue and Taxation Code of the State of California (also known as the "Teeter Plan"). Under this plan, the County advances funds to participating entities to cover the unpaid (delinquent) taxes (the "Teetered Taxes"). The County's General Fund benefits from this plan by being entitled to future collections of penalties and interest that are also due once the delinquent taxes are paid. A legal requirement of the Teeter Plan requires the County to maintain a tax loss reserve fund to cover losses that may occur if delinquent taxes are not paid and the property goes into default and is sold for less than the outstanding taxes and assessments. Throughout the year, all interest and penalties collected on Teetered secured and supplemental property taxes are first deposited into the Teeter Tax Loss Reserve Fund. Any excess amounts above 25% of the

total delinquent secured taxes and assessments may be transferred to the General Fund. For fiscal year 2015, collections from previous years' receivables are budgeted to decrease by $2.8 million based on the size of the outstanding annual receivables, anticipated collection trends and market conditions. In fiscal year 2015, excess amounts from the Teeter Tax Loss Reserve Fund are budgeted to decrease from $15.1 million in the fiscal year 2014 budget to $13.1 million due to the size of the outstanding annual receivables and market conditions. Excess amounts from the Teeter Tax Loss Reserve Fund are projected at $13.1 million in fiscal year 2016.

- Sales and use tax revenue and in lieu local sales and use tax ($24.4 million in fiscal year 2015) represents about 2.4% of budgeted general purpose revenue. These revenues are derived from taxable sales by retailers who sell or rent tangible personal property in unincorporated areas of the county or from use taxes from consumers who purchase tangible personal property from out of state. Use taxes are also imposed on the storage, use, lease or other consumption of tangible personal property at any time a sales tax has not been paid by the retailer. The growth in this funding source is generally impacted by population growth, new retail business formation and consumer spending trends. The in lieu local sales and use tax revenue replaces regular sales and use tax revenue with monies transferred from the Educational Revenue Augmentation Fund (ERAF) under the provisions of AB7 X1, one of the 2004 State budget bills. This legislation 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 redirected local sales and use tax revenues are replaced on a dollar-for-dollar basis with countywide property tax revenues shifted back from the ERAF. This funding mechanism is known as the "triple flip."
- Sales and Use Tax revenue in the county had been growing moderately through fiscal year 2008 in concert with population growth and new retail business formation in the unincorporated areas of the county. The recent recession, housing market declines and unemployment trends negatively impacted taxable sales at the Statewide, Southern California and San Diego regional levels. Sales and Use Tax revenue began to improve in calendar years 2010 and 2011 and increased very slightly in 2012. Fiscal year 2014 Sales and Use Tax revenue is projected to decrease by $0.2 million or 1.1% compared to budget and $0.5 million or 2.8% compared to fiscal year 2013 actuals. For fiscal year 2015, the amount is budgeted to increase by $0.5 million or 2.1% above the fiscal year 2014 Adopted Operational Plan. Sales and Use Tax revenue growth in fiscal year 2016 is anticipated to be $0.7 million or 3.0% over fiscal year 2015.
- Intergovernmental revenue ($40.9 million budgeted in fiscal year 2015) is approximately 4.0% of the total GPR in fiscal year 2015 and represents funding the County receives from various intergovernmental sources including Redevelopment Successor Agencies, the City of San Diego (pursuant to a Memorandum Of Understanding related to the County's Central Jail), the federal government (Payments in Lieu of Taxes (PILT) for tax-exempt federal lands administered by the Bureau of Land Management, the National Park Service, and the U.S. Fish and Wildlife Service), and the State of California (reimbursement to the County for the Homeowner's Property Tax Relief (HOPTR) program). The largest portion of this funding is from redevelopment successor agencies. Redevelopment agencies were dissolved by the California legislature in ABx1 26 on June 28, 2011. The California Supreme Court upheld the constitutionality of the dissolution on December 29, 2011. The Court extended the date of dissolution to February 1, 2012. Based on Section 34183 of the Health and Safety Code, the county auditor-

controller shall remit from the Redevelopment Property Tax Trust Fund to each local agency and school entity an amount of property tax revenues in an amount equal to that which would have been received under Section 33401, 33492.14, 33607, 33607.6, 33607.7 or 33676. Residual funds not allocated for specific purposes will be distributed to local taxing agencies under Section 34183 of the Health and Safety Code. The County General Fund and Library Fund, as affected taxing entities, receive a share of this tax distribution but this has not been included in the projection for fiscal year 2014. For fiscal year 2015, the amount budgeted in intergovernmental revenue is $0.3 million or 0.7% lower than what was projected for fiscal year 2014.

The County's Operational Plan for fiscal years 2015 and 2016 can be found on the internet: 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.