EXECUTIVE SUMMARY

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: February 27, 2015 **IBA Report Number:** 15-05

City Council Docket Date: March 2, 2015

Item Number: S400

FY 2015 Mid-Year Budget Monitoring

This report provides clarification or additional information for items outlined in the FY 2015 Mid-Year Budget Monitoring Report (Mid-Year Report), as well as an analysis of the Mayor's recommended Appropriation Adjustments. We have also included status updates on any changes to policy issues and programmatic budgetary items that we reviewed in IBA Report 14-46: IBA First Quarter Update on Policy Issues and Programmatic Budgetary Items. Detailed information regarding the recommendations presented below is included in the full report.

The Mid-Year Report reflects projected increased revenues of $14.2 million offset by increased projected expenditures of $9.3 million, for a net positive impact of $4.9 million over the FY 2015 Adopted Budget. This relatively small variance in revenues is due to a projected increase in major General Fund revenues, specifically: franchise fees, transient occupancy tax (TOT), and sales tax, that were offset by additional expenditures in General Fund departments, including increases to personnel expenditures in public safety departments. The Mid-Year Report's approximately $4.9 million budgetary surplus projection is an increase over the FY 2015 First Quarter Budget Monitoring Report's (First Quarter Report's) projected negative year-end budget variance of approximately $146,000.

SUMMARY OF IBA RECOMMENDATIONS

Our office believes that projections included in the Report are appropriate, although continued close monitoring is required on sales tax and property transfer tax, as well as personnel expenditures in public safety departments. Based upon projected year-end operating results, we support the requested Appropriation Adjustments with some additional recommendations as detailed below:

1. Requested Budget Adjustments – We support appropriating $12.7 million in increased revenues and expenditures above FY 2015 Adopted Budget levels.
2. Utilization of Mid-Year Budgetary Surplus – We support appropriating $3.9 million of the projected $4.9 million in the General Fund budgetary surplus to pre-fund the FY 2016 Public Liability and Long-Term Disability reserves. This use of the budgetary surplus will retain $11.3 million or 1% as excess equity above the City Reserve Policy minimum General Fund reserve level of 14%.

3. Mid-Year Ordinance – We recommend the Council revisit the language of the Mid-Year Ordinance to clarify that the City Council has the authority to approve or amend the full amount of surplus funding when the Mayor's mid-year funding recommendation is less than $5.0 million as interpreted by the City Attorney's Office. As written, the Ordinance contains conflicting clauses with respect to the Council's authority. Our office will work with the City Attorney's Office and the CFO to propose amended language for the Mid-Year Ordinance to clarify City Council authority.

THE CITY OF SAN DIEGO

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FY 2015 Mid-Year Budget Monitoring

OVERVIEW

The FY 2015 Mid-Year Budget Monitoring Report (Mid-Year Report) was issued on February 20, 2015, and presented to the Budget and Government Efficiency Committee on February 25, 2015. The Mid-Year Report describes the current status of revenues and expenditures and their year-end projections based on actual (unaudited) data from July 2014 through December 2014.

The Mid-Year Report reflects projected increased revenues of $14.2 million offset by increased projected expenditures of $9.3 million, for a net positive impact of $4.9 million over the FY 2015 Adopted Budget. This relatively small variance in revenues is due to a projected increase in major General Fund revenues, specifically: franchise fees, transient occupancy tax (TOT), and sales tax, that were offset by additional expenditures in General Fund departments, including increases to personnel expenditures in public safety departments. The Mid-Year Report's approximately $4.9 million budgetary surplus projection is an increase over the FY 2015 First Quarter Budget Monitoring Report's (First Quarter Report's) projected negative year-end budget variance of approximately $146,000.

The Mid-Year Report provides a thorough review of General Fund year-end projections for both revenue and expenditures and provides useful details about major revenues, departmental operations, and other programmatic items. The purpose of our report is to provide clarification or additional information for items outlined in the Mid-Year Report, as well as an analysis of the Mayor's recommended Appropriation Adjustments. We have also included status updates on any changes to policy issues and programmatic budgetary items that we had reviewed in IBA Report 14-46: IBA First Quarter Update on Policy Issues and Programmatic Budgetary Items. The items that were listed in that report included policy issues that members of the City Council identified during the FY 2015 budget process as ongoing priorities to monitor.

When it was originally issued on February 20, 2015, the Mid-Year Report requested City Council to approve the following items:

1. Appropriation of $12.7 million in increased revenues above FY 2015 Adopted Budget levels to provide necessary funding for unanticipated Fire-Rescue, Police, Public Utilities, and Office of Homeland Security expenditures.
2. Utilization of $3.9 million of the projected $4.9 million budgetary surplus to pre-fund the Public Liability and Long-Term Disability Reserves contributions.
3. Maintaining 1% of operating revenues or $11.3 million as excess equity[1] above the City Reserve Policy minimum General Fund reserve level of 14% to account for potential variations in projections.
4. Authorization for the Chief Financial Officer (CFO) to transfer available budget out of technically completed CIP projects to either fund balance or another CIP project or annual allocation of the same asset type.

Our office has specific recommendations related to the Mayor's requests 1 through 3 above, which are discussed at the end of this report, while item 4 has since been removed from the staff report. When the Mid-Year Report was presented to the Budget and Government Efficiency Committee on February 25, 2015, the Committee voted to move the report to Council without request 4 above, which would authorize the CFO to transfer available budget out of technically completed CIP projects. This request for authority will be brought forward to the Infrastructure Committee on March 11, 2015 as part of a larger discussion on Engineering & Capital Projects streamlining efforts, CIP capacity, and CIP cash management processes. It will also be heard at the Budget and Government Efficiency Committee on March 18, 2015 as part of a discussion on excess TransNet funds. Our office will provide a review of this requested authority, as well as other CIP cash management processes that are presented at that time, ahead of the proposed authority's inclusion in the FY 2016 Appropriations Ordinance.

FISCAL/POLICY DISCUSSION

General Fund Revenues

General Fund projected revenues have increased from both the FY 2015 Adopted Budget and First Quarter Report. Total General Fund revenue is projected to exceed the FY 2015 Adopted Budget by approximately $14.2 million, or 1.2%, and the First Quarter Report by $11.8 million, or 1.0%. As noted in the Mid-Year Report, this increase in projected year-end revenues is primarily due to an approximate $10.7 million increase in major General Fund revenues. Year-end projections for franchise fee revenue, the 5.5 cent portion of the TOT, sales tax, and property tax increased by a combined $10.8 million from the FY 2015 Adopted Budget. This was partially offset by a decline in the year-end property transfer tax revenue projection.

Projected departmental revenues have also increased overall, including the following significant increases:

[1] In the City's Reserve Policy, excess equity is defined as unrestricted fund balance, not otherwise assigned to General fund Reserves, and is available for appropriation. The current figure of $11.3 million is an estimate only; unrestricted fund balance is not determined until the City closes its books on June 30. The Mayor may propose one-time uses for Excess Equity in the May Revision that Council may accept, amend, or reject. The transfer of such funds would not occur until the fiscal year close is completed and fund balance is available above the 14% General Fund reserves.

- $3.0 million increase in Fire-Rescue Department revenues from the Adopted Budget, and a $1.5 million increase from the First Quarter Report, due to increases in strike team deployment reimbursements, increased permit fees, and Service Authority for Freeway Emergencies revenue.
- $1.3 million increase in Police Department revenues.

Increases in major General Fund revenues as well as significant increases in projected department revenues are part of the Mid-Year General Fund Appropriations Adjustment request to support projected over-budget expenditures.

Major General Fund Revenues

Our office has reviewed the year-end projections for property tax, sales tax, transient occupancy tax, and franchise fees included in the Mid-Year Report. The information included in the Mid-Year Report for these revenue sources provides excellent details about the increases in revenue projections as a result of San Diego Gas & Electric rate increases (franchise fees) and increases in consumer (sales tax) and tourism spending (transient occupancy tax) above budgeted levels. The following table outlines changes in projected year-end revenue for major revenues from the FY 2015 Adopted Budget and the First Quarter Report as compared to projections included in the Mid-Year Report.

FY 2015 Projected Year-End Revenue (in millions)					
	Adopted Budget	**First Quarter Projection**	**Mid-Year Projection**	**Variance: Adopted Budget to Mid-Year**	**Variance: First Quarter to Mid-Year**
Property Tax	$ 445.4	$ 443.7	$ 446.6	$ 1.2	$ 2.9
Property Transfer Tax	$ 9.2	$ 8.7	$ 8.1	$ (1.1)	$ (0.6)
Sales Tax	$ 257.1	$ 259.1	$ 259.1	$ 2.0	$ -
Transient Occupancy Tax	$ 92.3	$ 94.2	$ 94.5	$ 2.2	$ 0.3
Major Franchise Fees	$ 70.7	$ 71.1	$ 76.1	$ 5.4	$ 5.0
Other Major Revenue	$ 62.2	$ 63.3	$ 63.2	$ 1.0	$ (0.1)
Total:	**$ 936.9**	**$ 940.1**	**$ 947.6**	**$ 10.7**	**$ 7.5**

We believe the projections included in the Mid-Year Report are appropriate based on revenue distributions to date and current economic information, although we highlight some factors in the discussion of projected revenues in sales tax and property transfer tax below as meriting additional scrutiny and discussion. Due to the potential for variance in these factors, revenue receipts at year-end may be lower than currently projected, and could reduce the current projected surplus.

Property and Property Transfer Tax

Property Tax. The First Quarter Report projected an approximately $1.8 million decrease in property tax revenue. The Mid-Year Report has revised that projection to $1.2 million over property tax revenue included in the FY 2015 Adopted Budget, mainly due to a residual distribution from the Redevelopment Property Tax Trust Fund (RPTTF) and an increase in Motor Vehicle License Fee (MVLF) backfill payment. These modest increases do not warrant a change in the property tax growth rate, which remains at the Adopted Budget rate of 5.1%.

Property Transfer Tax. The Mid-Year Report projects property transfer tax to be approximately $8.1 million at year-end, a decrease of $1.1 million from the FY 2015 Adopted Budget, and a $654,000 decrease from the First Quarter Report. The City receives $0.55 per $1,000 of the sale price of residential and commercial real estate through the property transfer tax collected by the County. While median homes prices in San Diego County have increased, the number of homes sales has decreased and actual receipts for the first half of the fiscal year have come in under budget. The FY 2015 property transfer tax growth rate has been reduced from 11% to zero for the remainder of the fiscal year as a result of these lower than anticipated receipts, resulting in the reduced year-end projection. Actual revenue should continue to be closely monitored throughout the remainder of the fiscal year, and projections adjusted accordingly if necessary.

Sales Tax

The Mid-Year Report projects FY 2015 Sales Tax receipts to total approximately $259.1 million, $2.0 million over what was included in the FY 2015 Adopted Budget. This projection remains unchanged from projections included in the First Quarter Report. Data from HdL Companies, the City's sales-tax consultant, and other economic studies from Beacon Economics and UCLA Anderson School of Management show continued growth in consumer spending throughout the region. However, significant decreases in regional gasoline prices may result in a decrease in sales tax collected on fuel sales in the City, and could negatively impact total sales tax receipts in the City. Actual receipts should be closely monitored throughout the remainder of the fiscal year, and projections adjusted accordingly if necessary.

Transient Occupancy Tax

TOT revenues are projected to end the year approximately $2.2 million over budget in the Mid-Year Report, which is a modest increase of $260,000 from the First Quarter Report. The Mid-Year Report notes that this variance is due to increases in occupancy and room rates, as well as additional overnight visitors to San Diego during calendar year 2014.

Franchise Fees

Franchise fee projections included in the Mid-Year Report are projected to total approximately $76.1 million in FY 2015, $5.0 million over projections included in the First Quarter Report. This increase is largely attributable to a $4.5 million increase in franchise fees paid by SDG&E resulting from increased energy rates and consumption. SDG&E franchise fees account for 64.0% of General Fund franchise fee revenue, and are difficult to precisely forecast due to the City's inability to review SDG&E's financial forecasts for electricity and natural gas rates and sales volume.

Other Major Revenue

Other Major Revenues include non-department specific General Fund revenues such as interest earnings, refuse collector business tax, and General Governmental Services Billing (GGSB). The Mid-Year Report projects a $1.0 million increase over the FY 2015 Adopted Budget in these revenues due to disaster recovery reimbursements from previous fiscal years.

Departmental Revenues

Fire-Rescue Reimbursements for Strike Team Deployments

The Fire-Rescue Department is projected to receive unbudgeted revenue of approximately $1.0 million due to reimbursements from the California Office of Emergency Services for prior-year strike team deployments. This was noted in the First Quarter Budget Monitoring Report, which also indicated that the department was projected at that time to exceed budgeted overtime expenditures by $1.0 million due to current-year strike team deployments. Since the First Quarter, the department's over-budget overtime projection has increased to $3.7 million as discussed later in this report.

While many factors influence the department's usage of overtime, strike team deployments have been a consistent contributor to overtime needs. As strike teams are deployed during a given fiscal year, the Fire-Rescue Department incurs overtime expenditures as a result of the related backfill of positions. The department generally receives reimbursement for these costs in the following fiscal year. However, neither the expenditure nor the revenue associated with strike teams is included in the department's budget. Rather than account for unbudgeted strike team revenue and expenditures during the Mid-Year Budget Monitoring process, Financial Management could consider including these amounts in the annual budget development process.

Office of the City Treasurer

The Office of the City Treasurer projects that at the end of the fiscal year, the Department's revenue will exceed the budget by approximately $719,000 or 3.9%. One of the contributing factors to this revenue increase relates to the collection of delinquent parking citations. While this program with the Department of Motor Vehicles (DMV) is not new, collection referral fees are now being forwarded to the Department in addition to the delinquent fees, which have been collected in the past. Also contributing to the projected revenue increase is $140,000 in reimbursements for services performed for the transient occupancy tax (TOT) and Tourism Marketing District (TMD). These reimbursements are in part related to the City Treasurer's efforts to bring more short-term rental property owners into compliance.

General Fund Expenditures

Consistent with the First Quarter Report, the over-budget General Fund expenditures projected at Mid-Year are primarily related to over-budget salaries, wages and fringe expenditures, which are partially offset with under-budget non personnel expenditures. A breakdown of variances between the FY 2015 Current Budget and year-end projections is included in the table below.

General Fund Mid-Year Expenditures ($ in millions)								
	Adopted Budget		Current Budget		Mid-Year Projection		Variance	
Personnel Expenditures								
Salaries & Wages	$	493.4	$	496.6	$	504.9	$	8.3
Fringe Benefits		339.9		339.9		344.3		4.4
Sub-Total	$	833.3	$	836.5	$	849.2		12.7
Non Personnel Expenditures								
Contracts	$	173.7	$	175.0	$	172.9	$	(2.1)
Energy & Utilities		40.5		40.5		39.9		(0.5)
Information Technology		25.9		27.2		27.0		(0.2)
Supplies		27.0		25.0		26.7		1.7
Other		102.0		98.3		96.0		(2.3)
Sub-Total	$	369.1	$	365.9	$	362.5		(3.4)
TOTAL GENERAL FUND	$	1,202.4	$	1,202.4	$	1,211.7	$	9.3

Note that the numbers in the table above may not total due to rounding

General Fund year-end expenditures projected in the Mid-Year Report exceed the FY 2015 "Current Budget"[2] by approximately $9.3 million. This $9.3 million in over-budget expenditures has increased from the $2.5 million that was projected in the First Quarter Report. The $6.8 million difference is primarily attributable to personnel expenditures.

Comparing the Current Budget to the Mid-Year projection, total personnel expenditures are over-budget by $12.7 million, up from $6.2 million in the First Quarter Report. The $6.5 million increase in over-budget personnel expenditures since the First Quarter report includes a $5.0 million increase for Police Department overtime, as well as a $2.8 million increase for Fire-Rescue Department overtime.

Specific variances in the $12.7 million over-budget personnel expenditures (comparing the Current Budget to the Mid-Year projections) include the following:

- $3.7 million overage in Fire-Rescue Department overtime, including $1.0 million related to strike team deployments, as well as $1.2 million in over-budget special pay expenditures.
- $5.4 million in excess Police Department vacancy savings (above budgeted vacancy savings of $8.3 million). These excess vacancy savings are more than offset by $6.4 million in over-budget overtime. Note that when comparing the mid-year projection to the Adopted Budget, the excess vacancy savings is $7.7 million and the over-budget overtime is $8.7 million.
- $2.0 million overage in termination pay, largely due to increases in the Police and Fire-Rescue Departments.
- $1.8 million overage in pay-in-lieu of annual leave spread over various departments, most notably $386,000 for the City Attorney's Office.

[2]Although the Mid-Year Report "Current Budget" figures match the FY 2015 Adopted Budget figures in total, adjustments have been made among departmental budgets and expenditure categories. Unlike our review of the First Quarter Report, our review of the Mid-Year Report does not consider differences between the Adopted Budget and year-end projections. Major differences between the Adopted Budget and the Current Budget are described in IBA Report Number 14-45, "FY 2015 First Quarter Budget Monitoring."

- $4.0 million and $2.6 million increases in fringe for the Fire-Rescue and Police Departments, respectively. These increases are partially offset by decreases in other departments for an overall General Fund fringe increase of $4.4 million. This net $4.4 million increase is primarily due to increased Workers' Compensation (WC) and Long-Term Disability (LTD) costs, as well as the reallocation of fixed fringe costs based on updated citywide staffing configurations. The increases in WC and LTD costs are largely related to updated reserve target amounts since the FY 2015 Budget was adopted. Additional information on reserve target amounts is included in the Risk Management Reserves section of our review of the Five-Year Outlook (IBA Report 14-47REV) as well as in the section on General Fund Reserves below.

The decrease in total non personnel expenditures from the Current Budget to the Mid-Year projection is $3.4 million. Specific variances include the following:

- $2.5 million decrease in debt service due to the delay in issuing the first tranche of the pending DC3 infrastructure bonds.
- $1.7 million decrease in elections costs.
- $1.2 million decrease in transfers out due to the decline in Mission Bay lease revenues to be transferred to the Park Improvements Funds.
- The decreases above are offset with increases in other expenditures, most notably $1.6 million in Police Department expenditures related to the upgrade and maintenance of the 9-1-1 call manager system (see Departmental Expenditures section for additional information).

Other notable budget variances can be found in the Mid-Year Report produced by the Financial Management Department. Additional expenditure information is included in the Departmental Expenditures section of this report.

Departmental Vacancies

Fiscal Impact. As part of the normal budget cycle, positions that become vacant during the year are anticipated to generate vacancy savings. Vacancy savings have been estimated in the budget for normal turnover, including leaves of absence and incidence of newly hired employees that fill vacancies at lower salaries than budgeted.

However, currently projected salary savings are approximately $8.8 million in excess of the amount in the Current Budget, $5.4 million of which is related to the Police Department. Note that when comparing the mid-year projection to the Adopted Budget, excess vacancy savings increase from $8.8 million to $11.1 million (and from $5.4 million to $7.7 million for the Police Department).

Savings garnered through a higher level of vacancies is more than offset by other personnel expenditures, including termination pay, pay-in-lieu of annual leave, and overtime. Overtime projected for FY 2015 exceeds the Adopted Budget by approximately $13.7 million ($8.7 million for the Police Department); termination pay and pay-in-lieu of annual leave is projected to be $3.8 million over budget.

Although termination pay and pay-in-lieu of annual leave are difficult expenditure types to forecast, these areas should continue to be monitored and be right-sized as much as possible as should all salary accounts, including budgeting for a more realistic hire date. For example, it should be carefully considered whether it is reasonable to anticipate that new positions added to a budget will be filled for the full fiscal year. If not, the budget should reflect only partial year funding, as appropriate.

Vacancy Report Summary. The Mid-Year Report indicates that as of January 5, 2015 there were approximately 470.7 full time equivalent (FTE) vacancies related to the General Fund. Vacancies are constantly changing, and the January listing is one snapshot in time. The number of General Fund vacancies has decreased by 76.6 FTE between the October snapshot of 547.3 FTE (included in the First Quarter Report) and the January 5 snapshot.

Vacancy issues for the departments with the largest overages compared to budgeted vacancies (the Police and Transportation and Storm Water departments) were highlighted in the Mid-Year Report and are discussed in the Departmental Expenditures section below. Unfortunately, our office was unable to obtain a complete listing of vacancies by department to review in time for the release of this report.

Departmental Expenditures – General Fund

Civic San Diego

The Mid-Year Budget Monitoring Report notes that Civic San Diego's (Civic's) General Fund expenditures are expected to be approximately $910,000 under budget, which represents an increase in projected expenditures in FY 2015 of $730,000 over what was included in the First Quarter Budget Monitoring Report. The First Quarter Report had projected that Civic expenditures would be below the adopted budget by $1.8 million, but relied on extrapolating full-year costs based on two-months of expenditures and bills. The updated $910,000 under budget figure is based on updated and more complete information from Civic.

Civic's under-budget expenditure projections are partly due to an abnormally large amount of turnover earlier this fiscal year. As spending on Civic projects is ultimately dependent upon Department of Finance approval of proposed projects, which is outside of the City's control, it is difficult to accurately project future expenditures and it may be appropriate to adjust Civic's budget with updated information in the Year-End Budget Monitoring Report. Financial Management staff has indicated that it is continuing to review Civic's General Fund budget, and will make revisions as necessary in their Year-End Report.

We also note that Civic's budget includes expenditures to support the development of a public/private investment fund of $50-100.0 million for investment in transit-oriented development in the City's low-income, underserved neighborhoods such as Encanto. The request for proposal (RFP) for an investment advisor was released late last year; submissions were accepted from November 21, 2014 through January 12, 2015. Civic staff plans on interviewing the respondents and making a recommendation in mid-March.

Communications Department

The restructure of the Communications Department has progressed since the Department's original mid-year budget submittal in mid January. In the FY 2015 Adopted Budget, 20.00 FTE communications-related positions were budgeted for transfer into the Communications Department. However, these positions were not transferred from their original departments due to a delay in the required meet-and-confer process. The Communications Director was hired in November 2014, and an agreement with the San Diego Municipal Employees Association (MEA) was executed on February 12, 2015. The communications-related positions listed in this agreement are no longer reporting to their original departments and have transferred to the Communications Department. Given that the personnel expenditures projected for the remainder of the year in the Mid-Year Budget Monitoring Report did not include the transition of these positions to the Communications Department, we believe that year-end personnel expenditures could be higher than projected in the Communications Department, with a corresponding decrease in projected personnel expenditures in the original departments.

Department of Information Technology (IT)

The Department of IT projects that it will be under budget by approximately $200,000 at year-end due to minor fluctuations in activities. The FY 2015 Budget included $500,000 ($255,000 from the General Fund) to establish an email archiving system consistent with the City's retention policy. Based on a new option that was not available at the time of budget development, the Department of IT will be able to extend the use of its current system as a solution for the email archive. The Department of IT is consolidating the City and SDPD license into a single citywide license and is projecting approximately $100,000 in savings from the original estimate, pending a final quote from the service provider.

Additionally, mid-year actions in FY 2014 included using $258,000 in General Fund budget surplus to update the City's website. The project was expected to begin in FY 2014 and conclude in FY 2015. Vendor interviews and solicitations were completed in November 2014 and vendor quotes for the services were due on December 5th, 2014. A contract with Elevator Agency was executed on January 30, 2015 for the website's style guide and pattern library components, which will support website maintenance, and coding and design consistency. A vendor was selected for the community engagement component with a contract anticipated to be signed by the end of February 2015. The vendor selection process is underway for the updated website's Content Management System, with a projected June 25, 2015 completion date.

Fire-Rescue Department

Fire-Rescue Overtime. The Fire-Rescue Department is projected to exceed budgeted overtime expenditures by approximately $3.7 million, which represents a $2.8 million increase from the projection previously included in the First Quarter Budget Monitoring Report. The department has indicated that the overage is due primarily to overtime related to constant staffing, as well as strike team deployments.

It is important to note that Fire-Rescue is exceeding its overtime budget despite an increase of approximately $3.0 million in budgeted overtime expenditures between the FY 2014 and FY

2015 Adopted Budgets. The addition of two fire academies in the FY 2015 Adopted Budget, for a total of three academies in the fiscal year, was intended to increase department staffing levels and should have reduced the need for overtime. The significant increase in overtime expenditures warrants further review as the department prepares its FY 2016 budget request.

Overtime will be required for the operation of the new Skyline Temporary Fire Station, which is anticipated to open in April 2015. The FY 2015 Adopted Budget included $751,000 in added overtime to support the equivalent of 12.00 FTEs at the station for six months, as it was assumed at that time that the station would open in January 2015. Due to the fact that the station has not yet opened and will not incur related overtime expenditures until late April 2015, the department has reduced its overtime projection for Skyline to approximately $250,000 to fund two months of operations in FY 2015. The fact that the delayed opening of the Skyline Temporary Fire Station is projected to yield overtime savings, yet the department still anticipates exceeding its overtime budget by $3.7 million, illustrates the magnitude of the department's outsized usage of overtime.

The Mid-Year Budget Adjustment is based on a projection that takes into account, among other things, year-to-date overtime expenditures that have already occurred. However, the rate at which the Fire-Rescue Department is incurring over-budget overtime expenditures could increase even more rapidly in the second half of FY 2015 due to several potential factors. For example, additional strike teams could become necessary or the department could experience an increase in the use of annual leave and incur related backfill overtime costs. The IBA has concerns that at year-end, Fire-Rescue overtime expenditures may exceed budget even after FY 2015 Mid-Year Appropriation Adjustments have been made.

Fire-Rescue Salaries and Wages. The Fire-Rescue Department is projected to exceed its salaries budget by $1.1 million during the fiscal year, due to an over-budget expenditure of $1.2 million in special pays, which is partially offset by an under-budget expenditure of $100,000 in regular salaries. The minimal change in projected regular salaries indicates that the department is projected to meet its targets for budgeted salary savings due to vacancies. The department has indicated that the increased projection for special pays is due primarily to increases in EMT pay and paramedic pay, and to a smaller degree has been affected by an increase in administrative assignment pay.

As discussed earlier in this report, the department is also experiencing significant increases in overtime expenditures. Generally, the constant staffing model aims to offset overtime expenditures with budgeted vacancy savings. The Fire-Rescue Department is currently meeting its desired salary savings but is exceeding its overtime budget, which likely indicates that the department's overall staffing levels are out of balance and require further analysis.

Lifeguard Division Headquarters Facility Improvement. The FY 2015 Adopted Budget included $500,000 in expenditures for upgrades to the existing carpenter garage at the Lifeguard Division headquarters facility. As part of our office's review of the FY 2015 First Quarter Budget Monitoring Report, we noted that Park and Recreation staff previously housed at the carpenter garage had been relocated and that construction was anticipated to begin in January 2015. Since that time, the Fire-Rescue department has indicated that is working closely with Public Works-Facilities Division to finalize the project scope and cost estimate. Construction is now anticipated to begin in early FY 2016.

Park & Recreation Department

The Park & Recreation Department projects personnel expenditures to exceed budget by approximately $2.1 million primarily due to $900,000 in increased costs for fringe benefits and $540,000 in increased expenditures in hourly wages. The increase in fringe benefits is the result of citywide adjustments; and the increase in hourly wages expenditures is due to an increase in non-standard hours of operation for the recreation centers, new staff anticipated for the operation of other parks, and an increase in the participation of youth sports. The projected expenditures for the non-standard hours of operation are cost recoverable and a corresponding increase in revenue for these expenditures is projected. However, due to slightly lower than anticipated revenues from other sources such as the Mount Hope Cemetery, the projected increase in revenues is approximately $200,000.

Planning Department

In the Mid-Year Report, it was erroneously reported that decreased expenditures for community plan updates were attributed to the Equal Opportunity Contracting Program (EOCP) process. Financial Management and the Planning Department have since clarified the reason for the delays and cite three facts for the projected $500,000 surplus in non personnel expenditures: time needed for stakeholder involvement, shortage of staff in specialized disciplines, and a longer than anticipated time frame for contracting process. The Planning Department is working in conjunction with the Public Works contracting section to implement as-needed contracts to allow for task orders to be initiated throughout the duration of the contracts. The Planning Department intends to start issuing task orders beginning in April 2015 which is expected to assist in expediting community plan updates and amendments. The Planning Department also intends to fill all nine of their vacancies by the end of April 2015, including some of the specialized California Environmental Quality Act (CEQA) positions.

Police Department

Police Overtime. The Police Department is projected to exceed budgeted overtime expenditures by $6.4 million as compared to the Current Budget. It is important to note that the Current Budget differs significantly from the Adopted Budget. Since the Adopted Budget was approved by the City Council, $5.5 million has been transferred within the Police Department budget to its overtime budget. Of this amount, $3.2 million was related to the holiday overtime pay side letter as noted in the FY 2015 First Quarter Report. Although the transfer resulted in no net impact to the department’s overall budget, noting the overtime overage from the Adopted Budget rather than the Current Budget provides a clearer picture of the magnitude of the department’s increased usage of overtime. Compared to the FY 2015 Adopted Budget, the Police Department is projected to exceed budgeted overtime expenditures by $8.7 million.

The department has indicated that increased overtime is due primarily to shift extensions to allow for greater training and support for new officers by more experienced officers. As the department continues to face high levels of attrition and accelerates the hiring of new recruits, the need for additional overtime for training may continue in future fiscal years.

Police Vacancies and Attrition. The Police Department continues to experience a high number of vacancies in excess of budget, which has contributed to a projected increase in salary savings of $7.7 million compared to the Adopted Budget. Based on our review of Department staffing levels, these vacancies are primarily sworn rather than civilian. As of February 23, 2015, the department had a total of 140.00 vacant sworn positions. Although the department has made significant progress in hiring new officers by holding expanded police academies, the rate of attrition continues to exceed FY 2015 budget assumptions and is currently approximately 12 sworn departures per month. Of those sworn departures, a significant number have left the San Diego Police Department for other law enforcement agencies. As of February 23, 2015, 18 officers had been lost to other agencies in the first eight months of FY 2015. This surpasses the 17 officers lost to other agencies in all of FY 2014.

9-1-1 Call Manager System Upgrades. The Police Department is projected to exceed its non personnel expenditures budget by approximately $1.9 million. $1.6 million of this amount is attributed to expenses related to upgrading the City's 9-1-1 call manager system. This project, along with other public safety communications projects, was approved by the City Council on December 9, 2014. Of the $1.6 million project cost, approximately $1.2 million appears as an over-budget expenditure in the Department's Transfers Out category as a transfer to a CIP for the project. The total $1.6 million increased Police Department General Fund impact will be reimbursed by the State of California 9-1-1 Branch as part of a regular cycle upgrade in December 2017.

Transportation Storm Water Department

The Mid-Year Report projects an approximately $300,000 increase in revenues and a $1.0 million increase in expenditures for the Transportation and Storm Water Department (TSW) over what was included in the First Quarter Report. The increased expenditures are largely due to increased personnel expenses associated with filling vacancies.

The Mid-Year Report notes that TSW currently has 54.00 vacancies, including 33.00 over budgeted vacancies in the department. This is a decrease of 2.00 vacancies from the First Quarter Report. TSW indicates that it expects to fill all of its vacancies by the end of FY 2015 with the exception of 2.00 limited Junior Civil Engineers FTE positions, whose limited statuses expired in December 2014.

Departmental Expenditures – Non-General Funds

General Services – Fleet Division

Fleet Division continues to move forward with implementing its Most Efficient Government Operation reforms, though due to past meet-and-confer delays, expected savings from the program are not anticipated to be realized this Fiscal Year. Full implementation is expected to be completed in this Fiscal Year; that implementation includes a number of one-time costs which are reflected in the Mid-Year Report. Savings associated with the program, which are estimated to total $4.2 million annually, are expected to be realized in FY 2016. The Mid-Year Report includes $1.7 million in personnel expenses above that anticipated in the 2015 Adopted Budget, due to increased overtime, fringe benefits, and more filled positions than are budgeted.

Fleet Services' non personnel expenditures are expected to be $3.4 million under those included in the 2015 Adopted Budget, largely owing to significant decreases in fuel costs and in savings related to new maintenance contracts.

Park & Recreation, Golf Course Fund

In February 2015, the Office of the City Auditor released a Performance Audit of the Park and Recreation Department's Golf Division. Within the report, the Office of the City Auditor made several recommendations to improve golf operations including enhancing the marketing of the City's golf courses. The Golf Division added a Senior Public Information Officer to the FY 2014 Budget to address this matter; however this position has yet to be filled. In FY 2015, the City transferred many of its public information officers into the Communications Department to better coordinate these services. The Golf Division is in discussions with the Communications Department as to whether to address the marketing need with the identified position or by establishing an agreement with an outside consultant.

Public Works-Engineering & Capital Projects

The Engineering and Capital Projects Fund revenue is projected under budget by approximately $390,000 due to vacant reimbursable positions. Positions totaling 30.00 FTEs were added to the budget in FY 2015 for project management and delivery. The hiring of these positions has taken several months as promotions created new vacancies. Of the 30.00 FTE positions added to the FY 2015 budget, nine have been filled. Interviews for 21.00 more positions will soon be completed and offers will be made within the next few weeks.

Status of General Fund Reserves and Use of Budgetary Surplus at Mid-Year

Reserve Requirement

The Mid-Year Report provides a breakdown of the current total General Fund reserve balance, how much of this reserve balance is required to be utilized for the City's emergency and stabilization reserves, and the resulting projected excess equity after these requirements are met. The City's updated Reserve Policy requires that the combined emergency and stabilization reserves equal 14% of the last three fiscal years of audited General Fund operating revenues.

The 14% translates to a FY 2015 reserve requirement of $157.4 million as shown in the table below. Note that in future years, the City's required emergency and stabilization reserve amounts are anticipated to increase as revenues increase.

$ in millions	FY 2014 Reserve Requirement		FY 2015 Reserve Requirement	
FY 2014 Audited Revenues			$	1,171.7
FY 2013 Audited Revenues	$	1,092.0		1,092.0
FY 2012 Audited Revenues		1,108.4		1,108.4
FY 2011 Audited Revenues		1,010.4		
3 Year Average Revenues	$	1,070.3	$	1,124.0
14% of Average Revenues	$	149.8	$	157.4

Initial Excess Equity Estimate

The estimated FY 2015 beginning reserve balance is $182.5 million; however, approximately $8.9 million of this reserve is projected to be utilized in FY 2015 General Fund operations and $1.1 million will be utilized through re-budgeting of City Council Community Projects, Programs, and Services (CPPS) in FY 2016, leaving $172.6 million in reserves. As can be seen in the table below, there is $15.2 million in projected excess equity based on the current reserve requirement of $157.4 million.

Excess Equity Calculation ($ in millions)		
Estimated Beginning FY 2015 Reserve Balance	$	182.5
Projected Use of Reserves in FY 2015		(8.9)
Projected CPPS Re-Budgeted in FY 2016		(1.1)
Year-End FY 2015 Reserve Estimate	$	172.6
14% Reserve Requirement	$	157.4
FY 2015 ENDING EXCESS EQUITY ESTIMATE	**$**	**15.2**

Note that the numbers in the table above may not total due to rounding.

The $15.2 million excess equity is 1.4% of General Fund revenues. This percentage is similar to the recommendation made to the Council in the FY 2014 Mid-Year Report. At that time there was $37.0 million in projected excess equity, of which the Mayor recommended utilizing $22.9 million for various priorities. This left $14.1 million, or 1.3%, as the recommended remaining excess equity balance.

"Budgetary Surplus" and Mid-Year Budget Adjustments

Although the FY 2015 estimated excess equity balance is $15.2 million, as described above, the amount that can be recommended for use per the Mid-Year Ordinance is dependent upon **budgetary surplus**. The Mid-Year Ordinance, Ordinance-20084, amended the municipal code with regard to use of budgetary surplus for mid-year budget adjustments. The ordinance also requires Mayoral reporting on significant reductions in City services or programs.

The Mid-Year Ordinance requires the Mayor to report any budgetary deficit or surplus in the General Fund projection to the City Council and make a recommendation for addressing the deficit or surplus. In the case of a surplus, such as projected for the current year, the ordinance then specifies:

- The Mayor may recommend budgeting all, none, or any portion of projected surplus;
- The City Council may approve the Mayor's recommendation or modify such recommendation in whole or part; and
- The City Council may budget and appropriate up to the total amount recommended by the Mayor; or, if the Mayor recommends budgeting less than $5.0 million of the projected surplus amount, the City Council may only increase the adopted General Fund budget by up to $5.0 million or not more than 50% of any projected surplus, whichever total dollar amount is less.

The table below displays the $4.9 million in estimated budgetary surplus for FY 2015 based on Mid-Year Report projections. The FY 2015 Adopted Budget was originally balanced using $13.9 million in excess equity. The year-end projection shows that only $8.9 million of the $13.9 million will be needed, leaving a budgetary surplus of $4.9 million.

$ in millions	**Adopted Budget**	**Year-End Projection**	**Budgetary Surplus/(Deficit)**
Revenue	$ 1,188.6	$ 1,202.8	$ 14.2
Expenditures	$ (1,202.4)	$ (1,211.7)	(9.3)
USE OF EXCESS EQUITY	$ (13.9)	$ (8.9)	$ 4.9

Note that the numbers in the table above may not total due to rounding.

The Mayor is recommending that $3.9 million of the projected $4.9 million in the General Fund budgetary surplus be spent to pre-fund the FY 2016 Public Liability and Long-Term Disability (LTD) reserves, at $2.8 million and $1.1 million respectively.

After the Mayoral recommendation for using the $3.9 million in budgetary surplus, the remaining excess equity would be $11.3 million, or 1% of operating revenues, as displayed in the table below.

Excess Equity ($ in millions)	
FY 2015 Estimated Excess Equity	$ 15.2
Recommended Public Liability Reserve Contribution	(2.8)
Recommended Long-Term Disability Reserve Contribtuion	(1.1)
FY 2015 ADJUSTED EXCESS EQUITY ESTIMATE	**$ 11.3**

The Mayor recommends that the $11.3 million surplus remain as excess equity to be available for mitigation of any year-end budget overages or revenue shortfalls that are not part of the Mid-Year projections. The Mid-Year Report indicates that the excess equity projection will be updated again in May 2015 as part of the FY 2015 Year-End Budget Monitoring Report in order to allow for a discussion of the potential use of excess equity as part of the FY 2016 Proposed Budget.

Council Considerations Related to the Mid-Year Ordinance.

The City Attorney's Office has interpreted the intent of the Mid-Year Ordinance as allowing Council to approve or modify the Mayor's full surplus funding recommendation ($3.9 million) rather than 50% of the budgetary surplus (50% of $4.9 million, or $2.45 million). The City Attorney's Office further recommends that this ordinance be amended in the future to clarify this intent.

Based on the identified budget surplus and recommended use, Council options are as follows:

1. Accept the Mayor's budget recommendations in full and pre-fund the Public Liability and LTD funds in the amount of $3.9 million.
2. Modify the Mayor's recommendations as desired for any amount less than or equal to $3.9 million.

We recommend Council approval of the $3.9 million in pre-funding of the Public Liability and LTD reserve.

Proposed Utilization of Mid-Year Surplus and Requested Authorities

Mid-Year Appropriation Adjustments

The Mid-Year Report requests that $12.7 million in projected increases to revenues above FY 2015 Adopted Budget levels be used to provide necessary funding appropriations for unanticipated Fire-Rescue, Police, Public Utilities, and Office of Homeland Security expenditures as listed in the following table:

Requested General Fund FY 2015 Mid-Year Appropriation Adjustments ($ in millions)			
Department	**Expenditures**	**Revenues**	**Net Impact**
Citywide Program Expenditures	$ (3.6)	$ -	$ 3.6
Economic Development	$ (0.5)	$ (0.5)	$ -
Fire-Rescue	$ 9.4	$ 3.0	$ (6.4)
Major General Fund Revenues	$ -	$ 9.0	$ 9.0
Office of Homeland Security	$ 0.1	$ 0.1	$ -
Police	$ 6.9	$ 1.1	$ (5.8)
Public Utilities - Reservoir Recreation	$ 0.4	$ -	$ (0.4)
Total:	$ 12.7	$ 12.7	$ (0.0)

Appropriation Adjustments of approximately $1.3 million in expenditures and corresponding balancing revenues are also being requested for the following non-general funds:

- Refuse Disposal Fund: $900,000
- Concourse and Parking Garages Operating Fund: $240,000
- Mission Bay/Balboa Park Improvement Fund: $175,000

All General Fund Appropriation Adjustments are balanced through increased revenues or reductions in expenditures. Overall, our office supports the Appropriation Adjustments requests outlined in the Mid-Year Report. We note, however, that overtime expenditure projections for Police and Fire-Rescue exceed budgeted levels and have increased significantly over First Quarter Projections. Our office has concerns that these overtime expenditures may exceed budget even after the FY 2015 Mid-Year Appropriation Adjustments have been made, and also note the potential for lower than currently projected major General Fund revenues as discussed in the sections above.

Utilization of Mid-Year Budgetary Surplus

The Mayor is recommending the use of $3.9 million of the projected $4.9 million in the General Fund budgetary surplus be spent to pre-fund the FY 2016 Public Liability and Long-Term Disability Funds reserves:

Mayor's Recommended Use of FY 2015 Projected Budgetary Surplus		
Budgetary Surplus	$	4.9
Public Liability Reserve	$	(2.8)
Long-Term Disability Fund Reserve	$	(1.1)
Total Remaining Surplus:	$	1.0

The Mayor recommends that the remaining $1.0 million surplus remain as excess equity and be available to mitigate any year-end budget overages or revenue shortfalls that are not part of the Mid-Year projections. The Mid-Year Report indicates that the excess equity projection will be updated again in May 2015 as part of the FY 2015 Year-End Budget Monitoring Report in order to allow for a discussion of the potential use of excess equity as part of the FY 2016 Proposed Budget.

This pre-funding action is anticipated to bring the Public Liability reserve balance to 40% of outstanding public liability claims ($37.9 million), as compared to the 37% target level for FY 2015. The overall goal for the Public Liability reserve is to bring it to 50% funding of outstanding liabilities by FY 2019, which is currently $47.4 million. The $47.4 million overall target amount is different than the $48.3 million listed in the City Reserve Policy because the target amount was updated subsequent to the release of the FY 2014 actuarial valuation.

With the pre-funding of the $2.8 million FY 2016 Public Liability reserve contribution in FY 2015, estimated future reserve contribution amounts would be $9.4 million in total between FY 2017 and FY 2019 (in order to achieve the 50% target funding by FY 2019). The Public Liability Fund is supported entirely by the General Fund.

The pre-funding of the LTD reserve contribution ($1.1 General Fund portion) will achieve the target for 100% funding of outstanding liabilities in FY 2015, one year ahead of the City Reserve Policy goal. The 100% reserve funding target amount is currently $18.3 million.

Our office recommends Council approval of the Mayor’s plan to pre-fund the FY 2016 Public Liability and Long-Term Disability reserves amounts but notes that Council does have authority to change these priorities and introduce new ones up to $3.9 million as provided for in the Mid-Year Ordinance.

CONCLUSION

The Office of the IBA has reviewed the Mid-Year Report and we believe that projections included in the Report are appropriate, although continued close monitoring is required on sales tax and property transfer tax. Based upon projected year-end operating results, we support the requested Appropriation Adjustments listed below with some additional recommendations:

1. Requested Budget Adjustments – appropriate $12.7 million in increased revenues and expenditures above FY 2015 Adopted Budget levels to provide funding for unanticipated Fire-Rescue, Police, Public Utilities, and Office of Homeland Security expenditures.

   Overall our office supports the recommended Appropriation Adjustments, although we raise concerns about continued overages in overtime expenditures in the Police and Fire-Rescue departments as well as the potential for lower than currently projected major General Fund revenues that should be monitored through year-end and reviewed during the FY 2016 Proposed Budget process.

2. Utilization of Mid-Year Budgetary Surplus – appropriate $3.9 million of the projected $4.9 million in the General Fund budgetary surplus to pre-fund the FY 2016 Public Liability and Long-Term Disability reserves. This use of the budgetary surplus will retain $11.3 million, or 1% of operating revenues, as excess equity above the City Reserve Policy minimum General Fund reserve level of 14%.

   Our office supports the pre-funding of the FY 2016 Public Liability and Long-Term Disability reserves amounts.

3. Mid-Year Ordinance – revisit the language of the Mid-Year Ordinance to clarify that the City Council has the authority to approve or amend the full amount of surplus funding when the Mayor's mid-year funding recommendation is less than $5.0 million as interpreted by the City Attorney's Office. As written, the Ordinance contains conflicting clauses with respect to the Council's authority.

   The IBA will work with the City Attorney's Office and the CFO to propose amended language for the Mid-Year Ordinance to clarify City Council authority.

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