THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the Mayor's FY 2020-2024 Five-Year Financial Outlook

OVERVIEW

On November 7, 2018, Mayor Faulconer released the Fiscal Year 2020-2024 Five-Year Financial Outlook (Outlook), one of the City's important and annual financial planning tools. The Outlook is an integral part of the budget development process and is described in the City's Budget Policy as "the basis for determining the coming year's operating budget allocations."[1]

The City's Budget Policy states that the Outlook "shall… include projections for committed expenditures which are defined as the operational costs for new facilities, contractual obligations, federal and State legal mandates, and adopted City Council policies."[2] This year's Outlook includes General Fund Baseline revenue and expenditure projections as well as future critical expenditures identified by the Mayor, in conformance with the Budget Policy.

This year's Outlook projects Baseline deficits in the first two years of the Outlook period, followed by three years of surpluses. After taking into account the cost of the Mayor's Critical Strategic Expenditures, which are above and beyond the Baseline, the Outlook projects deficits in the first three years followed by two years of surpluses. For FY 2020, the Outlook's projected deficit (after including Critical Strategic Expenditures) is $73.6 million.

[1] Council Policy 000-02 *Budget Policies* page 2, last updated November 2017.
[2] Council Policy 000-02 *Budget Policies* page 5, last updated November 2017.

OFFICE OF THE INDEPENDENT BUDGET ANALYST
202 C STREET MS 3A SAN DIEGO, CA 92101
TEL (619) 236-6555 FAX (619)-236-6556

In this report, we review the information presented in the Outlook as well as additional items identified by our Office, including:

- An overview of Baseline revenues and expenditures reported in the Outlook
- An analysis of selected Critical Strategic Expenditures included in the Outlook
- A review of potential future funding needs not included in the Outlook
- A discussion of future financial challenges
- A discussion of potential options to address shortfalls

The Outlook and our Office's review of the Outlook are tools that the City Council can use to consider alternative expenditure priorities for the FY 2020 budget, as well as deficit mitigation strategies. Council may also wish to consider including alternative priorities or deficit mitigation strategies in their City Council Budget Priorities memoranda due to our Office in January 2019.

REVIEW OF THE OUTLOOK'S MAJOR GENERAL FUND REVENUES

The Outlook forecasts growth in General Fund revenues for each of the next five years; however, at a lower rate than the growth of recent years. The table below summarizes the projections from the Outlook, as well as the growth rates applied to the four largest revenue sources. Property tax, sales tax, TOT and franchise fees make up over 73% of the General Fund's revenues in FY 2019. More detail and analysis of the FY 2019 projections for these four revenue sources can be found in our review of the FY 2019 First Quarter Budget Monitoring Report (First Quarter Report).

Baseline General Fund Revenues (in Millions)							
	FY 2018 Unaudited Actual[1]	FY 2019 Projection[2]	FY 2020 Forecast	FY 2021 Forecast	FY 2022 Forecast	FY 2023 Forecast	FY 2024 Forecast
Property Tax	$ 535.5	$ 568.7	$ 597.9	$ 629.6	$ 660.8	$ 691.2	$ 721.2
Property Tax Growth Rate		*5.50%*	*5.25%*	*5.00%*	*4.75%*	*4.50%*	*4.25%*
Sales Tax	272.9	297.7	290.0	297.8	305.9	313.8	321.7
Sales Tax Growth Rate		*2.3%*	*2.4%*	*2.7%*	*2.7%*	*2.6%*	*2.5%*
Transient Occupancy Tax	121.9	128.7	134.8	140.4	145.7	150.9	156.1
TOT Growth Rate		*5.3%*	*4.8%*	*4.2%*	*3.7%*	*3.5%*	*3.5%*
Franchise Fees[3]	78.4	77.4	79.0	80.7	82.6	84.8	86.3
SDG&E Growth Rate		*2.0%*	*3.2%*	*3.5%*	*3.5%*	*2.6%*	*2.6%*
Cable Growth Rate		*-2.0%*	*-2.2%*	*-1.9%*	*-1.3%*	*-1.3%*	*-1.3%*
Other Revenues, including departmental revenues	416.9	389.0	400.1	407.4	418.7	428.6	439.5
Total General Fund Revenue	**$ 1,425.6**	**$ 1,461.5**	**$ 1,501.8**	**$ 1,555.9**	**$ 1,613.7**	**$ 1,669.3**	**$ 1,724.8**
Increase over Prior Year		*$ 35.9*	*$ 40.3*	*$ 54.1*	*$ 57.8*	*$ 55.6*	*$ 55.5*
Overall Growth %		*2.5%*	*2.8%*	*3.6%*	*3.7%*	*3.4%*	*3.3%*

[1] FY 2018 Unaudited Actuals from the FY 2018 Year-End Financial Performance Report

[2] FY 2019 Projection from the FY 2019 First Quarter Budget Monitoring Report, except for Other Revenues which is projected at budget.

[3] Franchise Fees in the FY 2020-2024 Five-Year Financial Outlook include departmental franchise fees. These have been moved to the Other Revenues in the table above for comparison to FY 2018 Unaudited Actual and FY 2019 Projection.

Note: Growth Rate is applied by Department of Finance to majority of revenue within each category, then additional adjustments are applied based on known information.

Generally, our office agrees with the slowing growth rates applied to revenues. As noted in the Outlook, the economy has seen steady improvements since 2009. A recession could occur during this Outlook period but is not reflected in the projections. Rather, the projections reflect slowing growth rates based on trends and the most recent information available. Following are some items of note regarding the projections in the Outlook.

- Property tax remains strong despite a slow-down in property sales due to the values of those properties remaining high. The Outlook projects 5.25% growth in property tax for FY 2020, slowing to 4.25% growth by FY 2024.
- The sales tax projection for FY 2019 is high in comparison to FY 2018 unaudited actual revenue due to a change in the State's system which resulted in $14.7 million of FY 2018 revenues being received in FY 2019. The future growth rates projected for sales tax range from a low of 2.4% in FY 2020 to high of 2.7% in FY 2021 and FY 2022.
- TOT revenue growth is projected to slow based on the most recent tourism information. In FY 2018, the average monthly growth was only 4.2% over FY 2017, whereas it had been over 9% in each of the two prior years.
- SDG&E makes up over 60% of franchise fee revenue. The projections in the Outlook are based on the current franchise agreement with SDG&E. Meanwhile, revenue from the cable companies is expected to continue to decline but is offset by steady 2% growth projected from the refuse haulers franchise fee.
- Revenue of $1.6 million per year from the Stadium agreement with San Diego State University for Aztecs football has been incorporated into the projections for FY 2020 and FY 2021, freeing up TOT revenue to support tourism-related activities in General Fund departments.

Overall, General Fund revenues are projected to grow by $40.3 million in FY 2020, as compared to the FY 2019 First Quarter projection. This is less than the growth projected in each of the future years, primarily due to the $14.7 million of sales tax received in FY 2019 that was expected in FY 2018. Each of the future years of the Outlook forecast over $54 million, or more than 3%, of revenue growth, assuming we do not experience a recession during this timeframe. Additional information on the current performance of General Fund revenues will be available in the FY 2019 Mid-Year Budget Monitoring Report (Mid-Year Report) and with the development of the FY 2020 Budget. Our Office will continue to monitor those trends.

REVIEW OF THE OUTLOOK'S GENERAL FUND BASELINE EXPENDITURES

Increases/(Decreases) from the FY19 Adopted Budget to the FY20 Outlook Baseline Projection ($ in millions)		
FY19 Adopted Budget		**$ 1,459.2**
Personnel-Related Expenditure Changes		**58.6**
Compensation Increases - Agreements with Employee Organizations [1]	$ 32.7	
Actuarially Determined Contribution (ADC) - Retirement Payment Increase	18.1	
Police Overtime Increase	2.5	
Workers' Compensation - Increased Contributions for Operating Expenses	2.4	
Step Increases for Salaries and Wages	1.9	
Termination Pay (for Annual Leave) Increase	1.1	
Fringe Benefits Increases (other than those separately listed)	1.1	
Other Post-Employment Benefits (OPEB) - 2.5% Annual Increase	1.0	
Miscellaneous Salaries and Wages Changes (other than those separately listed)	0.1	
Fire-Rescue Overtime Decrease [2]	(2.4)	
Non-Personnel Expenditure (NPE) Changes		**35.3**
General Fund Reserve Contribution Increase	9.2	
Contracts - 3.9% Annual Growth Rate	6.9	
Fleet Usage Fee Increase (FY19 fees reduced due to use of fund balance)	4.6	
Information Technology Increases (including $1.7M cyber security; $1.4M data center)	3.7	
Energy and Utilities - Various Growth Rates (electric, fuel, water, other)	2.3	
Contracts - Other Increases (including for elections, 101 Ash, refuse disposal fees)	2.1	
Miscellaneous NPE Changes (other than those separately listed)	1.6	
Supplies - 4.6% Annual Growth Rate	1.4	
Public Liability Insurance Premium Increase	1.2	
Commercial Paper Program Increase	1.2	
Charter Section 77.1 - Infrastructure Fund Transfer Increase	1.1	
Removal of FY19 One-Time Expenditures (see Five-Year Outlook, Attachment 2) [3]		**(12.5)**
Transfers to CIP for Information Technology Projects	(1.2)	
101 Ash Relocation Costs	(2.1)	
Transfers to Support Penny for the Arts	(3.9)	
Miscellaneous One-Time Expenditures (other than those separately listed)	$ (5.3)	
FY20 Outlook Baseline Projection		**$ 1,540.6**
Total Increase: FY19 Adopted Budget to FY20 Outlook Baseline (5.6% Increase)		**$ 81.4**

Note: Table may not total due to rounding.

[1]The Compensation Increases line includes variable fringe costs but does not include impacts to the ADC, which is listed on its own line.

[2]This Fire-Rescue overtime decrease partially offsets a $5.3M increase for fire overtime included in the Compensation Increases line (first budget change line in the table). The $5.3M overtime increase is related to changes in the firefighters' compensation MOU.

[3]Attachment 2 to the Five-Year Outlook includes "one-time expenditures" of $32.9M - only $12.5M of which is shown in the Removal of FY19 One-Time Expenditures section of this table. The remaining FY19 one-time expenditures in Attachment 2 are addressed among other components of this table and include: $17.1M Infrastructure Fund transfer; $3.6M Pension Payment Stabilization Reserve Contribution; $3.4M Fire-Rescue overtime; $0.6M for the General Fund Reserve contribution; and reduced expenditures of $4.6M for use of Fleet fund balance.

As shown in the table on the previous page, the Outlook's FY 2020 General Fund Baseline projection is increasing by $81.4 million (or 5.6%) from the FY 2019 Adopted Budget. The largest ***increases*** include:

- $32.7 million for compensation increases based on agreements with the City's recognized employee organizations – includes variable fringe, but not Actuarially Determined Contribution (ADC) impacts, which are incorporated on the ADC line;
- $18.1 million for the ADC pension payment increase;
- $9.2 million for the General Fund Reserve contribution increase;
- $6.9 million for the 3.9% annual increase in costs for contracts; and
- $4.6 million increase in Fleet usage fees (FY 2019 fees were reduced due to the use of fund balance to cover FY 2019 expenditures.)

Baseline increases are partially offset with a number of expenditure ***decreases***. The largest include:

- $3.9 million for one-time FY 2019 transfers to support the Penny for the Arts program;
- $2.4 million Fire-Rescue overtime reduction, which partially offsets a $5.0 million fire overtime increase included in the Compensation Increases line (This overtime increase relates to changes in the firefighters' compensation agreement); and
- $2.1 million for 101 Ash relocation costs – $689,000 is included for relocation costs in FY 2020.

There are no **programmatic** increases included in the General Fund Baseline expenditures projection. More detailed components of Baseline expenditures are discussed below.

Personnel-Related Expenditures in the Outlook Baseline

Compensation Increases – Multi-Year Agreements with Employee Organizations

General Fund compensation increases from agreements with the City's employee organizations (including variable fringe) are shown in the following table. FY 2020's $32.7 million impact for these agreements includes salary, overtime, and special pay increases. Offsetting decreases include those for Police Officers' flexible benefits and for Firefighters' annual leave payments in excess of accrual caps.

Multi-Year Agreements with the City's Employee Organizations *($ in millions)*

General Fund Compensation Increase/(Decrease) Over FY19 Amounts	FY20	FY21	FY22	FY23	FY24
Salaries (for all employees except Deputy City Attorneys Association)	$ 35.7	$ 41.4	$ 41.4	$ 41.4	$ 41.4
Fire Overtime Related to Fire MOU	5.3	5.7	5.7	5.7	5.7
Special Pays [1]	3.9	4.5	4.5	4.5	4.5
Pay-in-Lieu - Firefighters' Annual Leave Over Accrual Caps	(1.2)	(1.6)	(1.6)	(1.6)	(1.6)
Flexible Benefits - Police Officers with 8 or More Service Years	(11.1)	(11.1)	(11.1)	(11.1)	(11.1)
Total General Fund Compensation Increases Over FY19	**$ 32.7**	**$ 38.9**	**$ 38.9**	**$ 38.9**	**$ 38.9**

Note: Table may not total due to rounding.

[1] Includes 5% special pay for Police Officers with 20 or more years of service (approximately $2.5M for FY 2020 and $2.7M for the remaining years), as well as engineering and fire-dispatch special pays for Municipal Employees Association (MEA) employees and various special pays for American Federation of State, County and Municipal Employees (AFSCME) Local 127 employees.

The multi-year agreements, or memorandums of understanding (MOUs), are discussed on pages 30 and 31 of the Outlook. Amounts included in the Outlook's tables differ from those shown above. Our figures include the $11.1 million reduction in flexible benefits for Police Officers with eight or more years of service, which is offset by Police salary and special pay increases of $24.3 million for FY 2020 and $29.2 million for FY 2021 and the remaining Outlook years.

Salary Increases

Negotiated FY 2020 salary increases include 3.3% "across-the-board" increases for four of the six recognized employee organizations, as well as 3.3% increases for unrepresented employees. However, the Deputy City Attorney's Association (DCAA) MOU expires in FY 2019; and there are no DCAA-negotiated salary increases for FY 2020 included in the Outlook. Negotiations with DCAA are expected to commence early in calendar year 2019.

Additionally, the Police Officers' Association (POA) negotiated different salary increases for FY 2020 than the 3.3% received by other City employees. Across-the-board increases of 7.3% and 5.0% will begin July 2019 and January 2020, respectively.

MOUs for the POA and the remaining four employee organizations run through FY 2020; and FY 2021 contract negotiations are expected to begin during FY 2020. The Outlook does not contain estimates for any potential new negotiated compensation increases for FY 2021 (and through the remainder of the Outlook). The Department of Finance (DOF) estimates a 1% salary increase for City employees would be about $6.0 million for the General Fund.

Fire Overtime Related to the Fire MOU

The estimated Fire-Rescue overtime increase of $5.3 million (including variable fringe) in FY 2020 is associated with the current MOU with International Association of Firefighters Local 145. There are two components to this increase: $2.9 million for overtime related to the Fair Labor Standards Act (FLSA) cycle and $2.4 million for overtime for MOU-related backfilling of firefighters who are on annual leave.

The $2.9 million increased overtime related to the FLSA cycle is associated with a MOU change that began in FY 2018. This change allows non-productive time (such as vacation days and holidays) to be counted as hours actually worked for purposes of determining overtime hours. Thus, eligible firefighters who work more than 212 hours, including non-productive time, in their 28-day work cycle will be paid at the "time-and-a-half" overtime rate for such hours exceeding the 212-hour threshold.

Increased overtime related to backfilling other firefighters who are on annual leave is related to a MOU change associated with the capping of firefighters' annual leave accruals. Effective FY 2020, firefighters who have not reduced their annual leave balances below the allowable maximum accrual will cease to accrue annual leave. In addition to receiving mandatory payouts of excess annual leave amounts as prescribed in the MOU, firefighters have been taking more leave time to reduce their balances. When a firefighter takes leave time, in his/her absence, another firefighter will be requested to backfill the absent firefighter's post to keep the constant staffing model operational. This backfilling has been causing substitute firefighters to exceed (or further exceed) the 212-hour overtime threshold. The overtime cost of backfilling related to the MOU change in annual leave terms is estimated to be $2.4 million for FY 2020, increasing to $2.9 million for the remaining years of the Outlook.

Firefighters' Pay-in-lieu of Annual Leave Over Accrual Caps

As mentioned previously, the Fire MOU prescribes that mandatory payments over the annual leave accrual caps will continue each fiscal year until each employee's annual leave balance is below the maximum allowable accumulation. The FY 2019 budgeted amount for Firefighters' pay-in-lieu of annual leave over the accrual caps was $1.6 million. Beginning in FY 2021, amounts for Firefighters' pay-in-lieu of annual leave over the accrual caps is removed from the Baseline, as DOF estimates that such payments will no longer be needed. For FY 2020, estimated payments are reduced from the $1.6 million in FY 2019 to $400,000 (a $1.2 million reduction, as shown in the previous table).

Estimated Additional Cost Related to the Multi-Year Agreements

One additional cost not included in the Outlook is associated with a holiday-related compensation increase included in the current POA agreement (originally estimated in 2015 to cost $2.3 million). Although it is not significant when compared to overall General Fund expenditures (which total $1.54 billion for the FY 2020 Outlook Baseline), as a negotiated benefit we believe it is noteworthy.

In accordance with the POA agreement, a Police Officer is currently not compensated for a holiday which falls on his or her regularly scheduled day off. The elimination of this "holiday credit on a day off" was a negotiated contract term that went into effect for FY 2014. The reason for elimination of this holiday credit is that the City and POA agreed to convert certain holiday compensation to increased flexible benefits.

With the current POA contract, the elimination of the "holiday credit on a day off" stays in effect until June 30, 2020, at which time holiday credit for days off will again be compensated. Officers will receive straight-time pay or an equal amount of compensatory time (comp time) for such holidays. During negotiations on holiday benefits, the Financial Management (FM) Department estimated the cost of the "holiday credit on a day off" to be $2.3 million. This was based on employees receiving straight time pay for the holiday.

In actuality, variations could occur. For example, an Officer could choose to receive comp time. When that comp time is utilized as a day off, there is the potential for overtime to be incurred by another Officer "backfilling" for the absent Officer. This is conceivable, considering the current difficulties in Police Officer hiring and retention, as well as increased overtime. The overtime cost for backfilling an Officer would be at a rate of time and a half, rather than straight-time pay. It is also possible that an absent Officer's shift will not need to be backfilled, resulting in no cost.

Given these considerations, the recently negotiated POA salary increases, and the fact that the $2.3 million amount was used to negotiate compensation adjustments for Police Officers, this amount is a reasonable estimate for the reinstatement of the "holiday credit on a day off." Since reinstatement would be effective on June 30, 2020, the first full year for incurring costs would be FY 2021.

Public Safety Overtime

As of the First Quarter Report, FY 2019 Police Department overtime is projected to be $33.9 million, $6.9 million higher than the FY 2020 Outlook Baseline of $27.0 million. Additionally, FY 2019 Fire-Rescue overtime is projected to be $45.0 million, $4.3 million higher than the FY 2020 Outlook Baseline of $40.7 million. The projections for public safety overtime will be further analyzed and updated in the Mid-Year Report as well as during the FY 2020 budget development process.

Historically, overtime and other wage expenditures[3] that have been higher than budget amounts were offset (or partially offset) with vacancy savings from various departments. The following issues related to overages in overtime will require further review throughout the budget process:

- The costs of maintaining service levels via the use of overtime versus the filling of positions
- Approaches for reducing overtime in the future – through additional hiring and/or through other overtime reduction efforts, such as the Firefighter relief pool staffing model that is discussed in the "Selected Critical Strategic Expenditures Included in the Outlook" section of this report

Vacancy Savings

The annual Adopted Budget includes a listing of full-time equivalent (FTE) positions that are authorized to be filled; however, it does not provide funding for all authorized positions due to the vacancy factor. The budget removes funding for some positions in order to account for savings that routinely occur due to turnover, leaves of absence, and when newly hired employees fill vacancies at lower salaries than budgeted. The amount of funding removed from the budget for these occurrences, known as vacancy savings, reduces overall budgeted salaries and wages.[4]

As of the FY 2018 Year-End Financial Performance Report actual (unaudited) vacancy savings was $19.9 million higher than the $29.7 million budgeted vacancy savings (for a total of $49.6 million). Similarly, for FY 2017 actual vacancy savings came in $15.7 million higher than the $30.4 million budgeted amount (for a total of $46.1 million).

The City could consider whether it would be prudent to increase budgeted vacancy savings for FY 2020. Such an increase would reduce overall salary and wages expenditures. This potential reduction in expenditures could free up budget for other program areas. We caution that ensuring all other salaries and wages expenditures (special pays, overtime, hourly wages, vacation pay-in-lieu, termination pay) have sufficient budget levels will be important if vacancy savings is increased.

As mentioned previously, excess vacancy savings beyond the budgeted amount has offset overages in the other wage types.[5] Reducing total salaries and wages by increasing vacancy savings could

[3] Other wage expenditures include vacation pay-in-lieu of annual leave and termination pay.

[4] Leaving the unfunded positions in the budget keeps the authorized positions transparent.

[5] The condition where excess vacancy savings covers over-budget amounts for other wages types (or vice versa) can be a natural occurrence in a dynamic organization. For example, in a constant staffing model such as for fire suppression, overtime may be needed when the existing staffing levels are insufficient to meet required staffing levels. With increases in vacancies there may be times when more overtime is needed than was originally expected.

leave less of a cushion for other salaries and wages overages – which could pose a difficulty if those other salaries and wage types do not have sufficient budget. The FY 2019 Mid-Year Report will provide useful information on how vacancy savings and other wage types appear to be trending.

Pension Payment – ADC

The ADC is the retirement payment made by the City for its defined benefit pension. The Outlook's citywide ADC estimate for FY 2020 is $347.4 million. Of this amount, $257.1 million is for the General Fund, an increase of $18.1 million from FY 2019. The annual citywide ADC projections for the remaining Outlook years are about $354.0 million ($262.0 million General Fund).

The Outlook's ADC forecasts are based on the most recently provided estimates from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, in the FY 2017 actuarial valuation. These latest projections include an investment rate reduction from 6.75% for FY 2018 to 6.5% for FY 2019 and later years. They also include estimated impacts for Police Officers' pensionable pay increases that were approved in December 2017.

Subsequent to the completion of the latest ADC projections discussed above, the actual FY 2018 investment return was determined to be 8.9%. This is 2.15% higher than the 6.75% previously assumed, which will produce an investment "experience gain" and correspondingly, future reductions to ADCs. However, mitigating such ADC reductions will be impacts of pensionable pay increases that were not incorporated into the latest ADC projections, including:

- Negotiated non-Police Officer general salary increases (Impacts will be based on the difference between the negotiated 3.3% salary increases and SDCERS' 3.05% wage inflation assumption.)
- Special salary adjustments approved as part of the FY 2019 Salary Ordinance
- Negotiated special pay increases

Because of the complexity of the pension system variables, the total of ***all*** impacts to the ADC will not be known until the FY 2018 valuation has been completed. The FY 2018 valuation, which will incorporate not only the FY 2018 investment results and certain pensionable pay increases, but all FY 2018 experience gains and losses, is anticipated to be available in January 2019. This valuation will determine the FY 2020 ADC, and it is anticipated to include updated ADC estimates for FY 2021-2024.

<u>Future ADC Considerations</u>
First, we would note that many investment consultants believe a market correction is possible in the next five years. In such a case, if investment earnings are lower than assumed in the actuarial valuation, future ADCs could be increased.

Also, on November 5, 2018 the SDCERS Board of Administration held a retreat with its plan experts to consider actuarial assumptions and methodology. During the retreat the Board discussed methods for quicker pay-down of the Unfunded Actuarial Liability (UAL), as well as overall approaches to the pension plan funding. The Board directed its administrative staff to provide deliverables which are anticipated to be reviewed at its January 2019 meeting:

- Whether to implement a contribution floor for future years where employer contributions are significantly reduced (beginning FY 2029) – including underlying analysis and alternatives for improving plan funding
- Whether to set the assumption/methodology changes amortization period to 20 years (from 30 years) for new UAL amortization layers identified in and after the 2019 actuarial valuation
- An analysis regarding setting a 100% funding ratio goal (elimination of the UAL) for the 2038 actuarial valuation, including alternatives on how to achieve this goal
- An analysis of anticipated future negative cash flows and anticipated future liquidity requirements; a modified asset allocation that includes more risk-mitigating assets (due to maturing plan demographics); and various actuarial scenarios using lower investment return assumptions based on such future asset allocation changes
- A multi-year actuarial calendar with a schedule of Board tasks related to plan funding – including, but not limited to, valuations, demographic assumption experience studies, financial assumptions and methodology reviews, and actuarial audits

Non-Personnel Expenditures (NPE) in the Outlook Baseline

The Outlook discusses Baseline NPE expenditures for the following categories: supplies, contracts, information technology, and energy and utilities. Assumptions built into the Outlook projections for these categories are described in the Outlook report and they appear reasonable and are similar to prior Outlooks.

Additionally, the first page of this General Fund Baseline Expenditures discussion includes a table with a summary of major NPE changes from the FY 2019 Adopted Budget to the FY 2020 Outlook Baseline projection. Lastly, Outlook projections related to Workers' Compensation, Long-Term Disability, and Public Liability operations and Reserves, as well as the General Fund and Pension Payment Stabilization Reserves are discussed in Attachment 1 to this report.

Some items not included in the Outlook Baseline (or Outlook's Critical Strategic Expenditures) include:

- Compensation increases that may result from future negotiations with the City's employee organizations (The General Fund estimate for a 1% salary increase for City employees is approximately $6.0 million)
- Support for Penny for the Arts – $3.9 million budgeted as one-time expenditure in FY 2019
- Additional homelessness funding beyond the $7.7 million Baseline – for Navigation Center costs related to additional Police overtime and additional cleaning efforts surrounding the facility
- Lifeguard Academy – $238,000 budgeted as one-time expenditure in FY 2019

Other Noteworthy Items in the Baseline

Environmental Services: Reduction of Tipping Fee Discount for the City

From FY 2009 to FY 2016, all City departments received a $5 per ton disposal discount for loads delivered to the Miramar Landfill. To support the financial health and programs of the Refuse Disposal Fund, the City approved the elimination of the $5 per ton discount to City Forces over three years (FY 2016 through FY 2018)[6]. However, to mitigate the impact to the General Fund, the final portion of the discount elimination was postponed in both the FY 2018 and FY 2019 Adopted Budgets; currently a $2/ton discount remains. The Outlook's Baseline includes a $1 per ton ($300,000) discount reduction in FY 2020 and another $1 reduction in FY 2021 to restore the Refuse Disposal Fund. The impact to the General Fund would be increased costs of $300,000 in FY 2020 and an additional $300,000 in FY 2021 (for a total of $600,000) on an ongoing basis. These actions would completely eliminate the discount to the City.

Fleet: Usage Fees

As discussed during review of the FY 2019 Budget, departments' vehicle usage fee charges were reduced, resulting in one-time savings to the General Fund as the Fleet Operating Fund draws upon fund balance in FY 2019. The FY 2020 vehicle usage fee charges will need to be increased back to fully cost-recoverable levels. The Outlook includes a $4.6 million increase in Baseline expenditures to account for this.

Homeless Programs and Services

The Outlook includes $7.7 million in ongoing General Funds for homeless programs and services throughout the five-year window, as reflected in the table below. This is the same amount that was included in the FY 2019 Adopted Budget, less one-time funding for the San Diego Misdemeanants at Risk Track (SMART) program and for a consultant that supported the Select Committee on Homelessness.

Homeless Programs and Services Baseline General Fund Expenditures

Department	Program	Expenditures
Citywide Program Expenditures Department	Bridge Shelters	$ 2,762,000
Economic Development Department	Homeless Shelters and Services Programs[1]	2,287,106
	Safe Parking Program	410,667
	Housing Navigation Center	300,000
Police Department	Homeless Outreach Team	1,924,902
Total		**$ 7,684,675**

[1] These programs include: the Year-Round Interim Housing Program; Connections Housing Downtown; the transitional storage center located at 252 16th Street; and the Serial Inebriate Program. Funds are provided to the San Diego Housing Commisssion which oversees the programs per a memorandum of understanding with the City.

[6] Tipping Fee discount reduction plan consisted of a $2/ton reduction in FY 2016, a $2/ton reduction in FY 2017, and a $1/ton reduction in FY 2018 (Report to Council No. 15-067, dated June 17, 2015).

Information Technology

The Baseline increases in information technology (IT) expenses to the General Fund are $3.7 million for FY 2020. This represents almost a 12% increase over the FY 2019 IT budget for General Fund departments. The largest component contributing to this increase is the projected cost of switching to a new data center provider. The Department of IT estimates this transition to cost the City (all funding sources) approximately $2 million each year from FY 2020 through FY 2022, which would be roughly $1.4 million from the General Fund each year. Transition services when the City switched from San Diego Data Processing Corporation to ATOS were approximately $4 million, spread over multiple fiscal years. The other large change in the Baseline IT budget is the inclusion of cyber security costs, approximately $1.7 million for FY 2020, the majority of which were previously budgeted elsewhere.

Library: Ongoing Programming Funding

In the FY 2019 Adopted Budget, the City Council allocated $100,000 in ongoing funding for library programming which has been maintained in the Outlook's Baseline. This funding has allowed for the continuation of systemwide library programs such as the Summer Reading Program, 1000 Books Before Kindergarten, and Spring into STEAM. No additional funding for programming is assumed in the Outlook.

Real Estate Assets: 101 Ash Moving Expenses

The FY 2019 Budget includes one-time funding of $2.1 million to move City staff into 101 Ash. Since this was one-time funding, it has been removed from the Baseline in the Outlook and does not carry forward into FY 2020. However, as discussed in the FY 2018 State of the CIP Report which was issued in November 2018, the tenant improvements at 101 Ash are estimated to be completed in the summer of 2019 and employees would move in by fall of 2019 (in FY 2020). As such, one-time funding has been added back into the Baseline to account for the move in FY 2020. The moving cost estimated was revised to approximately $1.5 million in the July 2018 report to City Council regarding the 101 Ash Building Project and Appropriations. The General Fund portion of this is estimated to be roughly $689,000 and is included in the Outlook.

Transportation & Storm Water: Tree Trimming

During the FY 2019 budget development process, City Council restored $882,000 in ongoing funding towards the City's contract to trim street trees. This expenditure is maintained in the Outlook's Baseline allowing the Department to continue current service levels. More information on street tree maintenance, including the Department's quarterly palm tree trimming schedule, can be found at: https://www.sandiego.gov/trees/maintenance

SELECTED CRITICAL STRATEGIC EXPENDITURES INCLUDED IN THE OUTLOOK

Citywide Program Expenditures: Borrowing Costs to fund General Fund Capital Projects

Planned General Fund borrowing for capital improvement projects over the Outlook period remains at $270 million, unchanged from last year's Outlook. The current plan envisions three phases of commercial paper borrowing beginning in FY 2019 ($88.5M), FY 2021 ($90.8M), and FY 2023 ($90.7M). Staff assumes each phase of short-term commercial notes will be replaced after approximately two years with 30-year bonds issued in FY 2021, FY 2023, and FY 2025. The Outlook reflects this expectation by including $6.7 million for commercial paper (comprised of interest and program costs) and $26.3 million for debt service (principal and interest) on long-term bonds. Total General Fund borrowing costs over the Outlook period is $33 million. It should be noted that $1.3 million of this total has been included as a Baseline Expenditure given that issuance of commercial paper notes is being initiated in mid-FY 2019. The remaining $31.7 million is included as a Critical Strategic Expenditure in the Outlook.

By issuing and re-issuing (also known as "rolling over") commercial paper notes for shorter terms of not more than 270 days, the City borrows at lower short-term interest rates in the short-run and only borrows the amount needed for project expenditures when ready. This is as opposed to borrowing more funds than immediately needed with a long-term bond issuance which results in unnecessarily paying interest on idle bond proceeds (sometimes for three to four years) that have yet to be expended for capital project costs. This has been the City's practice for financing most General Fund capital projects to date; however, the go-forward plan calls for initially using commercial paper and subsequently replacing the notes with long-term bonds. The reason the City ultimately replaces commercial paper notes with long-term bonds is to better match the borrowing term with the estimated useful life of the long-term capital assets being financed.

While borrowing efficiencies and interest savings are achieved in the early years, the use of commercial paper in the short-term (usually for a period of three years or less) followed by the issuance of long-term bonds effectively extends the total borrowing period. City staff continuously monitors its capital needs and considers the risks associated with using commercial paper. Based on these needs and considerations, they believe they can act to replace outstanding commercial paper with long-term bonds in a manner that will be more cost effective than simply issuing long-term bonds to finance capital projects.

Enterprise Asset Management (EAM)

The EAM is what the City used to call the Infrastructure Asset Management Project, or I AM San Diego. EAM is a software solution that will play a significant role in the management of the City's infrastructure. It will enable staff to use information on assets, such as current conditions, geographic locations, and maintenance history to develop optimal maintenance and capital investment strategies. Phase I of EAM has been rolled out to four departments and will continue to be phased in across five additional departments between FY 2021 and FY 2024. This system will support the development of the Five-Year Capital Infrastructure Planning Outlook and guide funding decisions in the annual budget.

The Outlook includes EAM as a Critical Strategic Expenditure and includes requests from the Public Works General Services Branch and the Transportation and Storm Water Department (TSW), both Phase I departments, to facilitate stable implementation of the solution. Requests include upgrades of mobile devices which are used to access work orders, view and update information on assets, and access inventory information to see if parts are available to complete work. In addition, 10.00 FTE positions are included for TSW to better manage its inventory of supplies so that it is accurately reflected in the system, and to provide IT support as well as support for asset management functions and processes.

The Outlook also includes funding starting in FY 2021 for Phase II implementation to support user licenses and any changes needed to the system to support department needs.

Environmental Services: Compressed Natural Gas (CNG) Fueling Station Maintenance

The Outlook includes an additional ongoing funding allocation of $210,000 annually throughout the Outlook period to provide both preventative and as-needed maintenance for the CNG fueling station, once all four phases are fully built out. This additional funding will supplement the Department's current budget of $42,000 for fuel station maintenance. Phases 1 and 2 of the facility are in operation supporting 52 fuel lines. Phases 3 and 4 are expected to be completed in FY 2019 to include an additional 88 fuel lines. Given that the fueling station supports the Department's fleet of both refuse and recycling vehicles, this funding from the General Fund represents 60% of the total maintenance costs; the Recycling Fund will be responsible for the balance (40%).

Fire-Rescue: Added Firefighter Positions to Establish Relief Pool and Reduce Overtime

The Outlook includes the addition of 111.00 FTE firefighter positions over five years as a Critical Strategic Expenditure to increase staffing levels by creating a relief pool for firefighter personnel. The proposed new positions are in addition to other personnel adds in the Outlook related to expanded services such as new fire stations and Peak Hour Engines (discussed later in this section).

The relief pool is intended to improve the efficiency of the Department's constant staffing model by reducing its dependence on overtime, which has increased significantly in recent years. In FY 2019, the First Quarter Budget Monitoring Report projected that Fire-Rescue would exceed its overtime budget by $6.9 million by year-end, for a total expenditure of $45.0 million. In the short term, the Department has indicated it will hold a second fire academy in FY 2019 and will request funding during the mid-year budget adjustment process (discussed separately in our review of the First Quarter Report). The Relief Pool concept is intended to address staffing issues over the longer term.

By hiring more firefighters to staff a relief pool, the Department anticipates achieving net savings in personnel expenditures by shifting costs from overtime (premium pay) to salaries (straight pay). The following table illustrates the various components of establishing a relief pool included in the Outlook, including the cost of running additional fire academies and supporting added personnel, as well as the eventual overall net savings achieved beginning in FY 2022 due to reduced overtime.

Fire-Rescue Relief Pool Costs

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Additional FTEs	37.00	74.00	111.00	111.00	111.00
Personnel Expenditures (PE)	$4,344,243	$8,688,484	$13,032,727	$13,032,727	$13,032,727
Overtime Offset	($5,232,916)	($10,465,832)	($15,519,715)	($15,519,715)	($15,519,715)
Subtotal – Net PE Savings	($888,673)	($1,777,348)	($2,486,987)	($2,486,987)	($2,486,987)
Academy Cost to build Relief Pool (short-term)	$1,007,684	$1,007,684	$1,007,684	-	-
Additional Ongoing Academy (to maintain increased staffing level)	$1,007,684	$1,007,684	$1,007,684	$1,007,684	$1,007,684
Total Cost	**$1,126,695**	**$238,021**	**($471,619)**	**($1,479,303)**	**($1,479,303)**

As reflected in the table above, Fire-Rescue anticipates operating two additional fire academies in the first three years of the Outlook to build a relief pool, which would then be supported by only one added ongoing fire academy in the last two years of the Outlook and beyond. These academies are in addition to the one ongoing fire academy already included in the Outlook Baseline.

In previous reports, our Office has raised concerns about Fire-Rescue exceeding its overtime budget by significant amounts over the past several fiscal years. The proposed Relief Pool Critical Strategic Expenditure is intended to bring the Department's staffing levels into greater balance and reduce the Department's dependence on overtime to achieve constant staffing. While our Office is supportive of the Relief Pool in concept, should it be funded and implemented, close monitoring of personnel expenditures relative to overtime will be required in FY 2020 and beyond to verify whether anticipated net savings actually occur as planned.

Fire-Rescue: New Fire Stations Opening within the Outlook Period

The Outlook's Critical Strategic Expenditures include funding for operational expenses for four new fire stations projected to open within the Outlook period. These expenses are phased in over five years and total approximately $10.3 million in FY 2024, including the addition of 60.00 FTEs. Operational expenses include personnel expenditures and non-personnel expenditures such as equipment and supplies. Costs for items that may be considered capital in nature, like fire engines and ladder trucks, are routinely financed through the City's Equipment and Vehicle Financing Program (EVFP).

The four new fire stations identified in the Outlook as requiring operational funding over the next five years are listed below according to their expected opening date:

FY 2021 – North University City (developer funded)
FY 2022 – Black Mountain Ranch (developer funded)
FY 2023 – Fairmont Avenue (land purchased; lacks capital funding for construction)
FY 2024 – Paradise Hills (no land; lacks capital funding)

We note that all four stations were identified as high-priority sites by the 2017 Citygate Report, which recommended the addition of up to 12 new fire stations as well as other increased services such as Peak Hour Engines (discussed later in this report) in order to improve the Fire-Rescue Department's ability to meet its response time standards.

As noted in the list on the previous page, the first two stations already have full funding identified for capital construction costs. The final two stations, Fairmont Avenue and Paradise Hills, do not have full funding identified for construction at this time. We also note that the Paradise Hills Fire Station is planned to be a double-house station, which will require the addition of 24.00 FTEs as opposed to the standard 12.00 FTEs normally needed to staff a fire station.

Fire-Rescue: Rollout of Peak-Hour Engines (PHEs)

The Outlook includes as a Critical Strategic Expenditure the addition of six Peak-Hour Engine (PHE) fire units including 48.00 FTE firefighter positions, which are phased in over two years with a total cost of $6.5 million by FY 2021. The Outlook assumes the addition of three PHEs in FY 2020 and another three PHEs in FY 2021, which is consistent with the projections provided in last year's Outlook.

Peak-Hour Engines (PHEs) are fire engines that do not operate out of a fire station but are instead flexibly deployed in various areas based on need for 12 hours per day. Like traditional fire stations, PHEs are staffed by four-person crews. Due to the nature of firefighters' shifts, the budgetary impact of staffing one 12-hour PHE is 8.00 FTE firefighter positions.

PHEs are a new deployment concept that has not yet been utilized by the San Diego Fire-Rescue Department. PHEs were a key recommendation of the 2017 Citygate Report, which identified several geographic service gap areas contributing to performance challenges and offered several recommendations to improve response times. The Department has indicated that its intention with the PHE concept is to supplement rather than replace fire stations and existing Fast Response Squad (FRS) units. PHEs are anticipated to be implemented by deploying existing reserve fire engines and would not require any significant capital investment.

Following the release of the 2017 Citygate Report, which outlined the PHE concept, our Office reviewed the report recommendations in IBA Report #17-15 and worked with the Fire-Rescue Department to develop an implementation scenario in which the Department would pursue the Citygate priorities concurrently. The addition of six PHEs, along with the completion of new fire stations, would make significant advances in achieving the Citygate recommendations for improved emergency response in the City.

Fleet: Fleet Facility Repairs and Safety Upgrades

The Outlook includes the General Fund's portion (approximately 73%) of estimated costs for repairs at various Fleet facilities as well as safety improvements. The largest expense for FY 2020 is approximately $2.0 million (total cost for all funds $2.8 million) to the Capital Improvements Program for replacement and/or repairs of the City's car and truck washes. The next largest allocations in FY 2020 are to address deferred maintenance issues and worn-out shop equipment at Chollas and to purchase a fall restraint system for staff working on taller vehicles. Allocations in the future years include maintenance and equipment at Chollas, the Fabrication Shop, Miramar and Rose Canyon. We note that this line item does not include funding for Othello. Please see the “Potential Funding Needs Not Included in the Outlook” section later in this report.

Information Technology: Public Safety Radio

The Outlook includes funding increases for the City’s public safety radio system that range from $352,600 in FY 2020 to nearly $2.5 million in FY 2024. Over the five-years, these projections include expenses for the contract with Motorola, regulatory requirements, as well decommissioning old sites and adding new radio repeater sites. Approximately $264,000 is needed each of the next five fiscal years to meet new regulations which took effect in January 2018. The Department of IT has already conducted site audits and identified the sites requiring infrastructure improvements. The Motorola contract is projected to increase by approximately $88,000 in FY 2020 from adding two more radio repeater sites. The expenses in this line item are considered critical in order to keep the City’s emergency radio and dispatch system operational, maintain FCC licensing, and be eligible for grant funding.

Information Technology: City Website

Expenses to maintain the City’s public website are included in the Outlook. The largest component for FY 2020 is a one-time cost of approximately $192,000 to the General Fund ($473,000 to all City funds) to upgrade the version of the City’s website content management system (Drupal), which is needed to maintain security standards and reduce risk.

Information Technology: OSHA Reporting

Approximately $390,000 is included in the Outlook to provide a centralized solution for OSHA reporting. The Public Utilities Department is already using the system. This would fund licenses, configuration and training to bring other City departments into the system to provide efficiency improvements. However, City departments are currently meeting OSHA regulatory reporting requirements, and based on policy priorities and limited funding availability, this item does not appear to be critical for FY 2020.

Library: New Branch Libraries

The Outlook identifies 8.50 FTEs and approximately $784,000 in new ongoing annual operational costs beginning in FY 2021 for the Pacific Highlands Ranch library. However, based on the latest estimate for the completion of construction, the facility is not expected to open until January 2022 (FY 2022). As such, funding included in the Outlook for FY 2021 will not be required. We note that annual operational costs will be re-evaluated and refined as work on the facility continues to move forward. Attachment 2 provides detailed expenses for each facility anticipated to open or become operational within the Outlook period.

In addition to the ongoing operational costs discussed above, the facility will require the purchase of new materials (books, periodicals, etc.) to fully shelve the new library branch. Funding for these materials was requested by the Department but not included in the Outlook. This is discussed later in this report.

With respect to funding for the new Mission Hills Branch, which is scheduled to open in January 2019, and the new San Ysidro Branch currently anticipated to open in the summer of 2019, we note that only a partial year of non-personal expenditures for each branch was included in the FY 2019 Adopted Budget given the expected opening dates at that time. Approximately $171,000 (combined for both branches) is projected to be required starting in FY 2020 to annualize these operating costs which are not included in the Outlook's Baseline.

Parks and Recreation: New Parks and Joint Use Agreements

The Department expects 17 new/expanded parks to open, and 28 new Joint Use Agreements (Agreements) with local school districts, to become effective during the Outlook period. The Outlook projects operating expenses for the new parks and the Agreements to be approximately $3.8 million in FY 2020 and increasing to an aggregate expense of approximately $6.1 million in FY 2024 once all the new parks and Agreements have come on-line. The projected operating costs include the addition of 55.15 FTEs throughout the Outlook period to maintain the new parks and playgrounds, and another 2.0 FTEs annually during the Outlook period to address the projected acquisition of additional open space acreage. Attachment 2 to this report provides detailed expenses for each facility anticipated to open or become operational within the Outlook period.

Planning: Climate Adaptation & Resiliency Plan

The Outlook includes funding allocations of $310,000 in FY 2020 and $190,000 in FY 2021 for a total of $500,000 in funding to develop a Climate Adaptation & Resiliency Plan (Adaptation Plan). The Adaptation Plan, which is a component of the Climate Resiliency strategy within the Climate Action Plan (CAP), is intended to assist the City in identifying vulnerabilities and risks associated with changes to the City's environmental and socioeconomic system, planning for early action, and engaging in collaboration with other agencies.

The Department estimates the development of the Adaptation Plan to cost $1.2 million over the three-year work schedule based on a review of recently completed resiliency planning efforts by other local jurisdictions. In addition to the $500,000 in funding from the General Fund that is included in the Outlook, the City has received approval for grants totaling $538,000 ($100,000 from the Coastal Commission and $438,000 in SB1 funding). The Department plans to pursue additional grant funding opportunities to fill the remaining funding gap of $162,000. The General Plan Maintenance Fund may also be used, if necessary.

Planning: Housing Affordability Program (Housing SD)

The Outlook's Critical Strategic Expenditures includes annual funding of $250,000 in FY 2020, FY 2021, and FY 2022 to support the development of additional housing affordability initiatives under the Housing SD plan. Though the Planning Department has not identified specific programs, additional housing initiatives being considered include a 100% affordable housing incentive program, permanent supportive housing streamlining ordinance, additional updates to the Land Development Code, and an amendment to the inclusionary housing ordinance. While many of these housing initiatives can be prepared by staff, the Department is anticipating that it will need to contract out technical and environmental analysis in support of certain initiatives. The requested funding was based on the need to conduct this type of technical/environmental analysis for one housing initiative for each of the next three fiscal years.

Over the last few years, numerous initiatives intended to improve housing affordability have been completed, including the affordable/sustainable expedite program, companion units, affordable housing density bonus program, updates to the Land Development Code, production of a housing inventory report, and the streamlining of environmental review. Initiatives that are currently in process include transit priority area parking standards, mixed (moderate/middle) income density bonus program, parks master plan, updating the development impact fee (DIF) calculation methodology, and implementation of SB743 and Vehicle Miles Traveled (VMT). A complete list of completed and ongoing initiatives is maintained by the Department at https://www.sandiego.gov/housing/initiatives

Police: Additional Overtime until Staffing Improves

The Outlook includes an additional $6.0 to $7.8 million per year in overtime expenditures across the next five years to support Police Department operations. This additional expenditure, which is included as a Critical Strategic Expenditure, is intended to support sworn staffing while the Department continues its efforts to decrease vacancies.

As of November 19, 2018, the Department had 1,818 filled sworn positions out of 2,043 budgeted positions. We note that recent efforts to improve police officer staffing have shown signs of success, reducing the monthly officer attrition rate from 14 departures per month in FY 2018 to a current level of 10 to 11 per month. However, because it may take several years to reach full staffing (even with improved conditions), an increase in overtime expenditures in the meantime is likely required to maintain current service levels.

For FY 2020, the Outlook Baseline includes $27.0 million in overtime expenditures for Police (an increase of $2.5 million from the FY 2019 Budget). After adding the $6.5 million Critical Strategic Expenditure for overtime, total overtime funding for FY 2020 would be $33.5 million. This amount is roughly equal to current FY 2019 year-end projection for Police overtime of $33.9 million (discussed separately in our review of the First Quarter Report). If service level demands on the Police Department remain constant between FY 2019 and FY 2020 then the Outlook's proposed overtime funding levels appear reasonable. However, if increased demands are placed on the Police Department without corresponding funding increases (such as for added services at the Navigation Center), continued overtime overages are likely to occur. Additional factors that could affect overtime include whether vacancies are filled and whether extension-of-shift overtime is reduced.

Police: Added Sworn Positions Beginning FY 2022

The Outlook includes the addition of 21.00 sworn police officer positions per year for three years beginning in FY 2022, for a total of 63.00 additional officers across the Outlook period. As noted in the Outlook, the Police Department has a goal of reaching the sworn staffing level it last maintained in 2009, which was 2,128 officers. We note that this staffing goal, previously referred to as the Police Department's "Five-Year Plan," was first presented to Council in FY 2013. In recent years, the Department has not significantly increased its number of budgeted positions and has instead focused on filling its existing vacancies.

While the Outlook projects the need for added positions beginning in FY 2022, the Department has indicated that it does not anticipate a need for new positions until such time as an appropriate number of existing vacancies have been filled. The Department further noted that its priority will be filling budgeted vacant positions over the next two fiscal years, a strategy which our Office finds prudent.

Public Works – General Services Branch: Facilities Condition Assessments

The Outlook includes as a Critical Strategic Expenditure a total of $750,000 in General Funds between FY 2021 and FY 2023 for facilities condition assessments that may be needed during the Outlook period. This is intended to better inform needed improvements.

The last facilities condition assessment was conducted between FY 2014 and FY 2016. The assessment examined 693 City General Fund buildings to identify needed maintenance, repair, and capital improvements. In March 2017, Council approved a condition level that these buildings should be maintained using a facility condition index. To bring the City buildings up to a condition rating of "good", the assessment estimated that $828.7 million is needed. Public Works has since developed a draft asset management plan that takes into account the condition assessment results as well as improvements that are needed to meet departmental operational needs to guide facility maintenance and capital investments.

Public Works – General Services Branch: Investment in Facility Maintenance

The Outlook also includes investments in facility maintenance that were unfunded requests in the FY 2019 Adopted Budget. These include increased contract expenses for asbestos remediation; a Generator Technician and other non-personnel costs to ensure emergency generators work; and contract costs to implement facility rehabilitation projects. Staff has indicated that the rehabilitation projects require minor construction contracts since they are too large for in-house crews or require special expertise and are too small to be included in the Capital Improvements Program. Projects would provide HVAC, roof, and electrical system material replacements.

Our Office supports investments in City facilities. As indicated in the most recent Five-Year Capital Infrastructure Planning Outlook as of January 2018, City facilities had the third largest funding gap, behind storm water and streetlights. Inadequate investment in City buildings increases their deterioration, leads to significant increases in the City's deferred capital backlog, and could result in system failures.

Real Estate Assets: Removal of Mobile Homes from De Anza Cove

The Outlook includes an estimated $1.8 million of General Fund money for removal of mobile homes from De Anza Cove in FY 2020. The Park & Recreation Department is also pursuing an allocation of $2.0 million from the Mission Bay Park Improvement Fund (MBPIF) as listed in their November 15, 2018 report to the MBPIF Oversight Committee. It is not certain at this time if the MBPIF can be used for this purpose and discussions with the City Attorney's Office are ongoing.

However, if it is determined that MBPIF can be used and the allocation is approved by the MBPIF Oversight Committee, then the $1.8M identified in the Outlook will not be needed from the General Fund in FY 2020.

Short-Term Residential Occupancy (STRO)

The Outlook's Critical Strategic Expenditures include the addition of 8.00 FTEs and $7.2 million in associated expenditures for the Office of the City Treasurer over the Outlook period. These expenditures are intended to bring STRO property owners into compliance with the City's regulations governing TOT. Under the City's Municipal Code, any property located in the City that is rented out to transients for less than one month must obtain a Transient Occupancy Registration Certificate (TOT Certificate). This includes STRO rentals of any kind (i.e., whole home or home share) rented directly by the owner/operator, by property management companies or via third party hosting platforms. Currently, there are approximately 3,800 STRO properties that have obtained a TOT Certificate. While it is currently unknown how many STRO properties are not registered for a TOT Certificate, it is estimated that there are up to 15,500 STRO listings that are non-compliant[7].

We note that these additional resources included in the Outlook will not be utilized to perform any sort of enforcement or STRO licensing activities that were contemplated in the STRO Ordinance that was adopted by City Council on August 2, 2018, and subsequently repealed on October 22, 2018 after a referendum petition qualified the ordinance for a public vote. Further, the Outlook does not make any assumptions regarding any future STRO regulations being adopted; however, staff has indicated that these additional positions would be capable of absorbing a potential STRO licensing program, as previously proposed, should it be included in any future STRO Ordinance.

These positions will provide TOT administration, auditing and delinquent account services necessary to bring STRO hosts into compliance. STRO compliance activities will initially focus on outreach to STRO hosts believed to be non-compliant, requiring them to register for a TOT Certificate and pay back taxes, if necessary.

In July 2018, the City entered into a cooperative agreement with Host Compliance which will provide data and analytical services necessary to conduct TOT compliance, and potentially STRO regulatory compliance, should a STRO Ordinance be approved in the future. This will allow the City to obtain data from online hosting platforms of short-term rentals which can be used to enforce tax and regulatory compliance. The cost associated with this contract is estimated to total $2.5 million over the Outlook period.

These expenditures are projected to be offset by ongoing TOT revenue totaling $11.6 million over the Outlook period that likely would not otherwise be realized from non-compliant STRO properties. This projection is based on a relatively conservative assumption that STRO properties represent less than 50% of the estimated number of STRO listings that will begin to self-report after receiving a notice of non-tax compliance.

[7] Given that STRO properties are known to be listed on more than one online platform, the actual number of STRO properties will be less than the number of STRO listings.

TOT revenues are projected to be phased in over FY 2020 through FY 2022, as shown in the table below.

	FY2020	FY2021	FY2022	FY2023	FY2024
STRO Compliance Expenses	$1.7M	$1.7M	$1.3M	$1.3M	$1.3M
Projected TOT Revenue	$0.8M	$2.4M	$2.8M	$2.8M	$2.8M
Net Revenue	($0.9M)	$0.7M	$1.5M	$1.5M	$1.5M

This additional TOT revenue is included in the Critical Strategic Expenditures section of the Outlook and has not been incorporated into the TOT Baseline projection. The preceding table does not include any one-time back tax revenue that may be realized as a result of these activities. Back tax revenue is not included in the Outlook but is expected to be included in the FY 2020 budget development process.

Transportation & Storm Water: Sidewalk Repair

The Outlook includes the addition of a total of 10.00 FTEs and $4.0 million in associated expenditures over the Outlook period to address sidewalk ramping needs (i.e., placement of asphalt on sidewalk uplifts to mitigate potential hazard). The additional staffing consists entirely of Utility Worker Is which are phased in over the Outlook period (4.00 FTEs in FY 2020, 4.00 FTEs in FY 2021, and 2.00 FTEs in FY 2022). According to the Department, the City has received an average increase of approximately 40% in customer generated sidewalk repair requests in FY 2017 and FY 2018 through the Get It Done application. This has impacted the amount of time it has taken the Department to address reported sidewalk hazards. In FY 2018, the average time was 63 days. While the Department has been able to reduce this average down to 20 days by reallocating resources to this effort, they expect to decrease the average to 10 days through these additions.

In addition to sidewalk ramping, the Outlook includes ongoing annual funding of $1.1 million (totaling $5.6 million over the Outlook period) for contractual services to address the backlog of sidewalk slicing needs (i.e., grinding or horizontally cutting sidewalk uplifts to mitigate potential hazard) that were identified in the 2015 Sidewalk Condition Assessment. This is in addition to the $560,000 currently budgeted for slicing.

In total the Outlook includes $5.7 million in additional expenditures for sidewalk ramping and slicing repairs. Further discussion of sidewalk replacement funding, which was requested by the Department but not included in the Outlook, is discussed later in this report.

Transportation & Storm Water: Additional Positions to Support Programs

The Outlook includes the addition of 2.00 FTEs and $201,000 in associated annual personnel expenditures beginning in FY 2020 (increasing to 4.00 FTEs and $409,000 in FY 2021) to supplement staffing within the Department's Traffic Engineering Operations Division that support various initiatives, including Vision Zero, and the Climate Action Plan. The Department has indicated that current staff has been impacted by additional 1,100 high priority "Get It Done" requests per year, many of which are outside the scope of the strategic initiatives mentioned above. In addition, City Council Policy 200-07 "Marked Crosswalk Criteria at Uncontrolled Locations" has qualified numerous locations for pedestrian safety improvements requiring traffic control devices (e.g. crosswalks and flashing beacons). There are currently 32 staff dedicated to these activities.

POTENTIAL FUTURE FUNDING NEEDS NOT INCLUDED IN THE OUTLOOK

Fleet: Othello

As discussed in our review of the FY 2019 Proposed Budget, funding has not been allocated for the improvements needed at Othello in order to accommodate repairs for the City's heavy duty fire apparatus. The FY 2019 First Quarter Report notes that "The Fleet Operations Department is finalizing the plans for the Othello site . . . and plans to bring the item forward to City Council . . . in early 2019." Previous cost estimates provided to City Council have ranged from $6.3 to $17.0 million, as summarized in Fleet's report to Public Safety and Livable Neighborhoods Committee in July 2018. At a briefing with our office in November 2018, Fleet indicated that the construction and tenant improvement plans and timeline were being reviewed and modified by the Public Works Department. Once the cost estimates are finalized, Department of Finance (DOF) plans to work with Fleet on identifying funding options, which may reduce the impacts to the General Fund. However, if the costs fall to the General Fund as previously anticipated, this could increase expenses in FY 2019 thereby reducing Excess Equity available in FY 2020, and/or could increase costs in FY 2020 depending on the timing of the project.

Purchasing & Contracting: One-Time Costs for Animal Services Contract

In April 2018, City Council approved the animal services contract with the San Diego Humane Society (SDHS). That action included authorization for nearly $2.2 million of one-time start-up expenditures to occur in FY 2020. This has not been included in the Outlook. The Purchasing and Contracting Department is working with SDHS to finalize the projection for FY 2020 and anticipates this will be included in the FY 2020 Proposed Budget, although the amount could be less than $2.2 million. At this time, the only identified source of funding for this expense is the General Fund.

Real Estate Assets: Civic Center Plaza Reconfiguration

When the City entered into a lease-to-purchase agreement for Civic Center Plaza (CCP) in 2015, it anticipated reconfiguring floors to make more efficient use of space. At the time this was presented to City Council in January 2015, an estimated $15.0 million would be needed for the tenant improvements, which would include asbestos remediation, ADA improvements, and Title 24 requirements, as well as allow for an additional 245 employees at CCP. No funding has been allocated for CCP reconfiguration in the Outlook.

Lack of Planned New Expenditures in Support of Climate Action Plan

The stated purpose of the Critical Strategic Expenditures section of the Outlook is to identify future known needs, that are consistent with strategic initiatives supported by the Mayor and the City Council and to provide estimated fiscal impacts of those initiatives. The City's Climate Action Plan

(CAP) was approved with the support of the Mayor and the City Council in December 2015. The CAP includes specific goals, actions, and targets - many of which are to be initiated or achieved within the Outlook period. While planning for certain CAP expenditures may contemplate the use of enterprise or special funds, no new General Fund expenditures in support of the CAP have been discretely identified within the Outlook.

Councilmembers and CAP supporters have asked for near-term expenditure projections that would help them better monitor the City's progress toward achieving CAP goals and objectives. In March 2018, the Environment Committee asked if the IBA could endeavor to develop an expenditure outlook for the CAP. In the resulting IBA Report (#18-05), our office acknowledged some of the challenges encountered in attempting to preliminary develop a near-term expenditure plan for the CAP and recommended the DOF consider including CAP related expenditures into the Outlook as an attachment.

Graffiti Abatement

In the FY 2019 Adopted Budget, the City Council allocated $300,000 in one-time funding for graffiti abatement that is not being continued in the Outlook. If excluded from the FY 2020 Budget, this reduction would reduce the scope of the Department's graffiti abatement contract with Urban Corps by eliminating abatement of graffiti on residential property.

Library: Materials for New Pacific Highlands Ranch Library

As we noted in our review of Critical Strategic Expenditures included in the Outlook, funding for new materials that will be required to fully shelve the new library were requested by the Department but not included in the Outlook. According to the Department, these materials consist of approximately 75,000 items that would need to be ordered and funded by the General Fund in advance of the FY 2022 opening in phases given publication cycles: 35,000 items totaling $665,000 in FY 2020 and 30,000 items totaling $570,000 in FY 2021. The Department anticipates receiving donated funds to purchase the remaining 10,000 items.

Library: Security for Facilities

The Department received one-time funding of $288,000 in FY 2019 to supplement its existing $1.3 million base budget for security services. While this one-time funding is not carried forward in the Outlook, the Department's costs for security are anticipated to increase as a result of a new RFP for security guard services that was released earlier this year[8]. The RFP specifically required "upgraded" guards at library locations, which are more experienced and better trained in property theft reduction, crowd control and emergency procedures, to replace the current "basic" guards. Assuming the current FY 2019 service level, the Department preliminarily estimates overall annual security costs to increase by approximately $200,000 to $300,000 due to this change, although the actual cost will not be known until a contractor has been selected. Staff expects to request Council approval for the contract in early-2019 and seek a FY 2019 Year-end appropriation adjustment, if the contract is approved.

[8] RFP is not specific to Library locations only; other sites, each with their own scope of services under the RFP, include various Community Parks, Development Services permit center, Balboa Park, Rose Canyon, 20th & B, the Civic Center Public restroom, City Administration Building, City Treasurer Office, and homelessness initiative sites.

Parks and Recreation: Maintenance Assessment Districts (MADs)

As of FY 2017, updated Assessment Engineer's reports, which are required for each MAD to comply with Proposition 218, re-apportioned the general and special benefit allotments (i.e., portion of expense that the City or the District is responsible for). As a result of the re-apportionments, Department staff anticipates an increase to the general benefits (City portion), resulting in increased General Fund expenses throughout the Outlook period. The General Fund expenses are projected to increase from approximately $203,000 in FY 2020 to approximately $243,000 in FY 2021. The additional expenses related to the MADs were requested by the Department but were viewed as a budgetary request and excluded from the Outlook by the DOF.

Transportation & Storm Water Sidewalk Replacement – Concrete Crew

The Department's submission for the Outlook requested the addition of 13.00 FTEs and $6.6 million in total expenditures over the Outlook for an additional concrete crew to perform sidewalk replacements. This would provide the Department with a third concrete crew (12-person each) plus an additional Public Works Supervisor to perform the most urgent repairs associated with hazardous conditions, injury claims, and resident 50/50 cost-sharing projects ($479,000 in projected annual revenue from the cost-share would offset expenditures). Without this crew, the Department expects both the backlog of requests and associated response times to increase.

As discussed in our Office's report 18-35, "Review of Proposed Changes to the City's Sidewalk Maintenance Policy," replacements funded through the Capital Improvements Program take time to implement due to the need to scope out and plan locations to include in construction contracts and to conduct the bid and award process. An additional concrete crew would bypass this process and could address urgent repairs quickly. However, in our report we recommend that a plan be created to address the sidewalk backlog that includes, among other things, updated sidewalk funding and staffing needs. We believe that this plan would help inform where the greatest need for investment exists.

Code Enforcement to Support the City's Zero Waste Plan and Climate Action Plan

The City Council has approved the Zero Waste Plan and the Climate Action Plan as strategies for achieving the goals of diverting 75% of waste generated in the City from landfill disposal by 2020, 90% by 2035, and zero waste by 2040. One strategy identified in the plans is the development of outreach/educational programs and increased frequency of inspections for residential and commercial recycling and trash bins.

To implement this strategy, the Department had previously requested the addition of 2.00 FTEs and approximately $200,000 in annual expenses for two Code Compliance Officers during the FY 2019 budget development process. Additionally, the Department had requested the addition of 1.00 FTE and approximately $184,000 in annual expenses for one Program Manager position to lead the Code Compliance Section within the Department. The proposed position would be responsible for supporting enforcement of the City Recycling Ordinance and would focus on compliance with diversion requirements, review of Construction and Diversion (C&D) and other clean-up efforts. These requests were not funded in the FY 2019 Adopted Budget or included in the Outlook. As a result, there may be a delay in the City meeting its Zero Waste Plan goals.

Housing Navigation Center – Police Department

The Outlook includes increased Police staffing costs for enhanced security and outreach related to the new storage center approved in March 2018 (known as the Storage Connect Center). However, it does not consider costs for similar activities related to the Housing Navigation Center as it was approved November 13, 2018. These costs are largely driven by a memorandum issued to Councilmembers on the same day detailing the Mayor's commitment of providing improved security and cleanliness to the community around the Navigation Center. The commitment is referred to as a Community Impact Strategy.

Specifically, among other activities, the Police Department is tasked with leading an effort that discourages nuisance behavior and criminal activity, including providing a police presence for safety during the day and night. In addition, the City will supplement the security services for the Navigation Center to ensure a 24-hour per day security presence around the facility. It is unclear whether these requirements will result in the Police Department providing 24-hour security for the Navigation Center. According to Department, options are being evaluated.

Similar requirements were placed on the Department in a separate Community Impact Strategy for the Storage Connect Center. In addition, upon approval of the Storage Connect Center, a requirement was included that the City increase security to 24-hour per day and expand security to a half-mile radius for at least 90 days. Police fulfilled this requirement and though the time period has ended, the Department is continuing to provide 24-hour security. According to the FY 2019 First Quarter Report, Police Department activities related to the Storage Connect Center are anticipated to result in $2.0 million overbudget overtime costs. This is in addition to the $1.7 million appropriated to operate the Storage Connect Center in FY 2019. Providing similar security services for the Navigation Center will exacerbate Police's overtime problem until they can increase staffing.

Housing Navigation Center – Environmental Services Department

Like Police, the Environmental Services Department (ESD) has also taken on new activities related to the Storage Connect Center and will be performing similar activities for the Navigation Center. The Community Impact Strategy requires abatement of waste and abandoned belongings at least twice per week; litter removal at least five times per week; sanitation of the surrounding area at least once per week; and community engagement.

ESD has informed us that in order to provide the required Clean SD services for the Navigation Center, they plan to absorb these costs in their existing FY 2019 Clean SD budget of $4.2 million. They plan to do this by assigning a heightened priority to the Navigation Center which may result in other areas receiving less of a focus.

As the ESD and Police responsibilities related to the Navigation Center are new, and are not budgeted for FY 2019, our Office requested DOF to identify in the FY 2019 Mid-Year Report, the fiscal impact of the focused efforts on maintaining cleanliness around the Navigation Center, as well as the **new** Police and security services, and identify a funding source. Assuming absorption of the cost of new services within the current year budget is not a good practice and can lead to over expenditures and deficits, as witnessed in other areas. Similarly, the Navigation Center has the potential to be extended over the next five years. Therefore, the potential future fiscal impacts of these new activities should be reflected in the Five-Year Outlook as well.

FUTURE FINANCIAL CHALLENGES

Storm Water

In May 2013, the San Diego Regional Water Quality Control Board (Regional Board) adopted a new municipal storm water permit for San Diego. That permit mandates strict storm water quality requirements, and compliance with that permit will require significant increases in funding. The Transportation and Storm Water Department completed a Watershed Asset Management Plan (WAMP) in 2014 that notes activities and projects necessary to support flood risk management activities and compliance with the Regional Board's storm water permit. The WAMP, which was recently updated in October 2018, projects that funding needs total $3.1 billion through FY 2035. Penalties for not complying with storm water permits and requirements are up to $10,000 per day per violation.

Storm water permit compliance efforts have significant operational and capital needs which are higher compared to current spending levels. The FY 2019 Adopted Budget included a total of $52.1 million for storm water efforts, of which $26.9 million was dedicated to water quality efforts and $25.2 million to flood risk management. While the later years of the Outlook include 22.00 new FTE positions and $5.5 million in expenses for increased storm drain pipe maintenance and repair, the majority of projected storm water needs that are identified in the WAMP were not included in the Outlook's Baseline or discussed as critical expenditures. The table below shows total operational needs above the FY 2019 base budget that are not included in the Outlook.

Projected Operating Costs to Meet Permit Compliance *($ in millions)*

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Operations/Maintenance*	$12.7	$9.5	$21.3	$14.9	$13.7

* Reflects necessary operating expenditures identified in the WAMP, net of the Storm Water Division's FY 2019 base budget ($51.6 million) and storm water related Critical Strategic Expenditures included in the Outlook.

For capital needs, the Outlook notes that storm water flood risk management and water quality improvement projects have been identified, but the Outlook itself neither details those needs nor includes any of the projected costs for those needs. They are expected to be discussed in the Five-Year Infrastructure Planning Outlook, which staff plans to release in January 2019.

While future deferred capital bonds and commercial paper issuances may support some of the capital needs, they will not be sufficient to meet all storm water capital costs identified in the WAMP and other City CIP needs. The City continues to lack a dedicated funding source that provides revenues sufficient to address all storm water permit and mandate needs.

The City does have a Storm Drain Fee that is paid by water and sewer users. That fee collects 95 cents per month from single family residences and $0.0647 per hundred cubic feet of water use from multi-family and commercial water customers. In total, that fee brings in approximately $5.8 million per year.[9]

The Storm Water Fee rates have remained unchanged since the passage and implementation of California Proposition 218 in 1996. Proposition 218 allowed local governments to adjust water, sewer, and trash fees through a vote of the local legislative body (in the City of San Diego, this body is the City Council), but required other fee increases to be put to a public vote. This had the effect of making any increase in the storm drain fee subject to a two-thirds vote of City voters in a city-wide election, or majority vote of City property owners in a mail-out election. As the City became subject to increasingly stringent storm water quality mandates and permits, Proposition 218 has constrained its ability to adjust its Storm Drain Fee to compensate for those increased costs.

Last year, the California Legislature passed SB 231, which clarified the interpretation of Proposition 218 to include storm drains and storm water systems under the overall definition of sewers, and thereby allows local governing bodies to adjust storm water and storm drain fees without putting the issue to a public vote. The Council may wish to consider requesting additional information or a proposal on adjusting the City's Storm Drain Fee to help fund storm water permit requirements; an increase of $1.00 per parcel per month would generate an additional $6 million per year; as an example, an increase in the fee to $5.00 per parcel per month would generate an additional $30 million per year to fund storm water needs.

Infrastructure Shortfall

The most recent Five-Year Capital Infrastructure Planning Outlook released January 2018 identified a $1.58 billion funding gap between capital needs and available funding sources for FY 2019 through FY 2023. The gap is attributed to City assets that do not have a dedicated funding source. The greatest contributors to the funding gap include storm water needs, streetlights, General Fund facilities, parks, and sidewalks. Even with $270 million in anticipated financing for General Fund capital improvement projects over the Outlook period, General Fund capital needs far exceed funding available.

Our Office supports the anticipated investments over the Outlook period on infrastructure maintenance including storm drain pipe repair, facility improvements, and sidewalk repair. Continued deferral of these needs eventually adds to the capital backlog, increases liability to the City, or results in system failures.

Homelessness

Since the last Five-Year Outlook, the City, through the San Diego Housing Commission (Commission), has significantly expanded homelessness services. In the last year, the Bridge Shelter Program was initiated, evaluated, and then extended; a new transitional storage center was established (known as the Storage Connect Center); and a Housing Navigation Center has recently been approved. These program expansions have presented fiscal challenges to the City due to not budgeting for all known costs, as discussed earlier in this report with regard to the Storage Connect

[9] San Diego's storm drain fee is low compared to other coastal cities; Los Angeles' corresponding fee is $1.92 per month; Monterey's is $5.44 per month; Santa Monica's is $10.00 per month.

Center and the Housing Navigation Center. Also, the lack of an ongoing funding plan for the City's bridge shelters and the Storage Connect Center has posed fiscal challenges.

The Outlook includes $2.8 million in General Funds for the City's three bridge shelters. These expenses are largely for continued rental of shower, restroom, and laundry equipment. For FY 2019, the Commission is supporting the $11.1 million in remaining program costs by drawing on its property reserves – revenue generated from the properties that it owns and is set aside for major capital improvement needs, replacements, enhancements, and repairs. The Storage Connect Center provides a place for homeless individuals to safely place their belongings. Costs for this program of $1.7 million in FY 2019 are included entirely in the Commission's budget and is also supported by the Commission's property reserves.

The City has committed to backfilling the Commission for both programs' costs in FY 2018 and FY 2019. To date, our Office is aware of $15.5 million (in federal Community Development Block Grant funds and City Low-Moderate Income Housing Asset Funds) that has been allocated to the Commission for this purpose, with $2.9 million outstanding.

The Outlook does not include any additional funding to support the full Bridge Shelter Program or the Storage Connect Center directly. If it is envisioned that these programs continue, the City should identify ongoing funding instead of the current practice of backfilling the Commission on an annual basis with limited or one-time funding. We note that the Commission is overseeing the development of a comprehensive Strategic Plan for addressing homelessness in the City which may inform the longer-term plan of these programs. Though the use of additional General Funds would require cuts elsewhere, a potential new ongoing revenue source for homelessness could become available if voters were to approve (in a future election) the ballot measure for an expansion of the convention center and funding for road repairs and homelessness. This is discussed further in the next section.

OPTIONS TO ADDRESS SHORTFALLS

3% Budget Reduction Proposals

In November 2018, the Chief Operating Officer released two memoranda directing departments to submit 3% budget reduction proposals as part of the FY 2020 budget development process. The memoranda further noted that any reductions submitted should be available for immediate implementation in FY 2019 or by the start of FY 2020. At present, it is likely that not all department reductions submitted will be accepted and implemented due to potential operational impacts. We also note several other options to address shortfalls in the discussion that follows.

General Fund Excess Equity

The City could consider the use of any available Excess Equity for FY 2020 one-time needs. The amount that may be available is uncertain because the current $12.5 million estimate is not based on FY 2019 projections, but rather the FY 2019 Adopted Budget amounts. The FY 2019 projections that will be included in the Mid-Year Report (expected to be released at the end of January 2019) will provide a more updated sense of potentially available FY 2019 Excess Equity.

For additional information on the General Fund Reserve and Excess Equity, see Attachment 1 to this report.

Pension Payment Stabilization Reserve

The City could consider forgoing the Pension Payment Stabilization Reserve (PPSR) contribution of $4.2 million for FY 2020 (General Fund portion) and utilize these funds to pay part of the $18.1 million General Fund increase in the pension payment for FY 2020. For additional information on the PPSR, see Attachment 1 to this report.

Public Liability Reserve

As described in Attachment 1 to this report, we include the estimated $2.6 million of FY 2019 excess Public Liability (PL) Reserve for FY 2020 one-time needs. The City Council may also wish to explore whether there is any additional anticipated PL operating surplus with the DOF and Risk Management Department. We would note that PL claims can be volatile; and in recent years, the City has experienced some large claims payouts. For additional information on the PL Reserve, see Attachment 1 to this report.

Long-Term Disability Reserve

As described in Attachment 1 to this report, excess Long-Term Disability (LTD) Reserve amounts have been anticipated as a funding source for the June 2012 Proposition B death and disability benefit being negotiated with the City's employee organizations. Although negotiations for this new death and disability benefit have not concluded, and the City's cost to fund the benefit is uncertain, there may be interest in utilizing all or a portion of the LTD excess Reserve for one-time needs in FY 2020. One suggestion would be to use a portion of the excess Reserve, e.g. $2.3 million ($1.6 million General Fund). For additional information on the LTD Reserve, see Attachment 1 to this report.

People's Ordinance – Paid Refuse Collection

The People's Ordinance establishes the trash collection of single family homes as a responsibility of the City for no fee, but does not include multi-family homes. As a result, City residents that live in multi-family homes normally contract with a third-party collection service and pay for trash collection.

The Department has stated that providing collection services to single family homes represents approximately $34.5 million in ongoing costs for which no revenue is collected. The City is the only large California city to continue to provide free trash collection to single family homes.

Should the City wish to re-evaluate free collection service, the Department would be able to develop preliminary fee estimates based upon current and/or desired service levels. Transferring this cost to single family home residents would alleviate the General Fund of approximately $34.5 million in annual expenditures.

Storm Water Fee Increase

As we noted in the "Future Financial Challenges" section of this report, an increase to the City's Storm Drain Fee is an option that the City Council may wish to explore to help address storm water permit compliance funding needs. The amount of revenue that could be generated roughly equates to $6 million for each $1.00 (charged per parcel per month) the fee is increased. The City currently charges 95 cents per parcel per month.

Redevelopment Property Tax Trust Fund (RPTTF) Lawsuit

The City could receive an estimated $35-40 million in revenue pending the outcome of the *City of Chula Vista, et al. v. County of San Diego (Sandoval)* lawsuit. Local cities are challenging how the County allocates the RPTTF. A ruling is expected sometime in 2019; however, even if the cities prevail, the timing of receiving payment would still need to be determined.

South Dakota v. Wayfair

The South Dakota v. Wayfair decision allows the State to collect sales tax from goods that are sent into the State. Amazon accounts for approximate 49% of online sales in the country and already remits sales tax. The estimated impact to the City of San Diego is approximately $2 million per year. The State is expected to implement the new procedures for remote sellers in 2019. At this time, additional revenues have not been included in the Outlook projections but are likely to be fully received beginning in FY 2021.

Senate Bill 2 Funding

Senate Bill 2 (Atkins) was passed in fall of 2017 and imposes a $75 fee on real estate transaction documents, as specified. Half of the fee revenue in the first year provides planning grant funds to local governments to update planning documents and zoning ordinances to streamline housing production. Up to $500,000 will be available for large cities which must be spent by the end of FY 2022. A notice of funding availability is anticipated to be made available in Spring 2019. This funding could potentially help support implementation of eligible housing affordability initiatives through Planning Department's HousingSD Program. The Outlook includes $750,000 in General Funds through FY 2022 to analyze effects of proposed policy and ordinance changes.

In the second year and annually thereafter, funding will be made available to local governments for various activities related to affordable housing. Funds may also be used to assist homeless individuals or those at risk of becoming homeless. Once more information becomes available about this funding source, including funding levels, planning for its most impactful use can occur (funding guidelines are anticipated to be available in Spring 2019).

State Homeless Emergency Aid Program (HEAP) Funding

On December 4, 2018, the City Council approved authority to accept, appropriate, and expend $14.1 million in one-time State homelessness funding provided in the State's FY 2018-19 budget. The City has until June 30, 2021 to expend these funds. Assuming approved allocations are not reprogrammed over time, State funds will free up $1.1 million in General Funds through the spending period. This is due to planned expenditures on the following existing City programs: the City's first transitional storage center (located at 252 16th Street) and the Safe Parking Program. The exact General Fund impact attributable to each fiscal year is unknown at this time. Other planned expenditures of HEAP funding will go towards new homelessness services provided on a limited basis unless funding for their continuation is identified in the future.

Ballot Measure for Convention Center Expansion - Funding for Homelessness Programs

On September 20, 2018, the initiative to increase the City's TOT to expand the Convention Center, fund road repairs, and provide funding for housing and services for the homeless qualified to be placed on the ballot of the next regularly scheduled citywide General Election in November 2020, unless the Council decides to place the measure on the ballot of an earlier citywide Special Election (which could be in March 2020 or sooner). If voters approve this measure, 41% of the resulting tax increase will be allocated to broadly defined Homelessness Programs through FY 2024 (31% thereafter). Preliminary estimates suggest the 41% allocation could equate to roughly $139 million through the end of the Outlook period.

A portion of these funds could be used to continue and enhance ongoing General Fund support for an array of Homelessness Programs. For example, the City has yet to identify an ongoing source of funds to support the City's three bridge shelters and the recently adopted transitional storage facility. In FY 2019, General Fund and San Diego Housing Commission funds (to be backfilled with other City funds) in support of these programs is approximately $15.6 million.

Other Funding Options for Planned Borrowing Costs

The Outlook plans for the General Fund to cover approximately $33.0 million of borrowing costs for capital projects through FY 2024. The City could alternatively use revenue from two other special purpose funds (the Infrastructure Fund and the Capital Outlay Fund) to cover all or a portion of these costs. The City Charter requires revenue in these Funds to be used for capital projects. Borrowing costs in support of capital projects is defined as an eligible use.

The Infrastructure Fund receives a defined percentage of incremental growth in major revenues of the City. The Outlook projects the Infrastructure Fund will receive $57.0 million of new revenue from FY 2020 through FY 2022.

The Capital Outlay Fund receives proceeds from the sale of most City-owned real property. While it is difficult to project revenue from the sale of City-owned land going forward, the Capital Outlay Fund has received land sale proceeds of approximately $20.3 million since FY 2015. One significant property sale that is expected during the Outlook period is the sale of 132 acres of City-owned property in Mission Valley to SDSU (following voter approval of Measure G in the November 2018 election). The price and terms of the sale have yet to be negotiated and submitted to Council for review. While a portion of the sale proceeds will go to the City's Public Utilities Department, the balance (roughly estimated to be in the range of $25.0 million) will be deposited into the Capital Outlay Fund.

CONCLUSION

This year's Outlook identifies shortfalls in the first three years of the Outlook period after considering projected Baseline revenues and expenditures and the addition of the Mayor's Critical Strategic Expenditures. For FY 2020, the Outlook's projected deficit (after including Critical Strategic Expenditures) is $73.6 million. Our review of the Outlook analyzes and discusses the Baseline, selected Critical Strategic Expenditures, potential funding needs not included in the Outlook, and future financial challenges. Finally, we provide a discussion of potential options to address identified shortfalls.

The information provided in the Outlook, as well as in our review of the Outlook, allows the Council to begin identifying its top budget priorities and develop a strategy for achieving a balanced budget in FY 2020. In February 2019, the Council will adopt its City Council Budget Priorities Resolution which will provide early input for the Mayor's consideration regarding prioritization of various expenditures as well as mitigation strategies for ensuring a balanced budget.

Chris Olsen
Fiscal & Policy Analyst

Lisa Byrne
Fiscal & Policy Analyst

Jillian Kissee
Fiscal & Policy Analyst

Baku Patel
Fiscal & Policy Analyst

Angela Colton
Fiscal & Policy Analyst

Jeff Kawar
Deputy Director

Andrea Tevlin
Independent Budget Analyst

Attachments: 1. Reserves
2. New Facilities and Joint Use Agreement Annual Costs

RESERVES

The following sections discuss the General Fund Reserve, Pension Payment Stabilization Reserve (PPSR) and the Risk Management Reserves – including the Public Liability (PL), Workers' Compensation (WC), and Long-Term Disability (LTD) Reserves.

General Fund Reserve

The City's General Fund Reserve requirement is based on the past three fiscal years' audited General Fund operating revenues;[1] it is the product of the three-year average revenues and the target percentage for the applicable year. The three-year average, target percentage, and required Reserve amount are shown in the following table for each fiscal year, with the actual requirements for FY 2018 and FY 2019 (FY 2019 based on unaudited actuals) and estimates for FY 2020 through FY 2024.

General Fund Reserve

($ in millions)	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**
3-Year Average Revenues	$1,208.6	$1,264.0	$1,306.6	$1,358.1	$1,412.1	$1,473.6	$1,529.2
Reserve Requirement Target %	15%	15.25%	15.5%	15.75%	16%	16.25%	16.5%
Reserve Requirement Amount	**$ 181.3**	**$ 192.8**	**$ 202.5**	**$ 213.9**	**$ 225.9**	**$ 239.5**	**$ 252.3**

Note: Table may not total due to rounding.

The FY 2020 General Fund Reserve contribution is projected to be $9.8 million, an increase of $9.2 million over the $554,000 contribution budgeted for FY 2019. The FY 2019 budgeted contribution was so much lower because $10.3 million in FY 2019 contributions were prefunded in the FY 2018 Adopted Budget.

<u>FY 2019 General Fund Excess Equity</u>

Excess Equity is available fund balance that exceeds the required Reserve amount. The current projection for Excess Equity (per the First Quarter Budget Monitoring Report) is $12.5 million. However, this is based on FY 2019 ***Adopted Budget*** amounts, as more robust projections are not expected until the Mid-Year Budget Monitoring Report is released at the end of January 2019. Additionally, costs for the special election related to the convention center/homelessness/streets initiative ($5.0 million preliminary estimate), the planned Fire Academy, and the new Navigation Center will likely impact this projection, and such costs should be reflected in the FY 2019 Mid-Year Report.

Because there are projected deficits in the beginning years of the Outlook, as well as potential additional critical needs requested by departments that are not funded in the Outlook, the City could consider the use of any available Excess Equity for FY 2020 one-time needs. As such, it is included in the "Options to Address Shortfalls" section of this report.

[1] For further discussion of the General Fund reserve and reserve targets, see the City's Reserve Policy, which is Council Policy 100-20 (last updated June 2018).

Pension Payment Stabilization Reserve

The purpose of the PPSR is to have a source of funds available “to mitigate service delivery risk due to increases in the annual pension payment, the Actuarially Determined Contribution (ADC).” The PPSR was incorporated into the City’s Reserve Policy (Council Policy 100-20) in April 2016. The Reserve Policy requires the City to maintain up to 8% of the most recent three-year average of ADCs in the PPSR.

In FY 2016, the $16.0 million General Fund portion of the PPSR was funded, but it was fully employed in the FY 2018 Adopted Budget as a resource to mitigate the ADC increase. For historical context, the FY 2018 General Fund portion of the ADC increased by $45.2 million, two-thirds of which was primarily related to mortality assumption changes.

Within a year of (full or partial) depletion of the PPSR, the Mayor is required, per the City Reserve Policy, to prepare a plan for its replenishment. This plan was presented in the FY 2019-FY 2023 Five-Year Outlook, and it included $3.5 million to $3.9 million in General Fund contributions to the PPSR in each of the five Outlook years. The FY 2019 General Fund budget for the PPSR was $3.6 million.

The most recent Outlook continues replenishment funding for the PPSR from FY 2020 through FY 2023, with somewhat increased General Fund amounts of $4.2 million to $4.5 million. Since full funding is anticipated to be achieved in FY 2023, there is no Outlook contribution amount for FY 2024. The estimated fully-funded General Fund portion of the PPSR is approximately $21.0 million in FY 2023.

The City could consider forgoing the PPSR contribution of $4.2 million for FY 2020 (General Fund portion) and utilize these funds to pay part of the $18.1 million General Fund increase in the pension payment for FY 2020. We include forgoing the FY 2020 PPSR contribution in the “Options to Address Shortfalls” section of this report.

Risk Management Reserves[2]

<u>Public Liability Reserve</u>

The PL Fund supports costs to the City related to claims against the General Fund; and the PL Reserve is paid entirely from General Fund contributions. The City Reserve Policy specifies that by FY 2019 the City will attain the reserve target of 50% of the outstanding actuarial liability. The outstanding liability is based on the average value of annual actuarial liabilities for the three fiscal years ending in 2018, or $64.2 million. The 50% target estimate (to be achieved by FY 2019) is $32.1 million.

[2] For further discussion of the Risk Management reserves and reserve targets, see the City’s Reserve Policy, Council Policy 100-20 (last updated June 2018).

With $34.7 million as the estimated FY 2019 PL Reserve balance, there is an estimated excess of $2.6 million. Since the Reserve estimate exceeds all future years' target amounts as well, the Outlook does not include any PL Reserve contributions over the five-year period. The City could consider using these estimated excess PL Reserve funds for one-time needs. As such, we include the estimated $2.6 million of FY 2019 excess PL Reserve in the "Options to Address Shortfalls" section of this report.

With regard to PL Fund ongoing expenditures: amounts for insurance premiums, claims, and other costs are consistent for all five years of the Outlook (at $29.2 million). In FY 2018, due to anticipated surplus of PL Fund revenues over PL operating costs, $7.3 million in budgeted General Fund contributions were not needed (leaving these funds available for the General Fund). The City Council may wish to explore whether there is any additional anticipated PL operating surplus with the Department of Finance and Risk Management Department. We would note that PL claims can be volatile; and in recent years, the City has experienced some large claims payouts.

Workers' Compensation Reserve

City departments support funding for the WC Reserve (as well as WC claims and operations) via fringe benefits expenditures. The General Fund departments' portion of these WC fringe expenditures is approximately 80.1% in the FY 2019 Adopted Budget.

The City Reserve Policy requires a WC Reserve target of 12% of the outstanding actuarial liability. As with the PL Reserve, the outstanding liability is based on the average value of annual actuarial liabilities for the three fiscal years ending in 2018, which is approximately $260.9 million. The 12% target amount for FY 2019 is $31.3 million.

With $35.8 million as the projected FY 2019 WC Reserve balance, there is an estimated excess of $4.5 million ($3.6 million General Fund portion). However, the Outlook projects that all of this excess Reserve will be used as rate relief in FY 2020 (excess Reserve was budgeted for rate relief in FY 2019 as well). Utilizing the excess WC Reserve for rate relief lowers the fringe benefits amounts that City departments must contribute to support the WC Fund.

After all excess Reserve is utilized in FY 2020, the subsequent Outlook years require that contributions be made to the WC Reserve – citywide amounts of $355,000 for FY 2021, $627,000 for FY 2022, $639,000 for FY 2023, and $652,000 for FY 2024.

Long-Term Disability Reserve

Similar to WC funding, City departments support the LTD Reserve (as well as LTD claims and operations) via fringe benefits expenditures. The General Fund departments' portion of these LTD fringe expenditures is approximately 70%.

The LTD Reserve target level is 100% of the outstanding liability for LTD. As with the other Risk Management Reserves, the outstanding liability is based on the average of the annual actuarial liabilities for the three fiscal years ending in 2018. The 100% target amount for FY 2019 is $3.9 million.

With $12.9 million as the projected FY 2019 LTD Reserve balance, there is an estimated excess of $9.0 million. However, in FY 2020 (as in FY 2019) the full $2.7 million in projected LTD operating costs is anticipated to be covered with the excess LTD Reserve – leaving $6.3 million excess for FY 2020. Use of the excess Reserve is not anticipated to continue during the remaining Outlook years. Citywide LTD operating costs of $2.7 million are included in the Baseline for each of the remaining four Outlook years.

The City could consider using excess LTD Reserve funds for one-time needs. The General Fund portion of the $6.3 million excess is approximately $4.4 million. However, the City is currently negotiating with its recognized employee organizations regarding a death and disability benefit for employees who were hired on or after July 20, 2012, and, per the parameters of Proposition B (passed by the voters in June 2012), are not eligible for the defined benefit pension. Excess LTD Reserve amounts have been anticipated as a funding source for the new death and disability benefit.

Although negotiations for the new death and disability benefit have not concluded, and the City's cost to fund the benefit is uncertain, there may be interest in utilizing all or a portion of the LTD excess Reserve for one-time needs in FY 2020. One suggestion would be to use a portion of the excess Reserve, e.g. $2.3 million ($1.6 million General Fund). As such, we include $1.6 million of the excess LTD Reserve (General Fund portion) in the "Options to Address Shortfalls" section of this report.

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Fiscal Year 2020 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Park and Recreation	Audubon Elementary Joint Use Agreement	4	0.15	$47,287
Park and Recreation	Bay Terrace Recreation and Senior Center	4	1.50	$117,009
Park and Recreation	Dennery Ranch NP[1]	8	1.25	$292,313
Park and Recreation	East Village Green[1]	3	6.79	$672,234
Park and Recreation	Innovation (MacDowell) Middle Joint Use Agreement[1]	6	0.31	$82,360
Park and Recreation	Longfellow Elementary Joint Use Agreement	6	0.03	$7,588
Park and Recreation	North Park Mini Park	3	0.07	$18,488
Park and Recreation	Pacific View Leadership Academy Joint Use Agreement	4	0.25	$72,188
Park and Recreation	Rolando Park Elementary Joint Use Agreement	9	0.16	$50,012
Park and Recreation	Rowan Elementary Joint Use Agreement[1]	9	0.21	$62,463
Park and Recreation	Salk Neighborhood Park & Joint Use Development[1]	6	0.43	$113,063
Park and Recreation	Sandburg Elementary Joint Use Agreement[1]	6	0.29	$76,440
Park and Recreation	Spreckels Elementary Joint Use Agreement[1]	1	0.22	$58,539
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	$234,598
Park and Recreation	Staff for EB Scripps Comfort Station[1]	1	1.00	$91,396
Park and Recreation	Staff for Mission Trails East Fortuna Staging Area	5	0.50	$43,553
Park and Recreation	Citywide Park Maintenance[1]	Citywide	11.00	$1,735,877
Total Fiscal Year 2020			**26.16**	**$3,775,408**

Fiscal Year 2021 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Park and Recreation	14th Street Promenade	3	0.49	$52,338
Park and Recreation	Canon Street Pocket Park[1]	2	0.02	$5,215
Park and Recreation	Childrens Park Enhancement	3	0.48	$121,680
Park and Recreation	Fairbrook Neighborhood Park - CIP S01083[1]	5	0.21	$55,463
Park and Recreation	Franklin Ridge Pocket Park	7	0.01	$9,963
Park and Recreation	Johnson Elementary Joint Use Agreement	4	0.23	$86,917
Park and Recreation	Lindbergh-Schweitzer Elementary Joint Use Agreement[1]	6	0.30	$78,461
Park and Recreation	Olive Street Mini Park	3	0.16	$23,211
Park and Recreation	Stanley Middle School Joint Use Agreement[1]	1	0.16	$41,954
Park and Recreation	Stanley Middle (Pool) Joint Use Agreement	1	6.82	$504,595
Park and Recreation	Taft Middle Joint Use Agreement[1]	7	0.41	$108,787
Park and Recreation	Tubman Charter Elementary Joint Use Agreement[1]	9	0.15	$34,140
Park and Recreation	Valencia Mini Park	4	0.19	$65,924
Park and Recreation	Wangenheim Middle School Joint Use Agreement[1]	6	0.32	$83,676
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	$146,559
Park and Recreation	Citywide Park Maintenance[1]	Citywide	1.00	$111,196
Fire-Rescue	North University City Fire Station	1	12.00	$2,118,937
Total Fiscal Year 2021			**24.95**	**$3,649,016**

Fiscal Year 2022 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Park and Recreation	Florence Elementary School Joint Use Agreement[1]	3	0.08	$56,972
Park and Recreation	Hawthorne Elementary Joint Use Agreement[1]	6	0.32	$83,794
Park and Recreation	Hickman Elementary1	6	0.27	$71,449
Park and Recreation	Hidden Trails Neighborhood Park - CIP S00995	8	0.44	$96,592
Park and Recreation	Jones Elementary Joint Use Agreement[1]	7	0.35	$92,716
Park and Recreation	Lafayette Elementary Joint Use Agreement[1]	6	0.43	$114,514
Park and Recreation	Logan/Memorial K-8/Middle School Joint Use Agreement	8	0.09	$22,586
Park and Recreation	Mira Mesa Community Park (Phase II) - CIP L160021	6	3.19	$314,059
Park and Recreation	Pacific Beach Elementary School Joint Use Agreement[1]	2	0.08	$21,491
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	$146,559
Library	Pacific Highlands Ranch Branch[2]	1	8.50	$783,740
Fire-Rescue	Black Mountain Ranch Fire Station	5	12.00	$1,826,856
Total Fiscal Year 2022			**27.75**	**$3,631,328**

Fiscal Year 2023 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Park and Recreation	Benchley / Weinberger Elementary Joint Use Agreement[1]	7	0.24	$63,267
Park and Recreation	Dewey Elementary Joint Use Agreement[1]	2	0.09	$24,500
Park and Recreation	Marie Curie Elementary Joint Use Agreement[1]	1	0.34	$90,498
Park and Recreation	NTC Building 619	2	1.50	$172,617
Park and Recreation	Riviera Del Sol NP[1]	8	0.95	$222,493
Park and Recreation	Toler Elementary Joint Use Agreement[1]	2	0.16	$41,917
Park and Recreation	Webster Elementary Joint Use Agreement[1]	4	0.09	$31,056
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	$146,559
Fire-Rescue	Fairmont Avenue Fire Station	9	12.00	$2,118,937
Total Fiscal Year 2023			**17.37**	**$2,911,844**

Fiscal Year 2024 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Park and Recreation	Canyon Hills Resources NP Improvements - CIP S150061	6	1.14	300,662
Park and Recreation	Carmel Valley Neighborhood Park - CIP S006421	1	0.28	73,950
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	146,559
Fire-Rescue	Paradise Hills Fire Station	4	24.00	4,191,283
Total Fiscal Year 2024			**27.42**	**$4,712,454**

1. Includes one-time expense for items such as vehicles in the first year of operation. One-time expenses eliminated from subsequent years operating costs.
2. The Outlook reflects new ongoing annual operational costs begining in FY 2021; however, based on the latest estimate for construction, the Pacific Highlands Ranch Branch library is not anticipated to open until January 2022 (FY 2022).