THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2019 Mid-Year Budget Monitoring Report

OVERVIEW

The Fiscal Year 2019 Mid-Year Budget Monitoring Report (Mid-Year Report) was issued on January 28, 2019, and was presented to the Budget and Government Efficiency Committee on January 31, 2019. The Mid-Year Report describes the status of revenues and expenditures and their year-end projections based on actual (unaudited) data from the first five to six months of the fiscal year. The Mid-Year Report also provides useful details about major revenues, departmental operations, and other programmatic items. The purpose of the IBA review of the Mid-Year Report is to provide clarification and additional information for items outlined in that report.

The FY 2019 Mid-Year Report is projecting a General Fund year-end budgetary surplus of approximately $18.1 million. Of this amount, the Mayor is recommending appropriation adjustments of $11.9 million. Per the Mid-Year Ordinance, the "Council may approve the Mayor's recommendation or modify such recommendation in whole or in part, up to the total amount recommended by the Mayor."

Resulting excess equity is projected to be $30.7 million at year-end, which the Mid-Year Report indicates will be recommended as a partial budget balancing tool in the FY 2020 Proposed Budget. Since excess equity can be used only for one-time costs, proposals should be one-time in nature so as not to create a structurally unbalanced budget.

In this report, we review major General Fund revenues, salaries and wages, vacancy savings, the Mid-Year Ordinance, and the City Council's role in considering the Mayor's appropriation requests. We also offer updates on key issues such as homelessness, public safety overtime, and other items of interest to the Council.

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FISCAL/POLICY DISCUSSION

Major General Fund Revenues

The FY2019 Mid-Year Budget Monitoring Report includes projections for all General Fund revenue. The four largest revenue sources are property tax, sales tax, transient occupancy tax and franchise fees. Overall, these four revenue sources are projected to bring in approximately $30.4 million of revenue over the FY 2019 Budget, which is an increase of $5.5million from the $24.9 million over budget projection in the FY 2019 First Quarter Budget Monitoring Report. The property tax projection, while still over budget, has declined since the First Quarter Report while the other categories continue to increase. The table below includes both the FY 2019 first quarter and mid-year projections for comparison. Each of the four major revenue sources are discussed in more detail below.

Major General Fund Revenues (in Millions)								
	FY 2019 Budget	FY 2019 1st Quarter Projection	FY 2019 1st Quarter Variance	FY 2019 1st Quarter Variance %	FY 2019 Mid-Year Projection	FY 2019 Mid-Year Variance	FY 2019 Mid-Year Variance %	Change 1st Quarter to Mid-Year
Property Tax	$ 560.0	$ 568.7	$ 8.7	1.5%	$ 566.7	$ 6.7	1.2%	$ (2.0)
Sales Tax	282.1	297.7	15.7	5.6%	301.9	$ 19.8	7.0%	$ 4.1
Transient Occupancy Tax[1]	128.4	128.6	0.2	0.2%	130.3	$ 1.9	1.5%	$ 1.7
Franchise Fees	77.1	77.4	0.4	0.5%	79.1	$ 2.0	2.6%	$ 1.6
Total Revenue	**$ 1,047.6**	**$ 1,072.4**	**$ 24.9**	**2.3%**	**$ 1,078.0**	**$ 30.4**	**2.9%**	**$ 5.5**

[1] The FY 2019 First Quarter Budget Monitoring Report Transient Occupancy Tax (TOT) budget and projections included the 1 cent portion of TOT which is transferred from Special Promotional Programs into the General Fund. The FY 2019 First Quarter Projection reflected above has been revised to remove this amount for comparison.

Property Tax

The FY 2019 projection for property tax, based upon new and updated information available, is $6.7 million, or 1.2%, over the adopted budget in the Mid-Year Report. The largest portion of property tax revenue, representing 70% of this category, is the 1% assessed on property owners. While we are seeing a slow-down in home sales, home values in the City of San Diego remain high and, as a result, revenue from the 1% tax is trending higher than budget for FY 2019.

One distinct variance from the First Quarter Report is the year-end projection for the disbursements from the residual Redevelopment Property Tax Trust Fund (RPTTF) distributions. These amounts have also been updated based on the most recent information available, resulting in approximately $2.8 million additional revenue for FY 2019. However, this is lower than the $6.5 million additional revenue projected in the First Quarter Report. This change is due to a change in the scheduling of a payment during ROPS 13, which increases the obligation payment that must be made in June 2018, thus lowering the amount of revenue received to the General Fund. However, this change will result in an increase in revenue for FY 2020.

Sales Tax

The FY 2019 projection for Sales Tax is significantly over budget and was also projected significantly over budget in the First Quarter Report. This variance is primarily due to delays in receiving approximately $16.3 million of FY 2018 sales tax as a result of changes from the

California Department of Tax and Fee Administration, as noted in the Mid-Year Report. If the $16.3 million had been received in FY 2018 as expected, the FY 2019 projection would be roughly $285.6 million and trending at approximately 1.2% over budget. We are also seeing an increase since the First Quarter projections. Of the $4.1 million increase between the First Quarter and Mid-Year projections, $1.6 million is due to the delayed sales tax receipts but the other $2.6 million is ongoing revenues. However, even with this overbudget estimate in ongoing revenues, the Department of Finance maintains a 2.4% growth rate in the projections for the second half of the year. We will continue to monitor this and expect additional information in time for development of the FY 2020 Proposed Budget.

Transient Occupancy Tax

The Transient Occupancy Tax (TOT) projection in the FY 2019 Mid-Year report is $1.9 million or 1.5% over budget. This is an increase $1.7 million from the projection in the First Quarter report which maintained TOT at close to budget. An increase in TOT receipts was noted during the second quarter; however, Department of Finance has maintained a conservative growth rate for the projections in the remainder of the fiscal year based on industry information.

Franchise Fees

Franchise Fees are also projected to be over budget for FY 2019 by $2.0 million, or 2.6%, primarily due to additional revenue from SDG&E. Fees from SDG&E are the most significant contributor to the General Fund, representing over 60% of this category. In the Mid-Year Report, the projection has been increased by $2.3 million, or 4.8%, based on the clean-up payment projection provided by SDG&E. Refuse collection fees are also projected to be over budget by $350,000, or 2.6%. This is similar to what was projected in the First Quarter Monitoring Report. These increases are offset by lower cable franchise fee revenue, which is projected to be approximately $600,000 lower than budget, or 4.0%. This reflects the continuing downward trend for cable revenue.

General Fund Expenditures

As discussed in the Mid-Year Report, projected year-end General Fund expenditures are $23.1 million over-budget with notable overages in public safety overtime, supplies, and contracts. The Department of Finance has provided explanations for many of the budget variances in the Mid-Year Report; and our report supplements that information with a discussion of salaries and wages, as well as vacancies.

Salaries and Wages

The following table compares the FY 2019 Mid-Year expenditure projections to the Adopted Budget for various salaries and wages categories. The fourth column shows that salaries and wages in total are projected to be $11.4 million higher than what was included in the FY 2019 Adopted Budget.

Looking at the separate rows in the table, we can see that there is $10.6 million in salary savings, primarily related to higher vacancies than anticipated in the Adopted Budget. This $10.6 million in vacancy savings, though, is more than offset by overages in other salaries and wages categories: special pay, overtime, vacation pay-in-lieu, and termination pay.

The most significant overage, $17.4 million in overtime, is largely related to the Police and Fire-Rescue Departments – $8.6 million and $7.8 million, respectively. These sizable overages are highlighted later in this report.

FY 2019 Salaries and Wages Expenditures - General Fund				
	Adopted Budget	Mid-Year Projections	Variance: Mid-Year to Adopted[1]	Variance %: Mid-Year to Adopted
Salaries	$ 467,333,000	$ 456,775,000	$ (10,558,000)	-2.3%
Special Pay	32,346,000	33,355,000	1,009,000	3.1%
Overtime	66,634,000	84,043,000	17,409,000	26.1%
Hourly	13,535,000	13,160,000	(375,000)	-2.8%
Vacation Pay-in-Lieu of Annual Leave	6,882,000	9,278,000	2,396,000	34.8%
Termination Pay	2,369,000	3,894,000	1,525,000	64.4%
Total	**$ 589,099,000**	**$ 600,505,000**	**$ 11,406,000**	**1.9%**

Note: Table may not total due to rounding.

[1]Positive variances are overages, or spending above budget levels. Negative variances are spending below budget levels.

The next table displays FY 2019 projected departmental spending variances (as compared to the Adopted Budget) for various salaries and wages categories. Under-budget salaries, again totaling $10.6 million, are shown in the second column. Total salaries and wages – the net of all categories' overages and under-budget spending – are shown in the right-most column. A majority of departments' under-budget salaries more than offset over-spending in the other salaries and wages categories. However, the following departments are notable for net overages in total salaries and wages: Fire-Rescue (at $3.2 million) and Police (at $10.6 million).

Variances for Salaries and Wages Expenditures - General Fund							
Variances: FY 2019 Mid-Year to Adopted Budget	Salaries	Overtime	Special Pay	Hourly	Vacation Pay-in-Lieu	Termination Pay	Total Salaries and Wages
Fire-Rescue	$ (4,002,400)	$ 7,759,700	$ 373,600	$ (43,800)	$ (790,500)	$ (96,800)	**$ 3,199,800**
Police	(580,000)	8,607,800	533,100	49,200	949,600	1,062,800	**10,622,500**
Parks and Recreation	(1,017,900)	330,000	61,000	(63,900)	223,100	28,200	**(439,500)**
Facilities Services	(1,010,700)	411,300	8,000	200	130,000	5,400	**(455,800)**
Transportation & Storm Water	(743,600)	(202,000)	398,900	(24,100)	144,900	33,800	**(392,100)**
Environmental Services	(507,200)	441,300	(300)	600	167,800	10,800	**113,000**
City Attorney	(516,100)	24,400	(376,800)	198,300	424,400	182,600	**(63,200)**
Development Services	(271,900)	(61,200)	300	10,900	38,900	2,200	**(280,800)**
Planning	(231,700)	1,400	600	(15,300)	58,500	6,100	**(180,400)**
Purchasing & Contracting	(216,400)	18,600	700	(29,600)	42,500	9,100	**(175,100)**
Library	(53,600)	63,300	(27,300)	(397,500)	82,000	22,300	**(310,800)**
Other Departments	(1,406,500)	14,600	37,300	(60,300)	925,200	258,600	**(231,100)**
Total	**$ (10,558,000)**	**$ 17,409,200**	**$ 1,009,100**	**$ (375,300)**	**$2,396,400**	**$1,525,100**	**$ 11,406,500**

Note: Table may not total due to rounding.

[1]Positive variances are overages, or spending above budget levels. Negative variances are spending below budget levels.

Historically, overtime and other wage expenditures[1] that have been higher than budget amounts were offset (or partially offset) with vacancy savings from various departments. We believe it would be prudent to review the following issues related to overages in overtime 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 was included in the FY 2020-2024 Five-Year Outlook and discussed in our review of it.

Furthermore, at the Budget & Government Efficiency Committee meeting on January 31, 2019, Chair Bry commented that she would like to have a working group analyze a process to address vacancy issues, as well as how much more compensation is needed to attract talent.

Vacancy Savings Background

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.[2] [3] This is a common financial practice to avoid overbudgeting for salaries and wages.

However, the City's actual vacancy savings has been trending higher than budgeted amounts as shown in the table below. Although the FY 2019 projection for additional vacancy savings is less than the previous two fiscal years, it is still significantly higher than the Adopted Budget.

Vacancy Savings Comparison - General Fund

($ in millions)	Budgeted Vacancy Savings	Additional Vacancy Savings	Actual/ Projected Vacancy Savings [1]
FY 2019	$33.2	$10.6	$43.8
FY 2018	$29.7	$19.9	$49.6
FY 2017	$30.4	$15.7	$46.1
FY 2016	$21.5	$21.9	$43.4

Note: Table may not total due to rounding.

[1] FY 2016 through FY 2018 are actual amounts, and FY 2019 is the Mid-Year projected amount.

[1] Other wage expenditures include special pay, hourly wages, vacation pay-in-lieu of annual leave, and termination pay.

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

[3] 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.

At the Budget & Government Efficiency Committee meeting on January 31, 2019, Chair Bry proposed that the City should analyze whether it really needs to fill all funded positions, or whether some positions could be eliminated. We agree that this would be a useful review. Any potential reduction in expenditures for salaries could free up budget for other program areas. We caution, however, that for several years, higher vacancy savings have served as a funding source for overages in other salaries and wages categories. Ensuring that all other salaries and wage expenditures (overtime, special pays, hourly wages, vacation pay-in-lieu, termination pay) have sufficient funding levels will be important if positions are eliminated and salaries are reduced. Reducing total salaries and wages by eliminating funded positions (or alternatively, by increasing vacancy savings) could 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.

Departmental Expenditures

Projected Overbudget Homeless-Related Costs Covered with One-time Resources

The Mid-Year Report provides an update on homelessness expenditures and identifies areas where budget overages are projected at the end FY 2019. The table below outlines the requested appropriations for homelessness programs. We note that some activities driving the budget overages may continue into FY 2020, in which case ongoing resources may need to be identified. More information on the transitional storage center (known as the Storage Connect Center) and the Housing Navigation Center expenditures are provided in the following table.

FY 2019 Mid-Year Requested Appropriations

Program	Requested Appropriation	Receiving Department	Activity
Storage Connect Center	$2,100,000 Seized Asset Funds	Police Department	Security around facility and community
	$200,000 General Funds[1]	Citywide Program Expenditures Department	Lease payment for facility to be reimbursed by San Diego Housing Commission[2]
Housing Navigation Center[3]	$250,000 Seized Asset Funds	Police Department	Security around facility and community
Temporary Bridge Shelters	$300,000 General Funds[1]	Citywide Program Expenditures Department	Laundry pump services and other utility needs

[1] The Citywide General Fund appropropriation is funded by savings attributed to the deferred move-in date for 101 Ash.

[2] The Memorandum of Understanding between the San Diego Housing Commission and the City provides that the Commission will send lease payments to the City to then be paid to the owner.

[3] There are projected savings associated with funding provided in the FY 2019 Adopted Budget for the operation of the Housing Navigation Center since the site is not anticipated to open until the spring.

Storage Connect Center and Housing Navigation Center Program Expenditures

The appropriation requests for the Police Department noted above support the Storage Connect Center and the Housing Navigation Center for unbudgeted costs related to additional security that were not considered when the programs were initially approved. Additional unbudgeted sanitation activities were also placed upon the Environmental Services Department (ESD) when both programs were approved, but no appropriation is deemed necessary by staff.

The report requests a $2.1 million appropriation for projected overtime costs related to providing the required 24-hour per day security in a half-mile radius from the Storage Connect Center.[4] The requirement is only mandatory for the first 90 days of operating the storage center but the department plans to continue this activity through the end of the fiscal year. The department may need additional ongoing resources, should this activity continue into FY 2020.

Like the Storage Connect Center, when the Housing Navigation Center was approved, a requirement was included that the City provide 24-hour per day security around the facility.[5] At the time of the First-Quarter Budget Monitoring Report it was unclear how this requirement would be implemented. The Mid-Year Budget Monitoring Report includes a requested appropriation of $250,000 to cover anticipated overtime related to providing security in East Village, including around the Housing Navigation Center, assuming the navigation center opens in spring 2019.

ESD is required to provide additional sanitation services for the Storage Connect Center and the Housing Navigation Center, which were also not considered when the programs were approved. The Mid-Year Report provides that ESD is projecting savings in its current year appropriation of $4.2 million for the CleanSD program. The department will support additional sanitation services for the storage and Housing Navigation Center programs with the projected savings. However, these are one-time savings since they are from deferred personnel expenditures related to hiring 16.00 FTEs for CleanSD. All but one of these positions are filled, with the remaining expected to be filled soon. Nevertheless, according to staff, the department does not anticipate needing additional funding going forward.

Fire-Rescue Overtime and Additional Academy

The Mid-Year Report notes projected overages in overtime for the Fire-Rescue Department and provides explanations of the primary causes. For the purposes of our IBA review, we compare the current year-end projection to the FY 2019 Adopted Budget. As shown in the following table, projected overtime expenditures for FY 2019 are $45.9 million, compared to the Adopted Budget of $38.1 million.

Fire-Rescue Overtime – Historical Budget vs. Actuals (in millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Budget	$23.7	$26.7	$29.9	$30.1	$32.8	$38.1
Actual	$29.7	$31.5	$31.8	$32.5	$45.4	$45.9 (projected)

As shown above, Fire-Rescue's actual overtime expenditures have significantly increased in FY 2018 and 2019 as compared to the previous several fiscal years. From FY 2014 to FY 2017 average

[4] The Storage Connect Center provides a place for homeless individuals to place their belongings. Security requirements are included in a memorandum to the community surrounding the Storage Connect Center and in Housing Authority Resolution HA-1777.

[5] The Housing Navigation Center will provide outreach and assist homeless individuals to find housing and receive benefits. Like the Storage Connect Center, enhanced security commitments were outlined in a memorandum to the community surrounding the Housing Navigation Center.

overtime expenditures were about $31.4 million, compared to the most recent expenditures in FY 2018 and FY 2019, which are averaging over $45.6 million.

Our Office worked with Fire-Rescue to determine the main driving factors in this historical overtime increase of roughly $14.0 million. Contributing factors include effects of MOU changes ($5.0 to $6.0 million)[6], strike team deployments (roughly $4.5 million), weather-related events ($1.0 to $2.0 million), and higher vacancies yielding more constant-staffing overtime (roughly $2.5 million).

We also note that the Mid-Year Report's recommended appropriation adjustments include $710,000 in overtime expenditures to fund a second unbudgeted Fire academy in FY 2019. This is consistent with program updates provided in the FY 2019 First Quarter Report, which stated that a second academy is necessary for Fire-Rescue to maintain full firefighter staffing.

Police Overtime

The Mid-Year Report projects Police Department overtime expenditures to exceed budget in FY 2019 by approximately $8.6 million. The Department of Finance has provided explanations for this projected variance in its report. For additional context, we provide historical information on Police overtime expenditures in the table below.

Police Overtime – Historical Budget vs. Actuals (in millions)

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Budget	$11.8	$11.1	$18.0	$21.0	$26.3	$24.6
Actual	$17.8	$23.1	$25.0	$26.1	$29.7	$33.2 (projected)

Disparity Study Appropriation Adjustment

The FY 2019 Mid-Year Report proposes adding $200,000 to the Purchasing and Contracting Department to "begin the process of conducting a disparity study". Our office conducted research on disparity studies in 2016, presented in IBA Report 16-08 Disparity Study: An Overview of Municipalities and Government Agencies. At that time, we estimated that a disparity study for the City of San Diego would cost approximately $1.0 million.

It is unclear what will be accomplished with this initial $200,000 in FY 2019, although the Purchasing and Contracting Department did indicate that it is not intended to support City staff time. We also note that the funding for a disparity study was not included in the FY20-24 Five-Year Financial Outlook. While this initial $200,000 is being funded by excess revenues in FY 2019, we expect additional funding of approximately $800,000 to be needed to complete the study.

Four councilmembers identified a disparity study as a high priority for FY 2020 in their budget priority memos and two others have informally indicated support for a study to our Office. We recommend Council ask the Mayor's Office to specify how he intends to use the $200,000 to advance this priority in FY 2019. If the intent is to hire a consultant to initiate a citywide disparity

[6] Further details on Fire MOU changes are included in IBA Report 18-38, "IBA Review of the Mayor's FY 2020-2024 Five-Year Financial Outlook."

study, the Council should ask if the Mayor's intent is to budget the additional required funds in the FY 2020 Proposed Budget (approximately $800,000 depending on the scope of the study). Alternatively, the Council could consider redirecting some of the proposed mid-year appropriation adjustments to more quickly hire a consultant to begin work on the study.

Fleet Operating Fund Projection

The Fleet Operating Fund is currently projecting to spend $1.4 million more than revenue. Non-personnel expenditures are projected to exceed budget by $5.1 million or 16.7%. The vehicle usage rates charged to other city departments were set during the budget process based on budgeted expenditure levels. While some over budget revenue is expected from directly billable work, it is not projected to cover the entire overage. There is approximately $1.8 million in fund balance available to absorb the expenditures, if Fleet and Department of Finance are unable to reduce expenditures by year-end. However, this would bring the Fleet Operating Fund's balance to less than $400,000. In addition, it is likely that some of the overages in expenditures are ongoing expenses which will increase Fleet costs in FY 2020.

CONCLUSION

The Mid-Year Ordinance, in effect since 2011, requires the Mayor to report the mid-year deficit or surplus to the Council and provide a recommendation to address such deficit or surplus. The Mayor may budget all, none, or any portion of the surplus. The "Council may approve the Mayor's recommendation or modify such recommendation in whole or in part, up to the total amount recommended by the Mayor."

As required by the Ordinance, the Mayor has reported a General Fund year-end budgetary surplus of approximately $18.1 million. Of this amount, the Mayor is recommending appropriation adjustments of $11.9 million. This is the amount Council may approve or modify.

The $18.1 million in projected budgetary surplus yields $30.7 million in excess equity. DOF has described its plans to use this $30.7 million to help balance the FY 2020 Proposed Budget and close the deficit projected in the Five-Year Outlook. Since excess equity can be used only for one-time costs, proposals should be one-time in nature so as not to create a structurally unbalanced budget.

We note that one of DOF's proposed uses of excess equity in FY 2020 is a $4.3 million Pension Payment Stabilization Reserve (PPSR) contribution. Our Office will evaluate, based on the Mayor's budget proposal, whether an additional contribution to the PPSR is the best use of excess equity versus other funding needs identified by the Council and the community.

The Office of the IBA has reviewed the Mid-Year Report and has raised concerns about several expenditures. These include public safety overtime, costs related to homelessness, the Clean San Diego budget, Fleet Operations, and whether $200,000 is adequate for a Disparity Study. We believe that the projections included in the Report are reasonable, as are the requested appropriation adjustments. Updates to projected year-end revenues and expenditures will be available in the Third Quarter Report, scheduled to be released in May and reviewed by the Budget Review Committee on May 17, 2019.

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