

# IBA Review of the FY 2025-2029 Five Year Financial Outlook

City Council

Item 333

December 12, 2023



Office of the Independent Budget Analyst



# Role of the Outlook in the Budget Process

## Overview & Importance of the City's Outlook

- 2016 City Charter amendment requires Mayor to annually prepare a multi-year financial outlook for the General Fund
- Planning tool that informs the annual budget process
  - Allows Council to have a sense of Mayor's budget priorities, and to consider its own priorities and strategies to achieve a balanced budget in FY 2025
- *IBA's role*: To analyze the Outlook objectively and identify issues and options to assist the Council in decision making

# IBA Annual Review and Analysis of Outlook

**The IBA's report on the General Fund Outlook includes:**

Review and Analysis of:

- Overall fiscal condition
- Baseline revenues and assumptions
- Baseline expenditures
- Additional Outlook priorities beyond baseline
- Potential funding needs not included in Outlook
- Discussion of potential resource options



# General Fund Fiscal Condition

## Critical to Address the Structural Imbalance

Outlook projects nine-figure shortfalls in all five years

General Fund Revenue and Expenditures (\$ in millions)						
	FY 2024 Adopted Budget <sup>a</sup>	FY 2025 Outlook	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook
Baseline Revenues	\$ 1,944.7	\$ 2,019.4	\$ 2,083.0	\$ 2,153.9	\$ 2,226.0	\$ 2,313.4
Baseline Expenditures	2,051.5	2,156.2	2,239.5	2,303.8	2,386.3	2,454.7
<b>Baseline Shortfall</b>	<b>(106.8)</b>	<b>(136.8)</b>	<b>(156.5)</b>	<b>(149.9)</b>	<b>(160.3)</b>	<b>(141.3)</b>
Additional Priorities Beyond Baseline	(38.5)	(35.1)	(77.0)	(93.7)	(98.0)	(85.9)
FY 2024 Use of One-Time Revenues	73.0	-	-	-	-	-
Use of Available Excess Equity	72.2	56.5	-	-	-	-
<b>Overall Outlook Shortfall</b>	<b>\$ -</b>	<b>\$ (115.4)</b>	<b>\$ (233.4)</b>	<b>\$ (243.5)</b>	<b>\$ (258.3)</b>	<b>\$ (227.3)</b>

Note: Table may not total due to rounding.

<sup>a</sup> FY 2024 "Baseline Expenditures" and "Use of Available Excess Equity" include an \$8.1 million set-aside to fund the General Fund Reserve.

# General Fund Fiscal Condition *(cont'd)*

## Critical to Address the Structural Imbalance *(cont'd)*

- Annual budgets over the past three years were balanced, but not *structurally* balanced, relying on one-time ARPA funds
- The City now faces significant budget deficits beginning FY 2025
- The City must prepare to:
  - Seek a major source of new revenue in the immediate future, or
  - Plan for significant cuts and restructures that will result in lower service-levels and fewer City run programs

# Baseline General Fund Revenue

## Moderate Growth in Outlook Baseline Revenues

- Overall baseline revenue growth is reasonable
  - Increase steadily over the Outlook, averaging about 3.5% per year
  - Economic conditions suggest a 'soft-landing' vs a recession
  - Considerable risks remain due to recent consumer response to prolonged inflation and increased interest rates
- Major General Fund revenues
  - Property Tax and Franchise Fee projections are reasonable
  - Our analysis indicates Sales Tax and Transient Occupancy Tax projections may need adjustments

# Baseline General Fund Revenue *(cont'd)*

## Sales Tax and Transient Occupancy Tax (TOT)

- Recent declines in receipts warrant a reduction in FY 2024 base year forecasts (both Sales Tax and TOT)
- For Sales Tax, we believe growth rates should be lower in later Outlook years
- For TOT, we believe the 5.9% annual growth rate is reasonable, though we decrease the base year forecast

<b>IBA Estimated Revenue Reductions <i>(\$ in millions)</i></b>					
	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
<b>Sales Tax</b>	\$ 3.4	\$ 3.9	\$ 9.9	\$ 17.5	\$ 26.6
<b>TOT (Overall)</b>	\$ 8.7	\$ 9.3	\$ 9.8	\$ 10.4	\$ 11.0

# General Fund Baseline Expenditures

Support existing service levels; no new initiatives

Increases/(Decreases): FY 2024 Adopted Budget to FY 2025 Baseline Projection ( <i>\$ in millions</i> )	
<b>FY 2024 Adopted Budget<sup>1</sup></b>	<b>\$ 2,089.9</b>
Personnel Expenditure (PE) and Fringe Changes	55.8
Non-Personnel Expenditure (NPE) Changes	46.0
Removal of FY 2024 One-Time Expenditures	(35.6)
<b>FY 2025 Outlook Baseline Projection</b>	<b><u>\$ 2,156.2</u></b>
<b>Overall Increase: FY 2024 Adopted Budget to FY 2025 Outlook Baseline (3.2% Increase)</b>	<b>\$ 66.3</b>

<sup>1</sup> Includes \$8.1M GF Reserve Contribution

# General Fund Baseline Expenditures *(cont'd)*

Largest PE and Fringe Changes	
Compensation Increases Based on Current Non-Public Safety Labor Agreements	\$ 28.4
ADC (Pension Payment)	\$ 17.2
Assumed 3.05% General Wage Increase for Represented Public Safety Employees	\$ 10.9
General Wage Increases for Unrepresented Employees	\$ 5.5
Other Post-Employment Benefits (OPEB) Decrease	\$ (10.8)

*\$ in millions*

Largest NPE Changes	
GF Reserve Contribution Increase	\$ 14.2
Increase in Debt Service	\$ 11.4
Contracts: 2.95% Annual Growth Rate	\$ 5.6
Refuse Disposal Fees	\$ 5.3
Decrease in Infrastructure Fund Transfer	\$ (7.0)

Largest FY 2024 One-Time Expenditure Removals	
City Council CIP Additions	\$ (8.0)
Bridge to Home Program	\$ (5.8)
Vehicle Purchases: Various Departments	\$ (4.1)
Eviction Prevention Program	\$ (3.0)
Transfer to Refuse Packers from Refuse Disposal Fund	\$ (2.6)

# General Fund Expenditures (cont'd)

## Other Post-Employment Benefits (OPEB): *Change in Funding Strategy*

- City contributions reduced in earlier years/increased in later years
  - Reduced incrementally through FY 2050, rather than sharp reduction beginning FY 2035
- Diminishes the prefunding of prior strategy and related investment earnings available to pay OPEB costs
  - Causes City contributions to be higher in later years, and higher overall
- FY 2024 budgetary savings: \$15.4M (\$10.2M for General Fund)
  - Strategy change likely appropriate given City's significant projected deficits

# General Fund Baseline Expenditures *(cont'd)*

## Non-Personnel Expenditures

### Infrastructure Fund

- Projected sales tax reduction would lower contributions
- Outlook discusses potential suspension of contributions to mitigate projected General Fund shortfalls (\$24.0M for FY 2025)
- Impacts CIP – \$5.2B funding gap in latest CIP Outlook

### City Debt

Assumed Use for New Projected Debt <i>(\$ in Millions)</i>	
Funding for Prior Appropriations	\$ 351.9
Matching Funds for Stormwater WIFIA Loan	288.0
Unappropriated Funds for New Projects	182.1
<b>Total New Lease Revenue Bond Proceeds</b>	<b>\$ 822.0</b>

# Priorities Beyond the Baseline

## New Facilities

- Certain facilities projected to open during the Outlook period lack funding
  - It may be premature to project the opening dates
- New facilities can be delayed for budgetary reasons if necessary
- Parks and Rec expense overstated (\$3.4M for FY 2025)

Summary of Facilities Projected to Open During Outlook Period	
Library	Replacement Libraries <ul style="list-style-type: none"> <li>• Oak Park</li> <li>• San Carlos</li> </ul> Expansion: Ocean Beach
Fire-Rescue	Five New Fire Stations <ul style="list-style-type: none"> <li>• Torrey Pines</li> <li>• Black Mountain Ranch</li> <li>• Otay Mesa</li> <li>• Fairmount Avenue</li> <li>• Skyline Hills</li> </ul>
Parks and Recreation	20 new or expanded parks 14 new Joint Use Facilities

# Priorities Beyond the Baseline *(cont'd)*

## Planned Commitments – Homelessness Programs

- \$21.4M included for FY 2025; growing to \$42.9M in FY 2026
  - Developing replacement shelter beds
  - Funding anticipated operation costs beginning in FY 2025
  - Augmenting funding for current programs
- The City needs to prioritize programs due to funding constraints
  - Council may wish to learn more about how collaboration with other organizations (SDHC, County, Regional Task Force) would provide needed support
  - We believe a systematic evaluation of homelessness efforts focusing on program outcomes and cost efficiency should inform future budget decisions

# Priorities Beyond the Baseline *(cont'd)*

## Planned Commitments – Information Technology

- Total project implementation costs to modernize ERP
  - \$1.4M in GF for FY 2025 (*\$62.0M over Outlook period*)
  - \$1.6M in Non-GF for FY 2025 (*\$73.1M over Outlook period*)
- Our Office agrees that project/technical upgrade should not be delayed



# Potential Needs Not Included in the Outlook

<b>Select Operational Needs Not Included in the Outlook (<i>\$ in millions</i>)</b>					
	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
Stormwater Needs	\$129.9	\$142.1	\$145.2	\$149.2	\$156.4
Street Repair Positions	4.2	2.5	2.5	2.5	2.5
Streetlight Positions	12.2	3.5	3.5	3.5	3.5
Sidewalk Positions	7.4	4.4	4.4	4.4	4.4
Asset Management and EAM System	TBD	TBD	TBD	TBD	TBD
Homelessness and Housing Council Budget Priorities	22.4	9.9	10.2	10.5	10.8
Climate Action Plan Implementation	18.7	18.7	18.9	18.5	18.5
Arts & Culture Funding	8.3	20.6	22.6	24.8	27.1
SD Access 4 All - Digital Equity Program	1.3	1.3	1.3	1.3	1.3
Emergency Medical Services Alliance Model	5.3	5.3	5.3	5.3	5.3
<b>Total Additional Known Programmatic Costs</b>	<b>\$209.7</b>	<b>\$208.3</b>	<b>\$213.9</b>	<b>\$220.0</b>	<b>\$229.8</b>



# Potential Needs Not Included in the Outlook *(cont'd)*

<b>CIP Needs Not in the Outlook and Potential Resources (\$ in millions)</b>					
	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>	<b>FY 2028</b>	<b>FY 2029</b>
<b>Select CIP Needs Not Included in Outlook</b>					
Stormwater CIP Needs	\$212.3	\$529.5	\$274.9	\$244.7	\$381.3
Street Repair Funding Gap	130.4	212.4	254.3	359.0	428.9
Streetlight Replacements	74.8	88.7	92.2	95.9	99.8
Sidewalk Repair	17.0	17.7	18.4	19.1	19.9
Asset Management and EAM System	TBD	TBD	TBD	TBD	TBD
Homelessness - H-Barracks	7.2	0.0	0.0	0.0	0.0
Zero Emissions Municipal Building Operations Policy (ZEMBOP)	TBD	TBD	TBD	TBD	TBD
<b>Total CIP Costs</b>	<b>\$441.7</b>	<b>\$848.3</b>	<b>\$639.8</b>	<b>\$718.7</b>	<b>\$929.9</b>
<b>Potential CIP Resources</b>					
Infrastructure Fund	\$24.0	\$23.0	\$30.4	\$38.3	\$46.7
Climate Equity Fund	9.8	10.2	10.5	10.7	11.2
Unallocated Lease Revenue Bond Proceeds	0.0	0.0	5.1	88.5	88.5
<b>Total Potential CIP Resources</b>	<b>\$33.8</b>	<b>\$33.2</b>	<b>\$46.0</b>	<b>\$137.5</b>	<b>\$146.4</b>
<b>Potential CIP Shortfall</b>	<b>(\$407.9)</b>	<b>(\$815.1)</b>	<b>(\$593.8)</b>	<b>(\$581.2)</b>	<b>(\$783.5)</b>



# Potential Resource Options

## For FY 2025

### Estimated Funds Available

- General Fund Excess Equity (\$56.5M)
- TOT Fund Balance (\$7.8M)

### Funding Suspension

- Infrastructure Fund (\$24.0M)
- General Fund Contribution (\$22.3M)

### Additional Resources (TBD)

- Service Reductions
- Grants
  - Infrastructure Investment and Jobs Act
  - Inflation Reduction Act
  - State Funding for Homelessness

## Outlook Years *After* FY 2025

### Measure B (Nov 2022): People’s Ordinance

No relief possible until FY 2026 (*up to \$80-90M annually*)

### Measure C (Mar 2020) – TOT Increases

Legal determination expected in 2-3 years (*\$39.5M per year average for homelessness programs over first 5 years*)

### Potential Future Sales Tax Measure

Requires approval of San Diego voters (*e.g., 1¢ increase would generate roughly \$400M annually*)

### Potential Future General Obligation Bonds

Requires approval of SD voters

### Stormwater Fee Increase

Likely requires approval of SD voters (*rate of 4-5¢ per sq. ft. of impermeable surface could generate \$74M-\$93M per yr.*)

# Conclusion

- Baseline revenue and expenditure projections are reasonable
- Projected shortfalls show immediate need to address ongoing structural deficit and to support operations with regular, ongoing revenue
- Balancing priorities is critical – many priorities are not reflected in the Outlook shortfalls
- Next step in budget process
  - Council's updated budget priority memos due to our Office by Jan 12<sup>th</sup>

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***The City must either seek a major new revenue source in the immediate future, or begin implementing significant cuts to existing programs and service levels and severely constrain the addition of new or expanded programs and services.***

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