THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2021 Year-End Financial Performance Report

OVERVIEW

The FY 2021 Year-End Financial Performance Report (Year-End Performance Report) was issued on October 6, 2021 and presented to the Budget and Government Efficiency Committee on October 13, 2021. The Year-End Performance Report compares revenue and expenditure projections reported in the FY 2021 Third Quarter Budget Monitoring Report (Third Quarter Report) to unaudited actual revenue and expenditure activity for July 1, 2020 through June 30, 2021.

Our Office's review of the Year-End Performance Report highlights the changes in General Fund revenues and expenditures, and impacts on the General Fund Reserve and Excess Equity, and provides additional context and updates on those items. Additionally, as changes in overall revenues and expenditures are significant, with General Fund revenues coming in $45.3 million above Third Quarter Report projections, and General Fund expenditures $22.1 million under Third Quarter Report projections, we provide additional information on the potential impacts of these variances, including the projected use of American Rescue Plan Act (ARPA) funding in FY 2022 and beyond and the potential use of newly available Excess Equity. Additionally, as we note below, we recognize that Covid-19 continues to impact the City's revenues, expenditures, operations, and ability to make accurate forward-looking financial projections.

Ongoing Covid-19 Impacts

While the variances noted above are significant, it is also important to note that the variances – especially for revenues – are in large part due to continuing impacts of the Covid-19 pandemic on the City and its economy. We understand that unprecedented and rapidly changing circumstances make it challenging to develop accurate financial projections, though we are encouraged that the revenue and expenditure variances of 2.9% and 1.4% respectively from the Third Quarter Report, turned out to be positive for the City.

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As we note throughout our report, ongoing impacts of Covid-19 have resulted in both positive changes and ongoing challenges. The major improvement highlighted in the Year-End Performance Report is the accelerated economic recovery in San Diego, with sharp increases in revenues and near pre-pandemic levels of consumer confidence.[1] This is likely attributable to the successful and ongoing rollout of vaccines, with over 80% of eligible San Diegans being fully vaccinated as of October 20, 2021. The lifting of Covid-19 restrictions as the City moved into less restrictive tiers also positively impacted retail stores and restaurants, and allowed for increased recreational activities.

Even with improvement in revenues, the City continues to face significant impacts from the pandemic. The City took fiscally prudent measures to offset economic impacts of the pandemic, hiring only critical personnel and limiting non-essential spending. As such, in FY 2021, General Fund Departments saw impacts in salary and wage expenditures with delays in hiring and higher vacancies than budgeted. Departments continue to face delays and potentially higher costs due to shortages of supplies and materials, such as the global microchip shortage, as well as a limited number of available consultants and contractors, which can result in the need to re-bid capital improvement projects. The City will need to continue to monitor various ongoing impacts and make fiscally responsible and strategic decisions about how to address the financial challenges ahead.

FISCAL/POLICY DISCUSSION

REVENUES

Total General Fund revenue in the Year-End Performance Report is $1.61 billion, an increase of $45.3 million over Third Quarter projections. While this increase is large, it is also important to note that General Fund revenues are still $15.7 million, or 1.0%, below what was included in the FY 2021 Adopted Budget. Revenue projections from the Adopted Budget and from each of the quarterly budget monitoring reports are shown on the following table.

General Fund Revenue Projections by Quarter *($ in millions)*

	Adopted Budget	First Quarter Projection	Mid-Year Projection	Third-Quarter Projection	Year-End Performance	Variance: Adopted to Year-End	Variance: Third-Quarter to Year-End
Property Tax	$ 630.6	$ 635.4	$ 633.4	$ 634.8	$ 641.4	$ 10.8	$ 6.6
Sales Tax	274.4	284.0	283.3	283.8	303.7	29.3	19.9
Transient Occupancy Tax	90.5	66.2	54.6	58.9	68.1	(22.4)	9.2
Franchise Fees	67.7	67.4	68.4	75.4	76.2	8.5	0.8
Other Major Revenues	100.7	100.7	94.0	96.6	93.8	(6.9)	(2.9)
Departmental Revenues	457.0	457.0	401.4	410.3	422.1	(34.9)	11.7
Total	**$ 1,620.9**	**$ 1,610.7**	**$ 1,535.0**	**$ 1,559.9**	**$ 1,605.2**	**$ (15.7)**	**$ 45.3**

NOTE: Table may not total due to rounding.

As seen above, projections had been trending down after adoption of the FY 2021 Budget, with most revenue categories largely staying flat or declining in each of the first three quarterly updates. These declines – especially those associated with Transient Occupancy Taxes - were consistent

[1] The economic indicator consumer confidence, a measurement of the consumer’s willingness to spend, measured at 128.9 in June 2021, which is slightly below pre-pandemic levels of 132.6 in February 2020.

with the overall impacts the City saw from the Covid-19 pandemic. As San Diego was able to rapidly increase its vaccination rate, and as the State lifted a number of health-mandates and gathering/travel restrictions, the overall economic conditions in San Diego have started to rebound: the Year-End projection shows a significant increase from the Third Quarter Report, bringing Year-End revenues closer to initial projections used in the Adopted Budget.

Each major General Fund revenue source is discussed in more detail below.

Property Taxes

Property tax revenue increased by $6.6 million from the Third Quarter Report, mostly due to an increase in collection rates in FY 2021 to 99.0%. The FY 2021 Adopted Budget included a projection that collection rates would decline from the historical average of 99.2% to 97.6%, based on collection rates declining to 98.6% in FY 2020 due to the Covid-19 pandemic. However, while the collection rate did dip in the early part of FY 2021, collection rates for most of the year stayed well above the projection, and as such the unaudited actuals were $10.8 million higher than the Adopted Budget as well. This revenue increase, however, is not anticipated to dramatically change the FY 2022 projection, as the FY 2022 Adopted Budget assumed a collection rate of 98.9%.

Sales Taxes

Sales tax revenue increased by $19.8 million from the Third Quarter Report, and $29.3 million from the Adopted Budget, which is the single largest revenue increase in the Year-End Performance Report. Sales tax revenue is generally highly sensitive to overall economic conditions, and shifts in employment levels, consumer confidence, and unemployment benefits can have outsized influence on sales tax revenues. Sales tax projections in prior quarters were tempered by increased unemployment and declines in consumer confidence brought about by the pandemic. However, in the Year-End Performance Report, even with unemployment above pre-pandemic levels at 6.8%, the accelerated reopening of the local economy, along with the lifting of various health restrictions on gatherings and dining, have led to a significant rebound in taxable sales throughout the City.

Notably, the total $303.7 million in sales tax revenue is roughly equal to the total sales tax revenue of $304.4 million collected during FY 2019, the last full fiscal year before the beginning of the Covid-19 pandemic. While the increase here is large and brings the City's sales tax receipts back in line with pre-pandemic levels, it will be important to monitor the impacts of any supply-chain delays on taxable sales in the region, as they have the potential to impact certain retail sectors more heavily than others.

Transient Occupancy Taxes

General Fund Transient Occupancy Tax (TOT) revenue, or hotel tax revenue, increased by $9.2 million from the Third Quarter Report. While this is a significant increase, the $68.1 million in General Fund TOT revenue is still $22.4 million below amounts assumed in the Adopted Budget. We note that General Fund TOT receipts are still just over half of pre-pandemic TOT revenues ($131.9 million in FY 2019), even with the increase in the Year-End Performance Report.

TOT revenue continues to be the City's revenue source that has been most singularly and dramatically impacted by the pandemic. While the Year-End Performance Report does show significant growth over the Third Quarter, largely associated with increased demand for leisure travel that followed the earlier-than-expected lifting of travel restrictions in California, it is important to note that other types of travel that have generated significant TOT revenue in the past – business travel and group travel for conventions – continues to be low. Some group travel and conventions did resume in August 2021, however total business and group travel remains well below pre-pandemic highs.

Franchise Fees

Franchise fee revenue increased by $0.8 million from the Third Quarter Report, mostly due to a technical reclassification of SDG&E audit revenue. This change resulted in $1.1 million in revenue being added to franchise fees, with a corresponding decline in the Other Major Revenue category. This increase is partially offset by lower than expected cable franchise revenue of $400,000. Overall, the unaudited actuals were $8.5 million higher than the Adopted Budget mainly due to an increase in the SDG&E clean-up payment, which resulted in an increase of $7.0 million. This increase has already been included in the FY 2022 Adopted Budget.

EXPENDITURES

The Year-End Performance Report shows unaudited actual General Fund expenditures of $1.59 billion, which is $30.9 million, or 1.9%, less than the FY 2021 Adopted Budget, as shown in the table below. The actual expenditures are $22.1 million lower than projections in the Third Quarter Report.

FY 2021 General Fund Expenditures *($ in millions)*						
	Adopted Budget	**Third Quarter Projection**	**Year-End Unaudited Actuals**	**Variance: 3d Qtr to Year-End**	**Variance: Adopted to Year-End**	***Variance %: Adopted to Year-End***
Salaries and Wages	$ 647.9	$ 651.1	$ 652.0	$ (0.9)	$ (4.1)	*(0.6%)*
Fringe Benefits	491.9	490.9	488.6	2.3	3.3	*0.7%*
Non-Personnel Expenditures (NPE)	481.1	470.1	449.4	20.7	31.7	*6.6%*
Total General Fund Expenditures	**$ 1,620.9**	**$ 1,612.1**	**$ 1,590.0**	**$ 22.1**	**$ 30.9**	***1.9%***

Notes: Table may not total due to rounding.
Positive variances are spending below budget levels. Negative variances are overages, or spending above budget levels.

While the Year-End Performance Report focuses on comparing Third-Quarter Report projections to unaudited year-end actuals, our expenditure variance review provides a comparison of the Adopted Budget to the unaudited year-end actuals. Some of the more significant variances to the FY 2021 Adopted Budget are highlighted in the following sections, including expenditure decreases that are partially offset with expenditure increases.

Some of the larger expenditure decreases from the Adopted Budget include:

- $16.1 million in additional salary savings (primarily due to vacancy savings)
- $8.4 million in reduced transfers to the Parks Improvement Funds ($10.2 million budgeted, $1.8 million transferred)
- $6.1 million in reduced spending for Homelessness Strategies Department Non Personnel Expenditures (NPE) (Homeless Strategies expenditures are discussed later in this report.)

- $5.5 million in expenditures that were incurred directly in the Storm Drain Fund (rather than moving Storm Drain Fund revenues to the General Fund and spending from the General Fund as budgeted)
- $4.9 million in reduced fees paid to the Fleet funds (rather than transferring $4.8 million from the Fleet Replacement Fund to the General Fund as budgeted, $4.2 million in replacement expenditures were reduced, and usage fees were reduced another $655,000.)
- $4.2 million in hourly wage savings
- $3.8 million in IT expenditure savings for certain contract transition costs that are delayed until FY 2022
- $3.3 million in fringe savings (primarily due to lower flexible benefits spending and one-time savings from a change in how certain fixed fringe benefits are recognized budgetarily)

The lower spending levels listed above are partially offset with spending increases, including:

- $19.0 million in additional overtime, largely related to the Fire-Rescue Department, as discussed later
- $5.3 million for an additional transfer to the Public Liability Fund for previously unanticipated claims
- $3.9 million in additional termination pay and vacation pay-in-lieu expenditures

The remainder of this section will focus on specific budget areas, beginning with personnel expenditures, including significant department variances and overtime, and then continuing with notable non-personnel variances, mainly focusing on variances in Contracts spending overall as well as within in the Library, Environmental Services, Police, and Homelessness Strategies departments.

Personnel Expenditures

The following table compares the FY 2021 unaudited actuals to the Adopted Budget for various salaries and wage categories. The second column from the right shows that total salaries and wage expenditures net to $4.1 million more than what was included in the FY 2021 Adopted Budget (shown as a negative spending variance).

FY 2021 Salaries and Wages Expenditures - General Fund *($ in millions)*						
	Adopted Budget	**Third Quarter Projection**	**Year-End Unaudited Actuals**	**Variance: 3d Qtr to Year-End**	**Variance: Adopted to Year-End**	***Variance %: Adopted to Year-End***
Salaries	$ 510.3	$ 497.8	$ 494.2	$ 3.6	$ 16.1	*3.2%*
Special Pay	43.9	45.6	45.5	0.2	(1.6)	*(3.5%)*
Overtime	71.4	86.4	90.3	(4.0)	(19.0)	*(26.6%)*
Hourly	15.3	10.8	11.1	(0.3)	4.2	*27.3%*
Vacation Pay in Lieu/Termination Pay	7.0	10.5	10.8	(0.4)	(3.9)	*(55.3%)*
Total Salaries and Wages	**$ 647.9**	**$ 651.1**	**$ 652.0**	**$ (0.9)**	**$ (4.1)**	***(0.6%)***

Notes: Table may not total due to rounding.
Positive variances are spending below budget levels. Negative variances are overages, or spending above budget levels.

Looking at the separate rows in the table, we see that there is $16.1 million in net salary savings, primarily related to delays in hiring and higher vacancies than anticipated in the Adopted Budget.

We also see that this $16.1 million in salary savings is partially offsetting overages in other salaries and wage categories (special pay, overtime, and pay-in-lieu).

There is also $4.2 million in net hourly wage savings. The largest hourly wage savings are in the following departments: $2.1 million for Parks and Recreation; $1.5 million for Library; and $1.1 million for the Police Department. These hourly wage savings are partially offset with a $758,000 hourly wage overage in the Fire-Rescue Department.

The most significant overage, $19.0 million in overtime, is largely related to the Fire-Rescue and Environmental Services Departments – $18.0 million and $1.2 million, respectively. These overtime overages are partially offset with $815,000 in Police Department overtime savings. Overtime is addressed in a following section.

<u>Departmental Variances</u>

As previously mentioned, total salaries and wage expenditures net to $4.1 million more than what was included in the FY 2021 Adopted Budget. This overage includes all salaries and wage types (salaries, special pay, overtime, hourly, and pay-in-lieu costs). Categorized by departments, the $4.1 million overage is comprised of two offsetting amounts: $17.3 million for departments with salaries and wage overages, which is partially offset by $13.2 million for departments with savings.

Departments with the largest salaries and wage overages include:

- $13.5 million – Fire-Rescue (largely overtime overage with partially offsetting salary savings)
- $1.9 million – City Attorney (largely salary overage)
- $627,000 – Environmental Services (largely overtime overage with partially offsetting salary savings)
- $309,000 – Economic Development (largely salary overage)
- $254,000 – Real Estate Assets (largely salary overage)

Departments with the highest salaries and wage savings include:

- $3.2 million – Parks and Recreation (largely salary and hourly savings)
- $2.9 million – Library (largely salary and hourly savings)
- $1.3 million – Transportation (largely salary savings)
- $985,000 – Police (largely hourly and overtime savings with partially offsetting pay-in-lieu overages)
- $753,000 – Mobility (largely salary savings)
- $713,000 – Facilities Services (largely salary savings)
- $651,000 – Stormwater (largely salary savings with partially offsetting overtime and special pay overages)
- $415,000 – Office of Race and Equity (salary savings; positions not filled in FY 2021)
- $372,000 – Smart and Sustainable Communities (largely salary savings; positions have been transferred to other departments in FY 2022)
- $254,000 – Development Services (largely salary savings)

Overtime

The category of salaries and wages with the largest FY 2021 overage was overtime, netting to $19.0 million. Of this amount, $18.0 million occurred within the Fire-Rescue Department and was largely related to constant staffing, Covid-19 impacts, strike team deployments, and dispatcher and lifeguard services vacancies. Environmental Services had the next largest overage, at $1.2 million, of which $812,000 was for Coronavirus Aid, Relief, and Economic Security (CARES) Act reimbursed Covid-19 expenditures, and $343,000 was related to Covid-19 and injury absences, as well as vacancies. These overtime overages are partially offset with $815,000 in Police Department overtime savings.

The two departments with the largest FY 2021 overtime expenditures are the Fire-Rescue and Police Departments, which together comprised 93% of General Fund overtime costs. These two departments' overtime expenditures are discussed briefly below.

Fire-Rescue Overtime

As shown in the following table, Fire-Rescue's actual overtime expenditures have significantly increased in FY 2018 through FY 2021 when compared to the previous fiscal years. From FY 2014 to FY 2017 average overtime expenditures were about $31.4 million, compared to the most recent expenditures in FY 2018 through FY 2021, which average $45.7 million.

The Fire- Rescue Department has indicated that contributing factors for increases over the years include general salary increases; a Local 145 MOU change beginning FY 2018 that allows leave time (non-productive time) to count towards the threshold above which overtime is earned; increases in strike team deployments and weather-related events; and higher vacancies yielding more constant-staffing overtime (related vacancy savings partially offsets certain overtime for constant-staffing). Note that strike team deployment overtime is reimbursable, and therefore will not have an impact on the General Fund. For FY 2021 there was also increased backfill overtime for Covid-related absences and for personnel pulled from operations primarily to perform reimbursable Covid-19 activities, including the City's vaccination operations.

Fire-Rescue Overtime – Historical Budget vs. Actuals *($ in millions)*								
	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**
Actual	$ 29.7	$ 31.5	$ 31.8	$ 32.5	$ 45.4	$ 45.2	$ 41.1	$ 51.3
Budget	23.7	26.7	29.9	30.2	32.8	38.1	36.6	33.3
Overage	**$ 6.0**	**$ 4.8**	**$ 1.9**	**$ 2.3**	**$ 12.5**	**$ 7.0**	**$ 4.5**	**$ 18.0**

NOTES: Table may not total due to rounding.
FY 2014 through FY 2021 Actual amounts are based on unaudited actuals.

Of the $18.0 million overtime overage in FY 2021, $11.1 million is or will be offset by reimbursements ($5.3 million) and net savings in salary and special pay (approximately $5.8 million), resulting in a net General Fund impact of about $6.9 million.

For a more detailed break-down of the $18.0 million overtime overage, the Fire-Rescue Department provided the following components:

- $5.6 million – constant staffing for essential fire suppression posts
- $4.4 million – strike team deployments (reimbursable)
- $5.1 million – COVID-19 (non-reimbursable)

- $0.9 million – COVID-19 (reimbursable)
- $1.2 million – other divisional overtime, largely for dispatcher and lifeguard services vacancies
- $400,000 – required continuing education and training on COVID protocols
- $300,000 – weather related overtime

Police Overtime

For additional context, historical information on Police overtime expenditures is provided in the following table. Overtime increases in FY 2020 and FY 2021 are largely related to reimbursable Covid-19 activities, contractual salary increases, and Neighborhood Policing and Clean SD activities. Additionally, for FY 2020 there were overtime increases related to civil protest events.

Police Overtime - Historical Budget vs. Actuals *($ in millions)*								
	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019** [1]	**FY 2020** [2]	**FY 2021** [3]
Actual	$ 17.8	$ 23.1	$ 25.0	$ 26.0	$ 29.7	$ 31.9	$ 44.8	$ 37.2
Budget	11.8	11.1	18.0	21.0	26.3	24.6	35.9	38.1
Overage/ (Savings)	**$ 6.0**	**$ 12.0**	**$ 7.0**	**$ 5.0**	**$ 3.4**	**$ 7.4**	**$ 8.9**	**$ (0.9)**

NOTES: Table may not total due to rounding.
FY 2014 through FY 2021 Actual amounts are based on unaudited actuals.

[1] The $31.9 million FY 2019 actual amount includes approximately $29.3 million of General Fund and $2.7 million of Seized Assets Fund (SAF) expenditures.

[2] The $44.8 million FY 2020 actual amount includes $41.4 million and $3.4 million for the General Fund and SAF, respectively; and the $35.9 million budget amount includes $32.1 million and $3.9 million for the General Fund and SAF, respectively.

[3] The $37.2 million FY 2021 actual amount includes $32.9 million and $4.3 million for the General Fund and SAF, respectively; and the $38.1 million budget amount include $33.7 million and $4.4 million for the General Fund and SAF, respectively.

Non-Personnel Expenditures

Contracts Spending

The largest General Fund expenditure decrease is in the Contracts category of the budget, which is $17.9 million below the Third Quarter Report projection, and $8.9 million below the Adopted Budget.

As our Office explained in IBA Report 20-10, "Budget Review Committee Request for Information Regarding Development of the FY 2021 Budget," the Contracts spending category is comprised of more spending line items than consulting, maintenance, or other service contracts. The Contracts category also includes rent payments, payments to the Public Liability Fund, other insurance premiums, charges from the Fleet Department, Department of Information Technology, and other internal service departments where costs are assigned to City departments by the Department of Finance.

As part of the FY 2021 budget actions, the Council removed $6.3 million in appropriations from Contracts, which was approximately 2.6% of the Proposed Budget level prior to the May Revision. This reduction, recognizing that not all line items within the Contracts category could be reduced, was designed to be a general reduction. Council directed the Department of Finance to remove the funds from the Adopted Budget and left the implementation of the reduction to the discretion of the Department of Finance.

To effectuate this reduction, the Department of Finance provided each department with a Contracts reduction target. These targets were determined by the size of each department's Contracts budget after removing all non-discretionary and CARES Act funded amounts. The targets were then allocated to all of the appropriate departments and were subsequently included in the FY 2022 Adopted Budget. In making the allocations, the Department of Finance did not further identify the actual contracts or line items from which the reductions were to be made. Thus, the impact of the reduction targets was up to the discretion of the various departments.

General Fund Contracts Spending *($ in millions)*					
	Adopted Budget	**Current Budget**	**Third Quarter Projection**	**Year-End Unaudited Actuals**	**Over/Under Current Budget**
Citwide Program Expenditures	$ 53.1	$ 59.9	$ 70.2	$ 62.8	$ 2.9
Stormwater	19.9	17.3	14.7	16.4	(0.9)
Environmental Services	29.6	29.4	28.8	27.9	(1.5)
Police	36.2	35.6	35.3	31.6	(4.0)
Homelessness Strategies	38.1	35.5	33.9	30.4	(5.1)
All Other Departments	104.5	106.5	107.6	103.4	(3.1)
Total	**$ 281.4**	**$ 284.2**	**$ 290.5**	**$ 272.5**	**$ (11.6)**

NOTE: Table may not total due to rounding.

The above table highlights certain departments that either significantly overspent or underspent their Current Budget level for Contracts, with the Current Budget being the final budget at year end. The only departmental budget with significant overspending was within Citywide Program Expenditures, which spent about $2.9 million over budget. This overage, as mentioned previously, was mainly due the $5.3 million increase in transfers to the Public Liability Fund. This increase was offset by other decreases as further explained in further detail below.

The largest departments that underspent their Contracts budget include Stormwater, Environmental Services, Police, and Homelessness Strategies. In total, the majority of the large variances in Contracts were mainly due to changes in large nondiscretionary items, including spending categories such as Rent, Refuse Disposal fees, Fleet charges, and other similar items, or changes that had net zero impact to the budget like the removal of expenditures and revenue related to the Storm Drain Fund from the Stormwater General Fund budget. More specifics on various departmental changes related to Contracts spending can be found below.

Library Department

The Third Quarter Report projected that the Library Department would end FY 2021 over its contracts budget by approximately $965,000. This projection was based on the Library Department's expectation that additional branch locations could reopen in FY 2021 which would require increased security and janitorial services. Ultimately, branch reopenings did not occur until shortly after the start of FY 2022 on July 6, 2021, and therefore the increased funding need did not materialize. As such, the Year-End Performance Report reflects a $980,000 surplus in contractual expenses for the Library Department compared to 3rd Quarter projections; overall, the Department ended FY 2021 with contractual expenses $13,000 under its budget.

Environmental Services

Environmental Services Contracts spending ended the year approximately $900,000 below the Third Quarter Report projection, and approximately $1.5 million below budget. This was mainly due to a large decrease in refuse collection fees as the tonnage of refuse collected by City forces declined at the end of FY 2021. Other decreases included contractual services costs due to efficiencies within the CleanSD program and lower costs at the compressed natural gas facility.

Police

The Police Department ended FY 2021 approximately $4.0 million under its contracts budget primarily due to reduced non-discretionary fleet charges totaling $2.6 million. Also of note was approximately $550,000 in contractual savings due to an overall reduction in misdemeanor and jail bookings in FY 2021 as a result of COVID-19. Expenditures under the City's contract with the County are charged on a per booking basis and represent the Department's largest budgeted discretionary contractual expense at $5.1 million.

Homelessness Strategies

The Year-End Performance Report reflects a $3.5 million reduction in contractual expenditures from Third Quarter projections in the Homelessness Strategies and Solutions Department. This is largely driven by two changes. The first is the use of $1.9 million in federal COVID-19 related Emergency Solutions Grant funds for shelter operations at Golden Hall *in place of* General Funds as was originally budgeted. The second change is a decrease of $1.4 million in expenses related to new ancillary costs for the City's shelters for which the Department became responsible. These costs include utilities, water, maintenance, and other costs. Initial estimates were included in the Third Quarter Report, but few costs materialized or were delayed to FY 2022. Staff indicate that they are reevaluating estimates for these costs going forward as more actual expense information is received.

Comparison to the Adopted Budget

When comparing Year-End expenditures to the FY 2021 Adopted Budget, the Department underspent in Non-Personnel Expenditures by $6.1 million, down from the $47.8 million originally budgeted. Of this amount, $3.5 million is largely explained above. The remaining variance is primarily attributed to spending directly from the Coronavirus Relief Fund as explained in the Third Quarter Report ($2.4 million).

From a programmatic perspective, we note one significant change from the Adopted Budget which was discussed in the Third Quarter Report. The FY 2021 Adopted Budget provided $1.1 million for the San Diego Misdemeanants At Risk Track (SMART) Program, but the program ended. The program was planned to move and expand into a rehabilitated facility, but those plans were put on hold since the facility was instead used to shelter families during the pandemic. While there are savings associated with the end of the SMART program, the savings were redirected to support unanticipated ancillary costs related to the Golden Hall Bridge Shelter. As the Year-End Report indicates, those costs did not fully materialize.

Update on Council's Request for Regular Updates on Homelessness

Our Office would also like to update the City Council, on its request to be updated more frequently on homelessness-related expenses, since a significant portion are supported by grant funding not included in the Year-End Performance Report. On June 22, 2021 Council approved the appropriation and allocation of the second round of a state grant supporting homelessness. In doing so, Council amended the resolution to reflect a request that staff report to the Land Use and Housing Committee and provide an update on homelessness programs and the status of spending multi-year grant funds, including reallocations of resources as recommended by our Office's report 21-19. The updates could be included with other items presented to the committee, as appropriate.

The resolution further includes Council's request that staff provide updates on spending state grant and other funding related to homelessness in the quarterly budget monitoring report. Department of Finance staff anticipate providing an update on these homelessness expenditures in the FY 2022 Mid-Year Budget Monitoring Report. In addition, the Homelessness Strategies and Solutions Department is currently putting together a program and fiscal update for City Council.

GENERAL FUND RESERVE

The City Reserve Policy[2] goal for the General Fund Reserve is to reach 16.7% of operating revenues, which is to be phased-in through FY 2025. To realize this phase-in, over the past several years, the Policy's Reserve target percentage has increased by 0.25% annually. For FY 2021, which ends June 30, 2021, the Reserve Policy's General Fund target increased from 15.5% to 15.75% of operating revenues.

However, as a result of declining revenues due to the Covid-19 pandemic, the Mayor's Proposed Budget for FY 2021 did not include a General Fund Reserve contribution, and the City Council did not include a contribution in the FY 2021 Adopted Budget. Likewise, the FY 2022 Adopted Budget does not include a Reserve contribution.

Thus, the FY 2021 and projected FY 2022 Reserve levels remain at the FY 2020 balance of $205.6 million, as shown in the third row of the following table. The fourth row shows that, in the absence of a Reserve contribution, the FY 2021 Reserve is $8.2 million below the Reserve Policy target; and the FY 2022 Reserve is projected to be $14.8 million below the Reserve Policy target.

General Fund Reserve Policy vs Reserve Balance *($ in millions)*			
	FY 2020	**FY 2021**	**FY 2022**
Reserve Policy Target Percent	***15.5%***	***15.75%***	***16%***
Reserve Policy Target [1]	$ 205.6	$ 213.8	$ 220.4
Reserve Balance (FY 2020 and FY 2021) / Reserve Projection (FY 2022) [2]	$ 205.6	$ 205.6	$ 205.6
Difference: Amount Reserve Balance Is Below the Policy Target	**$ -**	**$ (8.2)**	**$ (14.8)**
Reserve Balance as Percent of Operating Revenues	***15.5%***	***15.1%***	***14.9%***

Note: Table may not total due to rounding.

[1]The Reserve Policy targets are based on the average of the prior three years' actual operating revenues.

[2]The Reserve Balance for FY 2021 (and FY 2022 projection) is based on the approach presented in the FY 2022-2026 Five-Year Financial Outlook, for which there is no contribution to the General Fund Reserve for FY 2021 through FY 2023.

[2] The City Reserve Policy is delineated in Council Policy 100-20.

NET IMPACT ON GENERAL FUND/EXCESS EQUITY

The FY 2021 Third Quarter Report estimated that there would be no Excess Equity remaining in FY 2021, after assuming the use of $37.7 million of American Rescue Plan Act (ARPA) funds and $14.5 million of Excess Equity to balance the anticipated deficit (shown in the third column from the right in the following table).

The Year-End Performance Report's unaudited actuals now show that revenues have increased from the third quarter projection by $45.3 million; expenditures have decreased by $22.1 million; and there is no longer the need for $37.7 million of ARPA funds for deficit mitigation (ARPA funds are discussed in greater detail below). Additionally, there is a set-aside of $3.0 million related to an elections cost reimbursement, which was received in FY 2021 but budgeted in FY 2022.

FY 2021 General Fund Comparison - Projections to Unaudited Actuals *($ in millions)*

	Adopted Budget	Mid-Year Projection	Third Quarter Projection	Year-End Unaudited Actuals	*Variance: 3d Qtr to Year-End*
Audited Beginning Fund Balance at June 30, 2020	$ 220.1	$ 220.1	$ 220.1	$ 220.1	*$ -*
Less: Reserve Target for FY 2021[1]	(205.6)	(205.6)	(205.6)	(205.6)	-
Available Fund Balance (or Excess Equity)	***14.5***	***14.5***	***14.5***	***14.5***	**-**
FY 2021 Activity - (Use of)/Addition to Fund Balance					
Revenue	1,620.9	1,535.0	1,559.9	1,605.2	*45.3*
Use of American Rescue Plan Act (ARPA) Funds	-	-	37.7	-	*(37.7)*
Election Reimbursement Planned for Use in FY 2022	-	-	-	(3.0)	*(3.0)*
Expenditures	(1,620.9)	(1,620.4)	(1,612.1)	(1,590.0)	*22.1*
(Use of)/Addition to Fund Balance	**-**	***(85.4)***	***(14.5)***	***12.2***	***26.7***
FY 2021 Year-End Excess Equity/(Reserve Target Deficit at Mid-Year)	**$ 14.5**	**$ (71.0)**	**$ 0.0**	**$ 26.7**	***$ 26.7***

Note: Table may not total due to rounding.

[1]The FY 2021 Adopted Budget did not include a contribution to fund the General Fund Reserve to the FY 2021 15.75% Reserve target level designated in Council Policy 100-20. As such, the Reserve level for FY 2021 remains at $205.6 million.

The elections cost reimbursement set-aside, combined with the revenue, expenditure, and ARPA funding variances, net to $26.7 million. This $26.7 million is the amount of Excess Equity that remains at the end of FY 2021, based on the unaudited actual results in the Year-End Performance Report. *Thus, Excess Equity has swung from zero anticipated in the third quarter projection to $26.7 million in the Year-End Performance Report.*

<u>American Rescue Plan Act (ARPA)</u>

In response to the Covid-19 pandemic, ARPA was signed into law on March 11, 2021, providing $350 billion in State and Local Fiscal Recovery Funds (SLFRF) throughout the country. The City expects to receive a total of $299.7 million from ARPA, half of which was received in May 2021 and the other half expected no sooner than May 2022. ARPA funds are available to provide government services and replace much of the City revenue lost because of the pandemic.

As noted above, in June the City planned to use $37.7 million of ARPA funds to balance the FY 2021 Budget. Additionally, $149.3 million was estimated as needed to balance the FY 2022 Budget, leaving the remaining $112.7 million to help mitigate a projected budget shortfall in the FY 2023 Budget. The $67.4 million positive variance reported in the FY 2021 Year-End

Performance Report means the City will not need to use any ARPA funds to balance the FY 2021 Budget and can instead carry these funds forward to address projected structural revenue shortfalls in FY 2023 and FY 2024. The projected amount of these shortfalls will be updated in the Five-Year Financial Outlook scheduled for release on November 10, 2021.

Adding the $37.7 million to the $112.7 million already being saved for FY 2023 provides the City with $150.4 million of ARPA funds available to mitigate projected structural revenue shortfalls in FY 2023 and FY 2024. Although subject to change, preliminary estimates from the Department of Finance suggest $109.6 million may be needed for FY 2023 which would leave $40.8 million for FY 2024. These estimates will also be updated in the Five-Year Financial Outlook.

It is important to note that while ARPA funds are available to backfill revenue lost due to the pandemic, they cannot be used for certain General Fund expenses. As noted in the conclusion of the Year-End Performance Report, ARPA funds cannot be used for: deposits into a pension fund; a non-federal grant match; debt service; to satisfy a judgement or settlement; or to contribute to reserves. However, based on the Year-End Performance Report, the City now has $26.7 million of Excess Equity (fund balance) that could be used to address these expenses. Final decisions about how to best use remaining ARPA funds will be made during the budget processes for FY 2023 and FY 2024.

Potential Use of Excess Equity

The Year-End Performance Report discusses potential uses for the $26.7 million in Excess Equity, including:

- Funding the General Fund Reserve to its FY 2022 target level
- Keeping the Pension Payment Stabilization Reserve funded at its current level rather than using it as a resource in FY 2022
- Mitigating one-time costs anticipated with the unwinding of Proposition B; or
- Lessening potential service level reductions that may be considered as a result of the anticipated structural revenue shortfalls after FY 2022

Potential uses of Excess Equity can be considered as FY 2022 progresses and as the City develops new information.

NEXT STEPS AND ADDITIONAL CONSIDERATIONS

Ultimately, any proposed use of Excess Equity will require Council's approval, and should the Mayor propose any changes to the current year's budget in the Mid-Year Report that will be released in January, Council will have the opportunity to either approve or amend those proposals during its review in February.

While the additional Excess Equity reported in the Year-End Performance Report is ultimately a positive, and the growth in revenue projections points to a rebounding local and regional economy that is recovering from the impacts of the COVID-19 pandemic, we do note that impacts from the pandemic continue to be felt, and some City revenues – most notably TOT revenue – continue to be volatile. It also remains to be seen how other economic issues such as supply-chain delays will impact the City's economy, revenues, and operations in the near future. The City will need to continue to monitor various ongoing impacts and make fiscally responsible and strategic decisions about how to address the financial challenges ahead.

Further context on the City's finances for the current fiscal year, as well as in future fiscal years, will be included in the First Quarter Budget Monitoring Report and the City's Five Year Financial Outlook, both of which are due to be released on November 10th. The City also anticipates being able to determine the one-time costs related to unwinding Proposition B in the next several months.[3]

CONCLUSION

The Office of the IBA's review of the FY 2021 Year-End Performance Report documents the changes to General Fund revenues, expenditures, and excess equity since the Third-Quarter Report projections, provides a high-level summary of year-end expenditure variances as compared to the FY 2021 Adopted Budget. We present this information in order to provide another tool for evaluating City expenditures for FY 2021 and to help guide Council's discussions around future budget decisions. Additional information is anticipated to come in the FY 2022 First Quarter Budget Monitoring Report and the Mayor's FY 2023-2027 Five-Year Financial Outlook, both of which are scheduled to be released November 10, 2021.

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[3] The City is currently negotiating with the four Recognized Employee Organizations (REOs) involved in the legal challenges to Proposition B. Based on preliminary estimates, the net one-time cost to the City with respect to unwinding Proposition B could be up to $77.5 million, *with approximately $46.1 million due from the General Fund*. The results of negotiations with the REOs will impact the one-time cost of unwinding Proposition B, as will the performance of financial markets and how they impact the existing defined contribution plan balances. The variables in the costing are many and complex, and changes to these preliminary estimates could be significant.