THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the Mayor's FY 2024-2028 Five-Year Financial Outlook

OVERVIEW

Importance of the City's Outlook

On November 10, 2022, Mayor Gloria released his *Fiscal Year 2024-2028 Five-Year Financial Outlook* (Outlook), one of the City's annual financial planning tools. The Outlook is an integral part of the budget development process and is described in *Council Policy 000-02: Budget Policies* as *"the basis for determining the coming year's operating budget allocations."* Former Mayor Sanders initiated the Five-Year Financial Outlook process in 2006 which was continued by subsequent Mayors. In 2015, the City Council initiated a Charter Review process with a focus on greater clarity of the budget process including the requirement for the Mayor to issue a multi-year financial outlook annually. In June 2016, with a vote of the people, Section 69 of the City's Charter was amended to require the Mayor to annually prepare a multi-year financial outlook for the General Fund.

> ***"The Mayor shall annually prepare a multi-year financial outlook for the general fund projecting anticipated revenues and expenditures in future years as a fiscal planning document and basis for the proposed budget."***

The City's Budget Policy was also amended to state: 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 Council policies."* While the Outlook should not be interpreted as a budget, it provides the Council and the public with a longer-term financial perspective and a preliminary indication of the Mayor's budget priorities. Each year many Council priorities will overlap with the Mayor's, but Council has final authority in the budget process to determine the City's budget priorities for the next fiscal year.

While the Council cannot change the Mayor's Outlook, the Council remains the ultimate budget authority, and can make changes to the budget following Mayor Gloria's release of the FY 2024 Proposed Budget. In doing so, the budget must stay balanced through identifying alternate budget reductions or new resources, delaying new facilities, consolidating or eliminating other programs, or other mitigation tools.

IBA Review and Analysis of Significant Annual Budget Reports

The release of the Outlook is the first look at the next fiscal year's overall budget issues and whether there is an anticipated surplus or shortfall in the General Fund. While the Executive Branch develops the Outlook, the Office of the Independent Budget Analyst (IBA) is charged with providing the City Council with a comprehensive review and analysis of the annual Outlook as well as all major budget reports – such as Quarterly Budget Monitoring Reports (including the First Quarter, Mid-Year and Third Quarter Reports), the Mayor's Proposed Budget, the Mayor's May Revision to the Proposed Budget, the Five-Year Capital Infrastructure Planning Outlook, and the CIP Budget Monitoring Reports.

Each fiscal year the Office of the IBA also develops the Council's Budget Priorities Resolution based on individual Councilmember's priorities memoranda, which is provided to the Mayor to help inform Mayoral budget priorities. The Council's initial Budget Priorities Resolution for FY 2024 was approved on November 1, 2022; and the Council will have an opportunity to update their budget priorities in January.[1] Additionally, in the last stage of the budget adoption process, the IBA provides a report to Council which recommends modifications to the Mayor's Proposed Budget based on final Council Budget Modification memoranda submitted to our Office in May, and Council can approve or revise these recommendations.

"Councilmembers shall . . . communicate their budget priorities to the IBA, who will analyze and consolidate the priorities into a proposed Council budget priorities resolution"

Review of the Mayor's Outlook

As shown in the report summary on the next page, this report consists of several sections. Some highlights of the sections are provided and discussed in greater detail in the body of our report. Our Office would like to thank staff from the Department of Finance and other City Departments for responding to our numerous questions in preparing this report. The IBA's role is to analyze the Outlook objectively, through various perspectives, and identify issues and options to assist the Council in decision-making. This information may also assist the public in understanding the budget process and the numerous challenges facing the City.

[1] This is the first Budget Priorities Resolution that has been prepared during September and October, which reflects action taken by the City Council on June 27, 2022 to accelerate development of Council's budget priorities in order to amplify their impact on the development of the Mayor's Proposed Budget. In the past, the Budget Priorities Resolution had been adopted by Council in February of each year, at which time a significant portion of the Mayor's Proposed Budget was already determined. Submitting the Budget Priorities Resolution earlier than in prior years is intended to better position Councilmember priorities for consideration in the Mayor's Proposed Budget. Council will also have the opportunity to update their budget priorities in January 2023.

REPORT SUMMARY

Overall fiscal condition

- Projected structural budget deficits persist throughout much of the Outlook period that will be critical to address in the future. Structural budget deficits occur when ongoing and sustainable revenue sources are not enough to support ongoing expenses.

Review and analysis of projected Baseline Revenue assumptions included in the Outlook

- With the information available to date, we agree with the projections in the Outlook but note that future economic conditions driving projections are particularly uncertain.
- The revenue outlook is generally positive with continued moderate growth for all major General Fund revenues. However, high inflation and federal efforts to combat it pose a risk to projections as well as heighten the risk of a recession.

Review and analysis of Baseline General Fund Expenditures

- We identify the changes from the FY 2023 Adopted Budget to the FY 2024 Outlook Baseline Expenditures which maintain service levels, with no new initiatives.
- We discuss major drivers of personnel-related expenditure increases including compensation increases, the defined benefit pension payment, and unwinding Proposition B.
- Non-Personnel Expenditures are also discussed with a focus on energy and utilities, information technology, SD Access 4 All, transfers to the Infrastructure Fund, and General Fund supported debt service. We note that the forecast for electric services is likely too low.
- Projected reserve balances, contributions, and changes to City policies delaying reserve level targets are also discussed. We believe the changes are reasonable.

Review and analysis of additional Outlook priorities beyond Baseline Expenditures

- With respect to funding for new facilities included in the Outlook: we discuss staffing needs for the anticipated opening of new or expanded parks, libraries, and fire stations and note two fire stations assumed to come online have large funding gaps.
- Planned commitments for continuing *existing* homelessness programs, modernizing information technology systems, and financing stormwater needs are also reviewed. For homelessness, we discuss the need to prioritize programs due to funding constraints, and call for a discussion of how regional collaboration will provide the necessary range of homelessness services.

Review and analysis of potential funding needs not included in the Outlook

- We identify existing programs and Council priorities that are not included in the Outlook that Council may want to consider during the budget process, such as those related to infrastructure, Climate Action Plan implementation activities, arts and culture, equity in recreation programming, the Fire/Police training facility feasibility study, and additional homelessness and housing programs.
- Additionally, there are significant funding needs for the Stormwater Department to be able to meet regulatory requirements for the existing system. We also raise issues for consideration when making future decisions pertaining to downtown office space.

IBA Discussion of Potential Mitigation Measures

- We cover various potential measures to mitigate the projected budget deficits.

OVERALL FISCAL CONDITION

The FY 2024 Outlook revenue and expenditure projections both show declines from the FY 2023 Adopted Budget. These decreases are largely related to removals of one-time adjustments that were included in the FY 2023 Adopted Budget – which for revenues, is largely related to federal American Rescue Plan Act (ARPA) funding. For the remaining Outlook years, Baseline Revenue and Expenditure projections show steady increases.

Nonetheless, projections in the Outlook continue to show General Fund deficits in initial years even when expenditures are limited to Baseline Expenditures associated with maintaining – not expanding – current City service levels. When planned commitments and other priorities are added to Baseline Expenditures, projected deficits that will have to be mitigated grow larger. While initial year deficits can likely be mitigated through using one-time revenue sources such as ARPA and Excess Equity, projected structural deficits persist throughout much of the Outlook period, as shown on the table below, and it will be critical to address this structural imbalance going forward.

Baseline Genenral Fund Revenue and Expenditures *($ in millions)*					
	FY 2024	**FY 2025**	**FY 2026**	**FY 2027**	**FY 2028**
Baseline General Fund Revenues	$ 1,881.1	$ 1,955.4	$ 2,017.3	$ 2,086.1	$ 2,149.4
Baseline General Fund Expenditures	1,931.6	1,978.0	2,038.1	2,085.4	2,143.3
Baseline (Shortfall)/Surplus	**(50.5)**	**(22.6)**	**(20.9)**	**0.7**	**6.1**
Additional Outlook Priorities Beyond Baseline	(25.4)	(73.0)	(86.4)	(94.8)	(118.7)
Recommended Use of Available ARPA Funds	52.1	-	-	-	-
Recommended Use of Available Excess Equity	23.8	48.3	-	-	-
Overall Outlook Shortfall	**$ 0.0**	**$ (47.3)**	**$ (107.3)**	**$ (94.1)**	**$ (112.6)**

Expenditures beyond the Baseline included in the Outlook augment projected deficits to $75.9 million in FY 2024 and close to $113 million in FY 2028. As discussed later in our report, there are other budget priorities for which significant resources will also need to be identified.

REVIEW OF BASELINE GENERAL FUND REVENUES

The table below reflects Baseline General Fund revenues for the Outlook period, plus FY 2023 revenues for context. The main driver of the $102.7 million decrease in General Fund revenues from the FY 2023 Adopted Budget to the FY 2024 Outlook projection is the removal of $147.6 million in one-time ARPA funds. However, $52.1 million in ARPA funding remains available and is recommended for use in FY 2024.

Review of Baseline Revenues
- Property Tax
- Sales Tax
- Transient Occupancy Tax
- Franchise Fees
- Cannabis Business Tax

Baseline General Fund Revenues *($ in millions)*							
	FY 2023 Adopted	**FY 2023 Projection**	**FY 2024 Projection**	**FY 2025 Projection**	**FY 2026 Projection**	**FY 2027 Projection**	**FY 2028 Projection**
Property Tax	$ 706.2	$ 720.4	$ 745.8	$ 782.2	$ 817.0	$ 853.8	$ 891.6
Sales Tax	380.2	386.0	394.1	403.1	418.5	434.4	448.7
Transient Occupancy Tax	135.2	149.9	155.8	162.0	168.5	175.2	182.1
Franchise Fees	95.6	96.3	100.2	101.3	102.4	94.2	95.1
Cannabis Business Tax	25.7	21.6	23.6	26.0	28.4	28.9	30.4
All Other Revenue Categories[1]	458.2	462.0	461.6	480.8	482.6	499.7	501.5
ARPA Funding[2]	147.6	147.6	-	-	-	-	-
Total	**$ 1,948.8**	**$ 1,983.8**	**$ 1,881.1**	**$ 1,955.4**	**$ 2,017.3**	**$ 2,086.1**	**$ 2,149.4**

Note: figures may not total due to rounding.

[1] Includes Transfers In, Charges for Services, Special Promotional Programs reimbursements, etc.

[2] The remaining $52.1 million in ARPA funds is recommended for use in FY 2024 but is not considered part of baseline revenues.

Generally, the outlook for Baseline General Fund revenues is positive over the next five fiscal years, with moderate growth rates assumed for all major General Fund revenue sources – Property Tax, Sales Tax, Transient Occupancy Tax, and Franchise Fees. This continues growth trends, though tempered, experienced in FY 2022 and growth projected in the FY 2023 First Quarter Budget Monitoring Report (First Quarter Report) – also see IBA Report 22-33. Economic conditions in the City also generally remain strong with low unemployment and high consumer spending despite persistently high inflation.

However, high inflation presents a significant risk to revenue projections assumed in the Outlook as the Federal Reserve continues to increase interest rates, which creates higher borrowing costs and makes it more difficult for residents to buy homes and businesses to invest. Because inflation remains well above the Federal Reserve's annual target of 2%, it plans to continue to increase interest rates with the goal of cooling the economy, reducing overall demand, and bringing down inflation. Some economists believe that this can be done without causing a recession (referred to as a "soft landing") but the risk of a recession is growing as inflation remains high and efforts to combat it increase.

In summary, future economic conditions driving revenue projections are uncertain. However, given the information available to date, our Office believes that revenue projections in the Outlook are reasonable as they generally reflect slower growth consistent with efforts to tame inflation while also considering recent revenue activity. We will continue to closely monitor economic conditions and revenues throughout the fiscal year. Each of the major General Fund revenue sources, as well as Cannabis Business Tax, are discussed in additional detail in this section.

Property Tax

Property taxes represent the single largest source of General Fund revenue. City property taxes are derived from three major sources: the Proposition 13 1% levy on the assessed value of property throughout the City, of which the City receives approximately 17%; Motor Vehicle License Fee (MVLF) backfill payments; and distributions from the Redevelopment Property Tax Trust Fund (RPTTF), which represents payments to the City as a result of the dissolution of the former Redevelopment Agencies.

Property taxes are projected to continue to grow throughout the projection period, but with higher growth in the near term and slower but steadier growth in the out years. For FY 2024, the Outlook projects property tax growth at 5.28%, which is slightly lower than the FY 2023 Adopted Budget projection of 6.00%. As mentioned in our report on the First Quarter Monitoring Report, actuals for FY 2023 are outpacing the 6.00% growth rate to date, which is already one of the highest projected growth rates utilized in the budget for property taxes, due to the robust housing and other property markets within calendar year 2021. While this hot market continued partially into calendar year 2022, since the middle of the year it has slowed dramatically from its peak, as rising interest rates have halted rapidly increasing house prices and decreased the number of sales. As such, the FY 2024 projected growth rate attempts to capture both the high prices and sales of the first half of the year with the tapering of the market in the second half of the year; this is reasonable given where the housing market in particular has turned this year.

Following FY 2024, growth rates in the out years of the Outlook vary between 4.29% and 4.35%. These projections reflect a more stable market that does not return to the price and sales increases of the previous years, which is prudent given the uncertainty over interest rates and other federal actions. Projections also include an assumption that properties not otherwise sold, transferred, or improved continue to grow in assessed values at the 2% per year maximum allowed under Proposition 13 given that inflation projections for all five years are well above 2%. Additionally, the Department of Finance has retained a property tax consultant, similar to the consultant retained for sales tax projections, and the new consultant has been working with the Department on these projections for a number of months. Given all of these factors, our Office agrees with these projections.

Sales Tax

Sales tax is the second largest single source of General Fund revenue and is derived from a tax on sales made in or delivered to the San Diego region. While the sales tax rate in the City of San Diego is 7.75%, only 1.0% goes directly to the City's General Fund.

The FY 2023 Adopted Budget included sales tax revenue of $380.2 million, though based on increased first quarter performance in FY 2023, FY 2023 sales tax revenues are now projected to total $386.0 million which is a 2.8% increase over FY 2022 sales tax revenues at year-end. We note that this is slightly below the projection provided by Avenu Insights & Analytics/MuniServices (the City's sales tax consultant) which assumes a 3.4% increase. The Outlook projects the City's sales tax revenues to increase throughout the Outlook period and assumes year-over-year growth as outlined in the table below. These projections closely track those provided by the City's sales tax consultant in its "soft landing" scenario.

Sales Tax Projected Growth Rate				
FY 2024	**FY 2025**	**FY 2026**	**FY 2027**	**FY 2028**
2.1%	2.3%	3.8%	3.8%	3.3%

The Outlook also includes low and high scenario projections for sales tax revenue. It is difficult to anticipate the trajectory of sales tax revenue one year from today and increasingly difficult further out in the Outlook period. Assuming continued economic tightening measures by the Federal Reserve do not trigger a recession, forecasting slower growth rates than the 2.8% projected to occur from FY 2022 to FY 2023 in the short term is reasonable. As noted earlier, though a recession is not currently forecasted, the risk of one is heightened. We note that the sales tax consultant's recession scenario assumes a 0.6% decrease in sales tax revenue in FY 2024[2] which would reduce sales tax revenue projected by about $10 million.

<u>Transient Occupancy Tax</u>

Transient Occupancy Taxes (TOT) – or hotel taxes – are the third largest major General Fund revenue source. San Diego's TOT rate is 10.5%, with 5.5% of that amount allocated to the General Fund (to support general City services), 4.0% to Special Promotional Programs (to support programs and services that encourage tourism to San Diego), and 1.0% allocated as discretionary/Council directed funding. The Outlook focuses on the 5.5% General Fund allocation of TOT.

TOT receipts were severely impacted by the COVID-19 pandemic but have made a strong recovery throughout FY 2022. The Outlook projects continued, although slower, growth in TOT revenues with the next five fiscal years projected to grow by 4.0% per year. This contrasts with the projected 9.8% growth in TOT revenues anticipated in FY 2023. According to Department of Finance, the 4.0% growth rate is based on historical average year-over-year growth prior to the pandemic.

We note that economic indicators for San Diego tourism recently forecasted by Tourism Economics for the Tourism Authority in general only reflect slight growth in *calendar year* 2023, leading to a much smaller projected growth rate of 0.3% (translated into *fiscal years*, this results in a dip in TOT revenue for the first and second quarters of FY 2024). However, we also note that that forecast incorporates the assumption of a mild recession. While there is heightened risk of a recession, economic indicators and actual revenue activity in FY 2023 so far support continued but moderate growth. Our Office agrees with a more normalized growth rate at this stage which is consistent with other forecasts used to develop the Outlook, though we will reexamine these assumptions during our review of the FY 2024 Proposed Budget.

One additional consideration with regard to the TOT revenue forecasted is the anticipated impact from recent changes to the City's Short-Term Residential Occupancy (STRO) regulations. Beginning on May 1, 2023, a STRO License will be required in order to rent out a residential dwelling unit on a short-term basis in the City of San Diego. Under the City's STRO Ordinance,

[2] The State's Financial Outlook also assumes a 0.6% decrease in sales tax revenue statewide in FY 2024 but does not assume a recession, although the threat of one is reflected.

the number of available licenses for certain license types are subject to a lottery process that will occur on December 16, 2022. Given this restriction relative to current activity, overall TOT collected from STROs beginning in FY 2024 is anticipated to be reduced. In 2021, our Office released IBA Report 21-06 "Impacts of Proposed Short -Term Residential Occupancy (STRO) Regulations on TOT Revenue" which estimated a 14% to 23% reduction in total TOT collected from STROs based on pre-pandemic activity in CY 2019; these percentages would have translated to a reduction ranging from $4.4 million to $7.3 million in TOT. Impacts associated with the STRO Ordinance are not factored into the Outlook, and therefore may reduce the TOT revenue forecasted in the Outlook for FY 2024 and beyond. With that said, as we noted in our 2021 report, there are a number of factors that could increase or decrease our estimated range of TOT lost. The Department of Finance and the City Treasurer's Office will need to re-evaluate the STRO Ordinance-related impacts during the FY 2024 budget development process.

Consideration of all TOT Revenues and Operational Impacts
As noted above, the TOT revenue projection in the Outlook focuses on the 5.5% General Fund allocation of TOT. However, it is important to note that changes in TOT receipts impact all three allocations (General Fund, Special Promotional Programs, and Council directed funding) that make up the full 10.5% TOT rate. While the 5.5% General Fund TOT allocation has the most direct impact on the City's General Fund finances, projections in the other allocations will impact City services as well, and we believe it is important that they be presented for consideration and review. Accordingly, the Department of Finance's projections for each allocation are shown on the following table.

Transient Occupancy Tax Revenue *($ in millions)*							
	FY 2023 Adopted	**FY 2023 Projection**	**FY 2024 Projection**	**FY 2025 Projection**	**FY 2026 Projection**	**FY 2027 Projection**	**FY 2028 Projecction**
General Fund Allocation (5.5%)	$ 135.2	$ 149.9	$ 155.8	$ 162.0	$ 168.5	$ 175.2	$ 182.1
Special Promotional Programs (4.0%)	97.2	107.9	112.2	116.7	121.4	126.3	131.3
Council Discretionary (1.0%)	24.3	27.0	28.1	29.2	30.4	31.6	32.8
Total	**$ 256.7**	**$ 284.8**	**$ 296.1**	**$ 307.9**	**$ 320.2**	**$ 333.0**	**$ 346.3**

Note: figures may not total due to rounding.

Franchise Fees
Franchise fees represent payments made by private companies to the City for the right to operate within the City's right-of-way. The main sources of franchise fee revenue are: from San Diego Gas & Electric (SDG&E) for the right to provide City residents and businesses with gas and electric services; from Cox Communications, AT&T, and Spectrum for the right to provide cable services to City residents; and from private refuse haulers that conduct business within City limits. Franchise fees from SDG&E and cable companies are based upon a percentage of revenue generated, while franchise fees from refuse haulers are based on tonnage.

Overall, franchise fees are projected to grow modestly during the Outlook period, with overall decreases in FY 2027 and 2028 due to the temporary suspension of annual minimum bid payments from SDG&E for the electric franchise agreement.[3] SDG&E franchise fees, which represent over

[3] The electric franchise agreement approved in May 2021 included a $70 million bid payment to be paid in $10 million installments over seven years, with interest. The seven years cover FY 2022-2026 and FY 2031-2032. The gas

66% of the overall franchise fee revenue, are projected to grow at 8.05% in FY 2024, and then by a lower 2.04% in FY 2025, continuing to grow around that pace throughout the rest of the Outlook period. The FY 2024 growth rate is based on anticipated rate increases SDG&E has currently submitted to the California Public Utilities Commission (CPUC) that are awaiting approval and will become effective in January 2023, as well as an assumption that overall electricity and gas demand remains stable in the next year. Out-year projections are based on historical trends in the growth of these fees, which are based on revenue receipts from SDG&E that can vacillate dramatically during any given year based on numerous factors, including future rate cases as well as weather patterns that may change gross electric or gas demand.

Cable franchise fees are projected to continue declining by 4.63% based on historical trends, while refuse hauler fees are projected to remain flat at $13.8 million per year due to no anticipated fee increases during the Outlook period. On the refuse hauler fees, we would note that the $13.8 million, while above the Adopted Budget amount of $13.6 for FY 2023, is below the First Quarter projection for these fees, which is $14.3 million and is based on increased tonnage to date. At minimum, the FY 2024 projection should increase to this level. Otherwise, our Office agrees with the overall franchise fee projections.

Transfers to Franchise Fee Related Funds

The Outlook assumes that the City will continue to transfer a portion of the regular SDG&E franchise fee payments into the Climate Equity Fund (CEF) within each year of the Outlook. The policy is for a minimum of 10% of the regular payments be transferred to the CEF each year. In the Outlook, this policy is effectuated, with between $7.5 million and $8.0 million included within the Transfers Out category. However, our Office notes that these amounts are $1.1 million above the 10% requirement in each year. This is based on a Council budget modification that increased the General Fund contribution to the CEF by $1.1 million on a one-time basis in FY 2023. While this was a one-time increase, it was included as an ongoing adjustment in the Outlook.

Additionally, the Outlook also includes a transfer to the Energy Independence Fund (EIF) in each year of the Outlook. The contribution to the EIF is supposed to be 20% of the General Fund portion of the SDG&E minimum bid payments. The amount of the FY 2023 allocation is $1.6 million, which remains flat during each year of the Outlook. Our Office notes that this is inconsistent with the policy, as the minimum bid proceeds increase from $8.4 million to $9.0 million from FY 2024 to FY 2026, which should result in increased payments to the EIF during those years. Conversely, as the minimum bid payments decrease in FY 2027, having the transfer included in FY 2027 and FY 2028 overpays the EIF by $1.6 million in each year.

Cannabis Business Tax

The Outlook includes projected revenue from the City's non-medical cannabis business tax (CBT). The tax applies to cannabis related business activities which includes but is not limited to transporting, manufacturing, packaging, and retail sales, with retail sales taxed at a rate of 8.0% while other activities are taxed at 2.0%. The Outlook's revenue projection starts with the average annual revenue from FY 2022, and then assumes modest annual revenue growth per operating

franchise agreement included a $10 million bid payment, paid out in equal $500,000 installments with interest over the 20-year term of the agreement. These bid payments are split the same as the regular franchise fee payments, per the City Charter, with 75% to the General Fund and 25% to the Environmental Growth Funds.

business of 1.5% per year. Additionally, the projection also assumes that the number of retail outlets grows from 24 in FY 2024 to 29 in FY 2028, while the number of cannabis production facilities (CPFs) grows from 48 in FY 2024 to 60 in FY 2028. These assumptions are similar to those of previous Outlooks, as well as the FY 2023 Adopted Budget, but the growth in both outlets and CPFs is slower than in prior years.

Overall, the forecast for CPF growth is basically unchanged from last year, with the exception that the new tax rate of 2% for these businesses is included. To date, gross receipts generated by CPFs has remained fairly constant, and the reduction in the tax rate has yet to result in an increase in local production facilities.

It is likely that the overall level of revenue from the CBT is too high within the Outlook. As mentioned in our review of the First Quarter Report, the industry is facing headwinds, including from pressures outside of the City, which is impacting retail outlets as they are now facing greater competition from other retail outlets in surrounding jurisdictions. In the First Quarter Report, the revenue projections have been reduced correspondingly, but this reduction has not been incorporated into the Outlook as there has not been enough information gathered to determine if the revenue declines within FY 2023 will be temporary. It will be important to continue to monitor this revenue source, particularly in the FY 2023 Mid-Year Budget Monitoring Report (Mid-Year Report), to ensure that an appropriate amount of revenue based on industry trends is included in the FY 2024 Proposed Budget.

REVIEW OF BASELINE GENERAL FUND EXPENDITURES

General Fund Baseline Expenditures support existing service levels; and therefore, there are no increases related to new programs in the Outlook's Baseline. However, we note that decision-makers may ultimately determine that continuation of certain Baseline services is not an optimal approach. In other words, some service levels could be reduced or eliminated in order to fund other needs and priorities determined to be more important. The City Council is the ultimate budget authority and can determine priority services that are different than those proposed by the Mayor.

Our review of General Fund Baseline Expenditures provides important context by addressing changes from the FY 2023 Adopted Budget to the FY 2024 Outlook Baseline. As shown in the following table, the Outlook's FY 2024 General Fund Baseline Expenditure projection is a ***net decrease*** of $23.4 million (or 1.2%) from the FY 2023 Adopted Budget – including a number of decreases and partially offsetting increases. The decrease is largely driven by removal of one-time expenditures that are higher than those of previous years. Disregarding the FY 2023 one-time amounts, net increases in remaining expenditures are $106.7 million.

The largest expenditure ***decreases*** shown in the table include:

- $40.2 million for one-time Capital Improvements Program (CIP) transfers
- $28.0 million for one-time pension payment transition costs for Proposition B employees
- $23.4 million in one-time funding for homelessness and housing programs
- $16.3 million for Supplemental Pension Savings Plan H (SPSP-H) costs, related to unwinding Proposition B
- $10.3 million for 101 Ash and Civic Center Plaza (CCP) rent removal
- $6.6 million for the Infrastructure Fund transfer
- $5.3 million in one-time funding for Watershed Master Planning consulting, vehicles, and IT equipment

Expenditure decreases are partially offset with a number of expenditure ***increases***, including:

- $32.0 million for compensation increases based on previously negotiated agreements with employee organizations
- $26.5 million for the Actuarially Determined Contribution (ADC) pension payment increase
- $12.3 million for compensation increases based on an assumed 3.05% general wage increase for non-public safety employees
- $11.2 million in debt service for new debt issuances
- $9.8 million for lower personnel expenditure savings
- $8.3 million for the Parks Improvement Fund transfers
- $8.0 million for amortization of the Unfunded Actuarial Liability (UAL) related to unwinding Proposition B

More detailed components of Baseline Expenditures are discussed in the sections following the table.

Increases/(Decreases) from the FY 2023 Adopted Budget to the FY 2024 Outlook Baseline Projection *($ in millions)*		
FY 2023 Adopted Budget		**$ 1,955.0**
Personnel Expenditure (PE) and Fringe Benefit Changes		**79.4**
Compensation Increases (based on current labor agreements)	$ 32.0	
Actuarially Determined Contribution (ADC) - Defined Benefit Pension Payment Increase	26.5	
Assumed 3.05% General Wage Increase for Non-Public Safety Employees	12.3	
Budgeted PE Savings Decrease (a budget increase)	9.8	
Amortization of Unfunded Actuarial Liability (UAL) - related to unwinding Proposition B	8.0	
FY 2023 Position Annualizations - Parks & Recreation Department	4.9	
Step Increases	2.5	
Supplemental Pension Savings Plan H (SPSP-H) Decrease - related to unwinding Proposition B	(16.3)	
Net Other PE Changes	(0.2)	
Non-Personnel Expenditure (NPE) Changes		**27.3**
Increase in Debt Service for New Debt Issuances	11.2	
Increase in Transfers to Parks Improvement Funds	8.3	
Contracts - 4.1% Annual Growth Rate	7.3	
Public Liability Increase: Insurance Premiums ($6.2M); Other Operating Costs ($833K)	7.0	
Public Liability Reserve Contribution	5.0	
General Fund Reserve Contribution Increase	3.5	
Fleet Fees Increases - vehicle usage ($2.5M) and vehicle replacement ($598K)	3.1	
Reserve Contributions for Workers' Compensation ($1.4M); Long-Term Disability ($387K)	1.8	
Supplies - 4.1% Annual Growth Rate	1.5	
Elections Cost Increase (including 2024 Primary Election)	1.4	
Information Technology (IT) - 4.1% Annual Growth Rate [1]	0.7	
Decrease in Infrastructure Fund Transfer	(6.6)	
Removal of 101 Ash and CCP Lease-to-Own Rent	(10.3)	
Net Other NPE Changes	(6.6)	
Removal of FY 2023 One-Time Expenditures (includes PE and NPE) [2]		**(130.1)**
Transfer to the Capital Improvements Program (CIP)	(40.2)	
Pension Payment Transition Costs for Post-Proposition B Employees	(28.0)	
Funding for Homelessness and Housing Programs	(23.4)	
Watershed Master Planning Consulting, Vehicles, and IT Equipment	(5.3)	
Extension of Shift Overtime - Police Department	(4.1)	
Vehicles and Sign Postage to Support Street Sweeping Efficiency & Expansion	(3.1)	
Sidewalk Vending Ordinance	(2.3)	
Support for State Senate Bill 1383	(1.8)	
Vehicles and IT Equipment to Support Stormwater Pump Station Repair & Automation	(1.7)	
SD Access 4 All: Broadband Access Expansion ($1.1M); Broadband Master Plan ($500K)	(1.6)	
Vehicles to Support Encampment Abatements and Sidewalk Sanitation	(1.2)	
Support for Stormwater Education and Outreach Program	(1.0)	
Net Other One-Time Expenditure Adjustments	$ (16.4)	
FY 2024 Outlook Baseline Projection		**$ 1,931.6**
Overall Decrease: FY 2023 Adopted Budget to FY 2024 Outlook Baseline (1.2% Decrease)		**$ (23.4)**

Note: Table may not total due to rounding.

[1] IT - 4.1% Annual Growth Rate includes increases in Computer Maintenance/Contracts, Hardware/Software, Professional IT Services, Enterprise GIS, and Network Access.

[2] Attachment 1 to the Five-Year Outlook, One-Time Uses section, includes one-time expenditures of $165.1m - only $130.1m of which is shown in the "Removal of FY 2023 One-Time Expenditures" section of this table. The remaining FY 2023 one-time expenditures are addressed among other components of this table, and the related Outlook, Attachment 1 amounts are: $28.4m Transfer to the Infrastructure Fund; $5.1m Transfer to the Public Liability Operating Fund; and $1.5m for the General Fund Reserve Contribution.

PERSONNEL-RELATED EXPENDITURES IN THE OUTLOOK BASELINE

Review of Baseline Personnel Expenditures
• Compensation Increases o Increases Based on Labor Agreements o Other Increases • Defined Benefit Pension Payment/ADC o Unwinding Proposition B

This section includes information on Personnel Expenditures (PE) in the Outlook's Baseline, including compensation increases, which are largely related to labor agreements, and the defined benefit pension payment, together with impacts related to unwinding Proposition B.

Compensation Increases

Compensation Increases Based on Labor Agreements

Compensation increases in the Outlook are largely based on agreements, or Memoranda of Understanding (MOUs), with the City's six Recognized Employee Organizations (REOs). As shown in the table on the preceding page, the Outlook forecast for FY 2024 includes $32.0 million for estimated compensation increases related to current MOUs. Part of this $32.0 million increase is related to the ***public safety*** MOUs, which run through FY 2024.[4] These agreements add $23.8 million to FY 2024 Baseline Expenditures, largely for general wage increases, as well as special wage adjustments and add-on pay increases for certain positions. The remaining $8.2 million largely relates to the annualization of special wage adjustments for the ***non-public safety*** REOs.[5]

Because the ***non-public safety*** REOs' current MOUs expire at the end of FY 2023 (June 30, 2023), the FY 2024 Outlook forecast includes an additional $12.3 million estimate for assumed 3.05% general wage increases for non-public safety employees – also shown in the preceding table. This amount includes estimates for employees represented by the non-public safety REOs ($9.1 million), as well as for unrepresented employees ($3.2 million), whose recent general wage increases have been consistent with those approved for the Municipal Employees Association. The $12.3 million total increase is subject to change based on completed negotiations for FY 2024, which have only recently begun. The Outlook also includes an assumed 3.05% general wage increase for ***all*** REOs, as well as unrepresented employees, during the remaining years of the Outlook. The annual 3.05% general wage increase is consistent with the salary inflation assumption in the latest SDCERS[6] actuarial valuation, which we believe is a reasonable approach.

Overall City Compensation Issues

Concerns regarding uncompetitive compensation have been pervasive citywide for a number of years over many job classifications. Over the last several years, the City, negotiating with its REOs, has been providing general wage increases, as well as working to target certain positions through special wage adjustments.

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[4] Public safety REOs include: SD POA (San Diego Police Officers Association); IAFF Local 145 (International Association of Fire Fighters, Local 145); and Teamsters Local 911, which represents the Lifeguards.

[5] Non-public safety REOs include: MEA (Municipal Employees Association); AFSCME Local 127 (American Federation of State, County & Municipal Employees, Local 127); and DCAA (Deputy City Attorneys Association).

[6] SDCERS is the San Diego City Employees' Retirement System.

In January 2022, the City Council adopted the City's Compensation Philosophy, which states that the City endeavors to pay at least the market median compensation for comparably situated public employees. Further, the Compensation Philosophy states that the "City's goal is to move toward the market median for all classifications that are currently under the market median."

Council support for competitive compensation was also included in the initial FY 2024 Council Budget Priorities Resolution approved November 1, 2022. In their individual priorities memoranda, most Councilmembers supported offering competitive salaries to City workers to enhance the City's ability to recruit and retain its workforce. Additionally, several Councilmembers are supportive of expediting the City's hiring process to fill vacancies across City departments, including three Councilmembers who requested allocating funding to accelerate the hiring process.

The City anticipates receiving updated total compensation surveys in January that will assist with the FY 2024 labor negotiations process. The City expects to see improvement in compensation competitiveness for many job classifications due to the recently negotiated compensation increases. However, further compensation increases are anticipated to be needed to bring the City to its goal for all classifications.

With respect to the recruitment and hiring process, a collaborative City working group (including management, the Personnel Department, Human Resources, Performance and Analytics, and Office of Race and Equity) is currently studying various aspects and making improvements on an ongoing basis. We are invited to participate and have seen notable progress, and we recommend a report be provided to Council in the next several months on that progress. The City Auditor's Office is also working on an audit of the hiring process, which is anticipated to be released in the Spring of 2023. Additionally, the City is working on a Request for Proposal (RFP) for an outside consultant to review the hiring process, as was funded in the FY 2023 Adopted Budget. The results of these initiatives and reports should help inform the City of staffing levels needed in Human Resources and the Personnel Department, and there may be additional needs considered during the FY 2024 budget process.

In addition to identifying resources to address any compensation deficits or recruitment and hiring process enhancements, the City must consider other citywide priorities, while working to better fill its vacant positions. It is important to note that all of these needs must be considered in the context of limited resources.

Other Compensation Increases

Several other FY 2024 compensation increases are noted in the table on page 12, two of which relate to FY 2023 positions that were not anticipated to be filled the entire year:

- $4.9 million in the "FY 2023 Position Annualizations" line: This addition is for the annualization of Parks & Recreation positions that were budgeted for less than a full year.
- $9.8 million in the "Budgeted PE Savings Decrease" line (a budget increase): This amount represents FY 2023 savings estimated for various new positions being filled for less than a full year, as well as for Police Department vacancies that are not anticipated for FY 2024.

Defined Benefit Pension Payment – Actuarially Determined Contribution (ADC)

The ADC is the retirement payment made by the City for its defined benefit pension. The Outlook's citywide ADC estimate for FY 2024 is $420.2 million, which is an increase of $35.9 million from FY 2023. Of the citywide amount, $310.4 million is for the General Fund, an increase of $26.5 million from FY 2023. The Outlook shows the citywide ADC increasing to about $429.4 million in FY 2028 (about $317.2 million for the General Fund).

The Outlook's FY 2024 ADC ***estimate*** and out-year ADC projections are based on the most recent estimates from SDCERS' actuary, Cheiron, which were included in the FY 2021 actuarial valuation. The Department of Finance also added to those projections an estimate for the ADC impact resulting from the investment experience loss that occurred in FY 2022. This experience loss is due to FY 2022 net investment return, at (1.7)%, being lower than the 6.5% return that was assumed in the FY 2021 valuation.

Several factors are anticipated to increase the ***actual*** FY 2024 ADC in addition to the FY 2022 investment experience loss. For example, any pensionable pay increases higher than assumed in the FY 2021 valuation could increase the ADC. As these impacts are uncertain, they are not addressed in the Outlook. There will also be impacts related to the unwinding of Proposition B, which are discussed in the next section.

Because of the complexity of the pension system variables, the total of all impacts to the FY 2024 ADC (as well as out-year projections) will not be known until the FY 2022 valuation has been completed.[7] The FY 2022 valuation is anticipated to be available in January 2023 and will incorporate all impacts of FY 2022 experience as compared to what was previously assumed for FY 2022 in the FY 2021 valuation.

Impacts Related to Unwinding Proposition B

The Outlook and the First Quarter Report discuss the unwinding of Proposition B, providing background information on the issues and status of the unwinding process. The City has concluded negotiations with five of its six Recognized Employee Organizations (REOs) regarding unwinding provisions for ***active employees*** who were hired when Proposition B was in effect. Accordingly, most of those employees have now joined the San Diego City Employees' Retirement System (SDCERS). Negotiations have not been fully completed with respect to those employees who are no longer employed with the City, and for members of the San Diego Police Officers Association (POA).

Initial Costs Related to Employees Who Transitioned to SDCERS

The First Quarter Report also provides costs related to the initial transition of the active employees to SDCERS membership. Of the associated $142.0 million in costs, $22.8 million related to the

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[7] In general, changes between initial ADC estimates and the actual ADC relate to two types of factors:

- Changes in actuarial valuation assumptions used to calculate the ADC – for example, those related to mortality, salary increases, and investment returns.
- "Experience gains and losses" – the differences between actual results and what was assumed in the prior valuation (For example, if future investment earnings are lower than assumed in the actuarial valuations, future ADCs could be increased.)

interest penalty mandated by the California Court of Appeal has been paid. The remaining $119.2 million is expected to be treated as a long-term debt to SDCERS – to be amortized over 20 years as part of the UAL[8] – as was recommended by SDCERS' actuary. As such, these amounts would not be billed until FY 2024 and beyond, as part of the ADC pension payments. However, the SDCERS Board is the final authority for how the debt is treated, and the Board could alternatively amortize the $119.2 million as an experience loss over 15 years or request upfront payment from the City. The Board is expected to review this issue in January 2023.

The Five-Year Outlook includes projections for the 20-year amortization approach recommended by SDCERS' actuary, which are estimated to be $10.8 million citywide and $8.0 million for the General Fund for all Outlook years.

"Normal Cost" Payments for Transitioned Employees

The City is also responsible for paying its portion of the annual "normal cost"[9] for the active Proposition B employees who transitioned to SDCERS from SPSP-H.[10] The SDCERS actuary has recommended the $36.8 million normal cost associated with FY 2024 be paid in FY 2024. Thereafter, normal costs for these employees will be included in the annual ADC calculations. The Outlook includes estimated amounts for these normal costs.

Based on the General Fund allocation the Department of Finance is using to estimate the General Fund portion of the ADC, $27.2 million of the FY 2024 normal cost would be allocated to the General Fund. This $27.2 million will be partially offset by a reduction in the FY 2024 General Fund budget for SPSP-H, which the Outlook projects will be $16.3 million. Netting these amounts yields about $10.9 million in incremental cost increase from the transition of active Proposition B employees to SDCERS. These estimates may change as the FY 2024 budget is developed.

NON-PERSONNEL EXPENDITURES (NPE) IN THE OUTLOOK BASELINE

Review of Baseline Non-Personnel Expenditures

- Energy and Utilities
- Information Technology
  - SD Access for All
- Infrastructure Fund
- Debt Financing/Debt Ratio Impacts

The Outlook discusses Baseline NPE for the following categories: supplies, contracts and services, information technology, energy and utilities, debt service, reserve contributions, and City Charter section 77.1 Infrastructure Fund. As part of our analysis, the table on page 12 of this report includes major NPE changes from the FY 2023 Adopted Budget to the FY 2024 Outlook Baseline projection. Select NPE areas are also discussed in more detail, including energy and utilities, information technology, SD Access for All, the Infrastructure Fund, and debt financing.

A general observation regarding the Outlook's NPE is that there are overall growth rates assumed for supplies, contracts, and information technology discretionary accounts (4.1% for FY 2024, and

[8] UAL is the Unfunded Actuarial Liability

[9] Normal cost is defined as the actuarial present value of retirement system benefits allocated to the current year by the actuarial funding method. In other words, it is the contribution amount associated with the pension benefits earned in the current year.

[10] SPSP-H is the Supplemental Pension Savings Plan H.

3.3% thereafter). With recent inflation concerns, both locally and nationally, it is difficult to forecast these expenditures. Additionally, for contracts, growth rates may be already included in contract terms. During the budgeting process, these areas should be further analyzed to ensure that needed service levels are achieved.

Energy and Utilities

For the Energy and Utilities expenditures category, the Department of Finance utilizes numerous forecasts and methodologies to project spending on all City utility costs, including electricity, gas, water, sewer, telecommunications, fuel, and other services. For fuel, the Department utilizes a projection prepared by the Fleet Services Division within the Department of General Services, while for water and sewer the Department of Finance utilizes water and sewer rate increases and baseline usage assumptions prepared by the Public Utilities Department (PUD) and in line with the PUD Five-Year Outlook. Energy prices for electricity, gas, and other fuels assume baseline usage and are augmented by forecasts rates provided by the US Energy Information Administration (EIA), while all other categories are increased by the Consumer Price Index (CPI).

While most of the forecasts appear to be reasonable and consistent, particularly those that utilize the expertise of other City departments, the forecast for spending on electric services is likely too low based on currently available information. The Outlook used the FY 2023 Adopted Budget electric services amount budgeted of $10.9 million, and then applied the EIA national forecast for energy prices, which ranges from negative 0.49% in FY 2024 to a 2.68% increase in FY 2028, to each year of the Outlook. We highlight this because this methodology results in the Outlook assuming *lower* spending on energy services in FY 2024, when as noted in the First Quarter Report, energy spending to date is already projected to be 43.8% *higher* in FY 2023. Additionally, the Sustainability and Mobility (SuMo) Department, which develops the budget for energy services and monitors spending for this expenditure citywide, has informed our Office that the current projection for energy services for FY 2024 for the General Fund is anticipated to be $17.0 million, which is significantly higher than what is included in the Outlook.

As mentioned in our report on the First Quarter Report, energy services costs have been increasing due to rate increases for electricity locally, as well as other usage factors that are all closely monitored by the SuMo department. This is different than what is happening nationally, which is captured in the EIA forecast, and potentially results in the Outlook missing local trends and expectations for where this expenditure category will be in the out-years. This spending will also start to become more important, along with spending on natural gas costs, as the City begins to implement the Zero Emission Municipal Building and Operations Policy (ZEMBOP) that is part of the Climate Action Plan 2.0. **Our Office recommends that future Outlooks utilize projections developed by the Sustainability and Mobility Department for energy and other utilities costs overseen by that Department.**

Information Technology

In the Five-Year Outlook, the Information Technology (IT) category includes costs related to hardware and software maintenance, help desk support, and other IT services. Costs in each year represent the known anticipated IT expenditures over the period. According to Department officials, CPI growth is not applied for baseline non-discretionary accounts, because the major IT services contracts (which were executed in FY 2022) will not change in FY 2024.[11] Supply chain issues could result in delays of some projects, but the current timelines, not assuming potential delays, have been factored into the projections in the Outlook.

The Five-Year Outlook removes one-time expenditures of $2.9 million, including $1.8 million in software, licensing, and professional IT services and $1.1 million that the City received from an Emergency Connectivity Fund (ECF) grant for broadband access expansion to support the SD Access 4 All Digital Equity Program.

SD Access 4 All

SD Access 4 All has been a popular and successful digital equity program. The FY 2023 Adopted Budget included approximately $2.1 million total funding for the SD Access 4 All program. The table below shows that $441,000 will remain in Baseline Expenditures to support the following:

- Wi-Fi at Public Libraries,
- Six City Park public Wi-Fi connections,
- Over 300 public Wi-Fi locations across low and moderate income (LMI) areas of the City,
- Digital Literacy Training (Tech on the Go), and
- Digital Navigator services to provide technical support and resources for residents.

FY 2023 Adopted Budget - SD Access 4 All		
Program Components	**Baseline**	**One-time Funding Being Removed**
Public Wi-Fi[1]	$ 261,000	$ -
Digital Equity Programs (Outreach for Affordable Connectivity; Tech on the Go; Digital Navigator Services; and Marketing, Supplies, and Communications)	180,000	-
Broadband Master Plan	-	500,000
Public Library Hotspot Lending Program - Broadband Access Expansion	-	1,115,520
Total	**$ 441,000**	**$ 1,615,520**

[1] Additional Wi-Fi locations are currently being evaluated but the related funding requirements are not yet fully developed.

The table also shows that $1.6 million in one-time funding is being removed, including $500,000 for the creation of a Broadband Master Plan.[12] This also includes $1.1 million for the ECF grant which covers the cost of the lending program for 4,000 mobile hotspot devices at Libraries. Department of IT officials noted that the mobile hotspot lending program is very popular with an over 90% utilization rate. The City plans to apply for ECF grant funds again for FY 2024 to attempt to continue the program. If the City does not receive the ECF grant, the Department will request alternative funding sources to continue the program in the budget development process.

[11] The growth rate was applied to one non-discretionary contract (enterprise GIS – Fixed) as well as discretionary IT contracts.

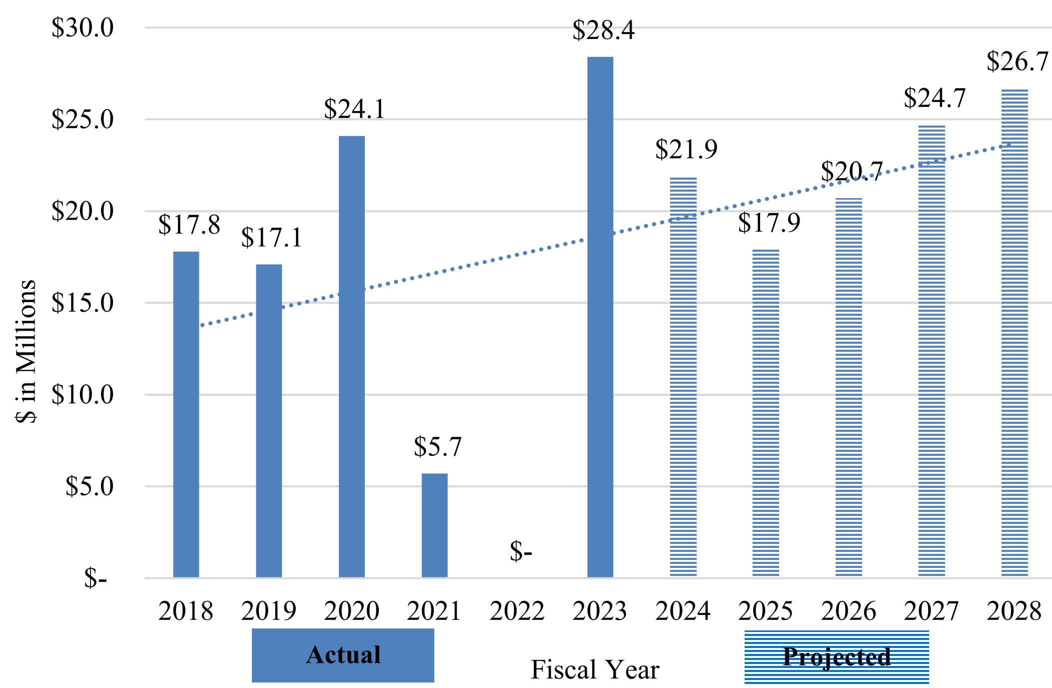
[12] The Broadband Master Plan will focus on broadband infrastructure planning for Low to Moderate Income areas of the City that currently lack access to affordable, high-quality internet connections. Having a plan in place will allow the City to apply for State and federal funding opportunities to develop infrastructure solutions through SB 156 and the Federal Infrastructure Bill.

Infrastructure Fund

The Infrastructure Fund was put in place after passage of Proposition H in 2016, which required the City to dedicate a portion of revenue increases to infrastructure spending.[13] The Outlook continues to assume contributions to the Infrastructure Fund over the five-year period in line with requirements in City Charter Section 77.1. Our Office believes contributing to the Infrastructure Fund is important given that the most recent Five-Year Capital Infrastructure Planning Outlook (CIP Outlook) (FY 2023-2027) shows an infrastructure funding gap of $4.3 billion for the City, an increase of 152.6% since the City began developing the CIP Outlook in 2015. The significant gap is largely due to limited resources and a lack of new or dedicated funding sources. This has led to ongoing deferral of needed projects, resulting in continued aging and deterioration of existing assets, which ultimately further increases costs.

The following chart shows budgeted amounts for the Infrastructure Fund since it was created in FY 2018, as well as funding projected in the Five-Year Outlook. Contributions to the Fund were reduced in FY 2021 and waived in FY 2022 due to revenue decreases associated with the COVID-19 Pandemic.

Infrastructure Fund Actuals and Projected in the Five-Year Outlook



The Infrastructure Fund has few restrictions on how it can be used for new infrastructure investments and can support financing costs related to General Fund capital improvements, as well as the repair and maintenance of infrastructure. This is a particularly important funding source for General Fund assets and related projects that lack a dedicated funding source. The General Fund

[13] Prior to FY 2023, the calculation to fund the Infrastructure Fund included a Major Revenues Increment based on an amount equal to 50.0 percent of the year over year growth in property tax revenues, unrestricted General Fund TOT, and unrestricted franchise fees. However, the Proposition H only required this increment from FY 2018 through FY 2022.

is another funding source with few restrictions, but the Five-Year Outlook does not assume any General Fund contributions to the CIP Program beyond transfers to the Infrastructure Fund given projected deficits.

In FY 2023, the Infrastructure Fund provided $28.4 million to support projects for City facilities, parks, storm drains, sidewalk repairs, streetlight circuit upgrades, and traffic calming. The types of projects to be funded for FY 2024 will be determined when developing the FY 2024-2028 CIP Outlook (to be issued on January 13, 2023) and FY 2024 CIP Budget and will consider Mayoral and Council priorities.

The Department of Finance did indicate that after all General Fund sources and uses are analyzed, if needed to balance the FY 2024 Proposed Budget the Mayor may propose suspending the requirement to make a contribution to the Infrastructure Fund in FY 2024; this would require a two-thirds vote of approval by the City Council. Our Office believes the Infrastructure Fund is an important source of funds for much needed maintenance and capital projects, especially for General Fund assets, and should only be suspended in extreme circumstances as was done due to economic hardships related to the COVID-19 Pandemic.

Debt Financing/Debt Ratio Impacts

The Outlook's Baseline includes projected debt service costs for borrowings anticipated to occur during the Outlook period. Included is the projected $175 million Lease Revenue Bond (LRB) issuance in 2023 which was recently authorized by the City Council on November 15, 2022, and two subsequent $90 million LRB issuances anticipated in FY 2025 and FY 2027, respectively. We note that the debt service expense associated with the $175 million LRB issuance is assumed in the Outlook to be $10.1 million annually; however, since the time of the Outlook's preparation, staff increased this estimate to $11.6 million when the bond authorization was presented to the City Council to account for increased interest rates. In total, $355 million in new long term-debt is assumed to fund prior City Council appropriations that total approximately $408 million and costs bond issuance. Approximately $57 million was funded using proceeds from the City's 2021A Lease Revenue Bond Issuance that occurred in June 2021.

Additionally, the Outlook includes debt service costs anticipated for the City's $359.2 million WIFIA loan to fund Stormwater improvements and projected Stormwater LRB issuances in FY 2025 and FY 2027 of $146.3 million each to meet the EPA's matching funds requirement for the WIFIA loan. Issues related to stormwater funding needs are discussed later in this report.

Short-term borrowings anticipated over the Outlook period are also included. These primarily consist of Equipment and Vehicle Financing Program (EVFP) financing costs to fund typical General Fund annual fleet and PC replacement needs.

Our Office worked together with the Department of Finance's Debt Management Division to prepare the following table which reflects the additional debt service costs that are assumed to be incurred by the General Fund during the Outlook period, as well as the associated impacts to the City's Debt Ratios.

General Fund Supported Debt Service *($ in millions)*						
	FY 2023 Adopted Budget	Forecast FY 2024	Forecast FY 2025	Forecast FY 2026	Forecast FY 2027	Forecast FY 2028
Existing Debt Service (Long-Term & Short-Term)	$ 79.0	$ 74.3	$ 68.2	$ 65.6	$ 61.9	$ 56.7
2023 LRBs ($175M)	-	11.6	11.6	11.6	11.6	11.6
2025 Proj. LRB Issuance ($90M)	-	-	-	5.2	5.2	5.2
2027 Proj. LRB Issuance ($90M)	-	-	-	-	-	5.2
Stormwater WIFIA Loan ($359.2M)	-	0.7	1.8	3.5	6.3	12.6
2025 Proj. Stormwater LRBs ($146M)	-	-	-	8.5	8.5	8.5
2027 Proj. Stormwater LRBs ($146M)	-	-	-	-	-	8.5
New Short-term Debt Service[1]	-	9.4	19.3	25.0	30.3	35.3
Totals	**$ 79.0**	**$ 96.0**	**$ 100.9**	**$ 119.4**	**$ 123.8**	**$ 143.6**
Pension and OPEB Costs	$ 328.8	$ 355.1	$ 353.7	$ 356.5	$ 359.3	$ 362.1
General Fund Revenue[2]	$ 1,977.6	$ 1,910.5	$ 1,981.8	$ 2,042.8	$ 2,120.8	$ 2,180.3
Debt Ratios						
10% Benchmark	**4.0%**	**5.0%**	**5.1%**	**5.8%**	**5.8%**	**6.6%**
Inc. Pension/OPEB - 25% Benchmark	**20.6%**	**23.6%**	**22.9%**	**23.3%**	**22.8%**	**23.2%**

[1] Short-term debt consists of General Fund Equipment and Vehicle Financing Program (EVFP) leases, IT computer hardware leases, and Commercial Paper interest costs.

[2] Includes other operating funds currently being used for exisiting debt service (e.g. non-General Fund TOT)

RESERVES

The Outlook discusses the General Fund Reserve, the Pension Payment Stabilization Reserve, and the Risk Management Reserves – including the Workers' Compensation Reserve, the Long-Term Disability Reserve, and the Public Liability Reserve. Each is discussed further below.

Review of Reserves

- General Fund Reserve
- Pension Payment Stabilization Reserve
- Risk Management Reserves

General Fund Reserve

As presented to the Budget and Government Efficiency Committee on November 18, 2022, the Department of Finance is proposing to amend the City's Reserve Policy (Council Policy 100-20) to extend the timeline to reach the General Fund Reserve target of 16.7% of General Fund operating revenues to FY 2030. The proposed amendment is largely driven by the impact of the COVID-19 pandemic on the City's revenues and expenditures. As a result of declining revenues due to the COVID-19 pandemic, neither the FY 2021 nor FY 2022 Adopted Budgets included a General Fund Reserve contribution. Thus, the FY 2022 Reserve level remained at the FY 2020 balance of $205.6 million, or 14.9% of operating revenues. The FY 2023 Adopted Budget included a one-time Reserve contribution of $1.5 million to bring the Reserve level to $207.1 million, or 14.3%.[14] The proposed Reserve Policy amendment would align the Reserve targets with what the City can reasonably achieve in the upcoming years based on current estimates that include the balancing of multiple priorities.

[14] Because the General Fund Reserve target is based on a percentage of operating revenues, even though a small contribution to the General Fund Reserve was budgeted in FY 2023, increasing operating revenues resulted in a decrease to the funding level on a percentage-basis.

General Fund Reserve Target %		
Target Date	**Current Policy**	**Proposed Policy**
June 30, 2022	16.00%	14.90%
June 30, 2023	16.25%	14.30%
June 30, 2024	16.50%	13.58%
June 30, 2025	**16.70%**	13.58%
June 30, 2026		14.10%
June 30, 2027		14.70%
June 30, 2028		15.35%
June 30, 2029		16.00%
June 30, 2030		**16.70%**

For FY 2024, the Outlook includes a $5.0 million contribution to bring the General Fund Reserve to the proposed policy target of 13.58%. Beyond FY 2024, the General Fund Reserve contributions range from $19.1 million in FY 2025 to $22.3 million in FY 2028.

Pension Payment Stabilization Reserve

Along with the proposed adjustments to the General Fund Reserve Policy, the Department of Finance is also proposing to amend the policy for the Pension Payment Stabilization Reserve (Pension Reserve). The Pension Reserve was created to "mitigate service delivery risk due to increases in the annual pension payment, the Actuarially Determined Contribution (ADC)." The current Policy requires the City to fund and maintain a Pension Reserve up to 8% of the most recent three-year average of the ADC. The proposed policy revision prioritizes funding the General Fund Reserve to the 16.7% target before funding and maintaining a Pension Reserve.

The FY 2023 Adopted Budget includes the use of $7.9 million from the Pension Reserve that is projected to be available in FY 2023 to cover costs associated with unwinding Proposition B. This use would deplete the General Fund portion of the Pension Reserve. The Outlook does not include any projected contributions to the Pension Reserve throughout the Outlook period, which is in line with the proposed new reserve policies. Given the Pension Reserve is more restricted than the General Fund Reserve, which could also be used to support cost increases in ADC, it is reasonable to prioritize funding General Fund Reserve to the target level when the City is projecting limited resources for reserve contributions.

Risk Management Reserves

The following table shows the FY 2024 Reserve targets for the Risk Management Reserves as compared to FY 2023 projected balances. The Outlook includes contributions in FY 2024 to reach anticipated reserve targets in all three Risk Management Reserves. Beyond FY 2024, the Workers' Compensation Reserve is the only Reserve with projected increases in Reserve targets. Accordingly, the Outlook includes contributions throughout the Outlook period.

Risk Management Reserve Projections (*$ in millions*)			
	Workers' Compensation	**Long-Term Disability**	**Public Liability**
FY 2024 Reserve Target	$ 35.2	$ 4.9	$ 38.8
FY 2023 Reserve Level Projection	33.6	4.3	33.8
Difference/FY 2024 Outlook Contribution - Citywide	**1.6**	**0.6**	**5.0**
FY 2024 Outlook Contribution - General Fund	**$ 1.4**	**$ 0.4**	**$ 5.0**

OUTLOOK PRIORITIES BEYOND BASELINE EXPENDITURES

NEW FACILITIES

New Facilities
• Parks and Recreation • Library • Fire Stations

The Outlook includes forecasted funding for new Parks and Recreation, Library, and Fire-Rescue facilities assumed to open during the Outlook period. Opening dates for the new facilities in the Outlook are not certain as timelines can be impacted by project delays. As our Office has highlighted in previous years, some new facilities currently in development are projected to open during the Outlook period, but they lack full funding for construction. The Outlook assumes funding will be received, but funding sources are unidentified. Without a clear funding plan, it may be premature to project the opening of these facilities and corresponding operating costs in the Outlook.

It should be noted that although new facilities are contemplated in the Outlook, they can be delayed for budgetary reasons if necessary.

Parks and Recreation: New Parks and Joint Use Facilities
The Department anticipates 21 new or expanded parks to open, and 12 new Joint Use Agreements (Agreements) with local school districts allowing shared use of various recreation facilities and yards to become effective during the Outlook period. The Outlook projects expenses for the new parks and the Agreements to be $5.0 million in FY 2024 and increasing to an aggregate expense of $9.3 million in FY 2028 once all the new parks and Agreements have come on-line. The projected operating costs include the addition of 69.75 FTE positions throughout the Outlook period to maintain the new parks and playgrounds.

We note that most of the required FTEs are needed in FY 2024 and FY 2025. The Outlook projection shows that 23.00 FTE positions are needed in FY 2024 and another 33.25 FTEs in FY 2025. Staff indicate that the opening dates of new parks and joint use facilities will be reevaluated as the budget process approaches. Many of the positions required are Grounds Maintenance Worker IIs; as of November 2022, the Parks and Recreation Department has 49.00 vacancies in existing Grounds Maintenance Worker II positions.

Library: New and Expanded Branch Libraries
The Library Department anticipates the opening of two new branch libraries and one library expansion during the Outlook period. The new libraries include the Pacific Highlands Library, the Oak Park Library, and the Ocean Beach Library expansion. Total assumed annual costs are $737,000 beginning in FY 2024 increasing to $1.1 million in FY 2028.

- *FY 2024 – Pacific Highlands Ranch Library:* Facility is fully funded, and construction is currently expected to be completed in May/June 2024. 9.00 FTEs and approximately $737,000 in new ongoing annual operational costs are assumed in the Outlook beginning in FY 2024; however, according to the Library Department, the actual staffing requirement is anticipated to consist of 9.50 FTEs. FY 2024 costs are prorated to correspond with the timing of opening the new library. Thereafter, $900,000 in expenses are projected for the first full year of operations and beyond.

- *FY 2027 – Oak Park Library (Replacement):* Received a $20.6 million grant from the State to fund construction costs; however, the Library Department has indicated that a revised project cost estimate will be necessary to account for rising costs. The Outlook includes $90,000 in additional ongoing non-personnel expenditures associated with this new facility that is planned to replace the smaller existing Oak Park Branch Library. While no additional staffing is assumed in the Outlook for the new facility, the Library Department has indicated that 2.00 FTEs are anticipated to be necessary for the new, larger facility, to supplement current Oak Park Library staffing.

- *FY 2027 – Ocean Beach Library Expansion:* Currently there is a funding gap of $3.5 million due to construction cost increases; the Library Department has indicated that confirmation of a grant award is awaited to fill this gap. The Outlook includes $41,000 in additional ongoing non-personnel expenditures associated with this new expanded facility. The Library Department does not anticipate a need for additional strafing.

<u>Fire-Rescue: New Fire Stations</u>

The Outlook assumes funding for operational expenses for four new fire stations assumed to open within the Outlook period. Total assumed annual costs are $2.6 million beginning in FY 2024 increasing to $14.3 million in FY 2028. Each new fire station requires a staffing level of 12.00 FTEs, with the exception of the Otay Mesa Fire Station (a double-house fire station) that requires 24.00 FTEs; in total 60.00 FTEs are assumed to be necessary during the Outlook period. Operational expenses include personnel expenditures and non-personnel expenditures such as equipment and supplies, as well as debt service for one electric fire engine and charging equipment for each facility. The four new fire stations identified in the Outlook as requiring operational funding over the next five years are listed below:

- *FY 2024 – Torrey Pines* (funded by UCSD); construction is currently anticipated to be completed in the third quarter of FY 2024.

- *FY 2025 – Black Mountain Ranch* (developer funded); funding gap will be reduced to $1.8 million after accounting for proposed appropriations in the FY 2023 CIP Mid-Year Budget Monitoring Report; completion is now anticipated to occur in early FY 2026, subject to funding identification.

- *FY 2025 – Fairmount Avenue* (land purchased, environmental permitting and design funded); currently lacks $20.0 million for construction; facility is unlikely to open in FY 2025 given the current funding deficiency.

- *FY 2028 – Otay Mesa Fire Station* (land purchased); currently lacks funding for design and construction.

A list of expenses for all new facilities anticipated to open or become operational within the Outlook period is attached to this report.

PLANNED COMMITMENTS

Homelessness

Planned Commitments
• Homelessness • Department of Information Technology • Stormwater

The Outlook includes planned commitments related to homelessness services that generally ***continue existing programs*** that were funded using one-time State grants and one-time General Funds in the FY 2023 Adopted Budget. In addition to maintaining existing programs, we note that the planned commitments also include additional funding for shelter expansion in FY 2024. The Outlook incorporates existing ongoing General Fund support for homelessness programs, as well as additional one-time State grant funds anticipated to be awarded to the City in FY 2024. However, even with the existing ongoing General Fund and anticipated one-time State funds, the Outlook identifies the need for an additional $16.4 million General Fund commitment in FY 2024.[15]

Barring additional State or federal grant funds beyond FY 2024, the Outlook shows a funding cliff for homelessness programs starting in FY 2025 which requires the projected General Fund commitment to grow to $54 million beyond existing ongoing General Fund support. If the State continues funding for homelessness that it has provided since FY 2019, the funding cliff could be partially mitigated. Without new or continued State or federal funding support, however, the anticipated General Fund commitment continues to increase throughout the Outlook period.

The growing General Fund need for homelessness services is largely driven by the rapid expansion of programs funded by one-time State funds, federal funds, and City General Funds. As a result, the size of the City's homelessness programs has grown dramatically in recent years. For instance, in FY 2018, a total of $2.8 million was budgeted for City shelters, whereas the FY 2023 Adopted Budget included $40.8 million for City shelters – a nearly fifteen-fold increase. Although rising demand for homelessness services in the City warrants expanded programs, establishing or expanding programs using one-time funds, in effect, results in an obligation for ongoing funding to cover program operating costs. Because it is unknown whether the State will continue to provide one-time funding beyond FY 2024 or establish an ongoing funding source for homelessness services, the City may need to reevaluate its budget priorities and consider tough decisions – to achieve more sustainable levels of funding and/or identify new ongoing revenue sources – in future years.

We note that Measure C on the March 3, 2020 ballot proposed an increase in San Diego's Transient Occupancy Tax to, among other things, provide additional funding for homelessness services. Measure C is discussed in further detail later in this report; the City is currently awaiting a final determination from the courts on whether Measure C is an approved ballot measure and whether the City's issuance of certain bonds under Measure C would be valid. If the City obtains a favorable

[15] It is important to note that not all homelessness programs provided by the City are included in the Department's budget. Additional programs and services are provided by other City departments as well as the San Diego Housing Commission. Those programs are not discussed in this section.

court judgement or outcome in the lawsuit (the timing for which is unknown), proceeds from future bonds issued could become a viable ongoing funding source for homelessness programs. If successful, it is unclear whether revenue from Measure C would be sufficient to cover all existing program costs, assuming continued State funding.

As Council thinks about the upcoming budget process as it relates to addressing homelessness, especially in light of limited budget resources, it is important to keep in mind how the programs outlined in the table on the following page advance the ambitious goals of the Community Action Plan on Homelessness (Plan) and its recommendations for both crisis response (e.g. increased shelter capacity) and permanent housing solutions (e.g. diverting individuals from homelessness and creating more affordable housing) to support flow through in the system. Consistent with the FY 2023 Adopted Budget, the Outlook prioritizes General Fund support for crisis response and stabilization, mainly through funding existing shelter operating costs. Because there is a severe lack of funding to fully implement the Plan, prioritization of strategies is needed, and the Homelessness Strategies and Solutions Department has asserted that its role within the regional context is to increase shelter capacity. Without a significant increase in ongoing resources to both support existing programs and to expand permanent housing solutions, the City could be limited in achieving goals outlined in the Plan.

An update of the Plan to reflect impacts from the pandemic on system needs and progress made since 2019 is currently in development and will likely be released by late January 2023. **In preparation of upcoming budget decisions for FY 2024 and the release of the updated Community Action Plan, Council may wish to request an informational presentation from staff on the updated plan, including any notable changes from the last version and how the updated plan will be implemented within the wider regional context. As part of this discussion, Council may wish to learn more about how collaboration with the San Diego Housing Commission, the Regional Task Force on Homelessness/Continuum of Care, and the County would be used to continue supporting a range of homelessness strategies, including prevention, diversion, and permanent housing solutions. Finally, over the long term, in addition to evaluating alignment with the Plan, we believe a systematic evaluation of the City and the Housing Commission's homelessness efforts with a focus on program outcomes and cost efficiency could help inform future budget decisions.**

The following table below provides a breakdown of homelessness programs anticipated to be supported in FY 2024 by the General Fund, as well as State and federal grant funds. The projected funding need for these programs may change depending on the City's allocation of State grant funds anticipated in FY 2024, which will likely be known by the end of December 2022. We note that the only program from the FY 2023 Adopted Budget not included in the Outlook is the Safe Camp Pilot Program for seniors, which received $200,000 in FY 2023, but staff has indicated that future funding for this program will likely be revisited after pilot implementation.

Breakout of FY 2024 Homelessness Planned Commitments *(Subject to Change)*		
System Component	**Programs**	**Anticipated Funding Needs**
Housing & Services $2.5 million	Rapid Rehousing - City Programs	$ 1,542,877
	Diversion - Family Reunification[1]	978,500
Crisis Response & Stabilization $49.9 million	Shelters	
	Bridge Shelter - 16th and Newton	6,768,694
	Bridge Shelter - Golden Hall (Downstairs)	5,418,078
	Bridge Shelter - Golden Hall (Upstairs)	5,353,091
	Family/Youth Non-Congregate Shelter	3,276,792
	Bridge Shelter - 17th and Imperial	3,220,910
	Interim Housing for Homeless Adults	2,379,185
	Senior Non-Congregate Shelter	2,333,980
	Palm Ave Shelter[2]	1,933,197
	Ancillary Shelter Costs	1,648,000
	LGBTQ+ Youth Services and Shelter*	1,545,000
	New Shelter Expansion	1,395,929
	Youth Case Management & Shelter	1,388,361
	Connections Interim Housing	1,171,532
	Women's Shelter	1,099,646
	Bishops Shelter	622,900
	Substance Use Disorder Shelters & Services	
	Sprung Shelter	5,150,000
	Harm Reduction Interim Shelter	2,213,714
	Safe Haven	413,501
	Serial Inebriate Program	298,700
	PLEADS Diversion Program	213,210
	Other	
	Safe Parking Programs	2,095,958
Engagement Services $10.9 million	Outreach	
	City-wide Street Outreach*	4,515,003
	Multidisciplinary Outreach Team Pilot*	515,000
	Storage	
	Storage Connect Center I	1,939,927
	Storage Connect Center II[3]	1,115,389
	Think Dignity Storage Facility	280,540
	Other	
	Homelessness Response Center	1,596,500
	Day Center for Homeless Adults	711,988
	PEER College Course	257,500
Administration $3.9 million	HSSD Administration	2,482,948
	SDHC Administration	1,425,291
	Total Expenses	**$ 67,301,840**
	Projected Grant and Ongoing General Fund Revenue Available	**$ 50,902,929**
	Funding Gap	**$ (16,398,911)**

Notes: Table only includes programs in the Homelessness Strategies and Solutions Department Budget.

[1] This item includes $450,000 for outreach activities, which is included in the Family Reunification provider contract.

[2] Staff indicated that the San Diego Misdemeanants At Risk Track (SMART) program is being redesigned. The redesigned SMART program is captured in this table as the Palm Ave Shelter.

[3] Although the location of the Lea Street Storage Facility may be reevaluated in FY 2024, staff expressed the intent to maintain a second Storage Connect Center, with the Outlook including funding for this purpose in the outyears.

* Program was newly funded in Adopted Budget FY 2023 and is in development (includes Downtown & Urban Core Outreach).

Department of Information Technology

The Five-Year Outlook includes funds for Enterprise Resource Planning (ERP) System modernization as part of the Department of Information Technology's (IT) planned commitments beginning in FY 2025. The City's current ERP system, SAP, will be reaching end-of-maintenance support in December 2027. Given this critical deadline, the Department is currently preparing to procure a consultant to evaluate the current SAP system and determine whether the City should upgrade to the next supported version of SAP or identify an alternative ERP system. Once this is determined (likely by the end of FY 2023), the scope of project implementation includes converting the City's current ERP system into a next-generation system and incorporates various components, such as hardware, software development and configuration, integration, change management and training. The target date for completion of this project is December 2027.

Amounts included in the Outlook represent the General Fund portion of these implementation costs, which is approximately 44% of total project costs. The Department of IT uses a three-tier methodology for determining how to allocate ERP-related implementation costs to the General Fund (44%) and non-General Fund departments (56%), such as Public Utilities. The average percentage of these components make up the total percentage each department is allocated.[16] This allocation is re-calculated each fiscal year but is generally consistent. Total estimated costs for the project, including General Fund and non-General Fund, are shown in the following table.

Next Generation ERP Project Implementation *($ in millions)*					
	FY 2024	**FY 2025**	**FY 2026**	**FY 2027**	**FY 2028**
General Fund (44%)	**$ -**	**$ 0.9**	**$ 1.3**	**$ 4.4**	**$ 4.4**
Non-General Fund (56%)	-	1.1	1.7	5.6	5.6
Total (100%)	$ -	$ 2.0	$ 3.0	$ 10.0	$ 10.0

We note that some modernization related costs were not included in the Outlook; the Department of IT expects to have a more detailed timeline and cost estimate for project implementation once a detailed evaluation of options and recommendation from the consultant is completed.

Stormwater

In addition to the other planned commitments, the Outlook also contains modest expenditure increases related to debt services payments for stormwater infrastructure. These payments are tied to the Stormwater Department's Water Infrastructure Finance and Innovation Act (WIFIA) loan that was recently secured by the City. The WIFIA program, which is overseen by the federal Environmental Protection Agency (EPA), provides up to 49% of the costs for capital investments made to the stormwater system by providing low interest loans. The City Stormwater Department has secured $359 million from this program, which must be matched by a total of $373 million from various City sources. These sources can include grants and financing from the State, as well as cash or other financing mechanisms produced or procured by the City.

[16] Tier one is the total proposed budget for Customer Care Solutions (CCS) and Environmental Health and Safety (EHS) and is allocated to the Public Utilities Department. Tier two is the total proposed budget for Enterprise Asset Management (EAM) and is allocated to EAM participating departments. Tier three allocation is the remaining OneSD fund proposed budget and is allocated Citywide by fund based on Citywide: baseline FTE's, Non-Personnel Original Budget, Non-Personnel Actual Expenditures, and Actual Revenues.

For the Outlook, the Planned Commitments addition includes debt service for both the WIFIA loans as well as an assumption that two $146 million lease revenue bond (LRB) issuances will be required, one in FY 2025, and another in FY 2027, for the matching requirement. The amount of the match assumes that other sources the City has already either procured or spent will make up the difference, including $11 million from grants and/or TransNet funds, $27 million from State Revolving Fund (SRF) loans, $37 million in prior expenditures, and $6 million in previously appropriated bond funds.

While these projections are appropriate at this time, there are two important considerations that could potentially change the payments required for debt service in the out-years of the Outlook. First, the composition of matching funds could dramatically change these payments, as additional grants or even SRF loans could decrease the amount of debt service required by lowering the amount of LRBs that need to be issued to meet the matching requirements. Second, the LRB repayments assume a 4.0% interest rate, which may change by the time the issuances are done in FY 2025 and FY 2027. The WIFIA loans have an interest rate of 3.11% over a 34-year payback period. The City and the Stormwater Department should remain vigilant in their efforts to secure additional matching funds that lower the long-term costs of the WIFIA program for the City.

Beyond debt service payments related to the WIFIA program, there is also an additional $400,000 in annual debt service payments beginning in FY 2026 related to the SRF loan for the Chollas Green Infrastructure and Storm Drain Improvements project.

POTENTIAL FUNDING NEEDS NOT INCLUDED IN OUTLOOK

There are additional needs and priorities not included in the Outlook that will need to be weighed during the budget process. These include priorities for which Councilmembers have expressed support and other known needs. We raise several of them in this section.

Funding Needs Not Included
• Infrastructure Investments ○ EAM System ○ Preventive Maintenance for Facilities Services Division ○ Council Infrastructure Budget Priorities • Environment & Climate Action Plan ○ Compliance Requirements – Stormwater ○ Climate Action Plan ○ Fleet Electrification • Additional Homelessness and Housing Priorities • General Fund Office Space Planning • Arts & Culture Funding • Equity in Recreation Programming • Fire/Police Training Facility Feasibility Study

Infrastructure Investments

Effectively managing the City's billions of dollars of infrastructure assets impacts the quality of life for residents and visitors and is a critical undertaking. The City's most recent CIP Outlook shows a $4.3 billion funding gap for infrastructure projects. Compared with the prior CIP Outlook (FY 2022-26), this represents a 43% increase in the funding gap, the largest year-over-year increase since the report was first created. Absent new resources, many needs identified in the CIP Outlook will remain unfunded.

Asset Management and the Enterprise Asset Management (EAM) System

Data-driven Asset Management practices play an important role in effectively planning for investments in infrastructure. The City's Enterprise Asset Management (EAM) system a is tool to support Asset Management and uses condition-based data to help staff identify projects needed for cost-effective maintenance, repair, and capital investment planning. The significant and growing infrastructure backlog illustrates a larger issue of the City needing to fully implement Asset Management practices and utilize the City's EAM System to determine how to effectively plan and allocate limited funds between much needed maintenance for existing infrastructure and constructing new capital projects. Chronic underfunding of Facilities Division also illustrates this challenge. We note that our Office will be reviewing this issue in more detail in our review of the upcoming CIP Outlook.

Preventive Maintenance for Facilities Services Division

An important tenant of Asset Management, conducting ongoing planned preventative and predictive maintenance is critical for optimizing the life of capital assets in the most cost-effective manner. Best practices suggest that *preventative* maintenance should account for at least 70% of repairs. Facilities Division staff currently spends about 84% of their work doing *reactive* maintenance to fix breakdowns and make emergency repairs, compared with only 16% of their work being dedicated to preventative maintenance. This represents the current level of service being funded in the baseline. More concerning, General Services Department officials told us this is an increase in reactive maintenance of 4% from the end of FY 2022 when the ratio was 80% *reactive* and 20% *preventative* maintenance.

This percentage is trending in the wrong direction, and our Office continues to express concern that a high enough priority is not being placed on maintenance and repair of critical City facilities.

We note that the Outlook does not increase service levels here. The Facilities Division currently has a 21% vacancy rate with 37.50 vacancies out of 177.50 total budgeted FTEs. General Services Department officials told us that Facilities Division continues to face challenges with recruiting despite improvements in the City's Compensation Philosophy.

When ongoing maintenance is chronically underfunded, the results are continued aging and deterioration of existing assets, ultimately further increasing costs. This also has resulted in the City spending funds on emergency repairs as assets fail and cause collateral damage, resulting in the inefficient use of limited resources. Chronic underfunding of maintenance and repair has been a significant contributing factor to the current deferred maintenance and capital backlog, and the funding shortfall of $593.9 million for City facilities reflected in the most recent CIP Outlook.

Council Infrastructure Budget Priorities

As discussed in our Office's report on the FY 2024 City Council Budget Priorities, Councilmembers expressed strong support for a wide range of infrastructure needs. All nine Council members were unanimous in prioritizing transportation and mobility safety, streets, sidewalks, as well as Library and Fire-Rescue facilities. Council Infrastructure Budget Priorities, as well as sources used to fund these priorities in previous years, is shown in the following table. We anticipate potential funding for many of these priorities will be included in the CIP Outlook that will be issued in January 2023, and we will provide a more detailed review at that time.

Asset Type	Prior Year Funding Sources
Transportation and Mobility Safety	
Pedestrian and Bicycle Safety	Transnet
Traffic Calming	Infrastructure Fund , General Fund, Climate Equity Fund (CEF), TransNet
Traffic Signals	General Fund, TransNet
Streetlights	Infrastructure Fund, CEF, TransNet
Streets - Modifications	
Modifications	Development Impact Fee (DIF), Facilities Benefits Assessment (FBA), TransNet
Pavement	Gas Tax, Trench Cut Fee, TransNet, General Fund
Sidewalks	TransNet, Infrastructure Fund
Stormwater	Infrastructure Fund, General Fund
Facilities	
Fire-Rescue	Infrastructure Fund, DIF
Library	General Fund
Parks & Recreation	Infrastructure Fund, General Fund Capital Outlay, CEF, Mission Bay Park Improvement Fund, San Diego Regional Parks Improvement Fund
Police	Facilities annual allocations - Infrastructure Fund, General Fund

Environment & Climate Action Plan

Compliance Requirements – Stormwater

As previously mentioned, there are additional funds included in the Outlook for debt service payments related to the Stormwater Department's WIFIA program as well as other additional debt service. However, in contrast to previous Outlooks prepared by Department of Finance, this Outlook does not include any additional operational support for the Stormwater Department to meet the numerous compliance requirements that the Department faces over the next couple of years. Our Office has repeatedly written about these needs and requests for the Department, and many of these needs were again submitted to the Department of Finance for consideration in the current Outlook. The table below provides a summary of requests submitted by the Department, almost all of which our Office has discussed in previous reports. These requests total 265.00 new FTEs and between $57.5 million and $75.2 million in net expenditures (total expenditures net of revenue generation) during the Outlook period.

While it is important to understand the full scope of the operational needs of the Stormwater Department, it is also worth noting that there tends to be a dramatic difference between the full need expressed by the Department and what ultimately is included in the Proposed Budget. For example, the previous Outlook noted that the Stormwater Department needed 227.00 FTEs and $78.5 million in net expenditures in FY 2023. However, 96.00 FTEs and $41.2 million in net expenditures was ultimately requested by the Department, with 46.00 FTEs and $17.9 million in net expenditures actually included in the Proposed Budget.

It should be noted that these operational needs relate to the current regulatory compliance needs and the maintenance of the current stormwater asset inventory. However, as previously mentioned in this report, the City is investing an additional $733 million through the WIFIA program to enhance stormwater infrastructure. While some of these investments will decrease the need for significant ongoing maintenance by refreshing the useful life of existing assets, many of the projects that will be built within that program will be new assets that will require additional maintenance personnel in the future in order to ensure that they are well maintained in a manner that meets the regulatory requirements that the assets are intended to address.

Stormwater Compliance Requests *($ in millions)*										
	FY 2024		**FY 2025**		**FY 2026**		**FY 2027**		**FY 2028**	
Activity (Expenditure)	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**
Levee Maint. & Repair Team	37.00	$ 10.9	39.00	$ 9.2	40.00	$ 9.4	40.00	$ 8.1	40.00	$ 8.2
Ramp Up for WIFIA	12.00	5.5	23.00	5.7	31.00	5.5	37.00	6.4	49.00	7.8
Other Budget Requests	-	1.1	-	1.1	-	1.1	-	1.1	-	1.1
Street Sweeping Improvements	17.00	4.2	22.00	2.7	26.00	3.2	30.00	3.5	32.00	3.4
Structural BMP Maintenance	24.00	6.9	24.00	2.8	24.00	2.9	24.00	2.9	24.00	3.0
Trash Capture	14.00	3.7	18.00	1.8	18.00	1.8	18.00	2.1	22.00	2.0
San Diego Bay Orders	-	2.4	-	3.9	-	8.1	-	17.1	-	31.9
Additional Inspectors	7.00	0.8	9.00	1.1	11.00	1.2	11.00	1.4	11.00	1.4
Officers to Abate Discharges	2.00	0.2	3.00	0.3	5.00	0.4	6.00	0.5	7.00	0.6
Channel Cleaning & Mitigation	3.00	10.6	16.00	11.9	16.00	13.0	16.00	13.9	16.00	14.0
Pipe Repair Support Team	24.00	5.2	24.00	3.3	24.00	3.4	24.00	3.5	24.00	3.5
Dig Alert	3.00	0.4	3.00	0.4	3.00	0.4	3.00	0.4	3.00	0.4
Compliance Monitoring Program	1.00	0.4	2.00	0.9	2.00	0.6	2.00	0.6	2.00	0.6
Education/Outreach Administration	1.00	1.6	3.00	1.8	3.00	1.9	3.00	1.9	3.00	1.9
Construction/Development Support	1.00	0.5	1.00	1.2	1.00	0.8	1.00	0.5	1.00	0.6
SD River Jurisdictional Monitoring	-	0.5	-	0.4	-	0.4	-	0.4	-	0.4
WQIP Updates & Pilot Studies	1.00	0.9	1.00	3.8	1.00	2.4	1.00	1.7	1.00	1.7
Third Pipe Repair Team	28.00	5.9	28.00	3.4	28.00	3.5	28.00	3.6	28.00	3.6
Pump Station Maintenance & Repair	-	1.7	-	1.7	-	1.0	-	0.6	2.00	0.1
IT Innovation & Support	-	0.1	-	0.1	-	0.1	-	0.2	-	0.1
Total FTE and Expenditures	**175.00**	**$ 63.4**	**216.00**	**$ 57.3**	**233.00**	**$ 61.0**	**244.00**	**$ 70.4**	**265.00**	**$ 86.4**
Activity (Revenue)		**Rev**		**Rev**		**Rev**		**Rev**		**Rev**
Ramp Up for WIFIA		$ (0.6)		$ (1.4)		$ (2.2)		$ (3.1)		$ (4.8)
Street Sweeping Improvements		(2.1)		(2.1)		(2.1)		(2.1)		(2.1)
Additional Inspectors		-		(0.7)		(0.8)		(0.8)		(0.9)
Officers to Abate Discharges		(0.0)		(0.0)		(0.1)		(0.1)		(0.1)
Pipe Repair Support Team		(1.5)		(1.5)		(1.5)		(1.5)		(1.5)
Third Pipe Repair Team		(1.7)		(1.7)		(1.7)		(1.7)		(1.7)
Total Revenue		**$ (5.9)**		**$ (7.4)**		**$ (8.3)**		**$ (9.3)**		**$ (11.2)**
Total FTE and Net Expenditures	**175.00**	**$ 57.5**	**216.00**	**$ 49.9**	**233.00**	**$ 52.8**	**244.00**	**$ 61.1**	**265.00**	**$ 75.2**

Climate Action Plan

Another expenditure category that was included in a majority of Councilmember budget memoranda was continued funding of the new Climate Action Plan (CAP), or CAP 2.0. As part of the Outlook process, the Sustainability and Mobility Department (SuMo) submitted requests for various known costs related to the ongoing implementation of the updated CAP, which are presented in the following table. These requests total up to 7.00 FTEs and up to $2.6 million within the Outlook period.

A full cost accounting of CAP 2.0 implementation is currently being prepared by the Energy Policy and Initiatives Center (EPIC) at the University of San Diego, which will seek feedback from all City departments impacted by the CAP and produce a five-year outlook of a similar structure to the Department of Finance’s Five-Year Financial Outlook. This process is currently ongoing, with a draft cost analysis expected in December 2022. This analysis will further inform the Climate Action Implementation Plan, which SuMo anticipates releasing in February 2023 in time for departments to submit budget requests and for the Department of Finance and the Mayor to consider inclusion of those requests for the FY 2024 Proposed Budget.

Climate Action Plan Requests *($ in thousands)*										
	FY 2024		FY 2025		FY 2026		FY 2027		FY 2028	
Activity	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**	**FTE**	**Exp**
As-Needed Energy Consulting to support muni energy projects; non-ESCO	-	$ 250.0	-	$ 250.0	-	$ 250.0	-	$ 250.0	-	$ 250.0
CAP - Decarbonization Roadmap and Implementation	1.00	468.8	2.00	703.7	2.00	707.4	2.00	611.2	2.00	615.1
CAP 3.0 Engagement, Implementation & Cost Analysis	-	-	-	-	-	100.0	-	250.0	-	-
Energy Service Company (ESCO) Third Party Owner's Rep	-	250.0	-	250.0	-	250.0	-	250.0	-	250.0
New positions identified in CAP Staffing Analysis	3.00	408.9	3.00	420.0	3.00	431.5	3.00	443.4	3.00	455.6
OCOF Outreach and Engagement Programming	-	100.0	1.00	308.8	1.00	308.8	1.00	308.8	1.00	308.8
Ongoing CAP monitoring support	-	100.0	-	100.0	-	250.0	-	250.0	-	100.0
ZEV Public (non-fleet) Charging Program Coordinator	-	-	1.00	158.8	1.00	158.8	1.00	158.8	1.00	158.8
ZEV Vehicle to Grid Pilot Project	-	-	-	-	-	100.0	-	100.0	-	100.0
Total FTE and Net Expenditures	**4.00**	**$ 1,577.7**	**7.00**	**$ 2,191.4**	**7.00**	**$ 2,556.6**	**7.00**	**$ 2,622.2**	**7.00**	**$ 2,238.3**

Fleet Electrification

Consistent with prior outlooks, the Outlook contains an estimate from the Fleet Services Division (Fleet) within the Department of General Services for assignment and usage charges from Fleet to the General Fund. This forecast includes not only Fleet operating expenses, but also contemplates costs for replacement of vehicles as well. One major goal of the City's Climate Action Plan is to increase the adoption of electric vehicles (EV) within the City fleet. However, due to a lack of market availability for medium- and heavy-duty vehicles and construction equipment, as well as unknown pricing for these vehicles, no additional costs for EVs were included in the Outlook forecast.

While pricing remains unknown for most vehicles, based on current experience and market conditions, it is forecasted that pricing for EVs will be significantly higher than like-for-like replacement. Currently, Fleet is working on a City Vehicle Replacement and Electrification Strategy which is anticipated to be complete in Spring 2023.

Additional Homelessness and Housing Priorities

The Outlook includes funding for some homelessness programs that received majority support from Councilmembers in their September 2022 budget priorities memoranda – this includes continued funding for shelter beds specifically dedicated to LGBTQ+ youth and homelessness outreach services. However, other programs that received majority support among Councilmembers were not included in the Outlook, including additional funding for the San Diego (Neil Good) Day Center for operational and repair costs, the Housing Stability Fund for rental assistance, and the Eviction Prevention Program for education and legal services for low-income renters facing eviction. The Outlook also does not include dedicated funding for the creation and preservation of affordable housing, which also received majority support.

General Fund Office Space Planning

The Department of Real Estate and Airport Management (DREAM) is contracting with Jones Lang LaSalle Americas, Inc. for an office space optimization analysis and a pilot program in the downtown Civic Core area. Funding for the consultant services, with a not-to-exceed amount of $725,000, was included in DREAM's FY 2023 budget. The results of the analysis and the pilot program could inform how the City reshapes its teleworking policy following the pandemic-driven rise in hybrid and remote work. The City enacted its first Telework Program in September 2022 to allow eligible department-approved employees to telework when operationally feasible. Employee teleworking schedules could change the overall needs for the City's real estate portfolio, necessitating a reassessment of the City office space needs. While the ultimate cost associated with downtown office space planning will be unknown until the analysis is completed in 12-18 months, we raise the following issues for Council considerations when making future decisions pertaining to downtown office space:

(1) *Timely Information Sharing with the Civic Center Revitalization Project*

As presented to the Council on October 17, the Economic Development Department is working on developing a Notice of Availability for a Civic Center Revitalization Project, with a tentative release date in March 2023. Meanwhile, the Civic Center Revitalization Committee has been meeting regularly to develop a vision/guiding principle for the revitalization project. Given site locations to be covered by the consultant study are part of the footprint to be included in the Civic Center Revitalization Project, it is critical to ensure timely two-way information sharing between the two projects. Otherwise, the results of the consultant study may have limited applicability in downtown area in the long run, and the redevelopment project may miss opportunities to create office space that meets the City's operational needs.

Additionally, lessons learned from the consultant study, including the pilot program, could inform Civic Center redevelopment. For instance, space-sharing, open space, and "hoteling" opportunities could be incorporated into space designs in Civic Center redevelopment plans.

(2) *Identify Cost Savings Opportunities to Offset Implementation Cost*

It is anticipated that implementing office space optimization measures following the consultant analysis may entail additional costs to the City, including costs associated with space reconfiguration, new furniture, and IT expenditures. However, the office space planning analysis may present long-term savings opportunities by increasing space efficiency. As the consultant study progresses, Council may wish to request DREAM to identify space savings opportunities, such as annual lease savings, that could offset the implementation cost, as well as cost avoidance opportunities such as using desk-sharing, a hybrid work model, and "hoteling" as alternatives to acquisition of new space. The latter could help the City avoid expanding its real estate footprint and associated costs while accommodating its headcount growth.

Arts & Culture Funding

The Outlook assumes no change in funding for Arts and Culture from the current FY 2023 funding level of $14.3 million. In their September 2022 budget priority memoranda, a majority of

Councilmembers expressed support for increasing overall funding for arts and cultural programs in the City, with several suggesting a FY 2024 funding level equal to 7% of Citywide Transient Occupancy Tax (TOT) revenues, with the ultimate goal of fully achieving the Penny for the Arts Blueprint goal of 9.52% of TOT (equal to 1 cent of the City's 10.5 cent TOT rate) within three years (FY 2026). The table below reflects the projected funding gap over the Outlook period assuming phased funding targets of 7% of Citywide TOT in FY 2024, 8% in FY 2025, and the full 9.52% goal in FY 2026 and beyond.

Arts and Culture Funding Levels *($ in millions)*					
	FY 2024	**FY 2025**	**FY 2026**	**FY 2027**	**FY 2028**
Total Citywide TOT (Proj.)	$ 296.1	$ 307.9	$ 320.2	$ 333.0	$ 346.3
Phased Funding Target (%)	**7%**	**8%**	**9.52%**	**9.52%**	**9.52%**
Phased Funding Target ($)	$ 20.7	$ 24.6	$ 30.5	$ 31.7	$ 33.0
Funding Level in Outlook	14.3	14.3	14.3	14.3	14.3
Funding Gap	**$ (6.4)**	**$ (10.3)**	**$ (16.2)**	**$ (17.4)**	**$ (18.7)**

Parks & Recreation Department – Equity in Recreation Programming Audit Implementation

On November 10, 2021 the City Auditor released the Performance Audit of Equity in Recreation Programming, which identified significant inequities in recreation program funding, availability, and access. The audit included 16 recommendations, and the Parks and Recreation Department's (P&R) response to the first Audit recommendation indicated that initial resources will be needed to implement several recommendations included in the Audit, including 10.00 FTEs and non-personnel expenditures for consultant support for marketing/outreach, as well as for recreational needs assessments and related survey and data analysis.

In the FY 2023 Adopted Budget, the Department received funding for 5.00 FTEs and $550,000, which is roughly half the required resources they had requested. Funding for the remaining 5.00 FTEs and additional non-personnel expenditures will be necessary in order for Department to fully implement the Audit recommendations.

Fire/Police Training Facility Feasibility Study

In their September 2022 Budget Priorities Memoranda, several Councilmembers supported funding to finalize the training facility feasibility study. In the FY 2023 Adopted Budget, $800,000 was included to fund Phase II of the Feasibility Study; $2.2 million remains outstanding for the final portion (Phase III) necessary to complete the study. The Fire-Rescue Department indicated that they plan to submit a request for this funding need during the FY 2024 budget development process. The current training facility located at the Naval Training Center (NTC) needs to be vacated by 2027 for Phase 2 of the Pure Water project.

POTENTIAL MITIGATION MEASURES

POTENTIAL MITIGATION MEASURES FOR FY 2024

Potential Mitigation Measures

• American Rescue Plan Act
• General Fund Excess Equity
• Grants/State or Federal Funding
  ○ Infrastructure Investment and Jobs Act
  ○ Inflation Reduction Act

The Outlook shows that General Fund Baseline Expenditures exceed Baseline revenues in FY 2024-2026. When adding projected operating expenses for anticipated new facilities, as well as planned commitments for homelessness programs, information technology, and stormwater debt service costs, the deficit expands to $75.9 million in FY 2024 and grows to $112.6 million in FY 2028. The Outlook assumes the use of ARPA funds and Excess Equity to fully address the projected deficit in FY 2024 and partially mitigate the deficit in FY 2025. In this section we discuss these resources as well as others that could be considered over the course of the Outlook, since there are many remaining priorities and funding needs.

American Rescue Plan Act (ARPA)

ARPA was signed into law on March 11, 2021, which provided the City with a total of $299.7 million. ARPA funds must be used by December 2024 (FY 2025) and are available to provide government services and replace a significant portion of revenue lost due to the COVID-19 pandemic. With $100.0 million of ARPA used in FY 2022 and $147.6 million budgeted for FY 2023, there is an estimated $52.1 million available for use in FY 2024. The Outlook recommends this funding being used in FY 2024 to partially mitigate the projected deficit. ARPA is a one-time funding source and should be used for one-time expenditures to achieve a structurally balanced budget.

General Fund Excess Equity

Excess Equity is available fund balance that exceeds the required General Fund Reserve and is not allocated or appropriated to any expenditure. It generally results from increases to General Fund revenues and/or General Fund expenditures that come in under-budget. The Outlook recommends the use of a projected current balance of $72.1 million in Excess Equity in FY 2024 and FY 2025. We note that Excess Equity has been largely held aside for any potential unanticipated Proposition B unwinding costs, and the amount available for future use is uncertain at this point because the current estimated balance is not based on comprehensive projections for FY 2023, but rather the FY 2023 Adopted Budget. The FY 2023 projections that will be included in the Mid-Year Report (expected to be released February 3, 2023) will provide a more updated sense of the projected Excess Equity that could be available in FY 2024.

Grants/State or Federal Funding

The City has opportunities to receive revenues or grant funding for various programs and projects. While future grant funding will vary from year-to-year and is generally not included in the Outlook, it has been critical for funding various City projects in the past. As grant funding is generally one-time in nature, absent an identified funding source to supplant funding from any particular grant upon its exhaustion, best practices suggest that grant funding should be used for one-time expenditures.

Known grant or federal funding opportunities for certain types of infrastructure, energy, and climate-related projects are discussed below. We note this is not an exhaustive list, and that specific funding is not known at this time. Our Office will continue to monitor these potential resources.

Infrastructure Investment and Jobs Act (IIJA)

The Infrastructure Investment and Jobs Act (IIJA) (also known as the Bipartisan Infrastructure Law) became federal law in November 2021 and will allocate about $1.2 trillion nationwide over ten years for transportation and infrastructure spending, with $550 billion going toward *new* investments and programs to address energy and power infrastructure, access to broadband internet, water infrastructure, and other projects. The State of California is estimated to receive $46.6 billion over ten years. The extent to which the City will benefit from this new funding currently is not clear as it primarily is being made available through competitive grants or formula-based funding that is passed through the State. While funding may be used primarily for capital projects, it is not limited to only those projects but rather depends on the type of grant.

As part of IIJA, the City will be receiving $1.18 million dollars in 2023 in one-time funding directly through the Energy Efficiency and Conservation Block Grant program. An effective strategy for evaluating potential grant and other funding opportunities is very important, and the City continues to evaluate internal and regional projects which may be eligible for funding. The City has submitted applications for the following projects (decisions on funding awards are expected in early 2023):

- U.S. Department of Transportation (DOT) Safe Streets and Roads for All Program – $15 million capital grant for traffic and pedestrian safety improvements along El Cajon Blvd
- U.S. DOT Bridge Investment Program – $24 million for phase I of the Palm Avenue Interstate-805 project
- National Oceanic and Atmospheric Administration (NOAA) Coastal Habitat Restoration and Resilience Grants for Underserved Communities – $590,000 for Planning grant for the Chollas Creek Watershed Regional Park Master Plan

Inflation Reduction Act (IRA)

The federal Inflation Reduction Act (IRA) was signed into law in August 2022 and will provide $385 billion in new energy and climate-related programs over ten years, with the goal of cutting nation-wide carbon emission by an estimated 40% by 2030. The IRA is expected to provide a combination of formula and competitive grant funding opportunities. While analysis of IRA programs and potential funding opportunities that could benefit the City and regional partners is still being conducted, examples of IRA programs that potentially could provide funding opportunities for the City include:

- U.S. DOT Neighborhood Access and Equity Program – $3 billion in competitive grants, with priority given to disadvantaged communities for projects that improve connectivity/mobility, reduce urban heat, and improve safety, among other things.
- Environmental Protection Agency (EPA) Environmental and Climate Justice Block Grants –

$3 billion in competitive grants to invest in disadvantaged communities and address disproportionate environmental and public health harms related to pollution and climate change.

- U.S. Department of Energy Latest and Zero Building Energy Code Adoption – $1 billion to support state and local governments to adopt updated building codes or that meet or exceed zero energy provisions.

POTENTIAL MITIGATION MEASURES AFTER FY 2024

Ballot Initiatives

Potential Mitigation Measures: After FY 2024

• Ballot Initiatives
  ○ November 2022 Measure B – People's Ordinance
  ○ March 2020 Measure C – TOT Increases
• Stormwater Fee Increase

November 2022 Measure B – People's Ordinance

As of the publication of this report, a majority of City voters appear to have approved Measure B during the 2022 General Election. Measure B, among other changes, removes the prohibition within the Municipal Code for the City to charge residents serviced by City forces for the costs for refuse, recycling, and other collection services. As our Office explained in IBA Report 21-23: *Analysis of the Fiscal Impact of the People's Ordinance*, most other cities within California already charge their residents for these services, while San Diego utilizes other City funds, most notably the General Fund, for this purpose.

With the passage of Measure B, the City can develop a fee in line with the Proposition 218 process to cover the costs for collection services, including increased collections costs incurred due to compliance with SB 1383, which requires the weekly collection of organic waste from all residents. According to City staff, up to approximately $79.2 million in costs in the FY 2023 Adopted Budget, including $58.7 million within the General Fund, could be covered by a fee if such a fee were currently allowed and levied. General Fund resources in particular could be redirected to other core services or used to cover deficits currently projected within the Outlook.

City staff from the Environmental Services Department currently project that completing the Cost of Service Study process required before the fee can be imposed will take approximately two years, which means that any budgetary relief due to Measure B would not occur until FY 2026 at the earliest.

March 2020 Measure C – TOT Increases

On March 3, 2020, Measure C (a citizens' initiative bond measure) received support from 65.24% of the voters – strong majority support but just under the two-thirds threshold. Measure C proposed increasing the hotel visitor tax (TOT) and using the resulting proceeds to fund Convention Center expansion and modernization and other convention center purposes, homeless services and programs, and street repairs.

In reliance on three recent appellate court decisions that concluded a special tax proposed by a citizens' initiative requires only a simple majority vote of approval, the City Council approved a resolution on April 6, 2021 declaring that Measure C was approved by the voters. In conjunction with that action, the City asked a trial court to confirm that Measure C was in fact approved by the voters. That question ultimately was not addressed by the trial court when it released its ruling in March 2022; rather the court determined that the City Council waited too long before declaring that the measure had passed. The City has since appealed that ruling to a higher-level appellate court in an attempt to validate that Measure C lawfully passed.

If the appellate court were to affirm that Measure C was approved by the voters in March 2020, and if that decision was not successfully appealed, then the City could have a viable ongoing resource to fund homelessness programs and services and road repair expenses that are currently being incurred by the General Fund. The City will not move forward with the tax increase until and unless it receives a legal determination that Measure C was approved by the voters.

Stormwater Fee Increase

As previously discussed in this report, the Stormwater Department has significant needs in order to be able to meet all current stormwater compliance requirements. The Outlook does include additional debt service directly related to Stormwater, totaling almost $30 million in FY 2028, which is anticipated to remain at that level for around 30 years. Currently these costs are borne by the General Fund, as the special revenues dedicated to stormwater activities are insufficient to address the full costs of compliance.

In response to an audit recommendation, as well as previous IBA reports on the issue, the Stormwater Department issued a funding strategy document in January 2021 which was subsequently approved by the Council. Following on from that document, in February 2022 the Department presented an analysis of a potential ballot measure that focused on the creation of a tax on the impermeable surface area of properties within the City at a rate between 4 to 5 cents per square foot of impermeable surface area. Such a measure, which would cost the typical single-family residence between $10 and $14 per month, would generate between $74 million and $93 million per year for stormwater activities. This funding could help offset numerous stormwater costs, including current operations, new operational needs, or even increased debt service related to stormwater activities. Currently, the City's storm drain fee costs single family residences less than $1 per month and generates approximately $5.7 million.

Passage of such a fee would require the approval of two thirds of voters at a general election if the measure was placed on the ballot by the City Council. Polling conducted by a consultant prior to the February 2022 presentation noted that a majority of voters would likely support such a measure, but that support was within the margin of error of the two thirds threshold that would be required for passage. As such, the measure was not placed onto the 2022 General Election ballot, and the Department indicated that it would continue educational efforts around this initiative.

CONCLUSION

While our report identifies several potential variations to projected finances in this year's Outlook, in general our Office believes that Baseline Revenue and Expenditure projections in the Outlook are reasonable. Projected baseline deficits in the Outlook – starting at $50.5 million in FY 2024 – show the effects of the City's past reliance on federal American Rescue Plan Act funds and other one-time funds to support the City's ongoing expenses. Particularly in areas of infrastructure maintenance and programs to combat homelessness, past reliance on one-time funding for ongoing needs has led to a structural imbalance that should be addressed in future years.

In addition to Baseline Expenditures associated with current service levels, there are other known costs that will need to be supported, such as operating new facilities, updating the City's information technology systems, and coming into compliance with stormwater regulations. Further, there are many other Council priorities that are only partially or not included in the Outlook, like expanding Climate Action Plan implementation; increasing homelessness services and housing opportunities; increasing funding for arts and culture; continued efforts for equity in recreation programming; and maintaining the City's infrastructure. It will be *critical* to identify new ongoing revenues to tackle these issues and achieve a structurally balanced budget that supports financial sustainability.

The information provided in the Outlook and in our review of the Outlook allows the Council to further identify its top budget priorities, and to begin developing a strategy for achieving a balanced budget in FY 2024. The next step in the annual budget process is for each City Councilmember to update their priorities for the FY 2024 budget and submit them to our Office by January 13, 2023. Given projected deficits in the Outlook, balancing the urgency of the wide variety of budget priorities will be critical, and we further encourage the inclusion of any potential resources in updated Councilmember budget priorities. In February 2023, the Council will adopt an updated City Council Budget Priorities Resolution, which will be developed based on the memos submitted to our Office. This resolution will provide the Mayor with input for developing the FY 2024 Proposed Budget.

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Attachment: New Facilities and Joint Use Agreement Annual Costs

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Department	Facility	Council District	FTE	First Year Expense
Fiscal Year 2024				
Parks & Recreation	Riviera Del Sol Neighborhood Park	8	1.50	$ 301,193
Parks & Recreation	Salk Neighborhood Park & Joint Use	6	0.00	30,479
Parks & Recreation	NTC/Esplanade	2	0.50	72,355
Parks & Recreation	Clairemont Canyons Academy Joint Use	6	0.50	114,809
Parks & Recreation	3 Roots Park	6	2.00	560,903
Parks & Recreation	Junipers Park	5	1.00	184,164
Parks & Recreation	North Central Square	3	0.50	64,943
Parks & Recreation	McGonigle Canyon Neighborhood Park	1	1.00	200,643
Parks & Recreation	Marston Middle Joint Use	6	0.50	112,226
Parks & Recreation	University Heights Dog Park	3	1.00	145,034
Parks & Recreation	Olive Street Mini Park	3	0.50	78,067
Parks & Recreation	Memorial Senior Center	8	2.00	165,983
Parks & Recreation	Balboa Park Botanical Gardens	3	2.00	296,788
Parks & Recreation	EB Scripps Comfort Station	1	1.00	151,684
Parks & Recreation	Citywide Facility Maintenance (various specialties)	Citywide	9.00	2,159,187
Parks & Recreation	City's Share of Joint Use Facility Major Maintenance/Repairs	Citywide	0.00	380,980
Library	Pacific Highlands Ranch Branch Library	1	9.00	736,564
Fire-Rescue	Torrey Pines (UCSD) Fire Station	1	12.00	1,755,503
Total Fiscal Year 2024			**44.00**	**$ 7,511,505**
Fiscal Year 2025				
Parks & Recreation	Pacific View Elementary Joint Use	4	0.50	$ 104,276
Parks & Recreation	Perry Elementary School Joint Use	4	0.50	119,421
Parks & Recreation	Boone Elementary School	4	0.50	107,094
Parks & Recreation	Whitman Elementary School	6	0.50	116,486
Parks & Recreation	Spreckels Elementary Joint Use	1	0.50	103,454
Parks & Recreation	Hickman Elementary Joint Use	6	0.50	111,906
Parks & Recreation	NTC Building 619	2	4.00	438,947
Parks & Recreation	Cannon Street Pocket Park		0.50	57,409
Parks & Recreation	Hidden Trails Neighborhood Park	8	0.50	126,307
Parks & Recreation	Dennery Ranch Neighborhood Park	8	1.50	332,285
Parks & Recreation	East Village Green	3	12.00	1,515,443
Parks & Recreation	Mira Mesa Aquadic Center	6	7.75	635,876
Parks & Recreation	Citywide Facility Maintenance (various specialties)	Citywide	4.00	792,397
Parks & Recreation	City's Share of Joint Use Facility Major Maintenance/Repairs	Citywide	0.00	450,874
Fire-Rescue	Black Mountain Ranch Fire Station	5	12.00	2,653,915
Fire-Rescue	Fairmount Ave Fire Station	4	12.00	2,653,915
Total Fiscal Year 2025			**142.75**	**$ 10,320,005**
Fiscal Year 2026				
Parks & Recreation	Rowan Elementary Joint Use	9	0.50	$ 100,696
Parks & Recreation	Pacific Beach Elementary Joint Use	1	0.50	80,504
Parks & Recreation	Eastbourne Neighborhood Park	5	0.50	97,957
Parks & Recreation	Shoal Creek Neighborhood Park	5	0.50	107,231
Parks & Recreation	Walden Neighborhood Park	5	0.50	89,856
Parks & Recreation	Lafayette Elementary Joint Use	6	0.50	139,790
Parks & Recreation	Citywide Facility Maintenance (various specialties)	Citywide	5.00	948,765
Parks & Recreation	City's Share of Joint Use Facility Major Maintenance/Repairs	Citywide	0.00	105,000
Total Fiscal Year 2026			**8.00**	**$ 1,669,799**
Fiscal Year 2027				
Parks & Recreation	Southwest Neighborhood Park	8	1.50	$ 353,365
Parks & Recreation	City's Share of Joint Use Facility Major Maintenance/Repairs	Citywide	0.00	180,000
Library	Ocean Beach Library Expansion	2	0.00	38,606
Library	Oak Park Library Expansion	2	0.00	90,439
Total Fiscal Year 2027			**1.50**	**$ 662,410**
Fiscal Year 2028				
Parks & Recreation	Epoca Neighborhood Park	8	1.00	$ 207,925
Parks & Recreation	Martinez Neighborhood Park	8	1.00	210,272
Parks & Recreation	Citywide Facility Maintenance (various specialties)	Citywide	2.00	492,240
Parks & Recreation	City's Share of Joint Use Facility Major Maintenance/Repairs	Citywide	0.00	307,500
Fire-Rescue	Otay Mesa Fire Station	8	24.00	6,088,960
Total Fiscal Year 2028			**28.00**	**$ 7,306,897**

Note: Facilities include one-time expenses for items such as vehicles in the first year of operation. One-time expenses are eliminated from subsequent years operating costs.