
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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FY 2009 Budget Status and Plan of Action

On Tuesday, October 14th, the Mayor announced a current year General Fund budget deficit in excess of \$40 million or 4% of the City's General Fund Budget. The memo indicates that Jay Goldstone, COO, will attend the October 15th Budget and Finance Committee to discuss this matter further but will not be prepared to recommend any specific actions for addressing the problem, beyond the existing hiring freeze, until November 12th.

At the September 24th Budget and Finance Committee, during the discussion of the City Comptroller's FY 2008 Year-End Report, Mary Lewis, CFO, noted that based on year-end actual revenues and two months of current year revenue collections, staff would be considering a First Quarter budget adjustment. Ms. Lewis noted that this was being considered largely due to disappointing Transient Occupancy Tax (TOT), sales tax and possibly even property tax collections, although more analysis was needed. Ms. Lewis indicated that if a budget adjustment is determined to be necessary, it would be presented as part of the First Quarter Report which would be available to the Committee on the regular schedule of November 12th.

At the September 24th meeting, Chairwoman Atkins, as well as Councilmembers Faulconer and Frye, expressed serious concerns about the current year budget in light of year-end results which showed a decline in TOT revenues and a \$20 million reduction in FY 2009 General Fund reserves when compared to FY 2008. In our report on the Year-End Results (IBA 08-101), we raised concerns about our reserve levels and noted that **"we will not recommend items to be funded from the Appropriated Reserve, unless additional information is obtained regarding revenues to be received in excess of**

budgeted levels, or that significant budgetary savings is expected, both of which could bolster the reserve.”

Councilmember-Elect Carl De Maio also expressed concerns about the current year budget status during public comment and called for early action. Committee members also noted concerns about the impacts of the continuing stress on the economy, as well as the threat of a State raid on local resources in light of the State’s significant budget gap. They further expressed a strong desire to see First Quarter results as early as possible, noting that the earlier that remediation steps are taken, the greater the savings that will be achieved.

Ms. Lewis responded that the Mayor had put a hiring freeze into effect in early September to begin to accrue savings which would help with a deficit situation. She noted that additional time and further analysis was needed to complete the First Quarter Report and that it would be presented to the Committee on November 12th with recommendations for necessary budget adjustments. The Committee requested that the Mayor provide an update on the hiring freeze, including the number of vacancies, the related service impacts, and the criteria for filling positions at the meeting of October 15th. The Mayor subsequently noted in his October 14th memo that he would request that Council President Peters docket the proposed budget actions for November 17th or 18th following the November 12th Committee meeting.

Since receiving and analyzing the Comptroller’s Year-End Report and noting our concerns in IBA Report 08-101, IBA staff has been reviewing potential strategies and actions to address a current year deficit. We learned of the magnitude of the projected deficit officially from the Mayor’s memo of Tuesday, October 14th. As of Tuesday afternoon, IBA staff had an initial meeting with Financial Management to begin to analyze the revenue projections. We have not yet seen any data on the expenditure side, though IBA staff has provided FM with suggested areas for savings and expenditure controls. FM has indicated that the earliest that they can share data with us is Monday, November 3rd. A staff report is expected to be provided on Wednesday, November 5th in advance of the Committee meeting.

At this point we are not in a position to verify the projected deficit of \$43 million. However, given what we have seen on the revenue side, we concur that strong actions are necessary now to right the budget.

Reductions in major General Fund revenues, including Property Tax, Sales Tax, and Transient Occupancy Tax, total \$33.2 million.

That being said, we are concerned that further actions beyond that of a hiring freeze

Major General Fund Revenue Revisions (in millions)	Revenue Revision
Property Tax	-\$14.5
Sales Tax	-\$2.6
Transient Occupancy Tax	-\$16.1
TOTAL	-\$33.2

are not being taken immediately which could help to mitigate the problem short term before more permanent fixes are identified and approved in November.

The Mayor has directed all department directors to identify possible reductions equal to 10% of their budget by the end of October. These proposed reductions along with other actions recommended by the CFO will then be brought forward to the Committee on November 12th and to the Council the following week. If the Police and Fire-Rescue Departments are included in the

10 percent reduction target, reductions totaling \$119 million will be identified. However, without the Police and Fire-Rescue Departments, a 10 percent reduction of the remaining General Fund departments would generate \$59 million in savings. However, it is likely that many of these proposed reductions will be in areas determined to be critical, and other options will need to be identified and considered.

General Fund Reduction Option (in millions)	FY 2009 Budget	Possible 10% Reduction
Police	\$410.7	\$41.1
Fire-Rescue	\$190.7	\$19.1
All other GF Depts	\$591.3	\$59.1
Total General Fund	\$1,192.7	\$119.3

While this work is going on, we recommend that you request the Mayor to consider the following short term actions immediately:

Inclusion of Known Savings

A number of items have been identified as possible areas of savings, though it is unclear at this point if they have been included as offsets resulting in the \$43 million deficit.

Additional information should be provided to show if these savings are accounted for:

- \$3.6 million debt service payment for deferred maintenance financing
- \$2.0 million in projected election savings
- Savings related to proposed MEA grievance settlement

Immediate Expenditure Restrictions

Expenditure controls in the following areas could begin to generate immediate savings:

Freeze travel and training

FY09 General Fund budget for travel and training totals \$1.85 million. Restricting expenditures in this area could generate savings immediately, without affecting services provided to the public. Approximately \$357,000 has been expended in this area so far, with \$1.5 million remaining.

Freeze equipment outlay purchases

FY09 General Fund budget for the equipment outlay category totals \$9.5 million. Excluding Police and Fire-Rescue Departments, all other departments total \$3.4 million within Equipment Outlay. Expenditures in this category to date total less than \$1 million, with \$8.5 million remaining. As the IBA has previously noted, FY08 expenditures in this category were well below budgeted levels, totaling just \$6.8 million, and the FY09 budget reflected an increase of 46% over actual FY08 expenditure levels. Controls in this area could easily generate immediate savings.

Freeze overtime

FY09 General Fund budget for overtime totals \$36.5 million. Of this amount, \$33.9 million has been budgeted for the Police and Fire-Rescue Departments, with \$2.58 million budgeted for all other General Fund departments. Overtime could be restricted to produce immediate savings.

Program Reductions

In addition to considering these short term corrections, we recommend that the Mayor provide the Council with options for programmatic and service reductions for Council consideration that are in excess of the remaining problem so that choices can be made. The Council may want to consider citizen hearings on the potential reductions prior to decision-making.

Expenditure Reductions Requiring Further Review/Approval

Additional expenditure reductions have been identified which would likely require further review and approvals, and possible discussions with the City's labor organizations, including:

Review budgeted contractual services

Of the \$52.3 million budgeted in FY09 for unclassified professional services, miscellaneous contractual services and other non-personnel expenses, \$35.4 million is still available. These budgeted line items should be reevaluated to determine if the commitment of any of these funds could be delayed and/or identified for savings. It should also be noted that of the \$22.0 million encumbered in prior year funds (noted above), 64% (or \$14.0 million) represent these same line items. Thus the City is expending funds for these contractual purposes from last year's funding in conjunction with new funds budgeted in FY09. Actions coming forward for Council approval need additional scrutiny to determine appropriateness, in light of budget deficit. For example, a request for slurry seal contracts in the amount of \$6 million is scheduled for the Council docket of October 20. In addition, contractual services for Grant Thornton in the amount of \$450,000 should be reviewed, given the PERB ruling related to the Managed Competition Program.

Review/release discretionary prior year encumbrances

A total of \$42.9 million had been set aside for prior year encumbrances at the close of FY08. To date, \$14.1 has been expended and \$22.0 million is still encumbered, leaving \$6.8 million available. However, \$3.3 million of this available balance has been identified for SDDPC encumbrances. Excluding this amount, \$3.5 million may be available in prior year funds that could be deappropriated and returned to fund balance upon verification by the Comptroller’s Office.

Initiate Mandatory Furlough

The IBA has prepared an estimate of potential savings to be achieved by implementing a Mandatory Furlough. Based on actual expenditure activity to date, estimates have been prepared for average hourly salary and fringe expenses for each General Fund department. Assuming that 75% of fringe benefits remain a fixed cost due to the Annual Required Contribution to the Retirement System and Retiree Health costs, average hourly costs for the General Fund total \$287,515. When excluding the Police and Fire-Rescue Departments, this amount is reduced to \$104,585.

ESTIMATED IMPACT OF MANDATORY FURLOUGH					
General Fund Dept	Avg Salary Expense Per Hour	Avg Fringe Expense Per Hour	Avg Total Personnel Expense Per Hour	Avg Total W/O Fixed Fringe Costs	One-Week Furlough Savings (40 hrs)
Police	\$103,927	\$59,455	\$163,382	\$118,791	\$4,751,640
Fire-Rescue	57,404	26,940	84,344	64,139	2,565,560
All Other Depts	91,986	50,398	142,384	104,585	4,183,400
Total	\$253,317	\$136,793	\$390,110	\$287,515	\$11,500,500

Assuming a 40-hour work week comprises the Mandatory Furlough, it is estimated that the General Fund could save approximately \$4.2 million. This amount could be doubled if a two-week furlough were to be implemented. It is important to note that additional personnel (other than Police and Fire) may need to be excused from furlough requirements because of the nature of their job responsibilities. And, it is possible that the savings noted above could be reduced by individuals who may already participate in the City’s Voluntary Furlough Program.

Initiate and Implement User Fee Policy

The User Fee Policy is anticipated to come forward to the Committee at its meeting of October 29. It is anticipated that the policy will provide for annual adjustments to cost-recoverable revenues to keep pace with increased costs. This policy has been long-awaited, and serious consideration should be given to any fee adjustments that can be accomplished immediately to ensure cost-recovery that could generate new and/or additional revenues to the benefit of the General Fund this year.

Bring forward actions to carry out loan repayment from Redevelopment Agency

The FY 09 budget includes the expected loan repayment from the Redevelopment Agency. Additional actions are needed by the City Council and the Redevelopment Agency to implement and approve the payment and its receipt by the City. A plan of action is needed to identify the necessary steps to ensure this repayment is accomplished this fiscal year and does not further contribute to even greater revenue shortfalls later in the year.

CONCLUSION

The IBA recommends the Committee request that the Mayor consider the short-term expenditure controls outlined in this report. It is recommended that the Committee request that the Mayor bring back options for programmatic and service reductions for Council consideration. It is also suggested that the amount of possible reductions provided to the Council should be in excess of the identified deficit to allow the Council to prioritize the available options. The Council may want to consider citizen hearings on the potential reductions prior to decision-making.

[SIGNED]

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