



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: December 5, 2017

IBA Report Number: 17-39

City Council Docket Date: December 11, 2017

Item Number: 201

IBA Review of the Mayor's FY 2019-2023 Five-Year Financial Outlook

OVERVIEW

On November 8, 2017, Mayor Faulconer released the Fiscal Year 2019-2023 Five-Year Financial Outlook (Outlook), one of the City's important and annual financial planning tools. The Outlook is not a budget, but as a planning tool it is an integral part of the budget development process and is described in the City Council's Budget Policy as "the basis for determining the coming year's operating budget allocations."¹

This year's Outlook projects that **Baseline** annual growth in revenues will exceed expenditures in each year except for FY 2020, which has a projected deficit of \$9.6 million. As an improvement to the Outlook this year, the Mayor has also included in his five-year projections the costs of known **Critical Strategic Expenditures**, likely to be necessary to meet future operational and service commitments. These expenditures include operating costs for new facilities scheduled to open during the Outlook period, debt service, and public safety staffing. With the Mayor's critical strategic expenditures included in the Outlook's bottom line, deficits are projected in each of the first three years of the Outlook period (a \$10.1 million deficit in FY 2019, \$34.6 million in FY 2020, and \$19.8 million in FY 2021). Budgetary surpluses remain in FY 2022 and FY 2023. The Outlook also includes a discussion of potential strategies for mitigating the projected deficit.

The deficits projected for the first three years of the Outlook period are largely related to elevated pension payments, slowing revenue growth, and compensation agreements with the Police Officers Association (POA) and other employee organizations. Our Office notes, however, that **the Outlook's deficit and surplus projections do not include other potential expenditure needs that were requested by departments, or that may be of importance to the community and to the City Council.**

¹ Council Policy 000-02 *Budget Policies* page 2, last updated November 2017.

In this report we review the information presented in the Outlook as well as additional items identified by our Office, including:

- An overview of Baseline revenues and expenditures reported in the Outlook
- An analysis of the Mayor's critical strategic expenditures
- Selected budget requests made by departments that were not included in the Outlook (note: department requests are only included in this report for Council information, our Office is not advocating funding these items)
- A review of expenditures that may be of interest to the community or to the City Council, and not included in the Outlook (note: these items are only included in this report for Council information, our Office is not advocating funding these items at this time)
- A review of potential mitigation actions for balancing the FY 2019 budget

The Outlook and our Office's review of the Outlook are tools that the City Council can use to consider alternative priorities for the FY 2019 budget, as well as deficit mitigation strategies. Council may also wish to consider including alternative priorities or deficit mitigation strategies in their City Council Budget Priorities memoranda due to our Office in January.

REVIEW OF GENERAL FUND BASELINE

The Baseline is composed of current ongoing General Fund revenues and expenditures that support City programs and services, and is based on the FY 2018 Adopted Budget after the removal of one-time resources and expenditures. The Outlook projects Baseline expenditures in excess of revenues (deficit) in FY 2020, and revenues in excess of Baseline expenditures (budgetary surplus) in FY 2019 and the last three fiscal years of the Outlook period. The projected deficit is largely related to elevated pension payments, slowing revenue growth, and compensation agreements with POA and other employee organizations. Details on General Fund Baseline revenues and expenditures are outlined in the following sections, and in Attachments 1 and 2 of this report.

General Fund Revenues

The Outlook projects major General Fund revenue growth in each of the next five fiscal years, although the rate of growth slows over time. The Outlook notes that the current period of economic expansion has not been marked by dramatic increases in revenue growth after the last recession, and that it has exceeded the average number of years (five) between recessions. The Outlook stops short of predicting the occurrence of a recession within the next five years, although in Financial Management's (FM's) presentation of the Outlook at the Budget and Government Efficiency Committee (B&GE) on November 15, 2017, the potential for an economic downturn was identified as a risk at some time during the Outlook period, after the 18-month mark.

Total Baseline revenues in the Outlook are projected to grow from \$1.43 billion in FY 2019 to \$1.67 billion in FY 2023, a \$230.5 million or 16.1% increase in revenues within the five-year period. This growth in revenues is higher than last year's Outlook that projected \$208.8 million or 15.3% growth within the Outlook's five-year period.

Generally, **our Office agrees with the slowing growth projections** included for each revenue source in the Outlook, although in a few instances we note that projections in fiscal years 2021-2023 are substantially higher than projections for FY 2018, as discussed in Attachment 1. The Outlook projections are reasonable for the purposes of forecasting, however, and we note that FM will report on, and adjust, budgeted growth rates throughout the year (if warranted) as part of the budget monitoring process. Finally, while we generally consider the Baseline revenue growth rates projected in the Outlook to be reasonable, in Attachment 1 we provide some alternate growth scenarios for consideration.

The following table displays the continued increase in total major General Fund revenues from FY 2017 actuals through the FY 2023 projection.

General Fund Revenues

Revenue Source (\$ in millions)	FY 2017 Actuals ¹	FY 2018 Budget	FY 2018 Projected ²	FY 2019 Forecast	FY 2020 Forecast	FY 2021 Forecast	FY 2022 Forecast	FY 2023 Forecast
Property Tax	\$506.2	\$534.6	\$539.3	\$563.7	\$590.2	\$622.6	\$651.6	\$679.9
Property Transfer Tax	9.5	10.1	10.1	10.5	10.8	11.2	11.5	11.8
Sales Tax	271.5	275.3	275.0	281.8	289.7	297.5	305.5	313.5
Transient Occupancy Tax	116.9	121.1	123.3	130.6	138.1	145.8	153.8	162.0
Franchise Fees	72.1	75.1	75.6	77.6	79.0	80.3	81.6	82.9
Other Revenues including department revenues	369.2	391.6	391.6	370.1	378.3	393.1	403.6	414.7
Total General Fund	\$1,345.4	\$1,407.7	\$1,414.9	\$1,434.3	\$1,486.1	\$1,550.4	\$1,607.6	\$1,664.8
% Growth over Prior Year ³		4.6%	5.2%	1.4%	3.6%	4.3%	3.7%	3.6%

Note: Table may not total due to rounding.

¹As reported in the FY 2017 Year-End Financial Performance Report.

²As reported in the FY 2018 First Quarter Budget Monitoring Report, except for Other Revenues which reflect the FY 2018 Budget. The FY 2018 First Quarter Budget Monitoring Report includes updated projections for major General Fund revenues (property tax, property transfer tax, sales tax, transient occupancy tax, and franchise fees) but does not include updated projections for Other Revenues which includes department revenues.

³FY 2019 Forecast total % growth over prior year as compared to FY 2018 Projected.

An additional discussion regarding the “low” and “high” scenario analysis of major General Fund Revenues, as well as the potential impacts of other risk factors such as a recession or the potential impacts of a Community Choice Aggregation program, can be found in Attachment 1. Details on the changes in growth rates for each revenue source are provided in the “Baseline General Fund Revenues” section of the Outlook.

General Fund Expenditures

This section highlights major changes over the Five-Year Outlook. General Fund Baseline expenditures in this year’s Outlook are projected to grow from \$1.43 billion in FY 2018 to \$1.54 billion in FY 2023, a \$104.5 million or 7.3% increase. This growth in expenditures is higher than last year’s Outlook that projected a \$155.7 million or 11.6% increase.

The following table presents the changes from the FY 2018 Adopted Budget to the FY 2023 General Fund Baseline projection.

Increases/(Decreases) from the FY18 Adopted Budget to the FY23 Outlook Baseline Projection (\$ in millions)	
FY18 Adopted Budget	\$ 1,433.8
Personnel-Related Expenditure Changes	90.8
Compensation Increases - Agreements with Employee Organizations ¹	\$ 74.2
Workers' Compensation - Operations Contributions	8.2
Other Post-Employment Benefits (OPEB) - 2.5% Annual Increases Over the Five-Year Outlook	5.4
Police Vacancy Savings Decrease (a salary increase)	3.0
Fringe Benefits (other than those separately listed)	1.9
Termination Pay (for Annual Leave)	1.8
Step Increases for Salaries and Wages	1.8
Long-Term Disability - Operating Contributions	1.7
Police Overtime Decrease	(3.0)
Actuarially Determined Contribution (ADC) - Retirement Payment	(4.0)
Non-Personnel Expenditure Changes	61.6
Contracts - 3.5% Annual Growth Rate Over the Five-Year Outlook	32.8
Energy and Utilities - Various Growth Rates (electric, fuel, water, other)	10.1
Supplies - 5.1% Annual Growth Rate Over the Five-Year Outlook	8.4
IT Sourcing Strategy - Help Desk, Data Center, Networks, Application Services Contracts	6.3
Transfers to Parks Improvement Funds	5.4
IT - 2% Annual Growth Rate Over Five Years (costs other than the sourcing strategy)	1.1
Contracts - Other Adjustments Outside of the 3.5% Annual Growth Rate	1.0
Removal of Library Match in FY 2019	(1.0)
Reserve Contributions (General Fund, Public Liability, Pension, Workers' Compensation)	(3.2)
Other Non-Personnel Expenditures	0.7
Removal of FY18 One-Time Expenditures (see Five-Year Outlook, Attachment 2) ²	(47.9)
Charter Section 77.1 - Infrastructure Fund Transfers	(17.8)
Citywide Special Election - TOT Ballot Initiative	(5.0)
Executive Complex Rent and 101 Ash Relocation Costs	(4.4)
Transfers to Support Penny for the Arts	(4.2)
Police Officer Recruitment and Retention	(4.0)
Transfer to Public Utilities for Low Flow Diversion Program Costs	(3.0)
Information Technology Network and Desktop Services	(2.7)
Homeless Prevention & Diversion Program (SDHC)	(1.1)
Transfer to Qualcomm for Debt Service Payment	(1.0)
Bond Debt Service Expenditures Covered by the Capital Outlay Fund in FY18	4.0
Other One-Time Expenditures	\$ (8.6)
FY23 Outlook Baseline Projection	\$ 1,538.3
Total Increase: FY18 Adopted Budget to FY23 Baseline (7.3% Increase Over the 5 Years)	\$ 104.5

Note: Table may not total due to rounding.

¹ Compensation increases of \$88.0M are offset by the \$13.8M decrease in POA negotiated flexible benefits that are categorized in the Outlook as a one-time expenditure.

² Removal of a net \$34.4 M in one-time expenditures is excluded from this section and included elsewhere in the table above. One-time removals include FY18 one-time expenditure increases: \$20.5M reserves; \$13.8M POA negotiated flexible benefits; \$3.0M Police overtime; and \$1.5M hardware and software discretionary costs (that was added back to the base budget). These one-time expenditure increases are partially offset with the following FY18 one-time expenditure decreases: \$3.0M Police vacancy savings; and \$1.4M Long-Term Disability (LTD) costs covered by the LTD Fund in FY18.

As shown at the bottom of the previous table, the Outlook's FY 2023 General Fund Baseline expenditure projection is increasing by \$104.5 million (or 7.3%) from the FY 2018 Adopted Budget. The largest increases over the five years include:

- \$74.2 million for compensation increases based on agreements with the City’s recognized employee organizations;
- \$32.8 million for the 3.5% annual increases in costs for contracts; and
- \$10.1 million for energy and utilities expenditures, based on various growth rates for costs such as electricity, fuel, and water.

The largest decrease over the five years is \$17.8 million related to the transfer to the Charter Section 77.1 Infrastructure Fund (which was approved by San Diego voters in June 2016). Annual General Fund transfers to the Infrastructure Fund are expected to continue through FY 2022. In FY 2023, the portion of the allocation formula that is generating transfer requirements (50% of year-over-year growth in major revenue sources) expires.

There are no programmatic increases included in the General Fund Baseline expenditures projection. The Outlook discusses amounts for critical strategic expenditures, which are also included in the calculation of the deficit or surplus for each Outlook year, unlike last year’s Outlook (but similar to Outlooks in prior years).

A detailed discussion of General Fund Baseline expenditures is included as Attachment 2 of this report. Attachment 2 provides context for notable areas and issues that the City Council has discussed during prior budget development and monitoring processes. Some areas covered include compensation increases related to multi-year agreements with employee organizations; salaries and wages, including special pays and vacancy savings; fringe benefits, including the Actuarially Determined Contribution (ADC) pension payment, flexible benefits, and the Supplemental Pension Savings Plan; and non-personnel expenditures (NPE).

CRITICAL STRATEGIC EXPENDITURES INCLUDED IN THE OUTLOOK

The City’s Budget Policy states that 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 City Council policies.”² This year’s Outlook includes Baseline revenue and expenditure projections as well as future critical expenditures identified by the Mayor, in conformance with the Budget Policy. Last year’s Outlook only included Baseline revenues and expenditures in the bottom line calculations for each of the five fiscal years, a change from prior Outlooks. Our Office supports the inclusion of critical expenditures in the bottom-line calculations, as it provides a more accurate and transparent picture of the City’s future financial needs.

In the following table our Office presents an overview of the Mayor’s critical expenditures included in the Outlook. **Additional new information on Fire-Rescue’s Peak-Hour Engines proposal is provided in a section following the table.** Information related to a number of the Mayor’s other critical expenditures is provided in Attachment 3 of this report.

² Council Policy 000-02 *Budget Policies* page 2, last updated November 2017.

Mayor's Critical Strategic Expenditures Included in Outlook

General Fund		FY 2019	Total Outlook Period
Baseline Revenues		\$ 1,434,313,822	\$ 7,743,295,804
Baseline Expenditures		1,431,925,069	7,539,265,426
Outlook Baseline Surplus/(Deficit)		\$ 2,388,754	\$ 204,030,378
Mayor's Critical Strategic Expenditures (Net Total)			
City Clerk	Replace and maintain electronic voting system and audio-visual equipment	\$ -	\$ 520,000
Deputy Chief Operating Officer Special Projects	Addition of new DCOO position responsible for large public project coordination and priorities	310,050	1,576,194
City Treasurer	Cannabis business tax program administration	275,773	1,415,089
Citywide Program Expenditures	Debt service for the General Fund's Capital Improvements Program	20,000	27,210,000
Environmental Services	Elimination of the tipping fee discount at the Miramar Landfill	-	2,100,000
Fire-Rescue Department	Fire dispatcher staffing	658,875	3,361,579
	Replace one helicopter	1,700,000	10,900,000
	Institution of peak hour engines (discussed below)	-	22,142,297
	Funding for operational staffing of fire stations scheduled to complete construction during the Outlook period ¹	925,000	17,683,997
Fleet Operations	Increase to charges to the General Fund for planned replacement of the City's fleet	-	53,264,411
Hepatitis A Response²	Expenses related to the City's response to the Hepatitis A outbreak, including street sanitation	2,665,884	5,462,748
Homelessness	General Fund support for safe parking program	338,000	507,000
Information Technology	Baseline adjustments	(682,825)	(3,414,125)
	Motorola public safety contract	478,500	4,306,500
	Cyber security initiative support	58,177	297,549
Library	Staffing and operating costs for new facilities ¹	142,809	4,880,072
Park & Recreation	Addition of staffing and operating costs for new facilities ¹	2,167,505	20,550,431
	MADs Proposition 218 compliance/general benefit	192,861	1,060,735
Performance and Analytics	311 Customer Experience (Get it Done) Phase 1 expansion	686,355	3,508,686
Planning	Middle Income Density Bonus Program	250,000	250,000
Police	Addition of civilian positions and equipment	991,432	5,052,892
	New equipment: body worn cameras and tasers	-	4,296,560
Transportation & Storm Water	Pothole repair	170,000	1,170,628
	Pipe maintenance and repair	765,080	3,909,144
	Street sweeping	107,716	2,691,490
	Slurry seal maintenance	-	7,800,000
	Stop guide	250,000	250,000
	Pavement assessment	-	800,000
Mayor's Critical Strategic Expenditures (Net Total)		12,471,192	203,553,877
Net Surplus/(Deficit)		\$ (10,082,438)	\$ 476,501

¹Projected first year operating expenses for new facilities are listed in Attachment 4 of this report.

²Since the Outlook was released, Financial Management has updated its projections related to Hepatitis A sanitation services. Updated projections for the Hepatitis A response, including Department response efforts and the sanitation contract, total approximately \$3.3 million in FY 2019 and \$8.5 million over the Outlook period.

As noted above, our Office provides additional details on a number of the Mayor's critical strategic expenditures in Attachment 3 of this report. However, one item in particular—the addition of Peak-

Hour Engine units—also represents a potential change in policy on priority fire station sites. We highlight this change in the section below, as well as including it as part of our review in Attachment 3.

Fire-Rescue - Peak-Hour Engines, Including Fire Station Reprioritization

The Outlook includes as a critical strategic expenditure the addition of a total of 48.00 FTE firefighter positions and \$22.1 million in associated expenditures over the Outlook period, to support the addition of six Peak-Hour Engine (PHE) units to the Fire-Rescue Department (three in FY 2020 and three more in FY 2021).

PHEs are fire engines that do not operate out of a fire station but are instead flexibly deployed in various areas based on need, for 12 hours per day. Like traditional fire stations, PHEs are staffed by four-person crews. The Fire-Rescue Department has indicated that PHEs could be implemented by deploying existing reserve fire engines and would not require any significant capital investment.

PHEs are a new deployment concept that has not yet been utilized by the San Diego Fire-Rescue Department. PHEs were a key recommendation of a 2017 report by Citygate and Associates, which identified several geographic service gap areas contributing to performance challenges and offered the following recommendations to close those gaps and improve response times:

- 1) Add a total of 12 new fire stations, including six stations currently in the City’s Capital Improvement Program (CIP) budget and six additional infill stations.
- 2) Add peak-hour fire engines, squads, or other flexibly-deployed units to serve the busiest areas of the City at the busiest times of day.

Following the release of the 2017 Citygate Report, which outlined the PHE concept, our Office reviewed the report recommendations in IBA Report 17-15 and worked with the Fire-Rescue Department to develop an implementation scenario in which the Department would pursue the Citygate priorities concurrently. At that time, the Department indicated its intention with the PHE concept was to supplement rather than replace existing priorities and efforts to build new fire stations, particularly the six stations currently in the City’s CIP budget. This approach was consistent with the Citygate Report’s prioritization of infill fire station construction over PHEs.³

During our review of the Outlook, however, the Department indicated it had begun considering serving certain priority fire station sites with PHEs *instead of*, rather than *in addition to*, building new fire stations. Specifically, Fairmount Avenue Fire Station (formerly Home Avenue) was cited as a project that could be served by PHEs. As discussed later in this report, Fairmount Avenue Fire Station was listed by Citygate as the number one priority of the six highest-priority new fire stations that are active CIP projects. Of those six stations, Fairmount is the only site that currently lacks full capital funding. The land for Fairmount Avenue Fire Station was recently purchased in FY 2017 and the FY 2018 CIP Budget cites a total of \$14.0 million in remaining unidentified funding needs for construction.

³ Section 1.7 of the 2017 Citygate Report recommends implementing three “Short-Term Steps,” including building fire stations, ahead of four “Long-Term Steps,” including adding Peak-Hour Engines.

Our Office notes that new capital funding may soon become available in the form of \$23.5 million in previously unanticipated Tobacco Settlement Bond proceeds which could be utilized for a variety of public safety facilities, including fire stations. On December 13, 2017, the City Council will be requested to approve a proposal by the Chief Financial Officer to spend \$13.7 million of this amount on the design and construction of a new Fire-Rescue Air Operations Facility. While the Air Operations Facility is an important project, diverting newly identified capital funding to this project ahead of Fairmount Avenue Fire Station (which was previously the Department's number one priority for improving response times) would represent a change in priorities. Other considerations such as both projects' readiness for construction may be valid reasons to prioritize one over the other; however, further vetting is appropriate. Our Office plans to release a separate IBA report on the Tobacco Settlement Bond item prior to Council consideration, with further analysis of the proposal.

POTENTIAL FUNDING NEEDS NOT INCLUDED IN THE OUTLOOK

In addition to reviewing the Outlook's Baseline projections and the Mayor's critical strategic expenditures, our Office considered other potential funding needs that may be necessary over the next five fiscal years, including:

1. Select department budget requests that were not included in the Outlook; and
2. Other items or programs of interest to the City Council and the community.

A discussion of these items is included in the sections that follow.

Select Department Requests not Included in the Outlook

The majority of department five-year funding requests were not included in the Outlook for a number of reasons. The request is not considered a Mayoral priority at this time, the request is capital in nature and may be considered for inclusion in the FY 2019-2023 Five-Year Capital Infrastructure Planning Outlook, or the submission was considered a FY 2019 "budgetary request" (for example, the addition of a single position to support day-to-day department functions that will be considered during the budget process).

Our Office reviewed all of the department submissions provided to FM, and in the sections below we have noted a number of items that Council may be interested in reviewing ahead of the upcoming budget. We also highlight some items that are considered "budgetary requests" and so are not included in the Outlook—including the second phases of projects currently underway—but that represent significant budgetary additions that may change the Outlook's bottom line projections if they are approved for funding. A brief discussion of capital requests not included in the Outlook is included in this report as Attachment 5.

The purpose of discussing these items is not to advocate for their funding, but to make the Council aware early in the budget process of some departmental priorities that are *not* included in the Outlook. These items are discussed in the following sections, and their associated costs are displayed in the table below.

Selected Department Five-Year Requests not Included in the Outlook

Department/Program	Request	FTE¹	FY 2019 Net Expense (General Fund)	Total Outlook Period (General Fund)
Environmental Services	Code Enforcement - CAP/Zero Waste	3.00	\$ 313,924	\$ 1,597,512
Fire-Rescue	Operations Funding for New Fire Stations (Fairmount and Paradise Hills)	36.00	-	\$ 12,978,532
Information Technology	PC Replacement	0.00	656,700	\$ 2,566,700
	Run the Business projects - OneSD	0.00	1,178,935	\$ 7,621,468
	Run the Business projects - IT Fund	0.00	389,880	\$ 1,187,500
Infrastructure Asset Management	IAM Support for Several Departments	8.00	883,027	\$ 4,478,199
Library	Janitorial Services for the Central Library	0.00	129,744	\$ 688,829
	Security Services	0.00	287,602	\$ 1,526,918
Personnel	Additional Staff Support	10.00	902,002	\$ 4,603,394
Performance & Analytics	Get it Done - Phase II	0.00	-	\$ 1,025,000
Planning	Climate Adaptation Plan	0.00	310,000	\$ 500,000
Police	Sworn and Civilian Positions	140.00	-	\$ 36,983,647
	Motorola Radio Replacement	0.00	1,729,221	\$ 8,646,105
Purchasing & Contracting	Animal Services Contract	1.00	147,318	\$ 753,370
Transportation Storm Water	Storm Water Permit Compliance Projects	55.00	13,319,859	\$ 98,219,152
Total Selected Department Five-Year Requests		253.00	\$ 20,248,212	\$ 183,376,325

¹Projected FTE as of FY 2023.

Because these items submitted by departments are not currently included in the Outlook, if they are included in the Mayor’s Proposed Budget or should the Council wish to include these expenditures in a future budget, additional deficit mitigation actions may be necessary.

Environmental Services Department - Code Enforcement to Support the City’s Zero Waste Plan and Climate Action Plan

The City Council has approved the Zero Waste Plan and the Climate Action Plan as strategies for achieving the goals of diverting 75% of waste generated in the City from landfill disposal by 2020, 90% by 2035, and zero waste by 2040. One strategy identified in these plans is the development of outreach/educational programs and increased frequency of inspections for residential and commercial recycling and trash bins. To implement this strategy, the Department proposed in their Outlook submission the addition of 2.00 FTE positions and approximately \$163,000 in annual expenses for two Code Compliance Officers beginning in FY 2019 and continuing throughout the Outlook period.

Additionally, the Department proposed the addition of 1.00 FTE and approximately \$151,000 in annual expenses for one Program Manager to lead the Code Compliance Section within the Department. The proposed position would be responsible for supporting enforcement of the City Recycling Ordinance and would focus on compliance with diversion requirements, review of Construction and Diversion (C&D) and other clean-up efforts.

Fire-Rescue Department – Additional New Fire Stations (Operations Funding for Stations that Lack Capital Funding)

In addition to the three fire stations discussed in Attachment 3, all of which are fully funded by the CIP for capital needs but will require General Fund support for ongoing operations, the Fire-Rescue Department also submitted requests for operational funding for the following two new fire stations beginning in FY 2022:

- Fairmount Avenue Fire Station (formerly Home Avenue)
- Paradise Hills Fire Station (double-house)

Operations needs for these fire stations were, appropriately, not included in the Outlook due to the fact that these stations currently lack full capital funding for construction. Remaining capital needs for these stations total approximately \$27.2 million, which could potentially be funded by future deferred capital bond issuances or new alternative sources of capital funding in future fiscal years. Should these or other fire stations be completed, additional operations funding of \$1.8 million per year would be required to support 12.00 FTE firefighter positions per station (in the case of Paradise Hills Fire Station, which is proposed to be a double-house, 24.00 FTEs and \$3.6 million would be required). Additionally, new fire apparatuses would need to be purchased at a cost of \$925,000 to \$2.2 million per station depending on the Department's operational needs, although those purchases would likely be financed through the Equipment Vehicle Financing Plan (EVFP).

Information Technology (IT)

PC Replacement

The Department of IT oversees the budget for the replacement of personal computers in General Fund departments, and the City's current policy is to replace its desktop computers every five years. As we noted in IBA Report 17-16, the City has recently replaced between 12-15% of its General Fund computers annually. If that trend continues, it would put the City on a replacement schedule of seven to eight years.

In November 2017 the City Council considered an amendment to the City's agreement with HP for computer equipment, and the staff report included updated estimates of what is needed for standard desktop PC replacements to maintain the policy of a five-year replacement schedule and to support upgrades to the City's operating system. Specifically for the General Fund, the staff report included a total of \$3.1 million for FY 2018, FY 2019, and the first nine months of FY 2020.

For the Outlook, the Department of IT requested \$2.6 million over the five-year period for PC replacement, in addition to the \$2.4 million already included in the baseline for this purpose. However, this request was not included in the Outlook. If the City would like to maintain its five-year replacement schedule and make needed upgrades the City's computers, these additional costs will need to be considered.

Run the Business Projects

The Department of IT's budget includes funding for a number of citywide IT projects that are supported through non-discretionary charges to the General Fund and non-General Fund department budgets that benefit from the implementation of those projects.

The Department of IT’s OneSD Support Fund houses a number of citywide IT projects that are currently in process—including IAM, the City’s new infrastructure management tool scheduled to go live in FY 2018; and Ariba, the City’s updated procurement software module. However, projected budget needs for these and other projects, which are considered to be “Run the Business”-type expenses, were not included in the Outlook’s bottom line forecast. Should the City decide to continue funding IT projects already underway, the impact to the General Fund would be approximately \$619,000 in FY 2019 and \$2.2 million over the Outlook period.

Department of IT - OneSD Support Fund Projects

Project	Initiated Prior to FY 2019?	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
IAM, Phase I maintenance and support	Yes	\$ 163,800	\$ 163,800	\$ 163,800	\$ 163,800	\$ 163,800
PBF (budget module) upgrade	Yes - upgrades existing module	-	-	365,500	-	-
Completion of Ariba	Yes	353,999	353,999	174,759	-	-
Open Text - document storage	Yes	100,823	67,215	-	-	-
Sub-total Ongoing Projects (General Fund)		618,622	585,014	704,059	163,800	163,800
IAM, Phase II maintenance and support	No	450,528	1,185,600	829,920	1,185,600	1,185,600
SAP data storage increase	No	109,785	109,785	109,785	109,785	109,785
Sub-total New Projects (General Fund)		560,313	1,295,385	939,705	1,295,385	1,295,385
Total General Fund:		\$ 1,178,935	\$ 1,880,399	\$ 1,643,764	\$ 1,459,185	\$ 1,459,185

The IT Fund supports the operational budget for Department staff who provide a variety of IT related activities for the City, including cyber security compliance and risk management, and management of IT Sourcing.⁴ The Department submitted requests for a number of “Run the Business”-type expenses that could have a General Fund impact of \$390,000 in FY 2019, and approximately \$1.2 million over the Outlook period. The following requests were not included in the Outlook:

Department of IT - IT Fund Projects

Project	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Cyber security monitoring tools	\$ 192,280	\$ 192,280	\$ 192,280	\$ 192,280	\$ 192,280
SharePoint and CityNet upgrades	71,820	-	-	-	-
Single Sign-on improvements	60,800	-	-	-	-
City Website upgrade for web services	36,480	-	-	-	-
Extension of Seamless Docs contract	28,500	-	-	28,500	-
Total General Fund:	\$ 389,880	\$ 192,280	\$ 192,280	\$ 220,780	\$ 192,280

Infrastructure Asset Management (IAM) Support

The City is developing the IAM software solution to improve the City’s management of infrastructure assets. IAM will enable staff to use information on infrastructure assets—such as current conditions, geographic locations, and maintenance history—to guide maintenance and capital investments.

⁴ Certain IT services are provided by vendors outside of the City. For instance: application development and maintenance; network services; and data center, help desk, and desktop support.

Phase 1 of IAM is being rolled out in two parts to the following departments: Department of IT/Wireless Technology Division, Public Works, Transportation & Storm Water (TSW), and Public Utilities. The first part of Phase 1 is scheduled to go live in December 2017 and the second part is scheduled to be implemented in March 2018. Phase 2 of IAM is scheduled to be implemented from FY 2019-FY 2022 to six additional departments or divisions including: Department of IT/Operations Management Group, Library, Police, Fire-Rescue, Environmental Services, and Park & Recreation.

In addition to requests submitted by the Department of IT discussed in the preceding section, several other departments submitted funding requests related to the implementation and maintenance of IAM, which were not included in the Outlook. These requests indicate the system may require additional support for participating departments as rollout of the solution continues. The following table summarizes the department submissions.

Department Operating Budget Requests Related to IAM

Department	Request	FY 2019	Total Outlook Period
City Comptroller	Accountant 3 for IAM implementation and maintenance ¹	\$ 94,122	\$ 480,562
Public Works - General Services	Support from the Public Works-Engineering & Capital Projects Branch for facilities condition assessment data maintenance	250,000	1,250,000
	Information System Analyst 3 for Facilities Division	99,595	507,927
Transportation & Storm Water	Addition of 6.00 FTE for IAM-related tasks to support Storm Water and Street Divisions	439,310	2,239,710
Total General Fund Costs		\$ 883,027	\$ 4,478,199

¹If approved, this position would be partially reimbursed by non-General Fund departments.

Library Department

Security for Library Facilities

The Department submission for the Outlook requested additional funding of \$288,000 in FY 2019 to \$324,000 by FY 2023 for the further expansion of security services at library facilities. An increase in visitors, homeless patrons, and security incidents system-wide are the driving factors for the desired expansion of guard services. Currently 24 of the 36 library facilities have security guards ranging from 8 hours of guard service per week to 52 hours of guard service per week. The Department is currently allocating the guard service to the facilities with the most incidents. Additional funding would allow the Department to improve guard services, however, each facility may not have an assigned guard. No library facility other than the Central Library currently has guard service during all operational hours.

Janitorial Services for the Central Library

The Central Library is the busiest public facility, servicing over one million users annually. The high traffic requires hygienic needs to be addressed during the day and after hours, particularly as the Central Library has been identified an “at risk” location (for both patrons and library staff) for Hepatitis A. Janitorial services can help mitigate the risk of spreading viruses such as influenza and various forms of Hepatitis. The Department has allocated current janitorial staff to address required services during operational hours, and contracts with an outside vendor for after-hours services. The cost for the after-hours services is currently being absorbed by the Department as

this was not originally anticipated during development of the FY 2018 Budget. These additional janitorial services are utilizing resources intended for core library services. The Department submission for the Outlook included additional funding ranging from \$130,000 in FY 2019 to \$146,000 in FY 2023 to appropriately fund the afterhours services. The Outlook includes \$47,000 for additional janitorial needs for the Department under the Hepatitis A (citywide) response for FY 2019. No allocations are identified in the Outlook beyond FY 2019.

Performance & Analytics – Phase II Expansion of the 311 Customer Experience (Get it Done) Application

The Outlook contains projected expenditures and revenues associated with the Phase I expansion of the Get it Done application, but does not include projected costs for Phase II. This second phase includes enhancements to Get it Done application capabilities, and increases the number of City departments that would be connected to the application, including City Council Offices, the City Information Line, and the Park & Recreation Department.

Projected costs for Phase II of the Get it Done application total approximately \$1.0 million over the last four years of the Outlook period, and include ongoing licensing and social media tool costs of \$50,000 per year beginning in FY 2020, as well as the addition of a number of one-time costs in each of the remaining years of the Outlook:

- FY 2021: \$125,000 – phone call routing improvements
- FY 2022: \$300,000 – customer relationship software for additional departments not included in Phase I, to track customer interactions
- FY 2023: \$400,000 – customer relationship software for the Park & Recreation Department to track customer interactions and provide a work order and reservation system

Should there be interest in expanding the uses of the Get it Done application beyond what is currently planned for Phase I, these projected Phase II costs will need to be reviewed and considered.

Personnel Department

The Personnel Department estimates it will need the addition of 10.00 FTE positions during the Outlook period. The total for all 10.00 positions is approximately \$900,000 annually as displayed in the table in the introduction to this section, but the Personnel Department has indicated that the positions would be added incrementally over the next five years.

The Department has determined its staffing needs based on its current workload, which has led to continual reallocation of staff to the most urgent and changing needs, as well as its expectations regarding continuing the implementation of automated processes.

Planning Department – Climate Adaptation Plan

One of the strategies within the City Council-approved Climate Action Plan (CAP) is Climate Resiliency. One of the City actions that falls into this CAP strategy is the development of a standalone Climate Adaptation Plan (Adaptation Plan). The Adaptation Plan will assist the City in

identifying vulnerabilities and risks associated with changes to the City's environmental and socioeconomic system, planning for early action, and engaging in collaboration with other agencies.

Per the Department's review of recently completed resiliency planning efforts by other local jurisdictions, the Department estimates the development of the Adaptation Plan will cost \$600,000 over a two and a half year work schedule. The City received approval for a grant from the Coastal Commission for \$100,000 to support vulnerability assessments of City infrastructure and properties. This analysis would be within the scope of the Adaptation Plan and this funding could be used to offset the total cost of the Adaptation Plan. The Department's Outlook submission included funding needs of \$310,000 in FY 2019 and \$190,000 in FY 2020 for a total of \$500,000. This request was not included in the Outlook.

Police

Additional Police Sworn and Civilian Positions

The Police Department requested, but the Outlook does not include, the addition of 88.00 FTE and 52.00 FTE sworn and civilian positions, respectively, to the Police Department over the next five years. The Department request proposed adding these positions in equal installments across four fiscal years, beginning in FY 2020 and continuing through FY 2023. This addition would fulfill the staffing needs identified by the Department in its Five-Year Plan, most recently updated in May 2016.

Motorola Radio Replacement

The Police Department requested, but the Outlook does not include, funding for the replacement of outdated police radios at a cost of \$1.7 million annually beginning in FY 2019 and continuing through all five years of the Outlook. The request would fund the replacement of approximately 300 portable radios per year. The Department has indicated that its current radios, a combination of Motorola XTS 2500 and XTS 5000 models, have surpassed their estimated service life and that neither model is currently being produced. Additionally, the manufacturer will no longer support the radios for parts, accessories, and repairs beginning in 2019. The Police Department has indicated that it plans to utilize State COPS grant funding to purchase the radios. If successful, there would be little to no General Fund impact and the cost would not affect the Outlook's expenditure projections.

Purchasing & Contracting – Animal Services Contract

Included in the Outlook's baseline projections is the transfer of approximately \$11.1 million from the Citywide Program Expenditures Department to the Purchasing & Contracting Department (P&C) for the City's animal services contract. The City has historically contracted with the County for animal services—animal control, shelter, and trapping—but that contract comes to an end as of June 30, 2018, and the County plans to outsource this service to a third party. P&C will procure and manage animal services for the City when the contract with the County has come to an end.

While the Outlook includes the transfer of the cost of the animal services contract to P&C, it does not include the addition of a position to manage the contract. The Department projects that budget

for the salary and fringe benefits associated with this position would be approximately \$147,000 in FY 2019, and \$152,000 for each additional year of the Outlook.

Transportation & Storm Water – Storm Water

In May 2013, the San Diego Regional Water Quality Control Board (Regional Board) adopted a new municipal storm water permit for San Diego. That permit mandates strict storm water quality requirements, and compliance with that permit will require significant increases in funding. The Transportation & Storm Water Department (TSW) completed a Watershed Asset Management Plan (WAMP) in 2014 that notes activities and projects necessary to support flood risk management activities and compliance with the Regional Board’s storm water permit. The WAMP projects that costs through FY 2040 will total \$3.1 billion. Penalties for not complying with storm water permits and requirements are up to \$10,000 per day per violation.

The Regional Board also recently approved the San Diego Bay Strategic Plan, which identifies and addresses ongoing sources of pollutants in 34 known polluted sites in San Diego Bay. To date the Regional Board has initiated seven sediment investigations where the City of San Diego has been identified as a Responsible Party. Penalties for not addressing these sites include fines of up to \$10,000 per day in addition to potentially increased financial responsibility for dredging costs in the tens of millions of dollars. Over the course of the Outlook, costs associated with these actions are estimated to total \$50.2 million.

While the Outlook does include 23.00 new FTE positions and \$10.2 million in expenses for increased street sweeping and storm drain pipe maintenance and repair, the majority of storm water related expenses and positions requested by TSW—including those expenses associated with the San Diego Bay Strategic Plan discussed above—were not included in the Outlook’s baseline or discussed as critical expenditures. Total storm water requests for operations funding that were not included in the Outlook are noted below, and also include requests for funding for additional channel clearing, implementing various parts of the City’s Water Quality Improvement Plan, and potential costs for mitigation associated with the emergency channel clearings that took place in 2016, among other requests.

Storm Water Operating Budget Requests Not Included in Outlook

	FY 2019	FY 2020	FY2021	FY 2022	FY 2023
FTEs (cumulative)	30.00	41.00	52.00	53.00	55.00
Personnel Expenses	\$ 2,363,331	\$ 3,203,934	\$ 4,055,063	\$ 4,123,223	\$ 4,259,545
Non-Personnel Expenses	\$ 10,956,528	\$ 14,361,528	\$ 14,636,000	\$ 12,430,000	\$ 27,830,000
Total Operating Expenses	\$ 13,319,859	\$ 17,565,462	\$ 18,691,063	\$ 16,553,223	\$ 32,089,545

Identifying sufficient funding to comply with storm water regulations and mandates remains a major issue facing the City, and is discussed later in this report in the “Future Financial Challenges” section.

Other Items of Interest not Included in the Outlook

Our Office also considered other expenditures that are not funded in the Outlook and that may be of interest to the community or to the City Council based upon prior year budget discussions. **The**

purpose of raising these items is not to advocate for their funding, but to note that there has been interest in these items in prior years and to offer a reminder that if no new resources are identified, any increased allocations to these items will most likely need to be offset with expenditure reductions elsewhere. A brief description of each of these items is listed in the following table.

Program/Department	Description
Commission for Arts & Culture – arts, culture, and community festivals funding	<ul style="list-style-type: none"> • \$10.4 million in annual allocated funding in the Outlook reflects the removal of the \$4.3 million in one-time resources allocated by Council for FY 2018. • The \$10.4 million falls short of the arts and culture funding goal of 9.52% of annual projected TOT revenue adopted by the City Council in FY 2013.
Environmental Services – pilot abatement program	<ul style="list-style-type: none"> • In the FY 2018 Adopted Budget, the City allocated \$800,000 in one-time funding to a pilot program for additional abatement services to nine areas within the City. • No additional funding has been allocated to the program within the Outlook period.
Park & Recreation – expanded recreation center hours	<ul style="list-style-type: none"> • The FY 2016-2020 Outlook included a plan for phased implementation of increased staffing and hours at all City recreation centers over four years. • Currently, 44 of the City’s 58 recreation/visitor centers are operational 60 hours per week. • The FY 2019-2023 Outlook does not continue to fund or discuss expanded operational hours at the remaining recreation centers, as in prior Outlooks.
Real Estate Assets Department – CCP reconfiguration	<ul style="list-style-type: none"> • When the City entered into a lease-to-purchase agreement for Civic Center Plaza in 2015, it anticipated reconfiguring floors to make more efficient use of space. • Reconfiguration was planned to occur from FY 2021 through FY 2025. • No funding has been allocated for CCP reconfiguration in the Outlook.
Transportation & Storm Water – graffiti abatement	<ul style="list-style-type: none"> • In FY 2017, TSW added 5.00 FTEs to address the need for graffiti abatement efforts and to address all graffiti abatement requests within a five day average timeframe, as recommended by the City Auditor. The current average abatement time is eight days. • To improve abatement time to the five days, 4.00 new FTE positions and \$1.5 million in associated equipment and personnel costs is expected to be needed; this amount is not included in the Outlook

Program/Department	Description
Transportation & Storm Water – tree planting and trimming	<ul style="list-style-type: none"> • TSW requests for the Outlook included \$300,000 in ongoing annual expenses for tree planting that was included in the FY 2018 Adopted Budget as a one-time expense to support the City’s Climate Action Plan. • The FY 2018 Adopted Budget included one-time support of approximately \$882,000 for tree trimming in the City rights-of-way. This funding was removed from the Outlook’s Baseline, and no additional funding for tree planting is included in the Outlook.

POTENTIAL RESOURCES AND MITIGATION ACTIONS

The Outlook discusses three possible actions to help address the Baseline deficit identified in FY 2019, but makes no recommendations for mitigation at this time. In the following sections our Office discusses the mitigating actions identified in the Outlook: budget reductions of 2% for all General Fund departments and for funds with a General Fund impact, the use of reserves in excess of policy targets, and the use of Excess Equity. We also discuss additional mitigating actions that could be considered for addressing the projected FY 2019 deficit: an alternate replenishment plan for the Pension Payment Stabilization Reserve, and a one-year suspension of the Infrastructure Fund. Additionally, Attachment 6 includes a discussion of new State legislation that, although it is not anticipated to affect General Fund projections in the Outlook at this time, may be a potential resource to the City in the future.

The following table displays projected resources associated with each action, including a potential total \$69.2 million in one-time (\$55.2 million), and ongoing (\$14.0 million), resources in FY 2019. Excess Equity and excess Risk Management Reserve amounts included in the table represent current year-end projections; however, the discussion of these items in the following sections anticipates that the amount available as a mitigating resource for FY 2019 will be reduced from these current year-end projections.

Potential Resources (\$ in millions)

Resource	One-time /Ongoing	FY 2019 Projection	Total Over the Outlook Period
Department Budget Reductions ¹	Ongoing	\$14.0	\$70.0
Excess Equity ²	One-time	17.9	17.9
Excess Risk Management Reserves	One-time	17.0	17.0
Pension Payment Stabilization Reserve Contribution	One-time	3.5	18.6
Infrastructure Fund Contribution	One-time	16.9	74.4
Total Potential Resources		\$69.2	\$197.9

Note: Table may not total due to rounding.

¹The Mayor's request to City departments was for reductions equal to 2% of their budgets, resulting in approximately \$28.0 million in budget reductions. However, not all budget reductions submissions will necessarily be implemented. A request for department reductions was also sent to departments for the FY 2018 Budget. Out of an estimated potential \$45 million in savings, a reduction of \$18.4 million, or 41%, was included in the FY 2018 Adopted Budget. In this table we include an estimate of 50% acceptance in budget reduction submissions.

²As of the First Quarter Report, Excess Equity is projected to be \$17.9 million. A revised estimate for Excess Equity will be provided in the FY 2018 Mid-Year Budget Monitoring Report expected to be released in January.

Budget Reductions of 2%

On November 8, 2017 the Chief Operating Officer (COO) released a memorandum directing departments to submit 2% budget reduction proposals as part of the FY 2019 budget process, and noted that any reductions submitted should be available for immediate implementation in FY 2018, or by the start of FY 2019. Estimated FY 2019 expenditure savings associated with 2% budget reductions is approximately \$28.0 million, although it is likely that not all department reductions submitted will be accepted and implemented due to potential operational impacts.

We would also note that guidelines in the COO's 2% reduction memorandum stated that **departments must "[c]onsider delaying or suspending the implementation of services or programs added or expanded in Fiscal Year 2018 or previous fiscal years"** and also focus on non-core services. We would note that delays in hiring of positions or in the implementation of FY 2018 budget actions, could impact important service areas.

Excess Equity

The General Fund (GF) Reserve requirement and Excess Equity are discussed in Attachment 7 to this report. Attachment 7 notes that the First Quarter Report estimates Excess Equity will be \$17.9 million at year end. However, this does not include FY 2018 estimated expenditures for Hepatitis A that may cause FY 2018 actual expenditures to exceed the FY 2018 Adopted Budget. Projected GF expenditures will be further vetted when the FY 2018 Mid-Year Budget Monitoring Report (Mid-Year Report) is released (scheduled for January 29, 2018).

When the FY 2018 Excess Equity estimate is updated as part of the Mid-Year Report, the Mayor may propose budgeting a portion of Excess Equity for additional one-time expenditures (up to the projected year-end surplus amount for FY 2018); and the City Council may subsequently modify

the proposal, if desired. Projected year-end Excess Equity will be subsequently monitored, and funds anticipated to be available may be budgeted for one-time FY 2019 expenditures.

Risk Management Reserves in Excess of Policy Targets

The following paragraphs discuss some alternatives related to reserve funds which may be available for budget deficit mitigation. Further background and expenditure information related to the GF and Risk Management Reserves (which include the Public Liability, Workers' Compensation, and Long-Term Disability Reserves), is included in Attachment 7 of this report.

Excess Public Liability Reserve

The Public Liability (PL) section in Attachment 7 describes how there is an estimated excess PL Reserve of \$4.1 million for FY 2018 and discusses expenditure estimates for the Outlook years. Although the estimated FY 2018 excess Reserve is \$4.1 million, the Reserve target level for FY 2019 increases from 47% to 50%,⁵ leaving only \$2.0 million in estimated excess Reserve for FY 2019. To mitigate the FY 2019 deficit, it may be reasonable to consider use of the estimated FY 2019 excess PL Reserve of \$2.0 million for one-time needs.

Excess Workers' Compensation Reserve

The Workers' Compensation (WC) section in Attachment 7 also reviews expenditure estimates for the Outlook years and identifies an estimated excess WC Reserve of \$7.0 million for FY 2018. (The GF portion of the excess Reserve would be approximately \$5.7 million.) However, the Outlook shows that this excess WC Reserve will be used as rate relief through FY 2020; and therefore, such excess Reserve is anticipated to be depleted by FY 2020. Since the City is facing projected deficits through FY 2021, utilizing the WC excess Reserve may be the least desirable option with respect to Risk Management excess Reserves.

Excess Long-Term Disability Reserve

The Long-Term Disability (LTD) section in Attachment 7 also describes how there is an estimated excess LTD Reserve for FY 2018. This estimated FY 2018 excess Reserve is \$10.3 million, approximately \$7.2 million of which is the GF portion. The City could consider using excess LTD Reserve funds for one-time needs. However, the City is currently negotiating with its recognized employee organizations regarding a death and disability benefit for employees who were hired on or after July 20, 2012, and, per the parameters of Proposition B (passed by the voters in June 2012), are not eligible for the defined benefit pension. Excess LTD Reserve amounts have been anticipated to be used as a funding source for the new death and disability benefit.

Although negotiations for the new death and disability benefit have not concluded, and the City's cost to fund the benefit is uncertain, there may be interest in utilizing all or a portion of the LTD excess Reserve for one-time needs in FY 2019. One suggestion would be to use a portion of the FY 2018 excess Reserve, e.g. \$6.5 million (\$4.5 million GF).

⁵ The \$34.7 million target amount assumes no change to the three-year average of outstanding liabilities when the FY 2018 actuarial liability amount becomes known.

Pension Payment Stabilization Reserve

The purpose of the Pension Payment Stabilization Reserve (PPSR) is to have a source of funds available “to mitigate service delivery risk due to increases in the annual pension payment, the Actuarially Determined Contribution (ADC).” The PPSR was incorporated into the City’s Reserve Policy in April 2016.⁶

The \$16.0 million GF portion of the PPSR was funded in FY 2016, and was fully employed in the FY 2018 Adopted Budget as a resource to mitigate the ADC increase. For historical context, the FY 2018 GF portion of the ADC increased by \$45.2 million, two-thirds of which was primarily related to mortality assumption changes. (For further discussion on the ADC and anticipated future changes to it, refer to Attachment 2, “General Fund Baseline Expenditures” under “Fringe Benefits.”)

Within a year of (full or partial) depletion of the PPSR, the Mayor is required, per the City Reserve Policy, to prepare a plan for its replenishment. This plan has been presented in the Outlook, and includes \$3.5 million to \$3.9 million in contributions to the PPSR in each of the five years of the Outlook. Since the City is facing near-term deficits and the ADCs included for each of the upcoming Outlook years are projected to remain at the heightened level that occurred in FY 2018, the City may want to consider an alternative replenishment plan, beginning after FY 2019.

Charter Section 77.1 (Proposition H) – Infrastructure Fund

The Outlook projects a total of \$74.4 million to be allocated to the Infrastructure Fund from FY 2018 through FY 2022. The Infrastructure Fund is not projected to require any deposits in FY 2023 because the portion of the allocation formula that is generating deposit requirements (50% of year-over-year growth in major General Fund revenue sources besides sales tax), expires at the end of FY 2022. The Outlook does not designate uses for the Infrastructure Fund, but the Mayor will do so for FY 2019 in the Proposed Budget.

Infrastructure Fund (\$ in millions)

FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
\$16.9	\$17.7	\$20.7	\$19.2	-

Eligible expenditures for the Infrastructure Fund include: acquisition of real property, construction, reconstruction, rehabilitation, and repair and maintenance of General Fund infrastructure, including all associated financing costs. Proposition H also included a provision that allows a one-year suspension of the requirement to allocate General Fund revenue growth to the Infrastructure Fund upon a two-thirds vote of the City Council. Suspending the measure would allow the revenue to flow to the General Fund for other City priorities.

It is important to note that the City will receive additional funds from a new gas tax that went into effect November 1, 2017 (SB 1). The FY 2018 Adopted Budget allocated \$9.6 million in projected SB 1 revenues for slurry seal maintenance for streets, which reflects a partial year of funding. The first full year of SB 1 revenues will occur in FY 2019, with the latest estimate being \$23.6 million.

⁶ The City’s Reserve Policy is Council Policy 100-20 (last updated November 2017).

If the Infrastructure Fund is not suspended, these additional funds will likely allow the Infrastructure Fund to support other projects associated with General Fund assets in place of slurry seal maintenance, which is being programmed for the current fiscal year.⁷ Finally, it should be noted that an initiative may be placed on the state-wide November 2018 ballot to repeal SB1.

FUTURE FINANCIAL CHALLENGES

In this report we have reviewed the revenues and expenditures projected in the Outlook, as well as discussed other funding needs projected to occur during the Outlook's five years, reviewed select expenditure requests submitted by departments, provided a brief overview of other expenditures that may be of interest to the City Council or the community, and considered mitigation strategies. In addition to this review and analysis, the sections below include an overview of potential future or ongoing challenges facing the City, which could require additional resources during the Outlook period.

Homelessness

The County's most recent Point-in-Time-Count (PITC)⁸ found that county-wide there were 9,116 individuals experiencing homelessness in the early morning hours of January 27, 2017. In the City of San Diego, a total of 5,619 individuals were counted—2,388 sheltered, and 3,231 unsheltered—which represents an 18% increase in the number of unsheltered homeless individuals, and a 64% increase in the number of tents and hand built structures from the previous PITC. This year, the Mayor and City Council have increased collaboration with partners including the San Diego Housing Commission (Housing Commission), County of San Diego, Regional Task Force for the Homeless, service providers, and private individuals to address the growing needs of this population; however, given the magnitude of the problem, we believe this issue will continue to require major resources.

Due to the emergency nature of much of this work at the City, we still do not have a complete picture of the costs related to homelessness (for both the current year, discussed in IBA Report 17-40, and for the Outlook period). We expect to learn more with the release of the Mid-Year Report and during the FY 2019 budget process, as we get a better idea of the costs and types of services that may be provided by the City. If the City expands homeless services, it will likely need to leverage additional federal, State, and local resources. Public-private partnerships, like that utilized for the Temporary Bridge Shelter Programs, could also be useful.

This year's Outlook identifies one item related to homelessness⁹—expansion of the Safe Parking Program—as a critical strategic expenditure. Given strong interest from the City Council and Mayor to help address the homelessness crisis, we note that additional services that have been and will likely require use of local funding sources, which could include the General Fund. For

⁷ The FY 2018 Adopted Budget allocates \$6.4 million out of the \$17.8 million Infrastructure Fund appropriation for slurry seal maintenance.

⁸ The 2017 *We All Count Annual Report* is available at: <http://www.rtfhsd.org/wp-content/uploads/2017/07/comp-report-final.pdf>

⁹ Not including work related to the Hepatitis A outbreak, which has disproportionately impacted the homeless community.

illustrative purposes, we highlight two items below—one that has already been approved, and one that is in development—that could have impacts on the General Fund in the Outlook period.

Temporary Bridge Shelters. As we noted in IBA Report 17-38, there are a number of costs that the City will cover per its Memorandum of Understanding (MOU) with the Housing Commission. These include ongoing obligations and post-operations costs that could occur in FY 2019 and FY 2020. Additionally, funding for the first seven months of operations was identified in FY 2018, but funding for services that could be provided in FY 2019 and the first half of FY 2020 has not. If the program agreements are extended, and if alternative funding sources are not identified, City General Funds may be needed to fulfill the obligations of the agreements.

Also of note, the Temporary Bridge Shelter Program that will be run by Father Joe’s Villages (FJV) that will house families experiencing homelessness, is expected to close earlier¹⁰ than the other two sites because the location is being developed for Permanent Supportive Housing. If the City would like to continue providing services for these families once the FJV program ends, additional funding may be needed to relocate the temporary structure to another location or to provide alternative housing opportunities.

Housing Navigation Center. On September 21, 2017, the Housing Commission released a Request for Proposals (RFP) on behalf of the City for a Housing Navigation Center (Center). The Center is envisioned to be an entry point to the Coordinated Entry System (CES), which could connect individuals experiencing homelessness with a range of services, as well as bridge housing. Preliminary estimates include the use of \$17.8 million over the Outlook period for the construction or renovation of a site, and for operations of the Center, projected as follows:

- \$15.0 million from the Community Development Block Grant (CDBG) Program;
- \$1.5 million from the General Fund; and
- \$1.3 million from the Low and Moderate Income Housing Fund.

If the City proceeds with a Housing Navigation Center, and alternative funding sources are not secured, there could be a General Fund impact of approximately \$300,000 in each year over the Outlook period.

Implementation of the Climate Action Plan

On December 15, 2015, the City Council adopted the Climate Action Plan (CAP) for the City of San Diego. The CAP is an organized plan of actions to be implemented by the City, regional, State, and federal agencies to achieve the targeted Greenhouse Gas (GHG) emission levels established by the State of California. The CAP has set target GHG emission reductions levels of 15% from 2010 levels (Base Year for comparison) by 2020, 40% by 2030, and 50% by 2035. The earliest of these target dates falls within the Outlook Period.

While the City has allocated \$128.4 million in FY 2017 and \$128.1 million in FY 2018 for CAP related projects, the City will need to continue to fiscally plan for future implementation of CAP

¹⁰ According to the revised contracts with the three service providers (available here: file:///C:/Users/ttacke/Downloads/SDHC.Memo%20to%20City%20Council_11.13.17.Final.pdf), if all options to extend were exercised, the FJV program would run through November 30, 2018, and the Alpha Project and Veterans Village of San Diego programs would run through December 31, 2019.

projects. Per the 2017 CAP annual progress report, which provides an update on projected GHG emission levels, the City is currently ahead of schedule in reaching the emission reduction targets for 2020.

The City will need to continue to monitor the progress in achieving the GHG target reductions and the need for additional resources as the City Attorney's Office has opined that "[t]he GHG emission reductions targets in the CAP are legally binding to the extent required by the California Environmental Quality Act (CEQA) mitigation measure for the 2008 City of San Diego General Plan, which is enforceable pursuant to CEQA."

Infrastructure - Growing General Fund Asset Needs

Last year's Capital Outlook identified a \$1.27 billion funding gap over fiscal years 2018 through 2022, associated entirely with asset types that rely upon General Fund support such as fire stations, police facilities, Americans with Disabilities Act projects, streets, bike facilities, street lights, storm water, and sidewalks. However, our Office notes that the gap is likely larger as the needs for General Fund facilities only reflected the work that staff has the capacity to complete, not total needs.

Since the last Capital Outlook, the following activities have been completed and result in an increase to the City's General Fund capital needs:

- A condition assessment of leased City buildings that are supported by the General Fund identified a necessary reinvestment of \$426.0 million to restore buildings to a good condition, as defined by a facility condition index. This is a point-in-time estimate and if left unaddressed, increases over time. This estimate also does not include costs to make necessary upgrades or expansions to facilities.¹¹
- A portion of the City's developed parks were assessed to determine the condition of their amenities (e.g. playgrounds and playing fields) and an estimated \$24.8 million was determined as necessary to bring the amenities to good condition, as defined by a park condition index. This estimate is also limited in the same way as leased facilities above. Additional parks were assessed in FY 2017 (with results pending), and more continue to be assessed in the current fiscal year.
- The Public Works Department has solicited input from Community Planning Groups to gather community capital needs in preparation for the next Five-Year Capital Infrastructure Planning Outlook. Many of the needs received are assets that are supported by the General Fund.

Potential Increases in Actuarially Determined Contributions (ADC)

Because of the complexity of the pension system variables, the total of *all* impacts to the ADC will not be known until the FY 2017 valuation has been completed. The City recently received an update to the estimated ADC impacts from the newly approved POA agreement (which begins with the FY 2020 ADC). The estimated additional impacts that are not included in the Outlook are around \$6.0 million for FY 2020-2021, increasing to \$8.0 million in FY 2023. Assumptions in

¹¹The Public Works Department is developing a facilities asset management plan which is expected to include existing condition assessment data and future operating needs to identify optimal maintenance and capital investment strategies.

these increased pension payment estimates include the addition of 225 Police Officers from FY 2019 to FY 2021. It is unknown at this time whether this will occur as anticipated.

Additionally, we learned that there may be potential increases to the FY 2019 ADC and future ADC projections from experience losses related to demographic assumptions (e.g. wage growth, mortality, retirements). Mitigating such potential increases, the actual FY 2017 investment return came in higher than the 12% preliminary estimate, at 13.5%.

The FY 2017 valuation, which will incorporate not only the final FY 2017 investment results but all FY 2017 experience gains and losses, is anticipated to be available in January 2018. This valuation will determine the FY 2019 ADC, and is anticipated to include updated ADC estimates for FY 2020-2023. Lastly, we would note that many investment consultants believe a market correction is possible in the next five years. In such a case, if investment earnings are lower than assumed in the actuarial valuation, future ADCs could be further increased.

Storm Water

As we noted in our review of department requests not included in the Outlook, the City faces upcoming deadlines associated with storm water permit requirements and mandates, with costs through FY 2040 estimated at \$3.1 billion. Over the course of the Outlook, storm water needs without identified funding sources total \$98.2 million in operating costs and \$383.6 million in capital costs, as shown below:

Additional Storm Water Funding Needs

	FY 2019	FY 2020	FY2021	FY 2022	FY 2023
Operations and Maintenance	\$ 13,319,859	\$ 17,565,462	\$ 18,691,063	\$ 16,553,223	\$ 32,089,545
Capital Projects	\$ 85,087,844	\$ 84,950,697	\$ 67,749,083	\$ 89,524,711	\$ 56,250,000
Total Additional Need	\$ 98,407,703	\$ 102,516,159	\$ 86,440,146	\$ 106,077,934	\$ 88,339,545

While future deferred capital bonds and commercial paper issuances may support some of the capital costs noted above, they will not be sufficient to meet all storm water capital costs and other City CIP needs, and they cannot be used to fund operating costs. The City continues to lack a dedicated funding source that provides revenues sufficient to address all storm water permit and mandate needs.

The City does have a Storm Drain Fee that is paid by water and sewer users. That fee collects 95 cents per month from single family residences and \$0.0647 per hundred cubic feet of water use from multi-family and commercial water customers. In total, that fee brings in approximately \$5.7 million per year.¹²

The Storm Drain Fee rates have remained unchanged since the passage and implementation of California Proposition 218 in 1996. Proposition 218 allowed local governments to adjust water, sewer, and trash fees through a vote of the local legislative body (in the City of San Diego, this body is the City Council), but required other fee increases to be put to a public vote. This had the effect of making any increase in the storm drain fee subject to a two-thirds vote of City voters in a

¹² San Diego's storm drain fee is low compared to other coastal cities; Los Angeles' corresponding fee is \$1.92 per month, Monterey's is \$5.44 per month, and Santa Monica's is \$10.00 per month.

city-wide election, or a majority vote of City property owners in a mail-out election. As the City became subject to increasingly stringent storm water quality mandates and permits, Proposition 218 constrained its ability to adjust its Storm Drain Fee to compensate for those increased costs.

Earlier this year, the California Legislature passed SB 231, which clarifies that per Proposition 218, storm drains and storm water systems should be included under the overall definition of sewers, and thereby allows local governing bodies to adjust storm water and storm drain fees without putting the issue to a public vote.

The Council may wish to consider requesting additional information or a proposal on adjusting the City's Storm Drain Fee to help fund storm water permit requirements. An increase of \$1.00 per parcel per month would generate an additional \$6 million per year, and an increase in the fee from \$0.95 to \$5.00 per parcel per month would generate an additional \$24.3 million per year to fund storm water needs.

CONCLUSION

This year's Outlook identifies structural shortfalls in the first three years of the Outlook period after considering projected Baseline revenues and expenditures and the addition of the Mayor's critical strategic expenditures. The Outlook also includes a number of mitigation actions; however, no specific budget balancing proposal is offered by the Mayor. Our review of the Outlook discusses potential mitigations, as well as budget priorities for Council consideration, including a selection of budget additions requested by City departments as displayed in the following table. While we are not advocating for the funding of these or other department requests, we raise them in this report to acknowledge that should these or other funding additions be included in future budgets, new resources or additional off-setting reductions will need to be considered.

Projected and Potential Expenditures in the FY 2019-FY 2023 Outlook Period

General Fund		FY 2019	Total Outlook Period ¹
Baseline Revenues		\$ 1,434,313,822	\$ 7,743,295,804
Baseline Expenditures		1,431,925,069	7,539,265,426
Outlook Baseline Surplus/(Deficit)		\$ 2,388,754	\$ 204,030,378
Mayor's Critical Strategic Expenditures (Net Total)		12,471,192	203,553,877
Net Surplus/(Deficit)		\$ (10,082,438)	\$ 476,501
Selected Department Five-Year Requests not Included in the Outlook			
Environmental Services	Code Enforcement - CAP/Zero Waste	\$ 313,924	\$ 1,597,512
Fire-Rescue	Operations Funding for New Fire Stations (Fairmount and Paradise Hills)	-	12,978,532
Information Technology	PC Replacement	656,700	2,566,700
	Run the Business projects - OneSD	1,178,935	7,621,468
	Run the Business projects - IT Fund	389,880	1,187,500
Infrastructure Asset Management	IAM Support for Several Departments	883,027	4,478,199
Library	Janitorial Services for the Central Library	129,744	688,829
	Security Services	287,602	1,526,918
Performance & Analytics	Get it Done - Phase II	-	1,025,000
Personnel	Additional Staff Support	902,002	4,603,394
Planning	Climate Adaptation Plan	310,000	500,000
Police	Sworn and Civilian Positions	-	36,983,647
	Motorola Radio Replacement	1,729,221	8,646,105
Purchasing & Contracting	Animal Services Contract	147,318	753,370
Transportation Storm Water	Storm Water Permit Compliance Projects	13,319,859	98,219,152
Total Selected Department Five-Year Requests not Included in the Outlook		20,248,212	183,376,325
Net Surplus/(Deficit)		\$ (30,330,650)	\$ (182,899,824)

The information provided in the Outlook, as well as in our review of the Outlook, allows the Council to begin identifying their top budget priorities and develop a strategy for achieving a balanced budget in FY 2019. In February the Council will adopt its City Council Budget Priorities Resolution which will provide early input for the Mayor's consideration regarding prioritization of various expenditures as well as mitigation strategies for ensuring a balanced budget.



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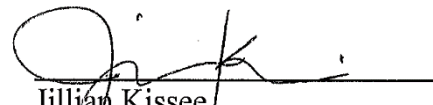
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- Attachments:
1. General Fund Baseline Revenues
 2. General Fund Baseline Expenditures
 3. Review of a Selection of the Mayor's Critical Strategic Expenditures
 4. New Facilities
 5. Department Capital Requests not Included in the Outlook
 6. New State Legislation
 7. Reserve Contributions