THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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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.

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

[2]As 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.

[3]FY 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 Response[2]	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**

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

[2]Since 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	FTE[1]	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**

[1] Projected 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**

[1]If 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 1, 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 lead 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

<u>Additional Police Sworn and Civilian Positions</u>
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.

<u>Motorola Radio Replacement</u>
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	• $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	• 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	• 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	• 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	• 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	• 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.

[1]The 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.

[2]As 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 homelessness[9]—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 earlier[10] 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

[11]The 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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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

Baseline General Fund Revenues – Major General Fund Revenues and Cannabis Business Tax

The Outlook projects major General Fund revenue growth in each of the next five fiscal years, although the rate of growth slows over time. Generally, our Office agrees with the slowing growth projections, although we note that projections for some revenues in fiscal years 2021-2023 are substantially higher than in previous years. We also generally consider the Baseline revenue growth rates projected in the Outlook to be reasonable, although in some cases we provide alternate "low" growth scenarios. Finally, we note that the Outlook speaks to the possibility of a recession during the Outlook time period, but stops short of predicting when one might occur, or what affect a recession would have on major General Fund revenues.

The sections below provide additional information about major General Fund revenues, as well as a review of cannabis business tax projections.

Property Tax

The Outlook includes the property tax year-end projection of approximately $539.3 million included in the FY 2018 First Quarter Budget Monitoring Report (First Quarter Report) as the basis for its five-year Baseline projections. A number of current assumptions are included in the Baseline calculation, including:

- Recent, continuing positive growth in year-over-year home prices
- Declines in notices of default and foreclosures
- An increase in the Case-Shiller home price index (July 2017 over August 2016)

While the Outlook assumes increased growth in property tax over the next five-years based on increasing valuation, the amount of growth in each year is reduced from a high of 6% in FY 2018 to a low of 4.25% in FY 2023, reflecting a decrease in the number of properties sold as property values climb. Our Office agrees with the growth rate included in the Outlook's Baseline projection. We also note that while growth continues to slow in the outer years of the Outlook, the lower growth rates forecast for FY 2023 are still higher than any projected in the last four years of *last* year's Outlook.

The Outlook's "high" scenario includes higher, but still slowing, growth in property tax, while the "low" scenario assumes an increase in mortgage rates that slows the number of home sales and growth in the median home price, as well as a reduction in the number of home values reassessed in FY 2019. In addition to these assumptions in the "low" scenario, our Office also notes the possibility of a federal tax reform package that includes changes to mortgage interest deductions, which may increase the rate at which property tax growth slows. Given these factors, we consider the property tax scenario analysis in the Outlook to be reasonable.

The Outlook also includes a projection for property transfer tax which is determined by the volume and price of property sales. The Outlook notes a slowing in property transfer tax growth from a high of 6% in FY 2018 to a low of 3% in fiscal years 2021 through 2023. This slowing reflects a projected reduction in the number of property sales and the tempering of property values throughout the Outlook period that our Office believes is reasonable.

Sales Tax

The Outlook projects that sales tax revenue will grow by 3% in FY 2019, 2.8% in FY 2020, 2.7% in FYs 2021 and 2022, and 2.6% in FY 2023. While these growth rates are higher than those that were included in last year's FY 2018-2022 Five Year Outlook, and are higher than the 2.5% growth rate included in the FY 2018 Adopted Budget, they are the same growth rates that are projected by Muniservices, the City's sales tax consultant, and we believe that they are appropriate for the forecasting purposes of the Outlook.

Growth in sales tax revenue is based on overall consumer spending, and is highly sensitive to consumer confidence and unemployment rates. San Diego's current unemployment rate is 4.5%, which is largely unchanged from 2016, and is consistent with the historical average unemployment rate for the region. Consumer confidence as measured by the Consumer Confidence Index (CCI) is currently measured at 119.8, which is near the record high of March 2017 and is an over 20% increase from 2016. The CCI had remained largely flat from January 2015 through January 2017, but has grown rapidly since then.

The Outlook does include two additional scenarios for higher and lower sales tax receipts. The Outlook's "high" scenario increases the FY 2018 growth rate from the 2.5% in the Adopted Budget to 3%, and the growth rates in FYs 2019-2023 by 0.1% (i.e. from 3% to 3.1%, 2.8% to 2.9%, etc.). Given that the economic conditions on which the Outlook's forecast are based, this scenario which shows small additional growth over the Outlook's forecast rates is appropriate – economic conditions are already good or near all-time highs.

The Outlook's "low" scenario decreases the FY 2018 growth rate from the 2.5% in the Adopted Budget to 0.0% (i.e. no growth over FY 2017), and decreases the growth rates in FYs 2019-2023 by 0.1% (i.e. from 3% to 2.9%, 2.9% to 2.8%, etc). It is worth noting that these lower rates would still be a significant increase over the rates that were assumed in last year's FY 2018-2022 Outlook; if overall economic activity or economic growth slows, actual receipts may come in below the amounts included in the Outlook's "low" scenario.

The Outlook does not contain any scenarios regarding a future recession or economic contraction. If a recession were to occur during the next five years, sales tax receipts would likely decrease further.

Transient Occupancy Tax

The Baseline TOT projection included in the Outlook assumes a 5.9% growth rate in FY 2018 that nominally declines to 5.3% growth in FY 2023. This decline is based upon an assumption of a softening of growth in overnight visitors, room supply, and room demand over the Outlook period, and is forecast based upon San Diego Tourism Authority (SDTA) data. Our Office notes that growth rates over the Outlook period remain higher than those projected last year which saw growth fall below 5% in fiscal years 2021 and 2022.

The Outlook's "high" growth scenario increases TOT growth to 7.7% in FY 2018, above the currently projected 5.9%, and is based upon the assumption of sustaining the strong growth in TOT that the City has experienced over the last three years. Conversely, the "low" TOT scenario is reduced dramatically from the prior year to reflect growth of 3.1% in FY 2018 that increases slightly to 3.3% in FY 2019 and falls to 3.1% again in FY 2023. These reduced rates are based on averages of reduced or negative TOT growth in prior years that included the last recession.

While our Office agrees that a recession remains a potential risk to the Outlook, the "low" scenario for other major General Fund revenues excluded a future recession as an event that was not predictable at this time. Last year's Outlook included a "low" scenario also based on prior year reduced or negative TOT growth but that excluded the last recession and reduced the Baseline by 0.4% per year. Using those criteria, a "low" scenario that excludes the last recession and is updated to include current Baseline growth rate projections is displayed in the following table.

TOT Five-Year Forecast: Low Growth Rate Scenario

	FY 2018 Projection	FY 2019 Forecast	FY 2020 Forecast	FY 2021 Forecast	FY 2022 Forecast	FY 2023 Forecast
Outlook Baseline Growth Rate	5.9%	5.9%	5.8%	5.6%	5.5%	5.3%
Low Scenario Growth Rate	5.5%	5.5%	5.4%	5.2%	5.1%	4.9%

Our Office notes that the Outlook's TOT Baseline assumptions are reasonable, based upon current known factors. We also note that ballot measures linking TOT increases to funding for specific projects have been proposed for previous local elections, and raise the potential that similar measures may be proposed for the November 2018 ballot which, if passed, may have an effect on the Outlook's TOT growth projections.

Franchise Fees

Franchise fees in the Five-Year Outlook consist mainly of payments from San Diego Gas and Electric (SDG&E), cable providers, and refuse haulers. Overall, the total of combined franchise fees are expected to increase slightly each year of the Outlook. Individual rates are discussed in detail below.

<u>Cable Franchise Fees</u>
Cable franchise fees currently constitute 22% of all General Fund franchise fees received by the City. The Outlook assumes no growth in cable franchise fees in each of its five years.

Cable franchise fee revenue has held relatively flat over the last several years. Annual cable franchise fee revenue declined slightly from FY 2011 through FY 2014. Cable revenue did grow slightly in FY 2015, but it again declined slightly in FYs 2016 and FY 2017. Current FY 2018 projections show an increase of 3.2% or $510,000 over the Adopted Budget.

While we believe a flat growth rate is appropriate for the purposes of the Outlook, we also note that cable franchise fee revenue is sensitive to overall consumer cable package subscriptions. An increasing proportion of cable customers dropping their subscriptions could lead to declines in overall cable franchise fee revenue.

SDG&E Franchise Fees

Franchise fees paid by SDG&E currently represent 59% of the total franchise fees received by the City. Projected revenue increases for SDG&E franchise fees are 2% for each year of the Outlook. This is based on energy cost forecasts provided by the US Energy Information Administration.

SDG&E franchise fee revenue is ultimately determined by erratic commodity rates and sales in the City. It is difficult to accurately predict any given year's revenue variance—in the past, these revenues have seen large single year increases (21.3% in FY 2016) and decreases (12.3% in FY 2010). While the projected growth in San Diego's population size and the consumer price index suggest likely increased demand and energy purchases, the volatility of this revenue source suggests that a conservative projected growth rate should be used, as is reflected in the Outlook.

Additional potential impacts to SDG&E Franchise Fees may exist. The City is currently investigating the feasibility of implementing a Community Choice Aggregation (CCA) program, in which the City would procure electricity and provide it to customers through SDG&E's transmission system. The impact that a CCA program might have on SDG&E franchise fees has not been examined, but it should be analyzed and considered as part of the City's research into forming a CCA.

Refuse Hauler Franchise Fees

Franchise fees paid by refuse haulers and tip fees at the Sycamore Landfill total 17% of all franchise revenues collected by the City. The Five-Year Outlook projects revenues from refuse hauler franchise fees to grow by 3% each year. Historically, growth and reductions in refuse disposal have broadly tracked overall economic conditions; forecasts by Beacon Economics and Muniservices for the San Diego region suggest a local economy that is expected to slowly grow. These indicators support the projections included in the Outlook.

Other Revenues

The Outlook includes growth projections for a number of other General Fund revenues in the following categories: Licenses and Permits including cannabis business tax; Fines, Forfeitures, and Penalties; Revenue from Money and Property; Revenue from Federal and Other Agencies; Charges for Services; Other Revenue; and Transfer In. Growth projections for these revenue categories have not changed from last year's Outlook. Our Office notes that changes to these revenue streams may be effected by a number of items including any significant increases in user fees,[1] successful applications for grant revenues, or actual receipt of the new cannabis business tax, as discussed in the following section.

[1] The Financial Management Department is scheduled to bring an update on the City's user fees to the City Council in February 2018. Any changes in user fees approved at that time will be included in the FY 2019 budget.

Other Revenues – Cannabis Business Tax Revenue

The Outlook includes projected revenue from the City's non-medical cannabis business tax (CBT), which will go into effect beginning January 1, 2018, when sales of non-medical cannabis become legal in the State of California. The Outlook includes CBT revenue of $5.5 million in FY 2019, which is roughly double the amount projected for a half-year of collections in FY 2018. The Outlook's revenue projection increases gradually each year through FY 2023, when revenue is estimated at $13.7 million.

The Outlook's CBT projection is based on sales tax data from current medical dispensaries and is limited to revenue that will be captured by permitted retail sales in the City. Growth in CBT revenue over the Outlook period is attributed to an increase in the CBT rate from 5% to 8% in FY 2020 and a moderate increase in the number of permitted retail outlets (currently capped at a total of 4 per Council District, for a total of 36 citywide). The Outlook acknowledges, and our Office agrees, that the CBT revenue projection is conservative due to the fact that it assumes no revenue from other permitted cannabis businesses such as cultivators, manufacturers, and distributors (currently capped at a total of 40 citywide). Once these other cannabis businesses open and operate legally within the City, CBT revenue will very likely be higher than assumed in the Outlook.

Despite the Outlook's conservative CBT revenue projections, we do not recommend increasing the projection until a baseline of actual revenue collections can be measured. Financial Management has indicated that it will refine its CBT revenue projection in the FY 2019 Proposed Budget upon review of the first two months of actual receipts in calendar year 2018. Our Office will continue to review CBT revenue as collections begin and throughout the FY 2019 budget development process.

Baseline General Fund Expenditures

This section highlights major General Fund (GF) Baseline expenditure changes. The following table presents the changes from the FY 2018 Adopted Budget to the FY 2019 Baseline projection. (A table with changes from FY 2018 to the FY 2023 Baseline is included in our main report.)

Increases/(Decreases) from the FY18 Adopted Budget to the FY19 Outlook Baseline Projection *($ in millions)*		
FY18 Adopted Budget		**$ 1,433.8**
Personnel-Related Expenditure Changes		**24.6**
Compensation Increases - Agreements with Employee Organizations [1]	$ 26.5	
Workers' Compensation - Operations Contributions	0.8	
Other Post-Employment Benefits (OPEB) - 2.5% Annual Increases Over the Five-Year Outlook	1.0	
Police Vacancy Savings Decrease (a salary increase)	3.0	
Fringe Benefits (other than those separately listed)	1.0	
Termination Pay (for Annual Leave)	0.8	
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	(8.9)	
Non-Personnel Expenditure Changes		**1.5**
Contracts - 3.5% Annual Growth Rate Over the Five-Year Outlook	6.0	
Energy and Utilities - Various Growth Rates (electric, fuel, water, other)	2.1	
Supplies - 5.1% Annual Growth Rate Over the Five-Year Outlook	1.5	
IT Sourcing Strategy - Help Desk, Data Center, Networks, Application Services Contracts	5.2	
Transfers to Parks Improvement Funds	1.0	
IT - 2% Annual Growth Rate Over Five Years (costs other than the sourcing strategy)	0.2	
Contracts - Other Adjustments Outside of the 3.5% Annual Growth Rate	1.2	
Removal of Library Match in FY 2019	(1.0)	
Charter Section 77.1 - Infrastructure Fund Transfers	(1.0)	
Reserve Contributions (General Fund, Public Liability, Pension, Workers' Compensation)	(15.5)	
Other Non-Personnel Expenditures	1.7	
Removal of FY18 One-Time Expenditures (see Five-Year Outlook, Attachment 2) [2]		**(28.0)**
Citywide Special Election - TOT Ballot Initiative	(5.0)	
Executive Complex Rent	(2.3)	
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)	
FY19 Outlook Baseline Projection		**$ 1,431.9**
Total Decrease: FY18 Adopted Budget to FY19 Outlook Baseline (0.1% Decrease)		**$ (1.9)**

Note: Table may not total due to rounding.

[1] Compensation increases of $40.3M 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 $54.4 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; $17.8M Infrastructure Fund transfers; $13.8M POA negotiated flexible benefits; $3.0M Police overtime; $2.1M relocation cost; 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 in the previous table, the Outlook's FY 2019 Baseline projection is decreasing by $1.9 million (or 0.1%) from the FY 2018 Adopted Budget. The largest ***decreases*** include:

- $15.5 million in net reserve contributions decreases (GF is decreasing $17.3 million to $97,000; Public Liability is decreasing $3.1 million to zero, Pension Payment Stabilization Reserve is increasing from zero to $3.5 million, and Workers' Compensation is increasing from zero to $1.4 million);
- $8.9 million for the Actuarially Determined Contribution (ADC) pension payment;
- $5.0 million for the FY 2018 budgeted Citywide Special Election;
- $4.2 million for one-time FY 2018 transfers to support the Penny for the Arts program; and
- $4.0 million for FY 2018 Police Officer recruitment and retention compensation increases.

Baseline decreases are offset with a number of expenditure ***increases***, the largest of which include:

- $26.5 million for compensation increases based on agreements with the City's recognized employee organizations;
- $6.0 million for the 3.5% annual increases in costs for contracts;
- $5.2 million for the Information Technology (IT) sourcing strategy, including Help Desk, Data Center, Networks, and Application Services contracts. These costs are based on contractual agreements with external vendors; and
- $4.0 million for bond debt service funded by the Capital Outlay Fund in FY 2018.

There are no programmatic increases included in the GF Baseline expenditures projection. More detailed components of Baseline expenditures are discussed in the following sections.

Personnel-Related Expenditures

Compensation Increases – Multi-Year Agreements With Employee Organizations

GF compensation increases from agreements with the City's employee organizations are shown in the following table. FY 2019's $26.5 million impact for these agreements includes salary increases, pension payment increases[1] related to Police Officers' salaries, and special pay increases. Offsetting decreases include those for Police Officers' flexible benefits and for Firefighters' vacation pay-in-lieu costs for accrued annual leave in excess of accrual caps.

Multi-Year Agreements with the City's Employee Organizations *($ in millions)*

GF Compensation Increase/(Decrease) Over FY18 Amounts	FY19	FY20	FY21	FY22	FY23
Salaries	$29.2	$66.5	$72.0	$72.0	$72.0
Pension Payment Increases - POA Salaries	-	6.4	15.9	15.9	15.9
Special Pays	1.8	2.0	2.0	2.0	2.0
Pay-in-Lieu - Firefighters' Annual Leave Over Accrual Caps	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Flexible Benefits	(2.5)	(13.8)	(13.8)	(13.8)	(13.8)
Total GF Compensation Increases Over FY18	**$26.5**	**$59.2**	**$74.2**	**$74.2**	**$74.2**

Note: Table may not total due to rounding.

[1] Pension payment increases refer to estimated increases to the ADC.

The multi-year agreements are further discussed on pages 27 and 28 of the Outlook. Amounts included in the Outlook's tables differ from those shown above. Our figures include, for the FY 2018 base, $13.8 million in negotiated FY 2018 flexible benefits for Police Officers with eight or more years of service. The corresponding FY 2019 amount is $11.3 million – a $2.5 million reduction for FY 2019, as shown in the line above the total in the preceding table. For the remaining Outlook years, the entire amount of such benefits has been removed and replaced with increased salaries.

Beginning in FY 2019, amounts for Firefighters' pay-in-lieu of annual leave over the accrual caps is not included in the Baseline. However, the current agreement with International Association of Firefighters, Local 145 indicates that mandatory payments over the cap will continue each fiscal year until each employee's annual leave balance is below the maximum accumulation. The FY 2018 budgeted amount for such payments was $2.1 million. Estimated payments under the current agreement with Local 145 are $1.6 million for FY 2019 and $1.4 million for FY 2020.

<u>Estimated Additional Costs Related to the Multi-Year Agreements</u>

The preceding table includes estimates for pension payment increases related to negotiated Police Officers' Association (POA) salary increases. Recently received updates to these estimates are higher, and amounts above those included in the Outlook are displayed in the first line of the following table. Note that assumptions in the 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.

In addition, the Outlook does not include the following amounts associated with other employee organizations' agreements:

- Estimates for certain special pay increases beginning in FY 2019; and
- Estimates for the difference between the 3.3% negotiated salary increases and the 3.05% assumed general salary increases included in the pension payment amount. These estimated increases do not include amounts related to the 3.3% in increased Municipal Employees' Association (MEA) general salaries above the assumed 3.05% increases, as that information is not available.

Estimated Additional GF Pension Payment Costs

($ in millions)	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Additional Costs Due to Updated Estimates - POA Salaries	$ -	$ 5.7	$ 5.9	$ 7.3	$ 8.0
Additional Amounts Related to Other Employee Organizations	-	0.2	0.9	0.9	0.9
Total	**$ -**	**$ 5.8**	**$ 6.7**	**$ 8.1**	**$ 8.8**

Note: Table may not total due to rounding.

Another estimated additional cost not included in the Outlook is associated with a holiday-related compensation increase included in the current POA agreement. Although it is not significant when compared to overall GF expenditures (which total over $1.43 billion for the FY 2019 Outlook Baseline), as a negotiated benefit we believe it is worth mentioning.

In accordance with the POA agreement, a Police Officer is currently not compensated for a holiday which falls on his or her regularly scheduled day off. The elimination of this "holiday credit on a day off" was a negotiated contract term that went into effect for FY 2014. The reason for elimination of this holiday credit is that the City and POA agreed to convert certain holiday compensation to increased flexible benefits.

With the current POA contract, the elimination of the "holiday credit on a day off" stays in effect until June 30, 2020, at which time holiday credit for days off will again be compensated. Officers will receive straight-time pay or an equal amount of compensatory time (comp time) for such holidays. During negotiations on holiday benefits, the Financial Management (FM) Department estimated the cost of the "holiday credit on a day off" to be $2.3 million. This was based on employees receiving straight time pay for the holiday.

In actuality, variations could occur. For example, an Officer could chose to receive comp time. When that comp time is utilized as a day off, there is the potential for overtime to be incurred by another Officer "backfilling" for the absent Officer. This is conceivable, considering the current difficulties in Police Officer hiring and retention, as well as increased overtime. The overtime cost for backfilling an Officer would be at a rate of time and a half, rather than straight-time pay. It is also possible that an absent Officer's shift will not need to be backfilled, resulting in no cost.

Given these considerations, the recently negotiated POA salary increases, and the fact that the $2.3 million amount was used to negotiate compensation adjustments for Police Officers, this amount is a reasonable estimate for the reinstatement of the "holiday credit on a day off." Since reinstatement would be effective on June 30, 2020, the first full year for incurring costs would be FY 2021.

Salaries and Wages

Page 26 of the Outlook discusses changes to Baseline salaries and wages (which do not include the effects of labor agreements discussed above). These baseline salaries and wages are increasing by $2.4 million from FY 2018 to FY 2019, largely due to estimated step increases and an increase for termination pay. Adjustments are also made for termination pay in the remaining years of the Outlook.

The following subsections highlight challenging salaries and wages budget areas that we have discussed in prior reports. FM has worked diligently over the last few years to enhance the financial system and financial projections in order to better address the City's needs and our changing environment. We highlight these areas for reference as we move forward in the FY 2019 budget cycle.

<u>Special Pays</u>

The $28.6 million for baseline special pays is $3.5 million less than FY 2017 actual spending. For historical context, special pay expenditures for FY 2017 totaled $32.1 million, approximately $4.0 million higher than the $28.2 million budget. The largest overages were in the Fire-Rescue and Police Departments at $1.7 million and $1.6 million, respectively. The variances are largely related to special pay that is associated with overtime. We recommend that FM examine potentially including a budget amount for such special pay expenditures.

Vacancy Savings

The Adopted Budget includes a listing of full-time equivalent (FTE) positions that are authorized to be filled; however, it does not provide funding for all authorized positions. The budget removes funding for some positions in order to account for savings that routinely occur due to turnover, leaves of absence, and when newly hired employees fill vacancies at lower salaries than budgeted. The amount of funding removed from the budget for these occurrences, known as vacancy savings, reduces overall budgeted salaries and wages.[2]

Vacancy savings is a budgeting tool used to reflect realistic hiring and turnover, and is not used to restrict hiring of authorized positions. Departments can fill unfunded positions during the year; however, departments must monitor hiring, salaries and wages expenditures, and all other expenditures to stay within their bottom line budgets.

In our review of the FY 2017 Year-End Financial Performance Report (IBA Report #17-37), we discussed that actual vacancy savings came in $15.7 million higher than the $30.4 million budgeted amount (for a total of $46.1 million). The FY 2016 actual vacancy savings had also been higher than budgeted; and as a result, FM had increased the FY 2017 vacancy savings budget by $8.9 million to get to the $30.4 million budget. We noted in our report that in the absence of hind-sight information regarding the FY 2017 hiring activity, this was a reasonable approach.

FY 2018 saw adjustments to the Police and Fire-Rescue Departments' vacancy savings; but considering recent trends and the results of FY 2017, a further increase to vacancy savings may be warranted. The FY 2018 Mid-Year Budget Monitoring Report will provide useful information on how vacancy savings appears to be trending. Below are areas affecting vacancy savings that could be considered in FY 2019 and future budget cycles:

- Continued (or new) hiring difficulties
- Anticipated budget deficits leading to an environment where hiring may be stifled[3]
- Estimated future retirement trends
- Adjustment of vacancy savings for new positions

Again, increasing budgeted vacancy savings reduces overall salary and wages expenditures. ***This potential reduction in expenditures could free up budget for other program areas.*** However, ensuring all other salaries and wages expenditures (special pays, overtime, hourly wages, vacation pay-in-lieu, termination pay) have sufficient budget levels will be important if vacancy savings is increased. In previous years, excess vacancy savings beyond the budgeted amount has offset overages in the other salaries and wages types.[4] Reducing salaries and wages by increasing

[2] Leaving the unfunded positions in the budget keeps the authorized positions transparent.

[3] On November 8, 2017 the Chief Operating Officer released a memorandum directing departments to submit 2% budget reduction proposals as part of the FY 2019 budget process, noting that any reductions submitted should be available for immediate implementation in FY 2018 or by the start of FY 2019. Guidelines in the memo indicate 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.

[4] The condition where excess vacancy savings covers over-budget amounts in other salaries and wages (or vice versa) can be a natural occurrence in a dynamic organization. For example, in a constant staffing model such as for fire

vacancy savings will leave less of a cushion for other salaries and wages overages – which could pose a difficulty if those other salaries and wages types do not have sufficient budget.

Fringe Benefits

Some of the items included in the following fringe benefits table are discussed in the paragraphs below, beginning with the pension's Actuarially Determined Contribution (ADC), followed by flexible benefits, and then the Supplemental Pension Savings Plan.

GF Fringe Benefits

($ in millions)	**FY16 Actuals**	**FY17 Actuals**	**FY18 Budget**	**FY19 Baseline**	**Change: FY18 to FY19**
Actuarially Determined Contribution (ADC)	$ 188.0	$ 185.5	$ 236.4	$ 227.5	$ (8.9)
Employee Flexible Benefits [1]	66.2	77.9	82.8	82.8	-
Other Post-Employment Benefits (OPEB)	39.8	39.0	40.9	41.9	1.0
Workers' Compensation (WC) [2]	28.3	23.2	22.4	24.6	2.3
Supplemental Pension Savings Plan (SPSP)	15.3	17.3	18.5	18.9	0.5
Other Fringe Benefits	25.5	26.1	23.6	25.9	2.2
Total GF Fringe Benefits	**$ 363.0**	**$ 369.1**	**$ 424.5**	**$ 421.6**	**$ (2.9)**

Note: Table may not total due to rounding.

[1] Excludes $13.8M and $11.3M in FY18 and FY19, respectively, for POA flexible benefits increases that are phased-out and replaced with increased salaries. These POA flexible benefits are included in the "Multi-Year Agreements With Employee Organizations" category.

[2] FY19 WC contributions include $23.2M for operating costs and $1.4M for the reserve. The $1.4M reserve contribution is otherwise included in the reserves section of the Outlook and our overall analysis.

<u>Pension Payment - ADC</u>

The ADC is the retirement payment made by the City for its defined benefit pension. The Outlook's citywide ADC estimate for FY 2019 is $312.3 million, of which $227.5 million is for the GF, a decrease of $8.9 million. The annual citywide ADC projections for the remaining years are about $319.0 million ($233.0 million GF). The Outlook's ADC forecasts are based on the most recently provided estimates from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, which incorporate a FY 2017 preliminary investment return of 12% (5% higher than the 7% previously assumed, producing an investment "experience gain").

These latest estimates also include recent Board-approved assumption changes: a discount rate reduction from 7% to 6.75% for the FY 2017 valuation and to 6.5% for subsequent years; and a revised, extended amortization of certain portions of the Unfunded Actuarial Liability (UAL). The revised amortization smooths pension payment estimates. Without the smoothing, the UAL is expected to drop significantly in FY 2029; with the smoothing, there is a more gradual drop in pension payments as a large portion of the UAL becomes fully amortized.

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suppression, overtime may be needed when the existing staffing levels are insufficient to meet required staffing levels. With increases in vacancies there may be times when more overtime is needed than was originally expected.

The combined effect of the assumption changes and incorporation of the preliminary FY 2017 investment return resulted in ADC projections that were lower than the ones provided with the June 30, 2016 actuarial valuation. This FY 2016 valuation gave us the actual FY 2018 ADC as well as out-year projections, which begin in FY 2019. A comparison of the figures from the FY 2016 valuation and the more recent estimates provided to the City is included in the following table.

Citywide ADC Projections

($ in millions)	**FY18** [1]	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
ADC Projections - FY 2016 Actuarial Valuation	$324.5	$329.3	$333.8	$337.9	$341.6	$345.2
ADC Projections - Five-Year Outlook	324.5	312.3	319.7	319.2	319.0	319.0
Difference - Citywide	**-**	**17.0**	**14.1**	**18.7**	**22.6**	**26.2**
GF Portion of the Difference	**$ -**	**$ 12.4**	**$ 10.3**	**$ 13.6**	**$ 16.5**	**$ 19.1**

Note: Table may not total due to rounding.

[1] The FY18 amount is the actual ADC, while the amounts for the remaining years in the table are projections.

Subsequent to the completion of the latest ADC projections discussed above (and as mentioned in the previous section of this attachment titled "Estimated Additional Costs Related to the Multi-Year Agreements"), the City recently received an update to the estimated ADC impacts from the newly approved POA agreement (which begin with the FY 2020 ADC). 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%.

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 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.

Employee Flexible Benefits

The following table shows historical and future estimated costs related to employees' flexible benefits—which are allotments employees can utilize for a number of benefits, including health care, dental, and vision. Increases on the line titled "Prior Years' Actuals and Current Benefit Level" are largely due to increased flexible benefits included in current and prior labor agreements. The impact of increases in budgeted positions is also a factor for those flexible benefits increases.

The impacts of future flexible benefits increases after FY 2017 are shown in the "Upcoming Increases – POA Multi-Yr. Agreement" line. For FY 2018, $13.8 million is budgeted to cover increased POA-member flexible benefits negotiated for Police Officers with eight or more years of service. The corresponding FY 2019 amount is reduced to $11.3 million. For the remaining Outlook years, these POA benefits have been removed and replaced with increased salaries. The remaining $74,000 of upcoming increases is related to the agreement with the Deputy City Attorneys Association (DCAA).

GF Flexible Benefits

($ in millions)	**FY15 Actuals**	**FY16 Actuals**	**FY17 Actuals**	**FY 18 Budget**	**FY19 Baseline**	**FY20 Baseline**[1]
Prior Years' Actuals and Current Benefit Level	$ 54.8	$ 66.2	$ 77.9	$ 82.8	$ 82.8	$ 82.8
Upcoming Increases - POA Multi-Yr. Agreement [2]	-	-	-	13.8	11.3	0.1
Total	**$ 54.8**	**$ 66.2**	**$ 77.9**	**$ 96.6**	**$ 94.1**	**$ 82.9**

Note: Table may not total due to rounding.

[1] The FY21, FY22, and FY23 Baseline projections are the same as the FY20 projection.

[2] Upcoming increases in FY19 include $74,000 for the DCAA, and $11.25 for POA. FY20 only includes the $74,000 DCAA amount.

Supplemental Pension Savings Plan (SPSP)

The SPSP line of the Outlook includes a defined contribution (DC) plan for City employees hired prior to July 1, 2009, as well as a DC plan for employees hired on or after July 20, 2012. Those employees hired after July 20, 2012, with the exception of sworn Police Officers, are no longer eligible to participate in the defined benefit (DB) pension plan. Instead they participate in SPSP-H, which was previously for hourly employees but was modified to include these new participants. Both the City and employees contribute 9.2% and 11% of eligible compensation for general members and safety members, respectively.

The only increases for SPSP-H included in the Outlook are minor, at approximately $855,000 over the five years. There are no SPSP-H increases in the Outlook for turnover that occurs during the five-year period. Such turnover will lead to an increasing number of SPSP-H members, specifically new-hires who are not eligible to participate in the DB pension plan.

With these new SPSP-H members and no related budget increase, there could be a potential SPSP-H shortfall in the vicinity of $1.0 million or more for FY 2019, depending on the extent of turnover and vacancies that occur. There could also be similar additive shortfalls for each subsequent year in the Outlook, as new SPSP-H members enter the system in the out-years.

Non-Personnel Expenditures (NPE)

The following table outlines the NPE changes from the FY 2018 Adopted Budget to the FY 2019 Baseline projection. Various components included in these changes are discussed in the following paragraphs.

Non-Personnel Expenditures (NPE)

($ in millions)	FY16 Actuals	FY17 Actuals	FY18 Budget	FY19 Baseline	Change: FY18 to FY19
Supplies	$ 32.1	$ 37.2	$ 34.7	$ 31.2	$ (3.5)
Contracts	229.3	240.3	244.6	236.9	(7.7)
Information Technology	24.2	26.5	31.8	34.5	2.7
Energy and Utilities	37.9	42.2	43.4	45.5	2.1
Other Expenditures [1]	101.8	68.9	93.9	73.8	(20.1)
Total NPE	**$ 425.3**	**$ 415.1**	**$ 448.4**	**$ 421.9**	**$ (26.5)**

Note: Table may not total due to rounding.

[1] In order to match the Outlook NPE figures, other expenditures for FY19 includes $1.4M for the WC reserve contribution that is normally expended as part of fringe benefits.

Supplies

Supplies are decreasing from the FY 2018 Adopted Budget to the FY 2019 Baseline projection by $3.5 million, largely due to the removal of $5.1 million in FY 2018 one-time expenditures (including $4.0 million for Police Officer recruitment and retention). This decrease is partially offset by a 5.1% growth rate applied to the remaining supplies expenditures budget.

Note that there were also $5.6 million in one-time supplies expenditures budgeted for FY 2017. Subtracting these from the actual FY 2017 expenditures yields $31.6 million, which is a little more than the $31.2 million FY 2019 Baseline.

Contracts

Contracts are decreasing from the FY 2018 Budget to the FY 2019 Baseline by $7.7 million due to a number of offsetting increases and decreases. The largest changes are listed below:

- $14.9 million ***decrease*** for removal of FY 2018 one-time contracts expenditures, including the special election budget of $5.0 million, $2.3 million for Executive Complex rent, $1.1 million for the Homeless Prevention & Diversion Program (SDHC), $882,000 for tree trimming services, and $800,000 for the littering and graffiti abatement pilot program;
- $6.0 million ***increase*** for the 3.5% growth rate applied to contracts.

The contracts category's 3.5% annual growth rate produces $32.8 million added to the Baseline over the five years in the Outlook ($6.0 million in FY 2019 and $26.8 million over the remaining years). The contracts spending level will be based on contracts in place and terms of those contracts, as well as the City's payment schedules. Service needs may vary from year to year, and the contracts spending category can include significant one-time expenditures. Accordingly, spending for contracts has varied over the past few years, as shown in the following table.

GF Contracts

($ in millions)	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**
Actual Expenditures	$ 165.7	$ 196.7	$ 177.9	$ 229.3	$ 240.3

Information Technology

FY 2019 Baseline information technology (IT) expenditures are increasing by $2.7 million, largely due to the $5.2 million increase for IT Sourcing Strategy costs (contracts for Help Desk, Data Center, Voice and Data Network, and IT Application Services). This increase is partially offset with $2.7 million in FY 2018 one-time IT Sourcing Strategy transition costs.

Energy and Utilities

Energy and utilities expenditures (including electrical, water, and fuel) are increasing in the FY 2019 Baseline by $2.1 million, based on various growth rates for different components, as explained in the Outlook.

Other Expenditures

Finally, the FY 2019 Baseline for other expenditures (including all reserves) is decreasing by a net $20.1 million. The largest ***decreases*** include:

- $15.5 million for reserve contributions (decreases of $17.3 million for the GF and $3.1 million for Public Liability, which are partially offset with increases of $3.5 million for the Pension Payment Stability Reserve and $1.4 million for Workers' Compensation);
- $4.2 million for one-time FY 2018 transfers to support Penny for the Arts;
- $3.0 million for one-time FY 2018 transfers to the Public Utilities Department for low flow diversion program costs;
- $1.0 million for the removal of the five-year Library Foundation donation match;
- $1.0 million for the FY 2018 one-time transfer to the Stadium Operations Fund for debt service payment; and
- $1.0 million decrease for the transfer to the Infrastructure Fund (based on revenue estimates).

These decreases are partially offset with the following expenditure ***increases***:

- $4.0 million for bond debt service funded by the Capital Outlay Fund in FY 2018;
- $1.5 million in Equipment Vehicle Financing Program (EVFP) costs – EVFP financing costs support projects such as the self-contained breathing apparatus (SCBA), IAM, and Computer Aided Dispatch (CAD); and
- $1.0 million in transfers to the Parks Improvement Funds.

Review of a Selection of the Mayor's Critical Strategic Expenditures

The Mayor's critical strategic expenditures listed in the Outlook net to approximately $12.5 million in FY 2019, and $203.6 million over the five-year period. Adding these critical expenditures to the Baseline results in deficits in the first three years of the Outlook. Additional information for a number of these critical expenditures is discussed in the sections that follow; details related to each of the Mayor's critical strategic expenditures can be found in the Outlook.

City Treasurer – Cannabis Business Tax Administration

To support the administration of the Cannabis Business Tax program, the Outlook includes the addition of 4.00 FTE positions and $1.4 million in related expenditures over the Outlook period as critical strategic expenditures. These costs are in addition to the $250,000 a year—or $1.3 million over the Outlook period—already included in the baseline. Positions added include 1.00 Accountant 4 and 1.00 Accountant 3 who will conduct audits of registered cannabis businesses, and 2.00 Administrative Aide 2 positions to help administer the program. The City Treasurer has started the process of hiring the Administrative Aide positions, and hopes to have these filled in January. Additional funding is included in the Outlook for banking fees, administrative hearing expenses, and security.

Citywide Program Expenditures – Debt Service for Planned Deferred Capital Bonds and/or Commercial Paper Borrowing

The Outlook includes approximately $27.2 million of debt service to support a $270 million borrowing plan for General Fund capital improvements over the Outlook period. The borrowing plan assumes $75 million of commercial paper notes being issued in FY 2019 and $97.5 million of bonds being issued in FY 2021 and again in FY 2023. The significant reduction in total associated debt service from prior year Outlooks is primarily explained by the changed timing of bond financings within each Outlook period.

This $270 million borrowing plan for General Fund capital improvements is the same plan that has been included in the two previous Financial Outlooks. It should be noted that borrowing has yet to commence as originally planned and borrowing timeframes continue to be pushed back as shown in the table below:

Evolution of the $270 Million Borrowing Plan in Recent Financial Outlooks

Outlook Period	FY 17-21	FY 18-22	FY 19-23
Planned Borrowing Timeframe	FY 17 - $90M FY 18 - $90M FY 19 - $90M	FY 18 - $90M FY 20 - $90M FY 21 - $90M	FY 19 - $75M FY 21 - $97.5M FY 23 - $97.5M
Total Planned Borrowing	$270M	$270M	$270M
Associated Debt Service	$56.8M	$47.2M	$27.2M

Staff indicates the delayed execution of the General Fund borrowing plan is attributable to the continued need to spend available cash from a variety of sources and the remaining proceeds from bonds issued in April 2015. While the IBA agrees it is fiscally prudent to spend available proceeds before borrowing, we remain concerned about 1) the slower than anticipated pace of spending for General Fund infrastructure and 2) the ability to assess whether or not the City is gaining or losing ground in addressing the tremendous backlog of General Fund infrastructure needs.

In recent years, the City Council has budgeted significant funds for additional personnel and recommended projects in hopes of reducing the General Fund infrastructure backlog. Without a better understanding of the progress being made on reducing the General Fund infrastructure backlog, the time required to spend available funds for needed projects, and knowledge of the most urgent infrastructure priorities, it will continue to be challenging for the City Council to make informed General Fund resource allocation decisions in a limited resource environment. General Fund infrastructure needs compete with other priority public services (public safety, park services, library services, etc.) for these limited resources. The multi-year plan for borrowing, and projected annual debt service expense, can and should be guided by a more comprehensive understanding of these factors.

Environmental Services Department (ESD) – Reduction of Tipping Fee Discount

From FY 2009 to FY 2016, all City departments received a $5 per ton disposal discount for loads delivered to the Miramar Landfill. To support the financial health and programs of the Refuse Disposal Fund, the City approved the elimination of the $5 per ton discount to City Forces over three years beginning in FY 2016.[1] The last portion of the discount was to be eliminated in FY 2018. However, to mitigate the impact to the General Fund, the final portion of the discount elimination was postponed until FY 2019 and extended through FY 2020. The Outlook includes a $1 per ton ($300,000) discount reduction in FY 2019 and FY 2020 to restore the Refuse Disposal Fund. The impact to the General Fund would be increased costs of $300,000 in FY 2019 and an additional $300,000 in FY 2020 on an ongoing basis. These actions would completely eliminate the discount to the City.

Fire-Rescue

<u>Dispatcher Staffing</u>
The Outlook includes the addition of 8.00 Fire Dispatchers and $659,000 in associated annual personnel expenditures beginning in FY 2019 as a critical strategic expenditure. Fire Dispatchers staff the Emergency Command and Data Center (ECDC) to answer 911 calls and dispatch Fire-Rescue personnel to emergencies. The ECDC currently has 43 budgeted Fire Dispatcher positions but has experienced difficulty in filling its budgeted positions. Fire-Rescue is currently aggressively hiring and training dispatchers to fill its vacant positions and has indicated that in addition to these efforts, adding 8 dispatchers in FY 2019 for a total of 51 dispatchers would enable the Department to meet its service level goals.

<u>Fire Helicopter Financing Costs</u>
On November 15, 2017, the Budget and Government Efficiency Committee approved a request from the Fire-Rescue Department to purchase a new fire helicopter (for a total of three helicopters

[1] Report to Council No. 15-067, dated June 17, 2015.

in the Fire-Rescue fleet) using the Equipment Vehicle Financing Program (EVFP) at a total financed cost of approximately $23.0 million over 10 years. The City Council is anticipated to consider this item in December 2017. If approved, the impact to the General Fund will be in the form of financing payments of $1.7 million in FY 2019 (due to a partial year) and continuing payments of $2.3 million in FY 2020 and the remaining years of the Outlook period. The Outlook includes these payments as a critical strategic expenditure. Our Office notes that, should the helicopter purchase be approved by Council, the financing payments will effectively be a mandate that must be funded during the Outlook period. We also note that, although the Outlook describes the helicopter purchase as a replacement, it is actually the acquisition of a new, third helicopter to increase the size of Fire-Rescue's air support fleet.

New Fire Stations (Operations for Fully-Funded Stations)
The Outlook's critical strategic expenditures include funding for operational expenses for three new fire stations projected to open within the Outlook period. These expenses total approximately $17.7 million over five years, including the addition of 36.00 FTEs, for the following fire stations:

- North University City Fire Station (FY 2020)
- Black Mountain Ranch Fire Station (FY 2021)
- UCSD Fire Station (FY 2022)

Financial Management has indicated that operations funding for the facilities listed above was prioritized in the Outlook because capital expenses for these stations are fully funded. Once construction of these new fire stations is complete, providing operational funding for the facilities will be a significant mandate for the City. Should the construction timeline for these facilities be slowed or delayed, operational savings could serve as a mitigation for creating a balanced budget.

Our Office notes that included in the operational expenditures for these fire stations are costs associated with the purchase of fire engines. In FY 2019 and FY 2022, $925,000 is included for the purchase of fire engines for North University Fire Station and UCSD Fire Station, respectively. These expenditures may not necessarily be borne by the General Fund if sufficient capital funding is available in the CIP budget to support the fire apparatus purchase. Alternatively, EVFP financing could significantly reduce the immediate General Fund impact of the purchase by spreading it over time.

Peak-Hour Engines, Including Fire Station Repriorization
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.

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. Further discussion of this potential change to fire station prioritization is contained in the "Critical Strategic Expenditures Included in the Outlook" section of this report.

Hepatitis A Response

In response to the Hepatitis A outbreak, the City has taken a number of actions related to sanitation, vaccination, and education. On October 9, 2017, the City Council ratified two emergency contracts: 1) for street sanitation to follow a County directive, and 2) for armed security to monitor portable restrooms deployed in response to the Hepatitis A outbreak.

The Outlook includes $699,000 a year—or $3.5 million over the Outlook period—for the continuation of sanitation services (bleaching of streets and sidewalks) as a critical strategic expenditure for the five-year period. However, since the Outlook was released, Financial Management has updated its projections for these services to approximately $1.3 million a year, or $6.5 million over the Outlook period. The revised estimates assume current service levels will continue, but if the County declares an end to the Hepatitis A emergency, this level of sanitation may no longer be needed.

Approximately $2.0 million in additional expenditures for departments to respond to Hepatitis A are also included as critical strategic expenditures for FY 2019, and are listed below:

- $960,000 for Quality of Life team staffing (Police)
- $600,000 for human waste disposal services (Transportation & Storm Water)
- $360,000 for personal protective equipment and supplies (Citywide)
- $47,000 for additional janitorial service needs (Library)

Although the outbreak is showing signs of slowing down, the County Board of Supervisors extended the declared state of emergency at its meeting on November 27. Since the emergency is still ongoing, we believe the Outlook reasonably includes costs related to street and sidewalk sanitation, and for various department expenditures related to the City's efforts. We note, however, that the expenditures included in the Outlook will likely continue to change since the City is still assessing the costs of its response efforts, and operational needs are evolving. Additional information about the financial impact of the City's Hepatitis A response for the current fiscal year should be available as part of the FY 2018 Mid-Year Budget Monitoring Report, and updated estimates for FY 2019 will come before Council during next year's budget process.

Information Technology

The Outlook includes critical strategic expenditures totaling $4.6 million over the Outlook period to support two items: 1) a contract with Motorola for the maintenance of the public safety radio system; and 2) the addition of a Program Manager position in the Information Technology (IT) Fund to oversee the City's PCI compliance program. These additions are offset by the removal of $3.4 million from the Baseline (over the Outlook period) for one-time expenses included in the FY 2018 Adopted Budget.

In February 2016 the City Council approved the execution of a five year agreement with Motorola, with a total not to exceed amount of $25 million, for the support of the City's new digital public safety radio system. The General Fund impact of this contract is expected to be $479,000 in FY 2019, and $4.3 million over the Outlook period. The Department indicates that increases each year of the Outlook period are projected because as new equipment is added to the network, additional support will be required to maintain its Key Performance Indicator goal of 99.999% availability of public safety wireless services.

The PCI Compliance Program Manager will oversee the City's efforts to protect account data (e.g. credit card information), and $298,000 is the anticipated impact of this position on the General Fund over the Outlook period.

Library Department – New/Replacement Branch Libraries

The Department anticipates opening two replacement/upgraded branch libraries (Mission Hills and San Ysidro) in FY 2019 and a new branch library (Pacific Highlands) in FY 2021 based on current construction schedules. The Outlook identifies 2.67 FTEs and approximately $593,000 in additional ongoing operating costs for the expansion of the Mission Hills and San Ysidro branch libraries, and 8.50 FTEs and approximately $947,000 in new ongoing operational costs for the Pacific Highlands branch. It should be noted that these projected costs are for the first full year of operation for the respective facilities.

The Outlook attempts to best match the need for the positions with the anticipated opening dates of the new facilities. For the San Ysidro Branch, 1.00 FTE is added in FY 2019 and an additional 1.05 FTEs are added in FY 2020 as the opening date is late in FY 2019. For the Mission Hills Branch, no staffing in added in FY 2019 as the opening date is projected to be in June 2019 (the end of the fiscal year). An additional 1.62 FTEs are added in FY 2020 for the Mission Hills Branch staffing needs. For the Pacific Highlands Branch, 4.25 FTEs are added in FY 2021 and an additional 4.25 FTEs are added in FY 2022 to meet the projected needs of this branch.

Opening dates and annual operating expenses for each facility will be re-evaluated and refined as work on the facilities moves forward.

Park & Recreation Department

Maintenance Assessment Districts (MADs)
The Outlook identifies additional unfunded projected costs due to an anticipated increase in financial liability associated with re-engineering the City MADs. The updated Assessment Engineer's reports, required for each MAD to comply with California State Proposition 218, have re-apportioned the general and special benefit allotments (portion of expense that the City or the District is responsible for). As a result of the re-apportionments, Department staff anticipates an increase to the general benefits (City portion), resulting in increased General Fund expenses throughout the Outlook period. The General Fund expenses are projected to increase from approximately $193,000 in FY 2019 to approximately $231,000 in FY 2023.

New Parks and Joint Use Agreements
The Department expects 21 new/expanded parks to open, and 32 new Joint Use Agreements (Agreements) with local school districts to become effective during the Outlook period. The Outlook projects operating expenses for the new parks and the Agreements to be approximately $2.2 million in FY 2019, increasing to an aggregate expense of approximately $5.6 million in FY 2023 once all the new parks and Agreements have come on-line. The projected operating costs include the addition of 54.72 FTEs throughout the Outlook period to maintain the new parks and playgrounds. The positions include the addition of 2.00 FTEs annually during the Outlook period to address the projected acquisition of additional open space acreage, and 10.00 FTEs to provide citywide park maintenance.

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

The Outlook includes funding for non-capitalizable costs and associated revenue for the Phase I expansion of the City's Get it Done application.[2] These costs, including the addition of 1.00 Program Coordinator position, represent an updated projection from the expenditures that were originally outlined in the Customer Experience & Service Delivery Implementation Planning Project (Get it Done implementation roadmap) and presented to the Rules Committee on October 26, 2016. The original Get it Done implementation roadmap also allowed for the possibility of a centralized 311 Call Center that is *not* included as part of the Phase I expansion.

A brief discussion of Get it Done Phase II expansion costs identified by the Department, but not included in the Outlook, is located in the "Potential Funding Needs not Included in the Outlook" section of this report.

Planning Department – Middle Income Density Bonus Program

In FY 2018 as one of several housing initiatives undertaken by the City, the Planning Department initiated the Middle Income Density Bonus Program. This program is focused on promoting the development of workforce housing, which is targeted at households earning 150% of the Area

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[2] Funding for FY 2018 capital costs for the Phase I expansion of Get it Done was approved by the City Council in October 2017, as part of Resolution 311360.

Median Income. The FY 2018 Adopted Budget included $250,000 in one-time funding to support this program. The initial funding was to provide for environmental assessment and analysis of the proposed policy and ordinance changes. The Department has identified a need for an additional $250,000 in FY 2019 to complete the detailed environmental analysis and develop necessary environmental documentation for City Council consideration. The Department anticipates an 18- to 20-month work program which began in FY 2018.

Police

Civilian Position Additions (Supplemental)
The Outlook's Critical Strategic Expenditures include the addition of 13.00 FTE civilian positions and approximately $1.0 million in related annual ongoing costs to support supplemental positions in the Police Department. The 13 civilian positions include nine Dispatchers, two Clerical Assistants, one Special Event Traffic Control Supervisor, and one Police Dispatch Supervisor. All 13 of these positions were added in FY 2018 as unbudgeted supplemental positions and are projected to be added as budgeted positions beginning in FY 2019.

Body-Worn Cameras and Tasers
The Outlook includes as a Critical Strategic Expenditure a total of $4.3 million over four years, beginning in FY 2020, to fund replacement of body-worn cameras and Tasers for Police officers. The Police Department has indicated that the body-worn camera funding would support a two-year replacement schedule as recommended by the manufacturer, and would replace cameras for existing officers. The Taser funding would allow for the purchase of Tasers for new officers and the replacement of existing malfunctioning and outdated units that are no longer supported by the manufacturer.

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Fiscal Year 2019 Department	Facility	Location of Facility (District)	Additional FTE	First Year Annual Expense
Park and Recreation	Encanto Elementary Joint-Use Agreement	4	0.16	$22,151
Park and Recreation	Linda Vista Elementary Joint Use Agreement[1]	7	0.19	39,860
Park and Recreation	Hawk Pocket Park (Guymon Street)	1	0.15	20,714
Park and Recreation	Holmes Elementary Joint Use Agreement[1]	6	0.32	62,641
Park and Recreation	Horton Elementary Joint Use Agreement[1]	4	0.25	58,081
Park and Recreation	Marvin Elementary Joint Use Agreement[1]	7	0.27	54,540
Park and Recreation	Pacific Highlands Ranch Community Park - CIP S10079[1]	1	5.51	540,866
Park and Recreation	Paradise Hills Elementary Joint Use Agreement	4	0.12	16,514
Park and Recreation	Pacific Trails Middle School Joint Use Agreement[1]	1	0.49	93,088
Park and Recreation	Torrey Meadows Neighborhood Park[1]	5	0.95	149,034
Park and Recreation	NTC Building 619	2	1.50	190,130
Park and Recreation	Transit Station Maintenance	8,9	2.00	126,851
Park and Recreation	Citywide Park Maintenance[1]	Citywide	5.00	562,233
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	230,802
Library	Mission Hills Branch[2]	3	1.62	301,907
Library	San Ysidro Branch[2]	8	2.05	290,776
Total Fiscal Year 2019			**22.58**	**$2,760,188**

Fiscal Year 2020 Department	Facility	Location of Facility (District)	Additional FTE	First Year Annual Expense
Park and Recreation	14th Street Promenade	3	0.50	$65,449
Park and Recreation	Audubon Elementary Joint Use Agreement	4	0.14	19,750
Park and Recreation	Bay Terrace Recreation and Senior Center	4	2.00	147,716
Park and Recreation	East Village Green[1]	3	5.79	584,477
Park and Recreation	Fairbrook Neighborhood Park - CIP S01083[1]	5	0.21	37,184
Park and Recreation	Innovation (MacDowell) Middle Joint Use Agreement[1]	6	0.26	53,166
Park and Recreation	North Park Mini Park	3	0.10	14,227
Park and Recreation	Olive Street Mini Park	3	0.16	19,629
Park and Recreation	Pacific View Leadership Academy Joint Use Agreement	4	0.21	29,624
Park and Recreation	Riviera Del Sol NP[1]	8	0.70	117,005
Park and Recreation	Rolando Park Elementary Joint Use Agreement	9	0.34	48,203
Park and Recreation	Rowan Elementary Joint Use Agreement[1]	9	0.18	48,385
Park and Recreation	Salk Neighborhood Park & Joint Use Development[1]	6	1.03	169,775
Park and Recreation	Sandburg Elementary Joint Use Agreement[1]	6	0.29	58,247
Park and Recreation	Spreckels Elementary Joint Use Agreement[1]	1	0.22	46,258
Park and Recreation	Stanley Middle (Pool) Joint Use Agreement	1	3.24	160,859
Park and Recreation	Taft Middle Joint Use Agreement[1]	7	0.33	65,318
Park and Recreation	Tubman Charter Elementary Joint Use Agreement[1]	9	0.12	24,261
Park and Recreation	Valencia Mini Park	4	0.19	24,352
Park and Recreation	Wangenheim Middle School Joint Use Agreement[1]	6	0.32	63,083
Park and Recreation	Balboa Park Maintenance[1]	3	2.00	181,065
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	149,756
Fire-Rescue	North University City Fire Station	1	12.00	1,759,333
Total Fiscal Year 2020			**32.33**	**$3,887,122**

Fiscal Year 2021 Department	Facility	Location of Facility (District)	Additional FTE	First Year Annual Expense
Park and Recreation	Canon Street Pocket Park[1]	2	0.02	$3,496
Park and Recreation	Franklin Ridge Pocket Park	7	0.00	1,525
Park and Recreation	Hidden Trails Neighborhood Park - CIP S00995	8	0.40	53,976
Park and Recreation	Lindbergh-Schweitzer Elementary Joint Use Agreement[1]	6	0.30	59,589
Park and Recreation	Stanley Middle School Joint Use Agreement[1]	1	0.16	35,124
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	146,280
Library[3]	Pacific Highlands Ranch Branch	1	8.50	946,612
Fire-Rescue	Black Mountain Ranch Fire Station	5	12.00	1,759,333
Total Fiscal Year 2021			**23.38**	**$3,005,935**

Fiscal Year 2022 Department	Facility	Location of Facility (District)	Additional FTE	First Year Annual Expense
Park and Recreation	Hawthorne Elementary Joint Use Agreement[1]	6	0.32	$63,489
Park and Recreation	Hickman Elementary[1]	6	0.27	55,157
Park and Recreation	Johnson Elementary Joint Use Agreement	4	0.20	28,287
Park and Recreation	Jones Elementary Joint Use Agreement[1]	7	0.35	68,975
Park and Recreation	Lafayette Elementary Joint Use Agreement[1]	6	0.43	83,604
Park and Recreation	Mira Mesa Community Park (Phase II) - CIP L16002[1]	6	3.19	276,449
Park and Recreation	Pacific Beach Elementary School Joint Use Agreement[1]	2	0.08	21,224
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	146,279
Fire-Rescue	UCSD Fire Station	1	12.00	1,759,333
Total Fiscal Year 2022			**18.84**	**$2,502,797**

Fiscal Year 2023 Department	Facility	Location of Facility (District)	Additional FTE	First Year Annual Expense
Park and Recreation	Benchley / Weinberger Elementary Joint Use Agreement[1]	1	0.24	$49,670
Park and Recreation	Canyon Hills Resources Neighborhood Park Improvements - CIP S15006[1]	6	1.14	201,571
Park and Recreation	Carmel Valley Neighborhood Park - CIP S00642[1]	1	0.40	68,089
Park and Recreation	Dennery Ranch NP[1]	8	1.23	177,544
Park and Recreation	Dewey Elementary Joint Use Agreement[1]	2	0.09	23,457
Park and Recreation	Grant K-8 Joint Use Agreement	3	0.08	11,047
Park and Recreation	Logan/Memorial K-8/Middle School Joint Use Agreement	8	0.08	11,047
Park and Recreation	Marie Curie Elementary Joint Use Agreement[1]	1	0.34	67,551
Park and Recreation	Toler Elementary Joint Use Agreement[1]	2	0.16	34,961
Park and Recreation	Staff for additional Open Space Acreage[1]	Citywide	2.00	146,279
Total Fiscal Year 2023			**5.76**	**$791,216**

1. Includes one-time expense for items such as vehicles in the first year of operation. One-time expenses eliminated from operating costs in subsequent years.
2. Branch library anticipated to open in FY 2019, however the Outlook staggers a portion of the additional staff into FY 2020. First Year Annual Expense figure represents the total additional staffing and expenses for facility.
3. Branch library anticipated to open in FY 2021, however the Outlook staggers a portion of the additional staff into FY 2022. First Year Annual Expense figure represents the total additional staffing and expenses for facility.

Department Capital Requests Not Included in the Outlook

The total amount of all department requests that were not included in the Financial Outlook averaged $147.1 million annually from FY 2019 to FY 2023. Of this amount, 67% (over the Outlook period) were **capital** requests from the Transportation & Storm Water Department (TSW). Because these are capital expenses, it is expected that these needs will be reflected in the FY 2019 – 2023 Five-Year Capital Infrastructure Planning Outlook to be released in January 2018, although not funded by the General Fund.

The following table summarizes TSW's unfunded capital requests and associated General Fund needs. Compliance with the Regional Board storm water permit requirements drive significant capital costs as reflected by the Drainage and Watershed Annual Allocation projected needs. Projects are listed in priority order as submitted by the department.

TSW Capital Requests Not Included in the Financial Outlook

Capital Improvement Project	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Sidewalk Repair/Replacement Annual Allocation[1]	$ 7,247,696	$ 7,247,696	$ 7,247,696	$ 7,247,696	$ 7,247,696
Drainage Projects Annual Allocation[2]	34,154,809	44,514,545	26,137,218	27,000,000	51,000,000
Guardrail Installation[3]	450,000	100,000	100,000	100,000	100,000
Street Light Circuit Upgrade[4]	3,500,000	3,500,000	3,200,000	3,200,000	3,200,000
Climate Action Plan and Vision Zero[5]	200,000	200,000	200,000	200,000	200,000
Signal Cabinet Replacement[6]	2,880,000	2,880,000	2,880,000	2,880,000	2,880,000
Watershed Annual Allocation[7]	50,933,035	40,436,152	41,611,865	62,524,711	5,250,000
New Facility at Chollas Operations Yard[8]	-	-	10,000,000	20,000,000	-
Total General Fund Costs	**$99,365,540**	**$98,878,393**	**$91,376,779**	**$123,152,407**	**$69,877,696**

[1]Funding to address the backlog of sidewalk replacement needs identified in the 2015 Sidewalk Assessment.

[2]Various CIP projects, including those to address aging assets as identified by the Watershed Asset Management Plan and replacement of the City's corrugated metal pipe system.

[3]Installation of guardrails at two high crash locations. According to TSW, guardrail installations do not qualify for TransNet funds.

[4]Funding to upgrade five series circuit projects in FY 19 and FY 20 and two circuits annually in out years. The City has about 52 street light circuits, and five series circuit projects have already begun.

[5]City Council Policy 200-07: Marked Crosswalk Criteria at Uncontrolled Locations, approved in 2015, has qualified numerous locations for pedestrian safety improvements requiring traffic control devices (e.g. crosswalks and flashing beacons). Certain locations are ineligible for TransNet funding. Funding would address about 20 locations annually.

[6]Signal cabinets and service meter pedestals house electronic equipment that manage traffic flow. Funding would replace about 320 traffic signal cabinets and service meter pedestals annually.

[7] Various CIP projects, including installation of water quality improvement assets as identified in the Watershed Asset Management Plan.

[8]New facility at Chollas Operations Yard for TSW staff. Existing staff is scattered in different buildings.

New State Legislation

The State recently approved two items of legislation that, while they are not anticipated at this time to affect General Fund projections in the Outlook, may be a potential resource to the City in the future. A brief description of each item is listed below.

Affordable Housing Funding Source

SB 2 was signed by the Governor in September 2017 and imposes a $75 fee on real estate transaction documents. From January 2018 through December 2018, half of the revenue collected by the State will be distributed to local governments to update planning documents and zoning ordinances in order to streamline housing production. The other half will be available to the Department of Housing and Community Development to assist individuals experiencing, or at risk of, homelessness. Starting in January 2019, 70% of revenue will be distributed to local governments for specified affordable housing purposes pursuant to the community block grant formula.

New Authority to Levy Tax for Regional Transportation

AB 805 was signed by the Governor in October 2017 and makes various changes to the laws that govern the San Diego Association of Governments, the San Diego Metropolitan Transit System (MTS), and the North County Transit District (NCTD). Among them, the bill allows MTS and NCTD to impose a 0.5 percent transactions and use tax, and issue bonds payable from the tax proceeds, all subject to voter approval. Eligible uses of these revenues are limited to public transit purposes, which include (1) public transit responsibilities under the jurisdiction of MTS and NCTD and repair and maintenance to related right-of-ways; or (2) any bikeway, bicycle path, sidewalk, trail, pedestrian access, or pedestrian access way. To the extent the MTS uses this taxing authority and it is approved by voters, expenditures in the latter category as well as any improvements to City streets could free up future capital financing or General Fund allocations currently planned for these purposes, for other projects.

Reserve Contributions

The following sections discuss the General Fund (GF) Reserve and the Risk Management Reserves (including the Public Liability, Workers' Compensation, and Long-Term Disability Reserves).

General Fund Reserve

The City's Reserve requirement is based on the past three fiscal years' audited GF operating revenues;[1] it is the product of the three-year average revenues and the target percentage for the applicable year. The three-year average, target percentage, and required Reserve amount are shown in the following table for each fiscal year, with the actual requirements for FY 2017 and FY 2018 (FY 2018 based on unaudited actuals) and estimates for FY 2019 through FY 2023.

General Fund (GF) Reserve

($ in millions)	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
3-Year Average Revenues	$1,178.3	$1,208.6	$1,257.1	$1,301.6	$1,348.2	$1,406.7	$1,463.0
Reserve Requirement Target %	14.75%	15.0%	15.25%	15.5%	15.75%	16.0%	16.25%
Reserve Requirement Amount	**$ 173.8**	**$ 181.3**	**$ 191.7**	**$ 201.8**	**$ 212.3**	**$ 225.1**	**$ 237.7**

Note: Table may not total due to rounding.

FY 2018 Excess Equity

After considering budgeted FY 2018 operating activity, FY 2018 year-end GF Excess Equity is projected to be $17.9 million (as of the First Quarter Report). Based on the latest unaudited actual GF Reserve balance for FY 2017, when adjusting for the FY 2018 activity and prefunding of the FY 2019 Reserve contribution, the projected FY 2018 year-end GF Reserve estimate is $199.2 million. Of this amount, $181.3 million is needed to meet the City's 15% Reserve requirement. This leaves $17.9 million in estimated Excess Equity, as shown in the following table. However, this does not include FY 2018 estimated expenditures for Hepatitis A that may cause 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).

FY18 Year-End Excess Equity Estimate *($ in millions)*	
FY17 Unaudited Reserve Balance	$ 218.2
FY18 Budgeted Use of Excess Equity [1]	(8.7)
FY18 Prefunding of FY19 GF Reserve Contribution	(10.3)
FY18 Year-End Reserve Estimate	***199.2***
FY18 15% Reserve Requirement (*includes FY18 contribution*)	(181.3)
FY18 Year-End Excess Equity Estimate	**$ 17.9**

[1] "FY18 Budgeted Use of Excess Equity" does not include 1) the $7.0M FY18 budgeted GF Reserve contribution, which is incorporated in the "FY18 15% Reserve Requirement" line and 2) the $10.3M FY18 prefunding of the FY19 Reserve contribution, which is included on its own line.

[1] For further discussion of the General Fund reserve and reserve targets, see the City's Reserve Policy, which is Council Policy 100-20 (last updated November 2017).

Because there are projected deficits in the beginning years of the Outlook, as well as potential additional critical needs requested by departments that are not funded in the Outlook, the City could consider the use of any available Excess Equity to accommodate unfunded one-time costs. This approach is not a recommendation, but is noted as a potential resource that could be considered to mitigate future deficits. As such, it is included in the "Potential Resources and Mitigation Actions" section of this report.

***Risk Management Reserves*[2]**

Public Liability Reserve

The Public Liability (PL) Fund supports costs to the City related to claims against the GF; and the PL Reserve is paid entirely from GF contributions. The City Reserve Policy specifies that by FY 2019 the City will attain the overall reserve target of 50% of the outstanding actuarial liability. The outstanding liability is based on the average value of annual actuarial liabilities for the three fiscal years ending in 2017, or $69.3 million. The overall 50% target estimate (to be achieved by FY 2019) is $34.7 million.

The FY 2018 target level is 47%, which equates to $32.6 million. With $36.7 million as the estimated FY 2018 PL Reserve, there is an estimated excess of $4.1 million. This includes a $3.1 million contribution from the GF in FY 2018. Since the Reserve estimate exceeds all future years' target amounts as well, the Outlook does not include any PL Reserve contributions over the five-year period.

With regard to ongoing expenditures of the PL Fund, there are no increases for insurance or claims and other costs—$12.4 million and $17.1 million, respectively—for each year of the Outlook. PL claims can be volatile; in the past few years, the City has experienced some large claims payouts. Subsequently, the actuarial liability has decreased, and claims are anticipated to be stable in the Outlook. The following table shows PL contributions, Reserve specifications, and Reserve estimates over the Outlook.

Public Liability Reserve and Operating Contributions

($ in millions)	**FY18[1]**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Reserve Target %	47%	50%	50%	50%	50%	50%
Reserve Target Amount	$ 32.6	$ 34.7	$ 34.7	$ 34.7	$ 34.7	$ 34.7
Estimated Reserve	36.7	36.7	36.7	36.7	36.7	36.7
Estimated Excess Reserve	**$ 4.1**	**$ 2.0**	**$ 2.0**	**$ 2.0**	**$ 2.0**	**$ 2.0**
Public Liability (PL) Contributions						
Reserve	$ 3.1	$ -	$ -	$ -	$ -	$ -
Insurance	12.4	12.4	12.4	12.4	12.4	12.4
Claims and Other Costs	17.1	17.1	17.1	17.1	17.1	17.1
Total PL Contributions	**$ 32.6**	**$ 29.5**	**$ 29.5**	**$ 29.5**	**$ 29.5**	**$ 29.5**

Note: Table may not total due to rounding.

[1]FY18 PL contributions are those included in the Adopted Budget, and the remaining years' costs are from the Outlook Baseline.

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[2] For further discussion of the Risk Management reserves and reserve targets, see the City's Reserve Policy, Council Policy 100-20 (last updated November 2017).

Although the estimated FY 2018 excess Reserve is $4.1 million, the Reserve target level for FY 2019 increases to 50%, or $34.7 million,[3] leaving only $2.0 million in estimated excess Reserve for FY 2019. The City could consider using these excess PL Reserve funds for one-time needs. As with GF Excess Equity, this approach is not a recommendation, but is noted as a potential resource that could be considered to mitigate future deficits. As such, we include the estimated $2.0 million of FY 2019 excess PL Reserve in the "Potential Resources and Mitigation Actions" section of this report.

Workers' Compensation Reserve

The City Reserve Policy requires a Workers' Compensation (WC) Reserve target of 12% of the outstanding actuarial liability. Like the PL Reserve, the outstanding liability is based on the average value of annual actuarial liabilities for the three fiscal years ending in 2017, which is approximately $249.7 million. The 12% target amount for FY 2018 is $30.0 million.

With $37.0 million as the estimated FY 2018 WC Reserve, there is an estimated excess of $7.0 million. However, the Outlook shows that this excess Reserve will be used as rate relief in FY 2019 and FY 2020 (and is budgeted for rate relief in FY 2018 as well). Utilizing the excess WC Reserve for rate relief will lower the fringe benefits amounts that City departments must contribute to support the WC Fund. Note that the GF departments' portion of WC contributions is approximately 80.8% in the FY 2018 Adopted Budget.

WC Reserve contributions are forecasted for each year of the Outlook—citywide amounts of $1.8 million for FY 2019 and $1.1 million for FY 2020 through FY 2023. Amounts are also included each year for increases in ongoing WC expenditures, which are projected to increase by 3.2% annually. The table below shows citywide WC contributions, Reserve specifications, and Reserve estimates over the Outlook. Note that the WC operating contributions include $4.6 million in rate relief reductions for FY 2018 and FY 2019, as well as $2.4 million for FY 2020.

Workers' Compensation Reserve and Operating Contributions (Citywide)

($ in millions)	**FY18[1]**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Reserve Target %	12%	12%	12%	12%	12%	12%
Reserve Target Amount	$ 30.0	$ 31.7	$ 32.8	$ 33.9	$ 35.0	$ 36.1
Estimated Reserve	37.0	34.1	32.8	33.9	35.0	36.1
Estimated Excess Reserve	**$ 7.0**	**$ 2.4**	**$ 0.0**	**$ 0.0**	**$ 0.0**	**$ 0.0**
Workers' Compensation (WC) Contributions						
Reserve	$ -	$ 1.8	$ 1.1	$ 1.1	$ 1.1	$ 1.1
Operating	27.7	28.7	32.0	35.5	36.6	37.8
Total WC Contributions	**$ 27.7**	**$ 30.5**	**$ 33.1**	**$ 36.5**	**$ 37.7**	**$ 38.9**

Note: Table may not total due to rounding.

[1]FY18 WC contributions are those included in the Adopted Budget, and the remaining years' costs are from the Outlook Baseline.

[3] 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.

Long-Term Disability Reserve

The Long-Term Disability (LTD) Reserve overall target level is 100% of the outstanding liability for LTD. As with the other Risk Management Reserves, the FY 2018 outstanding liability is based on the average of the annual actuarial liabilities for the most recent three fiscal years (FY 2015 through 2017). With the completion of the FY 2017 actuarial valuation, the FY 2018 outstanding liability has been significantly reduced from the prior year's $11.0 million, to $5.5 million.

Thus, with the projected FY 2018 Reserve balance at approximately $15.8 million, the target is projected to be exceeded by $10.3 million—after the use of $2.4 million for rate relief in FY 2018. Rate relief to cover operating costs is not anticipated to continue during the Outlook years. Citywide LTD operating costs of $2.4 million are included in the Baseline for each of the five years. Such costs have been relatively stable and are not anticipated to change significantly. Note that the GF portion of LTD contributions is approximately 69.7%.

The City could consider using excess LTD Reserve funds for one-time needs. The GF portion of the $10.3 million excess is approximately $7.2 million. 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 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 excess Reserve, e.g. $6.5 million ($4.5 million GF). As with other excess reserves, this approach is not a recommendation, but is noted as a potential resource that could be considered to mitigate future deficits. As such, we include $4.5 million of the FY 2018 excess LTD Reserve (GF portion) in the "Potential Resources and Mitigation Actions" section of this report.