THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2018 Mid-Year Budget Monitoring Report

OVERVIEW

The Fiscal Year 2018 Mid-Year Budget Monitoring Report (Mid-Year Report) was issued on January 29, 2018, and was presented to the Budget and Government Efficiency Committee on February 1, 2018. The Mid-Year Report describes the current status of revenues and expenditures and their year-end projections based on actual (unaudited) data from July 2017 through November 2017. The Mid-Year Report also provides useful details about major revenues, departmental operations, and other programmatic items. The purpose of the IBA review of the Mid-Year Report is to provide clarification and additional information for items outlined in that report.

The FY 2018 Mid-Year Report is projecting a General Fund year-end deficit of approximately $5.6 million, but there is no recommendation to address this deficit at this time. Instead, staff is recommending that any adjustments wait until the release of the Third Quarter Report (also referred to as the Year-End Budget Monitoring Report), which is scheduled for May 15, 2018.

Although the City Council is not being asked to make changes to the General Fund budget at this time, it is being asked to increase revenue and expenditure appropriations in the Development Services Fund and the Fleet Operating Fund. Our Office believes that these requests are appropriate and we do not raise any related concerns in this report.

Our review of the Mid-Year Report also includes a discussion of issues related to the Mid-Year Ordinance for Council's consideration. Recommendations corresponding to these items are included in the conclusion of this report.

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FISCAL/POLICY DISCUSSION

Major General Fund Revenues

FY 2018 General Fund revenues in the Mid-Year Report are projected to end the year $7.0 million, or 0.5%, above budget despite an overall decrease in the four major General Fund revenues from the FY 2018 First Quarter Budget Monitoring Report's (First Quarter Report) year-end projections, as displayed in the table on below. Reductions from the First Quarter Report in major General Fund revenues are due primarily to a significant reduction in property tax projections and a slight reduction in sales tax projections that are offset by a significant increase in franchise fee projections. These are discussed in greater detail in the section below.

The Mid-Year Report notes that miscellaneous General Fund revenues[1] are projected to end the year $1.5 million over-budget; this is primarily due to the closure of three unused funds – the Center City Maintenance Fund and the Child Care Construction and Operations Funds – which allow for the one-time transfer of $1.8 million into the City's General Fund. Increases in miscellaneous and department revenues augment the overall increase in major General Fund revenues above revenues in the Adopted Budget.

Our Office has reviewed the year-end projections for property tax, property transfer tax, sales tax, TOT, and franchise fees included in the Mid-Year Report. The following table outlines changes in year-end projections for major General Fund revenues from the FY 2018 Adopted Budget and the First Quarter Report as compared to the Mid-Year Report. Major General Fund revenues are projected to be over-budget by approximately $4.1 million at fiscal year-end.

FY 2018 Projected Year-End General Fund Revenue (*$ in millions*)

Revenue Source	Adopted Budget	First Quarter Projection	Mid-Year Projection	Variance: Adopted Budget to Mid-Year	Variance: First Quarter to Mid-Year
Major General Fund Revenues					
Property Tax	$534.6	$539.3	$532.9	($1.8)	($6.5)
Sales Tax	275.3	275.0	274.4	(0.9)	(0.6)
Transient Occupancy Tax	142.7	145.3	145.3	2.6	(0.0)
Major Franchise Fees	73.5	74.0	77.7	4.1	3.6
Sub-Total Major General Fund Revenues:	**1,026.1**	**1,033.6**	**1,030.2**	**4.1**	**(3.5)**
Property Transfer Tax[1]	10.1	N/A	10.4	0.4	N/A
Miscellaneous Revenues[1]	84.1	N/A	85.7	1.5	N/A
Department Revenues[1]	287.4	N/A	288.5	1.1	N/A
Total:	**$1,407.7**	**$1,033.6**	**$1,414.8**	**$7.0**	**($3.5)**

Note: Table may not total due to rounding.
[1]Year-end projections for property transfer tax, miscellaneous, and department revenues were not part of the First Quarter Report and are not available for comparison to the Mid-Year Report.

[1] The miscellaneous revenue category includes a mix of ongoing and one-time revenues that include the following: Charges for Current Services, Interest and Dividends, Motor Vehicle License Fees, Other Revenue, Refuse Collector Business Tax, Revenue from Federal and Other Agencies, Revenue from Money and Property, and Transfers In.

Overall we believe that the projections included in the Mid-Year Report are appropriate based on revenue distributions to date and current economic information. Additional details regarding the major General Fund revenues with significant variances from the First Quarter Report – property tax and franchise fees – are discussed below, along with a brief discussion of Cannabis Business Tax revenue.

Property Tax

FY 2018 property tax revenue in the Mid-Year Report is projected at $532.9 million, which is $1.8 million below the amount included in the Adopted Budget. The First Quarter Report projected property tax revenue to increase over the Adopted Budget by $4.7 million due to increases in receipts associated with the City's 1% property tax allocation and MVLF backfill payments. Consistent with that increase, the First Quarter Report suggested that the growth rate for property tax revenue projections could be increased from 5.0% to 6.0%. The Mid-Year Report shows those sources of property tax revenues as essentially unchanged from the First Quarter Report.

Nearly all of the Mid-Year Report's projected decrease in property tax receipts is the result of decreased residual RPTTF revenue that results from increased enforceable obligations included in the City's ROPS submitted to the State Department of Finance. As stated in the Mid-Year Report, this is largely associated with the CDBG loan repayment that will be used to purchase the site for the Housing Navigation Center; other increases in enforceable obligations, including those for the Park Boulevard At-Grade Crossing and NTC Storm Drain Outfalls, among others – also contribute to decrease in residual RPTTF revenue.

Franchise Fees

Franchise fee revenue in the Mid-Year Report is projected at $77.7 million; this is an increase of $4.1 million over projections in the Adopted Budget. This increase is largely due to increased revenue from SDG&E's General Fund franchise fee payments, which are now projected to total $47.9 million, $3.3 million over projections included in the Adopted Budget. SDG&E's franchise fees are based on a percentage of gross revenue from electricity sales and transmission; historically these franchise fees have been one of the most volatile sources of the City's General Fund revenue, with annual receipts over the last five years varying year-over-year by as much as 21%.

The remainder of the Mid-Year Report's increase in franchise fee projections are associated with cable television franchise fees – currently projected at $16.1 million, an increase of $138,000 over the Adopted Budget – and refuse hauler franchise fees – currently projected at $11.9 million, which is an increase of $650,000 over the Adopted Budget.

Cannabis Business Tax

The Mid-Year Report notes that the FY 2018 Adopted Budget includes $2.4 million in revenue associated with the City's new Cannabis Business Tax. Because collection of the tax only recently began on February 1, 2018, the Mid-Year Report appropriately does not update this revenue projection as data are not yet available. Financial Management has indicated that an updated Cannabis Business Tax revenue projection will be provided in the Third Quarter Report, scheduled to be released in May and reviewed by the City Council on June 11, 2018.

<u>General Fund Expenditures</u>

As discussed in the Mid-Year Report, projected year-end General Fund expenditures are $12.6 million over-budget largely due to overages related to Hepatitis A efforts, Bridge Shelter startup costs, Fire-Rescue air operations costs related to extreme fire weather conditions, and storm water and street maintenance needs. Projected expenditures are $12.6 million over-budget despite budgetary savings in the following areas:

- $10.4 million in salary savings, primarily due to vacancies
- $5.8 million in Citywide Program Expenditures contracts savings, largely due to the $5.0 million in savings for the proposed November 2017 special election
- $2.1 million in savings due to delayed 101 Ash Street occupancy
- $760,000 in debt savings related to the IAM asset management project (anticipated to occur in FY 2019)

Financial Management (FM) has provided explanations for many of the budget variances in the Mid-Year Report; and our report supplements that information with a discussion of salaries and wages, as well as vacancies.

Salaries and Wages

The net salaries and wages mid-year projection is $1.5 million higher than the Adopted Budget. As in prior years, a combination of over-budget and under-budget components net to this $1.5 million. The salaries and special pay categories are briefly discussed below, as are departments with the largest salaries and wages variances.

FY 2018 Projected Salaries and Wages Expenditures				
General Fund Amounts *($ in millions)*	**Adopted Budget**	**Mid-Year Projection**	**Variance**	**Variance %**
Salaries[1]	$ 434.2	$ 423.8	$ (10.4)	-2.4%
Special Pay	28.6	31.3	2.7	9.3%
Overtime	61.5	67.8	6.2	10.1%
Hourly	13.0	13.3	0.3	2.2%
Vacation Pay-in-Lieu of Annual Leave	7.3	9.3	2.0	27.1%
Termination Pay	2.4	3.0	0.7	27.2%
Total	**$ 547.1**	**$ 548.5**	**$ 1.5**	**0.3%**

Note: Table may not total due to rounding.

[1] The Mid-Year Report Salaries category includes Special Pay, producing a net salary savings of $7.7M (the $2.7M over-budget Special Pay offsets the $10.4M in salary savings, netting to $7.7M).

Salaries

The largest variance in the preceding table is $10.4 million in salary savings, which is primarily due to higher vacancies than projected in the Adopted Budget. Departments with the largest vacancy savings include Police, Fire-Rescue and Park & Recreation (with vacancy savings of $3.6 million, $3.1 million, and $583,000, respectively). This additional vacancy savings is more than offset by overages in other salaries and wages spending categories (special pay, overtime, hourly, vacation pay-in-lieu, and termination pay), for the net $1.5 million over-budget amount.

Special Pay

The $2.7 million special pay over-budget amount is largely in the public safety departments. The Police and Fire-Rescue overages are $1.8 million and $490,000, respectively.

For historical context, the FY 2018 Adopted Budget for special pay ($28.6 million) is $3.5 million less than FY 2017 actual spending of $32.1 million. The largest overages in FY 2017 were also in the Police and Fire-Rescue Departments, at $1.6 million and $1.7 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 in the FY 2019 Proposed Budget.

Departments with the Largest Salaries and Wages Variances

As previously discussed, the net salaries and wages mid-year projection is $1.5 million higher than the Adopted Budget, due a combination of over-budget and under-budget components. The table on the following page shows some of the largest departmental variances for the salaries and wages categories.

As shown in the table, the Police Department has vacancy savings of $3.6 million. This savings is largely offset with over-budget projections for other salaries and wages categories – such as $1.8 million in special pay and $772,000 in overtime.

The Fire-Rescue Department's vacancy savings of $3.1 million is more than offset with over-budget projections in other salaries and wages categories – including $490,000 in special pay and $3.2 million in overtime. A second fire academy (in addition to the one included in the FY 2018 Adopted Budget) has been included in the mid-year projections. The additional academy is being used as a means to mitigate an increasing number of vacancies, which are largely due to retirements as discussed later in this report. The most significant causes of overtime increases include increased fire suppression staffing needs for weather-related issues, strike teams and other reimbursable deployments, as well as lifeguard overtime.

Lastly, the Transportation and Storm Water Department is projecting a $2.5 million in overtime costs, $1.5 million higher than the $1.1 million Adopted Budget. The $1.5 million projected overage is largely related to emergency work.

FY 2018 Projected Salaries and Wages Expenditures			
General Fund Amounts *($ in millions)*	**Adopted Budget**	**Mid-Year Projection**	**Variance: Adopted to Mid-Year**
Salaries			
Police	$ 166.7	$ 163.1	$ (3.6)
Fire-Rescue	78.1	74.9	(3.1)
Park & Recreation	31.0	30.5	(0.6)
Other Departments	158.4	155.4	(3.0)
Subtotal Salaries	434.2	423.8	(10.4)
Special Pay			
Police	16.0	17.7	1.8
Fire-Rescue	11.5	11.9	0.5
Other Departments	1.2	1.6	0.4
Subtotal Special Pay	28.6	31.3	2.7
Overtime			
Police	26.3	27.1	0.8
Fire-Rescue	32.8	36.1	3.2
Transportation & Storm Water	1.1	2.5	1.5
Other Departments	1.3	2.1	0.8
Subtotal Overtime	61.5	67.8	6.2
Hourly Wages	13.0	13.3	0.3
Vacation Pay-in-Lieu	7.3	9.3	2.0
Termination Pay	2.4	3.0	0.7
TOTAL SALARIES AND WAGES	**$ 547.1**	**$ 548.5**	**$ 1.5**

Note: Table may not total due to rounding.

General Fund Departmental Vacancy Savings

The Adopted Budget includes a listing of full-time equivalent (FTE) positions that are authorized to be filled; however, the budget 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.[2] The amount of funding removed from the budget for these occurrences is known as vacancy savings. Such vacancy savings reduce overall budgeted salaries and wages.

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.

Currently projected FY 2018 General Fund vacancy savings is approximately $10.4 million in excess of the $29.7 million Adopted Budget amount, for a total of $40.1 million. The Police and Fire-Rescue Departments contribute $3.6 million and $3.1 million, respectively, of the projected $10.4 million additional vacancy savings.

As shown in the far right column of the following table, FY 2018 ***projected vacancy savings*** is 8.6% of budgeted salaries. This is higher than the FY 2018 ***budgeted vacancy savings*** of 6.4% of budgeted salaries (center column). The difference translates to the $10.4 million additional vacancy savings mentioned above. Additional vacancy savings for FY 2018 could be even higher, given recent trends and preparations for upcoming deficit years.[3]

Similarly, FY 2017 and FY 2016 ***actual vacancy savings*** were 10% and 9.8% of budgeted salaries. FY 2017 and FY 2016 ***budgeted vacancy savings*** were also lower, at 6.6% and 4.8% of budgeted salaries, respectively. These differences translated to additional vacancy savings in FY 2017 and FY 2016 of $15.7 million and $21.9 million, respectively.

Vacancy Savings Comparison - General Fund

($ in millions)	**Budgeted Salaries [1]**	**Budgeted Vacancy Savings**	**Budgeted Vacancy Savings as a Percent of Salaries**	**Actual/ Projected Vacancy Savings [2]**	**Actual/ Projected Vacancy Savings as a Percent of Salaries**
FY 2018	$ 463.9	$ 29.7	6.4%	$ 40.1	8.6%
FY 2017	$ 459.2	$ 30.4	6.6%	$ 46.1	10.0%
FY 2016	$ 444.1	$ 21.5	4.8%	$ 43.4	9.8%

Note: Table may not total due to rounding.

[1]The Budgeted Salaries amounts are the salaries in the Adopted Budgets before each year's vacancy savings is removed.

[2]FY 2016 and FY 2017 are actual amounts and FY 2018 is the Mid-Year projected amount.

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

[3] 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, 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.

Additionally, a January 8, 2018 memo from the COO set forth a requirement for executive review and approval for filling City vacancies.

For FY 2019, increasing vacancy savings (which reduces salaries and wages) may be warranted considering recent trends and preparations for upcoming deficit years. However, in FY 2018 and previous years, excess vacancy savings above budgeted amounts have offset overages in the other salaries and wages types (such as overtime and special pay).[4] Reducing salaries and wages by increasing vacancy savings will leave less of a cushion for those other salaries and wages overages – which could pose difficulty if those other salaries and wages types do not have sufficient budget.

Departmental Expenditures

Homelessness and Hepatitis A

The City's response to Hepatitis A, ongoing sanitation activities after the end of the public health emergency was declared, and homelessness initiatives are Citywide efforts that have required support from many departments. These are activities that were unanticipated at the time of the FY 2018 Adopted Budget. The next two tables below provide: 1) a listing of expenses that are projected to be incurred by the end of FY 2018 broken out by General Fund expenses and all other fund sources, and 2) a description of these activities.

The table below reflects a total of $9.8 million ($9.4 million General Fund) projected to be spent by the end of FY 2018 for Hepatitis A response, sanitation, and homelessness-related efforts. Of the $9.8 million total expenditures, $7.2 million ($7.1 million General Fund) is considered "unbudgeted", or expenses that fall outside of approved department budget levels at this time.

Hepatitis A, Sanitation, and Homelessness Unplanned Expenditure Projections for FY 2018

Activity	Total General Fund	Total Non-General Fund	Total Expenditures[1]
Hepatitis A Response	$ 5,040,000	$ 190,000	$ 5,240,000
Ongoing Sanitation	1,690,000	60,000	1,750,000
San Diego Riverbed Clean-up	320,000	140,000	460,000
Clean San Diego[2]	200,000	0	200,000
Bridge Shelters	1,810,000	20,000	1,830,000
Safe Parking Program	310,000	0	310,000
Total Expenditures	**$ 9,370,000**	**$ 410,000**	**$ 9,790,000**

[1]Table may not total due to rounding.

[2]The current estimate as of issuance of this report is a range between $200,000 and $345,000. Please refer to the Clean San Diego section on page 10 for more detail.

[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 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.

Description of Hepatitis A, Sanitation, and Homelessness Unplanned Activities for FY 2018

Activity	Description
Hepatitis A Response	• Activities from September 2017 to January 2018[5] • Provided activities such as vaccinations, sanitation, education, and a Transitional Camp Area at 20th and B Street from October 2017 to December 2017 • Transitional Camp Area provided a clean place for individuals experiencing homelessness to stay during the response efforts
Ongoing Sanitation	• Activities from January 23, 2018 and ongoing • Services include portable restrooms and associated security in downtown; Balboa Park restrooms open 24/7; sidewalk cleaning; and increased downtown street cleaning
San Diego Riverbed Clean-up	• Provides waste and debris removal from riverbed twice per week • Will be incorporated into Clean San Diego initiative
Clean San Diego	• Expected to continue in FY 2019 • Building off of the Litter and Graffiti Abatement Pilot Program, services include: street sweeping, litter removal (including homeless camp abatements), and waste abatement
Temporary Bridge Shelters	• Provides safe and sanitary shelter and assistance in obtaining permanent supportive housing for individuals experiencing homelessness • Site 1 opened December 1, 2017; serves adults; is operated by Alpha Project for the Homeless; and has 324 beds • Site 2 opened December 22, 2017; serves adult veterans; is operated by Veterans Village of San Diego; and has 200 beds • Site 3 opened January 2, 2018; serves adult women and families; is operated by Father Joe's Villages; and has 150 beds • Service provider agreements operative through June 30, 2018 with options to extend
Safe Parking Program	• City working with Jewish Family Services and Dreams for Change to expand program • Provides those who are temporarily living in cars with a safe place to park at night, assistance finding permanent housing, and other services

In addition to the activities outlined above, the Mid-Year Report provides information on new, upcoming homelessness initiatives being developed: the establishment of a Housing Navigation Center and an additional transitional storage facility. The report states that these initiatives are not projected to impact the City's budget in FY 2018. City Council recently approved the purchase of a site for the Housing Navigation Center using federal Community Development Block Grant (CDBG) funds. Beginning in FY 2019, annual operating costs for the Housing Navigation Center are projected to be $1.5 million, of which $300,000 will come from the General Fund.

[5]The time frame reflects the period from which San Diego County declared the spread of Hepatitis A in the county a local public health emergency, and when the county declared an end to the emergency on January 23, 2018.

FY 2018 costs for the operation of the transitional storage facility are expected to be supported with reprogrammed San Diego Housing Commission funds. FY 2019 operating costs of up to $1 million are anticipated to be offset by projected savings from temporary bridge shelters achieved in the current fiscal year. Ongoing funding for the transitional storage center is unknown at this time.

Upcoming Homelessness Initiatives

Activity	Purpose
Housing Navigation Center Site Purchase and Operations	• Estimated to open July 2018 • Council approved purchase of property for the center on January 29, 2018 for $7.3 million in federal CDBG funds • Will provide a central place for individuals experiencing homelessness to get connected to services that support permanent housing • Estimated annual operational costs of $1.5 million, of which $300,000 is General Fund, effective FY 2019
Transitional Storage Facility	• Estimated to open April 2018 • Will provide up to 1,000 individual storage containers (for use by homeless individuals to store their belongings), above those provided by the existing transitional storage center • Estimated annual operational costs of up to $1 million, effective FY 2019

Clean San Diego (CleanSD)

The Clean San Diego (CleanSD) program intends to expand upon the Litter and Graffiti Abatement Pilot Program that was initially funded in the FY 2018 Adopted Budget in the amount of $800,000. While this one year pilot program was limited in scope and specific only to nine areas of the City, CleanSD is expected to be a Citywide initiative that includes additional services beyond litter and graffiti abatement, such as street sweeping and other waste removal.

The Mid-Year Report discussed the addition of $2.0 million in new unbudgeted expenditures in FY 2018 for the Environmental Services Department to gear up and begin implementation of the CleanSD program. Of this amount, we understand that only $200,000 to $345,000 is expected to be readily expendable by expanding the current contract with Urban Corps by $200,000, and, if feasible, Alpha Project by $134,000 and Ocean Blue by $11,000. The balance, approximately $1.7 million, was included in the projection for the purchase of new vehicles (approximately $1.1 million), including two refuse packers and other light trucks, and additional personnel expenditures for 4.00 FTEs. The Department expects to utilize hold-over vehicles that were recently replaced by CNG variants, but that are still in working condition, for the rest of FY 2018, thereby reducing program funding needs. However, if funding is required for spending above the expansion of current contracts discussed above, the necessary appropriation adjustments will be brought forward for Council consideration together with the Third Quarter Report.

The program is proposed to continue beyond FY 2018 and therefore it will also impact the FY 2019 budget. The extent of the impact is currently expected to range between $4.0 and $6.0 million and will be included in the Mayor's FY 2019 Proposed Budget. This includes the funding of additional vehicle purchases, additional sidewalk sanitation services, the continuation of the Litter and Graffiti Abatement Program, the continuation of contracts with Urban Corps, Alpha Project, and Ocean Blue, and the addition of approximately 25.00 FTEs. It should be noted that the Department is exploring options to shift certain eligible program expenditures, both one-time and ongoing, to the Refuse Disposal Fund. FM expects to have more details available in the Third Quarter Report. At that time, additional information on actual program expenditures will be available to better evaluate FY 2019 budget impacts.

Fire-Rescue Department Staffing, Deployment Reimbursement, and Contracts

The Mid-Year Report notes that the Fire-Rescue Department plans to hold a second fire academy beginning in March 2018, in addition to the single academy included in the FY 2018 Adopted Budget, in order to maintain full fire suppression staffing. The additional fire academy is projected to incur approximately $970,000 in unbudgeted expenditures in FY 2018, primarily in the form of overtime and non-personnel costs for supplies. Fire-Rescue has attributed the need for the second academy to higher-than-anticipated attrition among firefighters caused primarily by retirements and exits from the Deferred Retirement Option Plan (DROP) prior to the end of the customary five-year period. While expenditures related to the second fire academy are unbudgeted, our office notes that management's decision to host the academy is consistent with the City Council's policy direction to maintain full fire suppression staffing in FY 2018.

A high-level discussion of personnel costs, including those for Fire-Rescue, is included earlier in this report. As noted earlier, Fire-Rescue is projected to exceed its overtime budget by $3.2 million in FY 2018. Of this amount, $2.3 million is attributed to strike team and other reimbursable deployments including firefighting efforts in other parts of California and support for hurricane relief in the Gulf States. Reimbursements for these disaster relief costs are anticipated be received from the state and federal government as unbudgeted revenue. Fire-Rescue has indicated that approximately $1.2 million in reimbursements will be received in FY 2018, which has been included in the Mid-Year Report. The remainder of reimbursements are expected to be received in FY 2019, also as unbudgeted revenue. Should reimbursements be received sooner than expected, such revenue could potentially be realized in FY 2018.

The Mid-Year Report projects $4.7 million in over-budget contract expenditures for the Fire-Rescue Department for a variety of air support resources including "Super Scooper" air tankers, heli-tankers, and other aircraft expenses. These contracts did not require City Council approval as each individual item was below the $3.0 million threshold for ratification. The Department has indicated that the additional aviation resources were contracted on an emergency basis from October 2017 to December 2017 to augment the City's two firefighting helicopters. The City Council recently approved the purchase of a third firefighting helicopter, which is due to be operational by November 2018.

101 Ash Street

The Adopted Budget included $2.1 million in expenditures associated with furnishing and making tenant improvements to the 101 Ash Street building (101 Ash), and the relocation of City staff from other locations to that building. The Council authorized the City to enter into a lease-to-purchase agreement for the building in the first half of FY 2017. During development of the City's

FY 2018 Budget, it was anticipated that departments that were then housed at the Executive Complex and the City Operations Building would move to 101 Ash during FY 2018.

The Mid-Year Report notes that tenant improvements are now expected to begin construction in April 2018, which will delay relocation of staff to 101 Ash until FY 2019. The Mid-Year Report therefore indicates that the $2.1 million budgeted for improvements and relocation to 101 Ash will not be expended in FY 2018, though it is important to note that any savings in FY 2018 associated with this delay will be offset by the same costs being carried forward to FY 2019. Additionally, given that the Mid-Year report notes that construction of tenant improvements is expected to begin in April, some budget for those improvements may still be necessary in FY 2018. It is also possible that the cost of tenant improvements may exceed past estimates, which would increase the total amount of funding needed for the building.

Accordingly, while the delay will likely result in fewer expenditures in FY 2018, it is important to note that those expenditures will still be necessary, and will shift into FY 2019.

Evan V. Jones Parkade Elevators

The FY 2018 Budget included $1.5 million in expenditures from the Capital Outlay Fund for modernization and retrofit of the elevators at the Evan V. Jones Parkade (Parkade). In January of this year, on an emergency basis, the City entered into a sole source agreement for up to $1.0 million with J.R. Filanc Construction for repairs of the Parkade elevators. Repair of the elevators requires design and fabrication of several pieces of equipment, and actual construction work on the elevators is estimated to begin in early summer.

Executive Complex

Shortly after release of the Mid-Year Report, the City received notice that monitoring of the ongoing retrofit of the Executive Complex building revealed construction debris that tested positive for asbestos. The City had been leasing office space in the Executive Complex, and various staff from the Planning, City Auditor, Corporate Partnerships, Development Services, Fire-Rescue, Homeland Security, and Public Works offices and departments maintained offices there. As a result of the asbestos notice, the City has relocated employees that had worked at the Executive Complex to other sites in the City, including the City Administration Building, the City Operations Building, 9601 Ridgehaven Court, and 525 B Street. The City does not anticipate moving employees back into the Executive Complex.

At this time, the budgetary impacts of this relocation are unknown. The City may realize some savings as a result of no longer making rent payments of approximately $200,000 a month for office space at Executive Complex, though this may require negotiations with the Executive Complex's current owner. Costs that might offset those potential savings include expenses associated with moving files and furniture out of Executive Complex, and the potential need to lease additional office space elsewhere for relocated employees and offices. It is important that operational needs and expenses associated with this sudden relocation of staff be consistently monitored and reported throughout the remainder of the fiscal year.

Mid-Year Budget Adjustments

Although the City Council is not being asked to make changes to the General Fund budget at this time, it is being asked to increase revenue and expenditure appropriations in the Development Services Fund and the Fleet Operating Fund. Our Office believes that these requests are appropriate and discuss them in greater detail below.

Development Services Fund Appropriation Adjustment

An appropriation adjustment of $1.3 million in expenditures is requested for the Development Services Fund to address projected increased costs primarily related to the implementation of the Accela project (DSD project tracking system replacement). Corresponding revenues are also requested in an equal amount in order to balance the fund. The additional revenue is available based on current year-end projections for revenues exceeding budget by $2.3 million. The net year-end projection for the Development Services Fund after the appropriation adjustment is $1.0 million.

Fleet Operating Fund Appropriation Adjustment

The Mid-Year Report recommends increasing both revenues and expenditures in the Fleet Operating Fund by $1.4 million. This change is associated with the Fire-Rescue department switching from using low sulfur diesel fuel to renewable diesel, which helps reduce greenhouse gas emissions. While Fire-Rescue previously purchased its diesel fuel directly, its fuel purchases will now go through the Fleet Operating Fund. This increases both revenues and expenditures in that Fund, but because it only shifts Fire-Rescue's fuel expenditures to the Fleet Operating Fund, it has no impact on the City's General Fund or Fire-Rescue's budget for fuel purchases.

Mid-Year Ordinance and City Council Role

The Mid-Year Ordinance, in effect since 2011, requires the Mayor to report the mid-year deficit or surplus to the Council and provide a recommendation to address such deficit or surplus. The Mayor may budget all, none, or any portion of the surplus. The Council may approve the Mayor's recommendation or modify such recommendation in whole or in part up to the total amount recommended by the Mayor.

As required by the Ordinance, the Mayor has reported $12.6 million in over-budget departmental expenditures for justifiable and unanticipated critical activities. This overage is offset by $7.0 million in revenue as outlined in the report, resulting in a projected FY 2018 deficit of $5.6 million. The Mayor's recommendation for addressing the deficit at this point is to do nothing but continue to carefully monitor the budget and review department hiring decisions. This is consistent with the treatment of a $4.0 million deficit at this time last year. While the Mayor could have recommended an appropriation adjustment to address the deficit, we agree it is not necessary with seven months of activity remaining in the fiscal year and careful oversight of the budget.

The Mid-Year Report also noted the need for a new $2.0 million expenditure in FY 2018 to expand the CleanSD Program in the Environmental Services Department. No funding source was identified for this program expansion. At the February 1st meeting of the Budget and Government

Efficiency Committee, the IBA raised concerns about the lack of a funding source for new services (potentially contributing to a structural deficit); reliance on generating department savings (and potential service reductions) to cover the costs; absence of Council input/approvals on a significant service expansion; setting a precedent for adding new unbudgeted services at mid-year, particularly in a deficit environment; and the inability for Council to consider this program expansion in the context of the overall budget and service priorities.

Recently, FM provided new information that only $200,000-$345,000 of the requested $2.0 million is likely to be spent in FY 2018. (See further discussion of CleanSD on page 10.) They have also confirmed that sufficient savings can be identified in the Environmental Services Department to address the reduced costs without affecting other services. Costs to continue the service expansions in FY 2019 are estimated to range between $4.0 and $6.0 million. This proposal will be included in the Mayor's FY 2019 Proposed Budget and be subject to City Council approval in the budget process.

Amendments to the Mid-Year Ordinance could be considered by the Budget and Government Efficiency Committee, requiring the Mayor to identify specific resources for expanded or new programs at mid-year whether it be a surplus, an appropriation adjustment, departmental savings, a program reduction, or new revenue. In the current Mid-Year Ordinance, Council's ability to modify the Mayor's Mid-Year recommendations for new expenditures is limited to when the Mayor has recommended use of surplus or appropriation adjustment to cover the costs. There was no surplus projected this year and no source of alternative funding was identified for the expanded CleanSD program.

CONCLUSION

The Office of the IBA has reviewed the Mid-Year Report and we believe that the projections included in the Report are appropriate, as are the requested appropriation adjustments. Updates to projected year-end revenues and expenditures will be available in the Third Quarter Report, scheduled to be released in May and reviewed by the City Council on June 11, 2018.

As discussed in this report, the Budget and Government Efficiency Committee may want to consider minor amendments to the current Mid-Year Ordinance with respect to the following:

- If the Mayor proposes expenditures for new or expanded services at Mid-Year, resources for funding them – whether it be a surplus, appropriation adjustment, departmental savings, program reduction, or new revenue – should be identified in the Mid-Year Report.

- Clarification of Council authority provided in the Ordinance for such expenditures and resources.

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