THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of the FY 2019 First Quarter Budget Monitoring Report

OVERVIEW

The Department of Finance (DOF) issued the Fiscal Year 2019 First Quarter Budget Monitoring Report (First Quarter Report) on November 7, 2018. The First Quarter Report describes the current status of major General Fund revenues and their year-end projections based on actual (unaudited) data from July 2018 through September 2018. The report also provides year-end projections of public safety departments' overtime expenditures and key non-discretionary expenditures, as well as updates on programs, General Fund balances and reserves, and Risk Management reserves. Finally, the report provides a year-end estimate for fund balance (Excess Equity). Year-end projections for other department expenditures are not included in the First Quarter Report, but will be provided in the FY 2019 Mid-Year Budget Monitoring Report (Mid-Year Report).

The projections and Excess Equity estimate included in the First Quarter Report inform the projections included in the FY 2020-2024 Five-Year Financial Outlook (Outlook), which our Office has analyzed and reviewed in a separate IBA Report. Our review of the First Quarter Report includes an analysis of major General Fund revenues, additional information on unbudgeted expenditure increases related to homelessness services and public safety overtime, and a discussion of other known additional costs likely to occur in FY 2019 not otherwise mentioned in the First Quarter Report.

FISCAL AND POLICY DISCUSSION

<u>Major General Fund Revenues</u>

The FY2019 First Quarter Report includes projections for the four largest General Fund revenue sources: property tax, sales tax, transient occupancy tax and franchise fees. Overall, these four revenue sources are projected to bring in approximately $24.9 million of revenue over the FY 2019

Budget. The significant variances are in property tax and sales tax, while transient occupancy tax and franchise fees are projected very close to budgeted amounts.

The FY 2019 projections are updated based on activity in the first three months of the current fiscal year and also take into account unaudited actual results from the end of the prior fiscal year (FY 2018). The table below includes both the FY 2018 unaudited actuals and the FY 2019 projections. While these four major revenue sources are projected at 2.3% over the current budget, this reflects an overall 6.4% or $65.4 million increase from FY 2018 results. Each of the four major revenue sources are discussed in more detail below.

Major General Fund Revenues (in Millions)							
	FY 2018 Unaudited Actual[1]	FY 2019 Budget	FY 2019 Projection	FY 2019 Projected Variance	Variance %	FY 2019 Growth over FY 2018	Variance %
Property Tax	$ 535.5	$ 560.0	$ 568.7	$ 8.7	1.5%	$ 33.2	6.2%
Sales Tax	272.9	282.1	297.7	15.7	5.6%	24.8	9.1%
Transient Occupancy Tax[2]	143.1	151.3	151.5	0.2	0.1%	8.4	5.9%
Franchise Fees	78.4	77.1	77.4	0.4	0.5%	(1.0)	-1.3%
Total Revenue	**$ 1,029.9**	**$ 1,070.5**	**$ 1,095.4**	**$ 24.9**	**2.3%**	**$ 65.4**	**6.4%**

[1] FY 2018 Unaudited Actuals from the FY 2018 Year-End Performance Report

[2] The FY 2019 First Quarter Budget Monitoring Report Transient Occupancy Tax (TOT) budget and projections include the 1 cent portion of TOT which is transferred from Special Promotional Programs into the General Fund. The FY 2018 unaudited actual reflected above has been revised to include this amount for comparison.

Property Tax

The FY 2019 projection for property tax, based on new and updated information available, is $8.7 million, or 1.5%, over the Adopted Budget. The largest portion of property tax revenue, representing 70% of this category, is the 1% tax assessed on property owners. While we are seeing a slow-down in home sales, home values in the City of San Diego remain high and, as a result, revenue from the 1% tax is trending slightly higher than budget for FY 2019. This reflects a 4.8% increase, or $18.1 million, over the FY 2018 unaudited actuals. The revenue in-lieu of motor vehicle license fees (MVLF backfill), accounts for approximately 26% of the General Fund property tax revenue. The FY 2019 projection for the MVLF backfill has been revised upward by $1.3 million based on updated information received from the County of San Diego regarding the amount that the City will receive this fiscal year. This results in an additional $ 8.3 million in MVLF backfill over the FY 2018 unaudited actual. The remaining portion of property tax revenues to the General Fund are from residual Redevelopment Property Tax Trust Fund (RPTTF) distributions. These amounts have also been updated based on the most recent information available, resulting in approximately $6.5 million additional revenue projected for FY 2019.

Sales Tax

The FY 2019 projection for sales tax is significantly over budget and also a significant change from FY 2018 unaudited actuals. As reported in both the FY 2018 Year-End Performance Report and the FY 2019 First Quarter Report, this variance is primarily due to delays in receiving approximately $14.7 million of FY 2018 sales tax as a result of system and process changes at the California Department of Tax and Fee Administration. If the $14.7 million had been received in FY 2018 as expected, the FY 2019 projection would be roughly $283.0 million and trending at only 0.3% over budget. At this time, DOF as well as the City's sales tax consultant, Avenu Insights & Analytics, continue to work with the State to reconcile sales tax data due to the delays. Clearer information should be available for development of the FY 2019 mid-year projections.

Transient Occupancy Tax

The Transient Occupancy Tax projections in the FY 2019 First Quarter Report include the 5.5 cent portion which is allocated directly to the General Fund, as well as the 1 cent portion which is transferred to the General Fund per Council approval in the Adopted Budget. Actual data is available for the first two months of the fiscal year and is trending on-budget. The approximate 5.2% increase projected for FY 2019 over FY 2018 unaudited actuals is consistent with the assumptions made in preparation of the FY 2019 Adopted Budget.

Franchise Fees

Franchise Fees are also projected to be on-budget based on the information available in the first few months of the fiscal year. The most significant contributor to the General Fund franchise fees is SDG&E, representing over 60% of this category. There is no new information available this early in the fiscal year regarding payments from SDG&E. The City receives a clean-up payment in February, and DOF will update their projection at that time. The next two largest components of franchise fees are the cable companies and refuse haulers, when combined with SDG&E, these three account for over 98% of the Major General Fund franchise fee revenue.

As stated in the First Quarter Report, the FY 2018 unaudited actuals from the refuse haulers came in higher than anticipated, resulting in an updated projection for FY 2019; however, this is offset by continuing decline in revenue from the cable companies. This results in an overall slightly over-budget projection for FY 2019 franchise fees. The reduction in franchise fees from FY 2018 unaudited actuals is due to the shift of more Sycamore Facilities franchise fee revenue to the Recycling Fund, which was accounted for in development of the FY 2019 Adopted Budget.

Selected General Fund Expenditures and Other Likely Costs in FY 2019

The following section provides additional information on unbudgeted expenditure increases related to homelessness services and public safety overtime, and a discussion of other known additional costs likely to occur in FY 2019.

Housing Navigation Center Costs

The First Quarter Report includes increased Police Department staffing costs for enhanced security and outreach related to the new transitional storage center. However, it does not consider costs for similar activities related to the Housing Navigation Center as it was approved November 13, 2018. A memorandum of understanding between the City and the San Diego Housing Commission requires the Police Department to provide regular patrols surrounding the Navigation Center, and the Environmental Services Department (ESD) to provide cleanings of the facility's exterior.

Additional and more specific requirements were placed on both departments in another memorandum describing the City's commitment to the community surrounding the Navigation

Center of enhanced security and cleanliness. Among its requirements is that the Police Department provide a presence for safety during the day and night and that the City supplement security services to ensure a 24-hour per day security presence around the Navigation Center. It is unclear whether these requirements will result in the Police Department providing 24-hour security for the Navigation Center which, as seen with the security activities related to the storage center, would have a significant budget impact. According to Police, options are being evaluated.

ESD is also required to provide abatement of waste and abandoned belongings at least twice per week, litter removal at least five times per week, sanitation of the surrounding area at least once per week, and community engagement. ESD has informed us that in order to provide the required Clean SD services for the Navigation Center, they plan to absorb these costs in their existing FY 2019 Clean SD budget of $4.2 million. They plan to do this by assigning a heightened priority to the Navigation Center which may result in other areas receiving less of a focus.

These costs are not included in the First Quarter Report. Therefore, our Office has requested that DOF identify them in the FY 2019 Mid-Year Report, including a funding source. Assuming absorption of the cost of new services within the current year budget is not a good practice and can lead to over-expenditures and deficits, as witnessed in Police Department overbudget overtime expenditures related to the transitional storage center.

Police Department Overtime: Projected FY 2019 Overages Are Cause for Concern; May Be Further Increased by Navigation Center

The First Quarter Report notes that the Police Department is projected to spend $33.9 million on overtime in FY 2019, exceeding its budget by $9.3 million. For additional context, the FY 2019 projection of $33.9 million is $4.2 million more than the Department's actual spending in FY 2018. Components of the increased overtime spending between FY 2018 and FY 2019 include new unbudgeted programs such as:

- $2.0 million for security around the transitional storage facility
- $500,000 for security around the San Diego riverbed
- $400,000 for general increased Neighborhood Policing

The items above represent increased service demands with which the Department has been tasked with no corresponding budget increase. Further, the FY 2019 Budget for Police overtime was reduced by $3.0 million for anticipated reductions in extension-of-shift spending[1] that have not fully materialized.

As noted above, much of the Department's new overtime spending over FY 2018 is due to new unbudgeted programs. These include commitments made to provide increased service around the transitional storage facility and San Diego riverbed. Furthermore, the First Quarter projections do not include additional commitments for enhanced services around the new Navigation Center. Assuming the Department provides similar services at the Navigation Center as it does at the storage facility, these added costs could total roughly $2.0 million. The Department is currently exploring potential ways to mitigate these costs while providing required service levels.

[1] Extension-of-shift overtime is scheduled in advance and is used for community policing, emergency calls, writing reports, training, and other police work.

It is significant that additional costs are being incurred by the Police Department for new programs which, although approved by the City Council as concepts, did not include accurate or complete cost projections. For this reason, we note that a related appropriation adjustment to support new programs must be included in the Mid-Year Report.

Fire-Rescue Department Overtime and Additional Fire Academy in FY 2019

The Fire-Rescue Department is projected to exceed its overtime budget by $6.9 million at fiscal year-end, for a total expenditure of $45.0 million. As noted in the First Quarter Report, the increase in overtime is largely offset by over-budget salary savings of $4.8 million and increased reimbursement revenue of $2.0 million, leaving a net General Fund impact of $160,000. While the General Fund impact may be minimal, our Office notes that efficiencies may be gained by reducing overtime either through increased hiring and/or through other overtime reduction efforts. A more detailed discussion of this concept is included in our review of the FY 2020-2024 Five-Year Financial Outlook.

The Fire-Rescue Department has indicated that approximately $1.1 million of the projected overtime overage is due to higher-than-anticipated attrition, which has left the Department with fewer firefighters than required to achieve full staffing. To correct the situation, the Department has requested approval via memorandum to the Chief Operating Officer to hold an additional unbudgeted fire academy in FY 2019 (for a total of two fire academies to be held in the fiscal year). Higher staffing levels are expected to reduce the necessity for overtime due to constant staffing requirements.

The additional fire academy in FY 2019 will cost approximately $1.1 million and is anticipated to be requested as an appropriation adjustment in the Mid-Year Report. Of that amount, $710,000 will be budgeted as overtime and has already been included in the year-end projection in the First Quarter Report. The Department has stated that the added academy could begin as soon as March 2019.

Funding for a Possible Special Election

On September 20, 2018, the initiative to increase the City's Transient Occupancy Tax to expand the Convention Center, fund road repairs, and provide funding for housing and services for the homeless qualified to be placed on the ballot of the next regularly scheduled citywide General Election in November 2020, unless the Council decides to place the measure on the ballot of an earlier citywide Special Election (which could be in March 2020 or sooner). There has been discussion of calling a special election early in 2019 to accelerate the voters' opportunity to decide. While Special Election costs are not known at this time, it is reasonable to roughly estimate they could be in the neighborhood of $5.0 million. If a request to call an early special election is docketed for Council consideration, it will be important for the Mayor to quantify the associated cost and identify a sufficient source of funding. A related appropriation adjustment would then need to be included in the Mid-Year Report.

CONCLUSION

Our review of the First Quarter Report includes an analysis of major General Fund revenues, additional information on unbudgeted expenditure increases related to homelessness services and public safety overtime, and a discussion of other known additional costs likely to occur in FY 2019 including an additional fire academy and a possible special election. Our Office will provide additional updates on these items as part of our review of the Mid-Year Report, expected to be released on January 28, 2019. As noted in this report, any new programmatic expenditures proposed by the Mayor should be included in the Mid-Year Report for Council consideration.

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