THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: TBD

IBA Review of the FY 2024 First Quarter Budget Monitoring Report

OVERVIEW

The Department of Finance issued the *Fiscal Year 2024 First Quarter Budget Monitoring Report* (First Quarter Report) on November 9, 2023. 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 2023 through September 2023, as well as providing revenue updates from specific departments. For expenditures, the report provides projections and updates on public safety personnel expenses, including overtime; Other Post-Employment Benefits (OPEB); and non-discretionary costs including debt, energy, fuel, information technology, rent, and water services. An update on the General Fund Reserve and Excess Equity is also included. Year-end projections for other General Fund revenues and expenditures are not included in the First Quarter Report but will be provided in the FY 2024 Mid-Year Budget Monitoring Report (Mid-Year Report).

In accordance with *Council Policy 000-02: Budget Policies*, the Department of Finance monitors the City's annual operating budget and presents quarterly reports to the Budget and Government Efficiency Committee and City Council which include forecasted year-end results. This is the first of those quarterly reports for FY 2024. The first quarterly report each year serves as an initial high-level look, based on only three months of actual data and select areas of focus. The Mid-Year and Third Quarter Budget Monitoring Reports are more robust, projecting full revenues and expenses for the General Fund as well as non-general fund departments, and often include requests for budget adjustments. Our Office reviews these quarterly reports and provides additional information and recommendations as appropriate for Council's consideration.

Our review of the First Quarter Report includes an analysis of major General Fund revenues, as well as additional information on public safety overtime and OPEB. The projections and Excess Equity estimate included in the First Quarter Report inform the projections included in the FY 2025-2029 Five-Year Financial Outlook (Outlook), which our Office analyzes and reviews in IBA Report 23-36.

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FISCAL AND POLICY DISCUSSION

MAJOR GENERAL FUND REVENUES

General Fund revenues in the First Quarter Report are $4.4 million below amounts included in the Adopted Budget. The decrease is largely driven by sales tax, though total sales tax declines in the First Quarter Report are partially offset by increases in property tax revenue due to higher than anticipated actuals in the first quarter of FY 2024. Each of the four major General Fund revenues is discussed below. A discussion of Cannabis Business Tax revenue is also included.

Major General Fund Revenues *($ in millions)*							
	FY 2023 Unaudited Actuals[1]	FY 2024 Adopted Budget	1st Quarter	1st Quarter Projections vs Adopted Budget	Variance from Adopted Budget (%)	1st Quarter Projection vs FY 2023 Actuals	Variance from FY 2023 Actuals (%)
Property Tax	$ 721.4	$ 758.6	$ 771.9	$ 13.2	1.7%	$ 50.5	7.0%
Sales Tax	384.7	$ 401.7	385.2	(16.5)	-4.1%	0.5	0.1%
Transient Occupancy Tax	161.8	$ 172.6	171.2	(1.4)	-0.8%	9.4	5.8%
Franchise Fees	111.3	$ 108.5	108.7	0.3	0.2%	(2.6)	-2.3%
Total	**$ 1,379.2**	**$ 1,441.4**	**$ 1,437.0**	**$ (4.4)**	**-0.3%**	**$ 57.8**	**4.2%**

[1] FY 2023 Unaudited Actuals are from the FY 2023 Year-End Financial Performance Report.

<u>Property Tax</u>

Property taxes represent the single largest source of General Fund revenue. The first quarter projection for Property Taxes is $771.9 million, which is an increase of $13.2 million from the Adopted Budget of $758.6 million. City property taxes are derived from three major sources: the Proposition 13 1% levy on the assessed value of property throughout the City, of which the City receives approximately 17%; Motor Vehicle License Fee (MVLF) backfill payments; and distributions from the Redevelopment Property Tax Trust Fund (RPTTF), which represents payments to the City as a result of the dissolution of the former Redevelopment Agencies.

The increase shown in the First Quarter Report is mostly within the 1% property tax allocation ($10.3 million), but there is also an increase in the MVLF payment ($2.8 million). These increases are attributable to higher-than-expected property tax distributions within the first three months of FY 2024. It is important to note that FY 2024 property tax receipts reflect the calendar year 2022 real estate market, which still reflected a housing market buoyed by low interest rates; the lag between housing market performance and property tax revenue is due to the timing of when properties are assessed and when associated taxes are due.

The increase in Property Tax revenue comes despite the fact that the Adopted Budget contained a relatively high 5.64% growth assumption in most property tax categories for FY 2024. In the previous year, the FY 2023 Adopted Budget contained a growth rate of 6.00% and the year-end property tax revenues came in above budget. The housing market in 2022 experienced a lower volume of sales compared to the previous year; as such, a growth rate lower than the previous year, but still above average, remains a reasonable projection for FY 2024. These above-average growth rates are expected to moderate in future years as they begin to reflect recent market activity, including further declines in sales driven by a higher interest rate environment.

Sales Tax
The First Quarter Report projection reflects sales tax revenue totaling $385.2 million in FY 2024, representing a $16.5 million decrease, or 4.1%, from the Adopted Budget. The Department of Finance decreased both the base upon which the FY 2024 sales tax projection was made (actual receipts in FY 2023) and the growth rates projected for FY 2024: sales tax growth rates were decreased from 1.5% for every quarter to 1.0% for the first quarter and 0.20% for the rest of the year. The updates to the sales tax projection for FY 2024 make the projection almost flat with actual sales tax revenues in FY 2023.

The majority of the decrease in projections is related to sales tax coming in below Third Quarter revenue projections in FY 2023, which was used as the base for FY 2024. The FY 2024 Adopted Budget assumed there would be 1.5% growth in sales tax revenues using an FY 2023 year-end projection of $395.7 million, which created the $401.7 million sales tax revenue projection in the FY 2024 Adopted Budget. FY 2023 sales tax revenues came in below the FY 2023 third quarter projection by $11.0 million, at $384.7 million. Therefore, the FY 2024 projection is starting from a lower point, or base, than previously assumed. We note that our Office flagged this anticipated decline in FY 2024 sales tax revenue in our recommended FY 2024 budget modifications report; although, current year actuals are trending below our Office's forecast as well.

Beyond the sales tax base decreasing to reflect the actual sales tax performance in FY 2023, the quarterly growth rates are all anticipated to decrease, and reflect a 1.0% growth rate for the first quarter and 0.20% for the following quarters. The actual sales tax revenues for the first quarter of FY 2024 came in $6.1 million lower than what was assumed in the FY 2024 Adopted Budget, or 4.6% lower than the first quarter of FY 2023 (and $4.7 million below the updated First Quarter projection).

The October UCLA Anderson Forecast predicts that the growth rate in taxable sales in California will be higher in calendar year 2024 than 2023, indicating it may be reasonable to predict growth towards the end of FY 2024 after declines in the first quarter. This forecast is consistent with the City's sales tax consultant's prediction. The actual sales tax revenue from the first quarter was closely aligned with what the City's sales tax consultant predicted, with the actuals coming in $350,000 higher than they had projected for the first quarter of FY 2024. The City's sales tax consultant included a growth rate of -4.1%, -2.8%, 1.2%, and 5.6% for each respective quarter, leading to a year-end projection for FY 2024 of $382.1 million.

Our office believes it would be reasonable to project sales tax revenues using the sales tax consultant's assumptions and growth rates given these projections align with the Anderson forecast's assumption of slower economic performance in calendar year 2023 and a slowly improving performance in calendar year 2024. This would result in a decrease of $3.1 million below first quarter projections.

Transient Occupancy Tax
Transient Occupancy Taxes (TOT) – or hotel taxes – are the third largest major General Fund revenue source. San Diego's TOT rate is 10.5%, with 5.5% of that amount allocated to the General Fund (to support general City services), 4.0% to Special Promotional Programs (to support programs and services that encourage tourism to the San Diego area), and 1.0% allocated as

discretionary/Council directed funding. While the First Quarter Report references the 5.5% General Fund allocation of TOT, it is important to note that changes in TOT receipts impact all of these allocations, as shown in the table below.

Transient Occupancy Tax Revenue *($ in millions)*			
	FY 2024 Adopted	**FY 2024 Projection**	**1st Quarter Projections vs. Adopted Budget**
General Fund Allocation (5.5%)	$ 172.6	$ 171.2	$ (1.4)
Special Promotional Programs (4.0%)	124.4	123.4	(1.0)
Council Discretionary (1.0%)	31.1	30.8	(0.3)
Total	**$ 328.2**	**$ 325.5**	**$ (2.7)**

Note: Figures may not total due to rounding.

The First Quarter Report projects the General Fund allocation of TOT to come in under the FY 2024 Adopted Budget by $1.4 million, which is a 0.8% decrease from the Adopted Budget. However, since the release of the First Quarter Report, TOT actual receipts have declined further. TOT actuals from July to October decreased by 3.7% compared to July through October of the previous year. When comparing the July through October actuals to the Adopted Budget, the actuals have decreased by 9.1% as compared to an adopted growth rate of 5.9%. Total declines in FY 2024 to date equate to a $9.0 million for overall TOT, which includes a $4.7 million decline in the General Fund portion of TOT.

The San Diego Tourism Authority and Tourism Economics releases a forecast for lodging demand and revenue growth every few months. An updated forecast was released in October for dates through the end of calendar year 2024. Tourism Economic projects a quarterly revenue growth rate (relative to calendar year 2019) of 23.7%, 20.9%, 19.1% and 23.4%, which would equate to $304.3 million for overall TOT in FY 2024 if applied to calendar year 2019 TOT actuals. When comparing these projections to actuals for previous years, the Tourism Economics projection came in under by 2.6% for both the second half of FY 2022 and all of FY 2023. Given these differences, it would be reasonable to adjust the forecast by an additional 2.7% to close the gap between their model and actuals, which would bring the adjusted forecast to $312.5 million for overall TOT and $162.9 million for the General Fund allocation of TOT, equating to a 4.2% growth rate from FY 2023 year-end actuals. Additionally, the Tourism Economics forecast utilized a recession-scenario assumption. Notably, the October UCLA Anderson Forecast does not predict a recession, and assumes a 'soft-landing' scenario; the forecast presented by Tourism Economics therefore reflects a more conservative projection for TOT revenues.

Given the most recent actuals for TOT to date have come in under budget by $4.7 million for the General Fund allocation of TOT, our Office projects year-end FY 2024 TOT revenues will be lower than those in the First Quarter Report. We suggest year-end actuals from FY 2023 and the most recent actuals in FY 2024 be used to update the FY 2024 year-end projection. The growth rate of 5.9% is still reasonable given historic TOT performance after economic downturns typically yielding a strong recovery spanning multiple years.

This would equate to an overall TOT projection of $317.2 million which includes $166.9 million in General Fund portion of TOT, which would decrease the General Fund allocation of TOT by an additional $4.3 million as compared to the First Quarter Report.

Franchise Fees

Franchise fees represent payments made by private companies to the City for the right to operate within the City's right-of-way. The main sources of franchise fee revenue are: from San Diego Gas & Electric (SDG&E) for the right to provide City residents and businesses with gas and electricity services; from Cox Communications, AT&T, and Spectrum for the right to provide cable services to City residents; and from private refuse haulers that conduct business within City limits. Franchise fees from SDG&E and cable companies are based on a percentage of revenue generated, while franchise fees from refuse haulers are based on tonnage. Franchise fee revenue in FY 2024 is projected to increase by $260,000 to $108.7 million. This increase is due to increased tonnage being deposited in the landfill during the first quarter.

Cannabis Business Tax

While not all departmental revenues are included within the First Quarter Report, this year's report does contain an early projection on FY 2023 revenues from the City's non-medical Cannabis Business Tax (CBT). The tax applies to cannabis related business activities which includes, but is not limited to, transporting, manufacturing, packaging, and retail sales, with retail sales taxed at a rate of 8.0% and other activities taxed at 2.0%.

The First Quarter Report projects that CBT revenue will decrease by $1.1 million, from $21.4 million in the Adopted Budget to $20.3 million, based upon gross revenue reductions reported in the most recent actuals. The report notes that these reductions are likely due to an oversupply of cannabis goods in California, which has resulted in a decrease in prices and taxable gross receipts. Since there have been continued declines from FY 2023 that are likely due to a saturated market, this trend will be important to monitor going forward to see if declines continue or if revenue from CBT levels out.

GENERAL FUND EXPENDITURES

In this section, we discuss expenditures related to public safety overtime and OPEB.

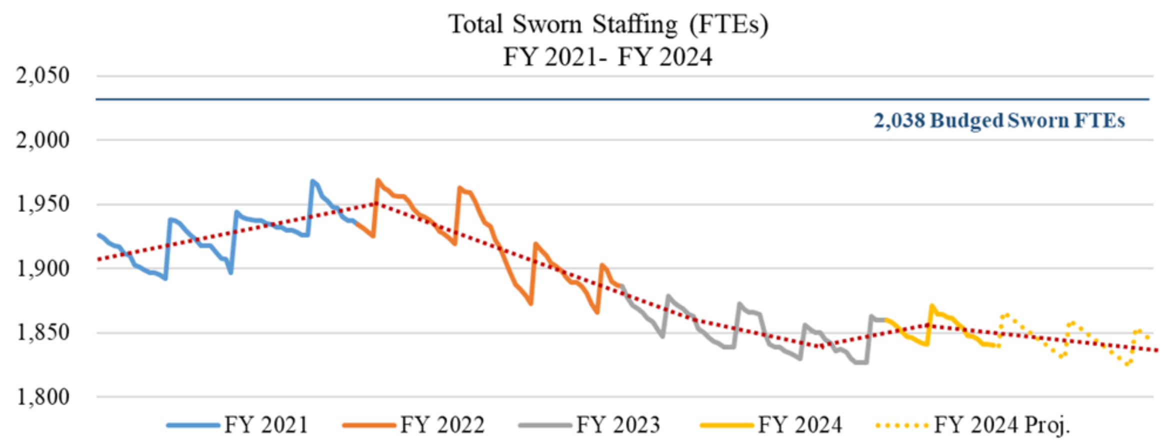
Public Safety Overtime

Police Overtime

The Police Department is projected to exceed its FY 2024 overtime budget by $7.8 million, or approximately 16%, at fiscal year-end, for total projected overtime expenditures of $57.2 million. At the Budget and Government Efficiency Committee meeting on November 17, 2023, the Police Department attributed this overage to several causes, including POA and MEA salary increases that were not accounted for within the Department's overtime budget.

The FY 2024 Adopted Budget for Police Overtime, at $49.3 million, was increased by $9.2 million from FY 2023. As discussed in IBA Report 23-08, *Review of the Fiscal Year 2024 Proposed Budget,* this increase consisted of several adjustments, including a $2.4 million ongoing overtime adjustment to account for negotiated salary increases. Also included, among other adjustments, was a one-time increase of approximately $5.0 million that was specifically sized in order to align the Department's overall overtime budget with FY 2023 Mid-Year Budget Monitoring Report which, at the time, projected a $9.2 million overtime expenditure overage at fiscal year-end.

While negotiated salary increases are largely accounted for within the Department's budget, the overall amount of overtime utilized by SDPD would need to decrease relative to FY 2023 in order to remain at budget. This was a plausible assumption given that the Department's sworn staffing level, as depicted in the chart below, showed a slight improvement preceding the release of the FY 2023 Proposed Budget. However, that brief trend did not continue for long. As we recently discussed in [IBA Report 23-34, *IBA Review of the FY 2023 Year-End Financial Performance Report,*] the Police Department is now currently projected to realize an overall net loss of sworn officers in FY 2024, primarily due to academy sizes that are well below the Department's recruiting goal.



The following table provides a breakdown of the Police Department's overtime budget by category, including year-end projections from the First Quarter Report. Highlighted are the two specific subcategories that are primarily utilized for purposes of meeting sworn staffing needs: "Patrol Staffing Backfill" and "Extension of Shift (General)." The primary factors contributing to the projected overage according to the Department include continuing staffing shortages, ongoing efforts to meet recommended staffing levels, a slight increase in calls for service requiring police responses and increased critical incidents. Additionally, the Department notes that it has implemented proactive crime prevention efforts using officers on an overtime basis to patrol certain high crime areas, including Belmont Park and the Gaslamp District. The Council may wish to enquire further with respect to these efforts and the other factors described above which are driving the projected overtime overage.

SDPD FY 2024 General Fund Overtime Breakdown					
Category	Subcategory	FY2024 Adopted Budget	FY 2024 YE Projection $	%	Projected Variance Over/(Under)
Extension of Shift	Extension of Shift (General)	$ 8,534,940	$ 10,931,115	128%	$ 2,396,175
	Reports	1,383,009	2,159,319	156%	776,310
	Training & Support	995,747	1,397,655	140%	401,908
	Emergency Calls	27,171	29,814	110%	2,643
	Patrol Staffing Backfill	13,126,683	15,577,794	119%	2,451,111
	Community Policing	482,578	813,071	168%	330,494
	Communications Staffing	1,500,528	1,995,479	133%	494,951
Call Back	Call Back	1,614,495	1,873,625	116%	259,130
Court	Court	2,373,408	1,475,129	62%	(898,279)
Holidays	Holiday Premium Pay	4,887,127	6,319,177	129%	1,432,050
Special Events	Special Events Commercial (1)	1,341,258	1,341,258	100%	-
	Special Events - Non-Profit (1)	1,304,565	1,304,565	100%	-
	July 4th Holiday Support	224,108	620,980	277%	396,872
	Ballpark Events (1)	1,560,657	1,560,657	100%	-
	Other Special Events (1)	483,367	483,367	100%	-
Grants/Task Forces	Grants/Task Forces (1)	2,756,481	2,124,005	77%	(632,476)
Other Events	Presidential/Dignitary Visits	82,415	1,539	2%	(80,876)
	Protests & Other Events	178,051	30,758	17%	(147,293)
	Neighborhood Policing	2,987,614	3,844,507	129%	856,893
	CleanSD	2,193,912	2,411,138	110%	217,226
	Other (inc. Covid-19)	246,086	705,968	287%	459,882
Miscellaneous	FLSA Overtime (Flores)	1,052,851	155,959	15%	(896,892)
TOTAL		**$ 49,337,051**	**$ 57,156,879**	**116%**	**$ 7,819,828**

(1) 100% reimbursable, with the exception of Non-Profit Special Events for which approx. 44% cost recovery is budgeted.

Over the past few years, actual overtime expenditures have increased considerably, from $37.2 million in FY 2021 to $50.8 million FY 2023, and are now projected to exceed $57 million by the end of this fiscal year. At the same time, budgeted overtime expenditures have increased from $30.7 million in FY 2022 to $49.3 million in FY 2024. Despite these increases, Police overtime continues to come in approximately $10 million over budget per year. ***Our Office stresses the importance of addressing the continued trend of Police overtime coming in over-budget, particularly given that the City is facing significant General Fund budget deficits over the next five years.***

The City Auditor is currently in the fieldwork stage of its audit on San Diego Police Department Overtime, which has a targeted completion date of February 2024. Objectives of the audit include determining if SDPD's overtime policies are in line with best practices and whether these policies are followed, determining if overtime costs are in line with comparable police agencies, and determining what factors contribute to most of SDPD's overtime costs and if there are opportunities to reduce these costs. Result from this audit should help inform the Department's overtime budget development in FY 2025 and, potentially, provide actionable recommendations to better manage Police overtime. Additionally, the FY 2024 Adopted Budget included $225,000 to retain a consultant to develop a branding and marketing strategy for a new recruitment campaign. The Department is hopeful this new marketing product, once developed, can help increase recruitment efforts. If successful, this could reverse the negative sworn staffing trajectory that is currently projected. The Department is currently in the evaluation phase of the Request for Proposals (RFP) process which is expected to be completed in February 2024. The timeline for when the new recruitment campaign will begin is not yet known.

Historical information on Police Department overtime expenditures is provided in the following table.

Police Overtime - Historical Budget vs. Actuals *($ in millions)*									
	FY 2016	**FY 2017**	**FY 2018**	**FY 2019 [1]**	**FY 2020 [2]**	**FY 2021 [3]**	**FY 2022**	**FY 2023**	**FY 2024**
Budget	$18.0	$21.0	$26.3	$24.6	$35.9	$38.1	$30.7	$40.2	$49.3
Actual	$25.0	$26.0	$29.7	$31.9	$44.8	$37.2	$40.9	$50.8	$57.2 Proj.
Overage/ (Savings)	**$7.0**	**$5.0**	**$3.4**	**$7.4**	**$8.9**	**($0.9)**	**$10.2**	**$10.7**	**$7.8 Proj.**

NOTES: Table may not total due to rounding; FY 2016 through FY 2023 Actual amounts are based on unaudited actuals.

[1] The $31.9 million FY 2019 actual amount includes approximately $29.3 million of General Fund and $2.7 million of Seized Assets Fund (SAF) expenditures.

[2] The $44.8 million FY 2020 actual amount includes $41.4 million and $3.4 million for the General Fund and SAF, respectively; and the $35.9 million budget amount includes $32.1 million and $3.9 million for the General Fund and SAF, respectively.

[3] The $37.2 million FY 2021 actual amount includes $32.9 million and $4.3 million for the General Fund and SAF, respectively; and the $38.1 million budget amount include $33.7 million and $4.4 million for the General Fund and SAF, respectively.

Fire-Rescue Overtime

The FY 2024 Adopted Budget for Fire-Rescue overtime, at $48.4 million, was increased by $15.7 million from FY 2023. Similar to Police overtime, the overtime budget for the Fire-Recuse Department was specifically sized in order to align the Department's overall overtime budget with the FY 2023 Mid-Year Budget Monitoring Report which, at the time, projected a $15.7 million overtime expenditure overage at fiscal-year end. The Fire-Rescue Department ultimately ended FY 2023 with overtime expenditures totaling $51.3 million, or $1.5 million in excess of mid-year projections.

For FY 2024, the Fire Rescue Department is projected to end FY 2024 with total overtime expenditures of $50.1 million. While this is projected to exceed the Department's overtime budget by $1.7 million, or approximately 3.4%, at fiscal year-end, it represents a reduction of $1.2 million relative to FY 2023 and is in line with actual overtime expenditures dating back to FY 2021. The Fire-Rescue Department estimates that salary savings from the corresponding sworn overtime is projected to be $5.0 million at year-end; however, it is unknown at this time how this projected salary savings compares to the increased Budgeted Personnel Expenditure Savings (BPES) in Fiscal Year 2024. A full analysis on departmental salary savings in comparison to the budget will be completed as part of the Mid-Year Budget Monitoring process.

Consistent with FY 2023, fire-suppression staffing shortfalls and Backfill Overtime accounts for the majority of the Department's projected overtime expenditures at approximately $32.8 million of the $50.1 million overall total.

Fire-Rescue Sworn Vacancies	
Fire Captain	30
Fire Engineer	32
Fire Fighter I/II/III	17
Total	**79**

A positive takeaway is the fact that overtime due to fire suppression staffing shortfalls is projected to end FY 2024 approximately $1.9 million below FY 2023 actuals. This is representative of the Department's expectation that it will be able to fill its 79 current sworn vacancies over the course of FY 2024 and reach full staffing during FY 2025. More information concerning upcoming fire academies and the Department's progress towards filling its Fire Captain and Fire Engineer ranks is provided in the First Quarter Report.

Backfill Overtime expenditures, on the other hand, are projected to end FY 2024 approximately $840,000 higher than FY 2023 actuals. When constant staffing positions utilize Leave Time, such as sick, vacation, military, or other leave, Backfill Overtime is required to fill those absences to maintain constant staffing levels for all fire suppression posts. The Department is not aware of a particular cause for the upward trend, though it noted that the projection could change as the year progresses.

The Fire-Rescue Department created a Relief Pool in the FY 2020 and FY 2021 Adopted Budgets, which added 37.00 FTEs in each of those years (74.00 FTEs total) above what is required for constant staffing. The intent of the Relief Pool is to utilize firefighters on regular time to backfill those firefighters out on leave or otherwise unable to work, in order to reduce Backfill Overtime spending. However, the Relief Pool cannot function as intended until all constant staffing positions are fully staffed; for this reason, anticipated reductions in overtime expenditures have not been realized given current vacancies. Considering normal attrition over the course of FY 2024, fully staffing all constant staffing positions is not anticipated to occur until FY 2025, after which the Department estimates that it can begin filling Relief Pool positions.

For additional context, historical information on Fire-Rescue Department overtime expenditures is provided in the following table.

Fire-Rescue Overtime – Historical Budget vs. Actuals *($ in millions)*									
	FY 2016	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**
Budget	$29.9	$30.2	$32.8	$38.1	$36.6	$33.3	$32.8	$32.8	$48.4
Actual	$31.8	$32.5	$45.4	$45.2	$41.1	$51.3	$50.7	$51.3	$50.1 Proj.
Overage	**$1.9**	**$2.3**	**$12.5**	**$7.0**	**$4.5**	**$18.0**	**$17.9**	**$18.6**	**$1.7 Proj.**

NOTES: Table may not total due to rounding; FY 2016 through FY 2023 Actual amounts are based on unaudited actuals.

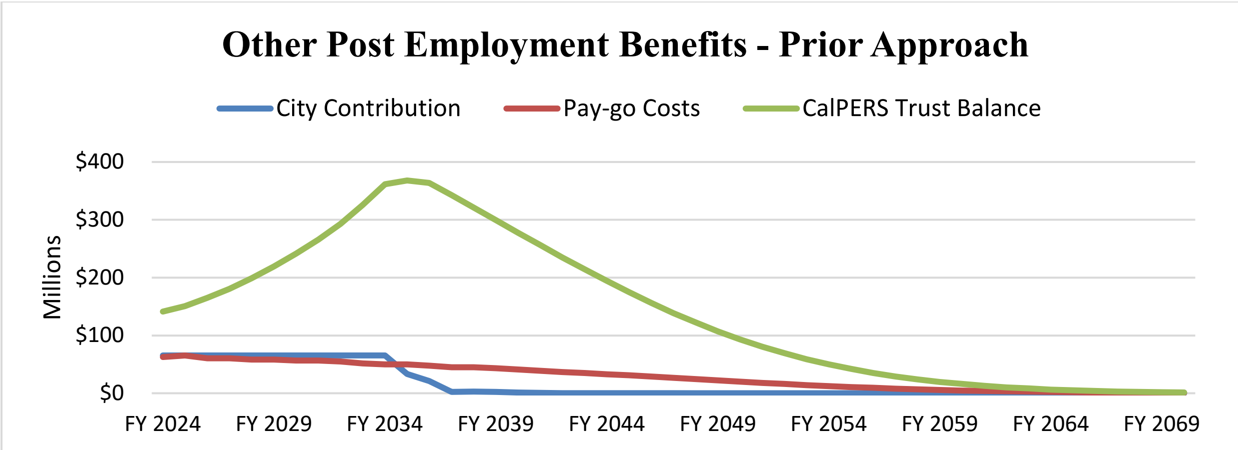
Retiree Healthcare Benefit/OPEB

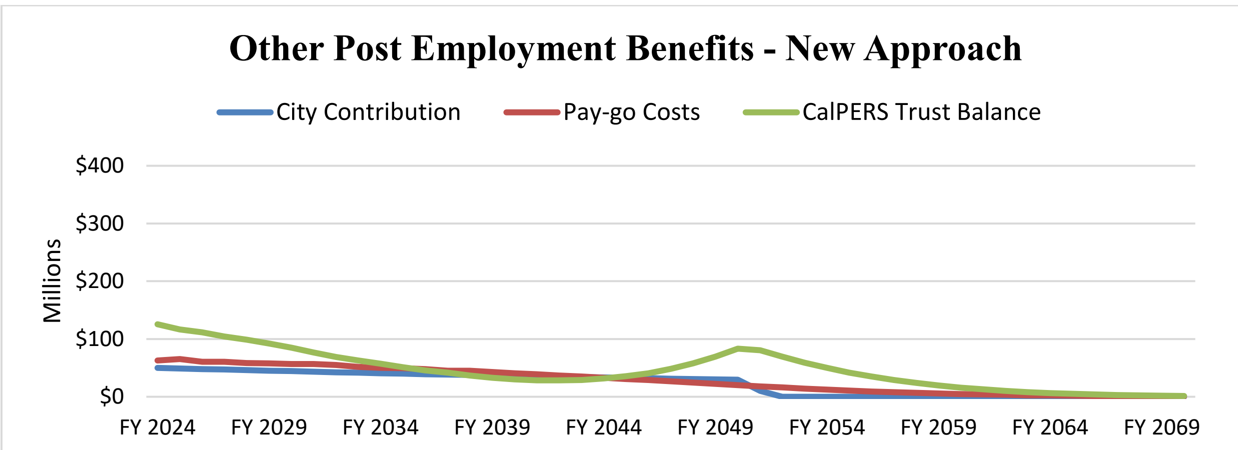
The City maintains a retiree healthcare benefit (also referred to as an Other Post-Employment Benefit, or OPEB) that has been closed to new members since July 1, 2005 and includes both defined benefit and defined contribution elements. Because this benefit is closed to new members, annual retiree healthcare costs are projected to decrease over time. The OPEB benefit is funded on a pay-as-you-go basis, along with a prefunding component. The CalPERS Employer Retiree Benefit Trust (CERBT) is the prefunding vehicle the City has employed to accumulate investment earnings that partially fund the benefit.

The First Quarter Report discusses a long-term strategy that would change the City's approach to OPEB funding, diminishing the prefunding component beginning in FY 2024, while still providing the needed resources to support the benefit (referred to as the "new approach"). The new strategy reduces City contributions for OPEB in earlier years and increases them in later years compared to the prior approach. The anticipated contributions under the new strategy are reduced incrementally over a longer period of time, smoothing them until FY 2050, rather than sharply reducing them beginning FY 2035.

Prior to this change in strategy, the City planned to make larger contributions in earlier years, which would enhance the prefunding component. The new approach studied by the City's actuary reduces the City's contributions in earlier years, as well as reduces the prefunding in the CERBT and related investment earnings that partially fund the OPEB benefit. Because less investment earnings would be available to pay the OPEB benefit under the new approach, City contributions would be higher in later years, and higher overall. Additional descriptions of OPEB and the funding strategy change can be found on page 17 of the First Quarter Report.

To better illustrate this change and associated impacts, the following charts show the City's contributions to fund/prefund OPEB; pay-as-you-go costs (for benefits provided to retirees); and the CERBT OPEB fund balance under the prior approach and the new approach.





Based on the actuary's analysis, it is preliminarily estimated that the new strategy would result in about $277.0 million of higher total contributions over time, or about $95.0 million in today's dollars, which exceeds the prior approach by 35% and 14%, respectively. Note that actual payment differentials could change over time based on investment earnings and benefit payouts that are different than assumed in the actuarial analysis.

Given the significant deficits projected for the next several years, the changed methodology for funding OPEB may be appropriate. Planned City contributions for this benefit under the new approach will be more aligned timing wise with the projected benefit payments to retirees than under the prior approach. The FY 2024 budgetary savings from the new approach is estimated to be $15.4 million, of which $10.2 million is associated with the General Fund.

CONCLUSION

Our review of the First Quarter Report includes an analysis of major General Fund revenues, as well as additional information on public safety overtime, and a change in the City's methodology for making annual OPEB payments.

While we believe revenues projected in the First Quarter Report for property tax and franchise fee revenue generally reasonable, we also note that due to the timing of the First Quarter Report, projections for sales tax and transient occupancy tax revenues do not take into account recent declines, and decreases of $3.1 million (sales tax) and $4.3 million (TOT) to those projections may be appropriate. Each revenue source should be closely monitored moving forward, and projections updated in the Mid-Year Report.

Public safety overtime expenditures – especially Police Department overtime – also bear increased scrutiny moving forward; we note that over the last five years, Police Department overtime has nearly doubled (from $31.9 million in FY 2019 to a projected $57.2 million in the current fiscal year), and has consistently come in significantly over-budget in recent years despite large increases in amounts budgeted in each year's adopted budget.

Finally, we note the shift in the City's approach towards funding OPEB results in budgetary relief in FY 2024 of $15.4 million ($10.2 million in the General Fund). While the new approach reduces OPEB payments for several years and is likely appropriate given the City's significant upcoming projected deficits, we also note that it will come with long-term costs associated with extending OPEB payments through FY 2050, rather than seeing a sharp drop in FY 2035.

As noted earlier, the First Quarter Report provides an initial, high-level look at the status of certain revenues and expenditures for the General Fund and more information, including updated projections, will be included in the Mid-Year Report. Our Office will continue to monitor the items we have discussed in this report as part of our review of the Mid-Year Report, expected to be released on February 2, 2024.

Nicky Bennett
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