THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2022 First Quarter Budget Monitoring Report

OVERVIEW

The Department of Finance issued the *Fiscal Year 2022 First Quarter Budget Monitoring Report* (First Quarter Report) on November 10, 2021. 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 2021 through September 2021. The report also provides revenue updates on American Rescue Plan Act (ARPA) funding, and specific department revenues. For expenditures, the report provides projections and updates on public safety personnel expenses, energy, fuel and water costs. An update on General Fund Reserves 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 2022 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 2022. 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 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 for Council's consideration. Our review of the First Quarter Report includes an analysis of major General Fund revenues; additional information on public safety overtime; and updates and discussion on a number of other noteworthy items, including the status of library re-openings, homelessness programs, and recreation center hours. The projections and Excess Equity estimate included in the First Quarter Report inform the projections included in the FY 2023-2027

Five-Year Financial Outlook (Outlook), which our Office analyzed and reviewed in IBA Report 21-28.

FISCAL AND POLICY DISCUSSION

Major General Fund Revenues

General Fund Revenues in the First Quarter Report are $18.3 million above amounts included in the Adopted Budget. While revenue projections for Property Tax show a decrease, that decrease is more than offset by increases in Sales Taxes and Transient Occupancy taxes. Increases in projections are largely consistent with the improved revenues that were shown in the FY 2021 Year-End Financial Performance Report. Each of the four major General Fund revenues is discussed below.

Major General Fund Revenues *($ in millions)*							
	FY 2021 Unaudited Actuals[1]	FY 2022 Adopted Budget	FY 2022 Projection	1st Quarter Projections vs Adopted Budget	Variance from Adopted Budget (%)	1st Quarter Projection vs FY 2021 Actuals	Variance from FY 2021 Actuals (%)
Property Tax	$ 641.4	$ 672.2	$ 662.0	$ (10.2)	-1.5%	$ 20.6	3.2%
Sales Tax	303.7	320.8	331.8	11.0	3.4%	28.1	9.3%
Transient Occupancy Tax	68.1	95.5	113.0	17.5	18.3%	44.9	65.9%
Franchise Fees	76.2	78.3	78.3	-	0.0%	2.1	2.8%
Total	**$ 1,089.4**	**$ 1,166.8**	**$ 1,185.1**	**$ 18.3**	**1.6%**	**$ 95.7**	**8.8%**

[1] FY 2021 Unaudited Actuals from the FY 2021 Year-End Financial Performance Report

Property Tax

Property taxes represent the single largest source of General Fund revenue. The first quarter projection for Property Taxes is $662.0 million, which is a decrease of $10.2 million from the Adopted Budget of $672.2 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 decrease is mostly within the 1% property tax allocation ($5.8 million) but there are also decreases in the MVLF payment ($2.7 million) and RPTTF ($1.6 million). All of the decreases are primarily attributable to the fact that allowable inflation on assessed values for FY 2022 under Proposition 13 is only 1%, which was the CPI growth rate from October 2019 to October 2020. Thus, all properties that are not sold, transferred, or significantly improved have assessments that have grown at half of the usual cap of 2%, which is significantly dragging down overall receipts despite other housing market indicators, such as sales and price growth, remaining relatively strong. As such, the Department of Finance (DOF) has revised the projected growth rate on receivables down from 4.50% to 4.00%, which is substantiated by the first few disbursements from the County and is in line with County projections for the remainder of the year. Our Office agrees with this projection and will along with DOF continue to monitor property tax receivables to ensure that another downward adjustment is not warranted.

Sales Tax

Sales Tax revenues are the second largest source of General Fund revenue. The first quarter projection for Sales Tax revenue is $331.8 million, which is an increase of $11.0 million from the Adopted Budget of $320.8 million. The increase is consistent with increased revenues that were shown in the FY 2021 Year-End Financial Performance Report, which showed significantly increased consumer sales and sales tax revenue over the final quarter of FY 2021.

The first quarter projection for Sales Tax continues to assume the 13.2% year-over-year growth rate that was assumed in the Adopted Budget, though that growth rate now applies to a higher revenue base than was assumed in the development of the budget. As we noted in our review of the Proposed Budget, a 13.2% growth rate is high, but is supported by several positive economic indicators, including significant growth in consumer confidence, declining unemployment, and continued growth in retail sales. While our office believes that the First Quarter Reports projections for Sales Tax are reasonable, and those projections are further supported by information from the City's sales tax consultant, it will be important to monitor any potential impacts of continued supply chain disruptions and other pandemic-related impacts as the year goes forward.

Transient Occupancy Tax

Transient Occupancy Taxes (TOT) – or hotel taxes – have historically represented 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 on the table below.

Transient Occupancy Tax Revenue *(in millions)*

	FY 2021 Unaudited Actuals[1]	FY 2022 Adopted Budget	FY 2022 Projection	1st Quarter Projections vs Adopted Budget	1st Quarter Projection vs FY 2021 Actuals
General Fund Allocation (5.5%)	$ 67.8	$ 95.5	$ 113.0	$ 17.5	$ 45.2
Special Promotional Programs (4.0%)	48.4	70.5	81.3	10.8	32.9
Council Discretionary (1.0%)	12.1	17.1	20.3	3.2	8.2
Total	**$ 128.3**	**$ 183.1**	**$ 214.6**	**$ 31.5**	**$ 86.3**

[1]FY 2021 Unaudited Actuals from the FY 2021 Year-End Financial Performance Report

The FY 2022 Adopted Budget assumed that TOT revenue would begin to see a recovery from the large declines that were brought about by the COVID-19 pandemic, with year-over-year growth in TOT revenue peaking in the second and third quarters of the fiscal year. However, growth in TOT revenues – generated from significant increases in regional leisure travel spurred on by increased progress against the COVID-19 Pandemic and the lifting of travel restrictions – occurred earlier than expected, with significant growth in TOT receipts in the fourth quarter of FY 2021, and corresponding increased first quarter projections for FY 2022 seen here.

It is important to note that both the Special Promotional Programs and Council Discretionary allocations also impact the General Fund. As the Council Discretionary allocation can be used for general City purposes, it is ultimately considered General Fund revenue.

Changes to the Special Promotional Programs allocation further impact the General Fund. This allocation is used to encourage tourism by supporting various arts and cultural programs, *and is also used* to reimburse certain General Fund programs that help drive tourism to the region such as parks, sports facilities, and lifeguards at City beaches. The Adopted Budget included $28.0 million in reimbursements to the General Fund for parks and lifeguard operations from the Special Promotional Programs allocation (in the amounts of $8.0 million and $20.0 million respectively). Given revenue growth, DOF's first-quarter projections suggest that this amount will increase to a total of $37.0 million in reimbursements to the General Fund.

We note that TOT revenue remains volatile and particularly sensitive to pandemic-related impacts, and that while some group travel is beginning to resume, much of the increases seen here have been generated by increased leisure travel, which may not be a sustainable source of long-term revenue growth. Continued monitoring of TOT revenue and efforts to encourage business and group travel will be important for long-term growth.

<u>Franchise Fees</u>

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 electric 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 the cable companies are based upon a percentage of revenue generated, while the franchise fees from refuse haulers are based on tonnage.

Franchise fee projections overall remain unchanged in the First Quarter Report, at a total of $78.3 million. SDG&E Franchise Fees, which represent 66.0% of the total franchise fee revenue, will be updated in the Mid-year Report once a projection on the February clean-up payment is received. Other franchise fees remain as projected.

Public Safety Overtime

<u>Fire-Rescue Overtime</u>

The Fire-Rescue Department is projected to exceed its overtime budget by $5.9 million at fiscal year-end, for a total expenditure of $38.7 million. As noted in the First Quarter report, some of this increase is offset by salary savings of $4.2 million and increased deployment reimbursement revenue of $1.6 million, resulting in a net General Fund increase of $0.1 million.

Overall, the causes for additional overtime for Fire-Rescue are consistent with previous years. According to the First Quarter Report, much of the overtime increases are due to staffing shortfalls which are primarily due to delays in the promotional process for Fire Captain and Engineer ranks attributable to COVID-19. To combat previous increases in overtime, the Fire-Rescue Department created a Relief Pool that would utilize firefighters on regular time to backfill for those firefighters out on leave or otherwise unable to work in order to reduce overtime spending. The addition of the Relief Pools was more than covered in the budget through reduced overtime. However, severe vacancies at the Engineer and Captain level, along with academies being delayed or not producing enough recruits to cover attrition, have resulted in no progress being made on filling the Relief Pool. Further, the Department has indicated that the Relief Pool cannot be established and function as intended until the regular positions are fully staffed.

In order to cover attrition within the current firefighting staff and fill the Relief Pool, the second fire academy added in FY 2021 on a onetime basis was made ongoing to maintain staffing levels and account for attrition, while a third fire academy was also added in FY 2022 on an ongoing basis to fill the Relief Pool positions. However, the third fire academy budgeted for FY 2022 is currently scheduled to start in March 2022 and will not graduate recruits until July 2022. As such, overtime savings attributable to the new academy graduates will not materialize until FY 2023.

Police Overtime

The Police Department is projected to exceed its overtime budget by $7.2 million at fiscal year-end, for a total expenditure of $37.8 million. This is primarily due to a $6.7 million increase in extension of shift overtime, which, as the First Quarter Report notes, is most likely due to increases in the volume of calls and service levels within the last three months.

While the projected overtime for Police is above the current budget for FY 2022, overall projected overtime expenditures are in line with recent historical spending for this department. The total budget for Police overtime in FY 2021 (including funding within the Seized Assets Fund) was $38.1 million, which is more than the current projected spend in FY 2022. As noted in the First Quarter Report, the FY 2022 Adopted Budget for the extension of shift overtime category is $2.0 million lower than it was in FY 2021, based on the premise that enhanced oversight could result in a reduction in the approval of extension of shift overtime. With the noted increases in service calls and backfill staffing shortages, these savings have not materialized.

Overall, the FY 2022 Adopted Budget contained a net reduction in overtime of $7.4 million as compared to the FY 2021 Adopted Budget, which included the $2.0 million for extension of shift as well as reductions in other overtime categories such as Neighborhood Policing ($1.0 million), COVID-19 related overtime funded by federal dollars ($2.0 million), CleanSD overtime ($1.0 million), special events ($1.0 million), and other categories ($0.4 million). The reductions for Extension of Shift, Neighborhood Policing, and CleanSD were budget mitigations, as the other categories normally are covered with corresponding revenues. Other than the Extension of Shift category, the Department is projecting to spend at budget in its other overtime categories, including Neighborhood Policing and CleanSD.

Other Updates

Library Department Hours, Resources, and Re-openings

Library hours were restored to near pre-pandemic levels in the FY 2022 Adopted Budget with the exception of the Central Library, which was reduced to 52 hours per week. The Library Department has yet to fully open all locations and restore Sunday hours to pre-pandemic levels due to staffing shortages, including 217.0 public facing vacancies. All but four locations (Ocean Beach, Clairemont, North Clairemont, and Mountain View/Beckwourth) are currently open for in-person services on Sundays, although these four locations do offer phone and book drop services.

The reopening of these four libraries and also restoration of Sunday hours for 14 libraries previously open on Sunday[1] are contingent on the filling of currently vacant positions. The hiring process to fill vacancies in key positions is currently ongoing, with final positions anticipated to be filled by the third quarter of FY 2022, as shown in the following table. Once all positions are filled, all locations will be open at near pre-pandemic levels except for the Central Library which has been reduced to the same schedule as branches with Sunday hours.

Library Positions/Recruitment Updates			
Position	**Status**	**Number of Vacancies[1]**	**Anticipated to be filled**
Library Assistant 1 – Full time	Panels have been formed and the Department is waiting for the lists and final new position creations from the FY 2022 approvals by the Personnel Department before interviews can begin	2	March /April 2022
Library Assistant 1 – Half time		86	
Library Assistant 2 – Full time	Panels have been formed and the Department is waiting for the lists and final new position creations from the FY 2022 approvals by the Personnel Department before interviews can begin	10	March /April 2022
Library Assistant 2 – Half time		42	
Library Assistant 3 – Full Time	Selections for appointments have been made, offers are currently being made as clearance is obtained by Personnel.	9	December 2021/January 2022
Library Assistant 3 – Half Time		40	
Librarian 1/2 – Half Time	Selections for appointments were completed on December 1. Offers will be made as soon as clearance from Personnel is obtained.	27	December 2021/ January 2022
Librarian 3 – Full Time	Interviews start to start week of Monday Dec 6, 2021.	1	January 2022
	Total	**217**	

[1]This includes previous vacancies and those positions added in the FY 2022 budget for Library public facing vacancies. Note, the FY 2022 positions were partially budgeted based on expected fill dates.

When critical Library Assistant 1 and 2 positions are filled as anticipated in March/April 2022, background checks are completed, and new staff are onboard, the Library Department will first reopen the four libraries currently closed. Then the Department will phase in restoration of Sunday hours for the 14 libraries previously open on Sundays, beginning with communities of concern.

Once all positions are filled in the last quarter of FY22, the Department may be making staffing tweaks at locations while they right-size the organization in line with services that are being provided (programing; Equity, Diversity and Inclusion or EDI; enhanced services, and other initiatives). However, the Department said they first must fill the FY 2022 allotted positions to create a new baseline for staffing and services.

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[1] The 14 libraries previously open on Sundays include Carmel Valley, Central, City Heights/Weingart, La Jolla/Riford, Logan Heights, Mira Mesa, Mission Valley, North University Community, Otay Mesa-Nestor, Pacific Beach/Taylor, Point Loma/Hervey, Rancho Bernardo, Serra Mesa-Kearny Mesa, and Valencia Park/Malcolm X.

Parks and Recreation Department: Pool and Recreation Center Hours

As our Office discussed in *IBA Report 21-10: Review of the FY 2022 Proposed Budget*, several of the Parks and Recreation Department's Key Performance Indicators were significantly impacted in FY 2021 due to COVID-19, including the number of aquatic users and recreation center operating hours. The First Quarter Report provides an update on pool service levels, reporting that operations have decreased to 25% of normal hours as a result of extreme staffing shortages of Pool Guards. Our office also inquired about the current hours of operation for recreation centers. According to staff, only nine centers are fully opened and the rest are opened with limited hours due to staffing shortages. Staff anticipate that in the coming months more recreation centers will begin operating at normal hours.

FY 2022 Homelessness Program Expansion Update

The FY 2022 Adopted Budget included a onetime allocation of $10 million from the General Fund to expand homelessness programs. The status of this investment is provided in the table below. As shown, most of the funding is intended for the creation of new interim shelter beds as well as substance use disorder interventions – efforts that are largely in development. However, several initiatives are well underway, such as the new Harm Reduction Shelter, expanded outreach and rapid rehousing programs, as well as the community college course aimed to expand the workforce to implement homelessness programs. We note that staff from the Homelessness Strategies and Solutions Department are preparing a program and fiscal update for City Council which may have more information to report on the implementation of programs listed in the following table. As of this writing, our Office is unaware of the timing of the item.

Status of FY 2022 Homelessness Program Expansion

Program	Funding	Status	Notes
Create 300 new interim shelter beds	$ 6,300,000	New Shelter Underway / Rest TBD	• $1.7 million has been obligated for a new Harm Reduction Shelter through San Diego Housing Commission (SDHC) Board action on 9/9/2021. Shelter to open in December. • Additional beds are to be determined.
Substance Use Disorder Interventions: 65 beds and potentially augment existing SIP and PLEADS programs	1,400,000	Majority is TBD	• $207,000 is supplanting grant funds previously used for PLEADS. SIP and PLEADS program expansions are to be determined. • Additional beds are to be determined.
Outreach Program Expansion	1,000,000	Underway	• Funds obligated through SDHC Board action on 7/9/2021.
Rapid Rehousing Program Expansion	1,000,000	Underway	• Funds obligated through SDHC Board action on 5/6/2021. Funds will support approximately 100 additional households.
Community College course to develop workforce (PEER)	300,000	Underway	• According to SDHC, funds are being used to support 4 courses this academic year, plus funds allow for additional training.
Total	**$ 10,000,000**		

Note: SIP and PLEADS are criminal diversion programs that offer treatment in place of arrest or custody. SIP - Serial Ineberiate Program, PLEADS - Prosecution and Law Enforcement Assisted Diversion Services

San Diego Misdemeanants At Risk Track (SMART) Program
Although there is $1.2 million in General Funds budgeted for the SMART Program in FY 2022, the program is not expected to resume this fiscal year, and no SMART Program expenditures are anticipated to occur this fiscal year. These funds could alternatively be spent on other homelessness programs in FY 2022 provided Council is notified, or they could remain unspent and result in expenditure savings. We note that the SMART Program has not operated since spring of 2021. However, staff estimate that the SMART Program will resume in FY 2023.

Department of Information Technology (DoIT) contracts
The First Quarter Report notes that DoIT is currently projecting Citywide IT fixed costs will be $4.4 million under budget, including $1.3 million under in the General Fund, and $3.1 million in non-General Funds. Previous contractual rates were extended for an additional year, resulting in savings in comparison to the non-discretionary allotment process which projected increased contract costs in FY 2022. According to the department, the cost increases for the new IT service contracts (discussed below) will occur in FY 2023, but the total amount will be approximately $800,000 less than originally projected in the FY 2022 non-discretionary allotment.

The City awarded new master service agreements in August 2021 for three areas of IT services (as shown in the following table) and will be in a transition period through the end of the fiscal year. This includes the transitioning of two service areas to a new vendor, from Atos to Zensar. DoIT told us that the transition process for the transfer of services to new providers makes it challenging to determine unanticipated costs or potential transition-related delays. For example, the transition includes knowledge transfer and shadowing of existing Atos staff, new tools to deliver services, a centralized IT Service Management system (ServiceNow) that will manage all help desk incidents, service requests, new Service Level Requirements reporting, and a data center migration out of the Atos data centers.

IT Services Contracts Transitioning in FY 2022

IT Services	Previous Firm	New Firm	Contract Awarded	Timeline/Steady State
Application development, maintenance, and support	CGI	CGI	8/1/2021	7/1/2022
Enterprise Compute, including data center and cloud services for over 1,000 servers to host City applications	Atos	Zensar Technologies	8/1/2021	12/13/2021
Workplace services, including service desk services, deskside support, and management and support of the City's centralized IT service management solution.	Atos	Zensar Technologies	8/1/2020	12/13/2021

The transition to steady state services for Enterprise Compute and Workplace Services is scheduled for December 13, 2021. The data center migration will take place between January and June of 2022 and poses the greatest challenge to determine unanticipated costs. Given the timeline, DoIT should have more accurate projections for nondiscretionary information technology expenditures in the Third Quarter Report.

General Services - Facilities Services Division Revenue

Facilities Services Division projects to be under budget in revenue by approximately $700,000. Facilities Division's primary revenue source includes reimbursable projects and routine maintenance work completed for non-General Fund departments. General Fund buildings make up the majority of the buildings that Facilities Services Division maintains; non-General Fund buildings are typically newer and in better shape than the General Fund buildings. Division staff indicated that they have little control over requests for tenant improvements or the priorities of the Non-General Fund Departments, because DOF sets the Facilities revenue budget which essentially establishes the target work that Facilities Services will do for non-General Fund departments. Additionally, the division has needed to provide services in support of homeless initiatives in the first quarter of this year, and made COVID19-related requests one of their top priorities.

Initially, Facilities responded to an increased demand for plexiglass requests and the installation of hand sanitizer stations and temperature scanners, but those requests decreased during the first quarter of FY 2022. Facilities has not had to respond to as many emergencies while in full operation due to a large number of City staff telecommuting and buildings being shut down. The Division noted the main impact they are facing due to the COVID-19 pandemic is an increase in vandalism throughout the City and some delays in getting material.

CONCLUSION

Our review of the First Quarter Report includes an analysis of major General Fund revenues; additional information on public safety overtime; and updates on several other noteworthy programs and items. 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 a full set of 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 January 28, 2022.

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