THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the FY 2022-2026 Five-Year Capital Infrastructure Planning Outlook

OVERVIEW

On January 27, 2021, the Active Transportation and Infrastructure Committee heard a report on the City's FY 2022 – 2026 Five-Year Capital Infrastructure Planning Outlook (CIP Outlook), and it will come to City Council for discussion on February 9, 2021. The CIP Outlook is a planning tool that forecasts the City's projected capital needs and funding sources over the next five years to inform budget decisions as well as facilitate long-term capital planning. It also supports development of the FY 2022 Proposed Budget for the Capital Improvements Program (CIP).

Our analysis of the CIP Outlook focuses on the projected capital needs and funding of *non-enterprise General Fund assets*, or those that are *not* supported by fees paid by customers, and therefore are a General Fund obligation. This is because the entirety of the $3.02 billion funding gap (the amount that projected needs exceed anticipated funding) is attributed to General Fund assets. Our report also discusses reasons that the funding gap is expected to grow; consequences of continuing to defer capital needs; and how closing the funding gap is dependent additional resources and the City's ability to spend them. We also offer suggestions for future discussion on ways to increase the CIP's capacity. Finally, looking towards the upcoming budget process, we emphasize that Council can reflect different priorities than those reflected in the CIP Outlook.

Background and Purpose of the CIP Outlook

The City Charter requires the Mayor to develop a multi-year capital plan which has been produced annually since 2015. This plan stemmed from a recommendation from the City Auditor's performance review of the CIP in 2011. As stated in City Council Policy 000-02, the CIP Outlook serves as the basis for the development of the annual CIP budget. The purpose of the CIP Outlook is to plan for current and future capital needs, and project available funding to better inform budget decisions. Because capital needs far exceed funding available, the City makes strategic investments in capital infrastructure during the annual budget process, but many needs are left unfunded.

FISCAL/POLICY DISCUSSION

High-Level Overview of CIP Outlook

Five-Year Funding Gap Experienced Largest Increase Ever

The CIP Outlook projects capital needs totaling $6.94 billion and funding available to support those needs, totaling $3.92 billion. This creates a funding shortfall of $3.02 billion over the five-year period, referred to as a funding gap. The funding gap has grown by 40% since last year's report which is the largest year-over-year increase since this report was first created. We also note that during the Outlook period, capital needs and funding are projected to decrease after FY 2024. This largely reflects the wind down of Phase I of the Pure Water project.

Our Office appreciates that the projected capital needs continue to be broken down into priority and discretionary categories. The box to the right outlines the criteria used for categorizing assets. This prioritization helps facilitate deeper conversations about what the City's infrastructure needs actually are, and which are most urgent. However, as discussed in the report, the CIP Outlook is not an exhaustive list of all City infrastructure needs, since it only covers the next five fiscal years.

Many asset types have capital needs that fall into both priority and discretionary categories. However, as shown in the second box to the right, several asset types have capital needs in which 100% are categorized as either priority or discretionary. Council can reflect different priorities with approval of the upcoming budget.

Priority Funding Gap Increased by Over $1 billion, and is Solely Made Up of General Fund Asset Types

The chart on the following page summarizes the total projected needs, funding, and funding gap broken into the two categories. The funding gap for priority needs of $2.31 billion has increased by $1.03 billion over last year's report. Storm water makes up about 40% of this increase, with the balance of the increase attributed to street pavement (repaving), streetlights, and existing facilities. Streetlights needs contributed to the priority fund gap increase because it was recategorized from

Definitions

Priority needs:

- Addresses life, safety, and legal mandates
- Could impact the core operation of a critical facility or asset
- Any Mayor and Council priority. Due to timing, this year's report does not reflect input from the new Mayor or new Councilmembers.

Discretionary needs:

- Remaining infrastructure needs that enhance the overall quality of life

Categories

100% of Needs Priority:

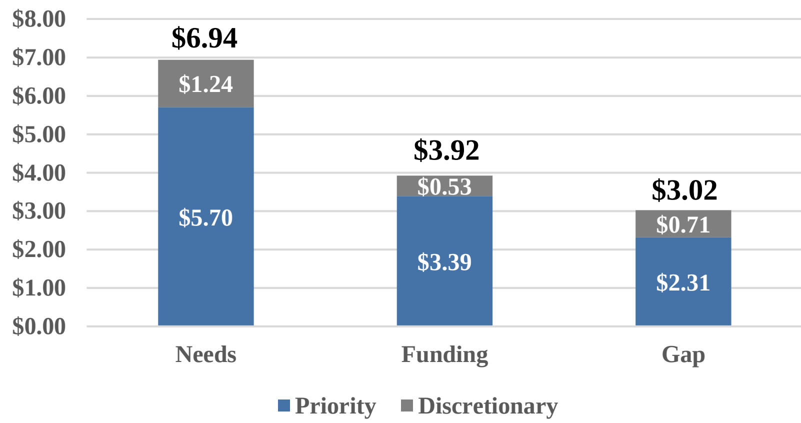
- Pure Water
- Storm Water
- Streetlights
- Pavement
- Traffic Signals
- Fleet

100% of Needs Discretionary:

- Bike Facilities
- New Transportation & Storm Water Facilities

discretionary in last year's report, to priority in this year's report. These asset types will be discussed in more detail further in this report.

FY 2022 – FY 2026 Projected Priority and Discretionary Needs, Funding, and Gap
($ in billions)



An enterprise asset is an asset, like water or wastewater, that is self-supporting with a dedicated funding source that is generated from fees collected from customers that use the assets. As reflected in the table on the following page, all enterprise assets are anticipated to fully meet their capital needs with anticipated revenue. Non-enterprise, General Fund assets (General Fund assets) do not have a dedicated funding source and must compete for limited funding, and therefore are an obligation of the General Fund. As shown in the table on the following page, all of the five-year funding gap is attributed to General Fund assets.

New Fire Stations is the only General Fund asset that is expected to have all its capital needs met, totaling $97.2 million. The CIP Outlook assumes design and construction costs of seven new fire stations and only design costs for two. However, we believe this to be an unrealistic expectation due to the funding source identified (Facilities Benefit Assessments), which we discuss further in this report. This would also create a significant strain on the General Fund operating budget once these projects are completed. The Five-Year Financial Outlook included operational costs for three new fire stations assumed to open within the Outlook period, totaling $5.8 million and 36.00 full-time equivalent positions. The operational costs for the remaining six fire stations would be phased in after the Outlook period, at an estimated cost of about $11.4 million and 72.00 additional full-time equivalent positions. The General Fund fiscal impacts of operating costs for completed capital projects should be a major factor in determining their priority and timing.

Public Utilities is an enterprise department. Its capital assets (water, wastewater, and Pure Water), heavily influence the CIP Outlook trends since they are associated with 42% of total capital needs and 75% of identified funding. **To avoid diluting the analysis of General Fund assets, which make up the entire funding gap, the remainder of this report will focus on those assets and exclude Public Utilities and other self-supporting enterprise assets such as Golf and Airports.**

Summary of the Five-Year CIP Funding Gap for FY 2022 - FY 2026

($ in millions)

Asset	Funding Gap	Proportion of Gap
Storm Water	$1,275.9	42%
Existing Facilities	538.8	18%
Streets and Roads - Pavement	280.5	9%
Streetlights	232.1	8%
Parks	198.2	7%
Traffic Signals	116.0	4%
Bike Facilities	108.1	4%
Sidewalks	107.2	4%
Bridges	54.1	2%
Streets and Roads - Modifications	42.5	1%
New Transportation & Storm Water Facilities	30.0	1%
New Libraries	27.5	1%
New Lifeguard Stations	6.7	0%
Fleet	2.3	0%
New Fire Stations	0.0	0%
General Fund Asset Total	**$3,020.0**	**100%**
Pure Water - Potable Reuse	0.0	-
Wastewater	0.0	-
Water	0.0	-
Airports	0.0	-
Golf	0.0	-
Enterprise Asset Total	**$0.0**	-

Projected Capital Needs Over the Outlook Period

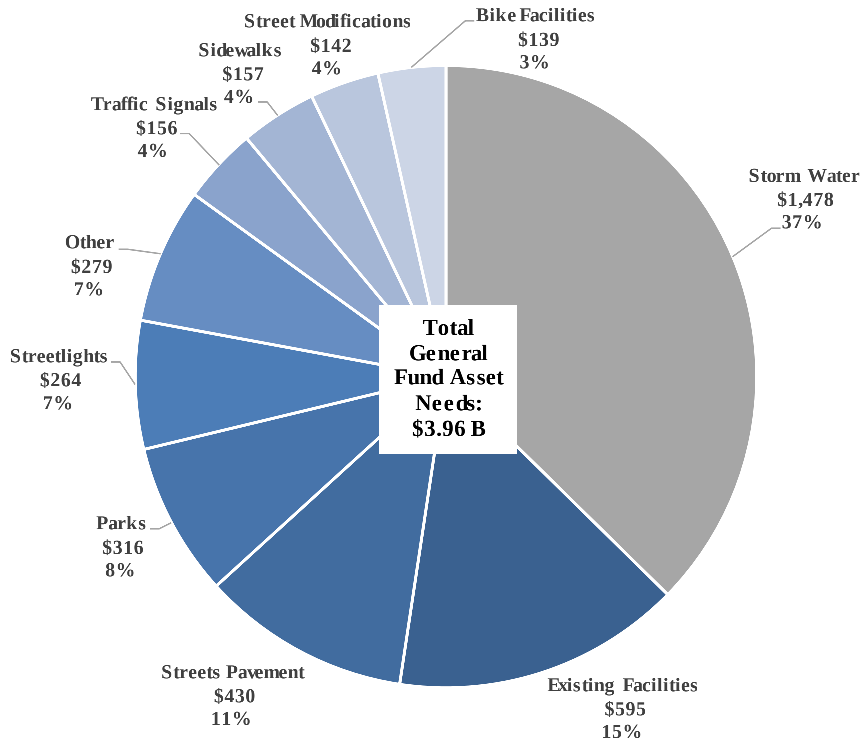
General Fund Asset Capital Needs Grew by 32%

Capital needs for General Fund asset types total $3.96 billion in the CIP Outlook, which is a $959.5 million, or a 32%, increase over last year's report. We note that storm water needs make up over half of the increase, with the remaining increase largely attributed to street repaving and existing facilities. The pie chart on the following page reflects the composition of the City's General Fund capital needs over the five-year period. The area shaded in gray demonstrates the magnitude of storm water capital needs among all others, making up 37%.

Because General Fund capital needs are staggeringly high, it is important to drill down to understand what is driving this great demand of resources. The following section provides additional detail on the asset types that make up 70% of total General Fund needs and are also the primary drivers of the increase in funding gap: storm water, existing facilities, street repaving, and streetlights.

FY 2022 – FY 2026 General Fund Asset Capital Needs

($ in millions)



<u>Storm Water Funding Needs Grew $518.8 Million, Totaling $1.48 Billion</u>
Storm water needs make up both the highest level of *total* needs of any asset in the CIP Outlook, as well as *unmet* needs. Over the five-year period, storm water capital needs total $1.48 billion, a 54% increase from last year's report. Storm water needs reflect the recently updated Watershed Asset Management Plan and are also contained in the new Storm Water Funding Strategy report released in January 2021. For more information, please refer to our Office's analysis of the Storm Water Funding Strategy (IBA Report 21-04).

Part of the increase in storm water needs is attributed to unfunded needs carried forward from previous fiscal years. **According to the Community Flood Assessment included in the CIP Outlook as Appendix F, in FY 2021 less than 1% of identified locations of concern for failure or flooding will be addressed due to current funding levels. These unfunded needs will be carried forward to future years.**

<u>Existing Facility Needs Increased by 18% Largely Due to Unfunded Needs from Prior Years</u>
Total five-year needs for existing facilities are $594.8 million, a net increase of $91.4 million (or 18%). Various renovations and repairs are needed for existing facilities belonging to the following General Fund departments:

- Library
- Park & Recreation
- Police
- Real Estate Assets – Facilities which manages facilities Citywide

Although other project needs decreased by $8.6 million, there was a $100.0 million increase in both priority and discretionary needs related to deferred capital needs identified in condition assessments of the City's facilities that were conducted between 2014 and 2016. At that time, the assessment identified a need to invest an estimated $828.7 million in City facilities to bring them up to a "good" condition. The CIP Outlook includes five years of funding needs from a long-term facilities asset management plan that was developed to address the facilities backlog. However, due to lack of funding, capital needs continue to be deferred while new capital needs are coming due, resulting in a significant increase in needs as compared to last year's report. **To illustrate, funding for City facility capital improvements in FY 2021 totals $2.1 million while last year's CIP Outlook reflected $47.6 million in priority needs (and an additional $21.7 million in discretionary needs) for FY 2021.**

Costs to Repave Streets Have Almost Doubled

Street repaving needs over the five-year period total $429.9 million, which is an increase of $210.4 million, or a 96%, over last year's report. For the first time in several years, street repaving is anticipated to have a funding gap, totaling $280.5 million. One significant factor impacting the funding gap is that, according to the Transportation and Storm Water Department (TSW), the average cost per mile to repair streets has almost doubled.

Our Office noted increases to street repair costs in our review of the FY 2021 Proposed Budget. At the time (April 2020), the average cost to overlay one mile was $400,000 and according to staff it is currently $780,000. This is the major driver of the increase in pavement capital needs since over 90% of the miles of streets planned for replacement in the CIP Outlook are anticipated to be overlay. However, the average cost per mile for reconstruction has also increased from $1 million to $6 million, and concrete streets has increased from $1.2 million to $1.5 million.

Street repaving capital needs in the CIP Outlook are driven by costs to achieve the annual street repair mileage goal to maintain an Overall Condition Index (OCI) rating of 70, signifying "good" condition. However, these costs do not account for miles that need to be made up due to not meeting the goal in previous years. From FY 2018 to FY 2020, the City repaired 73% of the annual mileage goal for capital repairs, so it is unlikely the City currently has an OCI of 70.

The only way to know if the City is maintaining an OCI of 70 is to do another condition assessment. The City's last street condition assessment was conducted in 2015 and 2016 and is used as one factor in determining which streets to prioritize for repair. **Consideration should be given to updating the street condition assessment especially given the level of investment the City has put into repaving streets in recent years.**

Costs to Install Streetlights Have Also Increased Significantly

As noted earlier, this year's report included streetlights within priority capital needs, whereas last year's report they were reflected as discretionary. Streetlight needs are driven by the following service levels: 1) installing all streetlights on the needs list by FY 2031; 2) replacing 5% of the City's total streetlight poles per year; and 3) replacing 49 streetlight series circuits to meet modern electrical standards over the next 25 years. Streetlight needs total $263.6 million over the next five years, which represents a 32% increase in capital needs over last year's report. Although streetlight funding needs are estimated to increase by $64.3 million, this is expected to yield fewer streetlight installations per year as compared to last year's report (470 per year versus 490). According to

TSW, the average cost to install new streetlights has increased from $25,000 per pole to $44,000. **Finally, we note that to meet the desired service levels for streetlights, the City would have to provide an average of $52.7 million annually. Funding for streetlights in FY 2021 totals $864,000.**

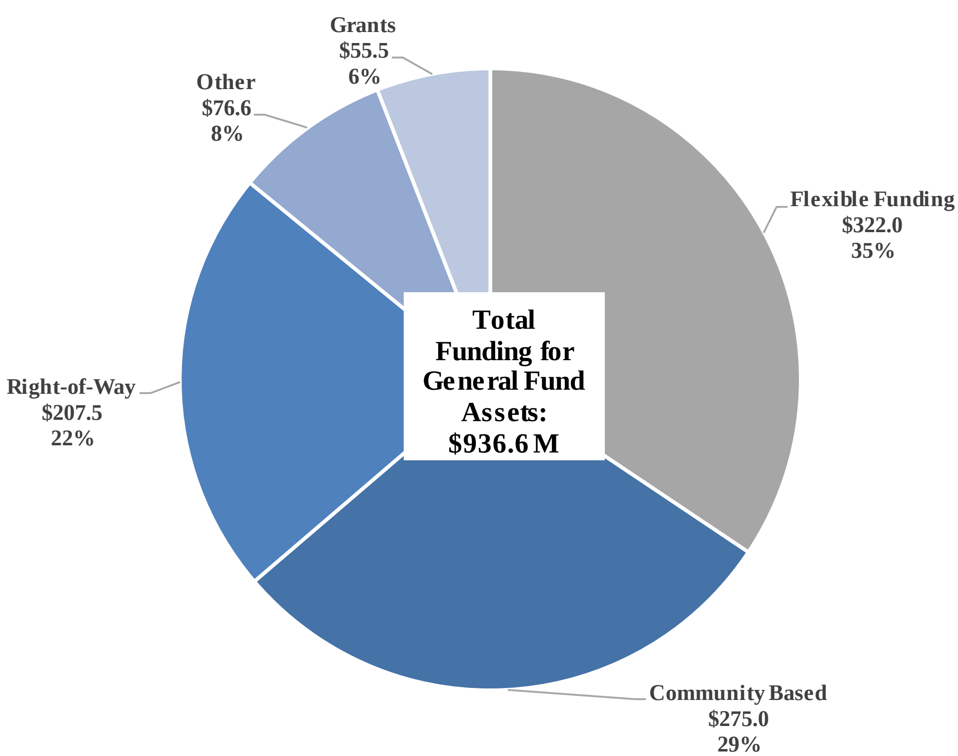
Projected Funding Over the Outlook Period

Though Funding is Projected to Increase, Billions in Needs are Left Unfunded

Although there are $3.96 billion in General Fund capital needs, there is only $936.6 million projected to be available to address those needs. This represents a 12% increase in anticipated funding over last year's report. Much of the projected funding has restrictions on the type of project that can be funded or in which community funds must be spent.

The pie chart below shows how much funding is projected over the Outlook period for General Fund assets grouping resources into four major categories: community-based funds (geographically restricted); funding restricted for use in the right-of-way; flexible funding for use on any General Fund asset; and other restricted funding sources (i.e. those that must be spent on certain assets, like regional parks). The increase in projected funding is largely driven by additional flexible funding expected to be made available through financing as compared to last year's report. However, as we explain in the next section, based on actual spending patterns, it is unlikely that the full $322.0 million in financing proceeds will be realized during the Outlook period. This report also makes other observations on certain fund sources.

FY 2022 – 2026 Projected Funding for General Fund Assets
($ in millions)



Additional Revenue from Financing is Contingent upon Pace of Spending

The timing of issuing additional debt for General Fund capital projects will ultimately be tied to how fast the City can spend borrowed proceeds. The financing plan assumed in the CIP Outlook includes $322.0 million in financing proceeds for the five-year period, in which bond issuances are expected to occur in each of the following years: FY 2021, FY 2023, and FY 2025. This timeline reflects the assumed pace at which the City is expected to spend each installment. We note that the FY 2021 authorization to issue $145 million was approved in November 2020 but Council approval of appropriations to projects is expected to occur before the end of FY 2021. Therefore, the CIP Outlook includes the revenue from the FY 2021 authorization in FY 2022. Bond issuances of $88.5 million are expected to occur in FY 2023 and FY 2025.

The City first authorized the use of commercial paper notes to finance General Fund capital projects in May 2018 and augmented the appropriation in the following August, resulting in a total initial installment of $88.5 million. It is anticipated that the initial installment will not be fully spent until June 2021 since $21.6 million remains unspent as of this writing. Instead of spending each tranche over a two-year period, as assumed in the CIP Outlook, it is more realistic that spending will occur over three years for the $88.5 million issuances and longer for the $145 million issuance, based on actual expenditures. This is important to note because a slower financing plan means that the FY 2025 issuance could be pushed outside of the five-year window, thus increasing the funding gap by $88.5 million, or more if the FY 2023 issuance is delayed as well.

Some Impact Fee Allocations are Unrealistic

Another significant resource for General Fund assets is community-based funding, which includes Facility Benefit Assessment (FBA) and Development Impact Fee (DIF) revenue totaling $275.0 million during the Outlook period. This revenue comes from impact fees based on private development activity and generally must be spent in the community from which they were generated on projects included in plans that identify needed new public infrastructure for each community (Impact Fee Studies or Public Facilities Financing Plans).

As mentioned earlier, the only General Fund asset that does not have a funding gap reflected in the CIP Outlook is New Fire Stations. The report identifies FBA revenue to fully fund $97.2 million in projected needs. This makes it appear as though there will be nine new fire stations in design or construction during the Outlook period. However, this is misleading because some new fire stations included in the CIP Outlook are currently ineligible for FBA revenue because they are not included in the required plans. These include: Skyline Hills Fire Station, Rancho Bernardo Northeast Fire Station, and Sabre Springs Fire Station. The CIP Outlook assumes that revenue for the remaining projects is generated in the appropriate community and comes in at a sufficient level.

There are also other projects that are allocated impact fee revenue in communities that are built-out (such as Ocean Beach) so the likelihood that sufficient development revenue would materialize in those communities to fund these projects is low. However, we note that the allocation of impact fee revenue may change in the future as the City is moving towards policy changes that would allow this resource to be used Citywide.

COVID-Related Declines in Mission Bay Revenue

We note that the [FY 2021 Mid-Year Budget Monitoring Report] projects a decline in revenue from Mission Bay lessees. The reduction results in the elimination of the transfer to the Mission Bay and San Diego Regional Park Improvement Funds which would have funded capital projects in FY 2022. Since this is new information, it is not reflected in the CIP Outlook, which instead estimates a total of $6.1 million from these sources in FY 2022. For reference, these fund sources are included in the pie chart above under "Other".

Major Takeaways of the FY 2022 – FY 2026 CIP Outlook

Funding Gap is Expected to Continue to Grow

The projected five-year capital funding gap is expected to continue to grow for several reasons. First, given the magnitude of the $3.02 billion funding gap, it will take time to have the conversations necessary to identify and act on a plan to address this issue. Each year the status quo continues, capital needs will continue to be deferred to future years.

Another factor that could contribute to a growing funding gap is the current fiscal environment. The FY 2021 Mid-Year Budget Monitoring Report released in January reflects a General Fund shortfall of $85.4 million and updated revenue projections which increase the shortfall for FY 2022. Unless federal stimulus or infrastructure funds become available, budget cuts will be necessary in FY 2022 and CIP projects could be defunded to mitigate the General Fund shortfall, as they were in FY 2020.

Finally, some major funding needs are excluded from the report as they are unknown at this time. Once these needs are identified, the funding gap will grow unless additional funding is also identified. Some examples of needs currently under review or will need to be reviewed include:

- 101 Ash Street Building Improvements
- Coastal erosion assessment
- Future updates to outdated condition assessments
- Pending Library Master Plan and Park Master Plan

Continuing to Defer Capital Needs Results in Inefficient Use of Limited Funds

"In FY 2021, it is anticipated that $26 million will need to be reallocated from other departments to address known failures and upcoming stormwater emergencies."

Stormwater Division
Community Flood Assessment

In recent years, consequences of continuing to defer storm water capital needs have been evident in the frequency of storm water emergency projects. In order to fund these projects, flexible funding has been taken away from other planned storm water projects as well as other high priority projects, such as sidewalks, parks, library, and fire-rescue projects. According to TSW's Storm Water Funding Strategy, a total of $26 million was diverted from other City projects to support storm drain emergencies in FY 2020. The projects that were defunded are planned to be backfilled with financing proceeds that could have otherwise funded new projects. Furthermore, according to the Community Flood Assessment in Appendix F of the CIP Outlook, another $26 million is anticipated to be reallocated from other departments in FY 2021 to address known failures and upcoming stormwater emergencies.

This reactive approach to addressing infrastructure has led to an inefficient use of limited resources. According to the Storm Water Funding Strategy, as of November 2020, bypass pumps were being used to temporarily divert stormwater runoff at 24 locations that had either failed or deficient infrastructure. It further states that the City had invested more in temporary pipe bypass fixes ($16.6 million) at these sites than it would have cost to replace or upgrade the failed pipes ($14.1 million). In addition, when failed infrastructure turns into an emergency project, the City pays for these at a premium and is only allowed to do the minimum work necessary to address the emergency, leaving additional repairs needed in the future. If capital needs of other asset types continue to be deferred, like existing facilities, similar consequences could arise.

Closing the Gap Will Depend on the City's Capacity to Spend Additional Funds

Closing the funding gap will require additional resources over time, but it will also depend on the City's capacity to spend those funds. To illustrate, the CIP spent $584.0 million in FY 2020, a record amount, but *priority* capital needs average $1.1 billion annually, for the next five years. We also note that $1.72 billion in previously appropriated funds in the CIP were unspent in FY 2020 and carried forward into FY 2021. The CIP Outlook discusses some of the factors limiting the City's capacity to deliver projects, including the regional demand and shortage of consultants, contractors, and skilled staff. These constraints appear to have continued even through the current pandemic.

Reducing Engineering and Capital Project's (ECP) vacancies is one way to increase the department's delivery of projects, but despite compensation increases for engineers and land surveyors beginning in FY 2019 and FY 2020, many vacancies persist.[1] According to the FY 2021 Mid-Year Vacancy Status Report, ECP has 154.00 vacant positions out of 825.50 authorized full-time equivalent positions. It also shows that 58% of the vacancies are attributed to Assistant and Associate Civil Engineer, Land Surveying Assistant, and Principal Engineering Aide positions.

Items to Consider for Moving Forward

If the City is going to meaningfully address its infrastructure funding gap with new resources over time, it will need to significantly increase its capacity to deliver projects. In our review of last year's CIP Outlook, our Office suggested some things the City can do in an effort to increase the CIP's capacity, though there could be many others. Each item would necessitate additional discussion and research. They include:

- **Identify how funds can be expended quicker:** The City could research the root causes of the delays in executing the infrastructure financing plan and whether the significant

[1] Beginning in FY 2019 and FY 2020, various add-on pays were provided to eligible engineers and land surveyors, ranging from 5% to 26% of base salary. An eligible employee can receive up to a maximum of 36% for more than one of these add-on pays, if applicable. Additionally, beginning in April 2020, a special salary adjustment increased base salaries by 10% for the following job classifications: Senior Survey Aide, Principal Survey Aide, Land Surveying Assistant, Land Surveying Associate, and Senior Land Surveyor.

funding in the CIP that is carried forward from year to year is reasonable. This may reveal barriers to spending that could be addressed.

- **Continue to closely evaluate capital needs and assumptions that drive them:** Questions to consider here include: Are needs in the CIP Outlook based on a cost methodology to achieve a particular service level target, or are they driven by actual planned projects? The more capital needs can be refined into ready projects, the quicker the City may be able deploy funds to projects when funding is made available.

- **Make strategic plans for high priority assets:** As currently forecasted, addressing the storm water funding gap alone would address 55% of the City's total priority funding gap. TSW is presenting its Storm Water Funding Strategy report to Council on February 9, 2021, the same day that the CIP Outlook report will be heard. Moving forward with a storm water funding strategy could allow the City to make a dent in its five-year funding gap.

- **Mitigate future growth of the funding gap:** The City can mitigate the growth of the funding gap by prioritizing preventative maintenance in the operating budget even during this challenging fiscal environment. As routine maintenance is deferred, it turns into larger, more costly, capital repairs. The City should also focus on remedying vulnerable storm water infrastructure identified in the Community Flood Assessment to reduce the frequency of costly emergency projects so that limited funding could go further.

- **Pursue efficiency measures:** ECP continues to identify ways to streamline the process of delivering CIP projects. Additional proposals are expected to come before Council for approval this year. Also, a new software solution called Enterprise Asset Management, that cost $47.1 million in capital expenses, is intended to improve the City's management of infrastructure assets and further enhance the City's ability to identify and prioritize needs. The system, among other things, identifies different CIP projects that can be bundled together if they are located near one another so that they can be addressed at one time. The CIP Outlook states that there are currently eight asset types using this system. **Council may wish to request an update on how this system is performing and increasing efficient implementation of the CIP.**

In the Short Term, Council Can Reflect Different Priorities in the Upcoming Budget

As discussed in our Office's report on the FY 2022 City Council Budget Priorities revised on February 4, 2021, Councilmembers expressed strong support for a wide range of infrastructure needs. The Mayor will set his priorities for General Fund assets through the allocation of funding sources with the most discretion, such as Infrastructure Funds and financing. If the proposed budget does not adequately address Council priorities, Council could consider reallocating funds in the proposed budget to better align with its infrastructure priorities. The table on the following page reflects the infrastructure priorities that a majority of Councilmembers supported in their Budget Priority Memoranda, with associated needs, funding, and gap for FY 2022.

We note that since there is such limited funding for General Fund capital needs, reallocating funding will likely require difficult decisions. For example, Gas Tax, Road Maintenance and Rehabilitation Act (RMRA), and Infrastructure Funds are excluded from the CIP Outlook. This is consistent with the Five-Year Financial Outlook which assumes that these sources will support street slurry seal. Council could choose to instead increase street overlay funding with these resources (combined with the currently anticipated allocation from financing), or fund other asset types using RMRA and Infrastructure funds. However, both slurry seal and overlay are Council priorities for FY 2022.

FY 2022 Needs, Funding, and Gap for Assets Prioritized by Councilmembers
($ in millions)

Asset Type	Need	Funding	Gap
Storm Water	$ 186.5	$ 60.0	$ 126.5
Streets - Pavement	86.0	43.4	42.6
Parks and Recreation Facilities[1]	53.8	21.1	32.7
Library Facilities[1]	6.3	0.5	5.8
Transportation Safety and Mobility			
Street - Modifications[2]	64.6	42.7	22.0
Streetlights	55.3	11.7	43.6
Bike Facilities	32.1	11.0	21.1
Traffic Signals	29.4	10.1	19.3
Sidewalks	22.4	18.8	3.6
Total	**$536.3**	**$219.3**	**$ 317.0**

[1] Includes new and existing facilities

[2] This includes $106,000 funded for bus stop capital improvement

CONCLUSION

The CIP Outlook reflects a $3.02 billion funding gap where needs exceed anticipated funding from FY 2022 through FY 2026. The funding gap is a 40% increase over last year's report which is the largest year-over-year increase since this report was first created. Storm water infrastructure needs are the largest contributor to this increase. Out of the total funding gap, $2.31 billion is associated with *priority* capital needs which can impact life and safety or are driven by legal mandates. Some of the remaining discretionary needs are also important to Council and should be addressed.

In our report, we identify three major takeaways of the FY 2022 – FY 2026 CIP Outlook. First, we expect the five-year infrastructure funding gap to continue to grow. Second, continuing to defer capital needs has resulted in inefficient use of limited funds with the need to fund costly emergency projects at the expense of other planned projects. Third, closing the gap will require additional funds over time but it will ultimately depend on increasing the City's capacity to spend additional funds. This report offers suggestions for future discussion on ways to increase the CIP's capacity.

As Council prepares for the upcoming budget season, we emphasize that it can choose to reflect different priorities than those reflected in the CIP Outlook. Council will have the most discretion over allocation of flexible funding sources to fund priority CIP projects. However, because flexible funding is so limited, prioritizing infrastructure needs will likely come with difficult tradeoffs.

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