THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of the FY 2022 Third Quarter Budget Monitoring Report

OVERVIEW

The Fiscal Year 2022 Third Quarter Budget Monitoring Report (Third Quarter Report) was issued on May 17, 2022 and was presented to the Budget Review Committee on May 19, 2022. The Third Quarter Report describes the status of revenues and expenditures and provides year-end projections based on actual (unaudited) data from nine months of the fiscal year. The Third Quarter Report also provides useful details about major revenues, departmental operations, and other programmatic items. With respect to requested actions, the Third Quarter Report requests Council approval of several appropriation adjustments and year-end budget authorities that will assist the Chief Financial Officer in closing out the fiscal year. The purpose of the IBA review of the Third Quarter Report is to provide clarification and additional information for items outlined in that report.

Overall, the year-end expenditure and revenue projections included in the FY 2022 Third Quarter Report appear reasonable, as do the third quarter appropriation adjustment requests. We do note that the City has received updated actual sales tax receipts through March 2022 which yield an additional $6.8 million above third quarter projections, and increases estimated Excess Equity at year end. Details of select revenue and expenditure projections included in the Third Quarter Report, including major General Fund revenue projections, expenditure variances in salaries and wages, the status of several of the City's reserves and other issues, are discussed in the following sections.

GENERAL FUND REVENUES

As shown in the table below, overall FY 2022 General Fund revenues are projected to be $1.78 billion at the end of the fiscal year, which is an increase of $34.1 million (2.0%) from the FY 2022

Adopted Budget, and an increase of $13.4 million from the Mid-Year Budget Monitoring Report. Major General Fund revenues are projected to increase by $62.5 million as compared to the Adopted Budget, primarily driven by accelerated recovery in sales tax and Transient Occupancy Tax (TOT). Much of the growth in departmental revenue as compared to the Adopted Budget was captured in the Mid-Year Budget Monitoring Report and is being used to support anticipated expenditure overages. Due to the projected increase in revenues, the Mayor plans to use $49.3 million less in American Rescue Plan Act funds than originally planned when Council adopted the FY 2022 budget. Additional detail on revenue changes are provided below.

FY 2022 Projected General Fund Revenue *($ in millions)*					
	Adopted Budget	**Mid-Year Projection**	**Third-Quarter Projection**	**Vaiance: Adopted to Third-Quarter**	**Variance: Mid-Year to Third Quarter**
Property Tax	$ 672.2	$ 658.5	$ 660.1	$ (12.1)	$ 1.6
Sales Tax	320.8	341.1	362.4	41.6	21.2
Transient Occupancy Tax	95.5	119.9	128.1	32.6	8.2
Franchise Fees	78.3	86.2	90.0	11.7	3.8
Other Major Revenues	111.0	103.2	99.7	(11.3)	(3.5)
Subtotal Major Revenues	***$ 1,277.8***	***$ 1,308.9***	***$ 1,340.3***	***$ 62.5***	***$ 31.3***
Departmental Revenues	***$ 316.4***	***$ 334.8***	***$ 337.3***	***$ 20.9***	***$ 2.5***
American Rescue Plan Act	***$ 149.3***	***$ 120.4***	***$ 100.0***	***$ (49.3)***	***$ (20.4)***
Total General Fund Revenue	**$ 1,743.5**	**$ 1,764.1**	**$ 1,777.6**	**$ 34.1**	**$ 13.4**

[1] Table may not total due to rounding

Major General Fund Revenues

Property Tax

Total Property Tax revenue in FY 2022 is projected to be at $660.1 million, which is a decrease of $12.1 million from the Adopted Budget. This decrease is primarily attributable to lower than projected revenues from all major aspects of the Property Tax, including the 1% base allocation ($7.8 million), motor vehicle license fees ($2.8 million), and the Redevelopment Property Tax Trust Fund (RPTTF) ($1.6 million) due to the allowable growth under Proposition 13 for properties not otherwise sold, transferred or improved only being 1% in FY 2022 as opposed to the maximum 2% allowed. These decreases are in line with decreases projected in the Mid-Year Report. For the Third Quarter in particular, Property Tax revenues are projected approximately $1.6 million above the Mid-Year Report, mostly due to increases in the RPTTF ($0.7 million) due to the use of available balances to meet the obligations contained in the ROPS, as well as increases in the base 1% property tax collection ($0.7 million) based of the most recently received actuals. There is also an addition of $0.2 million in one-time property tax revenues due to the anticipated close of the sale of Valencia Business Park, which is a former redevelopment agency property. Our Office agrees with these projections.

Sales Tax

Sales tax revenue in the Third Quarter Report is projected to total $362.4 million, an increase of $41.6 million or 13.0% above the Adopted Budget. This also represents a $21.2 million increase over projections in the Mid-Year Report. Consumer spending continues to be strong despite high inflation linked to increased demand, supply chain disruptions, and the ongoing war in Ukraine.

Given the significant projected sales tax growth over the Mid-Year Report, the Department of Finance (DOF) is increasing the assumed growth rate for the remaining portion of the fiscal year from 13.2% to 19.8%. The revised growth rate is consistent with the City's sales tax consultant, bringing the year-end projection within 0.4% of the consultant's forecast.

Since the Third-Quarter Report has been released, the City has received updated actual sales tax receipts through March 2022 which yield an additional $6.8 million above third quarter projections. This brings the total sales tax projection for FY 2022 to $369.1 million, or 1.5% above the City's sales tax consultant forecast.

This additional $6.8 million in sales tax revenue adds to the estimated $40.0 million in Excess Equity as reflected in the Third Quarter Report. As part of the FY 2022 Adopted Budget the City Council approved the Mayor's request of waiving Charter Section 77.1 which requires a certain amount of General Fund revenue to be deposited into the Infrastructure Fund. Therefore, with this requirement waived, these additional funds should be considered unrestricted General Fund revenue.

Transient Occupancy Tax

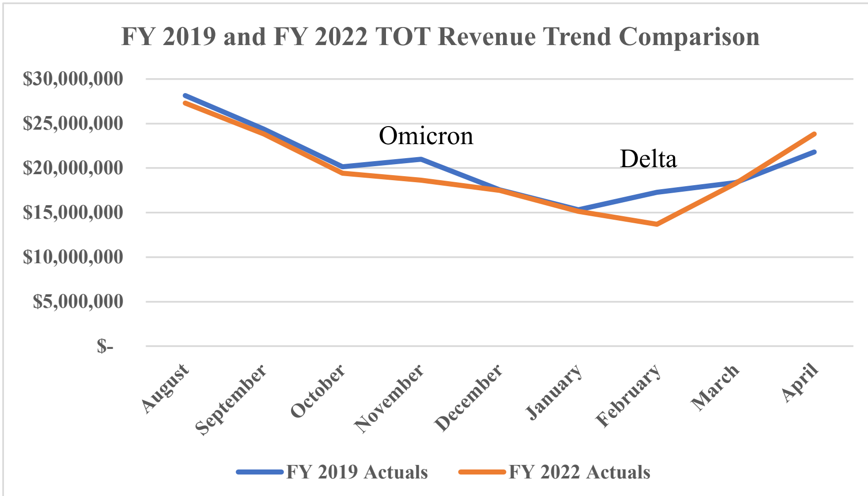
The City's Transient Occupancy Tax (TOT) revenue, or hotel tax revenue, is derived from a 10.5% tax on short-term stays in the region. That amount is broken into three separate allocations – a General Fund allocation of 5.5% (which is one of the City's four major General Fund revenues) and the remaining two allocations are budgeted in the TOT Fund. The two allocations include: 4.0% for Special Promotional Programs that supports the promotion of the City's cultural amenities and natural attractions, and 1.0% is "Council Discretionary" that ultimately ends up being allocated to the City's General Fund. Projected revenues for the full 10.5% TOT tax are included in the table below.

Transient Occupancy Tax Revenue *($ in millions)*					
	Adopted Budget	**Mid-Year Projection**	**Third-Quarter Projection**	**Vaiance: Adopted to Third-Quarter**	**Variance: Mid-Year to Third Quarter**
General Fund Allocation (5.5%)	$ 95.5	$ 120.0	$ 128.1	$ 32.7	$ 8.2
Special Promotional Programs (4.0%)	68.5	86.1	92.2	23.7	6.1
Council Discretionary (1.0%)	17.1	21.5	23.0	5.9	1.5
Total	**$ 181.1**	**$ 227.6**	**$ 243.4**	**$ 62.2**	**$ 15.7**

As shown, projected TOT revenues in the Third-Quarter Report will far surpass those projected in the FY 2022 Adopted Budget, by $62.2 million or 34%. Similarly, the General Fund TOT allocation is expected to come in $32.7 million over the FY 2022 Adopted Budget (an increase of $8.2 million from the Mid-Year Report).

Consistent with the FY 2023 Proposed Budget methodology for forecasting TOT revenue, the FY 2022 third quarter projection for the remainder of the fiscal year is updated to assume a growth rate relative to FY 2019, as opposed to the preceding year of FY 2021. The rationale for this is to reflect seasonality in the projection since impacts of TOT revenue in FY 2020 and FY 2021 have been more responsive to the COVID-19 pandemic and related restrictions than on travel seasons. This methodology is consistent with Tourism Economics' February San Diego Lodging Forecast.

The graph below shows how actual TOT revenue received through April has tracked with FY 2019.[1] Given the close alignment, aside from negative impacts sustained by two COVID-19 variants, we think this approach is reasonable.



For the remainder of the fiscal year, DOF assumes a more optimistic growth rate of -2.3% relative to FY 2019 (indicating revenue will come in below pre-pandemic levels) than Tourism Economics' -7.3% rate. We believe this is reasonable since it is based on average growth compared to FY 2019 for periods that did not experience COVID-19 variant impacts. Further, TOT revenue received so far in FY 2022 has outpaced the February Tourism Economics' growth rate projections.

Franchise Fees

Franchise Fees are projected to be at $90.0 million at the end of FY 2022, which is as increase of $11.7 million from the Adopted Budget, and an increase of $3.8 million from the Mid-Year Report. The majority of the increase from the Mid-year is due to a higher than anticipated clean-up payment from SDG&E, resulting in additional revenue of $4.0 million for FY 2022. As a reminder, most of the change between the Adopted Budget and the Current Budget is due to the recognition of SDG&E minimum bid payments as revenue under the Franchise Fee category, which were included as other revenue in the Adopted Budget. Other franchise fees from cable and refuse haulers continue to be projected close to the Adopted Budget, with cable franchise revenues projected to be $0.4 million below the Adopted Budget, and refuse hauler fees projected to be $0.2 million above the Adopted Budget. Our Office agrees with these projections.

American Rescue Plan Act

The FY 2022 Adopted Budget included $149.3 million of the City's $299.7 million allocation of federal American Rescue Plan Act (ARPA) funds. The FY 2022 Mid-Year Budget Monitoring Report reduced the projected need for ARPA funds to $120.4 million due to increased revenue

[1] Note that the first month of the fiscal year, July, is excluded from the graph since those collections are picked up in June, and if included, would skew the trendline.

projections. As revenues have continued to rebound faster than expected, the Third-Quarter Report continues to reduce the projected use of ARPA funds in FY 2022 to $100.0 million.

GENERAL FUND EXPENDITURES

The Third Quarter Report projects FY 2022 total General Fund expenditures to be $1.76 billion, $20.7 million higher than the FY 2022 Adopted Budget (which is a negative expenditure variance). This variance is 1.2% of the Adopted Budget, as shown in the following table. Note that the figures in our tables are different than the Department of Finance, as we are using the Adopted Budget as a base for comparison, whereas Department of Finance is using the current budget.

FY 2022 General Fund Expenditures *($ in millions)*						
	Adopted Budget	Mid-Year Projections	3d Quarter Projections	Variance: Mid-Year to 3d Quarter	Variance: Adopted to 3d Quarter	Variance %: Adopted to 3d Quarter
Salaries and Wages	$ 680.9	$ 691.8	$ 691.3	$ 0.5	$ (10.5)	(1.5%)
Fringe Benefits	533.4	528.7	530.8	(2.0)	2.6	0.5%
Non-Personnel Expenditures (NPE)	529.3	543.7	542.1	1.5	(12.8)	(2.4%)
Total General Fund Expenditures	**$ 1,743.5**	**$ 1,764.2**	**$ 1,764.2**	**$ (0.0)**	**$ (20.7)**	**(1.2%)**

Notes: Table may not total due to rounding.
Negative variances are overages, or spending above budget (or mid-year) levels. Positive variances are spending below budget (or mid-year) levels.

The focus of our General Fund Expenditures analysis is salaries and wages. Overall, salaries and wages are projected higher than the Adopted Budget by a net $10.5 million (shown above as a negative expenditure variance). However, there are a number of offsetting variances in salaries and wages' components, as discussed below. Our report does not discuss fringe benefits and Non-Personnel Expenditures (NPE) variances, as the Department of Finance addressed these in the Third Quarter Report.

Salaries and Wages

The following table compares the FY 2022 Third Quarter expenditure projections to the Adopted Budget for various salaries and wages categories. The second column from the right shows that salaries and wages in total are projected to be $10.5 million higher than what was included in the FY 2022 Adopted Budget (shown as a negative spending variance).

FY 2022 Salaries and Wages Expenditures - General Fund *($ in millions)*						
	Adopted Budget	**Mid-Year Projections**	**3d Quarter Projections**	**Variance: Mid-Year to 3d Quarter**	**Variance: Adopted to 3d Quarter**	**Variance %: Adopted to 3d Quarter**
Salaries	$ 546.7	$ 530.9	$ 520.5	$ 10.3	$ 26.1	4.8%
Special Pay	43.9	46.9	47.5	(0.6)	(3.5)	(8.1%)
Overtime	67.8	90.2	97.8	(7.6)	(29.9)	(44.1%)
Hourly	13.3	12.4	12.0	0.5	1.3	9.8%
Pay-in-Lieu of Annual Leave	9.1	11.5	13.6	(2.1)	(4.4)	(48.4%)
Total	**$ 680.9**	**$ 691.8**	**$ 691.3**	**$ 0.5**	**$ (10.5)**	**(1.5%)**

NOTES: Table may not total due to rounding.

Negative variances are overages, or spending above budget (or mid-year) levels. Positive variances are spending below budget (or mid-year) levels.

Looking at the separate rows in the table, we can see that there is $26.1 million in projected salary savings, primarily related to delays in hiring and higher vacancies than anticipated in the Adopted Budget. We can also see that this $26.1 million in salary savings is offsetting to overages in other salaries and wages categories (special pay, overtime, and pay-in-lieu).

The most significant overage, $29.9 million in overtime, is largely related to the Fire-Rescue and Police Departments – $16.8 million and $10.4 million, respectively. Overtime is addressed in a separate section that follows.

Departmental Variances

As previously mentioned, total salaries and wage expenditures net to $10.5 million more than what was included in the FY 2022 Adopted Budget. This overage includes all salaries and wage types (salaries, special pay, overtime, hourly, and pay-in-lieu costs). The $10.5 million overage includes departments with salaries and wage overages, which are partially offset by departments with savings.

Departments with the largest salaries and wage overages include:

- $8.7 million – Police (largely overtime overage, partially offset with salary savings [when including mid-year appropriation transfers from Citywide Program Expenditures])
- $10.8 million – Fire-Rescue (largely overtime overage, partially offset with salary savings [when including mid-year appropriation transfers from Citywide Program Expenditures])
- $2.7 million – City Attorney (largely salary overage, with overages in other categories)

Departments with the highest salaries and wage savings include:

- $2.8 million – Parks and Recreation (largely salary and hourly savings, partially offset with overtime overage)
- $1.2 million – Transportation (largely salary savings, partially offset with overtime overage)
- $850,000 – Facilities Services (largely salary savings)
- $643,000 – Library (largely salary savings)
- $609,000 – Stormwater (largely salary savings, partially offset with overtime overage)
- $454,000 – Economic Development (largely salary savings)
- $401,000 – Development Services (largely salary savings)

- $399,000 – City Treasurer (largely salary savings)
- $361,000 – Commission on Police Practices (largely salary savings, about half its salaries and wages budget)
- $331,000 – Planning (largely salary savings)
- $300,000 – Environmental Services (largely salary savings, partially offset with overtime overage)

Overtime

The category of salaries and wages with the largest FY 2022 projected overage is overtime, netting to an over-budget total of $29.9 million. Of this amount, $16.8 million is within the Fire-Rescue Department and $10.4 million is in the Police Department. The next largest overtime overages are $884,000 in Stormwater, $682,000 in Parks and Recreation, $632,000 in Environmental Services, and $389,000 in Transportation. The Fire-Rescue and Police Departments together comprise 93% of total General Fund overtime costs. These two departments' overtime expenditures are discussed briefly below.

Police Overtime

The FY 2022 Adopted Budget for Police Department overtime, at $30.7 million, is $7.4 million lower than what was budgeted in FY 2021. This reduction includes $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). However, even with savings garnered in some of the Department's overtime for these categories in FY 2022, the FY 2022 third quarter projection of $41.1 million is $10.4 million higher than the FY 2022 Adopted Budget. All Police overtime is budgeted in the General Fund in FY 2022.

For additional context, historical information on Police overtime expenditures is provided in the following table.

Police Overtime - Historical Budget vs. Actuals *($ in millions)*

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019 [1]	FY 2020 [2]	FY 2021 [3]	FY 2022
Actual	$ 17.8	$ 23.1	$ 25.0	$ 26.0	$ 29.7	$ 31.9	$ 44.8	$ 37.2	$ 41.1
Budget	11.8	11.1	18.0	21.0	26.3	24.6	35.9	38.1	30.7
Overage/ (Savings)	**$ 6.0**	**$ 12.0**	**$ 7.0**	**$ 5.0**	**$ 3.4**	**$ 7.4**	**$ 8.9**	**$ (0.9)**	**$ 10.4**

NOTES: Table may not total due to rounding.

FY 2014 through FY 2021 Actual amounts are based on unaudited actuals. FY 2022 Actual amount is based on third-quarter projections.

[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.

The following table provides a categorical breakdown of the Department's FY 2022 overtime budget in comparison with year-end projections.

SDPD FY 2022 General Fund Overtime Breakdown					
Category	**Subcategory**	**Adopted Budget**	**FY 2022 Third Quarter Projection ($)**	**FY 2022 Third Quarter Projection (%)**	**Projected Variance Over/(Under)**
Extension of Shift	**Extension of Shift**	$ 3,921,137	$ 7,216,355	184%	$ 3,295,218
	Reports	$ 1,214,838	$ 1,672,993	138%	$ 458,155
	Training & Support	$ 874,667	$ 672,341	77%	$ (202,326)
	Emergency Calls	$ 23,867	$ 27,017	113%	$ 3,150
	Patrol Staffing Backfill	$ 2,261,396	$ 9,171,805	406%	$ 6,910,409
	Community Policing	$ 423,898	$ 242,015	57%	$ (181,883)
	Communications Staffing	$ 1,333,440	$ 1,063,919	80%	$ (269,521)
Call Back	**Call Back**	$ 1,418,177	$ 1,607,441	113%	$ 189,264
Court	**Court**	$ 2,084,808	$ 1,631,555	78%	$ (453,253)
Holidays	**Holiday Worked Premium Pay**	$ 4,292,865	$ 4,736,338	110%	$ 443,473
Special Events	**Special Events Commercial**	$ 887,496	$ 887,496	100%	$ -
	Special Events - Non-Profit	$ 863,217	$ 863,217	100%	$ -
	July 4th Holiday Support	$ 196,857	$ 465,513	236%	$ 268,655
	Ballpark Events	$ 1,032,670	$ 1,032,670	100%	$ -
	Other Special Events	$ 319,838	$ 319,838	100%	$ -
Grants/Task Forces	**Grants/Task Forces**	$ 2,421,300	$ 2,421,300	100%	$ -
Other Events	**Presidential/Dignitary Visits**	$ 72,394	$ 3,628	5%	$ (68,766)
	Protests & Other Events	$ 156,400	$ 117,307	75%	$ (39,093)
	Neighborhood Policing*	$ 5,876,457	$ 5,876,457	100%	$ -
	Other (inc. Covid-19)	$ 77,665	$ 882,795	1137%	$ 805,130
Miscellaneous	**FLSA Overtime (Flores)**	$ 924,827	$ 216,034	23%	$ (708,793)
TOTAL		**$ 30,678,213**	**$ 41,128,033**	**134%**	**$ 10,449,819**

* Includes CleanSD related overtime expenditures

Two subcategories – Extension of Shift and Patrol Staffing Backfill – continue to be the primary drivers of the projected overage and are projected to exceed budget by $3.3 million and $6.9 million, respectively. All of the Department's other overtime subcategories taken together are projected to result in a net overage of approximately $244,000. As we discussed in IBA Report 22-03: *IBA Review of the FY 2022 Mid-Year Budget Monitoring Report*, these budgetary overages are primarily attributable to: (1) a rise in violent crime; and (2) increased 911 call volumes which have necessitated increased patrol staffing requirements. Of note, is the fact that the increase in 911 calls is occurring at the same time that the Department is experiencing a significant increase in sworn officer attrition (i.e., staffing requirements are increasing while staffing levels are decreasing). This is largely driving the overage in Patrol Staffing Backfill which is projected to end the fiscal year at more than 400% of budget. The table below reflects the changes to the

Department's overall sworn staffing and attrition metrics since the release of our Office's review of the FY 2022 Mid-Year Budget Monitoring Report.

SDPD – Sworn Staffing and Attrition Comparison			
2,036 Budgeted Officers	**As of Feb. 1, 2021**	**As of Jan. 31, 2022**	**As of May 23, 2022**
Staffing Level	1,938 filled	1,888 filled	1,866 filled
Total Attrition	101 (13 per month)	140 (20 per month)	217 (20 per month)
Lost to other Agencies	6 (1 per month)	26 (4 per month)	60 (5 per month)
Retirement	53	53	67

Fire-Rescue Overtime

As shown in the following table, Fire-Rescue's actual overtime expenditures have significantly increased in FY 2018 through FY 2022 when compared to the previous fiscal years. From FY 2014 to FY 2017 average overtime expenditures were about $31.4 million, compared to the most recent expenditures in FY 2018 through FY 2022, which average $46.5 million.

The Fire-Rescue Department has indicated that contributing factors for increased overtime levels over the years include general salary increases; a Local 145 Memorandum of Understanding (MOU) change beginning in FY 2018 that allows leave time (non-productive time) to count towards the threshold above which overtime is earned; increases in strike team deployments and weather-related events; and higher vacancies yielding more constant-staffing overtime (related vacancy savings partially offsets certain overtime for constant-staffing). Note that strike team deployment overtime is reimbursable and therefore will not have an impact on the General Fund. Reimbursements are most commonly received from the California Office of Emergency Services (CalOES) followed by the Federal Emergency Management Agency (FEMA). For FY 2021 and FY 2022 there was also increased backfill overtime for COVID-related absences (which includes increased absences for industrial leave) and for personnel pulled from operations to perform reimbursable COVID-19 activities, including the City's FY 2021 vaccination operations.

Fire-Rescue Overtime – Historical Budget vs. Actuals *($ in millions)*									
	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
Actual	$ 29.7	$ 31.5	$ 31.8	$ 32.5	$ 45.4	$ 45.2	$ 41.1	$ 51.3	$ 49.5
Budget	23.7	26.7	29.9	30.2	32.8	38.1	36.6	33.3	32.8
Overage	**$ 6.0**	**$ 4.8**	**$ 1.9**	**$ 2.3**	**$ 12.5**	**$ 7.0**	**$ 4.5**	**$ 18.0**	**$ 16.8**

NOTES: Table may not total due to rounding.

FY 2014 through FY 2021 Actual amounts are based on unaudited actuals. FY 2022 Actual amount is based on third-quarter projections.

Of the $16.8 million overtime overage in FY 2022, $7.6 million is or will be offset by reimbursements ($1.0 million)[2] and projected net savings in salary and special pay (approximately $6.6 million), resulting in a net General Fund impact of about $9.2 million.

[2] Fire-Rescue indicated that it anticipates receiving and additional $1.3 million in FY 2021 COVID-19 related reimbursements. Because these are for FY 2021 expenditures, they are not included as offsetting to the FY 2022 overtime overages. We included FY 2021 reimbursable overage amounts as an offsetting component to overtime overages in our review of the FY 2021 Year-End Financial Performance Report (IBA Report #21-24).

For a more detailed break-down of the $16.8 million overtime overage, the Fire-Rescue Department provided the following components:

- $13.7 million – constant staffing for essential fire suppression posts
- $1.1 million – strike team deployments ($711,000 is reimbursable)
- $734,000 – other divisional overtime, largely for dispatcher and lifeguard services vacancies
- $617,000 – COVID-19 related overtime ($320,000 is reimbursable)
- $373,000 – fire academies, which have been impacted by COVID-19
- $221,000 – required continuing education and fire recruit exams
- $30,000 – weather related overtime

RESERVES

This section discusses the FY 2022 status of several of the City's reserves, including the General Fund Reserve, Risk Management reserves, and the Pension Payment Stabilization Reserve (PPSR).

General Fund Reserve and Excess Equity

The City's Reserve Policy goal for the General Fund Reserve is to reach 16.7% of operating revenues, which is to be phased-in through FY 2025.[3] To realize this phase-in, over the past several years, the Policy's Reserve target percentage has increased by 0.25% annually. For example, the Reserve Policy's General Fund target increased from 15.5% of operating revenues in FY 2020 to 15.75% in FY 2021 and to 16% in FY 2022.

However, as a result of declining revenues due to the COVID-19 pandemic, neither the FY 2021 nor FY 2022 Adopted Budgets included a General Fund Reserve contribution. Thus, the FY 2021 and projected FY 2022 Reserve levels remain at the FY 2020 balance of $205.6 million, as shown in the third row of the following table. The fourth row shows that, in the absence of a Reserve contribution, the FY 2021 Reserve was $8.2 million below the Reserve Policy target; and the FY 2022 Reserve is projected to be $14.8 million below the Reserve Policy target.

General Fund Reserve Policy vs Reserve Balance *($ in millions)*			
	FY 2020	**FY 2021**	**FY 2022**
Reserve Policy Target Percent	***15.5%***	***15.75%***	***16%***
Reserve Policy Target [1]	$ 205.6	$ 213.8	$ 220.4
Reserve Balance (FY 2020 and FY 2021) / Reserve Projection (FY 2022)	$ 205.6	$ 205.6	$ 205.6
Difference: Amount Reserve Balance Is Below the Policy Target	**$ -**	**$ (8.2)**	**$ (14.8)**
Reserve Balance as Percent of Operating Revenues	***15.5%***	***15.1%***	***14.9%***

Note: Table may not total due to rounding.

[1]The Reserve Policy targets are based on the average of the prior three years' actual operating revenues.

Excess Equity

Excess Equity, as described in the Reserve Policy, is "Unassigned Fund Balance that is not otherwise designated as General Fund Reserves and is available for appropriation". For FY 2021,

[3] The City's Reserve Policy is delineated in Council Policy 100-20.

year-end Excess Equity totaled $26.6 million. Now, with the FY 2022 third quarter projections for increased operating revenues and decreased use of American Rescue Plan Act (ARPA) funding, estimated Excess Equity is projected to be $13.4 million higher, at $40.0 million for FY 2022 year-end. The Excess Equity amount could change as the fiscal year progresses; and new information subsequent to release of the Third Quarter Report indicates that the City will receive an additional $6.8 million in sales tax revenue above the amount projected in the Third Quarter Report.

Excess Equity can be used as a one-time resource, and Councilmembers supported its use in their FY 2023 budget priorities resolution, which was approved on February 7, 2022. We note that Excess Equity has not been budgeted in the FY 2023 Proposed Budget or May Revision, but rather has been held aside for unanticipated Proposition B unwinding costs. For example, if FY 2023 Proposition B costs are higher than currently estimated, or if SDCERS decides that it requires upfront payment of amounts the City has assumed will be amortized as part of the pension system's Unfunded Actuarial Liability ($56.3 million General Fund estimate), the Department of Finance anticipates covering those increased costs using Excess Equity and General Fund Reserve. See the Unwinding Proposition B section of our Recommended City Council Modifications to the Mayor's Proposed FY 2023 Budget and Review of the May Revision (IBA report 22-15) for additional information.

Risk Management Reserves

The following table shows the FY 2022 projected balances for the Risk Management Reserves as compared to the FY 2022 Reserve targets. While the Workers' Compensation Reserve is projected to be on target, the Long-Term Disability and Public Liability Reserves are projected to have deficits. We would note that the FY 2023 Proposed Budget/May Revise is forgoing funding of contributions to Risk Management reserves, which provides budget relief for the General Fund.[4]

Current Projected Deficits in Risk Management Reserves *($ in millions)*			
	Workers' Compensation	**Long-Term Disability**	**Public Liability**
FY 2022 Reserve Projection	$ 33.3	$ 4.3	$ 33.8
FY 2022 Reserve Target	33.3	4.7	36.9
Projected Surplus/(Deficit)	***$ -***	***$ (0.5)***	***$ (3.1)***

Note: Table may not total due to rounding.

Pension Payment Stabilization Reserve (PPSR)

Fiscal Year 2022

The third quarter projections do not utilize $7.9 million of revenue that had been included in the Adopted Budget for a transfer from the PPSR[5] to the General Fund. Because of increases in other projected revenues over budgeted amounts, the Department of Finance has determined that transfer

[4] The actual FY 2023 targets for the Risk Management reserves will not be known until the FY 2022 valuations are completed in the fall of 2022.

[5] The purpose of the Pension Payment Stabilization Reserve (PPSR) is to have a source of funds available "to mitigate service delivery risk due to increases in the annual pension payment, the Actuarially Determined Contribution (ADC)." The PPSR was incorporated into the City's Reserve Policy (Council Policy 100-20) in April 2016.

is no longer needed. The $7.9 million PPSR balance has been included in the FY 2023 Proposed Budget as a mitigation for impacts due to the unwinding of Proposition B.

Future Considerations

Currently, at $7.9 million, the PPSR is not funded to the level required in the Reserve Policy. However, since the $7.9 million is included in the FY 2023 Budget as a mitigation for Proposition B impacts, decisions regarding full funding of the PPSR are premature. There will need to be future discussions about bringing the PPSR to its required funding level, once it is utilized. Additionally, the Mayor is required to prepare a plan for replenishment of the PPSR within a year of (full or partial) depletion. As such, the Department of Finance anticipates bringing forward a revised City Reserve Policy for Council consideration during FY 2023.

OTHER UPDATES

Homelessness Strategies and Solutions Department

The Homelessness Strategies and Solutions Department (HSSD) is projected to end the year with $7.4 million in savings. The Third Quarter Report includes a request to use $1.0 million of these savings to offset over-budget expenditure projections in the Information Technology, Personnel, and Stormwater Departments. The savings are the result of delays in executing agreements for shelter site improvement and leases needed to implement the $6.3 million in one-time General Funds provided in the FY 2022 Adopted Budget to create over 300 new shelter beds. We note that the May Revision includes $5.4 million in FY 2023 to support the shelters as they are expected to come online at this time. After reviewing the memorandum attached to the Third Quarter Report, entitled "HSSD FY 2022 Third Quarter Projections and Grant Funding Update", we would like to highlight the following two programs.

Rapid Rehousing

We continue to see projected underspending of $500,000 (from a General Fund budget of $1.0 million) for the City's Rapid Rehousing Programs as was identified in the Mid-Year Report. According to staff, due to the tight housing market it takes new program participants several months to find a place to rent.

Day Center

A projected $200,000 in savings from another homelessness program (San Diego Misdemeanants at Risk Track, [SMART]) is being used to support the Day Center in FY 2022, for total program costs of $743,000. However, the proposed funding for the Day Center in FY 2023 is being reduced back to the program's historic funding level of $541,000. We note that the Community Action Plan on Homelessness called for a strategic decision to be made regarding the Day Center and how the site and program resources would be used in the future.

CONCLUSION

Overall, our Office believes the year-end expenditure and revenue projections included in the FY 2022 Third Quarter Report are reasonable and recommend approval of the FY 2022 appropriation adjustments and authorities as proposed in the FY 2022 Third Quarter Report.

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