

# IBA Review and Analysis of the Mayor's FY 2022-2026 Five-Year Financial Outlook

City Council, Item 330

December 15, 2020



Office of the Independent Budget Analyst



# Role of the Outlook in the Budget Process

## Overview & Importance of the City's Outlook

- Five-Year Financial Outlook (Outlook) was first initiated by Mayor Sanders in 2006 and has been continued by succeeding Mayors.
- It is a useful planning tool that provides long-term context and informs the annual budget process.
- In June 2016, with a vote of the people, Section 69 of the City's Charter was amended to require the Mayor to annually prepare a multi-year financial outlook for the General Fund.

*“The Mayor shall annually prepare a multi-year financial outlook for the general fund projecting anticipated revenues and expenditures in future years as a fiscal planning document and basis for the proposed budget.”*

# Role of the Outlook in the Budget Process cont'd

## Overview & Importance of the City's Outlook cont'd

- The Outlook is not a budget, but can provide Council a sense of the Mayor's budget priorities for FY 2022.
- Allows Council to begin identifying its top budget priorities and developing a strategy for achieving a balanced budget in FY 2022.
- While each year many council budget priorities will overlap with the Mayor's, Council has final authority in the budget process to determine the City's priorities for the next fiscal year.

# Role of the Outlook in the Budget Process cont'd

## Different Approach to this year's Outlook due to COVID-19

- Includes only the General Fund (GF) Baseline limited to existing programs, services, operations, and service levels.
  - Past Outlooks have included potential future expenditure needs of City department operations and services.
- For the current Outlook, departments were not asked to submit any future critical strategic expenditures or needs.
- Important for Council to be informed of potential significant funding needs over the five-year period to assist in developing 5-year financing plan.
  - New resources may need to be considered within this period.

# Role of the Outlook in the Budget Process cont'd

## IBA Annual Review and Analysis of Outlook

- Release of the Mayor's Five-Year Outlook is the first major step in the budget process, and is an information only item.
- Projections for this year's Outlook were particularly difficult to prepare given the uncertainty of impacts on City resources resulting from the ongoing COVID-19 crisis.
- Our Office compliments Department of Finance (DoF) staff for delivering a well thought out document under these extremely challenging times.

# Role of the Outlook in the Budget Process cont'd

## IBA Annual Review and Analysis of Outlook cont'd

- It is our role to analyze the Outlook objectively through various perspectives and identify issues and options to assist the Council in decision making.
- Over the next several weeks, we will be developing the Council's FY 2022 Budget Priorities Resolution based on individual Councilmember budget priority memos which are due to our Office on January 6.
- The resulting Resolution will be released to the Mayor and the public in early February.

# IBA Annual Review and Analysis of Outlook cont'd

## The IBA's report on the Outlook includes:

- Review and Analysis of Outlook Baseline Revenue Assumptions
- Review and Analysis of Outlook Baseline Personnel General Fund Expenditures
- Review and Analysis of Outlook Baseline Non-Personnel General Fund Expenditures
- Potential Future Funding Needs Not Included in the Outlook
- Discussion of Future Financial Challenges
- Discussion of Potential Mitigation Measures in the Outlook and Other IBA-Identified Potential Measures

# General Fund Baseline Revenues

- Our Office agrees with the projections in the Outlook for sales tax and franchise fees.
- We suggest a more conservative approach to Transient Occupancy Tax (TOT) revenues for FY 2022 and FY 2023.
- Assumptions in the Outlook:
  - Vaccine for COVID-19 will be available in FY 2022.
  - The economy will rebound similar to recoveries after past recessions.
  - City revenues will reach their lowest point in the current fiscal year.
  - Growth projected in all revenues from FY 2022 through FY 2026.

# General Fund Baseline Revenues cont'd

## Transient Occupancy Tax (TOT)

- Third largest major GF revenue source.
- Outlook shows 5.5% General Fund Allocation; IBA Report includes additional detail on 4.0% Special Promotional Programs and 1.0% Council Discretionary allocations.
  - Those allocations have indirect General Fund impacts, as a portion of them is transferred to the General Fund or used to reimburse General Fund expenses related to tourism.

# General Fund Baseline Revenues cont'd

## Transient Occupancy Tax (TOT) cont'd

- TOT revenue most directly impacted by COVID-19 Pandemic.
  - Current TOT revenues down to half of FY 2018-19 peaks.
  - Outlook assumes COVID-19 vaccine widely available in FY 2021, with tourism bouncing back with similar pattern to previous post-recession recoveries.
  - Outlook assumes TOT revenue will experience a 59.8% year-over-year growth rate in FY 2022.
- We caution that this sharp recovery may be overly optimistic.
  - Business and Industry may continue increased virtual meetings/telecommuting.
  - Return of large conventions may be slow.
  - Individual confidence to travel for vacations may take longer to return.

# General Fund Baseline Revenues cont'd

## Transient Occupancy Tax (TOT) cont'd

- We suggest considering alternative projections.
  - Reflects Department of Finance’s “Low Scenario.”
  - Decreases FY 2022 growth rate from 59.8% to 35.8%, consistent with slower recovery.

Transient Occupancy Tax Projected Revenues* (\$ in millions)					
	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
	Projection	Projection	Projection	Projection	Projection
Outlook Projection	\$ 200.3	\$ 217.6	\$ 236.6	\$ 246.0	\$ 255.9
Alternative Forecast	\$ 170.3	\$ 185.0	\$ 202.1	\$ 209.1	\$ 217.5
Growth Rate	35.8%	8.7%	8.7%	4.0%	4.0%
Difference	\$ (30.0)	\$ (32.6)	\$ (34.5)	\$ (36.9)	\$ (38.4)

\*Includes General Fund, Special Promotional Programs, and Council Discretionary allocations. For more detail, see IBA Report pages 6-8.

# General Fund Baseline Revenues cont'd

## Property Tax

- Single largest source of General Fund revenue.
  - Projections grow throughout Outlook period.
  - We suggest considering alternative projections:
    - Increases in FY 2023 and 2024, assuming collection rate returns to historical average (99.2%).
    - Decreases in FY 2025 and 2026, assuming lower growth rates to account for impacts on housing sales of supply and pricing.

Property Tax Projected Revenues (\$ in millions)					
	FY 2022 Projection	FY 2023 Projection	FY 2024 Projection	FY 2025 Projection	FY 2026 Projection
Outlook Projection	\$ 664.2	\$ 689.1	\$ 716.9	\$ 747.6	\$ 782.1
Alternative Forecast	\$ 664.2	\$ 691.7	\$ 717.9	\$ 746.8	\$ 777.4
Difference	\$ -	\$ 2.6	\$ 1.0	\$ (0.8)	\$ (4.7)

# General Fund Baseline Revenues cont'd

## Sales Tax

- Second largest source of General Fund revenue.
- Increases throughout Outlook period.
  - Declines in brick-and-mortar store sales partially offset by increases in online sales.
  - Projections consistent with those of City's sales tax consultant, economic forecasts, and trends.

Sales Tax Projected Revenues (\$ in millions)					
	FY 2022 Projection	FY 2023 Projection	FY 2024 Projection	FY 2025 Projection	FY 2026 Projection
Outlook Projection	\$ 300.5	\$ 317.9	\$ 335.7	\$ 347.4	\$ 358.2

# General Fund Baseline Revenues cont'd

## Franchise Fees

- Franchise Fees represent the fourth significant single source of General Fund revenue.
  - Consists of payments made by private companies (Utilities – SDG&E; Cable Providers – Cox, AT&T, Spectrum; Private Trash Collection) to the City for the right to operate within the right-of-way.
- Modest growth expected through Outlook period.
  - Projections are reasonable, assume continued SDG&E Franchise Agreement terms. This may change, but it is too early to project otherwise.

Franchise Fees Projected Revenues (\$ in millions)					
	FY 2022 Projection	FY 2023 Projection	FY 2024 Projection	FY 2025 Projection	FY 2026 Projection
Outlook Projection	\$ 71.0	\$ 73.0	\$ 74.4	\$ 75.8	\$ 77.4

# General Fund Baseline Revenues cont'd

## Cannabis Business Tax

- 8.0% Tax applies to cannabis related business activities, including, transporting, manufacturing, packaging, and retail sales.
  - Outlook projects a positive annual average growth of \$1.8M considering a steady increase in the amount of outlets & marijuana production facilities (cultivation, manufacturing, distribution).

Cannabis Business Tax Projected Revenues (\$ in millions)					
	FY 2022 Projection	FY 2023 Projection	FY 2024 Projection	FY 2025 Projection	FY 2026 Projection
Outlook Projection	\$ 22.0	\$ 23.0	\$ 25.4	\$ 28.8	\$ 29.2

# General Fund Baseline Expenditures

- The Outlook’s FY 2022 GF Baseline projection is increasing by a net \$48.4M (or 3%) from the FY 2021 Adopted Budget.

<b>Increase: FY 2021 Adopted Budget to FY 2022 Baseline Projection</b>	
<b>FY 2021 Adopted Budget</b>	<b>\$1,620.9</b>
Personnel-related Expenditure (PE) Changes	47.6
Non-Personnel Expenditure (NPE) Changes	30.6
Other Baseline Adjustments	14.5
Removal of FY 2021 One-Time Expenditures	(44.4)
<b>FY 2022 Outlook Baseline Projection</b>	<b><u>\$1,669.3</u></b>
<b>Total Increase to FY 2022 Baseline (3%)</b>	<b>\$ 48.4</b>



# General Fund Baseline Expenditures cont'd

<b>Largest PE Increase</b>	
ADC (Pension Payment)	\$ 39.8

<b>Largest NPE Increases</b>	
Deferred Capital Debt Service	\$ 8.0
Fleet Fees	\$ 6.2
Information Technology Costs	\$ 5.9
Infrastructure Fund (Prop H)	\$ 5.6
Other Debt Payments	\$ 4.2
Public Liability Insurance	\$ 3.1

<b>Other Baseline Increases</b>	
New Facilities	\$ 3.5
Street Resurfacing	\$ 11.0

<b>Largest FY 2021 One-Time Expenditure Removals</b>	
Operation Shelter to Home	\$ (30.0)
Small Business Relief Fund	\$ (12.8)
Rent Relief Fund	\$ (9.7)
New Covid-19 Expenditures	\$ (5.8)
Community Equity Fund	\$ (3.0)

\*Dollars in millions.

# General Fund Baseline Expenditures cont'd

## Areas Covered in IBA Annual Review and Analysis of Outlook

### Personnel Expenditures:

- Compensation Increases
- MOUs With Employee Organizations
- Defined Benefit Pension Payment – ADC
- Other Post-Employment Benefits (OPEB)

### Non-Personnel Expenditures:

- Annual Payments for Debt Obligations
- Homelessness Strategies
- Information Technology
- Infrastructure Fund
- New Facilities
- Street Repaving
- Vehicle Replacements

# General Fund Baseline Expenditures cont'd

## Review of Baseline Personnel Expenditures

- Compensation increases for labor agreements and other adjustments:
  - \$249,000 increase for elected officials' salaries (per November 2018 Measure L)
  - \$160,000 related to special pay for police officers with 20 or more years of sworn service
  - \$120,000 related to anticipated minimum wage increases
- MOUs with Employee Organizations
  - City is currently negotiating with all six of its recognized employee organizations regarding FY 2022 terms and conditions of employment.
  - Consistent with past outlooks, this Outlook does not contain estimates for any potential new negotiated compensation increases for FY 2022 or beyond.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Personnel Expenditures cont'd

- Defined Benefit Pension – Actuarially Determined Contribution (ADC)
  - Citywide ADC estimate for FY 2022 is \$418.0M (\$317.5M for the General Fund).
  - An increase of \$52.4M citywide (\$39.8M for the General Fund), which is significantly higher than previously expected.
    - Largest increasing factors include plan assumption changes, FY 2020 investment returns lower than expected, and salary increases higher than expected.
  - Amounts are still estimates: the actual FY 2022 ADC will be known when the FY 2020 actuarial valuation is released (anticipated in January 2021).
- Other Post-Employment Benefits (OPEB) – Retiree Health Benefits
  - FY 2021 was the first year with no increase in OPEB budget, at \$65.4M citywide. (The General Fund portion is \$43.0M).
  - There are also no OPEB increases during the five years of the Outlook.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures

- Annual Payments for Debt Obligations
  - Commercial Paper notes will continue to be issued over the Outlook period to finance CIP.
  - Outlook includes debt service for \$146.0M in lease revenue bonds (LRB) to be issued in FY 2021, some of which to refinance outstanding commercial paper notes, as well as two additional \$90.0M LRB issuances in FY 2023 and FY 2025.
- Homelessness Strategies
  - Funding for homelessness services in FY 2021 across City and San Diego Housing Commission's budgets exceeds \$200.0M.
  - Outlook reflects a subset of City programs, primarily to continue those currently funded with one-time State grants.



# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures cont'd

Breakout of Various Homelessness Services Funding Needs			
Program	FY 2022 Total	FY 2023 Total	FY 2024 - FY 2026 <sup>1</sup>
Temporary Bridge Shelters: 17th & Imperial	-	\$ 2,951,895	\$ 2,951,895
Temporary Bridge Shelters: 16th & Newton	-	6,723,900	6,723,900
Temporary Bridge Shelters: Golden Hall	329,807	4,432,092	4,984,442
Temporary Bridge Shelters: Ancillary services	433,067	303,164	303,164
Safe Parking: Aero/Balboa	410,667	410,667	410,667
Safe Parking: Mission Valley	756,234	756,234	756,234
Homelessness Response Center	300,000	300,000	-
Housing Navigation Center	(300,000)	(300,000)	(300,000)
Transitional Storage Facility: 16th Street	163,124	163,124	163,124
Transitional Storage Facility: Lea Street	900,000	-	-
Transitional Storage Facility: Sherman Heights	1,520,405	1,520,405	1,520,405
Family Reunification	500,000	500,000	500,000
Rapid Rehousing	410,262	1,364,178	1,364,178
Landlord Engagement Program	333,333	333,333	333,333
Flexible Housing Spending Pool	1,000,000	1,000,000	1,000,000
Prevention & Diversion Program	-	400,000	500,000
Outreach: Coordination	-	125,000	125,000
Outreach: Expansion of City Outreach Program	1,500,000	1,500,000	1,500,000
Prosecution and Law Enforcement Assisted Diversion Services (PLEADS)	207,514	207,514	207,514
<b>Total Expense</b>	<b>\$ 8,464,414</b>	<b>\$ 22,691,505</b>	<b>\$ 23,043,855</b>
<b>Total Revenue</b>	<b>\$ 8,464,414</b>	<b>\$ 2,168,092</b>	<b>-</b>
<b>Net General Fund Need</b>	<b>-</b>	<b>\$ 20,523,413</b>	<b>\$ 23,043,855</b>

<sup>1</sup>Note that the needs for FY 2024 through FY 2026 each total \$23.0 million, and therefore are grouped together.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures cont'd

- Information Technology (IT)
  - FY 2020 requests for proposals included workplace services, network, enterprise computing, and application development and maintenance.
  - \$5.9M increase in IT fixed costs for FY 2022, due to costs anticipated from new IT service contracts.
- Infrastructure Fund – Proposition H
  - Outlook includes \$11.3M in FY 2022 to support slurry seal, but no contribution is projected to be required in the outer years.
  - We believe the projected FY 2022 contribution is higher.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures cont'd

- New Facilities Anticipated to Open During Outlook
  - Assumed openings are best estimates, but not certain.
  - New facilities can be delayed for budgetary reasons.
- Parks & Recreation: 13 New Parks & 20 Joint Use Facilities
  - \$3.4M projected operating cost in FY 2022.
- Library: New Branch Library
  - Pacific Highlands Ranch Branch Library anticipated to open in FY 2023.
  - 9.50 FTE full staffing, and \$554,000 cost projected in FY 2023.
  - Project currently has \$1.5M funding need.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures cont'd

- New Facilities cont'd
  - Fire-Rescue: New Fire Stations
    - Three new fire stations anticipated to open within the Outlook period.
      - FY 2023 – Black Mountain Ranch (developer funded)
      - FY 2024 – Torrey Pines (funded by UCSD)
      - FY 2025 – Fairmont Avenue (land purchased; lacks \$20M in capital funding for construction)
    - Expenses phased in over 5 years total \$5.8M in FY 2026 and includes 36.00 FTEs.

# General Fund Baseline Expenditures cont'd

## Review of Baseline Non-Personnel Expenditures cont'd

- Street Repaving
  - Cost of Mayor Faulconer's street repair plan per year is \$48.1M to maintain Overall Condition Index (OCI) of 70.0 for streets.
  - Expenses offset by Gas Tax and Road Maintenance and Rehabilitation Fund funding.
  - Level of expenditure assumed in Outlook has not been achieved since FY 2014.
- Vehicle Replacements
  - Cost for replacement of GF vehicles will increase \$4.0M each year.
  - Outlook projects replacing 1,500 vehicles over five years.

# Potential Future Funding Needs Not Included in the Outlook

- **101 Ash Street Building**

- The only costs included in the Outlook are lease payments, which are currently being set aside in a separate interest-bearing account.
- Investigations and analysis underway, therefore, Outlook does not include any cost estimates for repairs/tenant improvements.
- Ongoing since Council approved lease-to-own agreement in October 2016.
  - Staff originally estimated to move into building July 2017 with renovations to 5 floors
  - Staff returned to Council in spring 2018 with new options, incl renovating all 19 floors
  - August 2018 Council approved staff's recommendation for all 19 floors
  - Construction began September 2018 & staff began moving in December 2019
  - Due to asbestos concerns, staff moved back out January 2020

# Potential Future Funding Needs Not Included in the Outlook cont'd

- **101 Ash Street Building** cont'd

- August 2020 update to Council incl 5 options staff is evaluating

Option	Estimated Overall Financial Impact
Option # 1: Stay the Course <sup>1</sup>	\$ 182,695,762
Option # 2: Exercise Prepayment Option at Year 5 of Lease and Sell Vacant at Loss	405,695,762
Option # 3: Exercise Prepayment Option at Year 5 of Lease and Perform Sale Leaseback <sup>1</sup>	316,695,762
Option # 4: Renegotiate Capital Lease	<i>Legal analysis required</i>
Option # 5: Walk Away/Default	<i>Legal analysis required</i>

<sup>1</sup> Includes Kitchell's preliminary estimate of \$115M of needed repairs to the building.

- Consultants currently continuing assessments and evaluations to provide information necessary to make decisions regarding how to proceed.
- Expect staff to return to Council in early calendar year 2021, cost unknown at this time.

# Potential Future Funding Needs Not Included in the Outlook cont'd

- **Affordable Housing Preservation**

- Goal to dedicate equivalent of 20% of Redevelopment Property Tax Trust Fund (RPTTF) in FY 2021 & all annual growth thereafter.
  - If included, would increase expenditures by \$6.3M in FY 2022 to \$14.2M in FY 2026.

- **Computer Replacements**

- No cost estimates included in Outlook for replacing outdated computers.

- **Disparity Study**

- Study is currently ongoing and is anticipated to be completed in February or March 2021.
  - Unknown cost if Council chooses to establish a new program based on results of study.

# Potential Future Funding Needs Not Included in the Outlook cont'd

- **Internet Access for Low-Income Communities**

- Initial one-time allocation in FY 2021 is \$500,000. Funding will be needed should Council wish to continue these services into future years.

- **Kearny Mesa Repair Facility**

- \$13.8M project needed for construction still had not been identified.

- **New Commission on Police Practices**

- Voter approved Measure B dissolves Community Review Board & establish new commission after Implementation Ordinance & meet & confer.
  - Estimated need could range between 7.00 FTEs and \$1.2M up to 16.00 FTEs and \$2.6M.

# Potential Future Funding Needs Not Included in the Outlook cont'd

- **Sidewalk Repair Team**

- Requires 23.00 FTEs and \$4.6M in FY 2022 (\$3.0M ongoing & \$1.6M one-time).

- **Special Promotional Programs – Arts and Culture Funding**

- FY 2021 budget reduced Special Promotional Programs by 44%.

- **Storm Water Expenditures**

- Recent gap between needs and resources projected at \$857.2M over the next five years based on 2014 Watershed Asset Management Plan (WAMP).
  - WAMP currently being updated & estimates could be significantly higher.
  - City Storm Drain Fee 95 cents/month only provides about \$5.7M revenue/year.

# Future Financial Challenges

## Potential challenges in developing a balanced budget:

- Funding for future MOUs negotiated with employee organizations
- Meeting the General Fund Reserve Policy goal of 16.7% of operating revenues by FY 2025
- Supporting existing homeless programs & services
- Addressing \$2.2B of General Fund infrastructure needs
- Potential pension issues
  - Lower investment earnings or assumption changes
  - Legal challenges regarding Proposition B

# Potential Mitigation Measures

## Possible alternatives to address the projected deficit

- Franchise Agreement Minimum Bid for electricity and gas distribution
  - Depending on the outcome of the bid, \$70.0M or \$8.0M over a ten-year period with interest.
- Use of General Fund Reserves & Excess Equity for FY 2022 one-time needs. (Current Excess Equity amount of \$14.5M is uncertain.)
- Paid Refuse Collection (Repeal of People's Ordinance)
  - Collection service to single family homes represents \$36.3M annually that could be freed up for General Fund programs.

# Potential Mitigation Measures cont'd

- Utilization of \$7.9M Pension Payment Stabilization Reserve (PPSR) to pay for a portion of the General Fund increase to the ADC consistent with City Reserve Policy.
- Permanent Local Housing Allocation
  - Potentially fund eligible homelessness activities including rapid rehousing and supporting case management services.
    - Requires Council to approve amendment to state plan.
- Potential Budget Reduction Proposals
  - Not all department reductions may be accepted.

# Potential Mitigation Measures cont'd

- Storm Water Fee increase
  - The City could raise approximately \$6.0M for each \$1.00 (charged per customer per month) the fee is increased. The City currently charges \$0.95 per customer per month.
- Waiving Infrastructure Fund transfer of \$11.3M would allow funds to go to other GF purposes.

# Next Steps in the FY 2022 Budget Process

- The next step in the annual budget process is for each City Councilmember to identify their priorities for the FY 2022 budget.
  - This is due to our Office by January 6, 2021.
- In February 2021, Council will adopt its City Council Budget Priorities resolution which is developed based on the memos submitted to our Office.
  - The resolution provides the Mayor with early input for developing the FY 2022 Proposed Budget.