THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: December 4, 2020 **IBA Report Number:** 20-25

City Council Docket Date: December 15, 2020

Item Number: TBD

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

OVERVIEW

Importance of the City's Outlook

On November 4, 2020, Mayor Faulconer released his *Fiscal Year 2022-2026 Five-Year Financial Outlook* (Outlook), one of the City's annual financial planning tools. The Outlook is an integral part of the budget development process and is described in *Council Policy 000-02: Budget Policies* as *"the basis for determining the coming year's operating budget allocations."* Mayor Sanders initiated the Five-Year Financial Outlook process in 2006 which was continued by subsequent Mayors. In 2015, the City Council initiated a Charter Review process with a focus on greater clarity of the budget process including the requirement for the Mayor to issue a multi-year financial outlook annually. 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."

The City's Budget Policy was also amended to state: the Outlook *"shall…include projections for committed expenditures which are defined as the operational costs for new facilities, contractual obligations, federal and State legal mandates, and adopted Council policies."* While the Outlook should not be interpreted as a budget, it generally serves to provide the Council and the public a sense of the Mayor's budget priorities. While each year many Council priorities will overlap with the Mayor's, Council has final authority in the budget process to determine the City's budget priorities for the next fiscal year.

We note that Mayor Faulconer approached the Outlook differently this year than in preceding outlooks. In consideration of the City facing serious financial challenges related to the uncertain COVID-19 environment, the Mayor chose to include only the General Fund Baseline, which is limited to existing programs, services, operations and service levels. In past Outlooks, potential future needs of City department operations and services were included for the sake of transparency and multi-year financial planning.

This year City departments were not asked to submit future critical strategic expenditures or needs. Therefore, this Outlook does not provide important information for the Council and the public about other critical funding needs and priorities facing the City over this five-year period. As a result, the Outlook serves more as a status quo forecast rather than a multi-year financial plan. This is particularly important to note if it is determined that new resources will be needed over the five-year period. We discuss this in more detail in our report.

While we agree that it is essential to show the status quo budget, from a broader policy perspective the Council should be made aware of other expenditure needs throughout the Outlook period so that Council can assess whether continuing all Baseline services included in the Mayor's Outlook is the best approach. In other words, the Council may want to reduce or eliminate programs in the Outlook to fund other community priorities.

While the Council cannot change the Mayor's Outlook, the Council is the ultimate budget authority and can make changes to the budget following Mayor-Elect Gloria's release of the FY 2022 Proposed Budget. In doing so, the budget must stay balanced through identifying alternate budget reductions or new resources, delaying new facilities, consolidating or eliminating other programs, or other mitigation tools.

IBA Review and Analysis of Mayor's Outlook and Other Significant Annual Budget Reports

The release of the Mayor's Five-Year Financial Outlook is the first major step in the City's budget process. While the Executive Branch develops the Five-Year Financial Outlook, the Office of the Independent Budget Analyst (IBA) is charged with providing the City Council with a comprehensive review and analysis of the annual Outlook as well as all major budget reports – such as Quarterly Budget Monitoring Reports (including the First Quarter, Mid-Year and Third Quarter Reports), the Mayor's Proposed Budget, the Mayor's May Revision to the Proposed Budget, and the Capital Improvements Program Five-Year Capital Infrastructure Planning Outlook and Budget Monitoring Reports. Each fiscal year we also develop the Council's Budget Priorities Resolution based on individual Councilmember's priorities memoranda, which is provided to the Mayor in February to help inform Mayoral budget priorities. In the last stage of the Council budget process, we provide a report to Council which recommends modifications to the Mayor's Proposed Budget based on final Council priorities, and Council can approve or revise these recommendations.

"Councilmembers shall . . . communicate their budget priorities to the IBA, who will analyze and consolidate the priorities into a proposed Council budget priorities resolution"

Review of the Mayor's Outlook

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 staff for delivering a well thought out and valuable document under these extremely challenging times. We also thank Department of Finance staff for responding to our numerous questions in preparing this report. The IBA's role is to analyze the Outlook objectively, through various perspectives, and identify issues and options to assist the Council in decision-making. This information may also assist the public in understanding the budget process and the numerous challenges the City is facing.

Revisions to the Mayor's Outlook

New information led the Department of Finance to release a revised Outlook on Monday, November 23, 2020.The table below compares the original November 4, 2020 Outlook projections against the projections in the revised Outlook:

FY 2022-2026 Five-Year Financial Outlook Comparison of Versions (in millions)			
	November 4, 2020	November 23, 2020	Change
FY 2022	($84.5)	($124.1)	($39.6)
FY 2023	($71.6)	($106.7)	($35.1)
FY 2024	($56.3)	($84.2)	($27.9)
FY 2025	($2.3)	($27.8)	($25.5)
FY 2026	$22.2	$5.9	($16.3)

The difference between the original and revised versions of the Outlook is largely due to updated SDCERS[1] estimates for the City's Actuarially Determined Contributions (ADCs), or pension payments. These updated estimates are significantly higher than previous projections. We discuss the latest ADC estimates in more detail later in our report.

Overview of the IBA's Analysis of the Outlook and Other Related Issues

Our report consists of five sections as shown below; some snapshots of the sections are also provided below and discussed in greater detail in the body of our report.

<u>Review and analysis of projected Baseline Revenue Assumptions included in the Outlook</u>

- As a result of our revenue analysis, we suggest considering a more conservative approach to Transient Occupancy Tax (TOT) revenues, particularly for FY 2022 and FY 2023. We have provided an alternative scenario for TOT revenues which we believe may be more appropriate for TOT projections.
- We comment on all other General Fund revenue categories and agree with the projections in the Outlook for property tax, sales tax, and franchise fees. For property tax, we provide an alternative forecast for discussion purposes.

[1] SDCERS is the San Diego City Employees' Retirement System, which administers the City's defined benefit pension.

Review and analysis of Baseline General Fund Expenditures

- Our report addresses changes from the FY 2021 Adopted Budget to the FY 2022 Baseline and identifies the largest cost increases and decreases.
- We review personnel-related expenditures and discuss the following topics: compensation increases due to State and local mandates and labor agreements, MOU's with employee organizations, the defined benefit pension payment (ADC), and Other Post-Employment Benefits (OPEB).
- Non-personnel expenditures are also highlighted, and we note there are no growth rates in the Outlook for supplies and contracts, which could impact current service levels.
- Additionally, we provide details about the funding allocated in the Outlook for certain programs and services such as homelessness, payment for debt obligations, Infrastructure Fund, new facilities expected to open in FY 2022, street repaving, Information Technology and Fleet vehicle replacements, as well as discuss issues for Council's consideration.

Potential Future Funding Needs Not Included in the Outlook

- We identify existing priority services and programs that are not included in the Outlook that Council may want to consider during the budget process, if not addressed in Mayor-Elect Gloria's FY 2022 Proposed Budget.
- Examples are the Digital Equity Project (Internet Access for Low-Income Communities), potential implementation of recommendations from the Disparity Study, the new Commission on Police Practices (approved by the voters in November 2020), storm water needs, the Kearny Mesa Repair Facility for fire engines, 101 Ash Building resolution, a General Fund allocation for the preservation of affordable housing, and sidewalk repairs.
- We raise issues for further Council consideration related to these and other areas not included in the Outlook.

IBA Discussion of Future Financial Challenges

- Our report also discusses pending financial challenges to be considered during the Outlook period.
- Future MOU Considerations: Although the City provided "across-the-board" salary increases for all employees in FY 2019 and FY 2020, recent compensation surveys have shown that the City's compensation levels for many employees are lower than comparable California public agencies. The Outlook does not contain estimates for any potential new negotiated compensation increases.
- General Fund Reserve: The Outlook does not include funding of the Reserve in accordance with *Council Policy 100-20: Reserve Policy*. With the potential for long-term adverse impacts of COVID-19 on the City's revenues, it is anticipated that the City may need to use some of the General Fund Reserve to maintain service levels in not only FY 2021, but also the first several years of the Outlook.
- Homelessness: As reflected in the Outlook, significant funding is needed to continue existing homelessness programs beginning in FY 2023 as one-time grants are expected to be exhausted. These needs fall to the General Fund as no other ongoing funding source has been identified.
- Infrastructure: Each year, the City estimates its capital infrastructure needs for the next five years in the Capital Infrastructure Planning Outlook report. In January 2020, an estimated funding shortfall of $2.2 billion was identified, where capital project needs exceed

projected available resources over the next five years. These infrastructure needs will be reassessed in the next report which is expected to be released in January 2021. Beginning to address the City's enormous infrastructure problem will require dedicated funding, further prioritization, and increased staff/contractor capacity to spend funds by expeditiously completing projects when funding is available.

- Future Pension Considerations: There are a couple future unknowns to consider with respect to the defined benefit pension. First, if future investment earnings are lower than assumed in the actuarial valuation, future ADCs could be increased. Second, there are ongoing legal challenges to Proposition B (which was approved by voters in June 2012). We will have a better idea of the anticipated timeframe for resolution of the Proposition B-related issues in the next few months.

<u>IBA Discussion of Potential Mitigation Measures in the Outlook and Other IBA-Identified Potential Measures</u>

- We comment on the potential mitigation actions included in the Outlook and discuss several other potential opportunities for mitigating measures:
  - Increasing the City's storm water fee
  - Charging fees for trash collection for single family homes
  - Potential franchise fees
  - Future reallocation of the Permanent Local Housing Allocation
  - Other resources that have been considered in the past are also discussed, including the Pension Payment Stabilization Reserve, potential budget reduction proposals, and the General Fund Reserve and Excess Equity.

REVIEW OF BASELINE GENERAL FUND REVENUES

As noted, the unprecedented time in which this Outlook was developed required the Department of Finance to make various assumptions about future events. Those assumptions have a large influence on the Outlook, and they have a direct bearing on projections that were assumed for General Fund revenues.

Review of Baseline Revenues

- Transient Occupancy Tax
- Property Tax
- Sales Tax
- Franchise Fees
- Cannabis Business Tax

Some of the most significant assumptions the Outlook makes are directly related to the COVID-19 pandemic: the Outlook assumes that a vaccine for COVID-19 will be widely available in FY 2022, and that the economy will rebound in a manner similar to recoveries after past recessions. The Outlook assumes that City revenues will reach their lowest point in the current fiscal year, and it projects growth in all revenues each year thereafter. Outlook projections are shown below.

Major General Fund Revenues *(in millions)*							
	FY 2021 Adopted	**FY 2021 Projection**	**FY 2022 Projection**	**FY 2023 Projection**	**FY 2024 Projection**	**FY 2025 Projection**	**FY 2026 Projection**
Property Tax	$ 630.6	$ 635.4	$ 664.2	$ 689.1	$ 716.9	$ 747.6	$ 782.1
Sales Tax	274.4	284.0	300.5	317.9	335.7	347.4	358.2
Transient Occupancy Tax	90.5	66.2	105.5	114.5	124.5	129.4	134.6
Franchise Fees	67.7	67.4	71.0	73.0	74.4	75.8	77.4
All Other Revenue Categories	558.1	558.1	404.0	415.0	433.6	447.1	450.5
TOTAL	**$ 1,621.3**	**$ 1,611.1**	**$ 1,545.2**	**$ 1,609.5**	**$ 1,685.1**	**$ 1,747.4**	**$ 1,802.8**

While our Office believes that increases in revenues associated with a recovery are appropriate, we also believe that the City should consider the potential for a slower recovery in some areas, and in the analyses of the major General Fund revenues that follow, we suggest potential alternative scenarios for Property Tax and Transient Occupancy Tax revenues.

Transient Occupancy Tax

Transient Occupancy Taxes (TOT) – or hotel taxes – are the third largest major General Fund revenue source. TOT receipts have been severely impacted by the COVID-19 pandemic, with projected FY 2021 TOT revenues representing less than half of TOT revenues at their peak in FY 2019.

The Department of Finance indicates that the TOT projections in the Outlook assume that a vaccine for COVID-19 will be widely available in FY 2022, and that TOT revenue will rebound significantly in FY 2022, but that revenue will not return to pre-COVID-19 peaks until FY 2025. The Outlook notes that changes to these assumptions would have large impacts on projected TOT revenues, and that the unprecedented nature of the COVID-19 pandemic and its impacts on the tourism sector make it difficult to prepare accurate projections for this revenue source. Our Office concurs with the difficulty of projecting TOT revenues given the unprecedented times, but as we discuss further below, we believe that it may be appropriate to take a more conservative approach in projections for earlier years than is currently projected in the Outlook.

<u>Expanded View of TOT Projections and Operational Impacts</u>

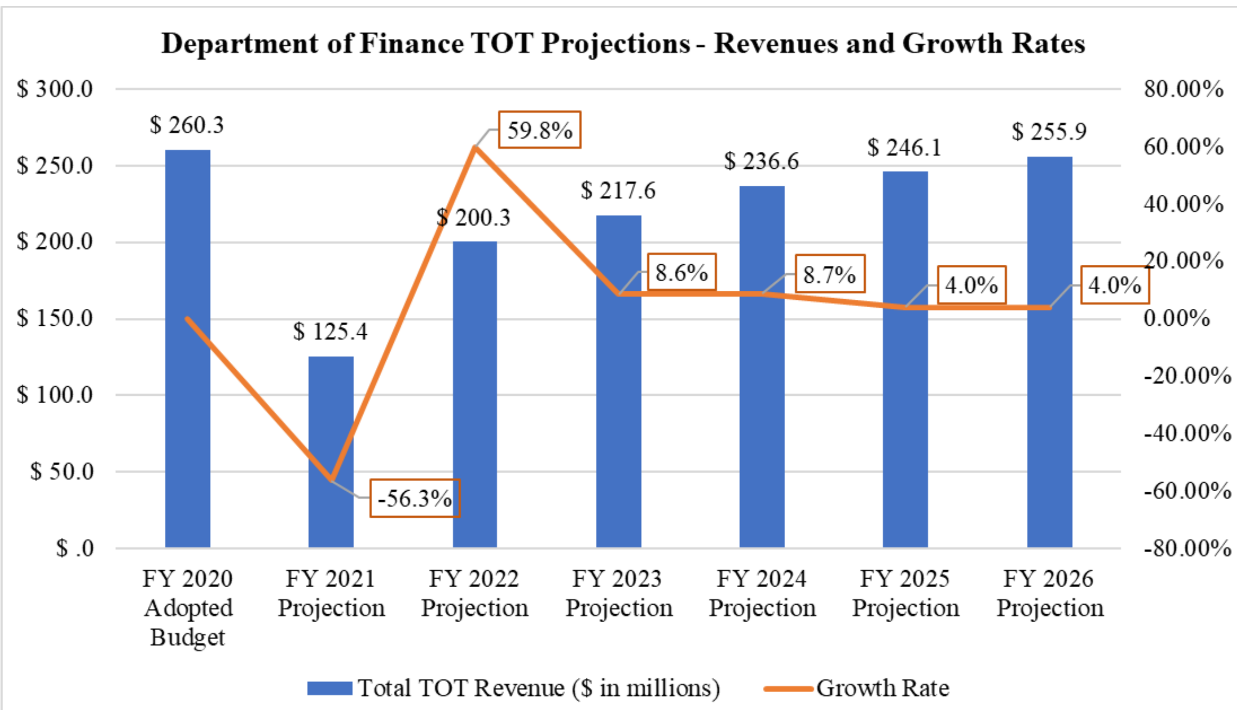
San Diego's effective TOT rate is 10.5%, with 5.5% of that amount allocated to the General Fund (to support general City services), 4.0% to Special Promotional Programs (to support programs and services that encourage tourism to the San Diego area), and 1.0% allocated as discretionary/Council directed funding. While the Outlook focuses on the 5.5% General Fund allocation of TOT, it is important to note that changes in TOT receipts impact all of these allocations. As discussed in our review of the First Quarter Budget Monitoring Report (IBA Report 20-24), the City's operations are impacted by changes in revenue to each of these allocations. While the 5.5% General Fund TOT allocation has the most direct impact on the City's General Fund finances, as projections in the other allocations will impact City services, we believe it is important that they be presented for consideration and review. Accordingly, the Department of Finance's projections for each allocation are shown below.

TOT Revenue *(in millions)*							
	FY 2021 Adopted	**FY 2021 Projection**	**FY 2022 Projection**	**FY 2023 Projection**	**FY 2024 Projection**	**FY 2025 Projection**	**FY 2026 Projection**
General Fund Allocation (5.5%)	$ 90.5	$ 66.2	$ 105.5	$ 114.5	$ 124.5	$ 129.4	$ 134.6
Special Promotional Programs (4.0%)	64.9	47.3	75.8	82.5	89.7	93.3	97.0
Council Discretionary (1.0%)	16.2	11.8	19.0	20.6	22.4	23.3	24.3
TOTAL (10.5%)	**$ 171.6**	**$ 125.4**	**$ 200.3**	**$ 217.6**	**$ 236.6**	**$ 246.0**	**$ 255.9**

As noted in IBA Report 20-24, the Council Discretionary allocation directly impacts overall General Fund revenues, as revenues from that allocation are transferred directly to the General Fund. Additionally, a proportion of the Special Promotional Programs revenue is used to reimburse the City's General Fund for various expenses associated with Parks and Recreation, Lifeguards, City facilities, and street sweeping, among other operations. Additional amounts from the Special Promotional Programs allocation are used to support the Commission for Arts and Culture, and various arts, culture, and community festivals and programs. Most of these programs went through budget cuts in the development of the FY 2021 Adopted Budget and the FY 2021 First Quarter Projections, with cuts concentrated in the arts programs and General Fund reimbursements to the Parks and Recreation and Lifeguards program.

At present, Department of Finance projections show growth in the Special Promotion Programs allocation will be used to restore reimbursements for the City's Parks and Recreation and Lifeguards programs, but that amounts supporting arts programs will be held flat at FY 2021 levels throughout the Outlook period. **While these projections may represent an initial approach towards allocating growth in TOT revenues, it is important to note that many of these reimbursement amounts are policy decisions, and through its authority to approve City budgets, Council will have the authority to use different priorities in allocating funds**, so long as those allocations remain within the bounds of existing law.

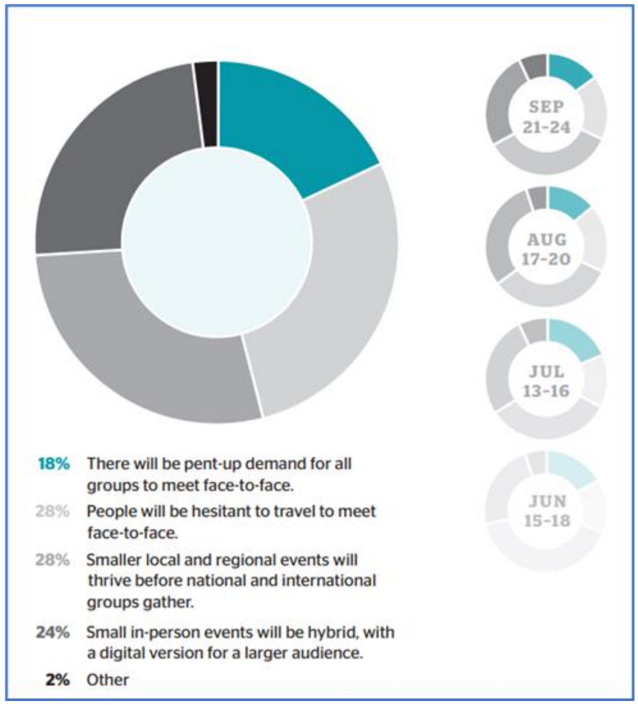
<u>Considering More Conservative TOT Projections</u>
As noted in the overview above, the Department of Finance indicates that TOT projections are in the Outlook assume that a vaccine for COVID-19 will be widely available in FY 2022, and that TOT revenue will rebound significantly in FY 2022, with TOT revenue returning to pre-COVID-19 peaks in FY 2025. Projected growth rates and revenues in the Outlook are shown below.



The Department of Finance indicates that these projections largely mirror the recovery in TOT revenues experienced after the 2008 recession, with pent-up demand leading to a significant bounce-back in tourism, hotel occupancy, and hotel room rates, with full recovery coming several years thereafter. However, given the unique impact that COVID-19 has had on the tourism sector, we believe that past economic recoveries may not provide as much guidance here as they otherwise would.

While the impacts of the COVID-19 pandemic on other General Fund revenues has been significant, those revenues have continued to track overall economic activity across a number of different sectors. The impact on tourism, however, has been immediate, direct, and large. Recovery in TOT revenue will be dependent on a number of factors that are uniquely affected by the pandemic and that are more specific than general consumer confidence or economic activity. Hotel occupancy rates have a direct impact on TOT revenues, and occupancy rates have plummeted during the pandemic as health concerns have led to individuals being less likely to travel for vacations, businesses increasingly turning to teleconferencing in place of travel, and large industries and business sectors pushing out or cancelling conventions and replacing them with online or virtual events. Even with the development and widespread distribution of a vaccine for COVID-19, it may take time for individuals and families to regain the confidence to travel for vacations, and it is likely that some businesses and industry groups will continue to support teleconferencing in place of travel, and/or favor smaller regional conventions over larger national ones.

Recent surveys conducted by the Professional Convention Management Association show that over half of planners are currently planning to launch virtual events to replace events that were previously held face-to-face, and note a belief that *"recovery is going to be long and drawn out, [and] corporate financial restraints will limit ability to travel extensively which will impact live events moving forward."*



Source - PCMA October COVID-19 Survey

While it is reasonable to project growth in TOT revenues above those currently projected for FY 2021, **we believe that a more conservative approach would allow the City to better plan for the potential that the recovery of travel and tourism – and its impact on the City's revenues – takes longer than currently projected**. The Outlook does provide different scenarios for TOT revenue, including a "Low Scenario" in which future growth in TOT revenue in FY 2022 is reduced (see below; amounts for "Special Promotional Programs" and "Council Discretionary" have been extrapolated from Department of Finance "General Fund Allocation" projections). At least for the initial years of this Outlook period, we believe these amounts may be more appropriate to use for projections.

TOT Revenue - Alternative Low Scenario *(in millions)*							
	FY 2021 Adopted	**FY 2021 Projection**	**FY 2022 Projection**	**FY 2023 Projection**	**FY 2024 Projection**	**FY 2025 Projection**	**FY 2026 Projection**
General Fund Allocation (5.5%)	$ 90.5	$ 66.2	$ 89.7	$ 97.4	$ 106.8	$ 110.0	$ 114.4
Special Promotional Programs (4.0%)	64.9	47.3	64.5	70.1	76.2	79.3	82.5
Council Discretionary (1.0%)	16.2	11.8	16.1	17.5	19.1	19.8	20.6
TOTAL (10.5%)	**$ 171.6**	**$ 125.4**	**$ 170.3**	**$ 185.0**	**$ 202.1**	**$ 209.1**	**$ 217.5**
Growth Rate	***N/A***	***-56.3%***	***35.8%***	***8.7%***	***8.7%***	***4.0%***	***4.0%***
Difference from Outlook Projection	***$ -***	***$ -***	***$ (30.0)***	***$ (32.6)***	***$ (34.5)***	***$ (37.0)***	***$ (38.4)***

Property Tax
Property taxes are the City's largest single source of General Fund revenue. 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 represent payments to the City as a result of the dissolution of the former Redevelopment Agencies.

Property Taxes are projected to continue to grow throughout the projection period, but at rates that are lower than some previous Outlooks. The growth rate in distributions is projected to decline from 4.25% in FY 2021 to 4.00% in FY 2022 and 3.75% in FY 2023, before increasing by 0.25% each year in the outer years. There is also an assumed decrease in the collection rate for current secured property taxes. Typically, the collection rate is at 99.2%. However, based on the actuals from FY 2020, the collection rate has been decreased to 98.6% due to the COVID-19 pandemic.

Alterative Property Tax Forecast
As previously mentioned, the two main changes to the Property Tax Forecast in the Outlook are a change in the growth rates, which decline by 0.25% each year from 4.25% in FY 2021 to 3.75% in FY 2023, before increasing by 0.25% each year to 4.5% by FY 2026, as well as a decrease in the expected collection rate from 99.2% to 98.6% in each year of the Outlook based on the FY 2020 actuals. Our Office would take issue in certain respects with each of these assumptions.

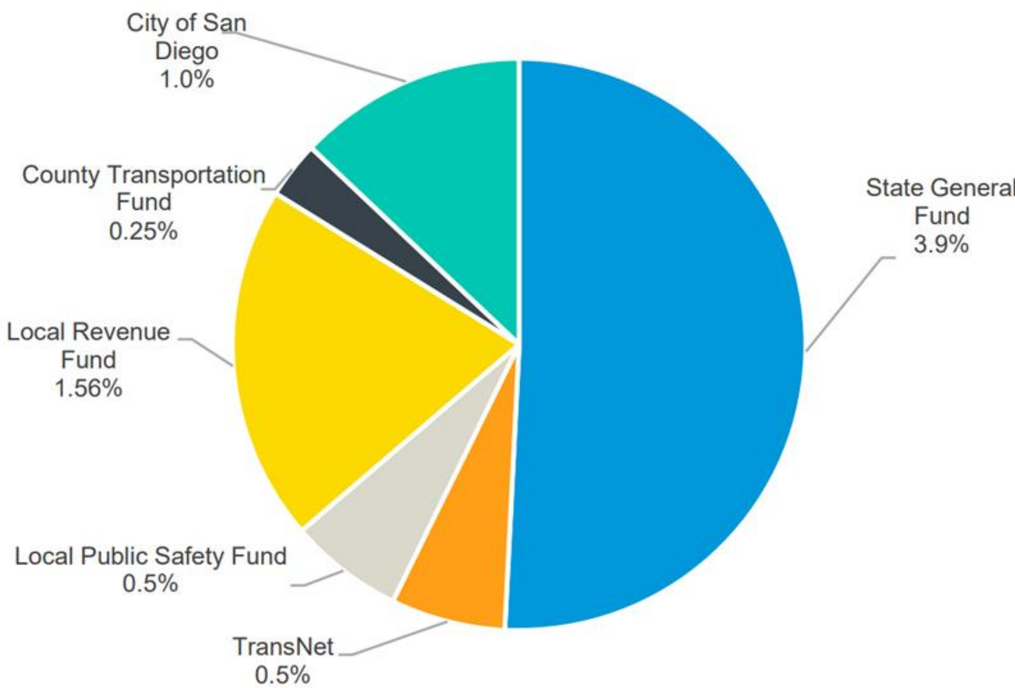
First, while we agree with the currently budgeted collection rates for FY 2021 and FY 2022, we feel that it is unrealistic that this rate would not return to the historical average of 99.2% by FY 2023. Doing so would increase the expected Property Tax revenue by approximately $2.6 million in FY 2023, and up to $2.9 million in FY 2026.

However, it is also possibly unrealistic that the overall property tax growth rate would increase beginning in FY 2024. The previous Outlook, which represented a robust but slowing economy, has projected property tax growth rates to decline steadily from FY 2020 through FY 2025. These declines were mainly driven by a decrease in the number of home sales, which has continued to decline as the housing supply declines. While the revenue impact of these declines have been offset somewhat by rising home prices, the increase in sales price is mostly driven by the lack of supply. Thus, if the supply of housing for sale did increase and sales were to pick up, price increases would probably be moderated. This was reflected in the recession analysis that our Office produced last year in *IBA Report 19-28: IBA Review of the Mayor's FY 2021-2025 Five-Year Financial Outlook,* which projected that Property Tax growth rates would only return to the originally projected growth path, but would not increase above 4.25%. Given this reality, in our new scenario we have lowered the projected growth rates for FY 2024 to 3.75% and for FY 2025 and FY 2026 to 4.00%. These decreases, combined with the increase in collection rate, would produce the changes displayed in the table on the following page.

Altnerative Projection for Property Taxes *(in millions)*					
	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
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)	(4.6)

Sales Tax

Sales tax is the second largest single source of General Fund revenue and is derived from a tax on all sales made in or delivered to the San Diego region. While the effective sales tax rate in the City of San Diego is 7.75%, only 1.0% of that amount goes directly to the City's General Fund. The remainder is split among the State and various other regional programs, as shown below.



Sales tax revenues have historically been correlated with overall economic activity, employment, and consumer confidence. During the initial outbreak of the COVID-19 pandemic, the City made significant decreases in its projections for sales tax receipts, with the FY 2021 Adopted Budget including sales tax revenue of $274.4 million, a decline of $23.5 million from the $297.9 million that had been budgeted in FY 2020 Adopted Budget. While actual receipts in the first quarter of FY 2021 do represent declines from FY 2020, the declines have been smaller than previously anticipated, as taxable sales have not been as heavily impacted by the COVID-19 pandemic as initially feared, with some declines in local sales being partially offset by slight increases in online sales. In many ways this represents an acceleration of trends that the City had been experiencing before the COVID-19 pandemic. Current FY 2021 sales tax projections have been revised upwards to $284.0M (for more detail on this adjustment, see *IBA Report 20-24: IBA Review of the FY 2021 First Quarter Budget Monitoring Report).*

The Outlook projects the City's sales tax revenues to increase throughout the Outlook period, and assumes year-over-year growth in sales tax revenue of 5.8% in FYs 2022 and 2023, 5.6% in FY 2024, 3.5% in FY 2025, and 3.1% in FY 2026. These growth rates suggest that overall taxable sales in San Diego will bounce back to pre-COVID-19 levels in FY 2022, with moderate and slowing growth thereafter. These projections closely track those provided by Avenu Insights & Analytics/MuniServices (the City's sales tax consultant), economic forecasts, and recent economic trends. Our Office believes that these projections are reasonable.

Franchise Fees

Franchise fees represent payments made by private companies to the City for the right to operate within the City 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.

Overall franchise fees are projected to grow modestly during the Outlook period. Revenue from SDG&E, which makes up over 60% of the overall franchise fee revenue, is projected to grow at 4.02% during each year. Cable franchise fees are projected to continue declining at 4.65% based on historical experience. Refuse hauler fees are projected to grow at 1.0% throughout the Outlook period. Our Office agrees with these projections.

The franchise fee projections for SDG&E assume that the current franchise agreements remain in place throughout the Outlook period. The expiration of these agreements on January 17, 2021, without new agreements in place, could potentially jeopardize this revenue source as the majority of the City revenue is derived from surcharges that are unique to the City franchise agreements. For more information on the surcharges, refer to *IBA Report 20-17: Analysis of the Initial Recommendations Concerning the Electric and Gas Franchise Agreements*. If the City were to lose the surcharge revenue for the entirety of FY 2022, it would result in a decrease of $25.6 million for the General Fund. However, at this point it is too early to determine if the expiration of the current gas and electric franchise agreements would impact City revenues. Our Office will continue to monitor the situation to determine the potential revenue impact.

Cannabis Business Tax

The Outlook includes projected revenue from the City's non-medical cannabis business tax (CBT). The tax applies to cannabis related business activities which includes but is not limited to transporting, manufacturing, packaging, and retail sales at a rate of 8.0%. The Outlook's revenue projection shows an average annual increase of $1.8 million through FY 2026 when the revenue is anticipated to be $29.2 million. Growth in CBT revenue in the Outlook's projection is primarily due to an increase in the number of outlets remitting taxes from 18 to 22 in FY 2022. Our Office will continue to review the CBT revenue throughout the FY 2022 budget development process as the cannabis business continues to develop with the advent of additional cannabis outlets and dispensaries, as well as the addition of potential changes to State, federal, and local regulations.

REVIEW OF BASELINE GENERAL FUND EXPENDITURES

General Fund Baseline expenditures support current service levels and are the expenditures that are forecast in the Mayor's Outlook. There are no increases related to new programs in the Baseline expenditures. From a policy perspective, decision-makers may determine that continuation of all Baseline services included in the Outlook is not an optimal approach. In other words, certain service levels could be reduced or eliminated to fund other needs and priorities that are determined to be more important. The City Council is the ultimate budget authority and can determine priority services that are different than those proposed by the Mayor.

For context, most of this Review of Baseline General Fund Expenditures addresses changes from the FY 2021 Adopted Budget to the FY 2022 Outlook Baseline. As shown in the table on the following page, the Outlook's FY 2022 General Fund Baseline expenditure projection is a ***net increase*** of $48.4 million (or 3%) from the FY 2021 Adopted Budget.

The largest cost ***increases*** shown in the table include $39.8 million for the defined benefit pension payment (ADC), as well as increases to the following Non-Personnel Expenditures:

- $8.0 million for deferred capital debt service payments, primarily related to the anticipated $146.0 million bond issuance in FY 2021,
- $6.2 million in Fleet fee increases,
- $5.9 million in information technology (IT) cost increases,
- $5.6 million in increased transfer to the Infrastructure Fund,
- $4.2 million for other debt payments, including those related to public safety radio replacements and sustainability loans, and
- $3.1 million for Public Liability insurance premium increase.

There are also other cost (and revenue) ***increases*** incorporated in the Outlook (shown in the Other Baseline Adjustments section of the following table), which net to $14.5 million and address homelessness services, new facilities, and street resurfacing.

Additionally, the table shows certain expenditure ***increases*** related to FY 2021 use of one-time resources to cover various costs. These FY 2021 resources, which temporarily reduced overall expenditures by $21.0 million, included $2.0 million in excess Public Liability Reserves, $4.4 million in Seized Assets Fund monies, and $14.5 million of Stadium sale proceeds.

Baseline increases are partially offset with a number of expenditure ***decreases***, largely related to FY 2021 expenditures that were one-time in nature and include:

- $30.0 million for Operation Shelter to Home,
- $12.8 million for the Small Business Relief Fund,
- $9.7 million for the Rent Relief Fund,
- $5.8 million for new COVID-19 operational expenditures, and
- $3.0 million for establishment of the Community Equity Fund.

More detailed components of Baseline expenditures are discussed in the sections following the table.

Increases/(Decreases) from the FY 2021 Adopted Budget to the FY 2022 Outlook Baseline Projection *(in millions)*		
FY 2021 Adopted Budget		**$1,620.9**
Personnel-related Expenditure (PE) Changes		**$ 47.6**
Actuarially Determined Contribution (ADC) - Defined Benefit Pension Payment Increase	$ 39.8	
Workers' Compensation Increased Contributions	2.7	
Step Increases for Salaries and Wages	2.4	
Termination Pay (for Annual Leave) Increase	1.9	
Compensation Increases Due to State & Local Mandates and Labor Agreements	0.5	
Net Salaries and Wages and Fringe Benefits Changes (other than those separately listed)	0.3	
Non-Personnel Expenditure (NPE) Changes		**$ 30.6**
Increase in Deferred Capital Debt Service Payments	$ 8.0	
Fleet Fees Increases - vehicle usage ($576,000) and vehicle replacement ($5.6M)	6.2	
IT Increases (including $3.5M help desk; $1.3M data center; $654,000 cyber security)	5.9	
Charter Section 77.1 - Prop H, Infrastructure Fund Transfer Increase	5.6	
Other Debt Payment Increases (incl. public safety radio replacement and sustainability loans)	4.2	
Public Liability Insurance Premium Increase	3.1	
Energy and Utilities - Various Growth Rates (electric, fuel, water, other)	2.1	
Decrease in Transfer to Parks Improvement Funds from Mission Bay Revenues	(4.1)	
Net Other NPE Changes (other than those separately listed)	(0.3)	
Other Baseline Adjustments per Outlook (includes PE and NPE)		**$ 14.5**
Various Homelessness Services ($8.5M expenditures offset with $8.5M in revenues)	$ -	
New Facilities (fire stations, Pacific Highlands Branch Library, parks, recreation facilities)	3.5	
Streets Resurfacing ($22.3M expenditures partially offset with $11.3M Prop H funding)	11.0	
Removal of FY 2021 One-Time Expenditures (includes PE and NPE) [1]		**$ (44.4)**
Operation Shelter to Home	$(30.0)	
Small Business Relief Fund	(12.8)	
Rent Relief Fund	(9.7)	
New COVID-19 Operational Expenditures	(5.8)	
Community Equity Fund	(3.0)	
Person-Centered Unsheltered Outreach Program	(1.5)	
Energy Franchise Consultant ($750,000); Low-Income Internet Access ($500,000)	(1.3)	
Public Liability Costs Covered with Excess Public Liability Reserve	2.0	
Neighborhood Policing Overtime Covered by the Seized Assets Fund	4.4	
Deferred Capital Debt Service Payments Covered by Stadium Sale Proceeds	14.5	
Net Other One-Time Expenditure Adjustments (other than those separately listed)	(1.3)	
FY 2022 Outlook Baseline Projection		**$1,669.3**
Total Increase: FY 2021 Adopted Budget to FY 2022 Outlook Baseline (3% Increase)		**$ 48.4**

Note: Table may not total due to rounding.

[1] Attachment 1 to the Five-Year Outlook, One-Time Uses section, includes one-time expenditures of $50.1M - only $44.4M of which is shown in the "Removal of FY 2021 One-Time Expenditures" section of this table. The remaining FY 2021 one-time expenditures are addressed among other components of this table, and the related Outlook, Attachment 1 amounts are: $5.7M Infrastructure Fund transfer; $2.0M for citywide elections; and a negative $1.9M adjustment to the Parks Improvement Funds transfer.

PERSONNEL-RELATED EXPENDITURES IN THE OUTLOOK BASELINE

Review of Baseline Personnel Expenditures
- Compensation Increases
- MOUs
- ADC
- OPEB

This section includes information on personnel-related expenditure increases in the Outlook's Baseline, including compensation increases due to State and local mandates and labor agreements; the potential for future compensation increases through agreements with employee organizations; the defined benefit pension payment; and retiree healthcare costs.

Compensation Increases Due to State & Local Mandates and Labor Agreements

The Outlook forecast for FY 2022 includes $529,000 in compensation increases related to labor agreements and other compensation adjustments as follows:

- $249,000 related to increased salaries for elected officials in accordance with the November 2018 Measure L,
- $160,000 related to special pays for police officers with 20 or more years of sworn service, and
- $120,000 related to anticipated minimum wage increases. (The FY 2022 increased cost is based on State minimum wage requirements, which are assumed to drive the minimum wage levels for the City in FY 2022. The relevant State-mandated increases to minimum wage are from $13 to $14 an hour, effective January 1, 2021, and from $14 to $15 an hour, effective January 1, 2022.)

MOUs With Employee Organizations

__Consistent with past outlooks, this Outlook does not contain estimates for any potential new negotiated compensation increases for FY 2022 or beyond.__

The City is currently negotiating with all six of its recognized employee organizations regarding FY 2022 terms and conditions of employment for their members. These terms and conditions are contained within the employee organizations' labor agreements, or memoranda of understanding (MOUs). Current MOUs for four of the employee organizations (AFSCME Local 127, IAFF Local 145, DCAA, and MEA)[2] expire at the end of FY 2021. For the other two employee organizations, POA and Teamsters Local 911[3], agreement was not reached with the City on MOUs for FY 2021, and the terms and conditions in the expired agreements remain in effect.

The Outlook does not contain estimates for any potential new negotiated compensation increases for FY 2022 (and through the remainder of the Outlook). The Department of Finance estimates a 1% salary increase for City employees would cost about $6.1 million for the General Fund, and a 3% salary increase would cost about $18.4 million. Please see the Future MOU Considerations section under Future Financial Challenges for more information.

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[2] The four employee organizations include: AFSCME Local 127 (American Federation of State, County & Municipal Employees, Local 127); IAFF Local 145 (International Association of Fire Fighters, Local 145); DCAA (Deputy City Attorneys Association); and MEA (Municipal Employees Association).

[3] The other two employee organizations include: POA (Police Officers Association); Teamsters Local 911 which represents the Lifeguards.

Defined Benefit Pension Payment – Actuarially Determined Contribution (ADC)
The ADC is the retirement payment made by the City for its defined benefit pension. The Outlook's citywide ADC estimate for FY 2022 is $418.0 million, which is an increase of $52.4 million from FY 2021. Of this amount, $317.5 million is for the General Fund, an increase of $39.8 million from FY 2021. The Outlook shows the citywide ADC increasing to about $441.0 million in FY 2026 (about $335.0 million for the General Fund).

The Outlook's FY 2022 ADC estimate and out-year ADC projections are based on the most recently provided estimates from the San Diego City Employees' Retirement System's (SDCERS) actuary, Cheiron, which were provided after the initial version of the Mayor's Outlook had been released (the Outlook has been subsequently revised). These latest estimates include impacts for select factors only (which are discussed below). Because of the complexity of the pension system variables, the total of all impacts to the FY 2022 ADC (and out-year projections) will not be known until the FY 2020 valuation has been completed. The FY 2020 valuation is anticipated to be available in January 2021 and will incorporate all impacts of FY 2020 experience as compared to what was previously assumed for FY 2020 in the FY 2019 valuation.

As mentioned above, Cheiron provided updated ADC estimates based on select factors only. The most recent estimates are significantly higher than the previous projections included in the FY 2019 valuation, as shown in the table below. The following are the select factors that have increased the estimated FY 2022 ADC, with corresponding amounts:

- $27 million increase related to assumption changes: On July 10, 2020 Cheiron presented the latest actuarial experience study[4], which included recommended changes to various assumptions that will be used to calculate the FY 2022 ADC (and project future ADCs). The SDCERS Board of Administration approved the recommended changes. The estimated increase is largely due to changes in mortality assumptions.
- $12 million increase due to asset loss, primarily related to investment returns: The actual FY 2020 investment return has been determined to be 0.5%. This is 6.0% lower than the 6.5% assumed in the FY 2019 valuation, which will produce an investment "experience loss" and correspondingly, increases to the FY 2022 and future ADCs.
- $13 million related to salary increases that were greater than anticipated: Impacts of certain pensionable pay increases, including FY 2020 Special Salary Adjustments (SSAs), will also increase the FY 2022 and future ADCs.

Changes in Estimated ADCs: Updated Impacts for Selected Factors (in millions)					
	FY 2022	**FY 2023**	**FY 2024**	**FY 2025**	**FY 2026**
ADC Projection Presented in FY 2019 Valuation	$ 365	$ 363	$ 362	$ 361	$ 357
Factor 1: Assumption Changes	27	28	28	28	28
Factor 2: Asset Loss	12	22	31	37	43
Factor 3: Salary Increases	13	14	14	14	14
Most Recent ADC Projection	**$ 418**	**$ 427**	**$ 434**	**$ 440**	**$ 441**
Increase from Projection in FY 2019 Valuation	***$ 52***	***$ 64***	***$ 72***	***$ 79***	***$ 85***

Note: Table may not total due to rounding.

[4] An experience study involves historical analysis of pension plan assumptions, including the rate of investment return, salary inflation, and retirement and mortality rates. The plan experience study is the basis for the actuary's recommended changes to the plan's actuarial assumptions.

Future Pension Considerations

There are a couple future unknowns to consider with respect to the defined benefit pension. First, if future investment earnings are lower than assumed in the actuarial valuation, future ADCs could be increased. Second, there are ongoing legal challenges to Proposition B, which was approved by voters in June 2012 – see the Future Financial Challenges section of this report for more information.

Other Post-Employment Benefits – OPEB

The City provides a retiree health benefit plan for employees hired before July 1, 2005, which is often referred to as OPEB. At the end of FY 2011, the City reached agreement with its six employee organizations regarding a restructured benefit level for employees retiring on or after April 1, 2012. The duration of the agreement with the employee organizations is 15 years, and it may be modified beginning after June 30, 2014.

The agreement provides that the City did not anticipate paying more than $57.8 million annually for this retiree health benefit through FY 2015, and thereafter does not anticipate increasing the payment by more than 2.5% annually. FY 2021 is the first year in which there is no anticipated increase in payment for OPEB; and the FY 2021 Adopted Budget remains the same as FY 2020, at $65.4 million citywide (the General Fund portion is $43.0 million). There are also no increases for OPEB payments during the five years of the Outlook.

The City's OPEB budget supports the following retiree health costs:

- The pay-as-you-go (PAYGO) cost associated with payments for eligible retirees under the City's ***defined benefit*** retiree health plans, including the restructured benefit;
- The contributions to the Health Reimbursement Arrangement (HRA) accounts for eligible employees who selected the ***defined contribution*** retiree health plan under the restructured benefit; and
- The cost associated with administration payments to SDCERS to manage the retiree health benefit program.

In addition to the City's payments that support the OPEB retiree health costs described above, a relatively nominal amount of funding is contributed by employees. If the combined amounts contributed by employees and the City are not enough to cover the costs, the City will withdraw funds from its CalPERS OPEB Trust Fund. Alternatively, if City/employee funding were to exceed OPEB costs, the City can pay into the CalPERS OPEB Trust Fund. The Trust Fund balance was $127.5 million as of September 30, 2020.

Non-Personnel Expenditures (NPE) in the Outlook Baseline

Review of Baseline Non-Personnel Expenditures
• Annual Payments for Debt Obligations • Homelessness Strategies • Information Technology • Infrastructure Fund • New Facilities • Street Repaving • Vehicle Replacements

The Outlook discusses Baseline NPE expenditures for the following categories: supplies, contracts, information technology, energy and utilities, reserve contributions, City Charter section 77.1 Infrastructure Fund, and other expenditures. The table on page 13 provides a summary of major NPE changes from the FY 2021 Adopted Budget to the FY 2022 Outlook Baseline projection.

A general observation regarding the Outlook's NPEs is that there are no growth rates assumed for supplies or contracts, a departure from previous years' Outlooks. Although a higher than needed growth rate could lead to expenditure estimates that are too high, zero growth rates may be akin to a service level reduction. Some current contracts may have growth rates included in their terms, and inflation could be a factor in the future. However, some contracts or supplies expenditures may be discontinued, should future revenue shortfalls persist. These areas should be analyzed to ensure that needed service levels are achieved and any short-funding of these areas is done strategically.

Annual Payments for Debt Obligations
The Outlook includes annual payments for all current and expected debt obligations. These payment obligations have been included as Baseline General Fund Expenditures (within the Non-Personnel Expenditures line item) on page 7 of the Outlook.

General Fund-supported debt obligations include:
- Bonds for Capital Improvement Program (CIP) projects
- Commercial Paper Notes issued to support CIP
- Equipment and Vehicle Financing Program (EVFP) payments
- Other Bond and Capital Lease Payments
- Lease to Purchase payments for the Civic Center Plaza and 101 Ash properties

The Outlook indicates commercial paper notes will continue to be issued over the Outlook period as a means of financing the CIP. The financing plan calls for periodically replacing outstanding short-term commercial paper notes with long-term lease revenue bonds (LRBs). The Outlook estimates approximately $90 million of LRBs will be issued in FY 2021[5], FY 2023, and FY 2025 to replace outstanding commercial paper. Annual debt service for the first two of these three planned LRBs will become due during the Outlook period. LRB debt service and commercial paper interest amounts have been included in the Outlook proforma.

Homelessness Strategies
There are numerous homelessness programs within the City of San Diego that are supported by a variety of funding sources between the City's and the San Diego Housing Commission's budgets.

[5] Up to $90 million of the planned $146 million LRB to be issued in FY 2021 will be used to replace/refund outstanding commercial paper notes at the time of issuance.

In recent years, additional funding has become available through one-time State grants, which have allowed the City to expand services. Due to the COVID-19 pandemic, even more one-time funding was made available to protect the homeless population. Funding allocated for homelessness services in FY 2021 across both the City's and the Commission's budgets exceeds $200 million. The Outlook reflects funding needs for a subset of City homelessness programs, primarily those that were established with previously mentioned State grant funding. Once the grants are expended, funding needs will shift to the General Fund if the programs are intended to continue and no other funding source is identified.

The following table lists the various homelessness services that are included in the Outlook.

Breakout of Various Homelessness Services Funding Needs			
Program	**FY 2022 Total**	**FY 2023 Total**	**FY 2024 - FY 2026[1]**
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
Total Expense	**$ 8,464,414**	**$ 22,691,505**	**$ 23,043,855**
Total Revenue	**$ 8,464,414**	**$ 2,168,092**	**-**
Net General Fund Need	***-***	***$ 20,523,413***	***$ 23,043,855***

[1] Note that the needs for FY 2024 through FY 2026 each total $23.0 million, and therefore are grouped together.

As reflected in the table above, FY 2022 funding needs total $8.5 million, which is significantly lower than the $22.7 million needed in FY 2023 and the $23.0 million needed each subsequent year. This is because the first round of a State grant called Homeless Housing, Assistance and Prevention (HHAP) is anticipated to cover a significant portion of homelessness services in FY 2022. Council approved allocations of the first round of HHAP on June 16, 2020.

The Outlook also incorporates revenue from a second round of State HHAP grant funding totaling $10.6 million. Proposed allocations for this grant have not come before Council yet. The revenue is assumed to completely offset the funding needs reflected in FY 2022 that are not covered by the first round of HHAP, as well as partially offset funding needs in FY 2023.

Below we discuss several notable policy decisions and assumptions included in the Outlook period which Council will have the opportunity to weigh in on in the future.

Ending the expansion of the Golden Hall shelter to downstairs halfway through FY 2022. Golden Hall, in the downtown San Diego Concourse, is the location of one of the City's temporary bridge shelters. As a response to the COVID-19 pandemic, the bridge shelters have relocated to the vacant Convention Center to allow for proper physical distancing (an effort referred to as Operation Shelter to Home). To provide additional shelter capacity once residents leave the Convention Center, on October 6, 2020, Council approved the expansion of the Golden Hall shelter to include the downstairs for up to 324 individuals. The Outlook assumes this shelter will run through the second quarter of FY 2022. We note that a decrease in funding for the Golden Hall Bridge Shelter is not reflected in the table because the first round of HHAP funds are assumed to be supporting the program which are not shown. According to staff, permitting restrictions require additional facility upgrades to be made if the downstairs were to be used long-term.

Ending the Lea Street storage facility after FY 2022. The Lea Street storage facility opened in November 2019 and is assumed to close after FY 2022 in the Outlook. This storage facility is considered temporary since the site is planned for a park, pursuant to the Mid-City Communities Plan. In October 2019, Council approved $400,000 to identify amenities for Chollas Triangle Park in preparation for its development, a process that is estimated to take three years.

Making the one-time expansion of homelessness outreach, ongoing. As part of the FY 2021 Adopted Budget, Council added $1.5 million in General Funds on a one-time basis to support person-centered outreach. This allocation is expanding the City's existing outreach efforts in the current fiscal year. As shown in the table, the Outlook assumes continuation of this program.

Reevaluation of the Homelessness Response Center after FY 2023. On October 27, 2020, Council approved necessary agreements for an initial eight-month term, with two one-year options to renew, to establish a Homelessness Response Center. When Council considered proposed allocations for federal programs on May 19, 2020, Council voted to remove funding for the Housing Navigation Center. Staff committed to returning with a plan to enhance the program, which led to the development of the Homelessness Response Center. Funding for the Homelessness Response Center is assumed only through FY 2023. Staff expect the Homelessness Response Center to be evaluated to determine if operations should continue beyond FY 2023. We note that federal funds were used to purchase the building that will house the Homelessness Response Center. If this program is discontinued and the building is not used for another eligible activity, the City could be required to repay the federal funds.

<u>Homelessness Strategies Base Budget</u>
The Outlook notes that $6.6 million is included in the Homeless Strategies base budget, in line with the FY 2021 Adopted Budget. When the Housing Navigation Center funding of $300,000 is backed out as the program no longer exists, this brings the base budget to $6.3 million.

The following makes up the rest of the homelessness base budget:

- $4.1 million to maintain shelter beds
- $2.2 million to support the Serial Inebriate Program, Connections Housing Interim Bed Program, and Interim Housing for Homeless Adults, collectively referred to as "Homeless Shelters and Services"

During FY 2020, the City transferred the sprung structure that housed homeless veterans prior to the pandemic to Chula Vista. The May Revision to the FY 2021 Proposed Budget repurposed $4.1 million originally planned to operate the Veterans Bridge Shelter, to provide shelter beds elsewhere so that the City did not lose the 200 beds that the shelter provided. On October 13, 2020, Council approved an expansion of 42 beds at Father Joe's Imperial Avenue campus with the use of one-time federal Coronavirus Aid, Relief, and Economic Security (CARES) Act funds. Ongoing funding for this program of about $1.5 million is assumed to come from the $4.1 million listed above to maintain shelter beds. The remaining funding is planned to support a partial year of the shelter located in the downstairs of Golden Hall as well as shelter related to the SMART (San Diego Misdemeanants At Risk Track) program.

Information Technology

The Outlook contains a $5.9 million increase in information technology (IT) fixed costs for FY 2022, which is primarily due to estimated costs anticipated from new IT service contracts. In FY 2020, the Department of Information Technology issued requests for proposals (RFPs) for the following IT services:

- Workplace services (desktop and help desk support),
- Enterprise computing (datacenter, cloud, disaster recovery and cyber security), and
- Application development and maintenance.

The new contracts will continue current levels of service with only minor enhancements such as providing mobile device support, a walk-up service desk for critical operations and cross-functional support to improve service deliver. However, since the existing service contracts were established years ago (some date back to May 2012), industry standards have changed and new estimates account for significant cost inflation. As such, the Department of Information Technology anticipates significant cost increases for the new contracts.

During our review of the FY 2021 Proposed Budget, we noted that the Department of Information Technology included estimated one-time costs in the current year to transition to new vendors (pending the outcome of the RFP process) and that ongoing costs of the new contracts would be realized in FY 2022. At this time, the Department anticipates finalizing contract negations by April 2021, beginning the transition to new vendors in May 2021, and reaching a steady state during the spring of 2022. The Department will have more firm cost estimates for these service contracts for the FY 2022 Proposed Budget.

We also note that the baseline IT projection included in the Outlook assumes the continuation of remote work support costs, such as providing network access to work remotely and cyber security.

Infrastructure Fund

As reflected in the Outlook, no contributions to the Infrastructure Fund are planned after FY 2022 since the piece of the calculation, outlined in Charter Section 77.1, that has been driving deposits into the fund is set to expire after FY 2022. This piece is referred to as the "major revenue increment" in which half of the year over year growth in property tax revenues, unrestricted General Fund TOT, and unrestricted franchise fees is required to be deposited into the fund. We note that although there are no projected contributions to the Infrastructure Fund beginning in FY 2023, nothing precludes Council from making allocations directly from the General Fund to support infrastructure.

The Outlook includes an $11.3 million contribution to the Infrastructure Fund in FY 2022 which is the result of two components: 1) growth in the major revenue increment projected to be $34.9 million, and 2) a decrease of $23.6 million in order to reconcile the FY 2020 contribution based on actual revenues. Each year, the deposit is reconciled once actual revenues are known, which occurs after Council adopts a budget for the upcoming fiscal year. Based on actual revenues, no contribution to the Infrastructure Fund was required in FY 2020 because there was no growth in the major revenue increment. However, the FY 2020 Adopted Budget includes funding for the Infrastructure Fund because it was calculated based on revenues estimates prior to COVID-19. Therefore, there is a need to reconcile this overpayment.

Our Office believes $23.6 million exceeds the amount required to reconcile the FY 2020 contribution. Embedded in this figure is additional funding that was provided to reconcile the FY 2018 contribution, which we believe should be left out. If so, **this would lead to a higher *net* FY 2022 contribution of $14.2 million instead of the $11.3 million reflected in the Outlook and would also increase the total projected deficit for FY 2022.**

Infrastructure Funds can be used in both the operating budget and the Capital Improvements Program budget. The Outlook assumes that Infrastructure Funds will go towards supporting slurry seal maintenance of streets which is an operating budget expense. During the budget process, Council could instead prioritize capital projects for the Infrastructure Fund since there is a great long-term need. Last year's Five-Year Capital Infrastructure Planning Outlook reflected a $2.2 billion funding gap between resources projected to be available and capital project needs. Alternatively, Council could waive Charter Section 77.1 and allocate Infrastructure Funds to help mitigate the General Fund deficit.

New Facilities

The Outlook includes forecasted funding for new Parks and Recreation, Library and Fire-Rescue facilities assumed to open during the Outlook. In past years, funding for new facilities were categorized as Critical Strategic Expenditures. Given that this year's Outlook does not include Critical Strategic Expenditures, assumed funding for new facilities has been incorporated into the Outlook's baseline, with the rationale that these facilities are scheduled to become operational in the Outlook Period. In this regard, we note two observations:

- First, while the assumed opening dates for the new facilities in the Outlook represent staff's current best estimates, these timeframes are by no means certain. Factors outside of staff's control – for example, responsibilities of San Diego Unified School District related to the opening of Joint Use Facilities – can impact opening timeframes. In addition, there are certain facilities included in the Outlook which do not currently have full capital funding; therefore, the schedule for constructing these facilities will be impacted by the availability of capital funds.

- Second, it should be noted that the new facilities contemplated in the Outlook can be delayed for budgetary reasons, if necessary. Given the challenges expected over the next several years, consideration should be given to competing General Fund needs to determine if the funding necessary to operate these facilities may be better utilized for another priority.

Parks and Recreation: New Parks and Joint Use Facilities
The Department anticipates 13 new or expanded parks to open, and 20 new Joint Use Agreements (Agreements) with local school districts to become effective during the Outlook period. The Outlook projects expenses for the new parks and the Agreements to be approximately $3.4 million in FY 2022 and increasing to an aggregate expense of approximately $6.2 million in FY 2026 once all the new parks and Agreements have come on-line. The projected operating costs include the addition of 54.82 FTEs throughout the Outlook period to maintain the new parks and playgrounds.

Library: New Branch Library (Pacific Highlands Ranch)
The Outlook identifies 9.50 FTEs and approximately $854,000 in new ongoing annual operational costs for the Pacific Highlands Ranch branch library which is currently anticipated to open in FY 2023. Leading up to the completion of construction, the Outlook attempts to best match the need for the positions with the anticipated opening date of January 2023. In FY 2022, 1.00 FTEs and $56,000 are assumed in preparation for the branch opening, with full staffing (9.50 FTEs) and $554,000 in FY 2023. Thereafter, $854,000 in expenses are projected for the first full year of operations and beyond.

We note that this project is currently $1.5 million short of full capital funding ($26.2 million). If additional FBA or other funding sources are not identified before the anticipated start of construction in June 2021, the opening timeframe discussed above may be delayed.

Fire-Rescue: New Fire Stations
The Outlook assumes funding for operational expenses for three new fire stations assumed to open within the Outlook period. These expenses are phased in over five years and total approximately $5.8 million in FY 2026, including the addition of 36.00 FTEs. Operational expenses include personnel expenditures and non-personnel expenditures such as equipment and supplies. Costs for items that may be considered capital in nature, like fire engines and ladder trucks, are routinely financed through the City’s Equipment and Vehicle Financing Program (EVFP).

The three new fire stations identified in the Outlook as requiring operational funding over the next five years are listed below:

- FY 2023 – Black Mountain Ranch (developer funded)
- FY 2024 – Torrey Pines (funded by UCSD)
- FY 2025 – Fairmont Avenue (land purchased; lacks capital funding for construction)

With respect to the anticipated opening dates for the Black Mountain Ranch and Torrey Pines (UCSD) Fire Stations, we understand that they are currently anticipated to occur one year later than what is reflected in the Outlook, in FY 2024 and FY 2025, respectively. All three stations were identified as high-priority sites by the 2017 Citygate Report, which recommended the addition of up to 12 new fire stations as well as other increased services such as Peak Hour Engines in order to improve the Fire-Rescue Department's ability to meet its response time standards.

Of the three fire stations included in the Outlook, only the Fairmont Avenue does not have full funding identified for construction at this time with an estimated gap of approximately $20 million based on latest cost estimates. A list of expenses for all new facilities anticipated to open or become operational within the Outlook period is attached to this report.

Street Repaving

Within the Other Baseline Expenditures, the Outlook assumes a General Fund distribution for slurry seal projects in order to preserve Mayor Faulconer's goal of maintaining an Overall Condition Index (OCI)[6] of 70. One of the metrics used to reach the OCI goal is to slurry seal 370 miles of streets per year. This would require expending $48.1 million per year, according to the Outlook, which would be offset by Gas Tax and Road Maintenance and Rehabilitation Fund funding. Any funding need left over after expending these sources is assumed to come from the General Fund.

The Outlook also assumes that the entirety of the Infrastructure Fund distribution would be used for slurry seal in FY 2022. This increases the expenditures in the Outlook by $11.0 million in FY 2022 (which would be $22.3 million without the Infrastructure Fund contribution assumption), increasing to $21.0 million in FY 2023, and then gradually declining to $16.1 million in FY 2026 as funding distributions from the other funds increases.

Our Office notes that the Outlook makes a number of assumptions by including these expenditures in order to maintain this particular service level. For one, the level of expenditure assumed for the Outlook has not been achieved since FY 2014, when street repaving became a major priority. The highest level of budget added in a particular year for slurry seal was $33.2 million in FY 2020, with the second highest total being $25.7 million in FY 2019. **However, actual spending on slurry seal projects has never matched the total amount of funding available, leading to a projected available fund balance for slurry seal of $36.0 million at the end of FY 2020.**

Further, since FY 2014, no General Funds have ever been budgeted or expended for slurry seal projects. It will be a policy call made by the next Mayor and City Council to determine the level of funding dedicated to street repaving in the future years or whether these funds could be better utilized for another priority.

Vehicle Replacements

The Outlook states that costs for the replacement of General Fund vehicles will increase by approximately $4.0 million each year. Projected vehicle replacement costs are based on anticipated vehicle life cycles and the Outlook notes a projected need to replace 1,500 vehicles over the next

[6] An OCI is a 0 to 100 point scale that measures the overall condition of City streets. An OCI of 70 to 100 is representative of good condition, an OCI from 40 to 69 is considered fair, and below 40 is considered poor.

five years of the Outlook. In addition, the Outlook notes that the remaining excess balance in the General Fund Fleet Replacement Fund is budgeted for use in FY 2021 which means there is no longer any fund balance available to offset annual General Fund vehicle replacement costs.

The General Fund Replacement Fund was established to serve as a savings account where funds were set aside annually through "assignment fees" towards the future replacement of vehicles. The vehicles were then purchased outright. The General Fund, however, has switched almost entirely to replacing vehicles using a debt financing program (with the exception of Police patrol vehicles and motorcycles[7]). This means that most of the General Fund's annual assignment fees are now paying debt service, rather than building up a savings account towards a future purchase. The previously built up "savings", or excess fund balance, was used in the FY 2021 budget to reduce costs to the General Fund due to revenue shortfalls from the impacts of COVID-19.

At the time of our review of the FY 2021 Proposed Budget, the Fleet Department estimated that approximately 68% of the General Fund's vehicles were within their useful life. Adding vehicles currently on order and those planned for purchase this fiscal year, the Department estimates this will bring the General Fund fleet closer to 75% of vehicles within their useful life. The projections in this Outlook, to replace 1,500 vehicles over five years, is with the goal of getting the General Fund up to replacing 100% of vehicles at the end of their useful life. The Department indicates that maintenance costs increase when vehicles are retained past their useful life and it is more cost-effective to replace vehicles on time. It should be noted, however, that this has been a policy decision in the past. At times, vehicle replacements have been postponed for short periods of time when overall General Fund revenues have fallen short of needs. This is why we are currently in the 68-75% range for vehicles within their useful life and the Department has been trying to catch up.

POTENTIAL FUTURE FUNDING NEEDS NOT INCLUDED IN THE OUTLOOK

Potential Future Funding Needs Not Included in the Outlook

- 101 Ash Street Building
- Affordable Housing Preservation
- Computer Replacements
- Disparity Study
- Internet Access for Low-Income Communities
- Kearny Mesa Repair Facility
- New Commission on Police Practices
- Sidewalk Repair Team
- Special Promotional Programs
- Storm Water Expenditures

In the following section, we identify significant programs that are not addressed in the Outlook. This is not intended to be an all-inclusive list but highlights items identified by City Council as priorities. They may be projects already underway, such as the internet access for low-income communities funded with federal CARES Act monies in the current fiscal year, or items with costs still to be determined such as the new Commission on Police Practices, or existing projects or programs that need additional funding, such as sidewalk repair.

[7] Due to the severe use and shortened lifecycles, these vehicles are not ideal for debt financing.

101 Ash Street Building

The Outlook includes the projected expense for lease payments on the 101 Ash Street Building, which is currently unoccupied. City staff provided an update to City Council in August 2020 and the investigations and analysis to evaluate the City's options on how to proceed are still underway. As such, the Outlook does not include any cost estimates for improvements to the 101 Ash Street building, moving costs, or any of the other options presented to City Council in August 2020. A summary of what has occurred to-date and the current status follows.

Brief History of the 101 Ash Street Building Improvements

In October 2016, the Real Estate Assets department presented to City Council a $127.8 million (over 20 years) lease-to-own agreement for the 101 Ash Street building, stating that it could accommodate up to 1,100 City employees. Council approved this proposal on October 17, 2016. Staff initially planned to renovate only five floors with the $5.0 million provided in the lease for tenant improvements, with the expectation that renovations needed for the remaining fourteen floors would be minimal. At the time the City took possession of the building, staff was expected to begin relocating into the building by July 2017.

However, after working with a space planner/design architect and the impacted City departments, staff decided that all 19 floors of office space should be renovated in order to increase the number of work stations from 800 to 1,150 at an estimated cost of $17.0 million. In January 2018, City staff put the project out to bid, including a requirement for a 24/7 construction schedule to complete the renovations in FY 2019. Bids came in at $32 million which far exceeded the $5 million of available funding. As a result, staff cancelled the bids.

Throughout this time, the City Council was not informed about the expansion in project scope or the related increased costs, and Council only became aware of the projects status after our Office and several Councilmembers began requesting updates on the project. A full report to Council from staff about the building and renovation project was not made until the spring of 2018, and no new funding for the increased costs was identified at the time for the expanded project.

After cancelling bids and updating and receiving input from Council, City staff started over with a new request for proposal (RFP) on two renovation options for the building: the original 5 floor renovation plan and the new plan to renovate all 19 floors. In addition, the RFP was pared back to eliminate costly components such as a 24/7 construction schedule.

In August 2018, staff returned to City Council with three options for Council's consideration. Staff recommended making tenant improvements to the entire building to increase the number of work stations from 800 to 1,150 at a capital cost of $25.9 million with an estimated moving expense of $1.5 million. Council accepted the staff recommendation of renovating all 19 floors based on staff projections of the City's future office space needs and projections of reduced future rental costs by moving more staff into the building.

Construction began at the 101 Ash Street building in September 2018 with City employees expected to be relocated to the building in the fall of 2019. Approximately 840 staff moved into the 101 Ash Street building in December 2019 and January 2020. However, due to asbestos concerns, the staff that had moved into the building were moved back out in mid-January 2020 and the remaining moves were put on hold. The Mayor's staff then hired a team of experts to evaluate what had gone wrong and what needs to be done to proceed.

Most Recent Update to Council
In August 2020, City staff presented an update to City Council utilizing preliminary information from the following consultants: forensic analysis (Hugo Parker, LLP), asbestos recommendations (Shefa Enterprises, Inc), initial facility condition assessment (Kitchell Corporation), and real estate expertise (Kidder Mathews). Staff presented five options that they would be evaluating.

The following table lists those five options and very preliminary cost estimates that were prepared by Kidder Mathews just a few days before the presentation to City Council. Staff explained that significantly more analysis is needed to refine these figures. For example, the Kitchell Corporation's initial $115 million estimate of needed repairs to the building was preliminary, based on the age of the building's systems but without having completed diagnostic testing.

Summary of Options for 101 Ash Street Building *As Presented by Staff to City Council on August 6, 2020*	
Option	**Estimated Overall Financial Impact**
Option # 1: Stay the Course[1]	$ 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[1]	316,695,762
Option # 4: Renegotiate Capital Lease	*Legal analysis required*
Option # 5: Walk Away/Default	*Legal analysis required*

[1] Includes Kitchell's preliminary estimate of $115M of needed repairs to the building.

Our Office analyzed the reports prepared by Hugo Parker, LLP and Kitchell Corporation; however, the preliminary cost estimates in the table above were not provided in advance with sufficient time for analysis, and they are not complete. Our findings and recommendations are summarized in *IBA Report 20-18: Review of 101 Ash Street Project Update and Next Steps*. We noted that City Council had received a significant amount of new, yet preliminary, information with little time to review and that no Council action was needed for staff to continue to move forward with investigations and studies already underway. We recommended that staff provide Council with monthly progress updates, that staff provide an updated estimate of the total anticipated costs to complete the analysis, and that the following information be provided when the item returns to Council:

1. A comprehensive re-evaluation of office space needs,
2. Refined repair estimates from the Kitchell Corporation,
3. A more expansive and thorough discussion of any and all options for addressing the issues at the 101 Ash Street property, and
4. Cost estimates should be presented for all viable options identified or suggested.

Current Status
According to staff, the Kitchell Corporation has been working to complete their facility condition assessment and cost estimates. Once that is completed, staff will engage Kidder Mathews to evaluate the costs of all options. In addition, Hugo Parker, LLP will continue their forensic investigation. Meanwhile, the City stopped making lease payments to Cisterra Partners LLC in September "because the City cannot occupy and utilize the building for its intended purpose as a

workspace"[8] and has set aside the funds in a separate interest-bearing account while negotiations continue with the lessor.

The results of these efforts, including refined cost estimates, are anticipated to come before City Council in early calendar year 2021. **No cost estimates regarding improvements to the 101 Ash Street building, moving costs, or any of the options presented in August are included in the projections in this Outlook.** However, the Outlook continues to assume the rent payments, which are currently being set aside in a separate fund, to be ongoing during the Outlook period.

Affordable Housing Preservation

On October 27, 2020, the City Council passed a resolution approving the proposed actions in the San Diego Affordable Housing Preservation Report. This included a provision that the City establish a strategic goal within the budget process to provide an appropriation for the preservation of affordable housing equal to 20% of the residual distributions in FY 2021 from the Redevelopment Property Tax Trust Fund (RPTTF), and then all growth in RPTTF residual distributions in future years. RPTTF currently flows into the General Fund as part of the property tax allocations. This would add to existing funds available for affordable housing preservation but would be a flexible source intended to specifically preserve naturally-occurring affordable housing. These allocations are not included in the Outlook. If they were included, it would increase expenditures by $6.3 million in FY 2022, increasing to $14.2 million in FY 2026, as shown in the table below.

RPTTF Residual Distributions for Affordable Housing Preservation *(in millions)*					
	FY 2022	**FY 2023**	**FY 2024**	**FY 2025**	**FY 2026**
Estimated Residual Distributions	$ 30.5	$ 32.0	$ 33.7	$ 35.6	$ 38.4
Affordable Housing Strategic Goal	6.3	7.8	9.5	11.4	14.2

Computer Replacements

Identifying funding to replace outdated City employee desktop computers has been an ongoing issue of concern. In FY 2020, the Department of Information Technology switched to a lease program for replacement of General Fund desktop computers. The Department's goal is to replace computers every five years (or 20% of computers each year) with a five-year lease, to match the expected useful life of the computers. The FY 2021 Budget does not include funding for additional computer replacements and the Outlook does not include any amounts for replacement of outdated computers moving forward. During the current year, many desktop computers are being replaced with laptops utilizing the CARES Act funding. The Department indicated that they are re-evaluating the approach to replacing General Fund computers in light of the shift to remote work and use of laptops (not covered under the current replacement program) and will incorporate any impacts into future budget projections.

Disparity Study

In April 2016, the Citizens Equal Opportunity Commission presented a report regarding recommendations for a disparity study and other improvements, to the Budget and Government Efficiency Committee. At the Committee's request, our Office conducted research on the costs of

[8] September 1, 2020 memorandum to the Honorable Mayor Kevin L. Faulconer from Rolando Charvel, Chief Financial Officer regarding 101 Ash Street building – Suspension of lease payments

conducting a disparity study and presented those in *IBA Report 16-08 Disparity Study: An Overview of Municipalities and Government Agencies*. In the FY 2019 Mid-Year Budget Monitoring Report, $200,000 was identified for the City to initiate a disparity study on City contracts. The study was then fully funded in the FY 2020 Adopted Budget and the Purchasing and Contracting Department hired BBC Research and Consulting in FY 2020 to conduct the study.

The study is currently ongoing and the Purchasing and Contracting Department anticipates having the study completed and presented to City Council in February or March 2021. At this time, it is unknown what recommendations will be made by BBC Research & Consulting and, subsequently, what the City's plan will be to address those recommendations. Should the City Council choose to establish any new programs to address disparity findings, those will likely require additional staff or other resources and the disparity study would need to be updated every few years. These potential additional costs to the General Fund are not included in this Outlook.

Internet Access for Low-Income Communities
The City Council included $500,000 in the FY 2021 Budget to provide greater internet access for residents in low-income communities in the City. This funding was allocated on a one-time basis to fund a pilot program to investigate and implement internet access options. A multi-departmental working group, led by the Information Technology Department, has been meeting on a regular basis to solicit input from low-income communities and identify cost-effective options for low or no-cost internet access. Representatives from the IBA and Council offices have been actively involved in these meetings.

Based on information gathered by the working group to date, the Information Technology Department has embarked on a multi-faceted approach to provide low or no-cost internet access through a variety of means at multiple sites in low and moderate-income communities. The current plan contemplates providing secure internet access in the following ways:

- Installing cabling and hardware at approximately 30 branch library locations in or very near low and moderate-income communities. This will provide no-cost outdoor internet access at these branch locations. Several of these sites will have designated internet patios that can also provide laptop computers to library patrons.
- Building on the work of San Diego Parks Foundation to provide internet access to 25 recreation centers, funding will be used to expand the availability of internet access to other recreation centers in or very near low and moderate-income communities.
- Exploring the possibility of funding up to 500 additional cellular "hotspot" devices for distribution by library branches in low-income communities. These devices enable users to connect their computers and phones to the internet.
- Pursuing partnerships with school districts that would allow the City to help fund the installation of outdoor internet access at targeted school sites in low-income communities where gaps in outdoor internet access may exist.
- Identifying existing outdoor cable Wi-Fi hotspot locations in low-income communities where the City could fund outdoor internet access at a discounted rate. The Information Technology Department is also in discussion with internet service providers who may have, or be willing to offer, discounted internet access options to low-income residents.

The working group is optimistic that significant additional low or no-cost internet access options will be created in low-income communities with the $500,000 one-time allocation in FY 2021. However, it should be noted that several of the above referenced internet access options can only be funded through the end of June 2021. If the City Council wishes to continue funding these services in FY 2022 and beyond, a similar amount of annual funding will be required in the coming budget years. This funding has not been included in the Outlook.

Kearny Mesa Repair Facility

The City began leasing the property on Othello Avenue in April 2017 to serve as a maintenance and repair facility for heavy duty fire apparatus. This was in response to findings by CST Fleet Services, a fleet consultant hired by the City, that separate shop space would increase maintenance efficiency for the City's 100+ heavy duty fire-apparatus, rather than sharing space with the refuse packers at the Miramar facility. The report, issued in April 2016, states that *"the current set up for performing the maintenance on both Fire and Refuse fleets at the Miramar Shop is not adequate to allow the technicians to be successful in keeping both fleets serviced, and meet the departments' needs. … In addition, without running a second shift, the Fire technicians do not have enough bay space to adequately do their jobs."*

After receiving multiple cost estimates ranging from $6.5 to $17.0 million to reconstruct the facility to accommodate the maintenance and repair of heavy-duty fire-apparatus, $1.0 million was allocated for design work, which included refining the construction cost estimate. This work resulted in an updated project cost estimate of $14.8 million (inclusive of the $1.0 million budgeted for design) and the project needs an additional $13.8 million of funding for construction.

The FY 2021 Adopted Budget reflects this $13.8 million as "anticipated" to be allocated in the current fiscal year. During our review of the FY 2021 Proposed Budget, our Office was told that this funding would be addressed during the next round of General Fund commercial paper debt financing[9]. However, the Kearny Mesa Repair Facility was not included on the project list with the most recent commercial paper authorization brought to City Council. It is not included in the FY 2021 First Quarter Budget Monitoring Report projections, nor is the $13.8 million addressed in this Outlook.

New Commission on Police Practices

With the approval of Measure B on November 3, 2020, voters approved the dissolution of the existing Community Review Board on Police Practices (CRB) and the establishment of a new Commission on Police Practices (Commission). Our Office prepared the fiscal impact statement for this measure which estimated that the necessary staffing and annual budget for the new Commission could reasonably range between 7.00 FTEs and $1.2 million and up to 16.00 FTEs and $2.6 million.

The next steps toward establishing the new Commission will involve the adoption of an Implementation Ordinance by the City Council which will further define how Commission members are selected and appointed, the Commission's investigative scope and process, as well as its other roles and responsibilities. The development of the Implementation Ordinance is

[9] The Kearny Mesa Repair Facility is not eligible for debt financing because the City is leasing the property. Debt financing was proposed to replace budget in other projects, thereby freeing up eligible funding for this project.

expected to be lengthy given the need to undergo a meet and confer process with the San Diego Police Officers Association. In an attempt to accelerate this process, a phased approach is being considered according to the City Attorney's Office, which would allow separate implementation components to proceed through meet and confer sooner than others before they are presented to City Council.

The Outlook does not include assumed funding needs for Measure B. While it is unknown precisely when the implementation ordinance and meet and confer process outlined above will reach the point where funding will be required for the new Commission, it is assured to be sometime during the Outlook period. We note that the CRB, which is to serve as initial/interim members of the Commission per Measure B, has requested funding for interim staff (10.00 FTEs) and other operating expenses in a Memorandum dated October 28, 2020. While the exact funding need outlined by the CRB has not been estimated, it is expected to fall within the range provided in our fiscal impact statement for Measure B.

Sidewalk Repair Team
The sidewalk condition assessment, first completed in 2015 and updated annually since then, has repeatedly called for the addition of a Sidewalk Repair and Replacement Team, which is not included in the Outlook. Additionally, a recent audit from the Office of the City Auditor regarding the City's Public Liability Management specifically highlighted improved sidewalk maintenance as a strategy to mitigate trip and fall liabilities. Adding an additional team would help alleviate the deficiencies in sidewalk repair which have previously led to an increased risk of falls and other injuries, resulting in litigation against the City. This team would require the addition of 23.00 FTES and $4.6 million in FY 2022, of which $3.0 million would be ongoing expenditures and $1.6 million would be in one-time costs.

Special Promotional Programs - Arts and Culture Funding
As noted in our review of Transient Occupancy Tax (TOT) revenues, the Outlook does not discuss the 4.0% portion of TOT that is allocated to Special Promotional Programs, though use of that allocation will have impacts on some of the City's General Fund operations. Decisions will also need to be made about the use of the Special Promotional Programs allocation to support the City's arts and cultural programs. The FY 2021 Budget reduced Special Promotional Programs funding for arts programs by 44% (reducing FY 2020 funding levels of $14.2 million to $7.9 million for FY 2021). If Council wishes to reprioritize arts and cultural programs, it may consider redirecting some of this revenue to those programs in future years, though it will have to balance the needs of those programs against other operational needs that also ultimately help to promote tourism to San Diego.

Storm Water Expenditures
In May 2003, the San Diego Regional Water Quality Control Board (Regional Board) adopted a new municipal storm water permit for San Diego. That permit mandates strict storm water quality requirements, and compliance with that permit will require significant increases in funding. The Transportation and Storm Water Department completed a Watershed Asset Management Plan (WAMP) in 2014 that notes activities and projects necessary to support flood risk management activities and compliance with the Regional Board's storm water permit. The 2014 WAMP projected $3.1 billion of funding needs through FY 2035. However, it is important to note that the

WAMP is currently being updated for inclusion into the Storm Water Funding Strategy, and costs could be significantly higher than previously projected. Penalties for not complying with storm water permits and requirements are up to $10,000 per day per violation.

Storm water permit compliance efforts have significant operational and capital needs which are higher than current spending levels. The FY 2021 Adopted Budget included a total of $47.5 million for storm water efforts, which is well below the previously projected WAMP need of $65.4 million. Without a finalized WAMP, we are unable to determine the potential operating deficit between what is in the Outlook and what will be included in the WAMP. However, there are some significant operating expenditures that, in addition to being included in the previous WAMP, were also identified as needs by the Office of the City Auditor. The most significant of these needs is the addition of an in-house pipe repair team, which was recommended in the June 2018 audit of the Storm Water Division. This team would require the addition of 24.00 FTEs and a total of $7.1 million in funding in FY 2022, of which $4.4 million would be ongoing and $2.7 million would be one-time.

These operational deficits are in addition to the projected gap between needs and resources for capital expenditures, with the most recent gap projected at $857.2 million for storm water over the next five years. This backlog will be updated based on the new WAMP in the next Five-Year Capital Infrastructure Planning Outlook, which staff plans to release in January 2021. While future deferred capital bonds and commercial paper notes may support some of the capital needs, they will not be sufficient to meet all storm water capital costs identified in the WAMP. In fact, emergency storm water needs are already taking up an ever growing share of the capital financing, increasing costs to complete storm water projects due to their emergency nature, as well as increasing costs for those projects that get delayed due to the necessity for immediate funding for storm water emergencies.

The City continues to lack a dedicated funding source that provides revenues sufficient to meet all storm water permit and mandated needs. The City does have a Storm Drain Fee that is paid by water and sewer users. That fee collects 95 cents per month from single family residences and $0.0647 per hundred cubic feet of water use from multi-family and commercial water customers. In total, the fees bring in approximately $5.7 million per year.

The Storm Water Fee rates have remained unchanged since the passage and implementation of California Proposition 218 in 1996. Proposition 218 allows local governments to adjust water, sewer, and trash fees through a vote of the local legislative body (in the City of San Diego, this is the City Council), but required other fee increases to be put to a public vote. This has the effect of making any increase in the storm drain fee subject to a two-thirds vote of City voters in a citywide election, or a majority vote of City property owners in a mail-out election. As the City became subject to increasingly stringent storm water quality mandates and permits, Proposition 218 has constrained the City’s ability to adjust the Storm Drain Fee to compensate for those increased costs.

However, various jurisdictions have been able to increase their storm water fees through the Proposition 218 process. In 2018, the City of Berkeley increased the storm water fee by $3.57 per month per customer through the mail-out election process, while Los Angeles County passed a parcel tax of 2.5 cents per square foot of impervious surface through a general election vote, which equates to an increase of approximately $6.92 per month per property owner to their respective property tax bills. The City of Del Mar and the City of Coronado are both considering increases to their respective storm water fees through the mail-out election process. The current fee in Coronado is $3.80 per parcel per month, with a proposed increase ranging from $3.95 to $19.57 per parcel per month for single family homes based on size. The current fee in Del Mar is approximately $19 per month for a typical household, with a proposed new rate structure scheduled to be considered early next year.

In 2017, the California Legislature passed SB 231, which clarified the interpretation of Proposition 218 to include storm drains and storm water systems under the overall definition of sewers, thereby allowing local governing bodies to adjust storm water and storm drain fees without putting the issues to a public vote. However, no jurisdiction has attempted to increase their fees through this process to date, as the Howard Jarvis Taxpayers Association has indicated that it will seek litigation against any California agency that increases storm water fees without a public vote, as it believes SB 231 is contrary to Proposition 218. An increase of $1.00 per water customer per month would generate an additional $6 million per year.

The IBA has advocated for several years that the City consider increasing the storm water fee, and the City Auditor made a recommendation in 2018 that the Storm Water Division initiate the development of a long-term funding strategy. Under the Mayor's leadership and with the support of the Council, the Storm Water Division is currently finalizing this funding strategy to meet storm water needs, including an analysis of potentially raising this fee. This report should be published sometime next January. The potential for a fee increase was not mentioned in the Mayor's Outlook.

FUTURE FINANCIAL CHALLENGES

In the following sections we identify areas that are likely to create future challenges in developing a balanced budget; however, some costs are unknown at this time or require long-term solutions and, therefore,are not included in the Mayor's Outlook.

Future Financial Challenges
• Future MOU Considerations
• General Fund Reserve
• Homelessness
• Infrastructure Needs
• Pension Considerations

Future MOU Considerations

The City is currently negotiating with all six of its recognized employee organizations regarding FY 2022 terms and conditions of employment for their members. These terms and conditions are contained within the employee organizations' labor agreements, or memoranda of understanding (MOUs). Current MOUs for four of the employee organizations (AFSCME Local 127, IAFF Local 145, DCAA, and MEA)[10] expire at the end of FY 2021. For the other two employee organizations, POA and Teamsters Local 911[11], agreement was not reached with the City on MOUs for FY 2021, and the terms and conditions in the expired agreements remain in effect.

[10] The four employee organizations include: AFSCME Local 127 (American Federation of State, County & Municipal Employees, Local 127); IAFF Local 145 (International Association of Fire Fighters, Local 145); DCAA (Deputy City Attorneys Association); and MEA (Municipal Employees Association).

[11] The other two employee organizations include: POA (Police Officers Association); Teamsters Local 911 which represents the Lifeguards.

The Outlook does not contain estimates for any potential new negotiated compensation increases for FY 2022 (and through the remainder of the Outlook). The Department of Finance estimates a 1% salary increase for City employees would cost about $6.1 million for the General Fund, and a 3% salary increase would cost about $18.4 million.

Although the City provided "across-the-board" salary increases for all employees in FY 2019 and FY 2020[12,13], recent compensation surveys have shown that the City's compensation levels for many employees are lower than comparable California public agencies. In a report released in April 2020, the City Auditor examined compensation competitiveness and other related issues (see the Performance Audit of the City's Strategic Human Capital Management).[14] One of the City Auditor's recommendations was for the City to develop a total compensation strategy identifying the City's desired labor market position; and City management agreed to develop such a strategy by the end of FY 2021. In the meantime, in conjunction with the FY 2022 MOU negotiations, the City is working on updated compensation surveys, which are expected to be finalized in the next couple of months.

Prior to FY 2019, the City had implemented nine years of citywide freezes on across-the-board salary increases, from FY 2010 through FY 2018. These salary freezes excluded any salary increases for individual employees resulting from promotions and merit increases. There were also a number of reductions to retirement benefits, including pension and retiree healthcare plans.

The across-the-board salary freezes from FY 2010 through FY 2013 were implemented in conjunction with an approximate 6% reduction in compensation for employees.[15] Subsequently, there were five additional years of pensionable pay freezes following voter approval of Proposition B in June 2012.[16] Non-pensionable compensation increases were provided during those five

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[12] With respect to across-the-board increases, each non-POA labor agreement, except DCAA's, increased pensionable pay for fiscal years 2019 and 2020 by 3.3% for each fiscal year. DCAA increases were 3.3% (plus an additional 2% or 3% for certain grades within the DCA job classification) in FY 2019 and 7.5% or 8.5% in FY 2020 depending on job grade. POA represented employees' compensation increases for FY 2019 and FY 2020 totaled 25.6% to 30.6%, depending on the length of sworn service, beginning July 1, 2018. These POA increases ranged from 5.0% to 8.3% semi-annually through June 30, 2020, with an additional 5% in FY 2020 for employees with 20 or more years of sworn service.

[13] In addition to the across-the-board increases, there were a few other notable types of pensionable pay increases that occurred in FY 2019 and FY 2020 based on recruitment and retention issues. First, eligible engineers received various add-on pays, ranging from 5% to 26% of base salary. An eligible engineer can receive up to a maximum of 36% for more than one of these add-on pays, if applicable. Second, a number of other job classifications received specified add-on pays, ranging from 3% to 20% of base salary. Lastly, special salary adjustments (SSAs) ranging from 2% to 20% of base salary were implemented for dozens of other job classifications.

[14] The Office of the City Auditor also released a report in July 2018, Citywide Human Capital Fact Book, which includes information on the City's workforce, retention and separations, employee satisfaction, compensation, and other matters. In November 2020, the Office released another human capital report, Performance Audit of Strategic Human Capital Management Part II: Employee Performance Management, which discusses incentives and discipline in the City's workforce.

[15] This discussion is intended as a general overview. The City bargains separately with each employee organization, and although there were citywide salary freezes, the 6% citywide compensation reductions were implemented through varying provisions within the six employee organizations' MOUs.

[16] There was an exception to the Proposition B pensionable pay freezes (FY 2014 to FY 2018): Beginning in FY 2017, add-on pays for Police Dispatchers were increased by 15% of base salary.

years[17], and portions of the 6% compensation reductions ceased for some employees. The five years of non-pensionable compensation increases served to mitigate the compensation reductions that had occurred since FY 2010.

If the City endeavors to attain a more competitive position with respect to comparable jurisdictions, the City will need to consider a long-term strategy to increase its compensation levels for many of its employees. We note the difficulty in increasing spending for the City during this time of reduced revenues, and any compensation increases that are considered in the near future may need to be funded with reductions to other City services and programs based on consideration of relative importance.

General Fund Reserve – City Reserve Policy vs. Outlook Funding Approach

The City Reserve Policy[18] goal for the General Fund Reserve is to reach 16.7% of operating revenues, which is to be phased in through FY 2025. To accomplish this phase-in, the Policy's Reserve target percentage increases by 0.25% annually, as shown in the first row of the table on the following page. The second row of the table shows the FY 2022-2026 Reserve Policy target amounts based on revenues included in the Outlook (FY 2020 and FY 2021 are based on unaudited actual revenues).

However, with the decline in revenues due to the COVID-19 pandemic, there was no General Fund Reserve contribution budgeted for FY 2021. Thus, the FY 2021 Reserve will remain at the FY 2020 balance of $205.7 million, as shown in the third row of the table. The fourth row shows that, in the absence of a Reserve contribution, the FY 2021 Reserve is projected to be $8.2 million less than the Reserve Policy target. The Outlook also anticipates there will be no General Fund Reserve contributions for FY 2022 and FY 2023, with the projected Reserve balance continuing at $205.7 million.

The Outlook's projected Reserve contributions for FY 2024, FY 2025, and FY 2026, are $22.8 million, $15.6 million, and $14.4 million, respectively (not shown in the table on the following page). With these contemplated contributions, the Reserve's anticipated funding level as a percentage of operating revenues would increase to 15.75%, 16%, and 16.25% in FY 2024, FY 2025, and FY 2026, respectively, as shown in the last row of the following table.

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[17] Non-pensionable compensation increases largely consisted of increases to flexible benefits allotments (used for healthcare, dental, and vision insurance etc.); certain types of overtime for Fire Fighters and Police Officers; and uniform allowances for certain employees.

[18] The City Reserve Policy is delineated in Council Policy 100-20. The General Fund Reserve has two components: the Emergency Reserve, which is 8% of operating revenues, and the Stability Reserve, for which the ultimate Policy goal is to reach 8.7%. Per the City Reserve Policy, the "Emergency Reserve will be maintained for the purpose of sustaining General Fund operations in the case of a public emergency such as a natural disaster or other unforeseen catastrophic event", and the "Stability Reserve will be maintained to mitigate financial and service delivery risk due to unexpected revenue shortfalls or unanticipated critical expenditures."

General Fund Reserve Policy vs Outlook Approach *(in millions)*							
	FY 2020	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**	**FY 2025**	**FY 2026**
Reserve Policy Target Percent	***15.5%***	***15.75%***	***16%***	***16.25%***	***16.5%***	***16.7%***	***16.7%***
Reserve Policy Target	$ 205.7	$ 213.8	$ 220.5	$ 226.8	$ 239.4	$ 254.7	$ 265.6
Outlook Reserve Level Projection	205.7	205.7	205.7	205.7	228.5	244.1	258.4
Difference: Amount Outlook Reserve Is Below Reserve Policy Target	**$ -**	**$ (8.2)**	**$ (14.8)**	**$ (21.2)**	**$ (10.9)**	**$ (10.7)**	**$ (7.2)**
Outlook Reserve as Percent of Revenues	***15.5%***	***15.15%***	***14.92%***	***14.73%***	***15.75%***	***16%***	***16.25%***

Note: Table may not total due to rounding.

With the potential for long-term adverse impacts of COVID-19 on the City's revenues, it is anticipated that the City may need to use some of the General Fund Reserve to maintain service levels in not only FY 2021, but also the first several years of the Outlook. Because of the expectation of significant revenue shortfalls, the Department of Finance will be considering potential revisions to the Reserve Policy, and will bring such revisions forward, as appropriate.

Our Office will evaluate any Reserve Policy revisions as they are being considered and brought forward; and the Department of Finance and our Office will continue to monitor FY 2021 activity. The next set of operating projections anticipated to be presented by the Department of Finance will be included in the Mid-Year Budget Monitoring Report, which is anticipated to be presented to the Budget and Government Efficiency Committee on February 3, 2021 and subsequently, the full City Council on February 22, 2021. Our Office will analyze those projections as part of the budget monitoring process.

Homelessness

The City continues to struggle to identify ongoing resources to support its expansion of homelessness services in recent years. As reflected in the Outlook, significant funding is needed to continue existing homelessness services beginning in FY 2023 as one-time grants are expected to be exhausted. As this time approaches and Council weighs competing priorities, we recommend that a strong focus be placed on program outcomes, so that successful strategies can be identified and maintained. We also suggest that identifying ongoing funding to continue successful homelessness programs take priority over other new or expanded programs. One option to partially address this issue is offered in the Potential Mitigation Measures section of this report. Finally, as programs are reassessed, we recommend ensuring that they align with recommended strategies, and further the goals outlined in the Community Action Plan on Homelessness.

The City continues to struggle to identify ongoing resources to support its expansion of homelessness services in recent years.

The Community Action Plan on Homelessness was approved by Council on October 19, 2019 and its implementation will require significant resources during the Outlook period and beyond. The plan, among other things, recommends a $914.0 million investment over ten years to provide 2,659 permanent housing units for single adults.

We note that, in some ways, the pandemic has accelerated the implementation of the Community Action Plan on Homelessness. With the help of COVID-19 related State and federal funding, the City has acquired two hotels that will provide 332 units for about 400 individuals. In addition, staff indicates that the City’s temporary shelter in the vacant Convention Center (Operation Shelter to

Home) has allowed necessary partners to come together and remove barriers to improve pathways to housing.

Infrastructure Needs

Like the annual development of the Five-Year Financial Outlook, the City annually prepares a Five-Year Capital Infrastructure Planning Outlook (CIP Outlook) for release in January. The CIP Outlook projects the City's capital needs and the revenue to address those needs over the next five fiscal years. The January 2020 CIP Outlook (for FY 2021 through FY 2025) showed that the City has a funding shortfall or gap of $2.2 billion to address infrastructure needs over the next five fiscal years. This projected funding gap continues to grow and is approximately $600 million higher than it was projected to be five years ago.

The $2.2 billion gap projected in January 2020 was divided between Priority Infrastructure Needs ($1.3 billion) and Discretionary Infrastructure Needs ($900 million). While storm water projects constitute most of the Priority needs gap, there are also significant unfunded priority needs in the following infrastructure categories: bridges, building facilities, fire and lifeguard stations, parks, sidewalks, streets and roads, and traffic signals. Projected Discretionary gaps exist for identified bike facilities, buildings, facilities, parks, sidewalks, and streetlights.

It is important to note that the projected gap represents General Fund infrastructure needs for which there is no identified funding. This contrasts with enterprise fund infrastructure (like Water and Wastewater) which typically have their own dedicated funding sources. The General Fund continues to be challenged to address many other critical priorities that compete with infrastructure for limited resources. Beginning to address the City's enormous unfunded infrastructure problem will require dedicated funding, increased prioritization, and increased staff/contractor capacity to expeditiously complete projects when funding is available.

Pension Considerations

There are a couple future unknowns to consider with respect to the defined benefit pension. First, if future investment earnings are lower than assumed in the actuarial valuation, future ADCs could be increased. Second, there are ongoing legal challenges to Proposition B (which was approved by voters in June 2012), as discussed below.

Proposition B was challenged by four of the City's recognized employee organizations (Unions), alleging a violation of the Meyers-Milias-Brown Act (MMBA) – the State law that governs collective bargaining for public agency employers, like the City.

Heeding a related California Supreme Court decision on August 2, 2018, the California Court of Appeal directed the City "to meet and confer over the effects of the [Proposition B] Initiative and to pay the affected current and former employees represented by the Unions the difference, plus seven percent annual interest, between the compensation, including retirement benefits, the employees would have received before the Initiative became effective and the compensation the employees received after the Initiative became effective." Additionally, the City is ordered "to cease and desist from refusing to meet and confer with the Unions and, instead, to meet and confer with the Unions upon the Unions' request before placing a charter amendment on the ballot that is advanced by the City and affects employee pension benefits and/or other negotiable subjects."

However, despite the Court of Appeal directives, Proposition B is still part of the San Diego City Charter. To remove Proposition B from the City Charter, the Unions have pursued a quo warranto process. The State Attorney General granted authority for the Unions to sue on August 15, 2019; and the complaint in quo warranto was filed on September 27, 2019. Pursuant to City Council direction, on November 18, 2019 the City Attorney's Office response to the Unions' complaint in quo warranto included language supporting a judgement that invalidates and removes Proposition B amendments from the City Charter.

The ultimate cost for resolution of the Proposition B legal challenges is dependent upon the pending negotiations with the Unions and compliance with federal tax laws and regulations with respect to retirement plans. Prior to such negotiations, the issue of whether Proposition B will be invalidated needs to be resolved. Currently, the California Superior Court in San Diego County is scheduled to make a determination regarding whether Proposition B is invalidated on December 18, 2020 or shortly afterward. However, depending on considerations of pending motions before the Court, that decision could be delayed. Additionally, if there is an appeal of the Superior Court's decision, and further, a subsequent California Supreme Court review, the issues may not be resolved for at least a couple years. We will have a better idea of the anticipated timeframe for resolution of these issues in the next few months.

POTENTIAL MITIGATION MEASURES

Potential Mitigation Measures
• Franchise Agreement Minimum Bid • General Fund Reserve & Excess Equity • Pension Payment Stabilization Reserve • Paid Refuse Collection • Permanent Local Housing Allocation • Potential Budget Reduction Proposals • Storm Water Fee • Waiving Infrastructure Fund Contribution

In this section we discuss potential options for Council's consideration in order to mitigate future deficits. Some may be available to include in the FY 2022 budget while others require significant policy changes which will require time to implement but could be helpful to address projected deficits in future years.

Franchise Agreement Minimum Bid

As previously mentioned, the franchise agreements for electricity and gas distribution within the City are set to expire in January 2021. As such, the City issued an invitation to bid (ITB) for new franchise agreements, which subsequently received one or more responses. Part of the ITB included a minimum bid that a bidding utility would have to pay to the City in order to be granted the new agreement. The minimum bids were set at $70 million for the electric franchise agreement and $10 million for the gas franchise agreement. If multiple bidders are deemed responsive when the bids are opened in front of the City Council, the winning bid could potentially be higher than the minimum bid.

The minimum bid without any further action would be unrestricted General Fund revenue which could be used to mitigate revenue shortfalls in either FY 2021 or FY 2022. However, while the final winning bid may be higher than $80 million in total, that does not mean that the City will receive all $80 million at once when the bidding has concluded due to two measures contained in the ITB. First, if the winning bidder decides to pay the winning bid up front, they are entitled to a 12.5% discount on the first $80 million of the winning bid. This provision, which was included to entice a bidder to provide more cash up front, would result in an actual cash payment of only $70 million. Second, the winning bidder also has the ability to pay the winning bid in installments over a ten year period, with interest. This would most likely result in only $8 million in FY 2021 and an additional $8 million in FY 2022 and each year thereafter within the Outlook period.

General Fund Reserve and Excess Equity

The City could consider the use of any available Excess Equity for FY 2022 one-time needs. The amount that may be available is uncertain because the current $14.5 million estimate is not based on comprehensive projections for FY 2021, but rather the FY 2021 Adopted Budget amounts. It is anticipated that to maintain service levels in FY 2021, the City may need to utilize this Excess Equity and could even need to use some General Fund Reserve. The FY 2021 projections that will be included in the Mid-Year Report (expected to be released at the end of January 2021) will provide a more updated sense of the projected Excess Equity and Reserve.

Paid Refuse Collection

The People's Ordinance, enacted by a ballot measure in 1919, established trash collection for single family homes as a responsibility of the City for no fee, but does not include multi-family homes. As a result, City residents that live in multi-family homes normally contract with a third-party collection service and pay for trash collection.

Providing refuse collection services to single family homes costs approximately $36.3 million per year, for which no revenue is collected. In addition to this, $19.0 million is funded by the Recycling Fund for collection of recyclable materials. The City is the only large city to continue to provide free collection services to single family homes, and this system may be considered inequitable to those that live in multi-family housing. Monthly fees charged by other large cities in California for comparable services range from $23 to $132 per month. Given the City's current costs, the monthly charge to the roughly 285,000 single family home residents currently served could be approximately $16 per month.

Should the City Council wish to reevaluate fees for refuse collection service, the Environmental Service Department would be able to develop more detailed fee estimates based upon current and/or desired service levels. Transferring this cost to single family home residents would alleviate the General Fund of approximately $36.3 million in annual expenditures. The repeal of the People's Ordinance would require a simple majority approval by voters.

Pension Payment Stabilization Reserve

The General Fund portion of the Pension Payment Stabilization Reserve (PPSR) was funded at $7.9 million at the end of FY 2020.[19] With the revenue shortfalls anticipated for FY 2021 due to the COVID-19 pandemic, there was no contribution funded in the FY 2021 Adopted Budget. Additionally, there are no PPSR contributions contemplated in the FY 2022-FY 2026 Outlook. Previously, the FY 2021-FY 2025 Outlook's anticipation was that annual contributions would be made until FY 2023, and the PPSR would be fully funded in accordance with the Reserve Policy.

[19] The $7.9 million balance in the General Fund PPSR includes the $3.6 million contribution for FY 2019 and the $4.3 million contribution for FY 2020.

To assist with the deficit and help maintain existing services, consideration could be given to using the $7.9 million PPSR balance to cover the estimated General Fund increase in the City's FY 2022 ADC which is consistent with the City Reserve Policy. Per the Policy, the intent of the PPSR is to "mitigate service delivery risk due to increases in the annual pension payment", or ADC. The Policy also states that the purpose of the PPSR is to provide a source of funding for the ADC when the ADC has increased year over year.

The FY 2021 General Fund portion of the ADC was $277.7 million, and the FY 2022 amount is projected to be $317.5 million, an increase of nearly $40.0 million year over year. This action would free up $7.9 million in one-time General Fund monies which could be used to help maintain critical services.

Permanent Local Housing Allocation

In 2017, Governor Brown signed Senate Bill 2 which created the Building Homes and Jobs Act establishing a $75 recording fee on certain real estate documents. Local governments receive 70% of revenue collected through the Permanent Local Housing Allocation, creating an ongoing funding source to address unmet housing and homelessness needs. The City is eligible for up to $34.7 million over five years.

On July 14, 2020, Council voted to approve a State-required five-year plan dedicating these funds for homelessness, focusing on creating and operating new permanent and transitional housing units. Council amended the resolution to, among other things, prohibit the use of these funds on navigation centers and emergency shelters.

To mitigate the significant funding needs for homelessness pending in FY 2023, the City's Permanent Local Housing Allocation could be considered to continue existing programs while satisfying Council's amendments to the resolution. Funds could be used for other eligible homelessness activities including rapid rehousing and supportive/case management services that allow people to obtain and retain housing – the tradeoff being fewer resources available for new permanent and transitional housing units. This would require Council to approve an amendment to the State plan. Significant ongoing funding would still need to be identified for other homelessness programs, including the Temporary Bridge Shelters.

Potential Budget Reduction Proposals

In November 2019, the Chief Operating Officer released a memorandum directing departments to submit 4% budget reduction proposals as part of the FY 2021 budget development process. The memorandum further noted that departments *"are required to **suspend all nonessential discretionary expenditures in Fiscal Year 2020**"*. As of the date of this report, there has been no such request to departments regarding budget reduction proposals for the FY 2022 budget or suspending FY 2021 discretionary expenditures.

If a request for submission of FY 2022 budget reductions is distributed to departments, it is likely that not all department reductions submitted would be accepted and implemented due to potential operational impacts. The past four adopted budgets (FY 2018 to FY 2021) include a total of $87.4 million in similar departmental reductions, making the potential for operational impacts more of a concern. On the other hand, if the Council is weighing the relative importance of various programs and services for inclusion in the budget, additional departmental cuts may be unavoidable.

Storm Water Fee

As we noted in the Potential Future Funding Needs Not Included in the Outlook section earlier in this report, an increase to the City's Storm Drain Fee is an option that the City Council may wish to explore to help address storm water permit compliance funding needs. The amount of revenue that could be generated roughly equates to $6 million for each $1.00 (charged per single family residence per month) the fee is increased. The City currently charges 95 cents per per month.

Waiving the Infrastructure Fund Contribution

Waiving the FY 2022 contribution to the Infrastructure Fund of $11.3 million (or more, as we explain in our Infrastructure Fund section of our Review of Baseline General Fund Expenditures) would allow funds to go to other General Fund purposes, thereby mitigating the FY 2022 deficit.

As the Outlook indicates, the City is facing another challenging budget year in FY 2022 and waiving the Infrastructure Fund contribution may need to be seriously considered. We note that the FY 2021 contribution of $29.4 million was waived in FY 2021 to help balance the budget and some capital projects were defunded to mitigate the FY 2020 budget. However, continuing to defer maintenance and capital infrastructure needs will lead to more failed systems and likely continue to grow the $2.2 billion funding gap reflected in the last Five-Year Capital Infrastructure Planning Outlook.

SUMMARY AND CONCLUSION

This year's Outlook identifies shortfalls in the first four years, and only projects a surplus in the fifth year. As noted earlier in our report, this year's Outlook only projects Baseline revenues and expenditures, reflecting status quo service levels without taking into consideration any specific department needs or Mayoral or City Council priorities for the next several years. As the Outlook is the first major step in the annual budget process, our report includes information about additional programs and potential revenue sources for Council's consideration. As we proceed through the budget process, the City Council will have the opportunity to decide whether to continue existing services at their current levels, as presented in this Outlook, or potentially reduce existing programs to increase or add services in other areas. The City Council may also choose to pursue other resources to support priority programs.

The information provided in the Outlook, as well as in our review of the Outlook, allows the Council to begin identifying its top budget priorities and to develop a strategy for achieving a balanced budget in FY 2022. The next step in the annual budget process is for each City Councilmember to identify their priorities for the FY 2022 budget and submit them to our Office by January 6, 2021. In February 2021, the Council will adopt its City Council Budget Priorities Resolution, which will be developed based on the memos submitted to our Office. This resolution will provide the Mayor with input for developing the FY 2022 Proposed Budget.

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Attachment: New Facilities and Joint Use Agreement Annual Costs

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Fiscal Year 2022 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Parks & Recreation	Children's Park Enhancement[1]	3	0.50	$ 228,359
Parks & Recreation	Dennery Ranch[1]	8	1.50	295,040
Parks & Recreation	Fairbrook Neighborhood Park[1]	5	0.50	88,689
Parks & Recreation	Franklin Ridge Pocket Park	7	0.00	2,348
Parks & Recreation	Johnson Elementary Joint Use[1]	4	0.50	90,492
Parks & Recreation	King Chavez Elementary Charter School Joint Use[1]	8	0.50	87,557
Parks & Recreation	La Paz Mini Park[1]	4	0.50	74,531
Parks & Recreation	Marie Curie Elementary Joint Use [1]	1	0.50	113,299
Parks & Recreation	Rolando Park Elementary Joint Use[1]	4	0.50	105,644
Parks & Recreation	Sequoia Elementary Joint Use[1]	6	0.50	124,451
Parks & Recreation	Standley Middle School Joint Use (Pool)	1	6.82	408,802
Parks & Recreation	Standley Middle School Joint Use[2]	1	0.00	-
Parks & Recreation	Citywide - Aquatics Maintenance for Standley Middle School Joint Use Swimming Pool[1]	1	1.00	132,434
Parks & Recreation	Citywide - Mowing / Sweeping Support[1]	Citywide	3.00	642,885
Parks & Recreation	Citywide - Park Forestry Support[1]	Citywide	2.00	378,441
Parks & Recreation	Citywide - Playground Crew Maintenance[1]	Citywide	3.00	611,765
Total Fiscal Year 2022			**21.32**	**$ 3,384,732**

Fiscal Year 2023 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Parks & Recreation	East Village Green[1]	3	7.50	1,337,847
Parks & Recreation	Hickman Elementary Joint Use[1]	6	0.50	101,557
Parks & Recreation	Hidden Trails Neighborhood Park[1]	8	0.50	112,685
Parks & Recreation	Lafayette Elementary Joint Use[1]	6	0.50	128,560
Parks & Recreation	Mira Mesa CP (Phase III - Recreation Center)[1]	6	3.50	323,963
Parks & Recreation	Olive Street Mini Park[1]	3	0.5	68,661
Parks & Recreation	Riviera Del Sol Neighborhood Park[1]	8	1.00	198,934
Parks & Recreation	Salk Neighborhood Park & Joint Use[1]	6	1.00	215,773
Parks & Recreation	Taft Middle Joint Use[1]	7	0.50	125,038
Parks & Recreation	Wagenheim Joint Use Facility[1]	6	0.50	108,602
Parks & Recreation	Citywide - Irrigation Maintenance Support[1]	Citywide	1.00	196,742
Parks & Recreation	Citywide - Mowing / Sweeping Support[1]	Citywide	2.00	403,090
Parks & Recreation	Citywide - Park Forestry Support[1]	Citywide	3.00	418,636
Parks & Recreation	Citywide - Pesticide Crew[1]	Citywide	1.00	124,713
Parks & Recreation	Citywide - Turf Maintenance Support[1]	Citywide	1.00	225,828
Library	Pacific Highlands Ranch Branch Library[3]	1	9.50	554,000
Total Fiscal Year 2023			**33.50**	**$ 4,644,626**

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Fiscal Year 2024 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Parks & Recreation	Lindbergh - Scheweitzer Joint Use[1]	6	0.50	$ 105,315
Parks & Recreation	NTC Building 619	2	2.50	224,357
Parks & Recreation	NTC/Esplanade[1]	2	0.50	62,861
Parks & Recreation	Pacific View Elementary Joint Use[1]	4	0.50	92,253
Parks & Recreation	Citywide - Mowing / Sweeping Support[1]	Citywide	1.00	201,545
Fire-Rescue	Black Mountain Ranch Fire Station[1,3]	5	12.00	582,202
Total Fiscal Year 2024			**17.00**	**$ 1,268,532**

Fiscal Year 2025 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Parks & Recreation	Boone Elementary School[1]	4	0.50	90,469
Parks & Recreation	Perry Elementary School Joint Use[1]	4	0.50	90,469
Parks & Recreation	Rowan Elementary Joint Use[1]	9	0.50	93,901
Parks & Recreation	Spreckels Elementary Joint Use[1]	1	0.50	93,105
Parks & Recreation	Whitman Elementary School[1]	6	0.50	106,137
Parks & Recreation	Citywide - Mowing / Sweeping Support[1]	Citywide	1.00	220,670
Fire-Rescue	Fairmount Avenue Fire Station[3]	4	12.00	1,981,432
Fire-Rescue	Torrey Pines (UCSD) Fire Station[3]	1	12.00	1,840,628
Total Fiscal Year 2025			**27.50**	**$ 4,516,809**

Fiscal Year 2026 Department	Facility	Location of Facility (District)	FTE	First Year Annual Expense
Parks & Recreation	North Central Square[1]	3	0.50	55,449
Parks & Recreation	Pacific Beach Elementary Joint Use[1]	1	0.50	69,274
Total Fiscal Year 2026			**1.00**	**$ 124,722**

[1] Includes one-time expenses for items such as vehicles in the first year of operation. One-time expenses are eliminated from subsequent years operating costs.
[2] This project provides for an enhancement to existing turf, therefore, no additional budgetary component is projected to be needed.
[3] Reflects the first full year of estimated ongoing operating costs following the facility opening date. With respect to the Black Mountain Ranch and Torrey Pines (UCSD) Fire Stations, we understand that these facilities are currently anticipated to open one year later than what is reflected in the Outlook, in FY 2024 and FY 2025, respectively.