

IBA Review of the FY 2024-2028 Five Year Financial Outlook

City Council

Item 331

December 13, 2022



Office of the Independent Budget Analyst



Role of the Outlook in the Budget Process

Overview & Importance of the City's Outlook

- Used as a planning tool and informs the annual budget process
- Amendment to City Charter in 2016 requires Mayor to annually prepare a multi-year financial outlook for the General Fund
- *IBA's role*: To analyze the Outlook objectively and identify issues and options to assist the Council in decision making

Role of the Outlook in the Budget Process cont'd

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

- The Outlook allows Council:
 - To have a sense of the Mayor's budget priorities
 - To begin identifying its top budget priorities and developing a strategy for achieving a balanced budget in FY 2024
- Council has final authority in the budget process to determine the City's priorities for the next fiscal year

IBA Annual Review and Analysis of Outlook

The IBA's report on the Outlook includes:

Review and Analysis of:

- Overall Fiscal Condition
- Baseline General Fund Revenue Assumptions
- Baseline General Fund Expenditures
- Additional Priorities Beyond Baseline Included in Outlook
- Potential Funding Needs Not Included in Outlook
- Discussion of Potential Mitigation Measures

Overall Fiscal Condition

Critical to Address Structure Imbalance

- Outlook shows General Fund deficits in initial years, even when limited to Baseline expenditures
- Initial years can likely be mitigated with one-time resources, but projected deficits persist

Baseline General Fund Revenue and Expenditures (\$ in millions)					
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Baseline General Fund Revenues	\$ 1,881.1	\$ 1,955.4	\$ 2,017.3	\$ 2,086.1	\$ 2,149.4
Baseline General Fund Expenditures	1,931.6	1,978.0	2,038.1	2,085.4	2,143.3
Baseline (Shortfall)/Surplus	(50.5)	(22.6)	(20.9)	0.7	6.1
Additional Outlook Priorities Beyond Baseline	(25.4)	(73.0)	(86.4)	(94.8)	(118.7)
Recommended Use of Available ARPA Funds	52.1	-	-	-	-
Recommended Use of Available Excess Equity	23.8	48.3	-	-	-
Overall Outlook Shortfall	\$ 0.0	\$ (47.3)	\$ (107.3)	\$ (94.1)	\$ (112.6)

Baseline General Fund Revenue

Moderate Growth in all Major General Fund Revenues

Baseline General Fund Revenues (\$ in millions)							
	FY 2023 Adopted	FY 2023 Projection	FY 2024 Projection	FY 2025 Projection	FY 2026 Projection	FY 2027 Projection	FY 2028 Projection
Property Tax	\$ 706.2	\$ 720.4	\$ 745.8	\$ 782.2	\$ 817.0	\$ 853.8	\$ 891.6
Sales Tax	380.2	386.0	394.1	403.1	418.5	434.4	448.7
Transient Occupancy Tax	135.2	149.9	155.8	162.0	168.5	175.2	182.1
Franchise Fees	95.6	96.3	100.2	101.3	102.4	94.2	95.1
Cannabis Business Tax	25.7	21.6	23.6	26.0	28.4	28.9	30.4
All Other Revenue Categories ¹	458.2	462.0	461.6	480.8	482.6	499.7	501.5
ARPA Funding ²	147.6	147.6	-	-	-	-	-
Total	\$ 1,948.8	\$ 1,983.8	\$ 1,881.1	\$ 1,955.4	\$ 2,017.3	\$ 2,086.1	\$ 2,149.4

- Overall, revenue growth in the Outlook is reasonable
- Future economic conditions are particularly uncertain

General Fund Revenue cont'd

Property Tax & Sales Tax

- Property Tax
 - Annual growth rates start at 5.3% in FY 2024 and then hover around 4.3% after FY 2024
 - Projections are reasonable given housing and property markets trends and inflation expectations
- Sales Tax
 - Annual growth rates start at 2.1% and fluctuate between 2.3% and 3.8% following FY 2024
 - Projections are reasonable, assuming no recession

General Fund Revenue cont'd

Transient Occupancy Tax, Franchise Fees, Cannabis

- Transient Occupancy Tax
 - Outlook projects 4.0% growth each year & differs from other near-term projections that incorporate mild recession
 - Outlook projections are reasonable, but will be reexamined
- Franchise Fees
 - SDG&E: 8% projected growth rate in FY 2024 followed by 2% growth rate for the rest of the outlook
 - Cable: Continued modest decline
- Cannabis Business Tax
 - Projection likely too high based on FY 2023 First Quarter projections



General Fund Baseline Expenditures

Support existing service levels; no new initiatives

Increases/(Decreases): FY 2023 Adopted Budget to FY 2024 Baseline Projection	
FY 2023 Adopted Budget	\$1,995.0
Personnel Expenditure (PE) and Fringe Changes	79.4
Non-Personnel Expenditure (NPE) Changes	27.3
Removal of FY 2023 Onetime Expenditures	<u>(130.1)</u>
FY 2024 Outlook Baseline Projection	<u>\$1,931.6</u>
Overall Decrease: FY 2023 Adopted Budget to FY 2024 Outlook Baseline (1.2% Decrease)	\$ (23.4)

*Dollars in millions.

General Fund Baseline Expenditures con't

Largest PE and Fringe Increases	
Compensation Increases - Based on Current Labor Agreements	\$ 32.0
ADC (Pension Payment)	\$ 26.5
Assumed 3.05% General Wage Increase for Non-Public Safety Employees	\$ 12.3
Budgeted PE Savings Decrease (a budget increase)	\$ 9.8
Unwinding Proposition B	\$ 8.0

Largest NPE Increases	
Debt Service - New Debt Issuances	\$ 11.2
Parks Improvement Funds Transfers	\$ 8.3
Contracts: 4.1% Annual Growth Rate	\$ 7.3
Public Liability Insurance Premiums	\$ 6.2
Public Liability Reserve Contribution	\$ 5.0

Largest FY 2023 Onetime Expenditure Removals	
Transfer to the Capital Improvements Program (CIP)	\$ (40.2)
Pension Payment Transition for Post-Prop B Employees	\$ (28.0)
Funding for Homelessness and Housing Programs	\$ (23.4)
Watershed Master Planning	\$ (5.3)
Extension of Shift Overtime - Police Department	\$ (4.1)

*Dollars in millions.

General Fund Baseline Expenditures con't

Personnel Expenditures

- Concerns regarding uncompetitive compensation
- Efforts to improve recruitment and hiring process ongoing
- Unwinding Proposition B
 - Initial cost for transition of active Prop B employees to SDCERS
 - amortized debt to SDCERS estimated \$8.0M (General Fund)
 - Incremental increase related to the “Normal Costs” for those employees – estimated \$10.9M (General Fund)
 - Additional Prop B aspects to negotiate and determine costs

General Fund Baseline Expenditures con't

Non-Personnel Expenditures

Energy and Utilities

- Forecast for spending on electric services is likely too low
- First Quarter Report projects FY 2023 energy spending to be 43.8% higher than budget

Information Technology

FY 2023 Adopted Budget - SD Access 4 All		
Program Components	Baseline	One-time Funding Being Removed
Public Wi-Fi ¹	\$ 261,000	\$ -
Digital Equity Programs (Outreach for Affordable Connectivity; Tech on the Go; Digital Navigator Services; and Marketing, Supplies, and Communications)	180,000	-
Broadband Master Plan	-	500,000
Public Library Hotspot Lending Program - Broadband Access Expansion	-	1,115,520
Total	\$ 441,000	\$ 1,615,520

General Fund Baseline Expenditures con't

Non-Personnel Expenditures

Infrastructure Fund

- Contributions over the five-year period in line with requirements in City Charter Section 77.1
- FY 2023-2027 Five Year Capital Infrastructure Planning Outlook shows \$4.3 billion in infrastructure funding gap

City Debt

- Debt service for \$355 million in new long term-debt
- Debt service for \$359 million Water Infrastructure Finance and Innovation Act (WIFIA) loan and \$292 million Stormwater LRBs
- Combined Debt Ratio and Pension/OPEB Ratio below 25% during Outlook period

General Fund Baseline Expenditures con't

Non-Personnel Expenditures

General Fund Reserve

- Contributions in line with proposed General Fund Reserve Policy
 - Extends the timeline to reach the General Fund Reserve 16.7% policy target

Pension Payment Stabilization Reserve

- No contributions - in line with the proposed Pension Reserve policy
 - Prioritizes funding the General Fund Reserve to the 16.7% target before funding and maintaining a Pension Reserve

Priorities Beyond the Baseline

New Facilities

- Certain facilities scheduled to open during the outlook period lack funding
 - Fairmount Avenue Fire Station still lacks \$20M for construction
 - Otay Mesa Fire Station lacks funding for design and construction

Summary of Facilities Projected to Open During Outlook Period	
Parks & Recreation	<ul style="list-style-type: none"> •21 new or expanded parks •12 new Joint Use Facilities
Library	<ul style="list-style-type: none"> •Two new: Pacific Highlands Ranch •One expanded: Ocean Beach
Fire-Rescue	Four new fire stations: <ul style="list-style-type: none"> •Torrey Pines •Black Mountain Ranch •Fairmount Avenue •Otay Mesa

Planned Commitments

Homelessness Programs

- Outlook largely continues existing programs that were funded using one-time funding sources
- Current ongoing General Fund support is insufficient
 - Additional \$16.4 million needed in FY 2024, growing to \$54 million in FY 2025
- Because of fiscal constraints:
 - **Council may wish to request staff presentation on updated Community Action Plan on Homelessness, when released, and role of regional coordination**
 - Evaluation of programs necessary based on alignment with Plan, outcomes, and cost efficiency

Planned Commitments

Stormwater and Information Technology

Stormwater

- Recently secured WIFIA Loan from the Federal EPA of \$359M must be matched by \$373M
- Considerations that could potentially change the payments required for debt service:
 - Securing additional grants to decrease obligation to match
 - Bond interest rate may change by the time the issuances are done

Information Technology

- General Fund costs to modernize SAP reflected in Outlook and will be refined upon completion of consultant evaluation

Potential Needs Not Included

Many Other Budget Priorities Exist

- Huge City infrastructure need
- Stormwater compliance requires significant resources
- Climate Action Plan 2.0
- Fleet electrification limited by market availability and pricing
- Additional homelessness and housing support
- Arts & Culture funding to meet goals

Potential Needs Not Included cont'd

Many Other Budget Priorities Exist cont'd

- Equity in recreation programming
- Fire/Police Training Facility Feasibility Study
- General Fund Office Space Planning
 - Costs unknown until assessment complete
 - Council considerations:
 - Critical to ensure timely information sharing with Civic Center Revitalization Project
 - Identify cost savings opportunities to offset costs to optimize office space

Potential Mitigation Measures

Measures for FY 2024

- **American Rescue Plan Act (ARPA)**
\$52.1 million
- **General Fund Excess Equity**
\$72.1 million FY 2024 & FY 2025
- **Federal Funding**
Infrastructure Investment and Jobs Act
Inflation Reduction Act

Measures for *After* FY 2024

- Ballot Measure
Measure B approved 2022 (People's Ordinance)
\$59 million expenditure in FY 2023; no relief possible until FY 2026
- Ballot Measure
Measure C of 2020 – TOT increases
Pending decision
- **Stormwater fee increase**
\$74 - \$93 million based on previous analysis
Vote required

Conclusion

- Baseline Revenue and Expenditure projections are reasonable
- Projected baseline deficits show effects of City's past reliance on one-time resources to fund ongoing expenses
- Structural imbalance should be addressed in future years, especially in infrastructure and homelessness
- *Next Steps*
 - Council's updated budget priority memos due to our office by January 13th

It will be critical to identify new ongoing revenues to address Council priorities and achieve a structurally balanced budget that supports financial sustainability.
