MAYOR'S BUDGET OFFICE

BOARD OF SUPERVISORS
BUDGET ANALYST

OFFICE OF THE CONTROLLER

March 19, 2004

The Honorable Gavin Newsom, Mayor
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Honorable Members of the Board of Supervisors
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: **Three-Year General Fund Budget Projection, FY 2004-05 through FY 2006-07**

Dear Mayor Newsom and Members of the Board of Supervisors:

The San Francisco Administrative Code Section 3.6 requires a three-year budget report to be issued annually by the Controller, the Mayor's Budget Director, and the Budget Analyst for the Board of Supervisors. This report projects revenues and expenditures for FY 2004-05 through FY 2006-07.

As shown in Table A below, we are projecting a $299.3 million General Fund shortfall for FY 2004-05. It should be noted that although we are projecting shortfalls in each of the next two fiscal years, all final budgets must be balanced and all projected shortfalls must be eliminated. The FY 2005-06 and FY 2006-07 projections both assume that any prior year projected shortfall is balanced with ongoing changes, either increased revenues or decreased expenditures. We believe that this will be difficult, in that there will probably be some one-time revenues or expenditure reductions used to balance the FY 2004-05 budget, which would result in larger projected shortfalls in later fiscal years.

Table A

Summary of Projected General Fund Surplus / (Shortfall), in US$ millions

	FY 2004-05	**FY 2005-06**	**FY 2006-07**

Projected Surplus / (Shortfall)	**($299.3)**	**($ 65.5)**	**$ 0.1**

Our projections reflect the estimated cost of providing the current level of City services through current business practices for General Fund Supported operations. These projections are not intended to commit the City to future spending levels. Actual funding decisions will be subject to availability of funds as well as policy decisions of the Mayor and Board of Supervisors.

Important assumptions to note in this year's Joint Report include:

- **Employees with labor contracts open for negotiation will continue to contribute 7.5% to the employees retirement system toward their own retirement**. If this assumption were not included, the projected shortfall in FY 2004-05 would be $53 million greater.

- **Employees with labor contracts open for negotiation will receive no wage, benefit enhancement or other inflationary increases.** If this assumption were not included, for every 1.0 percent increase in wages covered by open contracts, the projected shortfall in FY 2004-05 would be $7.1 million greater.

- For the first time since the early 1990s, the **Charter-mandated employer retirement system contributions are once again required**. Cost increases related to City-paid retirement contributions are projected to be $55.9 million for FY 2004-05. This increase is mainly the result of a $44.6 million increase into the **San Francisco Employees' Retirement System.** The remaining $11.3 million increase is due to CalPERS rate increases for various covered public safety personnel.

- **No COLAs or cost increases have been assumed for contractors or any other non-personnel expenditures.** If we had included cost increases based on the consumer price index projections from the State of California Department of Finance, we would show a $16.1 million increase in General Fund expenditures in FY 2004-05, $18.1 million in FY 2005-06, and an estimated $22.6 million in FY 2006-07.

- While the specifics may change over the next few months, we expect the State budget to include **nearly $100 million in on-going cuts to San Francisco, offset in part by the restoration of one-time cuts made in FY 2003-04 including Vehicle License Fee (VLF) backfill revenues**.

Table B on the next page provides a detailed breakdown of the key projected changes in sources and uses over the next three years.

Table B: Three-Year Budget Projection, US$ Millions
Summary of Major Sources & Uses Changes from Prior Year

	FY 2004-05	FY 2005-06	FY 2006-07
Sources - Fund Balance & Prior Year Reserves			
Prior Year Fund Balance	($47.1)	$25.0	$0.0
Closure of Reserves from Prior Years	(11.4)		
Use of the Rainy Day Reserve	27.6	(13.8)	(6.9)
Subtotal, Year-End Balance	**(30.9)**	**11.2**	**(6.9)**
Sources - Revenues & Transfers In			
General Taxes & Recurring Revenues	20.0	63.6	69.9
One-Time Revenues	(48.3)		
Transfers In	(11.5)	1.1	1.1
Estimated State Revenue Losses - One-Time in FY 2003-04	30.0		
Estimated State Revenue Losses - Governor's Proposed, On-going	(96.8)		
Estimated State Revenue Gains - Repayment of VLF 'Loan' from FY 2003-04			58.0
Subtotal, Revenues & Transfers In, excluding Redevelopment	**(106.5)**	**64.7**	**128.9**
Redevelopment Property Tax Increment, net impact	**(10.8)**	**(0.6)**	**(0.7)**
Uses - Salaries and Benefits			
Annualize Partial-Year Positions	(0.7)		
Annualize Previous Year MOU Provisions, Not Included Below	(0.1)		
Change in Work Days	4.4		4.4
Health and Dental Benefits for Current Employees	(10.5)	(18.9)	(21.8)
Health Benefits for Retirees	(11.0)	(10.0)	(12.2)
MOU Costs, Known - Nurses	(13.2)	(5.5)	
MOU Costs, Known - Police	(11.0)	(9.0)	(9.5)
MOU Costs, Removal of Step Freeze Increases, SEIU & Nurses	(3.7)		
Pension - PERS^ Contribution Rate Changes - Employer Cost	(11.3)	(2.5)	
Pension - SFERS^^ Contribution Rate Changes - Employer Cost	(44.6)	(20.7)	(20.2)
Unemployment Insurance	(2.6)		
Subtotal, Salaries and Benefits	**(104.3)**	**(66.6)**	**(59.3)**
Uses - Other Non-Salary			
Baseline Requirements	3.8	(8.9)	(10.5)
Capital & Facilities Maintenance (Restore back to $20.0 million per year)	(10.8)		
Debt Service Requirements, including Lease Financing Costs*			
Equipment Lease Financing	(1.4)	(4.4)	(6.7)
All Other Debt	(1.7)	(1.0)	3.6
Energy Costs - Natural Gas Prices	(1.5)	1.5	
Equipment Program (Restore back to $10.0 million cash program per year)*	(6.3)		
Settlement of Litigation & Claims	(13.0)		
Work Orders	(2.2)		
Worker's Compensation	(7.3)	(6.5)	(6.6)
Departments & Commissions			
Convention Facilities	(6.7)	1.2	1.4
Elections Department - Number of Elections	3.0	(3.0)	3.0
Ethics - Public Financing of Supervisorial Elections (Prop O, 11/2001)	(1.0)	1.0	(1.0)
Fine Arts Museum	(2.5)	(3.6)	
Fire Department - Reopen Station 33	(1.7)		
Human Services - Net Expenditure Growth	(2.7)	(11.8)	(12.4)
Public Health - Net Expenditure Growth	7.0	(28.7)	(22.8)
New Voter Mandates Since July 1, 2003			
City Services Auditor Baseline (Prop C, 11/2003)	(1.7)		
Dedicated Funding for Schools (Prop H, 3/2004)		(10.0)	(10.0)
Subtotal, Other Non-Salary	**(46.8)**	**(74.2)**	**(62.0)**
Projected Surplus / (Shortfall)	**($299.3)**	**($65.5)**	**$0.1**

Notes:
^ PERS = Public Employees Retirement Systems
^^ SFERS = San Francisco Employees Retirement Systems
* Reflects $10.0 million Cash Program and $10.0 million Lease Financing Program

SUMMARY OF OUR PROJECTIONS

The discussions under the SOURCES and USES sections below provide descriptions of the corresponding section of Table B on page 3.

SOURCES - Fund Balance & Prior Year Reserves

We are projecting a $30.9 million decrease in the FY 2003-04 year-end balance that will be available as a source of funds for the FY 2004-05 budget. This loss is attributable to the following:

Prior Year Fund Balance. The FY 2003-04 budget was balanced with $47.1 million from the FY 2002-03 fund balance. While the Controller's Six-Month Report reported a projected year-end fund balance shortfall of $1.3 million for FY 2003-04, the City cannot legally end the fiscal year with a shortfall. The Controller has also already implemented spending controls to ensure this. Therefore, we are projected to start FY 2004-05 with $47.1 million less than was available when we started FY 2003-04.

Closure of Reserves from Prior Years. The FY 2003-04 budget was balanced using prior year reserves totaling $11.4 million. However, no prior year reserves are projected to be available to fund the FY 2004-05 budget, which is an $11.4 million decrease. Reserves used in the FY 2003-04 budget included: the $4.2 million Emergency Reserve, the $4.0 million Budget Savings Incentive Reserve, the $1.5 million Recreation & Parks Savings Reserve and $1.70 million in MOU Reserves.

Use of the Rainy Day Reserve. The voters approved the creation of the City's new Rainy Day Reserve in November 2003. This resulted in a transfer of $55.1 million in previous Charter-mandated Cash Reserve into the new Rainy Day Reserve. Under the provisions outlined in the Charter-mandated Rainy Day Reserve, a partial draw down from the reserve would be permitted over the next three years. Projected use of the Rainy Day Reserve is $27.6 million in FY 2004-05, $13.8 million in FY 2005-06, and $6.9 million in FY 2006-07. Table B reports the year-over-year change in Rainy Day Reserve spending.

SOURCES - Revenues and Transfers In

State revenue reductions and a lagging economic recovery has resulted in budget shortfalls for FY 2003-04 revenues as reported in the Controller's Six-Month Report. Attachments 1 and 2 summarize General Fund Revenue and Transfer-In sources for the three-year projection, excluding changes to Health and Human Services revenues as well as the Redevelopment Agency's projected property tax increment impact, which are detailed separately in Table B and the narrative below.

- **General Revenues.**

  Taxes & Recurring Revenues. The estimate of a $20.0 million revenue increase for FY 2004-05 assumes revenue growth for most tax revenues from the FY 2003-04 projected year-end actuals of between 1.5 percent for Property Taxes, which we anticipate will be affected by a large backlog of assessment appeals, to 6.0 percent for Hotel Room Taxes, as shown in Attachments 1 and 2. FY 2005-06 and FY 2006-07 revenues are projected to grow 3.2 percent or $63.6 million and 3.5 percent or $69.9 million respectively from the prior year projection.

  One-Time Revenues. The FY 2003-04 budget was also balanced using one-time revenues. Most are not projected to be available in FY 2004-05, thereby creating a $48.3 million loss. The larger one-time revenues included in the FY 2003-04 budget were $25.0 million in Tobacco Settlement Penalties, $14.9 million in property sales and $4.7 million in Hotel Room Tax revenues re-allocated to the General Fund.

- **Transfers-In.** Transfers into the General Fund are projected to be $11.5 million less in FY 2004-05. These changes are explained by the following:

  Airport-Transfer In. The Airport Transfer is comprised of two components in FY 2003-04 – the Annual Service Payment and a final repayment to the General Fund for CalPERS retirement costs. The General Fund receives an Annual Service Payment from San Francisco International Airport based on concession revenues. Given weakness in air travel along with concession contract revisions, the Airport concession revenue transfer to the General Fund is projected to be $0.1 million less than the $18.5 million FY 2003-04 budget. The underlying revenue growth projected for concession revenue is 1.8 percent in FY 2004-05, 6.2 percent in FY 2005-06, and 5.5 percent in FY 2006-07.

  The second part of the transfer in from the Airport, which pays for related retirement costs for Airport personnel in the State's CalPERS system, is slated to end in FY 2003-04. This results in a $6.8 million decline from FY 2003-04 budgeted levels. The total impact on the Airport transfer to the General Fund is a decrease of $6.9 million in FY 2004-05.

  One-Time Transfers In. Overall, one-time transfers in are projected to be $11.4 million lower in FY 2004-05 compared to FY 2003-04 as a result of the loss of $4.6 million in one-time Building Inspection fund transfers and the $6.8 million loss of the non-recurring Airport Transfer related to CalPERS repayments to the General Fund discussed above.

- **Estimated State Revenue Losses.** In 2003-04 we projected a $30.0 million loss from the state. Here we remove that assumption and replace it with the $96.8 million of on-going State budget cuts included in the Governor's proposed budget. Additionally, FY 2006-07 includes the assumption the State will hold true to its promise to repay local government of the amount of VLF backfill 'loaned' by local governments to the State during the FY 2003-04 budget crisis – a projected $58 million payback for San Francisco.

- **Redevelopment Tax Increment Requirement.** Tax increment funding allocated to the Redevelopment Agency is partially funded from Property Tax revenue that would otherwise accrue to the General Fund. The FY 2003-04 budget was based upon an assumed gross tax increment of $38.2 million budgeted for the Redevelopment Agency – out of a total $60.1 million in total available tax increment. Our projection includes growth in Redevelopment tax increment funding which would result in a net General Fund revenue impact of $10.8 million in FY 2004-05, then $0.6 million in FY 2005-06 and $0.7 million in FY 2006-07. However, the tax increment would instead be used by the Redevelopment Agency to cover projected debt service and program costs. Without this increase in funding for the Redevelopment Agency, the net revenue impact included here would otherwise accrue to the General Fund.

USES – Salaries and Benefits

We are projecting increased labor costs of $104.3 million in FY 2004-05, followed by increases of $66.6 million in FY 2005-06 and $59.3 million in FY 2006-07. These are the results of various costs, including known memoranda of understanding (MOU) provisions for City employees, mandated health benefit and retirement cost increases, and changes in the number of workdays in each fiscal year. **Our projections for FY 2004-05, FY 2005-06 and FY 2006-07 do not include any increased costs due to labor contracts currently open for negotiation. To the extent that any wage or benefits increases are negotiated over the next three fiscal years, the projected shortfalls in FY 2004-05 and FY 2005-06 will increase. The projected surplus in FY 2006-07 would also decrease.**

- **Annualization of Partial-Year Positions.** In FY 2004-05, the City will incur additional costs to annualize new positions added to the FY 2003-04 budget. Since most of the new positions were funded for only three-quarters of a year, an additional $0.7 million in General Fund expenditure will be needed in FY 2004-05 to fund these positions for a full year.

- **Annualization of Previous Year MOU Provisions.** The ongoing cost of partial-year salary increases granted during FY 2003-04 and not shown separately in the MOU items outlined below will result in $0.1 million in additional General Fund cost in FY 2004-05.

- **Change in Work Days.** FY 2004-05 and FY 2005-06 both have 261 workdays, compared to 262 for FY 2003-04. FY 2006-07 has 260 workdays. As a result, the City's General Fund will save an estimated $4.4 million in FY 2004-05 of salary and benefits costs as compared to FY 2003-04. There will be no incremental cost or savings in FY 2005-06, followed by additional savings of $4.4 million in FY 2006-07.

- **Health and Dental Costs for Current Employees.** The Charter requires the City's contribution for individual health coverage costs to increase based on a survey of California's ten largest counties. The most recently conducted survey resulted in an 11.3 percent increase in the Charter-required contribution. Given this increase along with other projected changes in plan and fund balance usage as well as negotiated benefit provisions, General Fund costs overall are projected to increase by $10.5 million for FY 2004-05 for current employees. Our projections for FY 2005-06 and FY 2006-07 are based on projected underlying cost increases of 15.5 percent each year along with no use of fund balance – amounting to $18.9 million and $21.8 million, respectively.

- **Health Benefits for Retirees.** Charter Section A8.428 also mandates health coverage for retirees. These medical benefits for retirees are projected to increase in cost by $11.0 million, $10.0 million, and $12.2 million for FY 2004-05, FY 2005-06 and FY 2006-07 respectively.

- **MOU Costs – Known – Nurses & Police.** Most MOU contracts are set to reopen this spring; however, a few including Nurses and Police are closed. Of those closed contracts both Nurses and Police are projected to result in increased costs during the next three years. For Nurses, the additional costs associated with the cost of living increases and the market rate adjustments are $13.2 million in FY 2004-05 and $5.5 million in FY 2005-06. For Police, the labor cost increases are tied to a survey of various jurisdictions. Our projected cost increases are $11.0 million, $9.0 million and $9.5 million for FY 2004-05, FY 2005-06 and FY 2006-07 respectively.

- **MOU Costs, Removal of Freeze to Step Increases, SEIU & Nurses.** FY 2003-04 included savings due to a freeze in step increases for both SEIU and Nurses. The projected impact of removing the step freezes starting again in FY 2004-05 is $3.7 million.

- **Pension - PERS Contribution Rate Changes – Employer-Share Only.** The California Public Employees' Retirement System (CalPERS) has notified the City that the employer contribution rates for employees covered by CalPERS Safety will increase from 6.43 percent in FY 2003-04 to 20.80 percent in FY 2004-05. CalPERS has also reported that their projected contribution rate is 23.70 percent for FY 2005-06. We have assumed that same rate for FY 2006-07. These contribution rates result in additional costs of $11.3 million in FY 2004-05 and $2.5 million in FY 2005-06. The significant contribution rate increase is due primarily to CalPERS's lower than anticipated investment returns.

- **Pension - SFERS Contribution Rate Changes – Employer-Share Only.** After nine years of not having to make an "employer-share" contribution to the City's Retirement System due to its surplus funded status, lower than anticipated investment returns (like that of CalPERS mentioned above) along with the phasing in of voter-approved retirement benefit increases will require the City to start making contributions in FY 2004-05. Based on the San Francisco Employees' Retirement System's (SFERS) actuarial valuation as of July 1, 2003 (completed and published in January 2004) and the Retirement Board's economic assumptions adopted on February 27, 2004, we are projecting that employer-share contribution rates for employees covered by SFERS will increase from 0.00 percent in FY 2003-04 to 4.48 percent in FY 2004-05. The contribution rate is projected to increase by an additional 2.00 percent per year to 6.48 percent in FY 2005-06 and 8.48 percent in FY 2006-07. The result of this contribution rate increase is that City-paid contributions will be needed starting in FY 2004-05, resulting in additional costs of $44.6 million in FY 2004-05, $20.7 million in FY 2005-06, and $20.2 million in FY 2006-07.

- **Unemployment Insurance.** The City's General Fund is projected to have $2.6 million in incremental unemployment insurance costs during FY 2004-05.

USES – Other Non-Salary

We project other expenditure increases of $46.8 million in FY 2004-05, $74.2 million in FY 2005-06 and $62.0 million in FY 2006-07. These projections are based on the following assumptions:

- **Baseline Requirements.** The Charter specifies that baseline funding levels for the Municipal Transportation Agency (MUNI and Parking & Traffic), Public Library and Children's Services be adjusted by any changes in aggregate City revenues. As a result of changes in discretionary revenues to the General Fund discussed in the sources portion of this report, the required level of General Fund support for these baselines will change. The net impact on baseline funding requirements is an estimated savings of $3.8 million in FY 2004-05, then additional costs of $8.9 million and $10.5 million in FY 2005-06 and FY 2006-07 respectively. This projection assumes that the Children's Baseline appropriation will not decline during FY 2004-05 even though discretionary revenues are projected to decline. This policy decision to hold harmless the Children's Baseline, as has been the policy in the past, makes the FY 2004-05 total shortfall $1.9 million greater than would otherwise be the case.

- **Capital & Facilities Maintenance.** The FY 2003-04 budget includes $9.2 million in General Fund capital improvements and facilities maintenance expenditures. We are assuming an annual program of $20.0 million over the next three years, which results in a $10.8 million increase for FY 2004-05. This $20.0 million level is typical of funding in prior years.

- **Debt Service Requirements.** Based on information provided by the Mayor's Office of Public Finance, assuming a lease-financing program for equipment purchases of $10 million per year, the total lease financing costs are projected to increase $1.4 million, $4.4 million, and $6.7 million in FY 2004-05, FY 2005-06, and FY 2006-07 respectively. All debt service costs, other than that for lease financings, are projected to increase $1.7 million and $1.0 million in FY 2004-05 and FY 2005-06, with savings of $3.6 in FY 2006-07.

- **Energy Costs.** Natural Gas prices have increased significantly during FY 2003-04. Higher commodity pricing is projected to continue through FY 2004-05, and then decrease again during FY 2005-06. This will result in additional costs of $1.5 million in FY 2004-05, then $1.5 million in savings in FY 2005-06.

- **Equipment Program.** The FY 2003-04 original budget included cash expenditure of $3.7 million for equipment acquisition. We have assumed for our projection that the City will return to its past practice of purchasing $10.0 million of equipment on a cash basis. This results in additional costs of $6.3 million in FY 2004-05.

- **Settlement of Litigation & Claims.** Each year the City is exposed to various risks related to lawsuits. We funded the settlement of litigation and claims with reserve carryforwards from prior years for FY 2003-04. Such reserves are not projected to be available for FY 2004-05. We have assumed $13.0 million for annually budgeted litigation reserves, an amount comparable to recent average annual levels.

- **Work Order Recoveries.** A decrease in work order funding of $2.2 million is projected for FY 2004-05. This includes a $1.3 million reduction in Port work order reimbursements to the General Fund and a $0.9 million reduction in Treasure Island work order reimbursements.

- **Worker's Compensation Costs.** Continued implementation of the State's AB749 law and medical services inflation result in increases in most classes of workers' compensation benefits; however, the State's proposed workers compensation reform efforts could result in some savings. Projected cost increases after consideration of these variables are $7.3 million, $6.5 million and $6.6 million in FY 2004-05, FY 2005-06 and FY 2006-07 respectively. These projections assume 10.0 to 12.0 percent medical inflation cost increases, with remaining cost increases due to both benefit and utilization levels (i.e., the number of claims).

Departmental Expenditures

- **Convention Facilities.** Convention Facilities will again require General Fund support over the next three years to cover operating costs. Incremental costs of $6.7 million are included, starting in FY 2004-05. Then net savings of $1.2 million and $1.4 million are projected for FY 2005-06 and FY 2006-07 due to growth in hotel room taxes being stronger than projected expenditure increases.

- **Elections Department.** Assuming that FY 2004-05 will have only one regularly scheduled election, so $3.0 million of projected savings is included from FY 2003-04 budgeted levels (which had two regularly scheduled elections originally budgeted plus one recall and one runoff election). FY 2005-06 will have two regularly scheduled elections and the possibility of a runoff in December 2005; this will result in $3.0 million in additional costs in that year. FY 2006-07 will have one regularly scheduled election. We have not included the potential fiscal impact of implementing touch-screen and ranked-choice (i.e., Instant Runoff) voting technologies since related costs and implementation timing have not been fully determined at this time.

- **Ethics Commission - Public Financing of Supervisorial Elections.** Proposition O, approved in November 2001, created a publicly financed election program for supervisorial candidates starting in November 2002. This is projected to result in incremental costs of $1.0 million in FY 2004-05, followed by a decrease in costs of $1.0 million in FY 2005-06. Then, another increase of $1.0 million is projected for FY 2005-06 given that supervisorial elections are scheduled for November 2006.

- **Fine Arts Museum Operations.** With the opening of the new de Young Museum, we estimate that the General Fund contribution to the Fine Arts Department will increase by $2.5 million in FY 2004-05 and $3.6 million for a full year of operation in FY 2005-06.

- **Fire Department.** With the reopening of Station 33, additional General Fund costs of $1.7 million are projected beginning in FY 2004-05.

- **Human Services Department - Net Expenditure Growth.** The Human Services Department is projecting increased net expenditures for Aid and service costs of $2.7 million, $11.8 million and $12.4 million in FY 2004-05, FY 2005-06, and FY 2006-07 respectively. Net increases for FY 2004-05 are lower than would otherwise be the case due to higher projected Federal revenues helping to offset weakness in State funding. Overall, the Human Services Department receives about two-thirds of its funding from the State and Federal governments. These net expenditure increases are based upon underlying Aid expenditure growth of 5.0 to 5.5% from FY 2003-04 budgeted levels over each of the next three years.

- **Public Health – Net Expenditure Growth.** The Department of Public Health is projected to have a net savings of $7.0 million in FY 2004-05 due to strength in net patient revenues, which can partially fund known labor cost increases for Nurses of $13.2 million shown above. FY 2005-06 and FY 2006-07 have projected net expenditure growth of $28.7 million and $22.8 million respectively. Net expenditure growth is greater in the latter two years of this projection as revenues are not projected to grow as quickly as cost increases.

- **New Voter Mandates.** Two new voter mandates are projected to increase costs over the next three years. These include Dedicated Funding for Schools passed by the voters in March 2004, which will increase expenditures by $10.0 million in FY 2005-06 and FY 2006-07. Additionally, the mandated functions of City Services Auditor passed by the voters in November 2003 will require an additional $1.7 million in FY 2004-05.

Items Not Included in Our Projection

As with all projections, unforeseen events may occur that will change the City's future financial condition. In addition, there are items we are aware of now that may have an impact on the City's finances over the next three years, but we are unable to predict what that effect might be at this time.

- **Departmental Revenues.** In contrast to our projections for general tax revenue growth, we have made no overall assumption in this report about departmental fees increasing or decreasing versus our current year projections. To date, departments have been reviewing their service charges and fees; however, any changes to service charges and fees, for those that do not currently have automatic inflation escalators, will require Mayor and Board of Supervisors approval and are not included in this review.

- **Elections.** The potential fiscal impact of the timing and implementation of touch-screen and ranked-choice voting technologies has not been fully determined at this time. No incremental costs have been assumed for the possibility of any run-off election over the next three years.

- **MOU Costs – Unknown, Open Labor Contracts.** As previously noted, this report assumes no wage or benefit increases, other than for labor contracts already closed, including cost increases outlined above. For all other bargaining units with contracts set to expire over the three-year projection and/or that have re-opener clauses at the end of FY 2003-04, we have assumed no labor cost increases or benefit enhancements, along with a continuation of the Charter-mandated employee contribution of 7.5 percent toward their own retirement. While not included in Table A or B above, for informational purposes, every one percent increase in salaries for open contracts alone would cost the General Fund $7.1 million per year. Continued give back of 7.5 percent related to the employee share retirement contribution is equivalent to $53.0 million in FY 2004-05 for contracts open for negotiation.

- **Natural Disasters & Man-Made Disruptions.** As in previous reports, we have not included any projected costs associated with natural disasters or man-made disruptions.

- **New Development Projects.** There are several large, proposed projects that will likely result in both new tax revenues and associated costs. However, given the lagging recovery, our projections make no assumption regarding the net financial impact of these projects, which include Mission Bay, the Transbay Terminal, Mid-Market, and the conveyance and development of Treasure Island.

- **Non-Salary Inflation.** We have not included any assumption for inflation or COLAs for contractors or any other non-personnel expenditures. If we had included costs based on the consumer price index projections from the State of California Department of Finance, we would show a $16.1 million increase in General Fund expenditures in FY 2004-05, $18.1 million in FY 2005-06, and an estimated $22.6 million in FY 2006-07.

- **Pending or Proposed Legislation – Potential Revenue Increases.** Various proposed fee increases may come before the Board before the end of the year, including for example City Planning fees. These proposed increases have not been assumed in our projections.

- **State and Federal Budget Changes.** On March 2, California voters approved the **$15 billion bond** in long-term deficit refinancing, which was also already assumed in the **Governor's Proposed Budget**, released in January of 2004. In addition to the assumed approval of the $15 billion bond, the Governor's Proposed Budget also included **$96.8 million in on-going cuts to San Francisco**, which have been included in our projection. The Governor's Proposed Budget also included other revenue assumptions such as $500 million in tribal government gaming revenues, labor give-backs and the issuance of a $1 billion pension obligation bond – some or all of which may not come to fruition. To the degree these sources do not materialize, the State may reduce subventions to local government in an effort to eliminate any additional shortfall. However, the impact of potential changes in State and Federal budgets and allocations are unknown at this time.

SUMMARY

We project a $299.3 million shortfall for FY 2004-05, along with a shortfall of $65.5 million in FY 2005-06. FY 2006-07 is projected to have a slight surplus of $0.1 million. These projections assume that we continue to provide the current level of services, continue to maintain a $25.0 million General Fund Reserve and provide for a $20 million capital improvement and facilities maintenance program. The Charter requires that each budget must be balanced. Therefore, this report assumes that the shortfalls will be eliminated in the year in which they first appear.

This year presents us with a number of key risks and areas of heightened uncertainty that are of particular concern. The prolonged economic downturn has meant that revenue growth assumptions over the past several years have not come to fruition. Given the delays in the economic recovery, our key risks and uncertainty include:

Timing and Pace of the Recovery, including Key Revenue Uncertainty in:
- Property Tax Appeals,
- Business Taxes,
- Sales Taxes, and
- Hotel Room Taxes

State and Federal Budget Uncertainty
- Potential Further State Budget Reductions in particular; and

Salary and Benefit Cost Increases related to Labor Negotiations

We acknowledge that projections of the City's financial condition over multiple years are far less certain than those for the immediate future. This report is based on the best information available at this time. All three of our offices will continue to work closely together in the coming months and will keep you apprised of any changes that occur.

Respectfully submitted,

Ben Rosenfield Budget Director Mayor's Office	Edward Harrington Controller	Harvey M. Rose Budget Analyst Board of Supervisors

Attachment 1: General Fund Revenues, FY 2004-05 to FY 2006-07
Attachment 2: General Fund Revenue Growth Rates, FY 2004-05 to FY 2006-07

cc: Gloria Young, Clerk of the Board

ATTACHMENT #1: SOURCES OF FUNDING

Summary of Revenues & Transfers In

GENERAL FUND	FY 2002-03 Year-End Actuals	FY 2003-04 Revised Budget	FY 2003-04 Joint Report Projection	FY 2004-05 Projection Including Anticipated One-Time Events	FY 2004-05 Projection Excluding Anticipated for One-Time Events	FY 2005-06 Projection	FY 2006-07 Projection
Property Taxes	$ 518.7	$ 527.8	$ 527.8	$ 566.4	$ 535.7	$ 583.4	$ 606.8
Business Taxes	276.1	288.6	288.6	295.8	295.8	307.7	320.0
Sales Tax	115.6	122.5	118.0	92.0	122.7	96.6	102.4
Hotel Room Tax	74.7	90.1	87.9	88.4	93.1	94.6	102.2
Utility Users Tax	71.4	68.4	68.9	67.4	67.4	69.4	71.9
Parking Tax	29.7	32.7	31.5	32.1	32.1	34.4	36.1
Real Property Transfer Tax	51.5	55.0	63.0	66.2	66.2	69.5	71.5
Admission Tax	2.9	2.7	2.7	2.7	2.7	2.7	2.8
Subtotal - Tax Revenues	**1,140.5**	**1,187.6**	**1,188.3**	**1,211.1**	**1,215.8**	**1,258.3**	**1,313.6**
Licenses, Permits & Franchises	16.2	17.1	16.3	15.9	15.9	16.4	16.9
Fines, Forfeitures & Penalties	5.6	31.7	31.5	5.4	31.5	5.4	5.4
Interest & Investment Income	15.9	12.5	9.5	8.1	8.1	8.2	8.5
Rents & Concessions	17.6	19.3	19.3	19.9	19.9	20.9	22.0
Subtotal - Licenses ... Concessions	**55.3**	**80.6**	**76.7**	**49.4**	**75.5**	**51.0**	**52.8**
Federal Subventions	151.8	158.7	158.7	158.7	158.7	158.7	158.7
State Subventions							
Social Service Subventions	126.4	130.6	124.9	124.9	124.9	124.9	124.9
Health & Welfare Realignment	129.6	132.6	133.9	139.5	139.5	145.1	148.4
Health/Mental Health Subventions	63.6	69.4	69.4	69.4	69.4	69.4	69.4
Public Safety Sales Tax	64.3	65.3	65.3	67.3	67.3	70.6	74.2
Motor Vehicle In-Lieu (County & City)	103.9	112.6	86.6	115.2	89.2	119.8	182.6
Other Grants & Subventions	27.6	(6.1)	(13.9)	(80.7)	(13.9)	(80.7)	(80.7)
Subtotal - State Subventions	**515.4**	**504.3**	**466.1**	**435.5**	**476.3**	**449.0**	**518.6**
CHARGES FOR SERVICES							
General Government Service Charges	22.0	25.7	24.1	22.5	24.1	22.9	23.4
Public Safety Service Charges	10.8	15.9	15.6	15.6	15.6	15.8	15.9
Recreation Charges - Rec/Park	4.2	5.4	5.4	5.4	5.4	5.6	5.9
MediCal, MediCare & Health Svc. Chgs.	37.8	43.6	44.2	44.2	44.2	44.2	44.2
Other Service Charges	7.1	7.1	7.1	7.1	7.1	7.1	7.1
Subtotal - Charges for Services	**81.9**	**97.8**	**96.4**	**94.8**	**96.4**	**95.7**	**96.6**
Recoveries of General Government Costs	11.9	9.4	15.7	9.7	16.0	10.0	10.3
Other Revenues	9.0	20.9	20.9	5.1	20.9	5.1	5.1
TOTAL REVENUES	**1,965.9**	**2,059.3**	**2,022.8**	**1,964.2**	**2,059.6**	**2,027.8**	**2,155.7**
TRANSFERS INTO GENERAL FUND:							
Airport	21.2	25.3	24.7	18.4	25.2	19.5	20.6
Other Transfers	88.1	120.3	120.3	115.7	120.3	115.7	115.7
Total Transfers-In	**109.3**	**145.5**	**145.0**	**134.1**	**145.4**	**135.2**	**136.3**
TOTAL GENERAL FUND RESOURCES	**$ 2,075.1**	**$ 2,204.8**	**$ 2,167.8**	**$ 2,098.3**	**$ 2,205.1**	**$ 2,163.0**	**$ 2,292.0**
$ Change from Prior Year Revised Budget (PY Projection for Latter Two Years)				**$ (106.5)**	**$ 0.3**	**$ 64.7**	**$ 128.9**
% Change from Prior Year Revised Budget (PY Projection for Latter Two Years)				***-4.8%***	***0.0%***	***3.1%***	***6.0%***

ATTACHMENT #2: GROWTH IN SOURCES OF FUNDING…

Summary of Revenues & Transfers In Growth

GENERAL FUND	… FROM FY 2003-04 REVISED BUDGET				...FROM JOINT REPORT PROJECTION		
	FY 2004-05		FY 2005-06	FY 2006-07	FY 2004-05	FY 2005-06	FY 2006-07
	% Chg from FY 2003-04 Revised Budget	Adjusted for One-Time Events	% Chg from FY 2004-05 Projection	% Chg from FY 2005-06 Projection	Adjusted for One-Time Events	% Chg from FY 2004-05 Projection	% Chg from FY 2005-06 Projection
Property Taxes	7.3%	1.5%	3.0%	4.0%	1.5%	3.0%	4.0%
Business Taxes	2.5%	2.5%	4.0%	4.0%	2.5%	4.0%	4.0%
Sales Tax	-24.9%	0.2%	5.0%	6.0%	4.0%	5.0%	6.0%
Hotel Room Tax	-1.8%	3.4%	7.0%	8.0%	6.0%	7.0%	8.0%
Utility Users Tax	-1.4%	-1.4%	3.0%	3.5%	-2.1%	3.0%	3.5%
Parking Tax	-1.6%	-1.6%	7.0%	5.0%	2.0%	7.0%	5.0%
Real Property Transfer Tax	20.3%	20.3%	5.0%	3.0%	5.0%	5.0%	3.0%
Admission Tax	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Subtotal - Tax Revenues	**2.0%**	**2.4%**	**3.9%**	**4.4%**	**2.3%**	**3.9%**	**4.4%**
Licenses, Permits & Franchises	-6.7%	-6.7%	3.0%	3.0%	-2.4%	3.0%	3.0%
Fines, Forfeitures & Penalties	-83.0%	-0.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Interest & Investment Income	-35.4%	-35.4%	2.0%	3.0%	-15.0%	2.0%	3.0%
Rents & Concessions	3.3%	3.3%	5.0%	5.0%	3.3%	5.0%	5.0%
Subtotal - Licenses … Concessions	**-38.8%**	**-6.3%**	**3.3%**	**3.5%**	**-1.6%**	**3.3%**	**3.5%**
Federal Subventions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
State Subventions							
Social Service Subventions	-4.4%	-4.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Health & Welfare Realignment	5.2%	5.2%	4.0%	2.3%	4.2%	4.0%	2.3%
Health/Mental Health Subventions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Public Safety Sales Tax	3.0%	3.0%	5.0%	5.0%	3.0%	5.0%	5.0%
Motor Vehicle In-Lieu (County & City)	2.3%	-20.8%	4.0%	52.4%	3.0%	4.0%	52.4%
Other Grants & Subventions	1217.5%	127.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Subtotal - State Subventions	**-13.6%**	**-5.6%**	**3.1%**	**15.5%**	**2.2%**	**3.1%**	**15.5%**
CHARGES FOR SERVICES							
General Government Service Charges	-12.6%	-6.4%	2.0%	2.0%	0.0%	2.0%	2.0%
Public Safety Service Charges	-1.9%	-1.9%	1.0%	1.0%	0.0%	1.0%	1.0%
Recreation Charges - Rec/Park	0.0%	0.0%	5.0%	5.0%	0.0%	5.0%	5.0%
MediCal, MediCare & Health Svc. Chgs.	1.4%	1.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Service Charges	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Subtotal - Charges for Services	**-3.0%**	**-1.4%**	**0.9%**	**0.9%**	**0.0%**	**0.9%**	**0.9%**
Recoveries of General Government Costs	3.4%	71.1%	3.0%	3.0%	2.0%	3.0%	3.0%
Other Revenues	-75.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TOTAL REVENUES	**-4.6%**	**0.0%**	**3.2%**	**6.3%**	**1.8%**	**3.2%**	**6.3%**
TRANSFERS INTO GENERAL FUND:							
Airport	-27.2%	-0.4%	6.2%	5.5%	1.8%	6.2%	5.5%
Other Transfers	-3.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Transfers-In	**-7.9%**	-0.1%	**0.9%**	**0.8%**	**0.3%**	**0.9%**	**0.8%**
TOTAL GENERAL FUND RESOURCES	**-4.8%**	**0.0%**	**3.1%**	**6.0%**	**1.7%**	**3.1%**	**6.0%**