MAYOR'S BUDGET OFFICE

BOARD OF SUPERVISORS
BUDGET ANALYST

OFFICE OF THE CONTROLLER

March 8, 2001

The Honorable Willie L. Brown, 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 Budget Projection

Dear Mayor Brown, Ladies and Gentlemen:

The San Francisco Charter requires a multi-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 fiscal years 2001-2002 through 2003-2004.

We are projecting a $66.1 million revenue shortfall for 2001-2002. It should be noted that although we project shortfalls for each of the next three years, all final budgets must be balanced and all projected shortfalls must be eliminated. Our projections reflect the estimated cost of providing the current level of City services through current business practices. 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. Table A below provides a summary of the projected revenues less expenditures. Please refer to Table B for a detailed breakdown of the budget projections for the next three years.

Table A
Summary of Projected General Fund Surplus/(Shortfall)
(in millions)

	2001-2002	2002-2003	2003-2004
Projected Revenues less Expenditures	($66.1)	($26.3)	($31.5)

Table B
Three-Year Budget Projection
Summary of Major Changes
(in millions)

	2001-2002	2002-2003	2003-2004
Year-End Balance			
Available in Prior Year	(127.5)	(82.9)	(75.0)
Available in Budget Year	82.9	75.0	50.0
Subtotal, Year-end Balance	**(44.6)**	**(7.9)**	**(25.0)**
Revenues			
Tax revenue growth	103.1	73.4	70.3
Hetch Hetchy Transfer	(29.9)		
Airport transfer	3.0	3.0	1.8
DHS revenue offset	5.5	6.1	5.1
Subtotal, Revenues	**81.7**	**82.5**	**77.2**
Salaries and Benefit Items			
Annualize partial-year positions	(5.1)		
Anualize previous year MOU provisions	(8.3)		
Known MOU provisions	(21.3)	(28.9)	
Unknown MOU provisions	(22.7)	(24.1)	(49.3)
Health and dental rates	(9.4)	(4.2)	(4.4)
PERS safety retirement contributions	2.2		
Change in work days		(3.0)	(3.1)
Subtotal, Salaries and Benefit	**(64.6)**	**(60.2)**	**(56.8)**
Non-Salary Expenditures			
Required MTA baseline contribution	(1.9)	(5.0)	(5.0)
Required Library baseline	(1.6)	(1.5)	(1.5)
Required children services baseline	(1.4)	(3.7)	(3.7)
Capital program to $25M	1.6		
One-time programs/addbacks	10.1		
Equipment Acquisition to $10M	8.3		
Equipment lease-finance program	1.9		
Non-salary inflation	(20.8)	(21.2)	(22.4)
GF Contribution to Convention Facilities	(12.2)		12.2
Rent Increases	(1.5)	(3.2)	(6.3)
Natural Gas Increases	(6.5)		
Sheriff Department	(2.0)		
Fire Department	(3.3)		
Museum Operations	(0.5)	(2.0)	(0.2)
Retirement Health Benefits (Prop D)	(6.4)		
Publicly Financed Elections (Prop O)		(1.6)	
San Bruno Jail debt service	(2.4)	(2.5)	
Subtotal, Non-Salary Uses	**(38.6)**	**(40.7)**	**(26.9)**
Projected Surplus / (Shortfall)	(66.1)	(26.3)	(31.5)

SUMMARY OF OUR PROJECTIONS

Changes in General Fund Revenue and Other Sources of Funds

- **Year-End Balance.** The current-year budget was balanced with $127.5 million from the prior year's fund balance. The Controller's six-month report projects a 2000-2001 year-end surplus of $82.9 million or $44.6 million less than our current budget. We are also projecting that the City's year-end balance will diminish over time, assuming $75 million available at the end of 2001-02 and $50 million available at the end of 2002-2003.

- **General Fund Tax Revenue Growth.** We project stable General Fund revenue growth of approximately 4.1% to 5.4% annually over the next three fiscal years. The revenue growth projection is inclusive of a business tax estimate that reflects a reduction in a portion of our expected receipts to fund a business tax litigation reserve because of the outstanding business tax litigation against the City. The only expected decrease in revenue is in real property transfer tax revenues due to the recent slowdown in sales volume and potential volatility of this revenue source.

  Overall, General Fund revenues are projected to increase by $103.1 million over our 2000-2001 budgeted revenue, $73.4 million in 2002-2003 and $70.3 million in 2003-2004 (see Attachment I for detail by specific revenue source).

- **Hetch Hetchy Transfer.** Hetch Hetchy's hydroelectric operations generate sufficient electricity during wet months to meet customer demands, but during drier months it must purchase electric power from wholesale market providers. Each year, certain profits from Hetch Hetchy's operations, as defined by the Charter, are transferred to the City's General Fund. Due to the Public Utilities Commission's projection of high power costs over the next three years, we do not expect Hetch Hetchy to transfer any surplus funds to the General Fund in the fiscal years covered by this report. Consequently, we have included a reduction of $29.9 million in such revenues for 2001-2002.

- **Airport Transfer.** The General Fund receives an annual service payment from the San Francisco International Airport based on concession revenues. As new Airport facilities are completed and passenger volumes increase, concession revenues will grow. According to the Airport, this transfer is projected to increase by $3 million in fiscal year 2001-2002, $3 million in 2002-2003 and $1.8 million in 2003-2004.

- **DHS Revenue Offset.** The Department of Human Services (DHS) receives reimbursement from the State and Federal governments for several programs. As a result, a portion of the projected cost increases incurred by the department will be supported by non-General Fund sources. For our report, this results in offsetting revenues of $5.5 million in 2001-2002, with similar growth in future years.

Salary and Benefit Items

- **Annualization of Partial-Year Positions.** In fiscal year 2001-2002, the City will incur additional costs to annualize new positions added to the fiscal year 2000-2001 budget. Since most of the new positions were funded for only three-quarters of a year, an additional $5.1 million in General Fund expenditures will be needed in fiscal year 2001-2002 to fund these positions on an ongoing basis.

- **Annualization of Previous Year MOU Provisions.** The ongoing cost of partial-year salary increases granted during 2000-2001 will result in $8.3 million in additional General Fund costs in 2001-2002.

- **Known MOU Provisions.** Some bargaining units such as the Service Employees International Union, the largest such employee bargaining unit, have previously negotiated contracts that extend beyond the current fiscal year. Wage and benefit increases have been predetermined, and the new provisions will cost the General Fund approximately $21.3 million in fiscal year 2001-2002 and $28.9 million in 2002-2003.

- **Unknown MOU provisions.** We have projected that wages for employees in bargaining units with MOUs that have not yet been negotiated will increase by the same amount as the increase in the Consumer Price Index for Wages. Applying this index results in our projection of incremental costs of $22.7 million in fiscal year 2001-2002 (an increase of 3.3%), $24.1 million in fiscal year 2002-2003 (an increase of 3.4%), and $49.3 million in fiscal year 2003-2004 (an increase of 3.6%). **This estimate does not reflect the City's willingness or ability to pay, nor does it represent what will ultimately be negotiated.** Factors other than inflation, such as the adequacy of previous MOUs and the overall job market for similar job classifications, will also impact negotiations.

- **Health and Dental Costs.** The Charter requires the City's contribution for individual health coverage costs to increase based on a survey of California's ten largest counties. This survey resulted in an 11.3% increase and $4.4 million in increased General fund costs in 2001-2002. In addition, the City's General fund contribution to dependent health coverage, as required by MOUs, is estimated to increase by $4.8 million 2001-2002. We also expect a small increase in the City's employer contribution for dental coverage for a total General Fund increase of $9.4 million in 2001-2002 for health and dental costs. Our projections for 2002-2003 and 2003-2004 are based on a 5% inflation rate for such expenditures.

- **Public Employee Retirement System (PERS) Safety Retirement Contributions.** The City has been notified by PERS that the employer contribution rate for City employees covered by the PERS safety plan is decreasing from 9.4% to 5.4%, resulting in annual cost savings of $2.2 million.

- **Work Day Adjustment.** Fiscal year 2001-2002 includes the same number of workdays as the previous fiscal year. Fiscal year 2002-2003 includes one more workday than FY 2001-2002 while fiscal year 2003-2004 has one more workday than 2002-2003. As a result, the City will pay $3 million for salary and benefits in fiscal year 2002-2003 as compared to 2001-2002 and an additional $3.1 million in 2003-2004 as compared to 2002-2003.

Non-Salary Expenditures

- **Required Municipal Transportation Agency Baseline Contribution.** The Charter requires that the City increase its General Fund contribution transfer to Muni proportional to the increase in the City's discretionary revenues. Based on the revenue assumptions of this report, Muni's General Fund contribution transfer would increase by $1.9 million in 2001-2002 and approximately $5 million in each of the two subsequent fiscal years.

- **Required Library Baseline.** The Charter requires that the Library shall receive a minimum appropriation amount (baseline) from the General Fund. The required baseline is adjusted by changes in General Fund discretionary revenues. Because the Library is currently about $1.1 million under baseline and General Fund revenue will grow next year, an additional General Fund contribution of $1.6 million will be required in 2001-2002, an additional $1.5 million will be required in 2002-2003, and an additional $1.5 million will be required in 2002-2003.

- **Required Children Services Baseline.** Proposition D, approved by voters in November 1999, will require a $1.4 million increase in the required baseline for children's services in 2001-2002. Proposition D also increased the property tax revenue allocation to the Children's Fund from 2.5% to 3%. This change resulted in a reduction of General Fund property tax revenue of approximately $4 million and has been accounted for in our General Fund revenue growth discussed above.

- **Restoration of Facilities Maintenance and Capital Improvement Program to $25 million.** The fiscal year 2000-2001 budget includes a $26.6 million General Fund capital improvements and facilities maintenance program. We are assuming an annual program of $25 million over the next three years. This level of capital funding would result in savings of $1.6 million in 2001-2002.

- **Assumed Discontinuation of One-Time Programs.** As part of the 2000-2001 budget process, additional revenues and new funding from budget savings approved by the Board of Supervisors were added to the budget to fund several one-time expenditures. Because these expenditure are not assumed to be recurring, we are projecting reduced General Fund expenditures of $10.1 million in 2001-2002.

- **Reduced Funding of Equipment Acquisition to $10 million.** The 2000-2001 budget included an $18.3 million for equipment acquisition. We have assumed a $10 million equipment program over the next three years. This spending level would result in savings of $8.3 million in 2001-2002.

- **Equipment Lease-Finance Program Savings.** The lease purchase program through the Mayor's Office of Public Finance was $7.7 million in 2000-2001. According to the Mayor's Office, the debt service requirements on the leased equipment in 2001-2002 is estimated to cost $5.8 million resulting in a $1.9 million savings to the General Fund.

- **Non-Salary Inflation.** We project that inflation of 3.5% will result in increased General fund expenditures of $20.8 million for professional services and other non-salary items in 2001-2002 and similar increases thereafter. Of this total, $10.5 million is related to increased costs for services and materials and supplies in the Department of Public Health.

- **General Fund Transfer to Convention Facilities for the Moscone Expansion Project.** We have projected $12.2 million transfers from the General Fund in both FY 2001-2002 and 2002-2003 to fund the completion of the Moscone West expansion project. We have also projected that there will no longer be a need for this General Fund support in beginning in 2003-2004.

- **Rent Increases.** A number of real estate leases, negotiated during the property recession of the early 1990s, are expiring in the coming five years. Given current market conditions, we expect General Fund rental expenditures to increase by $1.5 million in 2001-2002 followed by additional increases of $3.2 million in 2002-2003 and $6.3 million in 2003-2004.

- **Natural Gas Increases.** In the current fiscal year, General Fund departments are projected to spend approximately $7.5 million above their budget for natural gas. Although we are anticipating some decreases in natural gas prices in the coming months, we are not expecting natural gas prices to return to the levels of last year. As a result, we are estimating an ongoing increase in our General Fund costs of $6.5 million for 2001-2002.

- **Sheriff Department Expenditures**. The Controller's six-month report projects that the Sheriff will require a supplemental appropriation during the current year in the amount of $2.3 million for overtime and workers compensation costs. Of this total, $300,000 is due to an extraordinary workers compensation claim that is not expected to recur. If the department's current spending pattern continues, we project that the ongoing cost of overtime spending by the Sheriff's Department will be an additional $2.0 million as compared to their 2000-2001 budget.

- **Fire Department Expenditures.** The Controller's six-month report projects that the Fire Department is overspending by $4.5 million because of their reliance on overtime to backfill for higher-than-expected absenteeism. This overspending is partially offset by $1.2 million is additional departmental revenues. If the department continues to experience this rate of absenteeism next year, the department will require approximately $3.3 million more than their 2000-2001 budget.

- **Museum Operations.** With the closure of the de Young Museum and the opening of the new Asian Art Museum, we estimate that the net General Fund contribution to these departments will increase by $0.5 million in 2001-02, $2 million in 2002-03 and an additional $0.2 million in 2003-04. These estimates could change if there are delays in the opening of the new Asian Art Museum or higher-than-expected growth in hotel tax revenue.

- **Retiree Health Benefits.** Proposition E, approved in November 2001, requires an increase in the City contribution to retiree health benefits starting in 2001-2002. We estimate that these provisions will result in an annual General Fund cost increase of approximately $6.4 million.

- **Public Financing of Supervisorial Elections.** Proposition O, approved in November 2001, creates a publicly financed election program for supervisorial candidates starting in November 2002. Proposition O has a spending limit of $2 per resident or approximately $1.6 million. Without having a detailed program budget for 2002-2003, we have assumed the maximum allowable cost will be spent.

- **San Bruno Jail Debt Service Payments.** Based on information provided by the Mayor's Office of Public Finance, debt service payments for the replacement jail at San Bruno will be $2.4 million in 2001-2002 and increase by an additional $2.5 million in 2002-2003.

Items Not Included in Our Projection

As with all projections, unforeseen events may occur that will change the City's financial condition as we report them today. 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.

- **Minimum Compensation Ordinance.** The Minimum Compensation Ordinance contains a provision that would require non-profit service providers to pay at least $10 per hour if the Joint Report finds that the City has a projected surplus for fiscal year 2001-2002. Since we are projecting a revenue shortfall we have not included these additional costs in our projection. According to the Mayor's Budget Office, if the City were to increase the minimum wage for nonprofit providers to $10 per hour it would cost the General Fund approximately $5 to $7 million per year.

- **New Development Projects.** There are several large, proposed projects that will likely result in both new tax revenues and associated costs. Our projections make no assumption regarding the net financial impact of these projects, which include Mission Bay, Bloomingdales, and development on Treasure Island.

- **Departmental Revenues.** In contrast to our projections for tax revenue growth, we have made no overall assumption in this report about departmental revenues increasing or decreasing.

- **State and Federal Budget Changes.** The impact of potential changes in State and Federal budgets are unknown and therefore not reflected in the report.

- **Workers Compensation.** Workers compensation costs in 2000-2001 have decreased compared to the prior year. We have not included expected cost increases in subsequent years because of this recent experience. There are significant risks of higher workers compensation costs if the State passes legislation to increase medical fee schedules and the maximum amount of indemnity payments for employees on disability leave.

- **Litigation Reserves.** Each year the City is exposed to various risks related to lawsuits. Other than reserves related to the ongoing business tax litigation that have been accounted for in our revenue estimates, we assume a level of litigation expenses comparable to prior years.

- **Elections.** The Elections department overspent their current year budget by approximately $2.5 million. Since this year included the implementation of a new voting system with all eleven supervisorial districts placed on the ballot, and with nine districts requiring a December runoff election, it is unclear how much of this overspending will be ongoing.

- **Department of Public Health (DPH) Revenues.** In the current fiscal year, DPH received a one-time allocation from the State of $5 million for Laguna Honda Hospital. As of this date, a continuation of this funding has not been included in the Governor's proposed budget for 2001-2002. Other DPH revenues are expected to increase slightly and offset the loss of the Laguna Honda Hospital revenue. Overall, there will be little or no overall growth in Public Health revenues in 2001-2002. Consequently, the effects of inflation are projected to result in further increases in the department's General Fund support allocation for salary and benefits and non-salary items discussed in this report.

- **Department of Human Services Aid Payments.** Unlike in recent years, we are not experiencing dramatic reductions in aid payments for the county adult assistance program. Overall, the Department of Human Services is projecting level aid payments as compared to the current year. There is a risk of increased aid payment caseloads if there is a significant economic downturn. We have not projected this potential cost increase in our report.

SUMMARY

We project a $66.1 million revenue shortfall for fiscal year 2001-2002. This assumes we continue to provide the current level of services, and we maintain a $30 million General Fund reserve and a $25 million capital maintenance program. Our projected budget shortfalls for fiscal years 2002-2003 and 2003-2004 are $26.3 million and $31.5 million respectively. However, the Charter requires that each budget must be balanced, therefore, this report assumes that the revenue shortfalls will be eliminated in the year they first appear.

We acknowledge that projections several years ahead are 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,

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

Attachment

cc: Gloria Young, Clerk of the Board