March 21, 2003

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, FY 2003-04 through FY 2005-06**

Dear Mayor Brown and Members of the Board of Supervisors:

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 FY 2003-04 through FY 2005-06.

As shown in Table A below, we are projecting a $347.2 million shortfall for FY 2003-04. It should be noted that although we are projecting shortfalls for the next two fiscal years, all final budgets must be balanced and all projected shortfalls must be eliminated. As noted elsewhere in this report, we assume no memoranda of understanding (MOU) increases, other than the MOU already approved for Nurses, for the three years of this projection It is also worth noting that the relatively good projections for FY 2004-05 and FY 2005-06 assume all of the FY 2003-04 projected shortfall is balanced with ongoing changes, either increased revenues or decreased expenditures. We believe that this is highly unlikely, in that there will probably be onetime revenues or expenditures used to balance the FY 2003-2004 budget, and that significant shortfalls could easily extend to those fiscal years. Any one-time or temporary corrections used in FY 2003-04 will require larger corrections in future years.

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

	FY 2003-04	FY 2004-05	FY 2005-06
Projected Surplus / (Shortfall)	**($347.2)**	**($11.3)**	**$ 2.5**

With the exception of proposed changes at the Department of Public Health, which is based on service delivery changes that have been included in the Department's submission of its FY 2003-04 budget, 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.

Important changes in this year's Joint Report, compared to that of prior years, include the following:

- For the first time since we started preparing these reports we have excluded any assumptions about wage or other inflationary increases in costs. Again, we assume no MOU increases, other than the MOU already approved for Nurses, for the three years of this projection. This change in reporting results in the fiscal year projections included in this report that are better than would otherwise be the case.

- For the first time in eight years, retirement system contributions are once again projected. Although we project no retirement system contributions for FY 2003-04, $29 and $45 million in additional costs have been included in FY 2004-05 and FY 2005-06, respectively.

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
Summary of Major Changes from Prior Year
(in million of US$)

	FY 2003-04	FY 2004-05	FY 2005-06
Sources - Fund Balance & Prior Year Reserves			
Prior Year Fund Balance	($94.7)	($2.4)	$0.0
Closure of Reserves from Prior Years	(29.2)	0.0	0.0
Subtotal, Year-End Balance	**(123.9)**	**(2.4)**	**0.0**
Sources - Revenues & Transfers In			
General Revenues			
Taxes & Recurring Revenues	(18.0)	69.8	82.3
One-Time Revenues	(33.5)	0.0	0.0
Human Services Revenues	2.8	8.1	8.1
Public Health Revenues	17.1	9.4	9.7
Transfers In	(3.3)	1.7	1.7
Estimated State Revenue Losses	(100.0)	0.0	0.0
Redevelopment Property Tax Increment Required Growth	(5.4)	(4.9)	(0.2)
Subtotal, Revenues & Transfers In	**(140.2)**	**84.0**	**101.6**
Uses - Salaries and Benefits			
Annualize Partial-Year Positions	(4.9)	0.0	0.0
Annualize Previous Year MOU Provisions	(11.3)	0.0	0.0
Change in Work Days	(3.6)	3.6	0.0
Health and Dental Rates	(12.1)	(20.4)	(21.3)
MOU Costs, Known - Nurses (net)	(5.4)	(13.2)	(5.3)
Pension - PERS^ Contribution Rate Changes - Employer Cost	(0.7)	(5.8)	(2.2)
Pension - SFERS^^ Contribution Rate Changes - Employer Cost	0.0	(28.6)	(45.3)
Restore City-Paid Retirement and 1% COLA	(22.5)	0.0	0.0
Use of Prior Year MOU Reserve Savings	(11.4)	0.0	0.0
Subtotal, Salaries and Benefits	**(71.9)**	**(64.4)**	**(74.1)**
Uses - Other Non-Salary			
Baseline Requirements	4.3	(7.5)	(8.6)
Children's Fund Shift	(4.1)	0.0	0.0
Debt Service Requirements, including Lease Financing Costs*	(0.9)	(6.2)	0.5
Equipment Program ($10.0 million cash program per year)*	(1.1)	0.0	0.0
Systems Projects	1.6	0.0	0.0
Worker's Compensation	(4.5)	(4.4)	(3.9)
Departments & Commissions			
Asian Art Museum - Full Year of Operation, Non-Salary Only	(0.5)	0.0	0.0
Elections Department	(4.0)	4.0	(4.0)
Entertainment Commission	(0.7)	0.0	0.0
Ethics - Public Financing of Supervisorial Elections (Prop O)	1.0	(1.0)	1.0
Human Resources - MOU Negotiations Costs	1.9	(1.9)	1.9
Human Services - Aid Payments Growth	(3.0)	(11.4)	(11.9)
Public Health - Net Expenditure Growth	(1.1)	0.0	0.0
Subtotal, Other Non-Salary	**(11.2)**	**(28.5)**	**(25.0)**
Projected Surplus / (Shortfall)	**($347.2)**	**($11.3)**	**$2.5**

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 above.

SOURCES - Fund Balance & Prior Year Reserves

We are projecting a $123.9 million decrease in the FY 2002-03 year-end balance that will be available as a source of funds for the FY 2003-04 budget. This loss is attributable to the following:

- **Prior Year Fund Balance.** The FY 2002-03 budget was balanced with $124.1 million from the FY 2001-02 fund balance. The projected year-end fund balance for FY 2002-03 is currently estimated to be $29.4 million. Therefore we will be starting the FY 2003-04 with $94.7 million less than was available when we started FY 2002-03. This amount reflects several changes for a net amount of $1.6 million less than the $31.0 million estimated in the Controller's Six-Month Report, which was issued on February 11. These changes are as follows:

    - An improvement of $25.0 million in additional departmental savings and project closeouts. In the Six-Month Report, the Controller noted that the Mayor had issued instructions to departments to reduce spending or cut capital budgets. We now estimate that $25.0 million in such savings will be achieved.

    - However, these expenditure reductions are more than offset by additional net revenue losses totaling $26.6 million. Business/Payroll Tax collections in late February and early March were $16.0 million less than expected. Also, we have reduced Sales Tax, Hotel Room Tax, the Airport Service Payment and various other projections for a net $10.6 million loss under the assumption that there will be no economic recovery this fiscal year.

Closure of Reserves from Prior Years. The FY 2002-03 budget was balanced using prior year reserves totaling $49.2 million, primarily from a redefinition of the cash reserve requirement, which provided a $37.1 million one-time funding source. However, only $20.0 million in prior year reserves is projected to be available to fund the FY 2003-04 budget, which is a $29.2 million decrease.

SOURCES - Revenues and Transfers In

The weak economy, which put downward pressure on FY 2002-03 revenues, has resulted in a lower starting base for FY 2003-04 revenues. 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, which are detailed separately in Table B and the narrative below.

- **General Revenues.**

Taxes & Recurring Revenues. The estimate of a $18.0 million reduction for FY 2003-04 assumes revenue growth from the FY 2002-03 projected year-end actuals of between 0.0 percent for Property Taxes, which we anticipate will be affected by a large backlog of assessment appeals, to 8.0 percent for Real Property Transfer Taxes, as shown in Attachments 1 and 2. However, this projection still results in revenues that are less than the FY 2002-03 budgeted level. Some of the projected growth is due to one-time revenue adjustments including the elimination of the New Jobs Tax Credit for Payroll Taxes, which expired at the end of 2002. FY 2004-05 and FY 2005-06 revenues are projected to grow 3.5 percent or $69.8 million and 3.9 percent or $82.3 million respectively from the prior year projection. However, this growth is more than offset by other revenue decreases.

One-Time Revenues. The FY 2002-03 budget was also balanced using one-time revenues. These are not projected to be available in FY 2003-04, thereby creating a $33.5 million loss. These one-time revenues include the following:

One-Time Revenues Budgeted In FY 2002-03	**US$ Millions**	
Sale of Property to the Redevelopment Agency	$	13.4
Repayment to the General Fund for Juvenile Hall Costs	$	12.0
Sale of Fire Department Property - Station One	$	3.0
One-Time Doubling of SCAP Subventions for Sheriff's Dept.	$	1.4
Gift from Opera for Children's Programs	$	1.0
Sale of Police Department Property - Potrero Station	$	1.0
SF CTA Paying Overhead Charges	$	0.9
Sale of Police Equipment - Helicopter	$	0.5
Sale of Property - Turk Parcel	$	0.2
TOTAL One-Time Revenues	**$**	**33.5**

- **Human Services Revenue.** The Department of Human Services (DHS) receives about two-thirds of its funding from the State and Federal governments. This report assumes caseload growth costs that will generate revenue from the State and Federal governments estimated to be $2.8 million in FY 2003-04, and $8.1 million in both FY 2004-05 and FY 2005-06.

- **Public Health Revenue Growth.** The Department of Public Health is projected to have $17.1 million in revenue growth over its current year budget. This includes:

  - a $13.4 million increase at San Francisco General Hospital, reflecting adjustments to MediCal and Medicare reimbursement and program enhancements in Trauma services, Outpatient Dialysis and expansion of Urgent Care,

  - a $2.4 million increase at Laguna Honda Hospital, reflecting increased Federal MediCal reimbursement rates for skilled nursing facilities and increased ancillary charges,

  - a $0.8 million increase in mental health revenues, and

  - a $0.5 million increase in various other revenues.

- **Transfers-In.** Transfers-In are projected to be $3.3 million less in FY 2003-04. These changes are explained by the following:

  Airport-Transfer In. The General Fund receives an Annual Service Payment from San Francisco International Airport based on concession revenues. Given the dramatic reduction in air travel since 2000 the Airport transfer to the General Fund is projected to be $1.9 million less than budgeted in FY 2002-03. From that reduced base, we are projecting concession revenue growth of 3.4 percent in FY 2003-04, 8.0 percent in FY 2004-05, and 7.5 percent in FY 2005-06. The Airport Transfer In, however, is also impacted by the level of payment from the Airport to the General Fund related to retirement costs for Airport personnel in the State's PERS system. The FY 2002-03 budget included an additional $3.0 million one-time payment in addition to the recurring annual payment of $1.3 million. This projection assumes that for FY 2003-04 and thereafter the PERS payment will be the $1.3 million annually recurring amount only. The net impact on the Airport transfer to the General Fund is a decrease of $4.3 million in FY 2003-04.

  Hetch Hetchy Transfer In. No transfer from Hetch Hetchy is assumed in this report.

  Other Transfers In. Other transfers in are projected to be $1.0 million greater in FY 2003-04 than in FY 2002-03 as a result of using additional 911 fees to cover costs currently budgeted for the Emergency Communication Department in the General Fund.

- **Estimated State Revenue Losses.** Given the likelihood for another delayed State budget adoption and heightened uncertainty with State-funded revenue sources, our projection assumes a $100.0 million loss in revenues from the State in FY 2003-04. This is equal to the estimated annual amount of cuts the Governor proposed in January 2003.

- **Redevelopment Tax Increment Requirement.** Tax increment funding allocated to the Redevelopment Agency reduces Property Tax revenue to the General Fund. The FY 2002-03 budget was based upon an assumed gross tax increment of $43.5 million accruing to the Redevelopment Agency. Our projection includes growth in Redevelopment tax increment funding of $5.4 million in FY 2003-04, $4.9 million in FY 2004-05 and $0.2 million in FY 2005-06 to fund the Agency's projected issuance of additional bonded indebtedness. Without this increase in funding for the Redevelopment Agency, the property tax increment included here would have accrued to the General Fund.

USES – Salaries and Benefits

We are projecting increased labor costs of $71.9 million in FY 2003-04, followed by increases of $64.4 million in FY 2004-05 and $74.1 million in FY 2005-06. 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. With the exception of the recently approved nurses MOU, no other labor contracts extend beyond the end of FY 2002-03. **Our projections for FY 2003-04, FY 2004-05 and FY 2005-06 do not include unknown MOU costs. To the extent that any unknown MOUs provide salary and benefit increases over the next three fiscal years, the projected shortfalls in FY 2003-04 and FY 2004-05 will increase, and the projected surplus in FY 2005-06 will decrease.**

- **Annualization of Partial-Year Positions.** In FY 2003-04, the City will incur additional costs to annualize new positions added to the FY 2002-03 budget. Since most of the new positions were funded for only three-quarters of a year, an additional $4.9 million in General Fund expenditures will be needed in FY 2003-04 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 2002-03 will result in $11.3 million in additional General Fund cost in FY 2003-04.

- **Change in Work Days.** FY 2003-04 has 262 workdays, compared to 261 for FY 2002-03. FY 2004-05 and FY 2005-06 both have 261 workdays. As a result, the City's General Fund will pay an estimated $3.6 million more in FY 2003-04 for salary and benefits as compared to FY 2002-03. There will be a savings in FY 2004-05 of $3.6 million due to one less workday in that fiscal year.

- **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 a 13.9 percent increase in the Charter-required contribution resulting in a $20.1 million increase in General Fund costs for FY 2003-04. The $20.1 million was offset by $8.0 million in one-time savings resulting from Health Service Board actions as of March 13, 2003. Our projections for FY 2004-05 and FY 2005-06 are based on 13.0 percent increases each year and amount to $20.4 million and $21.3 million, respectively.

- **MOU Costs – Known – Nurses (net).** In February, the Board of Supervisors approved the MOUs with the nurses. The additional costs associated with the cost of living increases and the market rate adjustments in order to make the City more competitive with respect to attracting and retaining nurses is $5.4 million in FY 2003-04, $13.2 million in FY 2004-05, and $5.3 million in FY 2005-06.

- **Pension - PERS Contribution Rate Changes – Employer-Share Only.** The California Public Employees' Retirement System (PERS) has notified the City that the employer contribution rates for employees covered by PERS Safety will increase from 5.43 percent in FY 2002-03 to 6.43 percent in FY 2003-04 and 14.80 percent in FY 2004-05. We have also included an estimated 18.00 percent rate for FY 2005-06. These contribution rate increases result in additional costs of $0.7 million in FY 2003-04, $5.8 million in FY 2004-05, $2.2 million in FY 2005-06. The significant contribution rate increase is due primarily to weakness in investment returns.

- **Pension - SFERS Contribution Rate Changes – Employer-Share Only.** After eight years of not having to make an "employer-share" contribution to the City's Retirement System, investment losses over the past several years will require the City to start making contributions in FY 2004-05. Based on the actuarial analysis done by the San Francisco Employees' Retirement System (SFERS), we are projecting that employer (City-paid) contribution rates for employees covered by SFERS will increase from 0.00 percent in FY 2003-04 to 2.40 percent in FY 2004-05, then 6.20 percent in FY 2005-06. 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 $28.6 million in FY 2004-05 and $45.3 million in FY 2005-06.

- **Restore 2.75% City-Paid Retirement and 1% COLA For Participating Bargaining Units.** The majority of bargaining units agreed to a one percent cost of living adjustment in FY 2003-04 in exchange for the their members paying 2.75 percent toward their retirement during FY 2002-03, thereby reducing the City's retirement pickup of employee-share costs by a like amount in FY 2002-03. The additional cost for restoring the 2.75 percent of City-paid retirement and the one percent COLA for employees of those affected bargaining units is $22.5 million in FY 2003-04.

- **Use of Prior Year MOU Reserve Savings.** In order to help balance the budget in FY 2002-03, the unexpended portion of the MOU reserve for FY 2001-02 was carried over to FY 2002-03 to fund MOU costs. This one-time $11.4 million carry forward will not exist at the end of FY 2002-03 to fund MOU costs in FY 2003-04.

USES – Other Non-Salary

We project other expenditure increases of $7.2 million in FY 2003-04, $32.5 million in FY 2004-05 and $21.0 million in FY 2005-06. These projections reflect 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 decrease by an estimated $4.3 million in FY 2003-04, followed by increased expenditures of $7.5 million in FY 2004-05 and $8.6 million in FY 2005-06. Changes in the Children's Baseline level is not included in these projections as that baseline is already $7.8 million above the required level of funding in the FY 2002-03 Budget.

- **Capital & Facilities Maintenance.** The FY 2002-03 budget includes $20.0 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, consistent with the typical level of funding in prior years, so no savings or additional costs are assumed in FY 2003-04 and thereafter.

- **Children's Fund Shift.** The FY 2002-03 budget used an accumulated fund balance of $4.1 million in the Children's Fund to reduce General Fund costs for various programs. Given the one-time nature of this source, continued provision of these services will require a restoration of $4.1 million from the General Fund in FY 2003-04.

- **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 additional debt service costs are projected to be $0.9 million in FY 2003-04 and $6.2 million in FY 2004-05. FY 2005-06 will have savings of $0.5 million due to the retirement equipment debt from prior years.

- **Equipment Program.** The FY 2002-03 original budget included cash expenditure of $8.9 million for equipment acquisition. We have assumed for our projection that the City will return to its past practice of purchasing $10 million of equipment with cash. This results in additional costs of $1.1 million in FY 2003-04.

- **Systems Project.** The FY 2002-03 budget included $1.6 million in one-time systems costs. These are not assumed for FY 2003-04, resulting in savings of $1.6 million.

- **Worker's Compensation Costs.** The passage of AB749 results in increases in most classes of workers' compensation benefits. Over the four-year phase-in period, the projected cost increases resulting from AB749 are estimated to total 22.8 percent, including both increased benefit levels and the projected growth in the number of claims. The projected impact of AB749 for the City is incremental costs of 7.4 percent or $2.5 million for FY 2003-04. Additionally, assuming 6.0 percent medical inflation, an estimated $2.0 million over the FY 2002-03 budget is needed for a total of $4.5 million in additional need in FY 2003-04. For FY 2004-05 and FY 2005-06, our projection assumed growth of 5.7 percent (an increase of

$4.4 million) and 3.2 percent ($3.9 million), respectively, for both benefit and utilization levels (i.e., the number of claims) resulting from the continued phasing in of AB749 as well as medical inflation of 6.0 percent in each year.

Departmental Expenditures

- **Asian Art Museum Operations.** With the opening of the new Asian Art Museum, we estimate that the General Fund contribution to this department will increase by $0.5 million in FY 2003-04 to fund a full year of operation.

- **Elections Department.** FY 2003-04 and FY 2005-06 will have two elections and the possibility of runoffs in December, this will result in $4.0 million in additional costs in each year. FY 2004-05 will have only one election, so $4.0 million of projected savings is included. We have not included the potential fiscal impact of implementing touch-screen and ranked-choice (i.e., Instant Runoff) voting technologies since related costs have not yet been fully determined at this time.

- **Entertainment Commission.** FY 2003-04 will be the first year of the Entertainment Commission. This will result in revenues generated from related permit and license fees being budgeted to cover costs for the new Entertainment Commission. Such revenues were formerly budgeted in Police and the Office of the Treasurer / Tax Collector. In FY 2002-03, permit fees budgeted in the Police Department were $251,970, and license fees budgeted in the Office of the Treasurer/Tax Collector were $451,000 for a total of $702,970. Our projection assumes that this will create a shortfall or need for additional General Fund support to backfill those revenues in the Police and Treasurer / Tax Collector departments in the amount of $0.7 million in FY 2003-04, unless administrative reorganizations are implemented to achieve savings.

- **Ethics Commission - Public Financing of Supervisorial Elections.** Proposition O, approved in November 2001, creates a publicly financed election program for supervisorial candidates starting in November 2002. The Ethics Commission has approved a budget for FY 2002-03 of $1.3 million for this purpose. Of this total, $0.3 million is staff costs that will recur. Our projection assumes savings in FY 2003-04 of $1.0 million as such expenditures will not be required since there are no supervisorial elections scheduled for 2003, followed by an increase of $1.0 million in FY 2004-05 for the November 2004 election. FY 2005-06 assumes a $1.0 million level of savings since no supervisorial elections are scheduled for 2005.

- **Human Resources Department – Labor Negotiations Expenditures.** The Human Resources Department budget included an additional $1.9 million for increased costs for Employee Relations due to MOU negotiations in FY 2002-03. Assuming a two-year negotiations cycle, this will result in savings of $1.9 in FY 2003-04, increased expenditures of $1.9 million in FY 2004-05, then savings of $1.9 million again in FY 2005-06.

- **Human Services Department Expenditures.** The Human Services Department is projecting increased aid payment costs in FY 2003-04 of $3.0 million, of $11.4 million in FY 2004-05 and $11.9 million in FY 2005-06. These increased costs are based upon the department's current projection of caseload increases and costs over the coming fiscal year. These projected increases are, however, substantially offset by revenues as noted in the Human Services Revenue paragraph on page 6.

- **Public Health Expenditures.** The Department of Public Health is projected to have a net $1.1 million increase in costs for FY 2003-04. This increase represents the net result of $19.9 million in increased costs of operations offset by $18.8 million in reductions of program costs resulting from reprogramming services in behavioral health, skilled nursing, housing and hospital services. It should be noted that expenditure estimates for the Department of Public Health assume service delivery changes that have been included in the Department's submission of its FY 2003-04 budget.

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 revenues 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. We note however, that proposed fee increases for the Recreation and Park Department, Parking Fine increases and Parking Meter increases are currently pending before the Board of Supervisors.

- **Elections.** While two elections are scheduled for FY 2003-04, it is really not possible to predict the likelihood that a run-off election will be required. Additionally, the potential fiscal impact of implementing touch-screen and ranked-choice voting technologies has not yet been fully determined at this time.

- **Litigation Reserves.** Each year the City is exposed to various risks related to lawsuits. We have assumed a level budget of $5.5 million for annually budgeted litigation reserves, an amount comparable to the current fiscal year.

- **MOU Costs – Unknown – All Other Bargaining Units, except Nurses.** As previously noted, this report assumes no MOU increases, other than the MOU already approved for Nurses, for the three years of this projection All other bargaining units, except nurses, have contracts set to expire at the end of FY 2002-03. While not included in Table A or B above, for informational purposes, every one percent increase in salaries alone would cost the

General Fund $12.0 million per year. Fringe benefits, premium pay and other salary related expenses would cost an additional $2.0 million per year for a total of $14.0 million.

- **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 economic slowdown, our projections make no assumption regarding the net financial impact of these projects, which include Mission Bay, Bloomingdales, and the conveyance and development of Treasure Island.

- **Non-Salary Inflation.** While not included in Table A or B above, we have calculated projected costs assuming they were to approximate general inflationary increases. This projection methodology would result in a $17.7 million increase in General Fund expenditures in FY 2003-04, $20.5 million in FY 2004-05, and $22.2 million in FY 2005-06. As with Unknown MOU Costs outlined above, these non-salary inflation cost estimates are based on the consumer price index (CPI) projections from the California Department of Finance for the subsequent three fiscal years.

- **Pending Legislation – Proposed Revenue Increases.** A number of proposed fee, fine, and meter increases are currently pending before the Board, including parking citations, MUNI fares, and parking meter rates. These proposed increases have not been assumed in our projections. Depending on the specific increase proposed, the General Fund might be impacted favorably by legislative approval. For example, the proposed increase in parking ticket and late fines would result in new revenue of approximately $10 million, because the General Fund's required baseline contribution to MUNI would decrease.

- **State and Federal Budget Changes.** We note that the State's reported shortfall is likely between $29 and $35 billion for FY 2003-04, depending on which assumptions are used. 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 with certainty at this time. The estimated amount of annual cuts included in the Governor's FY 2003-04 Proposed Budget in January 2003 totaled $100 million. This amount has been included as a loss of State revenue for FY 2003-04. A great degree of uncertainty still exists given legislative delays in moving forward on the Governor's mid-year reductions or even the Governor's FY 2003-04 Proposed Budget. Additionally, the proposed Realignment II included in the Governor's FY 2003-04 Proposed Budget is cause for significant uncertainty for San Francisco as projected funding growth will likely be lower than caseload and expenditure growth.

SUMMARY

Assuming no unknown MOU (wage) increases or non-salary inflation increases, we project a $347.2 million shortfall for FY 2003-04. This assumes we continue to provide the current level of services (with the exception of Public Health where the financial savings associated with their proposed behavioral health reprogramming is included), continue to maintain a $27.0 million General Fund reserve and provide for a $20 million capital improvement and facilities maintenance program. Our projected budget shortfall for FY 2004-05 is $11.3 million, followed by a projected surplus of $2.5 million in FY 2005-06. 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.

Admittedly, this year presents us with a number of key risks and areas of heightened uncertainty that are of particular concern. These include:

The Economic Impact of the War With Iraq
Timing and Pace of the Economic Recovery
Key Revenue Uncertainty, related to the timing of an economic recovery, which we have assumed starts by June 2003, including

- Property Tax Appeals,
- Business Taxes & Tax Credit Impact,
- Sales Taxes, and
- Hotel Taxes

State Budget Crisis

- Budget Reductions
- Realignment II's Impact

Federal Budget Policy
The Results of MOU 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	Edward Harrington	Harvey M. Rose
Budget Director	Controller	Budget Analyst
Mayor’s Office		Board of Supervisors

Attachment 1: General Fund Revenues, FY 2003-04 to FY 2005-06
Attachment 2: General Fund Revenue Growth Rates, FY 2003-04 to FY 2005-06

cc: Gloria Young, Clerk of the Board

<u>ATTACHMENT #1</u>: SOURCES OF FUNDING

Summary of Revenues & Transfers In

GENERAL FUND	FY 2001-02 ACTUALS	FY 2002-03 REVISED BUDGET	FY 2002-03 6-MONTH PROJECTION	FY 2002-03 JOINT REPORT PROJECTION	FY 2003-04 PROJECTION	FY 2004-05 PROJECTION	FY 2005-06 PROJECTION
Property Taxes	$ 510.0	$ 513.3	$ 521.3	$ 521.3	$ 521.3	$ 542.1	$ 569.2
Business Taxes	274.1	282.1	279.6	263.2	283.8	293.7	303.9
Sales Tax	111.3	130.5	120.0	117.8	124.9	132.4	139.0
Hotel Room Tax	72.3	97.1	84.1	78.3	82.6	90.9	100.0
Utility Users Tax	70.8	78.2	71.0	69.9	72.0	74.5	77.1
Parking Tax	30.5	34.4	31.1	31.1	32.7	34.3	36.0
Real Property Transfer Tax	47.3	45.2	52.0	52.0	56.2	61.2	67.3
Admission Tax	2.3	2.6	2.6	2.6	2.7	2.7	2.7
Licenses, Permits & Franchises	19.5	17.0	18.1	18.1	18.5	19.1	19.7
Fines, Forfeitures & Penalties	8.6	4.5	7.2	7.5	4.8	4.8	4.8
Interest & Investment Income	30.0	17.2	18.8	17.8	12.5	12.6	12.8
Rents & Concessions	17.6	17.8	17.4	17.4	18.3	19.3	20.3
Subtotal	**1,194.2**	**1,239.9**	**1,223.3**	**1,197.0**	**1,230.1**	**1,287.5**	**1,352.7**
Federal Subventions	150.4	145.5	145.5	145.5	145.5	145.5	145.5
State Subventions							
Social Service Subventions	124.7	139.4	133.9	133.9	133.9	133.9	133.9
Health & Welfare Realignment	127.5	127.7	127.7	127.7	131.5	136.8	143.6
Health/Mental Health Subventions	64.2	68.9	68.9	68.9	68.9	68.9	68.9
Public Safety Sales Tax	71.0	71.9	62.4	63.7	65.3	67.9	71.3
Motor Vehicle In-Lieu (County & City)	102.8	105.6	105.6	107.2	112.6	116.0	121.8
Other Grants & Subventions	20.9	28.5	27.9	27.9	26.5	26.5	26.5
Total State Subventions	**511.0**	**542.0**	**526.4**	**529.3**	**538.7**	**549.9**	**566.0**
CHARGES FOR SERVICES							
General Government Service Charges	18.5	20.9	21.1	21.0	20.5	20.9	21.3
Public Safety Service Charges	15.4	16.0	12.0	12.0	12.1	12.2	12.4
Recreation Charges - Rec/Park	9.4	5.8	4.9	4.9	5.4	5.6	5.9
MediCal, MediCare & Health Svc. Chgs.	43.5	42.4	42.4	42.4	42.4	42.4	42.4
Other Service Charges	4.8	6.4	6.4	6.4	6.4	6.4	6.4
Total Charges for Services	**91.7**	**91.5**	**86.8**	**86.7**	**86.8**	**87.6**	**88.4**
Recoveries of General Government Costs	11.0	9.7	10.6	10.6	8.6	8.9	9.2
Other Revenues	1.5	37.7	36.6	36.2	5.1	5.1	5.1
TOTAL REVENUES	**1,959.9**	**2,066.2**	**2,029.3**	**2,005.4**	**2,014.8**	**2,084.6**	**2,166.9**
TRANSFERS INTO GENERAL FUND:							
Airport	19.1	25.6	24.8	23.7	21.3	23.0	24.8
Hetch Hetchy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Transfers	86.0	105.2	106.2	106.2	106.2	106.2	106.2
Total Transfers-In	**105.1**	**130.7**	**130.9**	**129.8**	**127.5**	**129.2**	**130.9**
TOTAL GENERAL FUND RESOURCES	**$ 2,065.0**	**$ 2,197.0**	**$ 2,160.2**	**$ 2,135.2**	**$ 2,142.3**	**$ 2,213.8**	**$ 2,297.8**
$ Change from Prior Year Revised Budget (PY Projection for Latter Two Years)					**$ (54.7)**	**$ 71.5**	**$ 84.0**
% Change from Prior Year Revised Budget (PY Projection for Latter Two Years)					***-2.5%***	***3.3%***	***3.8%***

ATTACHMENT #2: GROWTH IN SOURCES OF FUNDING…

Summary of Revenues & Transfers In Growth

	… FROM FY 2002-03 REVISED BUDGET			...FROM JOINT REPORT PROJECTION		
	FY 2003-04	FY 2004-05	FY 2005-06	FY 2003-04	FY 2004-05	FY 2005-06
GENERAL FUND	% Chg from FY 2002-03 Revised Budget	% Chg from FY 2003-04 Projection	% Chg from FY 2004-05 Projection	% Chg from Joint Report Projection	% Chg from FY 2003-04 Projection	% Chg from FY 2004-05 Projection
Property Taxes	1.6%	4.0%	5.0%	0.0%	4.0%	5.0%
Business Taxes	0.6%	3.5%	3.5%	7.8%	3.5%	3.5%
Sales Tax	-4.3%	6.0%	5.0%	6.0%	6.0%	5.0%
Hotel Room Tax	-14.9%	10.0%	10.0%	5.5%	10.0%	10.0%
Utility Users Tax	-8.0%	3.5%	3.5%	3.0%	3.5%	3.5%
Parking Tax	-4.9%	5.0%	5.0%	5.0%	5.0%	5.0%
Real Property Transfer Tax	24.4%	9.0%	10.0%	8.0%	9.0%	10.0%
Admission Tax	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Licenses, Permits & Franchises	9.1%	3.0%	3.0%	2.4%	3.0%	3.0%
Fines, Forfeitures & Penalties	6.4%	0.0%	0.0%	-36.5%	0.0%	0.0%
Interest & Investment Income	-27.4%	1.0%	1.0%	-29.9%	1.0%	1.0%
Rents & Concessions	2.4%	5.7%	5.0%	5.0%	5.7%	5.0%
Subtotal	**-0.8%**	**4.7%**	**5.1%**	**2.8%**	**4.7%**	**5.1%**
Federal Subventions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
State Subventions						
Social Service Subventions	-4.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Health & Welfare Realignment	3.0%	4.0%	5.0%	3.0%	4.0%	5.0%
Health/Mental Health Subventions	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Public Safety Sales Tax	-9.1%	4.0%	5.0%	2.5%	4.0%	5.0%
Motor Vehicle In-Lieu (County & City)	6.6%	3.0%	5.0%	5.0%	3.0%	5.0%
Other Grants & Subventions	-6.9%	0.0%	0.0%	-5.0%	0.0%	0.0%
Total State Subventions	**-0.6%**	**2.1%**	**2.9%**	**1.8%**	**2.1%**	**2.9%**
CHARGES FOR SERVICES						
General Government Service Charges	-1.9%	2.0%	2.0%	-2.4%	2.0%	2.0%
Public Safety Service Charges	-24.2%	1.0%	1.0%	1.0%	1.0%	1.0%
Recreation Charges - Rec/Park	-7.8%	5.0%	5.0%	9.2%	5.0%	5.0%
MediCal, MediCare & Health Svc. Chgs.	0.0%	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%
Total Charges for Services	**-5.1%**	**0.9%**	**0.9%**	**0.1%**	**0.9%**	**0.9%**
Recoveries of General Government Costs	-11.0%	3.0%	3.0%	-18.6%	3.0%	3.0%
Other Revenues	-86.5%	0.0%	0.0%	-86.0%	0.0%	0.0%
TOTAL REVENUES	**-2.5%**	**3.5%**	**3.9%**	**0.5%**	**3.5%**	**3.9%**
TRANSFERS INTO GENERAL FUND:						
Airport	-16.6%	8.0%	7.5%	-9.9%	8.0%	7.5%
Hetch Hetchy	n/a	n/a	n/a	n/a	n/a	n/a
Other Transfers	1.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Transfers-In	**-2.5%**	**1.3%**	**1.3%**	**-1.8%**	**1.3%**	**1.3%**
TOTAL GENERAL FUND RESOURCES	**-2.5%**	**3.3%**	**3.8%**	**0.3%**	**3.3%**	**3.8%**