Budget Outlook & Department Instructions

December 2018

Agenda

- New Revenue Overview
- Five-Year Financial Plan
- Fiscal Outlook - Looking Forward
- Budget Instructions for Departments

Summary

- In the short-term, fiscal picture is similar to last year
- Cost pressures – near-term & uncertainty
  - Near-term pressures:
    - Growing employee costs, particularly pension costs
    - IHSS cost shift from state
    - Large number of baselines and set-asides
  - Uncertainty related to:
    - Labor negotiations
    - SF Housing Authority financial obligations
    - Recession risks
    - Potential budgetary and legislative changes from state and federal government
- ERAF windfall: One-time unexpected revenue recognized in FY 2018-19. Due to significant risks, we cannot assume availability as ongoing source.

Summary

- Need to continue responsible fiscal policies:
  - Build our reserves
  - Limit on-going cost growth
  - Fund strategic one-time investments
  - “Make every dollar count”

Summary

- Instructions to Departments:
  - Focus on accountability and equitable outcomes
  - Mandated departmental sustainability and efficiency proposals of 2% reduction in adjusted general fund support (growing to 4% in second year)
    - 1% contingency proposals (growing to 2% in second year)
  - Reprioritize funding and positions within departmental budget for “highest & best use”
  - New positions may be considered that align with the Mayor’s priorities

Summary: Mayoral Priorities

- Get things done to:
  - Build more housing
  - Reduce homelessness – housing & shelter
  - Address behavioral health needs
  - Clean up our streets and make them safer
  - Create equitable opportunities for everyone
  - Make government more accountable

Five-Year Financial Plan

ERAF "Windfall" – Not in the 5-Year Deficit

	FY 18-19
Excess ERAF	
FY 17-18	208
FY 18-19	207
	415
Baselines	
MTA	(38)
Schools	(9)
OECE	(4)
Children's Baseline	(15)
Library	(9)
Street Tree Maintenance	(2)
	(78)
Reserve Deposits	
City	(130)
Schools	(26)
	(156)
Net Available	181

- Mayor's focus on homelessness, behavioral health, and affordable housing
- Legislative risk is cause for uncertainty
- One-time investments or short-term funding commitments that serve as a bridge to more sustainable funding sources

- **Current year excess ERAF not included in deficit projections due to this uncertainty**

Five-Year Financial Plan – Assumptions

- “Base case” projection
- Revenue
  - Continued strong revenue growth
- Salary and Benefits
  - Benefit cost increases – pension and health
  - Inflation increase on personnel (average of Moody’s & CA DOF)
- Citywide Costs
  - IHSS cost increases from the State
  - Debt and capital expenditures
  - Inflation on non-personnel (including grants for nonprofits)

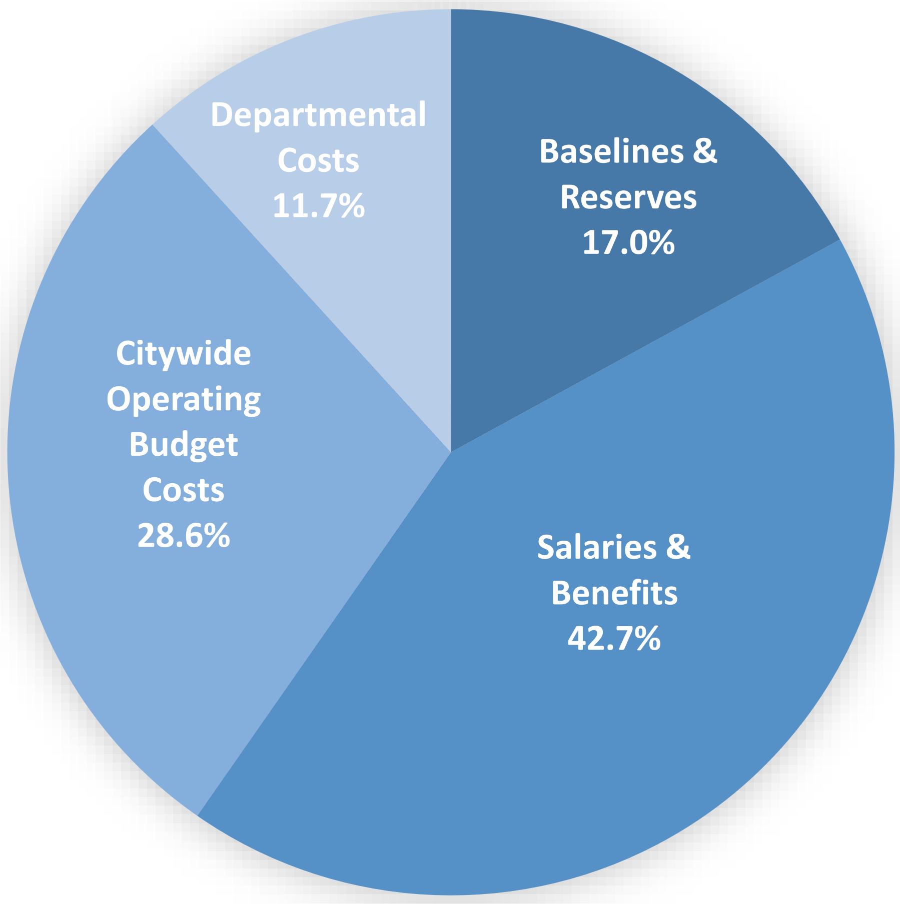
Five-Year Financial Plan Projection

	FY 19-20	FY 20-21	FY 21-22	FY 22-23	FY 23-24	% of Uses
SOURCES Increase / (Decrease)	**182.0**	**466.0**	**527.1**	**630.0**	**758.7**	
Uses						
Baselines & Reserves	(55.3)	(99.1)	(149.3)	(179.4)	(238.9)	17.0%
Salaries & Benefits	(180.7)	(317.9)	(421.9)	(529.2)	(598.4)	42.7%
Citywide Operating Budget Costs	(55.1)	(182.5)	(236.0)	(319.0)	(400.6)	28.6%
Departmental Costs	1.8	(29.9)	(82.7)	(122.4)	(164.8)	11.7%
USES (Increase) / Decrease	**(289.4)**	**(629.4)**	**(890.0)**	**(1,149.9)**	**(1,402.7)**	100.0%
Projected Cumulative Surplus / (Shortfall)	**(107.4)**	**(163.4)**	**(362.9)**	**(519.9)**	**(643.9)**	

Approx. $270.8 million for the upcoming two-year budget. Mayor must introduce a balanced budget each year.

Five-Year Financial Plan - Projected Expenditure Growth

- Total projected expenditure growth over the four year period is $1.4 billion
- The salaries and benefits section is driven by inflation on wages, and pension and health cost increases
- For Citywide operating costs, 40% of this growth is inflation on non-personnel & grants to nonprofits
- For baselines and set asides, MTA and the Children's Fund/PEEF make up 66% of the growth
- For Departmental costs, 57% of the growth is related to the IHSS cost shift from the state

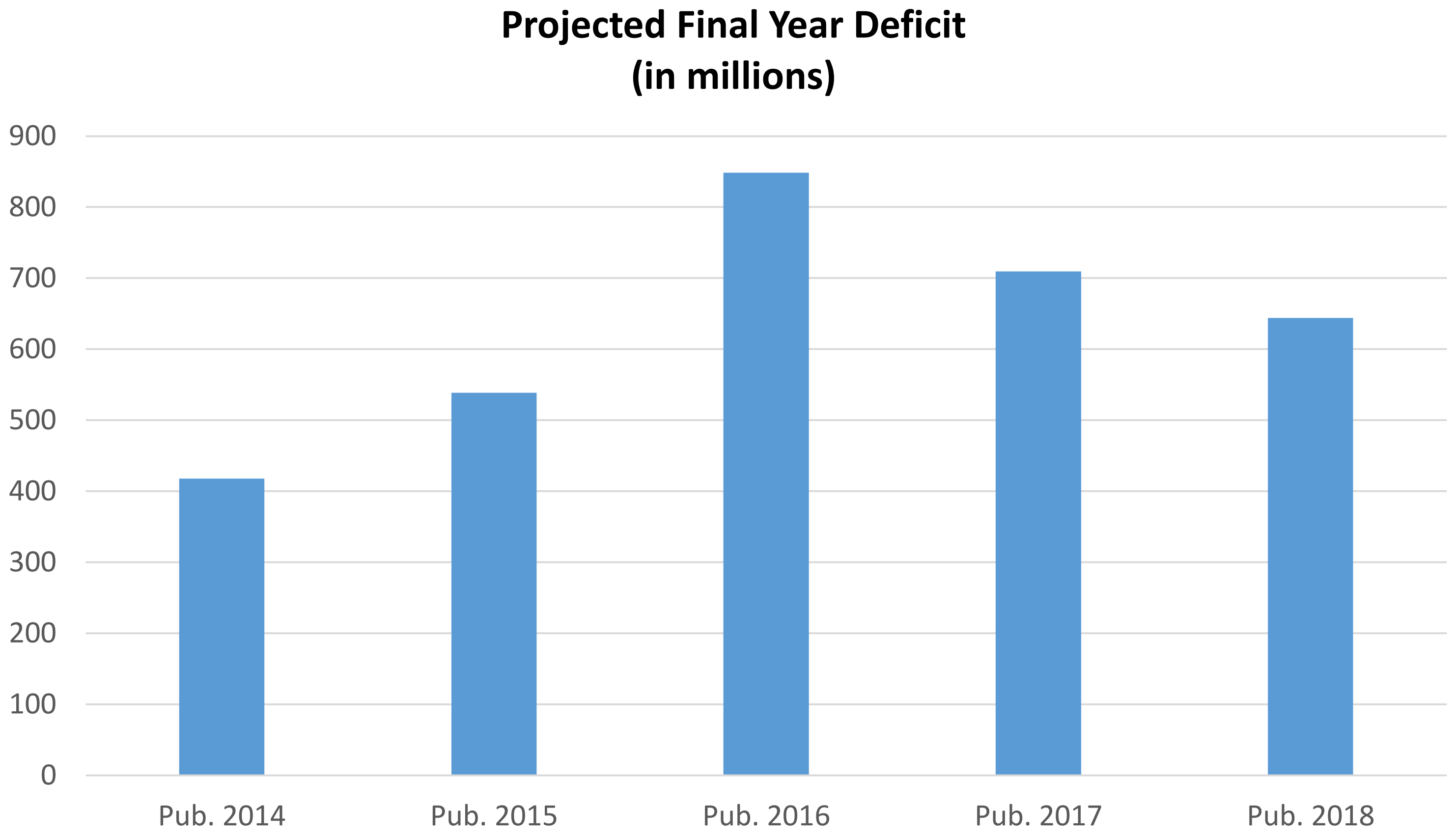


Fiscal Outlook

Near-term cost pressures

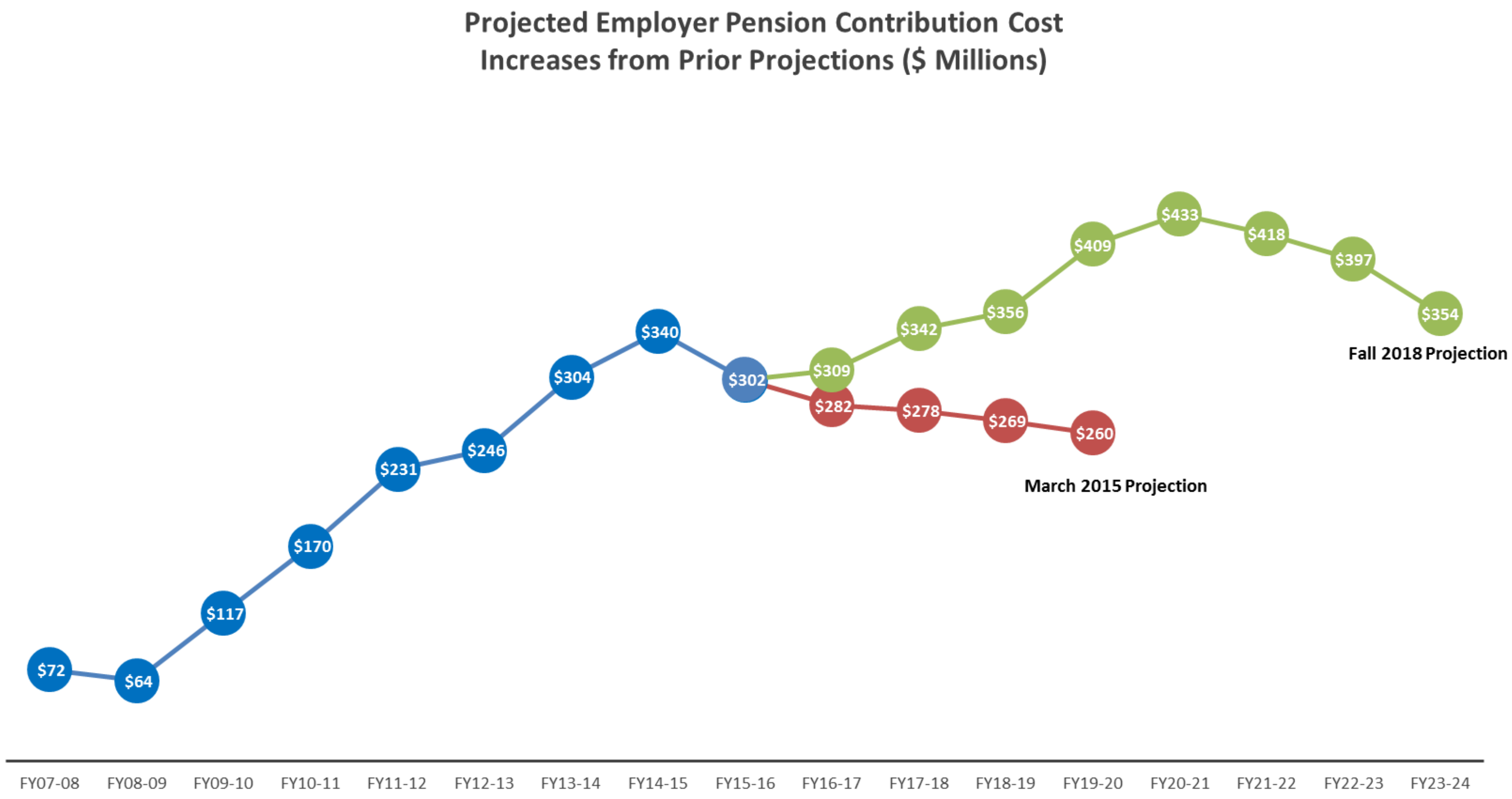
Future risks / Uncertainty

Structural Long-term Deficit



- Long-term deficit is higher than post-recession recovery levels
- Strong revenue is the largest driver of the reduction in the structural deficit in last two years

Looking Forward – Employee Pension Cost Growth



Note: FY07-08 to FY18-19 figures were budgeted pension costs

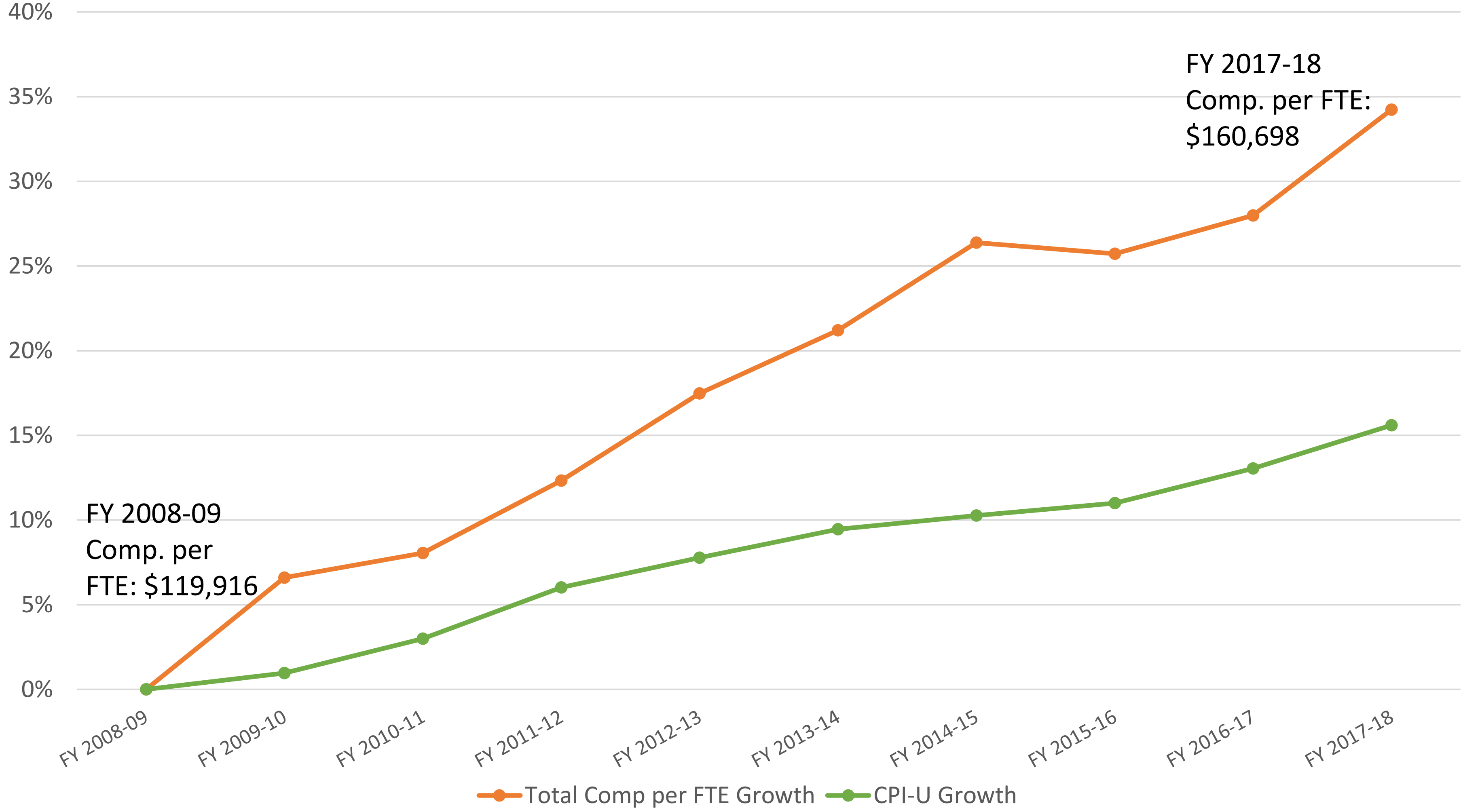
- Pension obligations have increased nearly 6-fold between FY 2007-08 and FY 2019-20
- Major cost drivers:
  - Fall 2018 discount rate change
  - Past poor market performance
  - Changes in retiree longevity
  - Supplemental COLAs (2014, 2017, 2018)

Rising Employee Costs - Salaries

- Spring 2019 labor negotiations
  - For “miscellaneous employees” (excludes Police and Fire)
  - 28 Memorandums of Understanding (MOUs)
  - Negotiate next spring (2019), for contracts starting FY 2019-20
- 1% wage increase = $22 million/year for open contracts *(General Fund only)*

Looking Forward – Employee Compensation Cost Growth

Personnel costs per FTE have grown at more than twice the rate of inflation during the past decade.

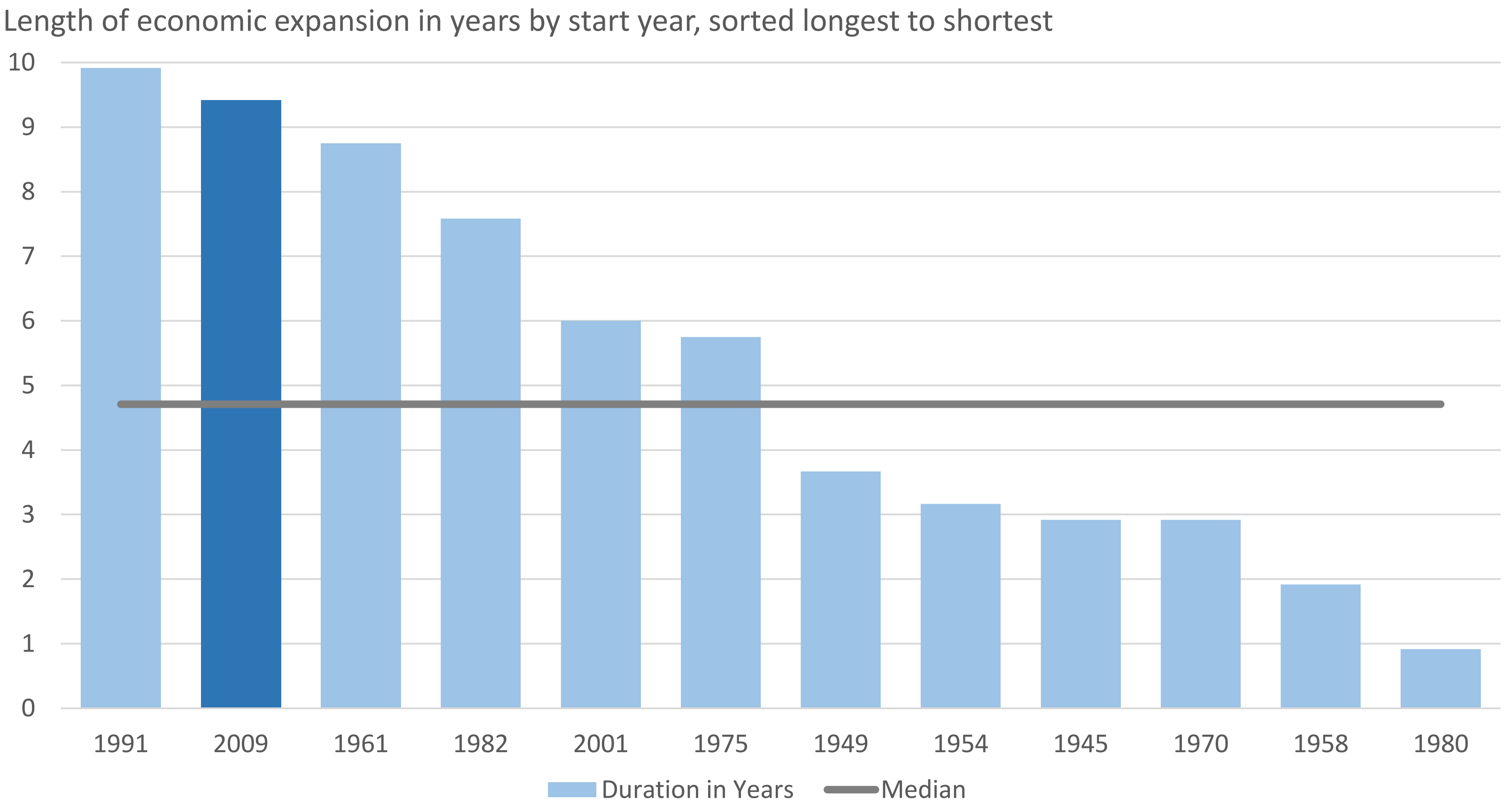


Looking Forward – Long-term Fiscal Challenges

- Baselines and set-aside spending
  - From 14% of General Fund sources in FY 94-95 to over 30% of projected current General Fund spending
- Cost shift from State on In-Home Support Services (IHSS) program will add over $100 M to annual budget by FY 2023-24, over and above previous projections
- SF Housing Authority financial needs
- Continued uncertainty from state and federal government

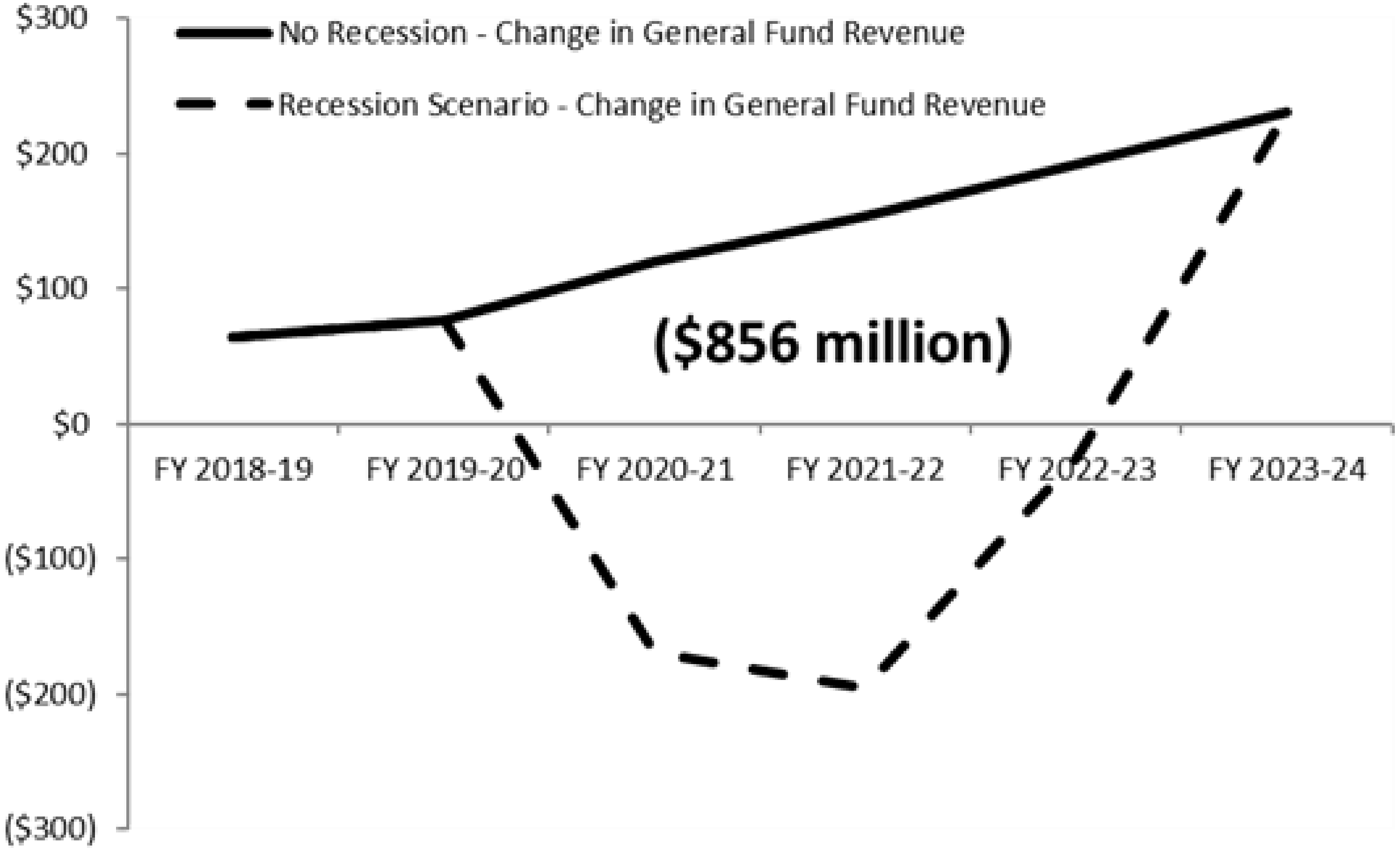
Looking Forward – Risk of Economic Climate

Our current expansion is the 2nd longest since 1945

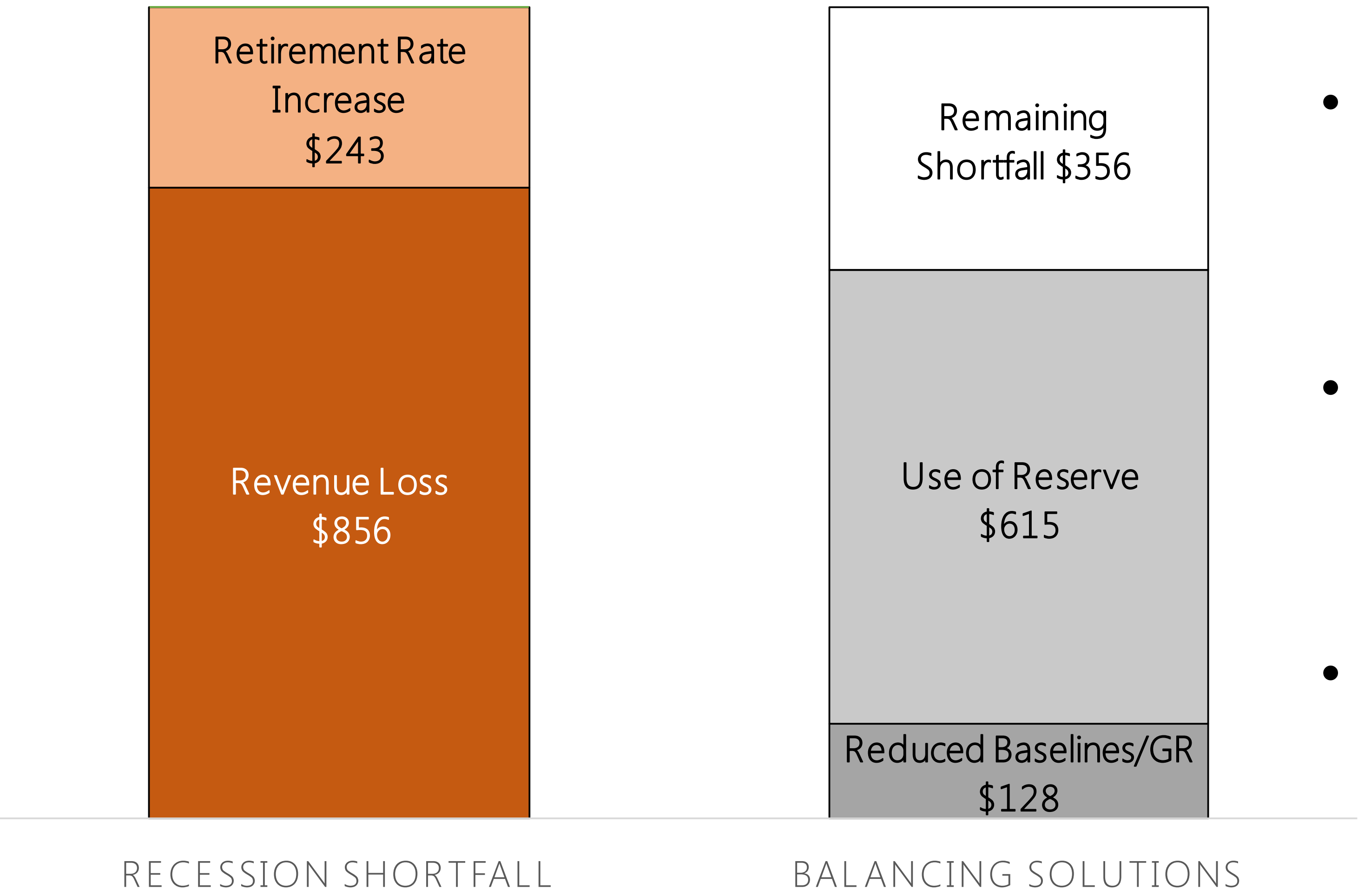


- Five-Year Plan assumes continued expansion, which would be the *longest ever expansion by 3 years*
- Indicators that economy is cooling:
  - Rising interest rates
  - Flattening yield curve (investor uncertainty about future economic growth)
  - Trade and other federal policy uncertainty

Looking Forward – Recession Scenario



Looking Forward – Recession Scenario



- Recessions trigger additional employer contributions to the retirement system
- Decline in reduced baselines and use of reserves only solves 68% of the shortfall
- Remaining gap will be made up through expenditure reductions

What should we do about all of this?

- Continue with sound fiscal practices:
  - Funding reserves
  - Ensure sustainable employee costs (wages, pension, & health)
  - Fund strategic one-time investments (capital, information technology, and equipment)
  - Limit on-going spending growth; especially limit FTE growth since employee costs growing faster than inflation

Department Budget Instructions

Budget Instructions for Departments

Key Themes: Accountability & Equitable Outcomes

Accountability: “Make Every Dollar Count”

- Demonstrate effective use of existing City funding
- Set meaningful and measurable metrics
- Achieve outcomes and goals as outlined (performance measures; project deliverables)

Equitable Outcomes: “Prioritize Those With the Greatest Need”

- City services that reflect the value that each person deserves an opportunity to thrive in a diverse and inclusive city (*Citywide Strategic Initiatives Framework*)
- Prioritize funding initiatives that serve residents with the highest need
  - Examples (but not limited to): unemployed, unhoused and homeless, people lacking economic mobility, and justice system involved

Accountability & Equitable Outcomes

When developing Departmental budgets, please consider the following questions:

1. What are the expected outcomes of this proposed allocation? Who will benefit and how?
2. What indicators do you currently use to measure progress on this issue? What new indicators do you need to track to better measure impact going forward?
3. On what timeline do you expect to achieve your stated outcomes?

Accountability & Equitable Outcomes

After reviewing budget submissions, the Mayor’s Budget Office will make requests for Accountability & Equitable Outcomes (AEO) plans for select programs, in consultation with the City Performance Unit.

City Performance Unit has developed an AEO plan template, and will require a detailed explanation of the initiatives:

- Goals
- Performance measures
- Timelines
- Reporting processes

Budget Instructions – Balancing the Budget

- Reprioritize within existing departmental budget for “highest & best use”
- Identify funds that could be spent more effectively & efficiently
- Sustainability & Efficiency Proposals
  - Required proposals to reduce general fund allocations
    - Equivalent to 2% of adjusted GFS (growing to 4% in the second year of the budget)
    - Provide a 1% (growing to 2% in the second year of the budget) contingency proposal to help with revenue and labor uncertainty

Budget Instructions - FTE

- Reprioritize changing staffing needs within existing FTE
- Departments shall not load new FTE requests in the budget system
- New positions may be considered that align with the Mayor’s priorities
  - Outline details in budget forms if requested by the Mayor’s Budget Office

Budget Instructions for Departments: Summary

Budget

- Propose on-going reductions and revenues equal to 2% of adjusted General Fund support in each year (growing to 4% in the second year of the budget)
- Provide a 1% (growing to 2% in the second year of the budget) contingency proposal to help with revenue and labor uncertainty

FTE

- Reprioritize changing staffing needs within existing FTE
- New positions may be considered that align with the Mayor's priorities
  - Departments shall not load new FTE requests in the budget system

- Enterprise / self-supporting must absorb all known cost increases
- Legally mandated to balance the budget by June 1

Calendar / Key Dates

Dec 12	Budget Outlook & Instructions issued
Mid Dec	Budget system opens to departments / CON budget system trainings
January 11	COIT and Capital budget requests due
Early February	Controller’s 6-Month Report
February 21	Budget submissions due
May	Controller’s 9-Month Report
	Governor’s May Revise
May 15	Labor agreements must be submitted to the Board of Supervisors
June 1	Mayor proposes balanced budget to Board of Supervisors
June	Budget and Finance Committee hearings
July	Budget considered at Board of Supervisors

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Questions?