

IBA Review of the FY 2026-2030 Five Year Financial Outlook

City Council

January 14, 2025

Item 331



Office of the Independent Budget Analyst



Role of the Outlook in the Budget Process

Overview & Importance of the City's Outlook

- 2016 City Charter amendment requires Mayor to annually prepare a multi-year financial outlook for the General Fund.
- Planning tool that informs the annual budget process
 - Allows Council to have a sense of Mayor's budget priorities, and to consider its own priorities & strategies for a balanced budget.
- *IBA's role*: To analyze the Outlook objectively and identify issues and options to assist the Council in decision-making

IBA Annual Review and Analysis of Outlook

Our report on the General Fund Outlook includes:

Review and Analysis of:

- Overall fiscal condition
- Baseline revenues and assumptions
- Baseline expenditures
- Additional Outlook priorities beyond baseline
- Potential funding needs not included in Outlook
- Potential resource and mitigation options



General Fund Fiscal Condition

Critical to Address the Structural Imbalance

General Fund Outlook Shortfall (<i>\$ in millions</i>)						
	FY 2025 Base ^a	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
Baseline Revenues	\$ 2,012.0	\$ 2,074.7	\$ 2,146.1	\$ 2,218.4	\$ 2,303.8	\$ 2,384.4
Baseline Expenditures	2,215.8	2,332.9	2,363.7	2,435.3	2,475.9	2,553.8
Baseline Revenue Surplus/(Shortfall)	\$ (203.7)	\$ (258.2)	\$ (217.6)	\$ (216.9)	\$ (172.1)	\$ (169.4)
One-time Expenditure Priorities	(22.4)	-	-	-	-	-
Use of Available Excess Equity	84.4	-	-	-	-	-
Use of Other One-Time Resources	141.7	-	-	-	-	-
Additional Priorities Beyond Baseline ^b	-	(71.1)	(84.9)	(90.5)	(101.8)	(107.0)
Revised Outlook Surplus/(Shortfall)	\$ (0.0)	\$ (329.3)	\$ (302.6)	\$ (307.4)	\$ (273.9)	\$ (276.3)

Note: Table may not total due to rounding.

^a The FY 2025 Base includes the FY 2025 Adopted Budget adjusted for one-time revenue and expenditure adjustments, including expenditure amounts for delayed reserve contributions and certain uses of non-general fund balances.

^b Includes planned commitments and support for new facilities.

General Fund Fiscal Condition *(cont'd)*

Critical to Address the Structural Imbalance *(cont'd)*

- FY 2025 GF Budget was balanced with \$84.4m in Excess Equity and \$141.7m in other-one-time resources.
- The City now faces a significant structural deficit.
 - Additional priorities beyond the baseline would increase projected annual shortfalls.
- We identify up to \$198.3m in potential mitigations that could reduce baseline shortfalls.
 - Would not completely eliminate the ongoing structural deficit, or address other priorities and planned commitments.
 - ***Additional cuts and mitigations will still be required.***

Baseline General Fund Revenue

GF Revenue Overview

- FY 2026 Outlook revenue, totaling \$2.07b, anticipated to be \$7.4m higher than 1st Quarter projected revenue for FY 2025.
- Remaining years' growth averages to 3.4% increase per year.
- Revenue projections generally reasonable; potential risks for Sales Tax and Transient Occupancy Tax (TOT) projections.
- Results of November 2024 election make it difficult to accurately forecast revenue, particularly for outer years.

Baseline General Fund Revenue *(cont'd)*

Major GF Revenue – Potential Risks

Sales Tax

- New projections anticipate declines in sales tax revenue to continue into FY 2026.
- If these projections are accurate, revenues may be \$20.0m to \$40.0m less in any given year than projected in the Outlook.

Transient Occupancy Tax

- Outlook TOT growth rate of 5.0% may be higher than what lodging industry expects.
- If growth rate of 2.5% is applied, FY 2026 TOT revenue would be \$3.5m lower than projected in the Outlook.



General Fund Baseline Expenditures

Support existing service levels; no new initiatives

Increases/(Decreases): FY 2025 Adopted Budget to FY 2026 Baseline Projection (\$ in millions)	
FY 2025 Adopted Budget	\$ 2,160.9
Personnel Expenditure (PE) and Fringe Benefit Changes	70.5
<i>Compensation Increases (largely based on labor agreements)</i>	<i>53.0</i>
Non-Personnel Expenditure (NPE) Changes	86.8
<i>General Fund Reserve Contribution</i>	<i>56.6</i>
<i>Increased Lease Revenue Bond Debt Service for CIP</i>	<i>20.3</i>
Removal of FY 2025 One-Time Expenditure Adjustments	14.6
<i>Use of Infrastructure Fund for GF Eligible Expenditures</i>	<i>14.7</i>
<i>One-Time Expenditures for Homelessness Support</i>	<i>(9.5)</i>
FY 2026 Outlook Baseline Projection	\$ 2,332.9
Overall Increase: FY 2025 Adopted Budget to FY 2026 Outlook Baseline (8.0% Increase)	\$ 172.0

Note: Table may not total due to rounding.

General Fund Expenditures *(cont'd)*

Personnel Expenditures

Employee Compensation Increases

- \$53.0m estimated in the Outlook for FY 2026 increases
 - \$45.0m for represented employees; \$8.0m for unrepresented
 - Based on FY 2026 provisions in the current MOUs with the City's REOs (unions)
- Remaining Outlook years:
 - Current MOUs expire at the end of FY 2026.
 - Outlook assumes 2.73% general wage increase annually.
 - Compensation increases negotiated with each REO may differ.

Actuarially Determined Contribution (ADC)

- Post-Outlook – FY 2024 draft actuarial valuation incorporates higher salaries than previously expected.
 - Resulting increase to FY 2026 GF baseline shortfall: \$27.3m estimated

General Fund Baseline Expenditures *(cont'd)*

Non-Personnel Expenditures

Information Technology

- Non-discretionary IT *enhancement* projects are not included in Outlook's baseline expenditures.
 - Debt service costs for the GF portion (\$61.8m) to modernize the City's SAP ERP systems are assumed.

Infrastructure Fund

- Outlook projects contributions to be \$8.8m for FY 2026.
- Strategic use of Infrastructure Fund to support infrastructure maintenance could help address shortfalls.

General Fund Baseline Expenditures *(cont'd)*

Non-Personnel Expenditures *(cont'd)*

Debt Financing

- GF debt service costs anticipated to total \$48.2m in FY 2025

Existing Appropriations	\$ 955.4m
Debt Proceeds	\$ (560.6m)
Existing Appropriations Requiring Future Debt	\$ 394.7m

Assumed New Debt Proceeds (FY 2026-2030)	\$ 1,024.1m
Existing Appropriations Requiring Future Debt	\$ (394.7m)
Appropriations Pending Future Council Action	\$ (149.9m)
Net Debt Capacity	\$ 479.5m

Debt Ratios

	FY 2025 Budget	Forecast FY 2026	Forecast FY 2027	Forecast FY 2028	Forecast FY 2029	Forecast FY 2030
10% Benchmark	4.5%	5.5%	6.0%	6.2%	6.8%	6.8%
Incl. Pension/OPEB - 25% Benchmark	23.0%	24.3%	24.4%	24.5%	22.3%	21.9%

Priorities Beyond the Baseline

New Facilities

- Certain facilities projected to open during the Outlook period lack full funding.
 - It may be premature to project the opening dates.
- New facilities can be delayed for budgetary reasons if necessary.

Summary of Facilities Projected to Open During Outlook Period	
Library	<ul style="list-style-type: none"> • Ocean Beach Library Expansion • Oak Park Replacement Library
Parks and Recreation	15 new or expanded parks 13 new Joint Use Agreements
Fire-Rescue	New Fire Stations: <ul style="list-style-type: none"> • Black Mountain Ranch • Otay Mesa

Priorities Beyond the Baseline *(cont'd)*

Planned Commitments – Homelessness Programs

FY 2026 Projected Homelessness Funding Gap <i>(\$ in millions)</i>	
Projected Grant and Ongoing General Fund Revenue Available	\$ 90.4
Existing Service Levels Total Expenses	(100.3)
Funding Gap for Existing Service Levels	(9.8)
Expanded Service Levels Total Expenses	(46.0)
Overall Funding Gap With All Planned Commitments	\$ (55.8)

Note: Figures subject to change and may not total due to rounding.

- \$33.7m of expanded service level expenses are associated with Kettner/Vine shelter.
- Uncertainties over future one-time State grant funds and timing of 2020 Measure C (TOT)
- Council may wish to consider:
 - Delay any planned service expansions to avoid larger budget shortfall
 - Re-evaluate and prioritize homelessness programs
 - Identify additional opportunities for regional collaboration

Priorities Beyond the Baseline *(cont'd)*

Planned Commitments – Stormwater Wetland Mitigation

- Payments estimated \$6.0m to \$8.0m per year
 - Result of channel clearing activities by Stormwater Department.
 - Required to cover past impacts from channel clearing emergencies and future planned maintenance or emergencies that may occur.
- More routine maintenance before overgrowth would negate need for future permits.
 - Stormwater reassigned various teams to maintain channels that were cleared.
 - Reassigned teams were taken off other duties, and could result in other emergencies elsewhere.



Potential Needs Not Included in the Outlook

<u>Operating Needs</u>
<p>Arts and Culture Funding \$5.5m - \$15.5m in FY 2026 for increased funding targets of 6.5% and 9.5%</p>
<p>Tenant Eviction Notice Registry Start-up costs of \$215k for NPE & \$285k for two positions; annual \$400k administrative costs</p>
<p>SD Access 4 All \$785k for Digital Equity Program existing services</p>
<p>Climate Action Plan (CAP) Implementation \$188.1m potential funding gap between CAP spending and Climate Action Implementation Plan</p> <p><u><i>Fleet Electrification</i></u> Potential \$94.2m in savings over 10 years; partially offset by \$23.7m - \$34.9m upfront costs for installation of charging infrastructure</p>

<u>Infrastructure Needs</u>
<p>Transportation – Road Repair Program Pavement Management Plan – 10-year, \$1.9b strategy to improve City’s PCI to 70; does not include 62 miles of unimproved streets</p>
<p>Stormwater Infrastructure \$1.6b deficit for Stormwater capital infrastructure needs for the next five years</p>
<p>New and Existing City Facilities Over \$1.0b for deferred maintenance needs</p>
<p>Zero Emissions Municipal Building Operations Policy (ZEMBOP) Projected cost \$80.0m - \$90.0m; actual net costs currently unknown, including efficiency savings from equipment, building retrofits, or energy controls responding to time-of-use rate triggers</p>



Potential Resource Options

Mitigations with More Certain Estimates

Baseline General Fund Outlook Projections with Mitigations (<i>\$ in millions</i>)					
	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030
Baseline Surplus/(Shortfall)	\$ (258.2)	\$ (217.6)	\$ (216.9)	\$ (172.1)	\$ (169.4)
Measure B Implementation (Refuse Collection Fee)	\$ 78.6	\$ 81.0	\$ 83.2	\$ 83.7	\$ 85.5
Suspend Reserve Contributions	63.2	(63.2)	-	-	-
Measure C Implementation (TOT Increase)	33.9	35.6	37.4	39.2	41.2
Parking Meter Rate Increase ^a	9.6	9.9	10.2	10.5	10.8
Strategic Use of Infrastructure Fund Contributions	8.8	11.1	16.7	22.6	28.8
Cannabis Business Tax Increase for Outlets (2%) ^a	4.3	4.4	4.6	4.7	4.9
Mitigations Subtotal	\$ 198.3	\$ 78.8	\$ 152.0	\$ 160.7	\$ 171.1
Baseline Surplus/(Shortfall) after Mitigations	\$ (59.9)	\$ (138.8)	\$ (64.9)	\$ (11.4)	\$ 1.8

Note: Table may not total due to rounding.

^a FYs 2027 - 2030 assume annual growth of 3%.

Potential Resource Options *(cont'd)*

Additional Resources for *FY 2025*

Increasing Parking Meter Rates (ongoing)

- \$800k/month, or \$9.6m/year estimated from doubling the City's parking meter rate to \$2.50/hr
 - Can be done *in current fiscal year* through Council or Mayoral action, revenue can reimburse eligible GF expenses.
 - Coastal areas likely require Coastal Commission approval and tidelands restrictions may apply for tidelands areas.
- Additional Parking Management Policy Amendments could also be considered
 - Increase overall percentage-share that flows to City while maintaining current amounts going to Community Parking Districts.
 - Update eligible expenditures; streamline parking district creation process, allow surge pricing, etc.

Potential Resource Options *(cont'd)*

Additional Resources for FY 2026

Measure B – Establishing Trash Fee (ongoing)

- New collection fee could free up an estimated \$78.6m for GF in FY 2026.
 - Critical to proceed with full cost recovery, adopt fees in July.

Increasing Cannabis Business Tax (ongoing)

- 2% increase on rate for outlets could generate \$4.3m.
- Council has authority to adjust rates up to 15%.
 - Currently at 2% for Cannabis Production Facilities and 8% for outlets

Potential Resource Options *(cont'd)*

Additional Resources for FY 2026 *(cont'd)*

Strategic Use of Infrastructure Fund (one-time, potentially ongoing)

- Would mitigate FY 2026 shortfall by \$8.8m
- Use for operations/maintenance of existing infrastructure, \$4.8b infrastructure capital gap would not be addressed.

Suspend Reserve Contributions (one-time)

- Estimated up to \$56.6m
 - If suspended, catch-up payments are required.
 - Mayor and DOF must prepare plan to address reduced reserve levels
 - Maintaining strong reserve balance is important
- FY 2026 Risk Management Reserve Contributions estimated at \$6.6m.

Potential Resource Options *(cont'd)*

Additional Resources for FY 2026 *(cont'd)*

Measure C – TOT Increase (ongoing)

- Would mitigate FY 2026 shortfall by \$33.9m
- Could Offset GF costs for homelessness expenditures
- Timeline/scenarios:
 - **Short:** Appellants settle before appeals trial begins in early spring 2025.
 - **Medium:** Appeals trial proceeds and the judge again rules in favor of the City in early summer 2025. In the event of another appeal, the CA Supreme Court decides against hearing the case.
 - **Long:** Case is successfully appealed to the CA Supreme Court, which could add an additional 1.5 years.

Potential Resource Options *(cont'd)*

Other Potential Mitigations

<i>Those beginning FY 2026 & with less certain estimates</i>
Identified in the Outlook
GF Excess Equity (one-time)
Budget Reductions (ongoing)
Additional Resources
Grants (one-time)

<i>After FY 2026</i>
Sales Tax Increase (ongoing)
General Obligation Bonds (one-time)
Stormwater Fee Increase (ongoing)
Property Transfer Tax Increase (ongoing)

Conclusion

- Baseline revenue and expenditure projections reasonable, though risks related to sales tax and increased pension payments exist.
- The City has options to *partially* address projected *baseline* shortfalls; any *additional* priorities or expenditures beyond baseline will require further cuts.
- **Cuts in FY 2026 will be required;** critical for the City to immediately implement those mitigations that it can ***in the current fiscal year***. Any additional revenue or savings in FY 2025 can be used to help balance FY 2026 budget.
- ***Failure to take immediate action will lead to the need for even deeper cuts in FY 2026.***