THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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

OVERVIEW

Importance of the City's Outlook

On December 4, 2024, Mayor Gloria released his *Fiscal Year 2026-2030 Five-Year Financial Outlook* (Outlook), one of the City's annual financial planning tools. The Outlook is an integral part of the budget development process and is described in *Council Policy 000-02: Budget Policies* as *"the basis for determining the coming year's operating budget allocations."* Former Mayor Sanders initiated the Five-Year Financial Outlook process in 2006 which was continued by subsequent Mayors. In 2015, the City Council initiated a Charter Review process with a focus on greater clarity of the budget process including the requirement for the Mayor to issue a multi-year financial outlook annually. In June 2016, with a vote of the people, Section 69 of the City's Charter was amended to require the Mayor to prepare a multi-year financial outlook for the General Fund annually.

"The Mayor shall annually prepare a multi-year financial outlook for the general fund projecting anticipated revenues and expenditures in future years as a fiscal planning document and basis for the proposed budget."

The City's Budget Policy was also amended to state the Outlook shall "…include projections for committed expenditures which are defined as the operational costs for new facilities, contractual obligations, federal and State legal mandates, and adopted Council policies." While the Outlook should not be interpreted as a budget, it provides the Council and the public with a longer-term financial perspective and a preliminary indication of the Mayor's budget priorities. Each year many Council priorities will overlap with the Mayor's, but Council has final authority in the budget process to determine the City's budget priorities for the next fiscal year.

While the Council cannot change the Mayor's Outlook, the Council remains the ultimate budget authority and can make changes to the budget following Mayor Gloria's release of the FY 2026 Proposed Budget. In doing so, the budget must stay balanced through identification of alternate budget reductions or new resources, delaying new facilities, consolidating or eliminating other programs, or other mitigation tools.

IBA Review and Analysis of Significant Annual Budget Reports & Council Budget Priorities

The release of the Outlook is the first look at the next fiscal year's overall budget issues and whether there is an anticipated surplus or shortfall in the General Fund. While the Executive Branch develops the Outlook, the Office of the Independent Budget Analyst (IBA) is charged with providing the City Council and the public with a comprehensive review and analysis of the annual Outlook as well as all major budget reports – such as Quarterly Budget Monitoring Reports (including the First Quarter, Mid-Year and Third Quarter Reports); the Mayor's Proposed Budget; the Mayor's May Revision to the Proposed Budget; the Five-Year Capital Infrastructure Planning Outlook; and the CIP Budget Monitoring Reports.

Each fiscal year the Office of the IBA also develops the Council's Budget Priorities Resolution based on individual Councilmember's priorities memoranda, which is provided to the Mayor to help inform Mayoral budget priorities. The Council's initial Budget Priorities Resolution for FY 2026 was approved on October 28, 2024.[1]

"Councilmembers shall . . . communicate their budget priorities to the IBA, who will analyze and consolidate the priorities into a proposed Council budget priorities resolution"

Review of the Mayor's Outlook

The Outlook notably projects significant, nine-figure deficits throughout each of the next five years. As the City is required by law to adopt balanced budgets on an annual basis, these deficits will have to be closed, either through the identification of additional revenues and resources, the reduction of existing or new expenditures, or both. While the City's annual budgets over the past several years were balanced, they were not structurally balanced and relied heavily on one-time resources. While the use of the federal American Rescue Plan Act (ARPA) and other one-time resources was necessary to maintain City services during the COVID-19 pandemic and its aftermath, our Office continually noted that this resource was projected to be exhausted, and that the

[1] This is the third Budget Priorities Resolution that has been prepared during September and October, which reflects action taken by the City Council on June 27, 2022 to accelerate development of Council's budget priorities in order to amplify their impact on the development of the Mayor's Proposed Budget. *Council will also have the opportunity to update its initial FY 2026 Budget Priorities Resolution in February 2025; to start that process, a call memorandum was issued mid-December 2024 for Councilmembers' updates to their budget priorities memoranda. Those priorities memoranda are due to our Office on January 10, 2024 and will be released on January 28 as part of an IBA report on updated Council priorities.*

City would be faced with a significant budget deficit if the structural imbalance was not addressed. The current FY 2025 Adopted Budget also made use of one-time resources to maintain ongoing services, recognizing the potential for significant increases to ongoing City revenues through Measure E, a one-cent sales tax ballot measure that ultimately failed to pass by 0.6% of votes cast. Given the failure of Measure E and the structurally imbalanced budgets of the last several years, deficits projected over the Outlook are large and will need to be addressed through immediate action.

While deficits projected in the Outlook are large, starting at a baseline shortfall of $258.2 million in FY 2026, it is also important to note that several potential mitigation measures exist that could significantly shrink projected deficits. Potential for additional revenue from a trash fee, increased parking meter fees and cannabis business tax rates, and the potential implementation of 2020's Measure C could generate up to $126.4 million in new resources. Strategic use of the City's Infrastructure Fund to provide operations and maintenance for City infrastructure, along with a potential delay in contributions to reserves, could provide an additional $71.9 million in expenditure relief. Even if these mitigations are implemented, however, *a shortfall will still exist for FY 2026 that will have to be closed through budget cuts and service reductions.* **To that end, it is critical that the City both immediately implement mitigations *in the current fiscal year*, and that the City severely constrain the addition of any new or expanded services and programs – any new expenditures *will have to be supported with additional cuts for the budget to return to structural balance.***

This report consists of several sections, which are highlighted in the Report Summary on the next page. Additional details and discussions are included in the body of our report. Our Office would like to thank staff from the Department of Finance and other City departments for responding to our questions in preparing this report.

REPORT SUMMARY

Overall fiscal considerations

- Projected structural budget deficits persist throughout the Outlook period that must be addressed. Structural budget deficits occur when ongoing and sustainable revenue sources are not enough to support ongoing expenses.

Review and analysis of General Fund baseline revenues and assumptions in the Outlook

- Most revenue projections in the Outlook are reasonable and buoyed by steadily increasing Property Tax growth. However, Sales Tax and Transient Occupancy Tax (TOT) projections in the Outlook, while relatively flat, may be too optimistic given recent trends.
- Revenue projections may have a higher-than-average degree of uncertainty because of the difficulty in forecasting federal economic policies following the November 2024 election.

Review and analysis of baseline General Fund expenditures

- We identify changes from the FY 2025 Adopted Budget to the FY 2026 Outlook baseline expenditures, which maintain service levels with no new initiatives.
- We discuss the largest personnel-related expenditure increases for FY 2026, which are largely based on provisions in current labor agreements and are estimated at $45.0 million for represented employees and $8.0 million for unrepresented employees.
- We also discuss select Non-Personnel Expenditures, including information technology, the Infrastructure Fund, and debt financing.

Review and analysis of additional Outlook priorities beyond baseline expenditures

- We discuss operating needs for the anticipated opening of new or expanded parks, libraries, and fire stations. Given the likelihood for service-level reductions during upcoming budget cycles, we note that the City should consider deferring the opening of new facilities if existing services, programs, and facilities are determined to be a higher priority.
- Planned commitments for homelessness programs and wetland mitigation costs are also reviewed. For homelessness, available resources are insufficient to fund the City's *existing* homelessness programs, even before expanded services are considered. We discuss the need to delay any planned service expansions and identify Council's key homelessness priorities given such funding constraints.

Review and analysis of potential funding needs not included in the Outlook

- We identify select high priority operating and infrastructure needs that are not included in the Outlook. These include, but are not limited to, support for arts and culture, SD Access 4 All, Climate Action Plan implementation, road repair, and stormwater compliance. Funding these priorities would require significant additional resources beyond what has been identified in the Outlook.

IBA discussion of potential resource and mitigation options

- We cover various potential measures to mitigate the projected baseline budget deficits, many of which can be implemented through Council or Mayoral action. Without a new major ongoing revenue source, significant budget cuts to programs and services will be needed to address the City's structural budget deficit.

OVERALL FISCAL CONSIDERATIONS

We begin the discussion with a look at the General Fund Outlook Baseline, which is comprised of ongoing revenues and expenditures. Ongoing baseline expenditures are associated with maintaining, rather than expanding, current City service levels. Although baseline revenue projections over the Outlook are steadily increasing, as shown in the first row of the following table, they are insufficient to cover projected baseline expenditures. The resulting "Baseline Revenue Shortfall," or structural budget deficit, is shown in the third row of the table. A structural budget deficit occurs when ongoing revenue sources are not enough to support ongoing expenses.

General Fund Outlook Baseline *($ in millions)*						
	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)**

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.

Based on the FY 2025 Adopted Budget, the City is beginning the Outlook period with a structural budget deficit of $203.7 million – shown in the FY 2025 Base column.[2] As shown in the next table, the FY 2025 General Fund Adopted Budget also included $22.4 million in one-time expenditure priorities beyond the baseline revenue shortfall. To mitigate the resulting shortfall, the FY 2025 Budget was balanced with $84.4 million in Excess Equity,[3] as well as $141.7 million in other one-time resources. The other one-time resources included $77.3 million in expenditure reductions and $64.5 million in increased revenues – about half of which was through reliance on non-general fund monies.

Thus, the FY 2025 Budget was balanced in accordance with City Charter requirements. However, using one-time resources for ongoing expenditures creates challenges in future fiscal years. ***The resulting operational deficits will need to be covered with newly identified revenues and through reductions to programs and services provided by the City. This structural imbalance must be addressed.***

[2] 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, for consistency with treatment of these areas in the Outlook years (FY 2026 through FY 2030).
[3] Excess Equity, is described in the City's Reserve Policy as "Unassigned Fund Balance that is not otherwise designated as General Fund Reserves and is available for appropriation." Excess Equity generally results from increases to General Fund revenues and/or General Fund expenditures that come in under-budget during any given fiscal year.

Revised Outlook Shortfall *($ in millions)*						
	FY 2025 Base [a]	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
Baseline Revenue Surplus/(Shortfall)	**$ (203.7)**	**$ (258.2)**	**$ (217.6)**	**$ (216.9)**	**$ (172.1)**	**$ (169.4)**
Adopted Budget: One-time Expenditure Priorities	(22.4)	-	-	-	-	-
Adopted Budget: Use of Available Excess Equity	84.4	-	-	-	-	-
Adopted Budget: Use of Other One-Time Resources	141.7	-	-	-	-	-
Outlook: 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.

Further, future service expansions expected by the public or needed for compliance with various laws or for health and safety reasons cannot occur without adequate funding. As shown in the second-to-last row of the preceding table, the Outlook incorporates additional priorities beyond the baseline, including planned commitments and support for new facilities. With these additional priorities, projected shortfalls – that need to be mitigated – grow larger, as shown in the bottom line of the table. For FY 2026, the projected shortfall increases to $329.3 million, although $33.3 million of the increased cost is related to the uncertain proposal for 1,000 new shelter beds, which is discussed on page 26 of our report.

Additionally, as discussed later, there are other budget priorities that are not included in these shortfalls. We would further note that the Outlook is based on information known at this time; unpredictable events such as an economic recession could significantly alter the projections.

In the Potential Resources Options section (beginning on page 38), we discuss possible mitigations for the Outlook's projected baseline shortfalls. The following table shows potential mitigations for which estimates are more certain. These mitigations, if implemented, would not completely eliminate the ongoing structural deficit, and they do not address budget priorities that are not included in the projected baseline shortfalls. *Additional cuts and mitigations will still be required*. However, these mitigations could significantly reduce projected shortfalls; further, all potential mitigations except the suspension of reserve contributions and strategic use of infrastructure fund contributions are ongoing in nature.

Baseline General Fund Outlook Projections with Mitigations *($ in millions)*					
	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
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%.

To provide additional context on the City's fiscal condition, the following table provides a summary of the City's conformance with select financial policies and how they are handled in the Outlook.

Conformance with Financial Policies		
City Financial Policies		**Mayor's Outlook**
Select Principles included in the annual Statement of Budgetary Principles	Elimination of the General Fund structural budget deficit	Does Not Conform: The structural budget deficit projection for FY 2025 Outlook is $258.2 million (at FY 2025 service levels), and persists throughout the Outlook period.
	Active pursuit of alternative service delivery methods for efficiency	In Process: The Outlook indicates that departments will conduct a strategic review of their programs to identify potential savings by implementing operational efficiencies; they will also evaluate potential service reductions.
	Prioritization for City services based on Charter requirements, public input, benchmarking, departmental goals, performance data, and equitable provision of services	In Process: Funding is included to support City Charter requirements, applicable laws, best practices, departmental goals, and public input that has been considered during budget development and adoption. In the Outlook the Mayor has identified additional services above baseline that he considers to be critical priorities. Priorities will be further considered during the upcoming budget development process.
	Identification of funding for ongoing expenses when considering new facilities or programs	Conforms: The Outlook identifies ongoing expenses for new facilities included in the Outlook.
	Achievement of 100% cost recovery for programs that intend full cost recovery through fees	Conforms: The City regularly reviews and adjusts user fees in accordance with its User Fee Policy; cost recovery levels are set upon approval of fees; and estimated fee revenues are included in baseline revenues. Of note, new and revised fees will be included in the FY 2026 Comprehensive User Fee Study, expected to be proposed to Council early in calendar year 2025; any adjusted fees will be reflected in the FY 2026 Proposed Budget.
	Fully fund the annual required defined benefit pension contribution	Conforms: The City has fully funded the annual required defined benefit pension contribution since FY 2006; estimated full funding is included in baseline expenditures.
	Fund the City's retiree healthcare costs in a manner that meets obligations to eligible members while keeping the related CalPERS fund solvent over the applicable benefit years	Conforms: This retirement benefit is also known as an Other Post-Employment Benefit, or OPEB. OPEB is funded in the Outlook in accordance with this long-term funding strategy, which was implemented in FY 2024. For additional information on this funding strategy, see page 10 of the IBA's Review of the FY 2024 First Quarter Budget Monitoring Report.
	Develop a plan to fund deferred capital infrastructure and maintenance	Does Not Conform: The City's most recent Capital Improvements Program Outlook shows a $4.8 billion funding gap for infrastructure projects for which resources have not been identified. One future resource the City could consider is the use of General Obligation bonds – see page 44 of this report for additional information.

Conformance with Financial Policies *(con't)*		
City Financial Policies		**Mayor's Outlook**
Debt Policy	The City's Debt Policy provides that the City shall strive to maintain certain General Fund debt ratios including: under 10% debt ratio (debt service/lease payments as a percent of total available revenues); below 25% debt ratio when combining debt service with pension and OPEB contributions.	Conforms; The City's debt ratios are projected to remain within Debt Policy parameters after accounting for projected debt service costs that are assumed to be incurred by the General Fund during the Outlook period. See page 20 for additional information.
General Fund (GF) Reserve	Goal is to incrementally increase the GF Reserve to 16.7% of GF operating revenues by FY 2030. The FY 2026 Reserve target is 14.1%, which is estimated to be $263.7 million.	Conforms, if not suspended: The Outlook includes funding in accordance with the City's Reserve Policy, which translates to an estimated FY 2026 contribution of $56.6 million, and an average $22.6 million over the remaining Outlook years. However, the Outlook discusses suspension of the GF Reserve contribution as a potential mitigation action to address projected budget shortfalls.
Risk Management (RM) Reserves	These Reserves include Workers' Compensation, Public Liability, and Long-term Disability Reserves, for which the goal is to maintain a balance equal to 12%, 50%, and 100% of outstanding claims, respectively, based on the most recent three-year average of actuarial liabilities.	Partially conforms, if not suspended: The Outlook includes funding in accordance with the City's Reserve Policy, with the exception of the Public Liability Fund, which will be temporarily short by the amount of outstanding inter-fund loan to the sewer fund (see IBA Report 24-33 REV for additional information). This translates to estimated FY 2026 contributions to the RM Reserves of $6.6 million, and an average $3.5 million over the remaining Outlook years. However, the Outlook discusses suspension of the RM Reserve contributions as a potential mitigation action to address projected budget shortfalls.
Infrastructure Fund	City Charter section 77.1 requires a transfer of designated revenues from the General Fund to the Infrastructure Fund. Allowable uses of these funds include acquisition of real property, construction, reconstruction, rehabilitation, and repair and maintenance of General Fund infrastructure, as well as associated financing costs. See page 19 for additional information.	Conforms: Contributions to the Infrastructure Fund are included for each of the five Outlook years in line with the requirements of Charter section 77.1. Projected contributions included in the Outlook range from $8.8 million in FY 2025 to $28.8 million in FY 2030.
Penny for the Arts	On October 22, 2012, the City Council approved a "Penny for the Arts" funding blueprint. The goal is to increase arts and culture funding from the City's Transient Occupancy Tax (TOT) to equate to 1¢ of the 10.5¢ TOT, or 9.52% of total TOT revenues.	Does Not Conform: The Outlook includes $16.2 million in Penny for the Arts funding for FY 2026, or 4.9% of total TOT revenues. The $16.2 million allocation is projected to grow 0.2% for the remaining four Outlook years, while overall TOT revenues are projected to increase by 5.0% per year. Thus, for FY 2030 Penny for the Arts funding is only projected to be 4.0% of total TOT revenues. See page 31 for additional information.
Library Ordinance	The Library Appropriation Ordinance (Library Ordinance, San Diego Municipal Code section 22.0228), requires that the Library Department budget be equal to 6% of the General Fund budget each fiscal year.	Does Not Conform: For FY 2025 the Library Department budget is equal to 3.6% of the adopted General Fund budget; and the Library Ordinance provisions were waived. Funding in accordance with the Library Ordinance is not included in the Outlook.

REVIEW OF BASELINE GENERAL FUND REVENUES

Review of Baseline Revenues
• Property Tax • Sales Tax • Transient Occupancy Tax • Franchise Fees • Cannabis Business Tax • Emergency Medical Services (EMS) Fund Transfer

The table below reflects baseline General Fund revenues for the FY 2026 to FY 2030 Outlook period and includes the FY 2025 Adopted Budget revenues and updated FY 2025 revenue projections included in the First Quarter Budget Monitoring Report (First Quarter Report). Total revenue for FY 2026 in the Outlook anticipates a relatively flat growth rate of 0.4%, or $7.4 million, above the FY 2025 projected revenue in the First Quarter Report of $2.07 billion.[4] Overall baseline revenues increase steadily for the remaining four years of the Outlook, with growth averaging about 3.4% per year.

General Fund Revenues *($ in millions)*							
Source of Revenue	FY 2025 Adopted	FY 2025 Projection	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
Property Tax	$ 808.9	$ 814.4	$ 844.4	$ 880.6	$ 918.5	$ 957.5	$ 998.2
Sales Tax	393.5	381.8	392.8	403.0	416.6	430.7	445.3
Transient Occupancy Tax	172.8	168.7	176.4	185.1	194.4	204.0	214.2
Franchise Fees	123.7	124.6	120.8	117.0	120.4	126.8	134.7
All Other Revenue Categories [a]	577.6	577.9	540.4	560.3	568.5	584.7	592.0
Total	**$ 2,076.5**	**$ 2,067.4**	**$ 2,074.7**	**$ 2,146.1**	**$ 2,218.4**	**$ 2,303.8**	**$ 2,384.4**

Note: Figures may not total due to rounding.

[a] Includes Transfers In, Charges for Services, Special Promotional Programs reimbursements, etc.

Major General Fund Revenues are derived from four revenue sources to the City that make up a combined 72.2% of General Fund revenues:

- Property Tax (39.0% of FY 2025 General Fund Adopted Budget)
- Sales Tax (18.9% of FY 2025 General Fund Adopted Budget)
- Transient Occupancy Tax (8.3% of FY 2025 General Fund Adopted Budget)
- Franchise Fees (6.0% of FY 2025 General Fund Adopted Budget)

As described in the First Quarter Report, FY 2025 year-end actual receipts for Sales Tax and Transient Occupancy Tax (TOT) are currently projected to be 3.0% and 2.4% lower than the Adopted Budget, respectively. During the Outlook period, however, TOT growth is expected to be positive in FY 2026 at 2.0% above the FY 2025 Adopted Budget and 4.6% above the FY 2025 projections due to decreased actual receipts; this is lower than the 5.0% growth rates projected in FY 2027 to FY 2030. Sales tax is projected to decline by 0.2% below the FY 2025 Adopted Budget in FY 2026, but then has an average annualized growth rate of 3.2% between FY 2027 to FY 2030, about 0.4 percentage points lower than General Fund revenues as a whole.

[4] FY 2025 revenue projections for Franchise Fees in the Outlook are $2.5 million higher than the First Quarter Report because refuse collection franchise fees are projected to be $0.5 million more than what was reported in the First Quarter Report, and $0.2 million from EDCO facilities and $1.8 million from police towing fees were not included as "Franchise Fee" revenue in the First Quarter Report.

Notably, recent results of the November 2024 federal election make it more difficult to accurately forecast revenue, particularly in the outer years of the forecast. The December 2024 UCLA Anderson Forecast notes that there is a high level of uncertainty due to unknown economic policies related to tariffs, immigration, federal regulation, and taxes.[5] The following sections discuss Property Tax, Sales Tax, TOT, and Franchise Fee revenues in greater detail. Additional discussion on Cannabis Business Tax revenue and the potential for transfers from the City's Emergency Medical Services Fund in future years are also included.

Property Tax

Property taxes are the single largest source of General Fund revenue and are projected to grow over the next five fiscal years, with slight upticks in the growth rate over the previous year for an average annualized basis of 4.23%. The Outlook projects that property tax collection in FY 2026 will be 4.17%, which is slightly lower than the FY 2025 Adopted Budget growth rate of 4.37% and significantly lower than the updated FY 2025 projected growth rate of 5.65% from the First Quarter Report.

Given the 12-18-month lag between when properties are assessed and when property taxes are distributed to the City, property tax revenue for the Outlook period of FY 2026 to FY 2030 will be impacted by the housing market trends in calendar years 2024 to 2028.

Of the total property tax revenue projected in FY 2026, about 62% comes from the 1% levy on assessed property value. Per Proposition 13, the growth in the assessed value of properties not otherwise improved or sold is capped at 2% annually or the California Consumer Price Index (CPI), whichever is lower. The UCLA Anderson Forecast predicts CPI staying above 2.0% during calendar years 2025 and 2026, indicating that changes in the assessed value of real property within the City will be driven by home sales and improvements that will establish a new assessed value.

The Outlook's FY 2026 property tax revenue forecast and growth rate are reasonable, though forecasted revenue and growth rates in FY 2027 and beyond will be subject to fluctuations in interest rates, inventory, and consumer confidence.

Sales Tax

Sales tax is the second largest single source of General Fund revenue and is derived from a tax on sales made in or delivered to San Diego. While the sales tax rate in the City of San Diego is 7.75%, only 1.0% goes directly to the City's General Fund.

During the November 2024 General Election, voters in the City of San Diego considered Measure E, which proposed raising the sales tax by 1.0% to 8.75% and would have effectively doubled the amount of sales tax revenue going to the City. The official results show the measure failed by 3,506 votes (0.6%). While the results of Measure E are especially sobering in the context of the

[5] UCLA Anderson Forecast, December 2024

City's structural budget deficit, the razor-thin margin prompted some City officials to discuss presenting a similar measure to voters in 2026. Our Office will closely monitor these discussions and developments.

The FY 2025 Adopted Budget assumed a growth rate of 4.3% and $393.5 million in revenue. However, the First Quarter Report projected sales tax will total $381.8 million in FY 2025, representing a $11.6 million, or 3.0%, decrease from the Adopted Budget. This is significant because the current FY 2025 projections serve as the base upon which future year projections are built.

The City recently received new projections from its sales tax consultant based on the third quarter of calendar 2024 (the first quarter of fiscal 2025), which indicate that year-over-year declines in sales tax revenue will continue not only through FY 2025, but into FY 2026 as well. If these projections are accurate, this would suggest that revenues shown in the Outlook may be $20 to $40 million higher than should be expected in any given year. Notably, these trends run contrary to statewide projections that were provided in the 2024 UCLA Anderson Forecast, which shows statewide growth in taxable sales trending higher than the Outlook projections for FY 2026 and FY 2027.

Our Office will closely monitor economic indicators that affect taxable sales (e.g. Consumer Price Index, employment, and Consumer Confidence) and provide further updates during the Mid-Year and Third Quarter Budget Monitoring Reports.

Transient Occupancy Tax

Transient Occupancy Taxes (TOT), or hotel taxes, are the third largest major General Fund revenue source. San Diego's TOT rate is 10.5%, with 5.5% of that amount allocated to the General Fund (to support general City services), 4.0% to Special Promotional Programs (to support programs and services that encourage tourism to San Diego), and 1.0% allocated as discretionary/Council directed funding. The Outlook focuses on the 5.5% General Fund allocation of TOT.

Transient Occupancy Tax Revenue *($ in millions)*

	FY 2025 Adopted	FY 2025 Projection	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
General Fund Allocation (5.5%)	$ 172.8	$ 168.7	$ 176.4	$ 185.1	$ 194.4	$ 204.0	$ 214.2
Special Promotional Programs (4.0%)	124.6	121.5	127.1	133.5	140.2	147.2	154.6
Council Discretionary (1.0%)	31.2	30.4	31.8	33.4	35.1	36.8	38.7
Total	$ 328.6	$ 320.5	$ 335.3	$ 352.0	$ 369.6	$ 388.1	$ 407.5

Note: Figures may not total due to rounding.

In FY 2023, as the City moved out of the COVID-19 pandemic and the dramatic impacts on travel and tourism continued to ebb, the City saw year-end TOT actuals 18.6% higher than FY 2022 actuals. Growth in TOT revenues since then, however, has slowed significantly: FY 2024 TOT revenues came in only 1.2% higher than FY 2023, and FY 2025 projected revenues after the First Quarter Report are expected to be 3.0% higher than FY 2024. These growth rates (1.2% in FY 2024 and 3.0% in FY 2025) are lower than the:

- Pre-pandemic historical average between FY 2012 and FY 2019 of 5.9%;

- FY 2025 Adopted Budget growth rate of 5.9%; and
- Outlook period growth rate of 5.0%.

The San Diego Tourism Authority and Tourism Economics release a forecast for lodging demand and revenue growth every few months.[6] An updated forecast was released in October 2024 that covers projections through the end of the calendar year 2025. They forecast a growth rate of 2.4% in FY 2025 and 2.2% in the first six months of FY 2026. Additionally, Tourism Economics' Travel Forecast predicts growth in domestic hotel demand in San Diego in calendar years 2025 through 2027 to be in the low 2.0% range.

TOT has historically been a volatile source of revenue that is highly susceptible to declines during economic downturns and increases during upturns. Tourism Economics' forecast indicates that the Outlook growth rate for TOT of 5.0% may be higher than what the lodging industry expects. If a lower growth rate of 2.5% is applied to the FY 2025 First Quarter Projections, then FY 2026 TOT Forecast would be $172.9 million or $3.5 million lower than currently forecasted.

Our Office will monitor changes in the forecasted growth rate as more post-November 2024 updated forecasts are produced and more TOT actual revenue is received by the City.

Franchise Fees

Franchise Fees represent payments made by private companies to the City for the right to operate within the City's right-of-way. The main sources of franchise fee revenue are:

- San Diego Gas & Electric (SDG&E) for the right to provide City residents and businesses with gas and electric services;
- Cox Communications, AT&T, and Spectrum for the right to provide cable services to City residents; and
- Private refuse haulers that conduct business within City limits.

Franchise Fees from SDG&E and cable companies are based upon a percentage of revenue generated, while franchise fees from refuse haulers are based on tonnage.

Overall Franchise Fees in the Outlook are projected to decrease by $2.9 million from the FY 2025 Adopted Budget to the FY 2026 forecast, and again decrease by $3.8 million from FY 2026 to FY 2027. During the outer years of the Outlook, Franchise Fee revenue is expected to increase by an average annualized growth rate of 4.8%.

The FY 2026 decline is primarily due to two changes. First, in FY 2025, the Environmental Services Department (ESD) proposed allocating franchise fee revenues for Sycamore Canyon from the Recycling Fund to the General Fund on a one-time basis, resulting in an increase of $4.3 million in revenue. This revenue is typically split between the Recycling Fund and the General Fund, but since FY 2020 had been solely dedicated to the Recycling Fund. Since this was a one-time transfer,

[6] The Tourism Economics forecast does not include data from short-term rentals (AirBnb, Vrbo, etc.) or Recreational Vehicle (RV) parks.

it is not included in the baseline forecast for the General Fund. However, based on discussions with ESD, there is the potential that this transfer to the General Fund could become permanent if the Recycling Fund can be relieved of its collections expenses (see discussion of Measure B and Waste Collection Fees later in this report). This would result in an ongoing revenue increase *above* the Outlook's projected revenues of $4.3 million.

The other decrease for FY 2026 is $2.1 million due to the transfer of 20% of minimum bid proceeds from the SDG&E franchise agreements to the Energy Independence Fund (EIF). The EIF was established by resolution in April 2022, and requires the Mayor and Council to consider putting into the fund 20% of any minimum bid proceeds received by the City, with the intention that these funds be reserved to either pay refunds of bid proceeds should the agreements be terminated early, pay for professional services to study the possible municipalization of gas and electric transmission systems, or pay for the development costs for renewable energy projects. In FY 2025, the payment to the fund was not only suspended, but the entire balance in the fund was transferred to the General Fund, save for $500,000 that was maintained in the EIF to continue work on an electric municipalization study.

SDG&E Franchise Fees Supporting Council-Established Funds

There are two fund transfers that are directly tied to SDG&E franchise fees, which were suspended in FY 2025, but are projected to resume in the Outlook. These transfers support the Council-established EIF and Climate Equity Fund. The General Fund impact of these transfers is shown in the following table.

Transfer of Franchise Fee Revenue to Climate-Related Funds					
	FY 2026	**FY 2027**	**FY 2028**	**FY 2029**	**FY 2030**
Climate Equity Fund	$ 8,808,000	$ 9,073,000	$ 9,436,000	$ 10,096,000	$ 10,904,000
Energy Independence Fund	2,383,000	117,000	120,000	124,000	127,000
Total Impact to General Fund	**$ 11,192,000**	**$ 9,190,000**	**$ 9,556,000**	**$ 10,220,000**	**$ 11,031,000**

Note that as part of the electric franchise agreement, SDG&E chose to pay their minimum bid proceeds, totaling $70.0 million, in installments, which included $10.0 million payments with interest in FY 2022 through FY 2026, and then the final two payments in FY 2031 and 2032.[7] Thus, there is a decline in General Fund revenue of $6.3 million (as well as the decrease in EIF amounts in the table above) in FY 2027.

Cannabis Business Tax

The Outlook includes projected revenue from the City's non-medical cannabis business tax (CBT). The tax applies to cannabis-related business activities such as transporting, manufacturing, packaging, and retail sales. Retail outlets are taxed at a rate of 8.0% while other activities, including cannabis production facilities (CPFs), are taxed at 2.0%. Note that per San Diego Municipal Code §34.0112, these tax rates can be adjusted through Council action, which is further discussed in our section on potential budget mitigations.

[7] Per the City Charter, all revenue derived from gas and electric franchise agreements, including bid proceeds must be split 75% to the General Fund and 25% to the Environmental Growth Funds.

The Outlook's CBT revenue projection uses FY 2024 revenue as its base and historical averages to forecast the number of outlets and CPFs through FY 2030. The Outlook assumes that the number of retail outlets will grow from 25 in FY 2026 to 29 in FY 2030, while the number of CPFs are projected to grow from 35 in FY 2026 to 40 in FY 2030.[8] For the FY 2026 forecast, total CBT revenue is estimated to be $18.2 million, which is $1.2 million lower than the FY 2025 Budget of $19.4 million. This decrease is largely attributed to the decline in average annual CBT revenue as a result of increased competition from surrounding municipalities, the illicit market, and delivery services.

Emergency Medical Services (EMS) Fund Transfer

The FY 2025 Adopted Budget included a $6.1 million one-time transfer from the EMS Fund to the General Fund as budget mitigation action. While the Outlook removes all one-time resources and expenditures included in the FY 2025 Adopted Budget, the Outlook's baseline revenues assume that this transfer will continue annually throughout the Outlook period.

According to the Fire-Recuse Department, revenue generated from EMS-related activity under the Alliance Model has exceeded expectations. At the time of budget approval in June 2024, the Department projected that the EMS Fund would end FY 2025 with a negative fund balance (a deficit) totaling approximately $7.0 million (after accounting for the $6.1 million transfer to the General Fund); however, with the benefit of having more than full year of actual revenue and expenditure data, the Department's current projections now anticipate that the EMS Fund will end FY 2025 with a positive fund balance (a surplus) of approximately $900,000 (after accounting for the $6.1 million transfer to the General Fund). This indicates that the EMS Fund is likely able to support the annual $6.1 million transfer to the General Fund assumed in the Outlook.

That said, transferred funds will limit the extent to which the Fire-Recue Department is able to reinvest these resources back into the EMS system. Additionally, it should be noted that the long-term operational and financial structure of the EMS system is unknown. As anticipated when the Council approved the transition to the Alliance Model in July 2023, the Fire-Rescue Department expects to conduct a new Request for Proposals (RFP) process, likely in FY 2026, that will either continue the Alliance Model or pursue a different EMS delivery method.

[8] The majority of CPFs that are included in the Outlook operate outside the City. The City Treasurer's Office anticipates the number of CPFs operating within the City will only range between 10 and 15 during the Outlook period.

REVIEW OF BASELINE GENERAL FUND EXPENDITURES

General Fund baseline expenditures support existing service levels; therefore, there are no increases related to new programs in the Outlook's baseline. However, we note that decision-makers may ultimately determine that continuation of certain baseline services may not be possible given the City's structural deficit: ***some service levels could be reduced or eliminated in order to fund other needs and priorities determined to be more important***. The City Council is the ultimate budget authority and can fund services that are different than those proposed by the Mayor.

Our review of General Fund baseline expenditures addresses changes from the FY 2025 Adopted Budget to the FY 2026 Outlook baseline. As shown in the table on the next page, the Outlook's FY 2026 General Fund baseline expenditure projection represents a net increase of $172.0 million (or 8.0%) from the FY 2025 Adopted Budget – including a number of increases and partially offsetting decreases.

The largest expenditure ***increases*** shown in the table include:

- $56.6 million for the General Fund Reserve contribution
- $53.0 million for employee compensation increases (largely based on labor agreements) – see the Personnel-related Expenditures section on page 17 for additional information
- $20.3 million for Lease Revenue Bond (LRB) debt service for CIP, including a new LRB issuance
- $14.7 million for ongoing General Fund expenditures (for Transportation, Stormwater, and Facilities) that were supported by the Infrastructure Fund in FY 2025
- $8.8 million for the Climate Equity Fund contribution
- $8.0 million for ongoing homelessness expenditures that were supported by the Affordable Housing Fund in FY 2025
- $7.1 million for the Actuarially Determined Contribution (ADC) pension payment increase
- $6.6 million for contributions to the Workers' Compensation, Public Liability, and Long-Term Disability Reserves
- $6.3 million for Workers' Compensation operating costs

Expenditure increases are partially offset by a number of expenditure ***decreases***, including:

- $12.3 million for the Charter section 77.1 transfer to the Infrastructure Fund – see the Non-Personnel Expenditures section on page 18 for additional information
- $7.2 million for elections costs
- $5.7 million for support for homelessness programs[9]

Several baseline expenditure changes are discussed in the sections following the table.

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[9] Includes funding for continued homeless shelter operations ($1.5 million), start-up costs for 1,000 Beds and the Safe Parking Program ($1.2 million), the Multi-Disciplinary Outreach Program ($1.1 million), Eviction Prevention Program ($963,000), Day Center improvements and services ($661,000), and Family Shelter operating costs ($315,000).

Increases/(Decreases) from the FY 2025 Adopted Budget to the FY 2026 Outlook Baseline Projection *($ in millions)*		
FY 2025 Adopted Budget		**$ 2,160.9**
Personnel Expenditure (PE) and Fringe Benefit Changes		**70.5**
Compensation Increases (largely based on labor agreements)	$ 53.0	
Actuarially Determined Contribution (ADC) - Defined Benefit Pension Payment Increase	7.1	
Workers' Compensation Expense Increase	6.3	
Step Increases	3.3	
Termination Pay Annual Leave	1.1	
Net Other PE Changes	(0.2)	
Non-Personnel Expenditure (NPE) Changes		**86.8**
General Fund Reserve Contribution	56.6	
Increased Lease Revenue Bond (LRB) Debt Svc. for CIP (incl. $15.7m for new LRB issuance)	20.3	
Climate Equity Fund Contribution	8.8	
Workers' Compensation ($3.1m), Public Liability ($2.7m), Long-Term Disability ($824k) Reserves	6.6	
Contracts - 2.33% Annual Growth Rate	4.9	
Net Change in Capital Leases & Energy Efficiency Loans (largely related to helicopter leases)	2.8	
Refuse Disposal Fees (largely due to removal of General Fund discount)	2.5	
Energy & Utilities - Incl. Water ($2.9m) & Electric ($1.9m) Increases; Fuel Decrease (-$2.6m)	2.8	
Public Liability Increase: Operating Costs ($983k) and Insurance Premiums ($728)	1.7	
Information Technology (IT) [a]	1.2	
Fleet Fees Net Decreases: Vehicle Usage (-$3.0m) Offset by Vehicle Replacement ($369k)	(2.6)	
Elections Cost Decrease	(7.2)	
Decrease in Infrastructure Fund Transfer	(12.3)	
Net Other NPE Changes	0.8	
Removal of FY 2025 One-Time Expenditure Adjustments (includes PE and NPE) [b]		**14.6**
<u>Add to Baseline: FY 2025 One-Time Expenditure Reductions</u>		
Use of Infrastructure Fund for GF Eligible Expenditures (not including debt service)	14.7	
Affordable Housing Fund Support for Homelessness Programs	8.0	
Delayed Hiring (Request to Fill Process)	4.5	
Use of Other Non-General Funds to Support Homelessness Programs [c]	3.3	
<u>Subtract from Baseline: FY 2025 One-Time Expenditure Additions</u>		
General Fund Supported CIP projects	(2.4)	
Portable Restrooms	(3.7)	
One-Time Expenditures for Homelessness Support [d]	(5.7)	
Net Other One-Time Expenditures	(4.0)	
FY 2026 Outlook Baseline Projection		**$ 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.

[a] Includes $408k associated with an annual growth rate of 2.33% for Computer Maintenance/Contracts, Hardware/Software, Hardware/Software Enhancements, Professional IT Services, Enterprise GIS, and Network Access. Additionally, an increase of $754k is associated with application services, cyber security, and help desk support.

[b] Attachment 1 includes a full listing of FY 2025 one-time expenditure adjustments, which net to a $25.6m one-time overall reduction. Only $14.6m of this is shown in the "Removal of FY 2025 One-Time Expenditure Adjustments" section of this table. The remainder is embedded elsewhere in the table and includes $8.5m for the waived Climate Equity Fund transfer, $2.1m for reduced Refuse Disposal fees, $1.3m for debt service costs borne by the Infrastructure Fund, and $250k in reduced capital lease payments; an offsetting $1.2m for termination pay is also embedded elsewhere in the table.

[c] Use of other funds to support homelessness programs includes use of Permanent Local Housing Allocation Program Funding ($2.3m); use of Low Income Housing Lease Revenue ($834k); and use of HOME - American Rescue Plan Funds ($240k).

[d] Includes continued homeless shelter operations ($1.5m), start-up costs for 1,000 Beds and the Safe Parking Program ($1.2m), the Multi-Disciplinary Outreach Program ($1.1m), Eviction Prevention Program ($963k), Day Center improvements and services ($661k), and Family Shelter operating costs ($315k).

PERSONNEL-RELATED EXPENDITURES IN THE OUTLOOK BASELINE

Review of Baseline Personnel Expenditures
• Employee Compensation

The Outlook notes two risks related to the unpredictability of certain personnel-related expenditures. One risk is the Actuarially Determined Contribution (ADC) pension payment, which can vary from projections year-to-year due to actual experience being different than what was assumed within the initial ADC projections. Differences that could cause unanticipated increases to the ADC include lower investment returns than assumed or higher salaries than expected. As such, higher salaries than previously expected by the actuary have been incorporated into the draft FY 2024 actuarial valuation, which includes the actual (unapproved) FY 2026 ADC and is expected to be considered for SDCERS[10] Board approval this March (after an initial hearing on January 10). The draft valuation indicates a higher ADC than was incorporated in the Outlook: the resulting increase to the General Fund baseline shortfall is estimated to be $27.3 million.

Another risk noted in the Outlook is related to future compensation increases, which is discussed below.

Employee Compensation

Salary and wage projections in the Outlook are largely based on labor agreements, or Memoranda of Understanding (MOUs), with the City's six Recognized Employee Organizations (REOs). As discussed below, the Outlook's estimated employee compensation increases take into account existing MOUs, as well as assumed general wage increases for years after the MOUs expire. The following table shows the Outlook's estimated annual compensation increases for represented members by REO, as well as for unrepresented employees.

FY 2026 - FY 2030 Compensation Increases for Bargaining Unit Groups *($ in millions)*

Bargaining Unit Group	**FY 2026**	**FY 2027**	**FY 2028**	**FY 2029**	**FY 2030**
Represented Employees - by REO					
Municipal Employees Association	$ 17.6	$ 26.2	$ 33.4	$ 40.9	$ 48.6
San Diego Police Officers Association	11.0	18.4	25.7	33.2	40.9
American Federation of State, County & Municipal Employees, Local 127	7.1	10.6	13.0	15.4	18.0
International Association of Fire Fighters, Local 145	6.0	10.2	13.5	16.9	20.4
Deputy City Attorneys Association	2.4	3.4	4.4	5.4	6.4
Teamsters Local 911 (lifeguards)	0.8	1.3	1.8	2.3	2.8
Total Compensation Increases for Represented Employees	*$ 45.0*	*$ 70.0*	*$ 91.8*	*$ 114.1*	*$ 137.0*
Unrepresented Employees	8.0	11.7	15.4	19.3	23.3
Total Compensation Increases	**$ 53.0**	**$ 81.7**	**$ 107.2**	**$ 133.4**	**$ 160.2**

As shown in the preceding table, the FY 2026 forecast includes $45.0 million for estimated compensation increases related to the REOs' current MOUs. These increases are primarily related to general wage increases and special wage adjustments for certain positions. The FY 2026 forecast also includes $8.0 million in estimated compensation increases for unrepresented employees,

[10] SDCERS is the San Diego City Employees' Retirement System.

whose recent general wage increases have been consistent with those approved for the Municipal Employees Association. The combined total FY 2026 compensation increase for both represented and unrepresented employees is $53.0 million.

Current MOUs for all REOs expire at the end of FY 2026 (June 30, 2026); and negotiations for FY 2027 MOUs will begin in the fall of FY 2026. The Outlook's estimates for compensation increases in FY 2027 and the remaining Outlook years are based on an assumed annual 2.73% general wage increase for members of all REOs, as well as unrepresented employees. These increases are reflected in the preceding table. Note that each year's column in the table includes the prior year's increase plus the increase for that year.

The 2.73% annual wage increase assumed for FY 2027 and the remaining Outlook years is equivalent to the average annual Consumer Price Index growth for the San Diego-Carlsbad region over the last fifteen years, which our Office finds reasonable. However, compensation increases negotiated with each of the City's REOs may end up higher or lower than assumed in the Outlook. For reference, as of FY 2025, a 1.0% general wage increase for General Fund employees is estimated to cost $8.7 million.

The Outlook, beginning on page 72, provides an overview of compensation issues, including discussion regarding the City's Compensation Philosophy and the City's goal of positioning itself to attract and retain top talent that can effectively deliver services to its citizens. This has been an important consideration in recent negotiation cycles with the City's REOs. Over the past several years, the City, working with its REOs, has made significant progress in increasing compensation to more competitive levels for many job classifications. The City endeavors to pay at least the market median compensation for comparably situated public employees. *Any budget mitigation efforts that would involve failing to keep pace with the market could help address the General Fund revenue shortfall, but could also move the City backwards in its ability to attract and retain talent.*

Non-Personnel Expenditures (NPE) in the Outlook Baseline

Review of Baseline Non-Personnel Expenditures

- Information Technology
- Infrastructure Fund
- Debt Financing

The Outlook discusses baseline NPE for the following categories: supplies; contracts and services; information technology; energy and utilities; other expenditures, including debt service; reserve contributions; and transfers to the City Charter section 77.1 Infrastructure Fund. As part of our analysis, the table on page 16 of this report includes major NPE changes from the FY 2025 Adopted Budget to the FY 2026 Outlook baseline projection. Select NPE areas are also discussed in more detail, including information technology, the Infrastructure Fund, and debt financing.

Information Technology

The Information Technology (IT) category reflects both discretionary expenditures and non-discretionary allocations to General Fund departments, including hardware and software maintenance, help desk support, and other IT costs. To develop the FY 2026 IT discretionary projection, any one-time costs included in the FY 2025 Adopted Budget were removed, in this case $134,000 was removed from baseline projections. Then, an increase of $754,000 was added to the FY 2025 Adopted Budget to meet contractual obligations for non-discretionary costs, including cyber security, application services, and help desk support; and $408,000 was added for a CPI growth rate applied to discretionary costs like hardware and software enhancements. The applied CPI growth rate is 2.3% for FY 2026 and 2.1% in subsequent years. Growth rate projections essentially reflect anticipated impacts of inflation.

Similar to last year, IT non-discretionary allocation projections are based on various methodologies including the actual consumption of services in the previous fiscal year, the quantities of licenses for IT products assigned to departments, and the quantities of personal computers assigned to departments. These are used to calculate a rate for each category of services, which is projected over the Outlook period. Minimal CPI growth is applied to baseline non-discretionary amounts because these costs are primarily captured in multi-year fixed-rate contracts which do not typically require annual CPI increases. Therefore, the growth was applied only to specific contracts, such as those requiring renewal during the Outlook period. Notably, IT non-discretionary *enhancement* projects are not included in the Outlook's baseline expenditures, though debt service costs for the General Fund portion ($61.8 million) to modernize the City's SAP ERP system are assumed, as will be discussed in the Debt Financing section below.

Infrastructure Fund

Charter Section 77.1 requires the City to dedicate a portion of revenue increases to the Infrastructure Fund, which is calculated based on sales tax increases over FY 2016 and whether there are any General Fund pension cost reductions for each Outlook year.[11] Dollars in the Infrastructure Fund are restricted to being used to support financing costs of capital improvements, and the operations and maintenance of City infrastructure. Given this, it has been an important funding source for General Fund assets and related capital projects that lack a dedicated funding source.

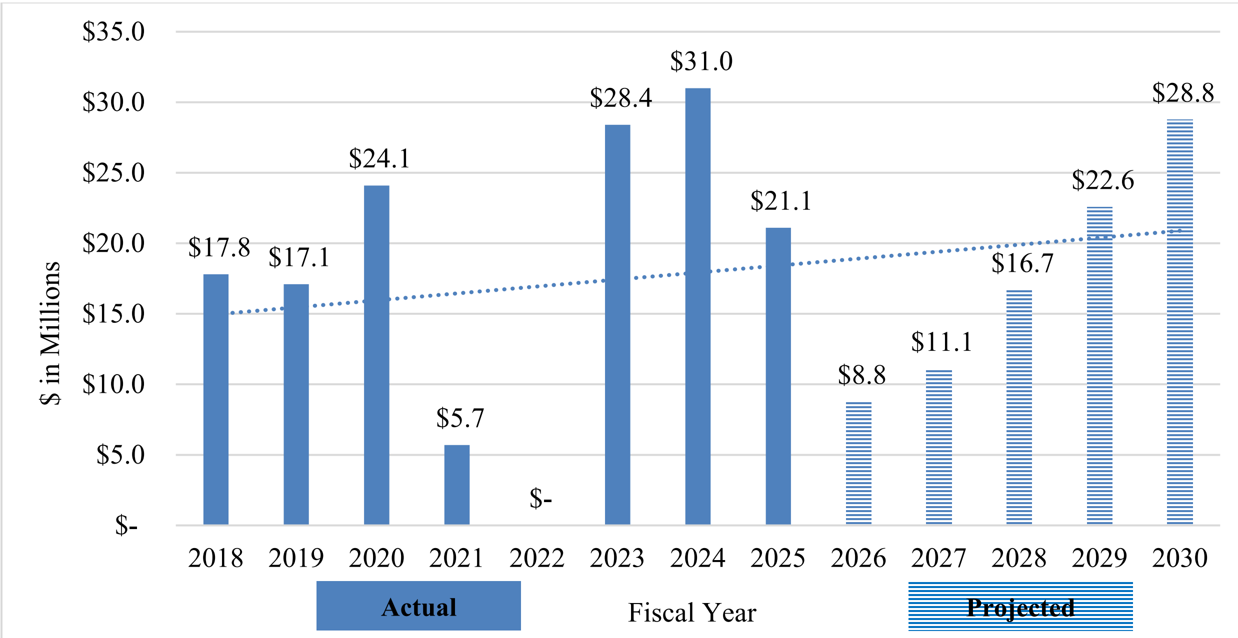
The Outlook projects Infrastructure Fund contributions to total $87.9 million over its five-year period. As contributions to the Infrastructure Fund are based on growth in sales tax revenues above a FY 2016 baseline, as adjusted by the California Consumer Price Index (CCPI), amounts dedicated to the Infrastructure Fund vary from year to year. Notably, FY 2026 contributions in the Outlook are projected at $8.8 million.[12]

[11] The Infrastructure Fund was established by Section 77.1 of Article VII of the City Charter, which dedicated a portion of growth in major General Fund revenues to fund General Fund infrastructure efforts. This amendment to the Charter (Proposition H) was passed by San Diego voters in June 2016.

[12] This total contribution does not reflect a $20.4 million *negative* true-up payment not yet distributed from the Infrastructure Fund that results from actual FY 2024 sales tax revenue coming in significantly below projections in relation to the 2016 baseline adjusted for inflation.

The following chart shows budgeted amounts for the Infrastructure Fund since it was created in FY 2018, as well as funding projected in the Outlook, including $8.8 million for FY 2026.

Infrastructure Fund Actuals and Outlook Projections



Notably, contributions to the Infrastructure Fund were waived in FY 2021 and in FY 2022 to help balance the City's operating budget given COVID-19 related revenue declines.[13]

In FY 2025, the Infrastructure Fund was used to support $1.3 million for debt service on eligible capital projects, $785,000 for Vision Zero capital projects, *and to support eligible operating expenditures*, such as repairs and maintenance for facilities, stormwater channels, streets, sidewalks, and streetlights.

While the Outlook does not project the suspension of Infrastructure Fund contributions, or any use to support the maintenance of existing infrastructure (and thereby offsetting other General Fund costs), our Office notes that such use could help address the City's near-term budget shortfalls. This will be discussed in more detail later in this report. We do note, however, that consideration should also be given to the cumulative impact this use could have on the City's $4.8 billion General Fund capital infrastructure backlog.

<u>Debt Financing</u>

The Outlook's baseline includes projected debt service costs associated with $1.02 billion in proceeds from three new General Fund-backed Lease Revenue Bond (LRB) issuances assumed over the course of the Outlook. These LRB debt proceeds are assumed to provide a total of $962.3 million for the General Fund Capital Improvement Program (CIP), including $278.3 million which

[13] The $5.7 million shown in the chart in FY 2021 represents a FY 2019 true-up amount.

will be needed meet the EPA's matching funds requirement for the City's Water Infrastructure Finance and Innovation Act (WIFIA) Loan to fund Stormwater improvements. The remaining $61.8 million is assumed for non-CIP purposes to finance the General Fund's portion of estimated costs related to the modernization of the City's SAP system. The LRB issuances are assumed to occur in FY 2026 ($379.6 million to fund spending in FY 2026-2027), FY 2028 ($407.8 million to fund spending in FY 2028-2029), and FY 2030 ($236.7 million to fund spending to occur in FY 2030), as broken down in the table below.

Assumed Use/Spending of Lease Revenue Bond (LRB) Proceeds by Fiscal Year *($ in millions)*						
LRB Issuance Year	**FY 2026**		**FY 2028**		**FY 2030**	**Total**
LRB Proceeds ($)	$379.6		$407.8		$236.7	**$1,024.1**
Use / Spending Year	**FY 2026**	**FY 2027**	**FY 2028**	**FY 2029**	**FY 2030**	**Total**
Capital Improvement Program	$149.6	$144.0	$120.0	$132.0	$138.4	**$684.0**
SAP Modernization	20.6	20.6	20.6	0.0	0.0	**61.8**
WIFIA Match	0.0	45.0	45.0	90.0	98.3	**278.3**
Total	**$170.2**	**$209.6**	**$185.6**	**$222.0**	**$236.7**	**$1,024.1**

The amount assumed for the CIP ($684.0 million excluding WIFIA projects) does not represent the funding needed for any specific project(s) or asset types within the CIP; rather, this amount reflects the City's anticipated capacity to issue debt for the CIP over the next five years, which is based on Engineering & Capital Project's (E&CP) projected spending rate ($10-12 million per month or $120-144 million per year).

As reflected in the following table, there is currently $394.7 million in existing Council-approved debt appropriations which require funding from future financing proceeds. In addition to this, the Department of Finance anticipates seeking future Council action to approve additional debt appropriations for remaining Stormwater WIFIA matching funds (estimated at $88.1 million) and the General Fund's SAP modernization costs (estimated at $61.8 million). Assuming these actions occur, overall debt appropriations will total $544.6 million; this compares against $1.02 billion of debt assumed to be issued over the Outlook period. This leaves $479.5 million in potential debt proceed which can either support additional capital projects, or which do not need to occur to support existing appropriations.

General Fund Debt Appropriation Summary		
EXISTING APPROPRIATIONS		
Existing CIP Appropriations	$	601,929,571
Existing WIFIA Match Appropriations		190,232,614
Existing Capital Equipment and Vehicle Appropriations		163,187,974
Total	**$**	**955,350,159**
DEBT PROCEEDS		
Debt Issued and Expended	$	346,901,884
Debt Available for Existing Appropriations		213,700,221
Total	**$**	**560,602,105**
Existing Appropriations Requiring Future Debt	**$**	**394,748,054**
Assumed New Debt Proceeds (FY 2026-2030)	**$**	**1,024,100,000**
Unappropriated Debt Capacity	**$**	**629,351,946**
APPROPRIATIONS PENDING FUTURE COUNCIL ACTION		
Remaining Stormwater WIFIA Match	$	88,100,000
SAP Modernization		61,800,000
Total	**$**	**149,900,000**
Net Debt Capacity	**$**	**479,451,946**

Short-term borrowings anticipated over the Outlook period are also included in the Outlook's projections. These consist of Equipment and Vehicle Financing Program (EVFP) financing costs for the replacement of three Police helicopters and one Fire-Rescue helicopter, as well as General Fund PC replacement needs.

Our Office worked with the Department of Finance's Debt Management Division to prepare the following table which reflects the additional debt service costs (i.e., principal and interest) that are assumed to be incurred by the General Fund during the Outlook Period, as well as the associated impacts to the City's debt ratios. The City's debt ratios are projected to remain within Debt Policy parameters after accounting for projected debt service costs that are assumed to be incurred by the General Fund during the Outlook period.

General Fund-Backed Debt Service *($ in millions)*						
	FY 2025 Adopted Budget	**Forecast FY 2026**	**Forecast FY 2027**	**Forecast FY 2028**	**Forecast FY 2029**	**Forecast FY 2030**
Existing Debt Service (Short-Term)	$ 19.3	$ 17.0	$ 14.2	$ 12.8	$ 7.9	$ 6.0
Existing Debt Service (Long-Term)	75.3	75.2	74.2	70.1	58.0	58.0
FY 2026 Proj. LRB Issuance ($379.6M)	-	15.7	22.7	22.7	22.7	22.7
FY 2028 Proj. LRB Issuance ($407.8M)	-	-	-	-	23.9	23.9
FY 2030 Proj. LRB Issuance ($236.7M) [a]	-	-	-	-	-	-
Stormwater WIFIA Loan ($359.2M)	0.2	1.4	4.0	7.1	13.2	14.4
New Short-term Debt Service [b]	-	5.3	15.5	25.4	31.2	37.9
Totals	**$ 94.8**	**$ 114.7**	**$ 130.6**	**$ 138.1**	**$ 156.9**	**$ 162.9**
Pension and OPEB Costs	$ 389.4	$ 395.8	$ 400.7	$ 411.7	$ 358.3	$ 361.8
General Fund Revenue [c]	$ 2,103.3	$ 2,101.5	$ 2,172.9	$ 2,241.1	$ 2,314.4	$ 2,395.0
Debt Ratios						
10% Benchmark	**4.5%**	**5.5%**	**6.0%**	**6.2%**	**6.8%**	**6.8%**
Inc. Pension/OPEB - 25% Benchmark	**23.0%**	**24.3%**	**24.4%**	**24.5%**	**22.3%**	**21.9%**

[a] Debt service assumed to begin in FY 2031, outside the Outlook period.

[b] Short-term debt consists of General Fund-backed Equipment and Vehicle Financing Program (EVFP) leases, IT computer hardware leases, and Commercial Paper interest costs.

[c] Includes other operating funds currently being used for existing debt service (e.g. non-General Fund TOT)

OUTLOOK PRIORITIES BEYOND BASELINE EXPENDITURES

While the Outlook projects significant funding shortfalls for existing baseline services and expenditures starting at $258.2 million in FY 2026, it also projects the potential for additional costs beyond baseline expenditures of $71.1 million (increasing to $107.0 million in FY 2030). These expenditures would increase the projected FY 2026 deficit from $258.2 million to $329.3 million. **Given the size of the *baseline* deficit projected for FY 2026, any additional *non-baseline* expenditures should be heavily scrutinized, as they will require offsetting expenditure cuts elsewhere.**

Additional non-baseline expenditures shown in the Outlook fall into two categories – New Facilities, and Planned Commitments, both of which are discussed below.

NEW FACILITIES

New Facilities
• Library
• Parks and Recreation
• Fire Stations

The Outlook includes forecasted funding for new Library, Parks and Recreation, and Fire-Rescue facilities assumed to open during the Outlook period. Opening dates for new facilities in the Outlook are not certain as timelines can be impacted by project delays. As in previous years, some new facilities currently in development are projected to open during the Outlook, though they lack full funding for construction. Without a clear funding plan, it may be premature to project the opening of these facilities and corresponding operating costs in the Outlook's projections.

Furthermore, given the likelihood for service-level reductions during upcoming budget cycles, the impacts of moving forward with new facilities while at the same time cutting or eliminating services at existing facilities will need to be taken into consideration. If existing services, programs, and facilities are determined to be a higher priority, deferring the opening of new facilities should be considered.

A list of expenses for new facilities anticipated to open or become operational within the Outlook period is included in Attachment 2 to this report.

Library

The Library Department anticipates the completion of the Ocean Beach Library expansion project and the replacement of the Oak Park Library during the Outlook period. Given that these new facilities will replace/expand existing library branches, no new staffing is assumed; new costs for these facilities in the Outlook instead include increases in NPE, including energy and other utilities, janitorial services, and landscaping. Total projected annual costs are $51,000 beginning in FY 2027 and increase to $154,000 in FY 2029.

Our Office includes additional updates for these Library facilities:

- *FY 2027 – Ocean Beach Library Expansion*: The expansion project is substantially funded, with $200,000 in unidentified funding. Award of a Design Build Contract is expected to be completed by July 31, 2025, with the Design Build Scope finished a year later by July 31, 2026. An opening date will be determined once construction is underway.

- *FY 2028 – Oak Park Library (Replacement)*: The library replacement project is partially funded. The City received a $9.1 million grant from the California State Library and is required to contribute $4.5 million in matching funds. Of the matching fund requirement, $1.0 million has been identified, with the remaining balance contributing to the total $5.9 million in unidentified funding. The Department is targeting mid-FY 2027 for construction completion, assuming required funding is identified.

We note that the previous Outlook (FY 2025-2029) anticipated that the San Carlos Library replacement would open in FY 2029; this new facility was withheld from the Outlook given its substantial funding shortfall totaling $31.5 million of the $47.5 million estimated total project cost.

Parks and Recreation

The Parks and Recreation Department anticipates 15 new or expanded parks to open, and 13 new Joint Use Agreements (Agreements) with local school districts allowing shared use of various recreation facilities. The Outlook projects new expenses for park facilities to total $9.4 million in FY 2026, which increases to an aggregate expense of $12.9 million in FY 2030; included in this aggregated expense is the addition of 69.25 FTE positions in total over the Outlook period.

We note that these totals include 3.00 FTEs and $2.9 million in FY 2026 expenses (of which $2.7 million is an ongoing) which assumes that the Parks and Recreation Department will take over brush management responsibilities across all City-owned land. While this is in-line with Recommendation 2.2 from the City Auditor's Performance Audit of the City's Brush Management on City-Owned Land,[14] it should be noted that the expenses assumed in the Outlook for this purpose do not relate to new facilities.

Fire Stations

The Outlook assumes funding for operational expenses for two new fire stations assumed to open during the Outlook period. Total assumed staffing needs and annual costs include 12.00 FTEs and $2.5 million beginning in FY 2028, increasing to 39.00 FTEs and $8.5 million in FY 2030. The two new fire stations identified in the Outlook are listed below:

- *FY 2028 – Fire Station 48: Black Mountain Ranch (primarily developer funded):* Current project cost estimate totals $33.0 million of which $3.0 million is unfunded.
- *FY 2029 – Fire Station 49: Otay Mesa (land purchased):* Current project cost estimate totals $39.0 million of which $34.0 million is currently unfunded. Tax increment revenue from the Otay Mesa Enhanced Infrastructure Financing District (EIFD) is anticipated to fund design and finance construction costs.

[14] Recommendation 2.2 states: "To ensure consistent and effective brush management across all City-owned land, the Chief Operating Officer should consider consolidating brush management responsibilities to the extent operationally and fiscally possible. OCA believes that the Parks and Recreation Department's Open Space Division is best positioned to expand its operations to achieve mandated brush management objectives. However, our assessment does not preclude other approaches that achieve the same objectives. A Service Level Agreement, Internal Order, or similar reimbursement mechanism should be established if/as appropriate".

PLANNED COMMITMENTS

Planned Commitments
• Homelessness Services • Stormwater – Wetland Mitigation

Homelessness Services

For homelessness programs and services, the Outlook includes planned commitments related to expanding sheltering capacity and increasing service levels, as well as maintaining existing homelessness services.

Among the most significant planned commitments is the addition of up to 1,000 new shelter beds proposed planned at a former industrial facility located at Kettner Boulevard and Vine Street. A proposal to lease the facility has not been approved by the City Council at the time of this writing. Operation and leasing costs associated with these new shelter beds total $33.7 million starting in FY 2026. If the proposal is brought forward to Council, it is unlikely that full-year operating costs would be necessary in FY 2026 due to time needed to complete tenant improvements and subsequently ramp up to operate at full capacity.

Planned commitments also include maintaining funds for existing programs funded on a one-time basis in the FY 2025 Adopted Budget, including the Neil Good Day Center, Multidisciplinary Outreach Team, and public restrooms. The Outlook incorporates existing ongoing General Fund support for homelessness programs, as well as additional one-time County, State, and federal grant funds the City anticipates receiving in FY 2026. However, even with existing ongoing General Fund and anticipated grant funds, the Outlook identifies the need for an additional $55.8 million General Fund commitment in FY 2026.[15]

To assess the General Fund commitment for expanded homelessness efforts specifically, our Office separated out planned commitments related to *existing* program services from *expanded* service levels in the table on the following page. The table includes homelessness programs anticipated to be supported in FY 2026 by the City's General Fund, as well as County, State, and federal grant funds. *Existing* program services include programs that are currently in operation, as well as pending programs that are also funded in the FY 2025 Adopted Budget. For replacement shelter beds needed to maintain shelter capacity following the planned relocation of four shelters in FY 2025, existing service levels assume the available operational budget from the four shelters, which can be redirected to support identified replacement beds.[16] *Expanded* service levels include program or service enhancements that are currently planned or pending; these include programs that received initial ongoing funding in the FY 2025 Adopted Budget, such as new Safe Parking at H-Barracks and up to 1,000 new shelter beds at Kettner and Vine.

[15] Notably, not all homelessness programs provided by the City are included in the Homelessness Strategies and Solutions Department (HSSD) budget. Additional programs and services are provided by other City departments as well as the San Diego Housing Commission. Those programs, such as federal housing voucher support for people experiencing homelessness, permanent supportive housing services, and SDHC-funded prevention, diversion, and landlord engagement programs, are not discussed in this section.

[16] Since the Five-Year Outlook was developed before recent actions to fund 263 replacement beds under the Short-Term Action Plan on Homelessness, as heard by Council on December 9, 2024, the Outlook assumed an overall increase in expenditures to fund replacement beds at an assumed $84 per bed night. Since actual costs for the replacement beds identified thus far can be accommodated within the existing operational budget, any expenditures beyond the existing operational budget are considered under *expanded service levels* for this exercise.

Breakout of FY 2026 Homelessness Existing Services and Planned Commitments *(Subject to Change)*		
Strategy	**Programs**	**Anticipated Funding Needs**
Existing Service Levels [a]		
Prevention and Diversion $9.5 million	Housing Instability Prevention Program	$ 5,356,000
	Eviction Prevention Program	3,000,000
	Family Reunification	809,000
	Rapid Rehousing	343,000
Emergency Shelters $43.7 million	Replacement Shelter Beds - Existing Funding[b]	11,268,000
	Bridge Shelter - 16th and Newton	8,642,000
	Family Non-Congregate Shelter	4,868,000
	Bridge Shelter - 17th and Imperial	4,323,000
	Domestic Violence Shelter	3,152,000
	Youth Case Management & Shelter	2,556,000
	Seniors Landing Non-Congregate Shelter	2,128,000
	LGBTQ+ Youth Services and Shelter	2,028,000
	New Permanent Shelter/Kettner & Vine - Existing Funding *(pending)*	1,265,000
	Connections Interim Housing	1,261,000
	Shelter Contract Compensation Increases	1,080,000
	Bishops Shelter	678,000
	New Family Non-Congregate (Expansion)	464,000
Substance Use Disorder Services $8.8 million	Rosecrans Sprung Shelter	5,555,000
	Harm Reduction Interim Shelter	2,765,000
	Safe Haven	439,000
Sheltering Options $18.2 million	Safe Sleeping Program	13,459,000
	Safe Parking Programs	3,918,000
	New Safe Parking at H-Barracks - Existing Funding *(pending)*	841,000
Outreach $6.5 million	Coordinated Outreach Program	3,483,000
	Other Outreach Activities	1,859,000
	Multidisciplinary Outreach Team Pilot	1,133,000
Other Services $9.0 million	Public Restrooms	4,736,000
	Homelessness Response Center	1,801,000
	Storage Centers[c]	1,492,000
	Day Center for Homeless Adults	948,000
Admin $4.6 million	HSSD Administration	3,702,000
	SDHC Administration	913,000
	Total Expenses	**$ 100,265,000**
New Planned Commitments/Expanded Service Levels [d]		
Shelters $44.3 million	New Permanent Shelter/Kettner & Vine - Increased Funding	$ 32,483,000
	Replacement Shelter Beds - Increased Funding	6,120,000
	Shelter Site Preparation Costs	4,900,000
	New Permanent Shelter: 5.00 FTEs for Admin and Maintenance	550,000
	New Permanent Shelter: Shelter Design Consultant	250,000
Safe Parking	Annualized Safe Parking at H-Barracks - Increased Funding	1,659,000
	Total Expenses	**$ 45,962,000**

[a] Generally assumes 3.0% program growth from FY 2025 Adopted Budget.

[b] Includes total existing operational funding for four shelters to be relocated in FY 2025: Golden Hall ($6.9 million), Interim Shelter for Homeless Adults at Paul Mirabile Center ($2.5 million), Women's Shelter/Rachel's Promise ($1.2 million), and Winter Weather Shelter ($1.1 million).

[c] Reflects the closure of Storage Connect II (one of the City's three safe storage sites) due to the expiration of a past settlement agreement and low utilization, according to staff.

[d] Expanded service levels include programs or services that are planned or pending; these are service level enhancements that received initial funding in FY 2025.

FY 2026 Projected Homelessness Funding Gap ***(Subject to Change)***		
Projected Grant and Ongoing General Fund Revenue Available	$	90,429,000
Existing Service Levels Total Expenses	$	(100,265,000)
Funding Gap for Existing Service Levels	**$**	**(9,836,000)**
Expanded Service Levels Total Expenses	$	(45,962,000)
Overall Funding Gap With All Planned Commitments	**$**	**(55,798,000)**

As shown above, the overall funding gap for homelessness planned commitments of $55.8 million in FY 2026 consists of $9.8 million in expenditures for *existing* homelessness services that lack a sufficient revenue source, and an additional $46.0 million for *expanded* service levels. Based on the table on the previous page, expenditures for existing homelessness programs total $100.3 million. With grant and General Fund revenue projected at $90.4 million, there is a $9.8 million shortfall for supporting existing homelessness services. A main driver for this shortfall is the addition of $8.5 million in existing, ongoing expenditures that were funded on a one-time basis in the FY 2025 Adopted Budget and subsequently removed from the FY 2026 baseline. Other factors include assumed program growth and revenue adjustments, including a projected increase in available State grant funds, although allocations from the latest round of State grants have not yet been announced.[17] The shortfall for existing service levels would decrease if currently pending programs, such as a new permanent shelter for up to 1,000 beds, are delayed and ongoing funding is not needed in FY 2026.[18] Expenditures for expanded service levels, such as new shelter beds and Safe Parking at H-Barracks, total $46.0 million, which adds to the overall homelessness funding shortfall.

In contrast to past years, the Outlook assumes continued one-time State grant funding throughout the Outlook period. The City anticipates receiving additional one-time State grant funds through FY 2027, as funded in the most recent State Budget. However, new or continued State or federal funding support beyond FY 2027 remains uncertain. If these one-time funds were no longer available, the anticipated General Fund commitment would increase throughout the Outlook period – starting at $76.3 million in FY 2027 and growing to $104.2 million in FY 2030 for existing homelessness services and planned commitments.

We note that 2020's Measure C proposed an increase to San Diego's Transient Occupancy Tax to, among other things, provide additional funding for homelessness services. Measure C is discussed in further detail later in this report; the City is currently awaiting a final determination from the

[17] The Outlook assumes the next round of State Homeless Housing, Assistance and Prevention (HHAP) grant funds will be comparable to historic averages of HHAP funds received by the City of $26.6 million, with half of the allocation made available in FY 2026 and the remaining half in FY 2027.

[18] If the Kettner and Vine proposal does not proceed, a portion of funds from the $18.7 million identified for tenant improvements could offset General Fund contributions for homelessness-related expenditures in FY 2025, including Permanent Local Housing Allocation ($4.9 million), General Fund for Capital Improvements Program ($400,000), and Low & Moderate Income Housing Asset ($250,000). Most of the one-time funds are from the Community Development Block Grant ($10.4 million) and, under this scenario, would be redirected to affordable housing development through the San Diego Housing Commission and Economic Development Department Notices of Funding Availability.

courts on whether Measure C is an approved citizens' initiative ballot measure and whether the City's issuance of certain bonds under Measure C would be valid. If the City obtains a favorable court judgment or outcome in the lawsuit (which could potentially be released in summer 2025), proceeds from future bonds issued could become a viable ongoing funding source for homelessness programs. If successful, based on recent projections, Measure C could generate between $33.9 million to $41.2 million annually for the first five years, which would be sufficient to cover all existing program costs, assuming continued State funding.

In preparation for upcoming budget decisions in FY 2026, Council may wish to consider delaying any planned commitments identified in the Outlook that represent expanded services to avoid further exacerbating the budget shortfall. Given current available resources are insufficient to fund the City's existing homelessness programs, Council may also want to re-evaluate existing homelessness programs and identify key homelessness priorities for the limited available resources, as well as opportunities to either increase non-General Fund resources or reduce General Fund expenditures while still considering program outcomes.

For instance, it may be worthwhile to examine the appropriate funding level for the City's current homelessness outreach efforts, aimed at connecting individuals experiencing homelessness to available shelter and other resources. The City's shelter bed daily occupancy rate is consistently around 98%, and the rate of completed referrals for shelter beds has dropped to 13% fiscal year-to-date as of the end of November 2024 (compared to a 19% completed referral rate in FY 2024). Without significantly expanding shelter capacity in FY 2026, additional referrals to shelter are likely to remain uncompleted; reassessing funding levels for homelessness outreach services to align with current shelter availability may help right-size the City's investments in outreach services.

Additionally, Council may want to explore additional opportunities for regional collaboration, especially for homelessness expenditures related to public health, such as requesting the County to fund public restrooms currently operated by HSSD to prevent public health outbreaks, or other initiatives that may operate more beneficially at the County level. For example, the Housing Instability Prevention Program, which provides financial assistance to housing unstable low-income households, could provide additional lower-cost housing options outside of the City limits to participants if this program were operated at the County level. Our Office will continue exploring options for the Council to consider to close the homelessness funding gap.

Stormwater – Wetland Mitigation

The other Planned Commitment contained in the Outlook is wetland mitigation payments, estimated at $6.0 to $8.0 million per year, required as a result of channel clearing activities by the Stormwater Department. Amounts for FY 2026 and 2027 represent estimates based on mitigation projects currently in the design and planning phase, while the remaining years are estimates for projects that are still in the early planning phase.

Amounts contained in the Outlook, totaling $38.0 million, are required both to cover past impacts from channel clearing emergencies, such as the activities that took place following the January 2024 storms, as well as future planned maintenance or emergencies that may occur. Providing more routine maintenance to storm channels before overgrowth turns them into protected wetlands would negate the need for future mitigation permits; to that end, the Stormwater Department has reassigned various teams to continue to maintain those channels that were cleared as part of the emergency response last winter. However, these reassigned teams were taken off of other duties, such as pipeline repair, and this could result in other emergencies elsewhere.

ADDITIONAL FUNDING NEEDS NOT INCLUDED IN OUTLOOK

The City has additional *unfunded* priorities not included in the Outlook projections. We review select unfunded Council priorities in this section, including operating needs that are non-infrastructure-related, as well as infrastructure needs.

OPERATING NEEDS (NON-INFRASTRUCTURE)

Operating Needs *Not* Included in Outlook

- Arts & Culture Funding
- Tenant Eviction Notice Registry
- SD Access 4 All – Digital Equity Program
- Climate Action Plan Implementation
  - Fleet Electrification

Arts & Culture Funding

The Outlook assumes a slight increase of $121,000 in funding for Arts and Culture from the current FY 2025 funding level of $16.1 million. In their initial FY 2026 budget priorities memoranda,[19] all nine Councilmembers expressed support for increasing overall funding for arts and culture programs in the City. While proposed funding levels varied, five Councilmembers supported fully funding the Penny for the Arts Blueprint goal of 9.52% of citywide Transient Occupancy Tax (TOT) in FY 2026, equal to 1¢ of the City's 10.5 cent TOT rate. This would require additional expenditures of $15.5 million in FY 2026 beyond what is included in the Outlook.

The remaining four Councilmembers supported incremental progress towards the Penny for the Arts goal, with two Councilmembers supporting a FY 2026 funding level equal to at least 6.5% of citywide TOT. This would require additional expenditures of $5.5 million in FY 2026 beyond what was included in the Outlook. In the FY 2025 Adopted Budget, arts and cultural programs received 4.9% of citywide TOT revenue.

The following table reflects the projected funding level for arts and culture programs over the Outlook period decreasing from 4.9% of Citywide TOT revenue in FY 2026 to 4.0% in FY 2030. The table also shows the projected funding gap over the Outlook period assuming funding target scenarios of 6.5% and 9.5%.

Arts and Culture Funding Levels *($ in millions)*

	FY 2026		FY 2027		FY 2028		FY 2029		FY 2030	
Total Citywide TOT Projection [a]	$333.7		$350.4		$368.0		$386.5		$405.9	
A&C Funding Level in Outlook	$16.2		$16.3		$16.3		$16.3		$16.4	
A&C Funding Level % of TOT [b]	4.9%		4.6%		4.4%		4.2%		4.0%	
Funding Target Scenarios (%)	**6.5%**	**9.5%**	**6.5%**	**9.5%**	**6.5%**	**9.5%**	**6.5%**	**9.5%**	**6.5%**	**9.5%**
Funding Target Scenarios ($)	$21.7	$31.8	$22.8	$33.4	$23.9	$35.0	$25.1	$36.8	$26.4	$38.6
Funding Gap	**($5.5)**	**($15.5)**	**($6.5)**	**($17.1)**	**($7.6)**	**($18.7)**	**($8.8)**	**($20.5)**	**($10.0)**	**($22.3)**

[a] Excludes revenue from RV parks as that goes directly into the General Fund.

[b] To meet the Penny for the Arts blueprint goal of 1¢ of the City's 10.5¢ TOT rate, the target percentage is 9.5%

[19] Councilmembers' initial FY 2026 budget priorities memoranda are attached to IBA Report 24-30 REV, titled *FY 2026 City Council Budget Priorities*. In addition to attaching individual Councilmembers' priorities memoranda, this report describes the Budget Priorities Resolution process and contains the budget priorities that constitute the City Council's initial FY 2026 Budget Priorities Resolution.

As part of the FY 2026 Budget Priorities Resolution process, at its October 2, 2024 meeting, the Economic Development and Intergovernmental Relations (ED&IR) Committee recommended allocating the full 1¢ (9.52%) of total TOT to arts and culture funding. At its October 16, 2024 meeting, the Budget and Government Efficiency (B&GE) Committee concurred with the ED&IR recommendation; Council ultimately approved this recommendation as part of its initial FY 2026 Budget Priorities Resolution.[20] Our Office notes that the additional arts and culture funding needed to meet the 9.52% goal in FY 2026 would be $15.5 million. Fully funding this amount would add to the $258.2 million shortfall projected in FY 2026 and would require additional expenditure cuts.

Tenant Eviction Notice Registry

The Tenant Eviction Notice Registry is needed to implement the Residential Tenant Protection Ordinance, approved by Council on April 25, 2023. Delays in implementation are due to a requirement that the registry go through the Transparent and Responsible Use of Surveillance Technology (TRUST) Ordinance process. If the registry is able to receive an exemption from the TRUST Ordinance, the San Diego Housing Commission can start to develop the online registry to receive at-fault and no-fault just cause eviction notices from landlords. Start-up costs include $215,000 for the portal, website, and tenant guide, as well as $285,000 for two positions for program administration and support. The Housing Commission expects ongoing administrative costs for staffing, the registry, and website maintenance to be $400,000 annually. These expenditures are necessary to support an already approved Council action but are not included in the Outlook.

SD Access 4 All – Digital Equity Program

The Department of IT's FY 2025 $1.6 million budget for SD Access 4 All is supported by one-time grant funding of $500,000 for the Broadband Master Plan; therefore the base budget in the Outlook is assumed as $1.1 million.[21] Funding will be needed in FY 2026 (and potentially future years) to support implementation and enforcement of the plan, but the specific amount will not be known until the plan is finalized in June 2025. The finalized Master Plan will include funding opportunities and recommendations for the City to consider as part of implementation.

An additional $785,000 in unfunded needs to support existing service levels is not included in the Outlook, as shown in the table on the following page. These services were previously funded on a one-time basis or have experienced increased costs.[22]

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[20] Included in the City Council's initial FY 2026 Budget Priorities Resolution is the Council's recommendation to the Mayor for use of the 1¢ TOT. IBA Report 24-30 REV, titled *FY 2026 City Council Budget Priorities*, describes the Budget Priorities Resolution process and contains the budget priorities that constitute the City Council's initial FY 2026 Budget Priorities Resolution.

[21] The $1.1 million base budget supports public WiFi access in City parks and libraries, a mobile hotspot lending program, and digital literacy training and navigation services.

[22] The Department anticipates that cost increases may be needed for these services, but estimates are not currently known.

Components	Cost	Details	Impact if Not Funded
Public Wi-Fi – To continue Wi-Fi services at 59 Parks and Recreation sites	$500,000	Wi-Fi for these sites was originally funded by the Parks Foundation ($1.4 million for infrastructure and services).	WiFi at all 59 sites will be discontinued. Public park WiFi is used by City staff for community-facing programs, along with many members of the public. It is estimated to cost at least $750,000 to reestablish services if infrastructure is removed and later rebuilt. Department staff has not identified grant funding opportunities that can specifically be used for public WiFi in parks, as most funding focuses on indoor spaces.
Public Library Hotspot and Chromebook Lending Program	$227,000	Additional funding was needed to address AT&T's price increases of 49% per unit for FY 2025.	If hotspot funding is not fully restored, this may result in reductions in the quantity of hotspots available to the public. Grant funding opportunities for this service may exist, such as the FCC's E-Rate Universal Service Program which provides discounts for telecommunications and internet access to eligible schools and libraries.
Digital Literacy Services	$57,000	Part of the required 2% reduction for FY 2025.	Training is provided by the San Diego Futures Foundation, a local non-profit service provider. If funding is not restored, training services and classes would be reduced or eliminated at most sites. The City collaboratively applied (with San Diego County and other local jurisdictions) for the National Telecommunications Information Agency Digital Equity competitive grant to support Digital Navigator and Digital Literacy programs. Award notifications are expected this winter.
Total	**$785,000**		

Note: Totals may not add due to rounding.

Climate Action Plan Implementation

Fully funding the Climate Action Plan (CAP) continues to be a major focus for the Council, and developing a definitive cost for full CAP implementation continues to be complex. Our Office prepared a comprehensive review of the CAP spending gap in FY 2024.[23] In our Office's analysis of the FY 2025 Proposed Budget,[24] we determined that there was a potential funding gap of $188.1 million (mostly for stormwater funding), based on a comparison of CAP spending with the Climate Action Implementation Plan (CAIP). Since stormwater spending on both an operational and capital basis remains underfunded, it can be assumed that many of these gaps still exist. While it continues to be difficult to place a specific number on the CAP gap, we reiterate that the most critical action associated with CAP implementation is resolving the City's ongoing structural budget deficit and infrastructure financing gap.

[23] IBA Report 23-26 *FY 2024 Climate Action Plan Expenditures, Funding Gaps, and Other Policy Considerations*
[24] IBA Report 24-09 *Review of the Fiscal Year 2025 Proposed Budget* (pg. 39)

There are two areas where the CAP has the potential to make significant impacts to the City's budget: fleet electrification and implementing the Zero Emissions in Municipal Buildings and Operations Policy (ZEMBOP). Fleet electrification is discussed below, and the ZEMBOP discussion is under the Infrastructure Needs section.

Fleet Electrification

The Fleet Services Division of the Department of General Services recently completed a Fleet Electrification Strategy, which was presented to the Environment Committee on March 14, 2024. That study looked at the potential costs to procure electric vehicles (EVs) in lieu of internal combustion engine (ICE) cars, with the goal of replacing all ICE cars with EVs by 2033. The California Air Resources Board (CARB) is also requiring that 50% of all applicable purchases be zero emission, with this increasing to all applicable purchases by January 1, 2027. Based on the strategy study, while the upfront capital to purchase EVs was more than for ICEs, when fuel and maintenance savings are factored in over ten years the transition to EVs could save roughly $94.2 million, or 11%, in overall fleet costs. This, however, does not account for the additional upfront costs of installing charging infrastructure at operations yards, which is currently estimated between $23.7 million and $34.9 million. Additionally, much of these savings come in the latter years of the projection, with the initial three years showing additional costs.

At present, none of these costs are included in the Outlook projections, mostly because Fleet Services does not know when and if EVs can be procured, especially given the limited supply of fully-electric heavy-duty vehicles on the market. Fleet Services is continuing to work with asset managing departments and the Sustainability and Mobility Department on Fossil Fuel Elimination Plans (due on January 1, 2025) and Fleet Charging Plans (due on January 1, 2026). Finalizing these plans is necessary before they can be incorporated into future budgets.

Infrastructure Needs – Deferred Maintenance and CIP

This section discusses the operating and capital needs for infrastructure assets, which are often planned over their lifecycle and often informed by asset-specific asset management plans (such as the Pavement Management Plan and Watershed Asset Management Plan).

Infrastructure Needs *Not* Included in Outlook
• Transportation – Road Repair Program • Stormwater Infrastructure • New and Existing City Facilities • Zero Emissions Municipal Building Operations Policy (ZEMBOP)

The City's General Fund lacks a dedicated funding source sufficient to provide for maintenance and capital needs, which has led to years of deferred maintenance and capital projects. This has increased the funding gap for General Fund capital infrastructure by 181.3% since FY 2016, reaching $4.8 billion in the last CIP Outlook, which excludes full facilities needs (as discussed below). Deferred maintenance has caused aging and deterioration of assets and led to expensive emergency repairs.

While the Five-Year Outlook focuses on operating costs, it is important to recognize that there also will be limited resources for capital funding in the upcoming CIP Outlook, which will again lead to a significant funding gap. Operating and capital budgets for General Fund infrastructure are interconnected; spending in one area reduces resources for the other. New capital projects also increase overall operating and maintenance costs, which requires the City to strike a balance and consider the cumulative impact across the capital and operating budgets. Given the projected budget shortfalls and the need to mitigate deficits, it is anticipated that staff will prioritize funding for projects already in construction, potentially reallocating resources and suspending early-stage projects that lack a full funding plan.

Transportation – Road Repair Program

The Transportation Department manages the City's extensive street network, aiming to achieve and maintain an average Pavement Condition Index (PCI) of 70 or above, which is considered "good" condition. However, a 2023 assessment indicated that the City's PCI had fallen to 63 due to prolonged underinvestment.

To address this, the Transportation Department prepared a Pavement Management Plan (PMP) in January 2024 that provides a ten-year, $1.9 billion strategy to improve the City's PCI to 70. Activities in the PMP include street resurfacing, rehabilitation, and reconstruction, along with a new condition assessment in FY 2027. As noted in the Outlook, the $1.9 billion called for in the PMP excludes work for 62 miles unimproved streets, which would require additional funding to be brought up to City standards. Although FY 2025 marked Year 1 of the PMP strategy and significant funding was allocated in the Adopted Budget for road repair, funding levels were $63.4 million below what was identified as needed for overlay and reconstruction activities, and by $23.9 million for slurry seal and other maintenance. Insufficient funding risks continued deterioration of the street network.

In FY 2025, strategic use of the Infrastructure Fund provided $11.1 million for Transportation's maintenance of streets. While funding sources like the Road Maintenance & Rehabilitation Account, Gas Tax, and TransNet can be used to address road repair needs, they are all currently fully committed. New funding sources need to be identified for both capital improvements (e.g. asphalt overlay, full-depth reclamation, and reconstruction) and maintenance (e.g. slurry seal, cape seal, and crack seal).

Stormwater Infrastructure

The Stormwater Department's mandated compliance activities have been chronically underfunded. To address this and determine appropriate funding levels, Stormwater developed the Watershed Asset Management Plan (WAMP) which projects the costs of ongoing operations and capital needs to meet Municipal Storm Water Permit requirements issued by the Regional Water Quality Control Board (RWQCB). These activities are vital for protecting water quality, preventing pollution, and sustainably and effectively managing stormwater runoff.

The WAMP estimates total costs of nearly $10.9 billion through FY 2042. Compared to the WAMP, in FY 2025 alone, Stormwater operations face a $136.2 million shortfall, with a projected five-year capital infrastructure deficit of $1.6 billion. Missed compliance deadlines have already resulted in the RWQCB mandating additional spending, such as the Time Schedule Order (TSO) requiring $2.5 million in FY 2024 and $750,000 in FY 2025. Continued underfunding could lead to additional fines and additional spending requirements over which the City will have less control.

Stormwater's needs are typically split between Flood Risk Management and Water Quality. Flood Risk Management focuses on preventing flooding by replacing or improving existing infrastructure, such as corrugated metal pipes, pump stations, and storm drains, along with some new assets such as stream restoration projects and new storm drain infrastructure. Water Quality projects improve water quality through "green infrastructure" projects (e.g., swales, infiltration and detention basins, wetlands restoration, and stormwater capture projects). Of the estimated $10.9 billion needed through FY 2042, WAMP projections allocate $2.0 billion for Flood Risk Management and $8.9 billion for Water Quality.

New and Existing City Facilities

Unlike the Transportation and Stormwater Departments, the City lacks a current asset management plan for its facilities, as condition assessments from FY 2014-2016 are outdated. Chronic underfunding of the Department of General Services (DGS) – Facilities Services has led to continued aging and deterioration of existing facilities, increasing costs and necessitating costly emergency projects. The City no longer has accurate data on facility needs, and the $146.2 million identified in the most recent CIP Outlook likely underrepresents actual requirements due to reliance on outdated assessments and site observations from AMDs.[25]

A recent City Auditor performance audit estimated deferred maintenance needs likely exceed $1.0 billion[26] and recommended updating condition assessments, developing a facilities management plan, and budgeting $143.0 to $287.0 million – far above previous Facilities Services budgets of $20.0 to $30.0 million – for annual routine maintenance and repairs. Implementing several recommendations is contingent upon updated condition assessments. Implementing the recommendation for condition assessments is estimated to require $2.2 million to update the FY 2014-16 Facilities Condition Assessment; $1.0 million to assess the City's three major services yards (Chollas, 20th and B, and Rose Canyon); and $330,000 to assess 60 General Fund facilities not previously assessed (totaling $3.5 million).[27]

Facilities Services is currently developing a request for proposals (RFP) for an as-needed contract to conduct condition assessments as funding becomes available, spreading costs over several years. While this is a high priority for Facilities Services, it will be competing with other citywide priorities during the FY 2026 budget process.

Zero Emissions Municipal Building Operations Policy (ZEMBOP)

The ZEMBOP was adopted to guide the elimination of fossil fuels from all City facilities by 2035. Based on numerous completed electrification strategies, previous estimates to address all 400 City

[25] In the most recent CIP Outlook, a projected $641.0 million was reported in the "FY 2030 and beyond" category as needed to fund the capital backlog for facilities.

[26] While Facilities staff do not have the resources to properly update condition assessments, using escalation factors against the old condition assessment numbers, their estimates were in the same $1.0 billion range.

[27] This was requested as part of the FY 2025 Proposed Budget process, which was not funded.

facilities have ranged from $80.0 to $90.0 million. However, these cost estimates only represent the projected cost of fuel, and do not include efficiency savings from the equipment itself, building retrofits, or energy controls responding to time-of-use rate triggers. Therefore, actual net costs to the City are still unknown. More information will be known when individual departmental Fossil Fuel Elimination Plans are completed in January 2025.

Additionally, the ZEMBOP mainly applies to new projects and facility retrofits and does not require all facilities to switch at once. The Sustainability and Mobility Department (SuMo) is working to develop financing mechanisms to offset potential increased costs for these projects, such as an Energy Savings Performance Contract (ESPC). Under an ESPC, the City would select an Energy Service Company (ESCO) which would provide the upfront capital for energy retrofits, including removing gas equipment and installing equipment that increases energy efficiency. These projects would then save the City costs on its utility bills, from which the ESCO would be paid back over a predetermined period of time. As stated at the April 11, 2024 Environment Committee, SuMo has already selected its first vendor, and is working with the vendor to identify specific projects to be part of the first portfolio of City facilities. Individual contracts to execute these projects are expected to be presented to the Council during 2025.

POTENTIAL RESOURCE AND MITIGATION OPTIONS

The Outlook projects General Fund baseline expenditures to exceed baseline revenues for all five Outlook years. When adding projected operating expenses for anticipated new facilities, as well as planned commitments for homelessness programs and stormwater wetland mitigation, the deficit grows to $329.3 million in FY 2026, and is projected to range from about $274.0 million to $307.0 million for the remaining Outlook years. In this section we highlight resources that should be considered to mitigate projected deficits over the course of the Outlook.

Notably, the potential resource options that will be discussed could provide up to $198.3 million in additional revenues or reduced expenditures beyond the Outlook's projections for FY 2026, which would reduce the FY 2026 projected baseline shortfall to $59.9 million. Nearly all of these mitigation measures can be implemented through Council or Mayoral action. As budget and service level cuts will be required under any scenario, it will be critical for the City to pursue several or all of these resources to avoid the need for additional cuts to City programs and services in FY 2026 and beyond. For reference, estimated impacts of these mitigations on the baseline shortfall for each year of the Outlook are shown in the table.

Baseline General Fund Outlook Projections with Mitigations *($ in millions)*

	FY 2026 Outlook	FY 2027 Outlook	FY 2028 Outlook	FY 2029 Outlook	FY 2030 Outlook
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%.

The next several pages include additional information on the resource options shown in the previous table, as well as other, less quantifiable resource options that could be considered *beginning* in FY 2026 – such as the use of available Excess Equity, budget reductions, and grants. Subsequently, we provide a discussion on resource options that could be considered *after* FY 2026. For each potential resource, we indicate whether it is one-time or ongoing in nature.

POTENTIAL RESOURCE OPTIONS FOR FY 2026

Potential FY 2026 Resource Options

• Resources Identified in the Outlook
  ○ Suspended or Strategic Use of Contributions for Certain Policy Targets
    ▪ General Fund Reserve and Risk Management Reserves Contributions
    ▪ Infrastructure Fund Contributions
  ○ Other
    ▪ November 2022 Measure B – People's Ordinance
    ▪ General Fund Excess Equity
    ▪ March 2020 Measure C – TOT Increase
    ▪ Budget Reductions
• Additional Resources to Consider
  ○ Cannabis Business Tax Rate Increase
  ○ Increasing Parking Meter Rates
  ○ Grants – Federal or State Funding

Resources Identified in the Outlook

Suspended or Strategic Use of Contributions for Certain Policy Targets

Suspended General Fund and Risk Management Reserves Contributions (one-time)
When balancing the City's funding priorities for FY 2026, the City could consider forgoing the FY 2026 General Fund Reserve contribution, currently estimated at $56.6 million. This could provide one-time funding for critical priorities. It is worth noting that the City elected to waive General Fund Reserve contributions in FY 2024 and FY 2025, keeping the Reserve at its FY 2023 target balance of $207.1 million.

Use of this large one-time resource will not mitigate the structural budget deficit. Additionally, waiving the General Fund Reserve contribution in FY 2026 would require catch-up payments in future years. In accordance with the City's Reserve Policy, the Mayor, working with the Department of Finance, will prepare a plan that addresses the reduced Reserve level and the steps needed to meet the policy target for the Reserve. Given the City's significant budgetary constraints, waiving the FY 2026 General Fund Reserve contribution in part or in whole may be necessary; however, thoughtful consideration should be given when using this resource, as maintaining strong reserve balances is an important part of ensuring a fiscally responsible budget process, and ultimately helps insulate the City from economic downturns while simultaneously keeping down the City's cost to pursue financing for its capital needs.

As an additional one-time resource, the City could consider waiving FY 2026 contributions to the Risk Management Reserves (Public Liability, Workers' Compensation, and Long-Term Disability), which are currently estimated at $6.6 million in total. Combined with waiving the General Fund Reserve, this potential mitigation totals $63.2 million.

Strategic Use of Infrastructure Fund Contributions (one-time; potentially ongoing)
As discussed above, the Outlook assumes that contributions to the Infrastructure Fund will require substantial expenditures in each year of the Outlook. However, we note dollars in the Infrastructure Fund could also be used in place of General Funds that would otherwise be used for repair and maintenance of existing infrastructure, as opposed to funding new capital needs. This strategic use of the Infrastructure Fund contribution would mitigate the FY 2026 shortfall by $8.8 million. Notably, this would not address the City's estimated five-year capital funding gap of $4.8 billion.

Other Resource Options Identified in the Outlook

November 2022 Measure B – People's Ordinance (ongoing)
At the November 2022 election, a majority of City residents approved Measure B, a proposition that allows the City to recover costs for solid waste management services (i.e. trash collection). Following the passage of the measure, the City has been developing a fee to accomplish this consistent with Proposition 218.[28]

Staff from the Environmental Services Department presented an update to the City Council on December 13, 2024, that covered their public outreach to date, their proposed timeline for fee development, and sought the approval from Council to utilize tax roll billing as the method for payment collection. Based on the schedule provided by ESD, staff intends to release a full cost-of-service study in the beginning of 2026, and seek final Council approval of a fee in the summer of 2026. **Hitting this deadline is crucial, as in order for revenue to be collected on tax rolls and available for FY 2026, the fee must be approved in July, prior to the August legislative recess.** Otherwise, the City will need to wait an entire additional year to receive this revenue.

Currently, there is $71.5 million budgeted in the City's General Fund for the Collection Services Division of ESD. If this amount was covered by a new waste collection fee, the entirety of that $71.5 million General Fund subsidy would be available for other City services. Preliminary projections of resources that could be freed up by implementing a fully cost-recoverable fee are presented in the table below; actual revenue generated by a waste collection fee will be further detailed in the forthcoming cost-of-service study and may vary from amounts presented here. It will be critical to ensure that study captures all potentially recoverable costs.

Collection Services - Estimated General Fund Cost *($ in millions)*						
	FY 2025	**FY 2026**	**FY 2027**	**FY 2028**	**FY 2029**	**FY 2030**
Total Expenses	$ 71.5	$ 78.9	$ 81.3	$ 83.5	$ 84.0	$ 85.8
Total Revenue	$ 0.3	$ 0.3	$ 0.3	$ 0.3	$ 0.3	$ 0.3
Outlook Impact	**$ 71.2**	**$ 78.6**	**$ 81.0**	**$ 83.2**	**$ 83.7**	**$ 85.5**

Due to the magnitude of the budget shortfall projected for FY 2026, failure to adopt a trash fee by July, or adoption of a fee that does not fully recover the cost to provide collections services, will require additional and substantial reductions to other expenditures and City services. **Our Office strongly encourages the City to pursue full cost recovery here to help mitigate the needs for cuts to other core City services.**

[28] Under Proposition 218, a fee that is levied as a condition of property ownership cannot exceed the cost of the service provided, and the amount of the fee imposed on each parcel cannot exceed the proportional cost of the service attributable to the parcel. Under the proposition, three types of fees can be levied without requiring a vote of the public: fees for water, sewer, and trash services. The potential trash fee will follow the same process the City follows to set water and wastewater rates.

General Fund Excess Equity (one-time)
Available Excess Equity[29] could be used to help mitigate the FY 2026 projected shortfall; however, an updated projection for this one-time resource is not anticipated until release of the Mid-Year Budget Monitoring Report on January 31, 2025.

For reference, available Excess Equity at FY 2024 year-end was $20.6 million; but with the subsequent release of the FY 2025 First Quarter Budget Monitoring Report, major General Fund revenues and certain other revenues are now projected to be lower than budgeted. The First Quarter Report also highlighted several increased expenditure estimates, including for public safety overtime. Since the First Quarter Report only provides an initial, high-level look at the status of certain General Fund revenues and expenditures, the first comprehensive projections will not be available until the Mid-Year Report is released.

At that time, full expenditure projections will be presented, including how much salary and other expenditure savings are anticipated considering the strategic hiring freeze, suspension of non-essential overtime and other non-essential expenditures, and other budget mitigation actions initiated by the Mayor in early December 2024. The forthcoming mid-year projections will provide a better estimate for Excess Equity that could be available in FY 2026, although it will be updated again with the Third Quarter Budget Monitoring Report in mid-May 2025.

March 2020 Measure C – TOT Increase (ongoing)
On the March 2020 ballot, San Diego voters considered Measure C, a citizens' initiative bond measure that would increase the City's hotel visitor tax (TOT). The increased TOT revenue would fund Convention Center expansion and modernization, as well as homelessness services and street repairs. Measure C received support from 65.2% of voters – a strong majority but just under the two-thirds threshold that was then assumed to be necessary.

While the measure was likely approved nearly five years ago, the City has not collected increased TOT because certain aspects of the measure have been in litigation. In August 2024, a trial court ruled in favor of the City and the validity of the measure as approved by citizens. However, three opponents of the measure have appealed the trial court's decision to an appellate court. The case has been expedited by the court, and it is expected that briefings from all parties will be completed by February 2025, oral arguments will be completed by June 2025, and an opinion from the appeals court would come in early summer 2025.

There are multiple scenarios that could play out that would affect the timeline to allow the City to begin collecting Measure C revenues. Our Office notes three possible scenarios:

- **Short**: Given strong rulings in favor of the City, all three appellants decide to settle the litigation before the appeals trial begins in early spring 2025.

[29] Excess Equity, as described in the Reserve Policy, is "Unassigned Fund Balance that is not otherwise designated as General Fund Reserves and is available for appropriation." Excess Equity generally results from increases to General Fund revenues and/or General Fund expenditures that come in under-budget during any given fiscal year.

- **Medium:** The appeals trial proceeds and the judge again rules in favor of the City in early summer 2025, and in the event of another appeal, the CA Supreme Court decides against hearing the case.
- **Long:** The appeals trial proceeds and the judge again rules in favor of the City in early summer 2025, but the case is successfully appealed to the CA Supreme Court, which could add an additional 1.5 years.

If the case resolves in the City's favor, the City could have a viable ongoing resource to fund homelessness programs and services and road repair expenses that are currently being covered by the General Fund. If Measure C starts full collections at the beginning of FY 2026, it could generate an estimated $187.3 million (an average of $37.5 million per year) over the first five years for homelessness programs and services. This is $5.6 million lower than the $192.9 million estimated by the Department of Finance in the Outlook, due to our estimate using the latest projected growth rates for FY 2025 that ultimately reduce the projected revenue generation over the five-year Outlook period.

<u>Budget Reductions</u> (ongoing)
On December 9, 2024, the Chief Operating Officer released a memorandum directing General Fund departments (and certain funds that impact the General Fund) to submit budget reduction proposals to address the FY 2026 projected baseline shortfall and the City's structural deficit.

Additionally, in budget development, Departments were instructed that "[a]ny program or function deemed non-critical, in the context of the City's limited resources, must be entered into the City's budget system as a budget reduction proposal." Anticipated impacts of budget reduction proposals are to also to be considered by management before final determinations are made. The overall goal is to align available resources with the most critical City services.

Additionally, on December 4, 2024, the Mayor announced several deficit mitigation efforts to begin immediately, including: a hiring freeze; suspension of non-essential overtime and other non-essential expenditures; zero-based review of outside contracts for opportunities to reduce expenditures; prioritization of capital projects; halting the Civic Center revitalization effort; evaluation of City leased office space for efficiencies; and evaluation of revenue-generating measures such as increased fees and fines. These and other mitigations could generate Excess Equity in FY 2025 that could help mitigate the FY 2026 revenue shortfall.

<u>Additional Resources to Consider for FY 2026</u>

Cannabis Business Tax Rate Increase *(ongoing)*
In 2016, San Diego voters approved Measure N, which established a Cannabis Business Tax (CBT) on non-medical cannabis businesses that operate within the City. Current tax rates are 2.0% for cannabis production facilities (CPFs), and 8.0% for retail outlets. City Council has the authority to adjust both of these rates up to 15.0% through an ordinance.

The Outlook assumes that the current CBT rates will remain unchanged for the duration of the Outlook period. However, raising the CBT rate for both CPFs and cannabis outlets could generate more revenue for the City. Our Office estimates that each increase of 1.0% in the CBT rate for retail outlets could generate up to $2.2 million in revenue for FY 2026. For illustrative purposes, an increase of 2% to the tax rate on retail outlets would generate up to $4.3 million, and this is reflected in the mitigations tables of this report.

Our Office cautions that significantly increasing the CBT rate could have a large detrimental effect upon cannabis businesses within the City, since many retail outlets and CPFs have been facing economic pressures from increased competition in other jurisdictions and a thriving illicit market. However, this potential revenue source is worth highlighting as it is a tax rate that can be adjusted through a vote of the City Council.

Increasing Parking Meter Rates *(ongoing)*
The City currently manages approximately 5,300 metered parking spaces, the majority of which charge an hourly rate of $1.25 between the hours of 8 a.m. to 6 p.m., except for Sundays and holidays. As our Office discussed in IBA Report 22-31: Response to Request for Analysis of Revenue Opportunities, dated November 25, 2022, the City could consider increasing parking meter rates to generate additional revenue that would offset eligible costs that would otherwise be supported by the General Fund. Doubling the per hour parking meter rate across the City to $2.50 per hour administratively is allowed under San Diego Municipal Code §86.0123, and corresponding revenue generated in the Parking Meter Operations Fund could double from $9.6 million budgeted in FY 2025 to $19.2 million. The City Treasurer indicated that implementing new rates on parking meters is a relatively easy process which can be effectuated quickly following City Council or Mayoral action; however, increases to metered parking in coastal areas will likely require California Coastal Commission approval, and tidelands restrictions may also apply to any revenue received in tidelands areas.

In accordance with Council Policy 100-18 (Community Parking District), 45% of all parking meter revenue (less administrative and parking meter operation costs incurred by the City) collected within each Community Parking District is allocated to that Community Parking District to be used for improvements and activities that increase the availability, supply, and effective use of parking. The remaining 55% flows to the Parking Meter Operations Fund which primarily reimburses General Fund Departments for eligible expenditures.[30] Should the City move forward with a parking meter rate increase, the City Council should also consider amending Council Policy 100-18 to maintain the current dollar amounts going to Community Parking Districts but increasing the overall percentage-share that flows to the Parking Meter Operations Fund.

Other revenue opportunities pertaining to parking meters include extending parking meter hours, installing additional parking meters, and adopting demand-responsive pricing. In order for any of the actions discussed above to effectively mitigate the General Fund's structural budget deficit,

[30] Consistent with State law, San Diego Municipal Code sections 82.08 and 82.09(b) set forth parameters on the use of parking meter revenue.

the City will need to ensure that there are sufficient expenditures currently being incurred by the General Fund that are eligible to be offset by parking meter revenue.

Grants – Federal or State Funding *(one-time)*
The City regularly applies for grant funding from various State and federal programs. Grants have been an important source of funds for City projects in the past, but are generally not included in the Outlook as they are typically one-time funding sources that vary from year to year, and should be used for one-time expenditures. Key infrastructure funding programs include the Infrastructure Investment and Jobs Act (IIJA), which will allocate $1.2 trillion nationwide from FY 2022-2032 (the City has been awarded $24.7 million on IIJA grants to date), and the Inflation Reduction Act (IRA), which provides grants for climate, conservation, and energy related infrastructure projects (the City has been awarded $10.0 million in IRA grants to date).

POTENTIAL RESOURCE OPTIONS AFTER FY 2026

Potential Resource Options: After FY 2026
• Future Sales Tax Measure • Future General Obligation Bonds • Future Stormwater Fee Increase • Future Property Transfer Tax Increase

Potential Future Sales Tax Measure (ongoing)
The sales tax rate in the City is 7.75%, of which 1.0% goes to the City. In August of 2024, our Office estimated that a 1.0% sales tax rate increase in the City to 8.75% could generate an additional $360 million to $400 million in revenue for the General Fund in the first full year of implementation. In November voters in the City narrowly rejected Measure E, a one cent sales tax increase, by 3,506 votes.

We note that the potential to put another sales tax increase measure on a future ballot exists, and if passed, would have the potential to generate significant additional revenue to support core City services and infrastructure, though the City's existing structural budget deficit will have to be addressed in the short-term before another potential sales tax measure is considered.

Potential Future General Obligation (GO) Bonds (one-time)
Many other cities use GO bond programs to provide funding for capital infrastructure, and a GO bond program, if successful, could help the City address its $4.8 billion deferred capital backlog and free up other funding sources (like the Infrastructure Fund) for operations and maintenance. GO Bond measures generally include specific projects to be implemented with the bond funds, and public committees can be used to identify priority projects and provide oversight to ensure funds are spent on these projects as intended. In recent years, GO Bond programs have provided $390.0 million to $1.2 billion for streets and parks, drainage, housing and shelters, libraries, and public safety capital projects in several large US cities, including San Francisco, CA, Phoenix, AZ, and San Antonio, TX. Because GO bonds are paid through additional levies on property taxes, California law requires that they must achieve two-thirds voter approval. For reference, every $100.0 million in GO Bonds issued would increase property taxes by approximately $1.64 per $100,000 of assessed value.

<u>Potential Future Stormwater Fee Increase</u> (ongoing)
The City has long discussed a potential stormwater fee to address operational and capital needs. In January 2021, the Stormwater Department proposed a Funding Strategy outlining stormwater needs and funding options, leading to a draft ballot measure in February 2022. This measure proposed a 4 to 5 cent per square foot impervious surface tax, which would have generated $74.0 to $93.0 million annually and cost single-family homes $10 to $14 a month. However, it was not pursued due to the requirement for two-thirds voter approval and polling that indicated insufficient support.

After the January 2024 storms, Council's Rules Committee revisited the issue, and considered a similar measure with a 7 cent per square foot tax which was estimated to generate $129.6 million annually. Again, the measure was dropped due to the high voter threshold.

An alternative under Proposition 218 allows for a property-related stormwater fee via a mail ballot to property owners, requiring a simple majority approval. This approach, used by other cities, requires a cost-of-service study to ensure fees align with service costs. Implementing this method, however, would still require a public vote, and would require additional time and research, and additional resources for the Stormwater Department. For more information on stormwater fees and the fee approval process, please refer to IBA Report 21-04 *Analysis of the Stormwater Division Funding Strategy Report*.

<u>Potential Future Property Transfer Tax Increase</u> (ongoing)
Property transfer taxes, also known as real estate transfer taxes or documentary transfer taxes, are levied on any real property that is sold or transferred. In San Diego, the county and city each receive $0.55 per $1,000 of the sale price of the property.

Increases to property transfer taxes are possible through a vote of the people (a simple majority for general use or a two-thirds vote for specific uses). Several other California cities have adopted property transfer tax rates that increase progressively with the sale-price of properties. Cities with similar median home prices to San Diego who have adopted progressive transfers taxes, include San Francisco[31] ($5.00 to $60.00 per $1,000), Culver City[32] ($0.45 to $4.00 per $1,000), Los Angeles[33] ($0.45 to $5.95 per $1,000), and San Jose[34] ($0.75 to $1.50 per $1,000).

In FY 2024, the revenue from the existing property transfer tax of $0.55 per $1,000 of property value generated $9.6 million for the General Fund. A voter-approved increase to $1.10 per $1,000 could double this amount to $19.2 million.

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[31] "Transfer Tax." *City & County of San Francisco Office of the Assessor-Recorder.* www.sfassessor.org/recorder-information/recording-document/transfer-tax. Accessed January 6, 2025.
[32] "Real Property Transfer Tax." *City of Culver City.* www.culvercity.org/Services/Make-a-Payment/Real-Property-Transfer-Tax. Accessed January 6, 2025.
[33] "Real Property Transfer Tax and Measure ULA FAQ." *City of Los Angeles Office of Finance*. finance.lacity.gov/faq/measure-ula. Accessed January 6, 2025.
[34] "Measure E." *City of San José City Clerk.* www.sanjoseca.gov/your-government/appointees/city-clerk/elections/2020-elections/measure-e. Accessed January 6, 2025.

CONCLUSION

While our report identifies several potential variations to projected finances in this year's Outlook, in general our Office believes that baseline revenue and expenditure projections in the Outlook are reasonable, though risks related to declining sales tax revenue and increases to pension payments exist. The projected baseline deficits in the Outlook – $258.2 million in FY 2026 and an annual average of $194.0 million from FYs 2027-2030 – clearly show the immediate need to address the City's ongoing structural budget deficit. While the City was able to maintain and expand services over the last several years with help from the use of ARPA funding, that revenue has run out, and the City must ensure its regular, ongoing operations can be supported with regular, ongoing revenue.

Importantly, the City has options to *partially* address the projected shortfalls. In the Potential Resources and Mitigations Options section of this report, we discuss potential mitigations to the Outlook's projected shortfalls and include a table of mitigations for which estimates are more certain. If implemented, these mitigations – of which two-thirds represent ongoing resources – could reduce the projected shortfall for FY 2026 by up to $198.3 million. However, even altogether they would not completely close the ongoing structural deficit or the budget shortfall projected for FY 2026, and they do not address budget priorities or any additional planned expenditures that are not included in the Outlook's projected baseline shortfalls. **Especially given potential decreases in existing revenues and increases in anticipated pension payments, additional budget reductions and mitigations will be necessary. It will be critical for the City to immediately implement those mitigations that it can *in the current fiscal year*, as any additional revenue or expenditure savings in FY 2025 can be used to help balance the FY 2026 budget. *<u>Failure to take immediate action will lead to the need for even deeper cuts in FY 2026.</u>***

The information provided in the Outlook and in our review allows the Council to begin developing a strategy for achieving a balanced budget in FY 2026. Additional information on the City's current-year financials will be provided in the Mid-Year Budget Monitoring Report, due to be released on January 31st.

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Attachment 1: FY 2025 One-Time Expenditure Adjustments
Attachment 2: New Facilities and Joint Use Agreement Annual Costs

FY 2025 Adopted Budget One-Time Expenditure Adjustments	
FY 2025 One-Time Expenditure Additions	
Portable Restrooms	$ 3,710,000
Continued Homeless Shelter Operations	1,456,921
Start-Up Costs for 1,000 Beds and Safe Parking Program	1,249,265
Transfer to the Capital Improvements Program - San Carlos Library	1,200,000
Debris Assistance Program	1,200,000
Termination Pay for City Employees	1,175,438
Multi-Disciplinary Outreach Program	1,100,000
Small Business Enhancement Program	1,061,000
Youth Care Development Drop-In Pilot	1,002,000
Transfer to the Capital Improvements Program - Jeremy Henwood Park	1,000,000
Tree Services related to Urban Forestry Air Pollution Control District Settlement	969,169
Eviction Prevention Program	962,573
Community Projects, Programs, and Services	900,000
SD Access for All	784,000
Bacteria TMDL Time Schedule Order	750,000
Business Cooperation Program Rebate	690,000
Day Center Improvements	660,933
Chollas Yard Parking Expansion	453,506
Project Labor Agreements	400,000
Family Shelter Operating Costs	315,000
Library Materials	230,000
Parks and Recreation New Supplies and Equipment	208,002
Library Donation Match	200,000
Pothole Repair Vehicle	174,000
Transfer to the Capital Improvements Program - UTC Streetlights	150,000
General Benefits for Maintenance Assessment Districts	144,622
Support for Your Safe Place – A Family Justice Center	96,000
False Alarm Tracking and Billing System Replacement	90,750
Non-Personnel Expenditures for New Positions	55,910
Software to Support Central Asphalt Team	47,950
Recreational Programming Support	10,000
Total FY 2025 One-Time Expenditure Additions	***22,447,039***
FY 2025 One-Time Expenditure Reductions	
Annualization of Independent Legal Counsel	(90,000)
Reduction of Window Washing at Central Library	(221,000)
Use of HOME - American Rescue Plan Funds	(240,342)
Reduction of Tree Planting Services	(562,000)
Reduction in Traffic Signal Cabinet Supplies	(700,000)
Reduction of Water Services	(724,000)
Use of Low Income Housing Lease Revenue	(834,176)
Reduction in Second Helicopter Overtime and Maintenance	(850,000)
Budgeted Personnel Expenditures Savings for New Positions	(1,575,432)
General Fund Discount of Refuse Disposal Fees	(2,100,000)
Use of Permanent Local Housing Allocation (PLHA) Program Funding	(2,250,000)
Delayed Hiring (Request to Fill Process)	(4,493,948)
Affordable Housing Fund Support for Homelessness Programs	(8,000,000)
Waiver of the Climate Equity Fund Contribution	(8,469,702)
Use of Infrastructure Fund for General Fund Eligible Expenditures	(15,969,222)
Other Budget Reduction Proposals	(958,626)
Total FY 2025 One-Time Expenditure Reductions	***(48,038,448)***
Net FY 2025 One-Time Expenditure Adjustments	**$ (25,591,409)**

NEW FACILITIES AND JOINT USE AGREEMENT ANNUAL COSTS

Department	Facility	Council District	FTE	First Year Expense
	Fiscal Year 2026			
Parks and Recreation	Citywide Brush Mgmt. Consolidation	Citywide	3.00	$ 2,897,120
Parks and Recreation	East Village Green	3	12.00	1,640,904
Parks and Recreation	Citywide Facility maintenance (New Facilities)	Citywide	5.00	1,165,121
Parks and Recreation	Bruce Brown Memorial Park	6	4.00	1,076,699
Parks and Recreation	Mira Mesa Aquatic Center	6	8.75	1,055,917
Parks and Recreation	Hidden Trails Neighborhood Park	8	2.50	597,744
Parks and Recreation	Solterra Vista Neighborhood Park	1	1.00	270,056
Parks and Recreation	Eastbourne Neighborhood Park	5	1.00	241,164
Parks and Recreation	Hickman Elementary Joint Use	6	0.50	142,155
Parks and Recreation	Rowan Elementary Joint Use	9	0.50	128,154
Parks and Recreation	Federal Boulevard Pocket Park	9	0.50	110,629
Parks and Recreation	Pacific Beach Elementary Joint Use	1	0.50	109,186
Total Fiscal Year 2026			**39.25**	**$ 9,434,851**
	Fiscal Year 2027			
Parks and Recreation	Citywide Facility maintenance (New Facilities)	Citywide	7.00	$ 2,000,665
Parks and Recreation	Beyer Park	8	4.00	848,707
Parks and Recreation	Black Mountain Ranch Park	5	3.00	828,560
Parks and Recreation	Dennery Ranch Neighborhood Park	8	2.50	648,288
Parks and Recreation	Mira Mesa Community Park	6	0.50	315,585
Parks and Recreation	Junipers Park	5	1.00	249,760
Parks and Recreation	Shoal Creek Neighborhood Park	5	0.50	164,076
Parks and Recreation	Perry Elementary Joint Use	4	0.50	150,590
Parks and Recreation	North Central Square Park	3	0.50	104,433
Library	Ocean Beach Library Expansion	2	-	51,201
Parks and Recreation	Walden Neighborhood Park	5	-	37,664
Total Fiscal Year 2027			**19.50**	**$ 5,399,530**
	Fiscal Year 2028			
Fire-Rescue	Black Mountain Ranch Fire Station	5	12.00	$ 2,476,953
Parks and Recreation	Citywide Facility maintenance (New Facilities)	Citywide	2.00	492,032
Parks and Recreation	Jones Elementary Joint Use	7	0.50	177,375
Library	Oak Park Library	4	-	94,551
Total Fiscal Year 2028			**14.50**	**$ 3,240,912**
	Fiscal Year 2029			
Fire-Rescue	Otay Mesa Fire Station	8	27.00	$ 5,690,128
Parks and Recreation	Lafayette Elementary Joint Use	6	0.50	173,617
Parks and Recreation	Foster Elementary Joint Use	7	0.50	129,260
Parks and Recreation	Toler Elementary Joint Use	2	0.50	125,663
Parks and Recreation	Benchley-Weinberger Elementary Joint Use	7	0.50	112,638
Parks and Recreation	Perkins Elementary Joint Use	9	0.50	112,638
Total Fiscal Year 2029			**29.50**	**$ 6,343,944**
	Fiscal Year 2030			
Parks and Recreation	Carver Elementary Joint Use	4	0.50	$ 115,585
Parks and Recreation	Florence Elementary Joint Use	3	0.50	115,585
Parks and Recreation	Ross Elementary Joint Use	6	0.50	115,585
Total Fiscal Year 2030			**1.50**	**$ 346,755**

Note: Facilities include one-time expenses for items such as vehicles in the first year of operation. One-time expenses are eliminated from subsequent years operating costs.