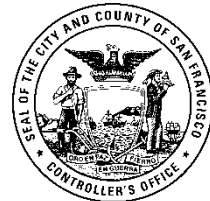


# City and County of San Francisco

Controller, Mayor, Board of Supervisors' Budget Analyst

## **Five Year Financial Plan Update for General Fund Supported Operations FY 2016-17 through FY 2019-20**

**Joint Report by the Controller's  
Office, Mayor's Office, and Board  
of Supervisors' Budget Analyst**



*December 7, 2015*



# City and County of San Francisco

Five Year Financial Plan Update for General Fund Supported Operations

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## Summary

San Francisco Administrative Code Section 3.6(b) requires that in each even-numbered year, the Mayor, Board of Supervisors Budget Analyst, and Controller submit an updated estimated summary budget for the remaining four years of the City's Five Year Financial Plan. This report provides updated expenditure and revenue projections for Fiscal Years (FY) 2016-17, FY 2017-18, FY 2018-19 and FY 2019-20, assuming no changes to current policies and staffing levels. The next full update of the City's Five Year Financial Plan will be submitted by the Mayor on or before March 1, 2017.

Table 1 summarizes the projected changes in General Fund supported revenues and expenditures over the next four years. As shown in Table 1, this report projects shortfalls of \$99.8 million in FY 2016-17, \$240.2 million in FY 2017-18, \$474.5 million in FY 2018-19, and \$538.4 million in FY 2019-20.

**Table 1. Summary of General Fund Supported Operations  
Projected Budgetary Surplus/(Shortfall) (\$ Millions)**

Sources	Savings / (Cost) Change from Prior Year, \$ Million			
	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
Use of One-Time Sources, Prior Year Fund Balance & Reserves	(57.0)	-	(126.3)	-
Regular Revenues, Transfers, & Other	132.6	152.5	168.2	164.5
<b>Subtotal - Sources</b>	<b>75.6</b>	<b>152.5</b>	<b>42.0</b>	<b>164.5</b>
<b>Uses</b>				
Salaries & Benefits	(112.4)	(100.2)	(98.7)	(120.8)
Other Expenditures, Reserves & Transfers	(63.0)	(192.7)	(177.5)	(107.6)
<b>Subtotal - Uses</b>	<b>(175.4)</b>	<b>(292.9)</b>	<b>(276.2)</b>	<b>(228.4)</b>
Total Net General Fund Impact (from Prior Year)	(99.8)	(140.4)	(234.3)	(63.8)
<b>Projected Cumulative Surplus / (Shortfall)</b>	<b>(99.8)</b>	<b>(240.2)</b>	<b>(474.5)</b>	<b>(538.4)</b>

This projection demonstrates that although revenues are growing each year, they are not growing fast enough to keep pace with the projected increase in expenditures. As a result, a gap remains despite continued economic growth. The City currently projects revenue growth of \$434.6 million, or 9.5% over the four year period of this Plan, and expenditure growth of \$972.9 million, or 21.2%.

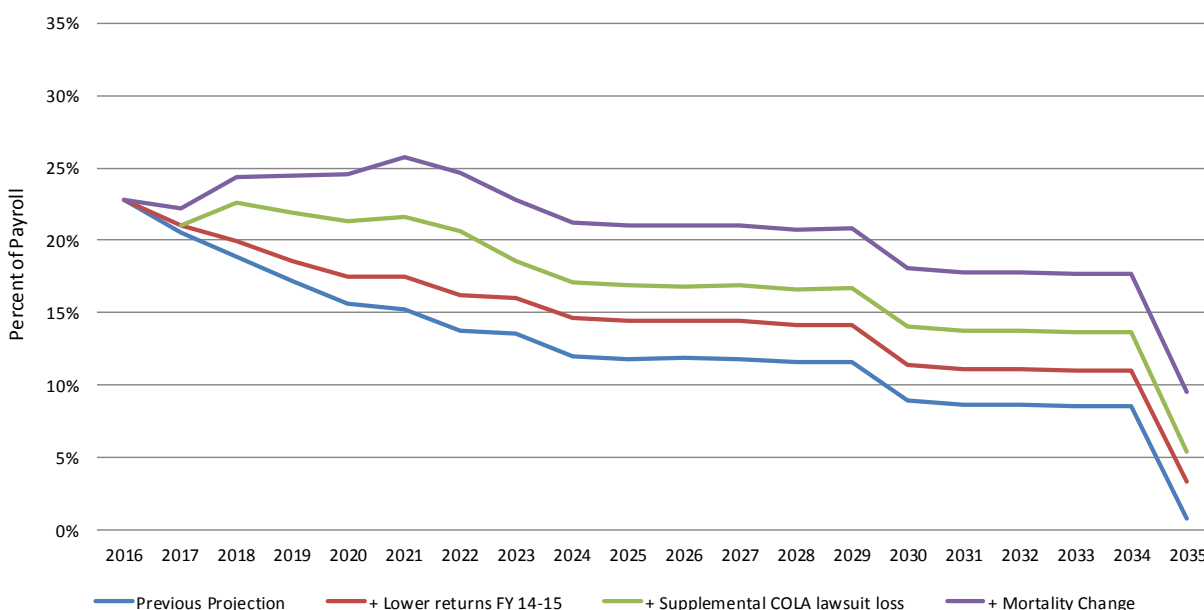
The City has made steady progress over the past several years to align expenditure and revenue growth. However, the final year of this projection estimates a larger projected shortfall (\$538.4 million) than the final year of the report did eight months ago (\$402.0 millions). This is

largely due to increases in the projected employer contribution rates for the City’s retirement system; and the adoption of several voter-approved baselines and set-asides with spending requirements without commensurate revenue increases. A more detailed description of these two factors follows, which together make up approximately 40% of the projected shortfall in FY 2019-20.

**Increase in Employer Contribution Rates to City Retirement System:** The Five Year Financial Plan, last updated in March 2015, anticipated a decline in retirement costs after FY 2014-15. However, three main factors have led to a reversal of this downward trend including: lower than expected actual FY 2014-15 investment earnings; updated demographic assumptions, which show that retirees are living longer and collecting pensions longer than previously expected; and an appellate court ruling against the City which found that voter-adopted changes to the conditions under which retirees could receive a supplemental COLA violated retirees’ vested rights.

Figure 1 demonstrates the impact of these three factors by showing the change in the percent of payroll that the City must pay for its employees compared to its prior projection with each additional factor above added over time.

**Figure 1. Employer Contribution Rate Percent of Payroll 2016-2035**



The cumulative effect of these factors on employer contribution rates is significant because it reverses the downward trend anticipated by the City and employees alike. The City’s prior financial projections reduced overall General Fund pension contributions from approximately \$300 million annually to approximately \$260 million annually by FY 2019-20. The net impact of the changes identified above reverse that trend, growing the employer contributions by \$113 million by the end of the projection period. This is a significant driver of the City’s structural deficit.

**Increases in Voter Adopted Baselines and Set-Asides:** Over the past several years, City voters have adopted several baselines and set-asides to provide additional funding for housing, transportation, children’s services, to increase the City’s minimum wage rate, and most recently

to support legacy businesses. When voters approve additional increases to existing baselines, set-asides, or other spending increases without commensurate revenue increases from new funding sources, this grows the projected deficits and future obligations of the City and also reduces policymakers' flexibility when balancing the budget. Table 3 shows that the cumulative effect of these changes sums to \$109.6 million by FY 2019-20.

**Table 3. Cumulative Effect of Voter Adopted Baselines and Set Asides 2011-2015**

	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>
Housing Trust Fund 2011	(2.8)	(2.8)	(2.8)	(2.8)
MTA population growth 2014	(5.0)	(3.0)	(3.2)	(3.3)
Children's Fund Increase 2014	(5.3)	(5.6)	(6.5)	(1.1)
Minimum Wage 2014	(11.3)	(14.8)	(16.1)	(7.6)
Legacy Business 2015*	(3.7)	(3.9)	(3.8)	(4.2)
Subtotal Propositions	(28.1)	(30.2)	(32.3)	(19.0)
<b>Cumulative Propositions</b>	<b>(28.1)</b>	<b>(58.3)</b>	<b>(90.6)</b>	<b>(109.6)</b>

\* Legacy Business is not a charter amendment, which means it is subject to the Budget Appropriation Ordinance each year.

While the projected shortfalls shown in Table 3 reflect the difference in projected revenues and expenditures over the next five years if current service levels and policies continue, San Francisco's Charter requires that each year's budget be balanced. Balancing the budgets will require some combination of expenditure reductions and/or additional revenues. These projections assume no ongoing solutions are implemented. To the extent budgets are balanced with ongoing solutions, future shortfalls will decrease.

### Key Assumptions

Key assumptions affecting the FY 2016-17 through FY 2019-20 projections are:

- **No major changes to service levels and number of employees:** This projection assumes no major changes to policies, service levels, or the number of employees from previously adopted FY 2015-16 and FY 2016-17 budgeted levels unless specified below.
- **Continued economic expansion:** These projections assume the economic expansion that began in FY 2009-10 will continue through the forecast period and will be reflected in tax revenue increases. The rapid rates of growth experienced in the early part of the expansion (FY 2010-11 and FY 2011-12) have continued through FY 2014-15 but have begun to slow in FY 2015-16 and are expected to continue to slow in the forecast period. Economic growth, and the revenue derived from it, is heavily dependent on changes in employment, business activity and tourism. These revenues are expected to increase at a slower pace throughout this forecast. This report does not assume any economic downturns or large changes in macroeconomic conditions; however, the City has historically not experienced more than six consecutive years of expansion.
- **Outcome of the November 2015 election:** This report recognizes the passage of the Legacy Business Ordinance which broadened the definition of a Legacy Business and created a Legacy Business Historic Preservation Fund.
- **Assumes negotiated wage rates through FY 2016-17 for most employees and through FY 2017-18 for police officers and firefighters. Inflationary increases assumed on labor agreements thereafter:** This projection assumes the negotiated rates for most labor

unions of 3.25% for FY 2016-17, given formulae contained in most adopted bargaining agreements. Beginning in FY 2017-18, open contracts are assumed to have salary increases equal to the change in the Consumer Price Index (CPI-U). This is projected by the California Department of Finance to be 2.5% for FY 2017-18 through FY 2019-20. The City will negotiate 24 open Memoranda of Understanding (MOUs) in FY 2016-17, and it will negotiate with police officers and firefighters in FY 2017-18. For police officers and firefighters, this report assumes previously negotiated wage increases of 2% in both FY 2016-17 and FY 2017-18, and increases of CPI (2.5%) for Fiscal Years 2018-19 and 2019-20.

- **Health and dental insurance cost increases:** This projection assumes that the employer share of health and dental insurance costs will increase by approximately 5.0% per year. The Health Service System anticipates negotiating rates for calendar year 2017 in late spring 2016, to be adopted by July 2016. For retiree health benefits, this report assumes that the City will continue its current practice of combined pay-as-you-go funding and prefunding the amounts due for retirees. The growth in the retiree obligation has been estimated based on projected cost increases of approximately 7.0% per year.
- **Retirement plan employer contribution rates will increase:** This report assumes total retirement costs will increase over the next four years. As discussed above, this is a significant change from the previously adopted Five Year Financial Plan, which assumed a reduction in employer contribution rates starting in FY 2015-16 and declining every year through FY 2019-20.

SFERS employer contribution rates are based on projections prepared by the Retirement System's actuary in November 2015. They assume continuation of the SFERS Board adopted investment returns of 7.5%. Projections reflect employee contributions to retirement required under Proposition C.

For CalPERS members, this report includes rate increases starting in FY 2015-16 due to adjusted mortality assumptions adopted by the CalPERS Board in February 2014.

- **Inflationary increase on non-personnel operating costs:** This projection assumes that the cost of materials and supplies, professional services, contracts with community-based organizations and other non-personnel operating costs will increase by the CPI-U (as projected by the California Department of Finance) rate of 2.5% per year from FY 2017-18 through FY 2019-20, building off of amounts in the adopted FY 2016-17 budget. One exception is a 6% inflation rate is assumed on pharmaceuticals due to higher costs for new specialty drugs and treatments.
- **Ten Year Capital Plan, Five Year ICT Plan and inflationary increases on equipment:** This projection assumes the adopted FY 2016-17 funding levels for capital, information technology, and equipment. For capital in the remaining three years, the report assumes funding will increase based on the levels assumed in the City's FY 2016-25 Ten Year Capital Plan, which was adopted in April 2015. The Information Technology investment projection includes full funding for both the annual and major IT project allocations as recommended in the City's FY 2016-20 Information and Communications Technology (ICT) Plan, which was adopted in April 2015. Starting in FY 2017-18, the report assumes that equipment funding will increase by CPI-U each year from the adopted FY 2015-16 level of funding.

- **Deposits to and withdrawals from reserves:** The base case projection assumes no withdrawals from the City’s Rainy Day Economic Stabilization, Budget Stabilization, Budget Savings Incentive, or Rainy Day One-Time reserves. Deposits are assumed for the City’s General Reserve in accordance with Controller’s Financial Policies. This report does assume withdrawals in the first two years from the Recreation and Park Budget Savings Incentive Reserve.
- **Office of Community Investment and Infrastructure (OCII) tax increment:** Under SB 107 enacted in September 2015, State law provides the Office of Community Investment and Infrastructure additional authority to issue debt for contractual obligations existing prior to the dissolution of the former San Francisco Redevelopment Agency. The projection assumes that OCII will issue debt to finance affordable housing obligations and infrastructure at the Transbay and Mission Bay development areas.
- **Public safety multi-year hiring plans:** This report assumes the continuation of the City’s multi-year hiring plans at several public safety departments, including:
  - Three Police Academy classes (50 police officers per class) each year through FY 2017-18, followed by two classes a year onwards to address retirements and keep the Police Department at the Charter-authorized level of officers;
  - Two Fire Academy classes (48 firefighters per class) from FY 2016-17 through FY 2017-18 and one class per year in FY 2018-19 and FY 2019-20 to keep up with expected retirements;
  - Classes sufficient to replace separations and promotions of Emergency Medical Technicians and Paramedics will be scheduled at the Fire Department’s Ambulance Division; and
  - Two 9-1-1 dispatcher classes (12 dispatchers per class) in FY 2016-17 at the Emergency Communications Center of the Department of Emergency Management, and then one class annually thereafter through FY 2019-20 to keep up with expected retirements.

## Key Factors That Could Affect These Forecasts

As with all projections, uncertainties exist regarding key factors that could affect the City’s financial condition. These include:

- **Economy:** Historically, periods of economic expansion are followed by economic contraction, or recession. Since the end of the Great Depression there have been 13 recessions, or approximately one every six years on average. The current economic expansion began more than six years ago. It would be an historic anomaly to not experience a recession within the projection period of this report. Because of the difficulty of projecting the timing of a recession, this report assumes slower rates of growth, rather than declines, in revenue throughout the report; however, it is important for the City to closely monitor economic conditions over the coming years.
- **Preliminary estimate of state and federal budget changes:** A two year, \$8 trillion federal budget bill was approved on November 2, 2015. Most notably, the budget increases domestic spending; however, the details of the additional spending are currently being negotiated and are therefore unknown at this time.

This report does not assume significant changes in funding at the state level, although many uncertainties exist, particularly with the Department of Public Health. The biggest potential risk is associated with negotiations among counties and the State to develop the formula and milestones for the new five year Medi-Cal Waiver (“1115 Waiver”) that will be effective

through FY 2019-20. Similar to prior waivers, some portion of the revenues associated with the new waiver will be tied to outcome milestones. The requirements and formulas defined in the 1115 Waiver will affect revenues, but until the agreement is finalized, the specific impact is not known, and no associated changes are assumed in this report. Additional uncertainties include potential changes to the State re-alignment take-back and take-back of federal Disproportionate Share Hospital (DSH) payments. The City will continue to monitor the state and federal budgets.

- **Collective bargaining agreement negotiations:** Other than approved wage increases in collective bargaining agreements and inflation on open contracts in FY 2017-18, FY 2018-19 and FY 2019-20, this report does not assume any wage changes due to labor negotiations. Wage or benefit changes above or below these assumptions would increase or decrease the City's projected deficit.
- **Further increases to the City's employer pension contribution rates:** As mentioned above, an appellate court recently ruled against the City and found that voter-adopted changes to the conditions under which retirees could receive a supplemental COLA violated retirees' vested rights. Proposition C required that the Plan be 100% funded before it granted supplemental COLAs. This report assumes the City funds supplemental COLAs owed to retirees since 2011; however, it does not assume any future supplemental COLAs, which will increase employer pension contribution rates even further in the future. It also assumes retirement system investment returns at the 7.5% discount rate. Actual returns below this level will increase contributions.
- **Pending or proposed legislation – potential fee / departmental revenue increases:** Fee increases may be proposed to the Board of Supervisors before the end of the year or as part of the FY 2016-17 and FY 2017-18 budget. No increases above those budgeted in the adopted FY 2015-16 and FY 2016-17 budget are assumed in this projection.
- **Deficits will differ if new budget commitments made:** If voters approve increases to existing baselines, set-asides, or create new mandatory spending increases without commensurate revenue increases from new funding sources, these commitment would grow the projected deficits shown in this report. Additionally, this report does not assume the adoption of any supplemental appropriations which would increase the budget shortfall.
- **Public Health – Enterprise Health Records (EHR):** Over the next five years the Department of Public Health (DPH) will begin preparing, building, and rolling out a new integrated enterprise health record (EHR) system which will replace its existing suite of clinical, financial, and billing systems. Preparation for and implementation of EHR will be phased-in; expected costs related to the changes include fortifying existing IT infrastructure and planning, implementation, and staffing costs associated with those phases. Prior consultant studies have estimated one-time implementation costs of approximately \$125 million over five years, which do not include any staffing or planning upgrades. Funding for the project is anticipated to come from departmental revenues, reallocation of current expenditures, and philanthropic support.

## **Schedule of Upcoming Reports Containing Budget Projections**

- **Early February - Controller's Six-Month Budget Status Report:** This report will provide updated revenue, expenditure, and ending fund balance projections for FY 2015-16.
- **Mid-March – Update to the Joint Report:** This report will update the revenue and expenditure forecasts for FY 2016-17 through FY 2019-20.
- **Mid-June - Controller's Discussion of the Mayor's Fiscal Year 2016-17 and 2017-18 Proposed Budget ("Revenue Letter"):** This report will provide the Controller's opinion regarding the reasonableness of the revenue estimates in the Mayor's Proposed Budget.

## **Appendix: Projected Changes to General Fund Supported Revenues and Expenditures**

Table A-1.	Key Changes to General Fund Supported Sources and Uses
Table A-2a.	Summary of General Fund Supported Operating Revenues and Transfers In
Table A-2b.	Revenue Growth Factors
Table A-3.	Projected Baselines and Mandated Expenditures FY2016-20
Table A-4.	Projected Uses, Deposits & Balances of Reserves FY2016-20
Figure A-1.	Projected Employer Pension Contribution Cost Increases from Prior Projections
Figure A-2.	Employer Contribution Rate Percent of Payroll 2016-2035
Table A-5.	Estimated Employer Contribution Rates for the Retirement System
Table A-6	Capital, Equipment and Technology Costs
Figure A-3.	Number of Months between Recessions in the U.S. (1904 to 2015)
Figure A-4.	Comparison of Revenue in Base Case and Recession Scenarios
Table A-7.	Projected General Fund Shortfall in Recession Scenario



# Appendix: Projected Changes to General Fund Supported Revenues and Expenditures

**Table A-1. Key Changes to General Fund Supported Sources and Uses**

	2016-17	2017-18	2018-19	2019-20
<b>SOURCES Increase / (Decrease)</b>				
General Fund Taxes, Revenues and Transfers net of items below	132.7	133.6	138.7	140.0
Change in One-Time Sources	(80.2)	-	(126.3)	-
Department of Public Health Revenues	6.5	10.3	11.0	11.8
OClI Tax Increment	(1.3)	(2.6)	3.4	4.1
Other General Fund Support	17.9	11.2	15.1	8.6
<b>TOTAL CHANGES TO SOURCES</b>	<b>75.6</b>	<b>152.5</b>	<b>42.0</b>	<b>164.5</b>
<b>USES Decrease / (Increase)</b>				
<b>Baselines and Reserves</b>				
Municipal Transportation Agency (MTA) Baselines	(17.1)	(16.5)	(24.0)	(19.5)
Children's Fund and Public Education Enrichment Fund	(13.3)	(12.4)	(14.6)	(8.5)
Housing Trust Fund	(2.8)	(2.8)	(2.8)	(2.8)
All Other Baselines	(3.1)	(3.6)	(3.8)	(3.7)
Deposits to General Reserve	5.0	(1.0)	(1.0)	(0.8)
Other Contributions to Reserves	5.7	(0.4)	(0.4)	(0.4)
<b>Subtotal Baselines and Reserves</b>	<b>(25.6)</b>	<b>(36.7)</b>	<b>(46.6)</b>	<b>(35.7)</b>
<b>Salaries &amp; Benefits</b>				
Annualization of Partial Year Positions	(19.7)	-	-	-
Previously Negotiated Closed Labor Agreements	(64.9)	(12.0)	-	-
Projected Costs of Open Labor Agreements	(0.8)	(51.9)	(71.3)	(73.0)
Health & Dental Benefits - Current & Retired Employees	(27.9)	(23.3)	(23.7)	(24.5)
Retirement Benefits - Employer Contribution Rates	(6.9)	(21.8)	(3.6)	(3.7)
Other Salaries and Benefits Savings / (Costs)	7.8	8.8	(0.1)	(19.6)
<b>Subtotal Salaries &amp; Benefits</b>	<b>(112.4)</b>	<b>(100.2)</b>	<b>(98.7)</b>	<b>(120.8)</b>
<b>Citywide Operating Budget Costs</b>				
Minimum Wage	(11.3)	(14.8)	(16.1)	(7.6)
Legacy Business	(3.7)	(3.9)	(3.8)	(4.2)
Capital, Equipment, & Technology	19.8	(30.1)	(34.5)	(5.2)
Inflation on non-personnel costs and grants to non-profits	(14.8)	(34.6)	(34.3)	(34.3)
Debt Service & Real Estate	(6.3)	(28.8)	(14.3)	(8.7)
Sewer, Water, and Power Rates	(2.4)	(2.5)	(3.0)	(3.2)
Other Citywide Costs	(6.0)	(5.5)	(3.0)	(2.9)
<b>Subtotal Citywide Operating Budget Costs</b>	<b>(24.6)</b>	<b>(120.2)</b>	<b>(109.1)</b>	<b>(66.1)</b>
<b>Departmental Costs</b>				
City Administrator's Office - Convention Facilities Subsidy	(2.0)	(11.1)	(0.7)	-
Elections - Number of Scheduled Elections	4.3	-	-	(4.5)
Ethics Commission - Public Financing of Elections	(0.1)	(0.6)	0.7	(2.5)
Golden State Warriors Transportation and Infrastructure	(2.3)	(0.1)	(6.8)	(0.2)
Public Safety Hiring Plans	(11.6)	(7.9)	(2.8)	(3.2)
Mayor's Office of Housing - HOPE SF and Local Operating Subsidy	(1.8)	(2.3)	(4.6)	(2.7)
Human Services Agency - Aid	(1.8)	(2.7)	(2.8)	(2.7)
Navigation Center Operations	(1.0)	-	-	-
Public Health - Operating and one-time costs for capital projects	7.2	(10.2)	(2.9)	9.6
All Other Departmental Savings / (Costs)	(3.9)	(0.9)	(1.9)	0.5
<b>Subtotal Departmental Costs</b>	<b>(12.8)</b>	<b>(35.8)</b>	<b>(21.8)</b>	<b>(5.8)</b>
<b>TOTAL CHANGES TO USES</b>	<b>(175.4)</b>	<b>(292.9)</b>	<b>(276.2)</b>	<b>(228.4)</b>
<b>Projected Surplus (Shortfall) vs. Prior Year</b>	<b>(99.8)</b>	<b>(140.4)</b>	<b>(234.3)</b>	<b>(63.8)</b>
<b>Cumulative Projected Surplus (Shortfall)</b>	<b>(99.8)</b>	<b>(240.2)</b>	<b>(474.5)</b>	<b>(538.4)</b>

## Notes to Table A-1

### **SOURCES – Revenues and Transfers In**

**General context underlying revenue estimates:** These projections assume continued modest growth in tax revenues during the next four years. With the exception of property tax revenues, which did not decline during the last recession, local tax revenues bottomed out in FY 2008-09 and FY 2009-10, and returned to pre-recessionary levels by FY 2011-12, one to two years earlier than projected at the start of the recovery. The pace of revenue growth during the projection period will depend heavily on the strength of the national economy and local technology industry.

Below are details on specific revenue streams included in the General Fund Taxes, Revenues and Transfers line of Table A- 2a.

**Property Tax:** General Fund property tax revenues are expected to grow from a budget of \$1,291 million in FY 2015-16 to an estimated \$1,553 million in FY 2019-20. General Fund property tax revenue assumptions include:

- **Roll growth:** The locally assessed secured roll typically grows based upon an annual statewide inflation factor capped at 2% and new base year property value assessments triggered by changes in ownership or new construction. The change in the California CPI (measured October-to-October of the previous two years) is known at 1.525% for FY 2016-17, and this report assumes the maximum 2.0% for FY 2017-18 through FY 2019-20.

For changes in ownership and new construction, it is assumed that an additional 2% of secured roll growth occurs at minimum each fiscal year. Developments of large, new multi-unit residential and commercial buildings are expected to add another \$2.6 billion in FY 2016-17, \$1.2 billion in FY 2017-18, \$3.6 billion in FY 2018-19, and \$0.8 billion in FY 2019-20 to the secured assessment roll. Changes in ownership of large office buildings and other high-value parcels are expected to add another \$3.4 billion, assumed to be equally distributed over the three years ending FY 2018-19, to the secured roll.

The state assessed board roll and the unsecured roll comprise about 7.6% of the overall taxable property values in San Francisco and tend to change in less predictable manners. In this Plan, the board roll value is assumed to remain at the FY 2015-16 value of \$2.9 billion, and the unsecured roll is assumed to grow at an annual rate of 1% from the FY 2015-16 value of \$11.8 billion through FY 2019-20.

- **Supplemental and escape assessments:** Supplemental assessments capture changes in value for the portion of the tax year remaining following a trigger date that results in a change in the base year assessed value of a property. The escape assessment captures a full year's increase in assessed value up to four years after the trigger date occurred. This Plan assumes supplemental and escape assessment revenue of \$57.7 million in FY 2016-17, declining about 10% per year through FY 2019-20 as the volume and size of such assessments is expected to decrease. Supplemental and escape assessments have traditionally been a significant source of variance in property tax revenues.
- **Reduced reserve requirements:** Property tax revenue set aside to fund Assessment Appeals Board (AAB) decisions in FY 2016-17 through FY 2019-20 is assumed at \$10 million per year. The number of assessment appeals received from property owners and

their agents during the FY 2015-16 annual assessment appeals filing period that ended September 15<sup>th</sup> was less than 1,000, compared to more than 3,500 new appeals filed during the same period in FY 2009-10.

- **Sales tax in-lieu (Triple Flip) expiration:** Beginning July 1, 2004, the State of California decreased the general purpose sales and use tax rate for local governments from 1% to 0.75%, and shifted the 0.25% difference to the State to pay debt service on Economic Recovery Bonds. In exchange, local governments were allowed to replace the lost local sales tax dollar-for-dollar from property tax revenues apportioned to the County's Educational Revenue Augmentation Fund (ERAF). This shift of sales and property tax revenue, also known as the Triple Flip, will expire on December 31, 2015. The 0.25% of sales tax will revert back to local governments beginning January 1, 2016 and the sales tax in-lieu revenue reflected in property tax revenues will be eliminated, resulting in a shift of \$12.2 million in FY 2015-16 and \$51.7 million in FY 2016-17 respectively from property tax to local sales tax. See the discussion of Sales Taxes for additional details.
- **Change in San Francisco Children's Fund property tax allocation factor:** San Francisco voters approved Proposition C on November 4, 2014, which renewed and increased the property tax set aside for the Children's Fund. As a result, the Children's Fund allocation factor increased from \$0.0300 in FY 2014-15 to \$0.0325 in FY 2015-16. The Children's Fund allocation factor will subsequently increase to \$0.0350 in FY 2016-17, to \$0.0375 in FY 2017-18, and to \$0.0400 in FY 2018-19 on each \$100.00 valuation of taxable property. The allocation of property taxes to the General Fund decreases each year by the same incremental change to the Children's Fund factor.

**Business Taxes:** Business taxes are expected to grow from a budget of \$634.5 million in FY 2015-16 to \$773.8 million by FY 2019-20. Business taxes include payroll, business registration fees, and gross receipts taxes. Revenues from business taxes and registration fees follow economic conditions in the City and grew strongly from FY 2010-11 to FY 2014-15, reflecting underlying gains in employment and wages during the period. Business tax revenues are sensitive to changes in the economic condition of the City. The two main factors that determine the level of revenue generated are employment and wages. Wages are projected to show strong growth between 2017 and 2021 while employment growth is projected to decelerate. Overall, business taxes are projected to grow over the five year time period.

In November 2012, San Francisco voters passed Proposition E to replace a 1.5% payroll tax on businesses with a tax on a business's gross receipts at rates that vary by size and type of business. During this five year period, the new tax structure is being phased in as the payroll tax is phased out. The phase-in is designed to adjust tax rates in order to generate the same amount of revenue as the original 1.5% payroll tax. Revenue collected from gross receipts tax will vary based on implementation factors and any policy changes. The shift to a new and far more complex tax structure is significant, and revenues may be sensitive to the administrative burdens of the new system. The projections include an assumption of diminishing administrative and implementation risk associated with the transition. A large component of the 7.3% growth from FY 2016-17 to FY 2017-18 is an assumption that there will be a large drop-off in tax refunds associated with these risks; underlying growth is projected to be 5.5% in that year.

**Sales tax:** Sales taxes are expected to grow from a budget of \$172.9 million in FY 2015-16 to \$228.8 million in FY 2019-20. Underlying growth in local sales tax is projected to be slightly above inflation, complemented by an increase of \$51.7 million, fully annualized in FY 2016-17, due to the conclusion of the Triple Flip. As described in the Property Tax section, the Triple Flip is a funding shift beginning in FY 2004-05 under which the State withheld 0.25% of the local 1% portion of sales tax to pay debt service on the \$15.0 billion in bonds authorized under the

California Economic Recovery Bond Act (Proposition 57). In return, local governments retained an equivalent amount of property tax that they would otherwise have shifted to schools. These bonds will be retired on December 31, 2015 and 0.25% of sales tax, or \$46.7million for FY 2014-15, which had previously been recognized as property tax revenue, will shift to sales tax revenue. Sustained growth in sales tax revenue will depend on changes to state and federal law and order fulfillment strategies for online retailers. Projections assume no changes from state laws affecting sales tax reporting for online retailers

Sales and use tax revenue is generated from six major business groups, plus a county and state pool category that captures select countywide activity. When a sale cannot be identified with a permanent place of business in the state, the local sales tax is allocated to local jurisdictions through countywide or statewide pools. Accordingly, certain sellers are authorized to report their local sales tax either on a countywide or statewide basis. Recent growth in sales tax is in large part attributable to increases in county pool receipts, and the majority of this growth came from increased online purchasing activity.

**Hotel tax:** Hotel Tax is projected to grow from a budget of \$384.1 million in FY 2015-16 to \$457.9 million in FY 2019-20. Hotel Tax revenue is influenced by three factors – average daily room rates (ADR), occupancy rate, and supply of available rooms –represented by revenue per available room (RevPAR). Revenue per available room is projected to grow in the five year period, but at a somewhat slower pace mostly due to lower expected occupancy rates. Recent growth has been fueled by generally strong demand from all segments of the market (tourist, convention, and business), and more specifically by completion of the Moscone Convention Center renovations in July 2012, which boosted growth from convention-related business. Constrained hotel room supply has resulted in large increases in the average daily room rate.

San Francisco and a number of other jurisdictions in California and the U.S. are involved in litigation with online travel companies regarding the companies' duty to remit hotel taxes on the difference between whole sale and retail prices paid for hotel rooms. Hotel tax revenue will be impacted by the timing and direction of any resolution to this litigation.

**Real Property Transfer Tax:** Real property transfer tax (RPTT) revenue is projected to decrease from a budgeted level of \$275.3 million in FY 2015-16 to a projected annual level of \$225.0 million in FY 2018-19 and FY 2019-20. This revenue is one of the most volatile of all sources and is highly sensitive to economic cycles and interest rates. Transfer taxes are assessed at different rates according to the amount of the transaction. The highest tier is 2.5% of transaction value for transactions of more than \$10 million. While the number of transactions in this tax tier are small (1.4% in FY 2014-15), the proportion of total transfer tax revenue they generate is quite large (62.6% in 2014), contributing to the volatility of the revenue source.

Recent growth in RPTT revenue has largely been a function of the lack of more attractive alternative investment opportunities as demonstrated by historically low U.S. Treasury Bond rates. Our projections anticipate that rising interest rates during the reporting period will increase the attractiveness of alternative investments and result in reductions to transfer tax revenue from the peak level experienced in FY 2014-15.

Tables A-2a and A-2b summarize revenues and transfers-in. Highlights are noted below.

**Table A-2a. Summary of General Fund Operating Revenues and Transfers In (\$ Millions)**

	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
	Year-End Pre-Audit	Original Budget	Projection	Projection	Projection	Projection
Property Taxes	\$ 1,272.6	\$ 1,291.0	\$ 1,349.0	\$ 1,406.0	\$ 1,485.0	\$ 1,553.0
Business Taxes	609.6	634.5	656.9	704.9	738.7	773.8
Sales Tax	140.1	172.9	202.9	211.5	220.0	228.8
Hotel Room Tax	394.2	384.1	408.4	426.8	440.8	457.9
Utility Users Tax	99.0	93.6	95.4	96.5	97.5	98.6
Parking Tax	87.2	89.7	91.6	94.0	96.4	98.4
Real Property Transfer Tax	314.6	275.3	250.0	237.5	225.0	225.0
Stadium Admission Tax	1.3	1.4	1.4	1.4	6.3	6.5
Access Line Tax	48.9	45.6	47.2	48.3	49.6	50.8
<b>Subtotal - Local Tax Revenues</b>	<b>2,967.6</b>	<b>2,988.0</b>	<b>3,102.7</b>	<b>3,227.0</b>	<b>3,359.2</b>	<b>3,492.7</b>
Licenses, Permits & Franchises	27.8	27.2	27.0	27.1	27.3	27.5
Fines, Forfeitures & Penalties	6.4	4.6	4.6	4.6	4.6	4.6
Interest & Investment Income	11.7	10.7	12.3	12.7	13.0	13.4
Rents & Concessions	24.5	15.4	14.3	14.3	14.3	14.3
<b>Subtotal - Licenses, Fines, Interest, Rent</b>	<b>70.4</b>	<b>57.8</b>	<b>58.2</b>	<b>58.7</b>	<b>59.2</b>	<b>59.8</b>
Social Service Subventions	234.9	240.7	247.8	247.8	247.8	247.8
Other Grants & Subventions	(9.0)	2.2	2.2	2.2	2.2	2.2
<b>Subtotal - Federal Subventions</b>	<b>225.9</b>	<b>242.9</b>	<b>250.0</b>	<b>250.0</b>	<b>250.0</b>	<b>250.0</b>
Social Service Subventions	194.4	211.1	219.7	221.0	223.6	226.3
Health & Welfare Realignment - Sales Tax	129.8	137.7	136.7	137.3	138.7	140.8
Health & Welfare Realignment - VLF	27.6	31.8	33.3	34.5	35.7	36.8
Health & Welfare Realignment - CalWORKs MOE	14.9	25.4	25.3	25.3	25.3	25.3
Health/Mental Health Subventions	73.2	102.2	104.3	104.3	104.3	104.3
Public Safety Sales Tax	94.0	98.0	102.1	106.2	111.5	117.1
Motor Vehicle In-Lieu (County & City)	0.6	-	-	-	-	-
Public Safety Realignment (AB109)	32.1	36.4	36.9	38.6	40.2	41.6
Other Grants & Subventions	40.8	15.1	14.8	14.8	14.8	14.8
Preliminary State Budget Assumption	-	-	-	-	-	-
<b>Subtotal - State Subventions</b>	<b>607.3</b>	<b>657.6</b>	<b>673.2</b>	<b>682.1</b>	<b>694.1</b>	<b>707.0</b>
General Government Service Charges	54.6	56.0	56.0	55.3	55.3	55.3
Public Safety Service Charges	38.4	36.3	36.1	36.1	36.1	36.1
Recreation Charges - Rec/Park	20.9	18.8	18.8	18.8	18.8	18.8
MediCal, MediCare & Health Svc. Chgs.	78.4	78.2	78.6	78.6	78.6	78.6
Other Service Charges	18.4	16.5	17.1	17.1	17.1	17.1
<b>Subtotal - Charges for Services</b>	<b>210.6</b>	<b>205.8</b>	<b>206.7</b>	<b>206.0</b>	<b>206.0</b>	<b>206.0</b>
<b>Recovery of General Government Costs</b>	<b>5.8</b>	<b>9.7</b>	<b>9.9</b>	<b>9.9</b>	<b>9.9</b>	<b>9.9</b>
<b>Other General Fund Revenues</b>	<b>11.5</b>	<b>35.7</b>	<b>11.5</b>	<b>11.5</b>	<b>11.5</b>	<b>11.5</b>
<b>TOTAL REVENUES</b>	<b>4,099.1</b>	<b>4,197.5</b>	<b>4,312.2</b>	<b>4,445.2</b>	<b>4,589.9</b>	<b>4,736.9</b>
<b>Transfers in to General Fund</b>						
Airport	40.5	40.8	41.8	42.7	44.9	46.6
Other Transfers	121.6	165.9	165.9	165.9	165.9	165.9
<b>Total Transfers-In</b>	<b>162.1</b>	<b>206.8</b>	<b>207.7</b>	<b>208.5</b>	<b>210.8</b>	<b>212.5</b>
<b>TOTAL GF Revenues and Transfers-In</b>	<b>4,261.2</b>	<b>4,404.3</b>	<b>4,519.9</b>	<b>4,653.8</b>	<b>4,800.7</b>	<b>4,949.4</b>

**Table A-2b. Revenue Growth Factors**

	<b>FY 2015-16</b>	<b>FY 2016-17</b>	<b>FY 2017-18</b>	<b>FY 2018-19</b>	<b>FY 2019-20</b>
	<b>% Chg from FY 2014-15 Original Budget</b>	<b>% Chg from FY 2015-16 Projection</b>	<b>% Chg from FY 2016-17 Projection</b>	<b>% Chg from FY 2017-18 Projection</b>	<b>% Chg from FY 2018-19 Projection</b>
Property Taxes	1.4%	4.5%	4.2%	5.6%	4.6%
Business Taxes	4.1%	3.5%	7.3%	4.8%	4.8%
Sales Tax	23.4%	17.3%	4.3%	4.0%	4.0%
Hotel Room Tax	-2.6%	6.3%	4.5%	3.3%	3.9%
Utility Users Tax	-5.5%	2.0%	1.1%	1.1%	1.1%
Parking Tax	2.9%	2.0%	2.7%	2.5%	2.0%
Real Property Transfer Tax	-12.5%	-9.2%	-5.0%	-5.3%	0.0%
Stadium Admission Tax	4.9%	0.0%	0.0%	366.1%	2.8%
Access Line Tax	-6.7%	3.4%	2.5%	2.5%	2.5%
<b>Subtotal - Tax Revenues</b>	<b>0.7%</b>	<b>3.8%</b>	<b>4.0%</b>	<b>4.1%</b>	<b>4.0%</b>
Licenses, Permits & Franchises	-2.3%	-0.7%	0.7%	0.7%	0.7%
Fines, Forfeitures & Penalties	-28.3%	0.0%	0.0%	0.0%	0.0%
Interest & Investment Income	-8.5%	15.4%	2.8%	2.8%	2.8%
Rents & Concessions	-37.1%	-7.2%	0.0%	0.0%	0.0%
<b>Subtotal - Licenses, Fines, Interest, Rent</b>	<b>-17.8%</b>	<b>0.6%</b>	<b>0.9%</b>	<b>0.9%</b>	<b>0.9%</b>
Social Service Subventions	2.5%	3.0%	0.0%	0.0%	0.0%
Other Grants & Subventions	-124.6%	0.0%	0.0%	0.0%	0.0%
<b>Subtotal - Federal Subventions</b>	<b>7.5%</b>	<b>2.9%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
Social Service Subventions	8.6%	4.1%	0.6%	1.2%	1.2%
Health & Welfare Realignment - Sales Tax	6.0%	-0.7%	0.5%	1.0%	1.6%
Health & Welfare Realignment - VLF	15.2%	5.0%	3.5%	3.4%	3.3%
Health & Welfare Realignment - CalWORKs MOE	70.8%	-0.6%	0.0%	0.0%	0.0%
Health/Mental Health Subventions	39.7%	2.0%	0.0%	0.0%	0.0%
Public Safety Sales Tax	4.2%	4.3%	4.0%	5.0%	5.0%
Motor Vehicle In-Lieu (County & City)	0.0%	0.0%	0.0%	0.0%	0.0%
Public Safety Realignment (AB109)	13.4%	1.5%	4.6%	4.1%	3.4%
Other Grants & Subventions	-62.9%	-1.9%	0.0%	0.0%	0.0%
<b>Subtotal - State Subventions</b>	<b>8.3%</b>	<b>2.4%</b>	<b>1.3%</b>	<b>1.8%</b>	<b>1.9%</b>
General Government Service Charges	2.7%	0.0%	-1.2%	0.0%	0.0%
Public Safety Service Charges	-5.5%	-0.4%	0.0%	0.0%	0.0%
Recreation Charges - Rec/Park	-10.1%	0.3%	0.0%	0.0%	0.0%
MediCal, MediCare & Health Svc. Chgs.	-0.2%	0.5%	0.0%	0.0%	0.0%
Other Service Charges	-10.4%	3.8%	0.0%	0.0%	0.0%
<b>Subtotal - Charges for Services</b>	<b>-2.3%</b>	<b>0.5%</b>	<b>-0.3%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Recovery of General Government Costs</b>	<b>66.4%</b>	<b>1.4%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Other Revenues</b>	<b>209.7%</b>	<b>-67.7%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>TOTAL REVENUES</b>	<b>2.4%</b>	<b>2.7%</b>	<b>3.1%</b>	<b>3.3%</b>	<b>3.2%</b>
<b>Transfers in to General Fund</b>					
Airport	0.9%	2.3%	2.1%	5.3%	3.8%
Other Transfers	36.5%	0.0%	0.0%	0.0%	0.0%
<b>Total Transfers In</b>	<b>27.6%</b>	<b>0.4%</b>	<b>0.4%</b>	<b>1.1%</b>	<b>0.8%</b>
<b>TOTAL GF Revenues and Transfers-In</b>	<b>3.4%</b>	<b>2.6%</b>	<b>3.0%</b>	<b>3.2%</b>	<b>3.1%</b>

## ***SOURCES – One-Time Sources Including Fund Balance & One-Time Reserves***

**Change in starting fund balance:** This report assumes available fund balance of \$248.7 million, including \$194.1 million previously appropriated in FY 2016-17 by the FY 2015-16 and FY 2016-17 adopted budget in addition to anticipated surpluses from FY 2014-15 and FY 2015-16 of \$16.6 million and \$35.7 million, respectively. The report assumes use of this fund balance to be split evenly across the two upcoming budget years as a one-time starting source of \$123.2 million in each year. This results in a year over year reduction in General Fund-supported starting fund balances of \$57.0 million in FY 2015-16, \$0.0 million in FY 2016-17, and a loss of \$123.2 million in FY 2018-19.

**Changes in Use of Reserves:** No change in use of reserves is assumed until FY 2018-19. In FY 2015-16 through FY 2017-18 there is a projected annual withdrawal from the Recreation and Parks Budget Savings Incentive Reserve of \$3.1. No reserve withdrawals are anticipated in FY 2018-19 and FY 2019-20.

- **Budget Savings Incentive Fund:** The Citywide Budget Savings Incentive Fund receives 25% of year-end departmental expenditure savings to be available for one-time expenditures. We assume no withdrawals or deposits from this reserve during the reporting period, resulting in an unchanged ending balance of \$33.9 million.
- **Rainy Day One-Time Reserve:** Charter Section 9.113.5 establishes a Rainy Day One-Time Reserve funded by 25% of revenue growth over 5%, which can be used towards one-time expenses. We assume no withdrawals or deposits from this reserve during the reporting period, resulting in an unchanged ending balance of \$43.1 million.
- **Rainy Day Economic Stabilization Reserve:** Charter Section 9.113.5 establishes the City Rainy Day Reserve Economic Stabilization Fund, an economic stabilization reserve funded by 37.5% of revenue growth over 5%, which can be used to support General Fund operating budgets in years when revenue declines. We assume no withdrawals from or deposits to this reserve during the reporting period, resulting in an unchanged ending balance of \$71.9 million.
- **Recreation & Park Budget Savings Incentive Reserve:** The Recreation and Park Savings Incentive Reserve, established by Charter Section 16.107(c), is funded by the retention of year-end net expenditure savings by the Recreation and Park Department and must be dedicated to one-time expenditures. This report assumes annual withdrawals of \$3.1 million in FY 2015-16 through FY 2017-18, resulting in a projected ending balance of \$1.3 million.

## ***SOURCES – Other Citywide and Departmental Revenues***

**Public Health Revenues:** The Department of Public Health (DPH) projects a revenue increase of \$6.5 million in FY 2016-17, \$10.3 million in FY 2017-18, \$11.0 million in FY 2018-19, and \$11.8 million in FY 2019-20. The increases are due to projected growth in revenues from direct patient care in the San Francisco Health Network (SFHN), including capitated and fee-for-service reimbursement. Approximately 90,000 individuals are currently enrolled to receive health care services at SFHN through programs including Medi-Cal Managed Care, Healthy Workers, and Healthy San Francisco. The forecast assumes SFHN will maintain this level of enrollment. However, the State recently reduced the capitation rate for the Medi-Cal expansion population by 29%, reducing forecasted growth in capitated revenues. Fee for service payments are assumed to increase by an average of 2% each year.

**Office of Community Investment and Infrastructure (OCII) Tax Increment:** Under SB 107, enacted in September 2015, State law provides OCII additional authority to issue debt for contractual obligations existing prior to the dissolution of the former San Francisco Redevelopment Agency. The projection assumes that OCII may issue debt to finance affordable housing obligations and infrastructure at the Transbay and Mission Bay development areas. The City and OCII will continue to work collaboratively to implement development at existing areas in Transbay, Mission Bay, and Hunters Point Shipyard and Candlestick Point and deliver affordable housing. This results in an incremental General Fund cost of \$1.3 million in FY 2016-17 and \$2.6 million in FY 2017-18. Starting in FY 2018-19, the incremental need for General Fund support falls by \$3.4 million and then an additional \$4.1 million in FY 2019-20 due to lower debt service payments and the completion of some OCII projects.

**Other General Fund-Supported Revenues:** Other General Fund supported revenues are projected to increase by \$17.9 million, \$11.2 million, \$15.1 million, and \$8.6 million over the next four years. This includes other miscellaneous revenue such as increased draw from the state and federal government to pay for additional salary and benefit costs at the Human Services Agency, and increases in the Airport concession revenue to the General Fund.



## ***USES – Changes to Baselines and Reserves***

### **Changes to Baselines**

The Charter specifies baseline-funding levels for various programs or functions that are generally linked to changes in discretionary General Fund revenues, though some are a function of Citywide expenditures or base-year program expenditure levels.

As a result of growing discretionary revenue, the City's mandated contributions to baselines and set-asides is increasing by \$36.3 million, \$35.3 million, \$45.2 million, \$34.5 million in FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20, respectively. Key changes to baseline contributions are summarized below and in Table A-3.

The City's current baselines include:

- **MTA Baselines** Charter section 8A.105 establishes a minimum level of funding for the Municipal Transportation Agency (MTA) and the Parking and Traffic Commission within the MTA to provide predictable, stable and adequate level of funding for the MTA. Consistent with the Charter, the funding for these two baselines is adjusted annually by the percent increase or decrease in General Fund Aggregate Discretionary Revenues (ADR). Also included in the MTA baseline total is an amount equal to 80% of annual parking tax revenue as mandated by Charter Section 16.110.

Proposition B, passed by the voters in November 2014, additionally adjusts these baselines by the growth in population; first, in FY 2015-16 by the cumulative growth in population during the most recent ten year period, and subsequently by the annual growth in population. The funds provided through Proposition B must be appropriated as follows:

- 75% of funds for transit system improvements to the Municipal Railway to improve the system's reliability, frequency of service, capacity and state of good repair; and
- 25% of funds for transportation capital expenditures to improve street safety for all users.

Combining all required Muni baselines and parking tax transfers, the MTA is expected to receive additional incremental revenue each year over the next four years of \$17.1 million, \$16.5 million, \$24.0 million, and \$19.5 million. This projection includes assumed additional service costs of \$6.8 million in FY 2018-19 and \$2.3 million in FY 2019-20 related to the opening of the new Central Subway. Charter section 8A.105 states that contributions to the MTA must be adjusted when new ongoing transit services are added above those provided in the base year (2000-01). In 2019, the Central Subway project will be complete, extending the T Third light rail service to Chinatown and nearly doubling current T Third service levels.

- **Public Education Enrichment Fund Annual Contribution:** Proposition C, passed by the voters in November 2014, extended the Public Education Enrichment Fund Annual Contribution (PEEF) for 26 years in order to fund the City's Preschool For All programs and provide support to the San Francisco Unified School District, until June 30, 2041, eliminated a provision that allowed the City to defer up to a quarter of the contribution to PEEF in any year the City had a budget shortfall of \$100 million or more, and eliminated a credit for in-kind services allowed as an offset against the contribution.

The PEEF contribution is projected to increase by \$3.7 million, \$4.0 million, \$4.3 million, and \$4.3 million in FY 2016-17 through FY 2019-20. These increases reflect the

percentage increase in the City's aggregate discretionary revenue over the next four years, as prescribed by Charter Section 16.123-2.

- **Children's Fund Property Tax Set-aside:** Proposition C extended the Children's Fund and the property tax set-aside for 25 years, until June 30, 2041, and increased the property tax set-aside from \$.03 for each \$100 of assessed property value in FY 2014-15 to \$.04 by FY 2018-19. In addition, Proposition C added a new priority population to benefit Transitional Aged Youth (TAY). Without the legislation, the Fund would have grown due to the projected growth in property tax revenue. Combining the planned growth with the new growth due to the policy change, the overall value of the Children and Youth Fund will increase from a budgeted \$59.9 million in FY 2015-16, to \$69.2 million in FY 2016-17, \$77.5 million in FY 2017-18, \$87.8 million in FY 2018-19, and \$91.9 million in FY 2019-20. The impact to the General Fund of this set-aside increase is partially offset by reductions to other baselines. Isolating the policy change of the increased percentage of property taxes dedicated to the Children's Fund, the additional General Fund support needed each year is \$5.3 million in FY 2016-17, \$5.6 million in FY 2017-18, \$6.4 million in FY 2018-19, and \$1.1 million in FY 2019-20.
- **Children's and Transitional Aged-Youth Baselines:** This report assumes that the required expenditure appropriations for the Children's and Disconnected Transitional-Aged Youth Baselines are more than exceeded in each year, therefore, no net budgetary impact is projected.
- **Housing Trust Fund:** This report assumes that the Housing Trust Fund will continue to grow by \$2.8 million in each year, as prescribed by Charter.

**Other Baseline and Mandate Requirements:** In addition to those listed above the Charter specifies baseline-funding levels for various programs or functions, including the Public Library, Public Education, Children's Services, the Human Services Care Fund, and the City Services Auditor. Baseline amounts are generally linked to changes in discretionary City revenues, though some are a function of Citywide expenditures or base-year program expenditure levels.

Table A-3 shows the City's projected baseline contribution and the change from the prior year over the next four years, including FY 2015-16 budgeted contributions for the City's baselines.

**Table A-3. Projected Baselines and Mandated Expenditures FY 2016-20 (\$ in millions)**

Total Contribution	FY 15-16	FY 16-17	FY 17-18	FY 18-19	FY 19-20
	Budget				
Public Education Enrichment Fund	94.7	98.4	102.4	106.7	111.0
Children's Fund Property Tax Set Aside*	59.9	69.2	77.5	87.8	91.9
Housing Trust Fund	25.6	28.4	31.2	34.0	36.8
MTA Baselines (Including Prop B)	369.6	386.7	403.3	427.3	447.0
Library Preservation Baseline	67.6	70.3	73.1	76.2	79.2
Controller- City Services Auditor	15.2	15.6	16.2	16.7	17.2
Municipal Symphony Baseline	2.4	2.5	2.7	2.8	3.0
	<b>635.1</b>	<b>671.0</b>	<b>706.4</b>	<b>751.5</b>	<b>786.1</b>
<b>Change in General Fund cost</b>		<b>FY 16-17</b>	<b>FY 17-18</b>	<b>FY 18-19</b>	<b>FY 19-20</b>
Public Education Enrichment Fund		(3.7)	(4.0)	(4.3)	(4.3)
Children's Fund Property Tax Set Aside*		(9.3)	(8.3)	(10.2)	(4.2)
Housing Trust Fund		(2.8)	(2.8)	(2.8)	(2.8)
MTA Baselines (Including Prop B)		(17.0)	(16.6)	(24.1)	(19.6)
Library Preservation Baseline		(2.6)	(2.9)	(3.1)	(3.1)
Controller- City Services Auditor		(0.4)	(0.6)	(0.6)	(0.5)
Municipal Symphony Baseline		(0.2)	(0.1)	(0.2)	(0.1)
		<b>(36.0)</b>	<b>(35.4)</b>	<b>(45.1)</b>	<b>(34.6)</b>

\* The impact to the General Fund of the Children's Fund Property Tax setaside increase is partially offset by reductions to other baselines.

### Changes to Reserves

The net change in deposits to reserves is estimated to be a savings of \$10.7 million in FY 2016-17, followed by increased costs (deposits) of \$1.4 million in FY 2017-18, \$1.4 million in FY 2018-19, and \$1.2 million in FY 2019-20. Key changes to reserves are summarized below and reflected in Table A-4.

The City has a number of reserves that are available to insulate the City's budget and services from a dramatic event and soften the impact of economic shocks. Projected deposits to reserves include:

- General Reserve:** Consistent with the financial policies adopted by the Board of Supervisors in December 2014 and codified in Administrative Code Section 10.60(b), which, the General Reserve value will increase to 3.0% of General Fund revenues by FY 2020-21. This report anticipates the General Reserve rising from 1.75% of regular General Fund revenues in FY 2015-16 to 2.75% in FY 2019-20.

Projections for deposits to the General Reserve are \$17.8 million, \$12.8 million, \$13.8 million, \$14.7 million, and \$15.5 million in FY 2015-16, FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20 respectively. This report also assumes no withdrawals and that unspent monies at the end of each fiscal year will be carried forward to the subsequent year.

- Rainy Day One-Time Reserve:** Charter Section 9.113.5 establishes a Rainy Day One-Time Reserve funded by 25% of revenue growth over 5%, which can be used towards one-time expenses. This report projects no deposits to or withdrawals from this reserve from FY 2015-16 through FY 2019-20.
- Budget Stabilization Reserve:** Consistent with the financial policies adopted by the Board of Supervisors in April 2010 and codified in Administrative Code Section 10.60(b), this report anticipates the budgeted deposit of \$19.4 million to this reserve in FY 2015-16 based on real property transfer tax receipts above the five year average. No additional withdrawals or deposits are projected.

- **Salary and Benefits Reserve:** This reserve projects the need for an increase of \$16.1 million in FY 2016-17 due to potential costs related to open labor negotiations that were not accounted for in the FY 2016-17 budget. In each of the three final years, this Plan projects increasing the Salary and Benefits Reserve by CPI from the \$13.9 million level appropriated in FY 2015-16. The increase is projected to support costs related to labor agreements not budgeted in individual departments, and assumes the reserve will be fully spent each year.
- **Litigation Reserve:** This reserve supports annual City liabilities related to claims, settlements, and judgments. This Plan assumes \$15.9 million in FY 2015-16, as previously appropriated. In the following four years, the reserve is projected to return to \$11.0 million, consistent with historic levels, and is assumed to be fully spent each year.

Table A-4 outlines the projected uses, deposits, and balances of all reserves discussed above and in the Sources section of this Plan.

**Table A-4. Projected Uses, Deposits & Balances of Reserves FY 2016-20 (\$ in millions)**

	FY 15-16 (Deposit)/ Use	FY 16-17 (Deposit)/ Use	FY 17-18 (Deposit)/ Use	FY 18-19 (Deposit)/ Use	FY 19-20 (Deposit)/ Use
General Fund Reserve	(17.8)	(12.8)	(13.8)	(14.7)	(15.5)
Budget Savings Incentive Fund	-	-	-	-	-
Recreation & Parks Budget Savings Incentive Reserve	(3.1)	(3.1)	(3.1)	-	-
Rainy Day Economic Stabilization Reserve	-	-	-	-	-
Rainy Day One-Time Reserve	-	-	-	-	-
Budget Stabilization Reserve	(19.4)	-	-	-	-
Salary and Benefits Reserve*	(13.9)	(30.0)	(30.4)	(30.8)	(31.2)
Litigation Reserve*	(15.9)	(11.0)	(11.0)	(11.0)	(11.0)
<b>TOTAL</b>	<b>(70.1)</b>	<b>(56.9)</b>	<b>(58.3)</b>	<b>(56.5)</b>	<b>(57.7)</b>

	FY 15-16 Ending Balance	FY 16-17 Ending Balance	FY 17-18 Ending Balance	FY 18-19 Ending Balance	FY 19-20 Ending Balance
General Fund Reserve	73.5	86.3	100.0	114.8	130.3
Budget Savings Incentive Fund	33.9	33.9	33.9	33.9	33.9
Recreation & Parks Budget Savings Incentive Reserve	7.5	4.4	1.3	1.3	1.3
Rainy Day Economic Stabilization Reserve	71.9	71.9	71.9	71.9	71.9
Rainy Day One-Time Reserve	43.1	43.1	43.1	43.1	43.1
Budget Stabilization Reserve	151.4	151.4	151.4	151.4	151.4
Salary and Benefits Reserve*	-	-	-	-	-
Litigation Reserve*	-	-	-	-	-
<b>TOTAL</b>	<b>381.2</b>	<b>390.9</b>	<b>401.6</b>	<b>416.3</b>	<b>431.8</b>

\* These reserves are assumed to either be spent or closed to fund balance at the end of each fiscal year.

### **USES – Salaries and Benefits**

This report projects General Fund supported salaries and fringe benefits to increase by \$112.4 million in FY 2016-17, \$100.2 million in FY 2017-18, \$98.7 million in FY 2018-19, and \$120.8 million in FY 2019-20. These increases, discussed in greater detail below, reflect the annualization of partial year positions approved in the current fiscal year, provisions in collective bargaining agreements, health and dental benefits for current and retired employees, retirement benefit costs, and other salary and benefit costs.

**Annualization of Partial Year Positions:** In FY 2016-17, the City is projected to incur \$19.7 million in additional costs to annualize positions funded for only a partial year in the FY 2015-16 budget.

**Previously Negotiated Closed Labor Agreements:** The additional salary and benefit costs of closed labor agreements are projected to be \$64.9 million for FY 2016-17 and \$12 million for FY 2017-18. Current contracts negotiated in 2014 with 27 employee organizations and covering approximately 28,000 employees will continue through FY 2016-17. With a few exceptions, the negotiated agreements include raises of 2.25% to 3.25% (depending on inflation) in July of 2016. This report assumes an increase of 3.25% based on the latest inflation projections from the California Department of Finance for February 2016. The Memorandum of Understanding (MOU) for police officers and firefighters is closed one additional year through FY 2017-18, and include negotiated wage increases of 2.0% in each of the next two years.

**Projected Costs of Open Labor Agreements:** Beginning in FY 2017-18, this report assumes that most bargaining units receive salary increases equivalent to the change in the Consumer Price Index (CPI-U), which is projected by the California Department of Finance to be 2.5% through FY 2019-20. For police officers and firefighters, the report also assumes increases of 2.5% in FY 2018-19 and FY 2019-20. The additional salary and benefit costs for open collective bargaining agreements, using these assumptions, are projected to be \$51.9 million, \$71.3 million, and \$73 million in FY 2017-18, FY 2018-19 and FY 2019-20, respectively. These increases are provided for projection purposes only; actual costs will be determined in labor negotiations to be conducted in FY 2016-17 for most employees and in FY 2017-18 for police officers and firefighters.

#### **Health and Dental Benefits – Current and Retired Employees:**

**Current Employees:** Each spring, the Health Service System (HSS) negotiates the following calendar year rates with health plans. The HSS Board adopts these rates in July, and then HSS holds open enrollment for employees every October.

In order to ensure competition between health plans by minimizing migration, the Health Service Board has used one-time and ongoing strategies to reduce the price gap between plan rates. Industry predictions anticipate that medical and pharmacy inflation rates will increase at a rate which is greater than the Health Service Board negotiated plan rates. Therefore projections in this report assume average increases of approximately 5.0% in health and dental rates in each year. Given these assumptions, health and dental insurance premium costs paid by the employer related to current employees are projected to increase by \$15.6 million in FY 2016-17, \$12.7 million in FY 2017-18, \$13.5 million in FY 2018-19, and \$14.2 million in FY 2019-20.

The key uncertainty at this time last year was the impact of federal taxes and fees levied on employer based health plans as part of the implementation of the Affordable Care Act (ACA). The initial fees and taxes imposed by the ACA are included in estimated health costs. In addition, the Excise Tax on High Cost Plans (or “Cadillac Tax”), effective in 2018, is estimated to increase General Fund costs by \$0.1 million, \$0.2 million, and \$0.4 million in FY 2017-18, FY 2018-19, and FY 2019-20, as estimated by the Health Service System’s actuary. This assumes continued utilization of Health Care Flexible Savings Accounts (FSAs), which are subject to the tax. In addition, it assumes that employers will be allowed to blend the health premium rates for Medicare and pre-Medicare retiree plans. At this time, however, regulations on implementation of the tax have not been issued, and the actuary estimates that if blending of retiree premiums is ultimately not permitted, it would increase General Fund costs above the projections in this report, (assuming no effect on plan migration or plan changes that would reduce premiums, such as increased co-pays or deductibles).

**Retired Employees:** Charter Section A8.428 mandates health coverage for retired City employees. The cost of medical benefits for retirees is projected to increase General Fund support by \$6.2 million, \$6.7 million, \$7.1 million, and \$7.6 million in FY 2016-17, FY 2017-18, FY 2018-19 and FY 2019-20, respectively. Proposition B, passed by voters in June of 2008, began to address this unfunded liability by requiring employees hired after January 10, 2009 and the City to pay 2.0% and 1.0% of pre-tax compensation, respectively, into a Retiree Health Care Trust Fund. Proposition C, passed by voters in November of 2011, added to these provisions by requiring all remaining employees and the employer to begin contributing to the Fund beginning in FY 2016-17. Starting July 1, 2016, employees hired before January 10, 2009 will contribute 0.25% of pre-tax compensation into the Fund with additional 0.25% of each subsequent year, up to a maximum of 1.0%, and the City will match the contributions. As a result, General Fund expenditures will grow \$6.1 million, \$3.8 million, \$2.9 million, and \$2.3 million each year FY 2016-17 through FY 2019-20, respectively.

**Retirement Benefits – Employer Contribution Rates:** The majority of City employees are part of the San Francisco Employees Retirement System (SFERS), and some public safety personnel are part of the California Public Employees Retirement System (CalPERS). In November 2011, Proposition C changed the way the City and employees share in funding pension benefits. The base employee contribution rate remains at 7.5% for most employees when the City contribution rate is 11% of payroll. When the City contribution rate is above 11%, employees pay an additional amount based on the salary band in which their wages fit.

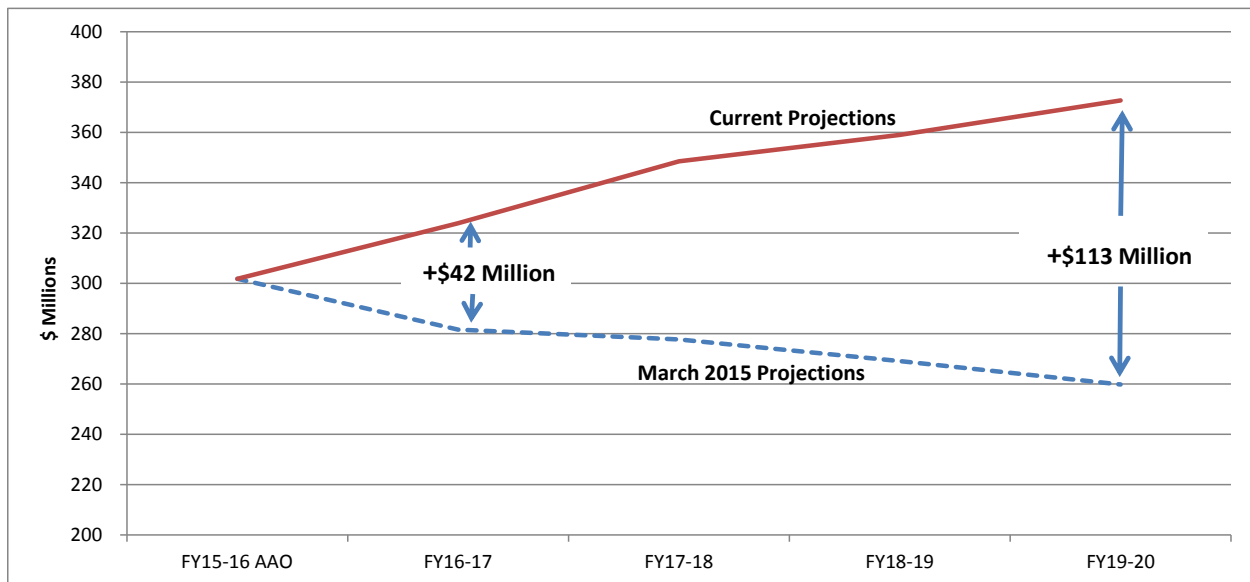
SFERS employer contribution rates presented in the December 2014 Five Year Financial Plan (and updated in March 2015) were based on projections prepared by the Retirement System's actuary in the fall of 2014. Rates in this report are based on projections provided in November 2015, and final FY 2016-17 rates will be adopted by the Retirement Board in the coming months. Projections reflect employee contributions to retirement required under Proposition C. The Five Year Financial Plan anticipated a decline in retirement costs after FY 2014-15, as asset losses during the 2008 financial crisis were fully recognized and subsequent asset gains incorporated, and as propositions implemented between 1994 and 1998 became fully amortized. However, several factors have now led to a reversal of this trend, leading to projected increases in costs:

- Actual FY 2014-15 investment earnings of just under 4.0%, compared to the actuarially assumed rate of return of 7.5%, have been incorporated and will be smoothed over the next five years. It is important to note that while the Retirement System's actuary did not recommend a reduction to the discount rate of 7.5%, it did present materials at the November 18, 2015 board meeting showing that the number of large public retirement plans assuming rates under 7.5% has increased significantly since 2009, and many investment consultants project future returns to be lower than they have in the past 10 to 20 years.
- Updated demographic assumptions adopted by the Retirement Board on November 18, 2015. Every five years, the Retirement System conducts a demographic study to determine whether actuarial assumptions are aligned with the most current data on how long retirees are collecting pensions after they retire. The study showed that retirees are living longer and collecting pensions longer than expected, which will require increased contributions in order to cover the additional pension payments.
- An appellate court ruling against the City which determined that voter-adopted changes to the conditions under which retirees could receive a supplemental cost-of-living adjustment (COLA) violated retirees' vested rights. Proposition C required that the Plan be 100% funded before it granted supplemental COLAs. Since 2011, the earnings of

Retirement System investments would have triggered two supplemental COLAs. The incremental cost of these two COLAs is included in the estimated contribution rates and costs below. Of note, the rates do not yet include the cost of any future supplemental COLAs.

The cumulative effect of these factors on employer contribution rates is significant not only because it reverses the downward trend anticipated by the City and employees alike, but in the magnitude of the cost increases projected. Figure A-1 below shows that the March 2015 update to Five Year Financial Plan projected General Fund pension contribution costs declining from \$301.8 million in FY 2015-16 to \$281.6 million in FY 2016-17, a savings of \$20.3 million. Costs were projected to continue declining, reaching \$259.8 million in FY 2019-20. Given the factors above, however, current projections are for costs to increase in FY 2016-17 to \$323.9 million, or \$42.3 million more than the prior projection, and to increase in each year after that, adding \$113.0 million in costs by FY 2019-20.

**Figure A-1. Projected Employer Pension Contribution Cost Increases from Prior Projections**

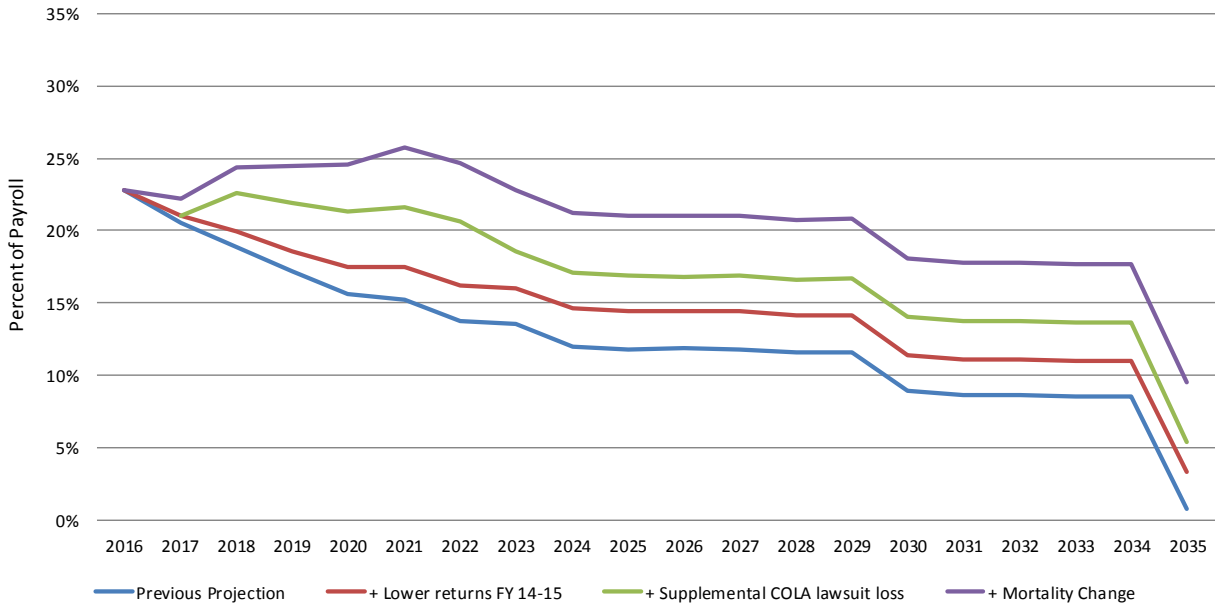


The maximum employer contribution rate for non-safety employees in salary band 2 is 18.61% in the current fiscal year. This rate is projected to increase to 19.0%, 20.2%, 20.3%, and 20.4% in FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20, respectively, as shown in the table below. Compared to rates reported one year ago, this represents increases in rates of 1.5%, 3.6%, 5.3% and 6.1% over the next four years. Rates for Police and Fire safety employees vary based on date of hire. This report assumes the maximum employer contribution rate for police officers and firefighters will increase from the current rate of 17.8%, to 18.2%, 19.3%, 19.4%, and 19.5% over the next four years.

Overall these changes will generate an increase in cost to the City of \$6.9 million, \$21.8 million, \$3.6 million and \$3.7 million in FY 2016-17, FY2017-18, FY2018-19, and FY 2019-20 respectively.

Figure A-2 below (shown earlier in this report) shows the change in the percent rates of the City will have to pay as a result of the three changes discussed above.

**Figure A-2. Employer Contribution Rate Percent of Payroll 2016-2035**



For CalPERS members, this report includes rate increases that began in FY 2014-15 due to adjusted mortality assumptions adopted by the CalPERS Board. The CalPERS rate in the current year is 23.7% and is projected to increase to 26.3%, 28.0%, 29.8% and 31.5% in FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20. Updated CalPERS projections based on the June 2014 valuation will be available in December 2015, and these rates may subsequently change.

Table A-5 below reflects the total contribution rate, the portion of the rate that employees contribute, and the City's portion.



**Table A-5. Estimated Employer Contribution Rates for the Retirement System**

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
<b>Estimated Total Contribution Rates</b>	29.7%	31.9%	32.0%	32.1%
<b>Non-Safety</b>				
<b>Employee Contribution (1)</b>				
Band 1, < \$26.68/hour	7.5%	7.5%	7.5%	7.5%
Band 2, < \$53.35/hour	10.0%	11.0%	11.0%	11.0%
Band 3, >\$53.35/hour	10.5%	11.5%	11.5%	11.5%
<b>Additional rate factors</b>				
Band 1, < \$26.68/hour	0.8%	0.9%	0.9%	0.9%
Band 2, < \$53.35/hour	0.7%	0.7%	0.7%	0.7%
Band 3, >\$53.35/hour	0.7%	0.7%	0.7%	0.7%
<b>Estimated Net Employer Contribution (1)</b>				
Band 1, < \$26.68/hour	21.4%	23.5%	23.6%	23.7%
Band 2, < \$53.35/hour	19.0%	20.2%	20.3%	20.4%
Band 3, >\$53.35/hour	18.5%	19.7%	19.8%	19.9%
<b>Police and Fire Safety Employees (2)</b>				
<b>Estimated Total Contribution Rates</b>	30.0%	32.2%	32.3%	32.4%
Employee Contribution & additional rate factors	11.8%	12.8%	12.8%	12.8%
<b>Estimated Net Employer Contribution</b>	18.2%	19.3%	19.4%	19.5%

**California Public Employees Retirement System (CalPERS) (3)**

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
<b>Total Estimated Contribution Rate</b>	27.4%	29.1%	30.9%	32.6%
Employee Contribution & additional rate factors	1.1%	1.1%	1.1%	1.1%
<b>Net Employer Contribution</b>	26.3%	28.0%	29.8%	31.5%

(1) Employees are divided into three bands based on FY 2016-17 estimated wage floors.

(2) Retirement contribution rates vary depending on hire date.

(3) The next CALPers update is expected in December 2015.

**Other Salary and Fringe Benefit Savings/(Costs):** Other salary and benefit cost changes are expected to be modest, with the biggest changes occurring due to the changing number of work days in a given fiscal year. Most fiscal years consist of 261 workdays for regularly scheduled shifts and 365 days for 24/7 operations. FY 2016-17 is a normal year but FY 2015-16 is a leap year and contains 366 days for 24/7 operations and 262 workdays for regularly scheduled shifts; therefore, the City incurs General Fund savings of \$8 million in FY 2016-17. FY 2017-18 contains only 260 regularly scheduled workdays and the City expects to see savings in that year of \$8.9 million. FY 2018-19 is the same as FY 2017-18, and FY 2019-20 is another leap year, which means the City incurs additional General Fund costs in that year of \$19.4 million compared to the prior year. Other salary and benefit changes include changes to costs for unemployment insurance, Long Term Disability, and any changes to the FICA income cap, as well as other small salary and fringe adjustments.

## ***USES – Citywide Operating Budget Costs***

Over the next five years, the City will also incur increasing non-salary operating costs. Citywide non-salary operating costs are projected to increase by \$24.6 million, \$120.2 million, \$109.1 million, and \$66.1 million in FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20, respectively. These increases span multiple departments and are described in more detail below.

**Minimum Wage (Proposition J):** In November 2014, voters adopted a Charter amendment increasing the local minimum wage from \$11.05 to \$15.00 per hour by 2018. After reaching \$15.00, the wage will increase by CPI on July 1 of every subsequent year. This report assumes a CPI-U increase of 2.5% in FY 2019-20.

The major cost driver of the policy change for the City is the In-Home Supportive Services (IHSS) program, which employs over 19,000 individuals. These workers received an hourly wage of \$12.00 prior to the implementation of the minimum wage increase. IHSS is a State and County supported program housed within the budget of the Human Services Agency. In addition, there are some City contracts which directly pay for staff and a limited group of city employees whose wages are below \$15.00 per hour.

Overall these changes to the City's minimum wage result in an increase in General Fund support of \$11.3 million in FY 2016-17, \$14.8 million in FY 2017-18, \$16.1 million in FY 2018-19, and \$7.6 million in FY 2019-20.

**Legacy Business:** In November 2015, Proposition J, an advisory measure, was approved by the voters. The ordinance created a Legacy Business Historic Preservation Fund which allows the issuance of annual grants to registered Legacy Businesses of \$500 per full time employee (up to a maximum of \$50,000 per business), as well as an annual grant to landlords of legacy businesses of \$4.50 per square foot of leased space (limited to \$22,500, and the lease must meet certain criteria). Changes to the definition of Legacy Business and the establishment of the new Preservation Fund could result in new costs to the General Fund of up to \$3.7 million in FY 2016-17, \$3.9 million in FY 2017-18, \$3.8 million in FY 2018-19 and \$4.2 million in FY 2019-20, as additional Legacy Businesses join the register each year and become eligible for grants.

**Capital, Equipment, and Technology:** Changes in funding for capital, equipment, and technology will result in an incremental decrease in General Fund support of \$19.8 million in FY 2016-17, and then incremental increases of \$30.1 million in FY 2017-18, \$34.5 million in FY 2018-19 and \$5.2 million in FY 2019-20. Please see Table A-6 for further detail.

**Table A-6. Capital, Equipment and Technology Costs (\$ Millions)**

	Projected Levels				
	2015-16	2016-17	2017-18	2018-19	2019-20
Capital Plan Budget	122.8	118.5	137.5	147.2	157.6
Capital FF&E, Move Costs	11.0	1.0	3.2	22.9	12.2
Equipment	16.1	8.5	17.4	17.9	18.3
Information & Communication Technology Budget	6.6	2.3	11.7	12.8	14.1
Additional Radio Contracts	-	11.5	-	-	-
FAMIS Project	9.1	9.8	0.3	-	-
Major IT Investments	3.2	6.4	18.3	20.5	22.5
Capital Planning Fund Contribution	12.6	-	-	-	-
<b>Total One-time Costs</b>	<b>181.4</b>	<b>158.0</b>	<b>188.4</b>	<b>221.3</b>	<b>224.7</b>

	Year-Over-Year Change			
	2016-17	2017-18	2018-19	2019-20
Capital Plan Budget	4.3	(19.0)	(9.7)	(10.4)
Capital FF&E, Move Costs	10.0	(2.2)	(19.7)	10.7
Equipment	7.6	(8.9)	(0.5)	(0.4)
Information & Communication Technology Budget	4.3	(9.4)	(1.1)	(1.3)
Additional Radio Contracts	(11.5)	11.5	-	-
FAMIS Project	(0.7)	9.5	0.3	-
Major IT Investments	(3.2)	(11.9)	(2.2)	(2.0)
Capital Planning Fund Contribution	12.6	-	-	-
Department of Technology Rates *	(3.5)	0.3	(1.6)	(1.6)
<b>Year-Over Year Change</b>	<b>19.8</b>	<b>(30.1)</b>	<b>(34.5)</b>	<b>(5.2)</b>

\* Department of Technology rates are excluded from the "Projected Levels" table above they represent an on-going cost, rather than a one-time cost.

This report assumes that capital budget funding will increase based on preliminary levels assumed in the City's FY 2016-25 Ten Year Capital Plan for FY 2017-18 through FY 2019-20, which results in an increase in General Fund support of \$19.0 million, \$9.7 million, and \$10.4 million, respectively. In FY 2016-17, the capital projection reflects a decrease in General Fund support of \$4.3 million due to budgeted funding in FY 2015-16 greater than what was assumed in the Capital Plan. This report also assumes the expiration of a one-time cost of \$12.6 million to initially fund the Capital Planning Fund in FY 2015-16.

Additionally, the City is experiencing changing costs related to furniture, fixtures and equipment (FF&E) associated with new and upgraded City facilities. The report assumes incremental changes in General Fund support including a decrease of \$10.0 million in FY 2016-17, an increase of \$2.2 million in FY 2017-18, an increase of \$19.7 million in FY 2018-19, and a decrease of \$10.7 million in FY 2019-20. These costs are related to projects such as renovated fire stations funded through the ESER I and II bonds, seismic upgrades to San Francisco General Hospital Building 5, a new ambulance facility for the Fire Department, a new Animal Care and Control facility, a City plan to consolidate permitting staff and operations from various leased and City-owned properties into one building, and other large Certificate of Participation and General Obligation bond-funded capital projects.

Citywide equipment costs are projected to decrease by \$7.6 million in FY 2016-17 consistent with the adopted budget. To reach previous levels of investment as well as projected need, equipment costs are projected to increase by \$8.9 million in FY 2017-18. Increased cost assumptions based on CPI result in annual \$0.5 million increases in FY 2018-19 and FY 2019-20. Equipment is defined as an item costing \$5,000 or more with an expected life span of three years or more. This projection assumes that no equipment purchases will be funded through the

use of lease revenue bonds in any of the next four years. By using cash instead of debt financing, the City saves on financing costs, reducing the overall cost of equipment purchases over the long term.

Citywide technology costs are projected to decrease by \$4.3 million in FY 2016-17, as reflected in the adopted FY 2016-17 budget. Technology costs are projected to increase by \$9.4 million in FY 2017-18, \$1.1 million in FY 2018-19, and \$1.3 million in FY 2019-20, consistent with the City's Information and Communication Technology (ICT) Plan for FY 2015-16 through FY 2019-20. These costs are related to infrastructure and security improvements, as well as department-specific technology updates.

This report also assumes an increase in funding for major Information Technology investments in the amount of \$4.6 million in FY 2016-17, \$1.7 million in FY 2017-18, \$1.9 million in FY 2018-19, and \$2.0 million in FY 2019-20. These increases reflect 10% growth on the prior year, consistent with ICT Plan assumptions to annually grow IT funding. This increase is also assumed to reflect the risk of unanticipated cost expenditures related to replacing the City's aging information and communication technology systems over the coming several years – specifically, the continued replacement of the Citywide financial system and the public safety radio system – as discussed in the ICT plan.

Finally, the Department of Technology's rates are projected to increase in FY 2016-17 by \$3.5 million as included in the adopted budget. Rates are projected to decrease by \$0.3 million in FY 2017-18, reflecting the expiration of one-time project costs, and then increase by \$1.6 million in FY 2018-19 and \$1.6 million in FY 2019-20 due to inflationary increases on salaries and benefits.

**Citywide – Inflation on non-personnel costs and grants to non-profit contractors:** Over the next four years, this report assumes that the cost of materials and supplies, professional services, contracts with Community-Based Organizations and other non-personnel operating costs will rise by Consumer Price Index (CPI-U) increases of 2.5% for FY 2017-18 through FY 2019-20. The projection reflects the adopted FY 2016-17 budget spending levels in the first year of the report, which includes a 2.5% cost-of-doing business increase for nonprofit organizations. This report also assumes inflationary increases on the costs of pharmaceuticals of 4% in FY 2016-17 and 6% in FY 2017-18 through FY 2019-20. The increasing cost of pharmaceuticals is largely driven by the high cost of new specialty drugs and treatments.

These assumptions generate an increase in costs to the City of \$14.8 million, \$34.6 million, \$34.3 million, and \$34.3 million in FY 2016-17, FY 2017-18, FY 2018-19, and FY 2019-20, respectively.

**Citywide –Debt Service and Real Estate:** Over the next four years, total debt service and real estate related costs are projected to increase by \$6.3 million in FY 2016-17, \$28.8 million in FY 2017-18, \$14.3 million in FY 2018-19 and \$8.7 million in FY 2019-20. These projections include current debt repayment requirements and projected debt service and real estate costs for investments anticipated in the Capital Plan. These projections do not include debt service related to the Moscone Convention Center, which is reflected in the Convention Facilities Fund subsidy projection.

The increases in debt service from FY 2016-17 to FY 2018-19 result in incremental General Fund increases of \$5.1 million, \$24.3 million, and \$10.1 million; there is no change in FY 2019-20. These changes are primarily due to Certificates of Participation (COPs) for the War Memorial Veterans Building seismic upgrade, equipment leases for Zuckerberg San Francisco General Hospital, HOPE SF, and new facilities for a number of City departments relocating from the Hall of Justice.

Real estate cost increases include leases for private property as well as ownership and maintenance costs for City-owned buildings. Over the next four years, these costs are projected to decrease by \$1.2 million in FY 2016-17, then increase by \$4.5 million in FY 2017-18, \$4.2 million in FY 2018-19, and \$8.7 million in FY 2019-20. These projections are driven primarily by the space needs of City departments. The expiration of lease-back agreements and costs associated with new facilities for various City departments, the Crime Lab, and a new Animal Care and Control facility are partially offset by savings from departments moving out of formerly City-owned buildings. Privately-leased space projections include new rental costs for the Department of Elections as well as negotiated rent escalations for existing leases.

**Citywide – Sewer, Water and Power rates:** The base case assumes increased General Fund transfers to the Public Utilities Commission (PUC) for the cost of sewer, water, and power expenses. Sewer and water rates have been adopted by the PUC Commission through FY 2017-18 and will cover the cost of planned capital improvements, including the Water System Improvement and the Sewer System Improvement Programs. The final two years of sewer and water rate projections are PUC financial plan assumptions and have not been adopted as approved rate increases. In FY 2016-17 and beyond, this projection uses PUC financial plan assumptions for power rate increases. The PUC's financial plan assumes a half cent per kilowatt hour increase in FY 2016-17 through FY 2019-20. If these increases are implemented, the total General Fund impact of increased sewer, water, and power rates is a cost of \$2.4 million, \$2.5 million, \$3.0 million, and \$3.2 million each year over the next four years.

**Other citywide costs:** This category includes increases in the City's workers' compensation costs, requests for services between city departments through work orders, and other minor changes. These items together result in General Fund costs of \$6.0 million, \$5.5 million, \$3.0 million and \$2.9 million in the remaining four years of the report.

### ***USES – Departmental Costs***

Departmental cost increases are as follows: \$12.8 million in FY 2016-17, \$35.8 million in FY 2017-18, \$21.8 million in FY 2018-19, and \$5.8 million in FY 2019-20.

**City Administrator's Office – Convention Facilities Subsidy:** This report assumes the Convention Facilities Fund will need a General Fund subsidy increase of \$2.0 million ongoing starting in FY 2016-17, increasing by \$11.1 million in FY 2017-18 and \$0.7 million in FY 2018-19. These cost increases are due to expected lower operating revenue at the facilities due to their partial closure during planned expansions and use of prior year fund balance.

**Elections – Number of Scheduled Elections:** The number of elections, and the associated costs for holding elections, vary annually. Currently, one election is projected in FY 2016-17 (a presidential general election), one gubernatorial primary election in FY 2017-18, one gubernatorial general election in FY 2018-19, and two elections (a municipal election and a June presidential primary) in FY 2019-20. This schedule results in projected incremental savings of \$4.3 million in FY 2016-17 over FY 2015-16, during which two elections are scheduled (a municipal election and June primary election), and an additional cost of \$4.5 million in FY 2019-20. Any special election not included in this projection would result in increased General Fund costs dependent on the complexity of the ballot and the size of the electorate.

**Ethics Commission – Public Financing of Elections:** The Ethics Commission administers the Election Campaign Fund. Annual General Fund deposits to the Campaign Fund are governed by ordinance and equal \$2.75 per resident, of which 15% is available for administrative costs in most years. In the fiscal year of a mayoral election, the Fund is required to contain \$7.50 per

resident plus an additional 15% for administrative costs. Funds not used in one election are carried over for use in the following election and at no time shall the total amount in the Fund exceed \$7.0 million.

The following projection assumes: General Fund deposits in all five years of the forecast; eligible candidates will qualify and accept disbursements each fiscal year based on historical actuals; and that a mayoral election will be held in FY 2019-20. Under these assumptions, the Ethics Commission assumes a cost of \$0.1 million in FY 2016-17, a cost of \$0.6 million in FY 2017-18, a savings of \$0.7 million in FY 2018-19, and a cost of \$2.5 million in FY 2019-20. These costs are highly sensitive to the actual amount of funds disbursed in mayoral and supervisorial campaigns.

**Golden State Warriors Event Center:** The Golden State Warriors plans to construct a multipurpose event center and retail and office project at 16<sup>th</sup> Street and 3<sup>rd</sup> Street in Mission Bay. In November 2015, the Mayor and Board of Supervisors approved the creation of the Mission Bay Transportation Improvement Fund to pay for public infrastructure improvements, equipment and public services to address the community's transportation and other needs in connection with events at the center. From FY 2016-17 through FY 2019-20, this report projects estimated annual incremental project costs of \$2.3 million, \$0.1 million, \$6.8 million and \$0.2 million. These costs will be funded entirely with revenue generated from the project through increased property, business, sales, hotel, utility user, and stadium admission taxes.

**Public Safety Hiring Plans:** Over the next five years, this report assumes a policy to implement multi-year hiring plans for several of the City's public safety departments. Mostly, these plans are meant to backfill retirements to ensure no loss of service, and in some cases to increase capacity and service to the public.

The base case assumes three Police classes of 50 officers over the next two years for a total of 150 hires a year until FY 2017-18, which will allow the Police Department to reach its Charter mandated full duty sworn level of 1,971 officers. Then starting in FY 2018-19, the report assumes there will be two classes per year for the Police Department to backfill retirements and ensure staffing levels stay at this new higher level. The increasing costs for these classes are \$10.8 million, \$10.6 million, \$0.7 million and \$0.6 million over the next four years. Additional growth beyond the charter mandated 1,971 level is not assumed in this report; but may be revisited in future budget cycles.

For the Fire Department, this report includes an assumption of two firefighter classes of 48 firefighters in FY 2016-17 and FY 2017-18, and then one class of 48 firefighters per year in FY 2018-19 and FY 2019-20. This will allow the Fire Department to keep pace with an expected surge in retirements and ensure no loss of service. In combination with projected retirements and the Fire Department's \$8.2 million SAFER grant for 36 additional firefighters for two years, staffing costs are projected to decline in FY 2016-17 by \$0.7 million and \$2.9 million FY 2017-18, increase in costs of \$2.3 million in FY 2018-19, and then an incremental cost in FY 2019-20 of \$2.3 million. The increase in costs in the out years is the result of step increases for new firefighters hired in FY 2015-16 through FY 2017-18 and relatively slower pace of retirements at the end of the projection period compared to the start of the projection period.

The base case also includes increasing costs in FY 2016-17 associated with incremental step costs of 72 Emergency Medical Technicians (EMTs) and Paramedic positions added over the last two fiscal years to meet minimum response time goals. This report assumes an increase in General Fund support at the Fire Department related to these additional EMTs and step adjustments of \$0.5 million in FY 2016-17 and then increasing slightly by CPI-U in the out years.

Finally, the Department of Emergency Management's 9-1-1 Emergency Communications Center will hold two classes of 12 dispatchers to replace retirements and other separations in FY 2016-17, followed by one class of 12 dispatchers each subsequent year through FY 2019-20 that will require an increase in General Fund support of \$1.0 million in FY 2016-17 and relatively flat each year thereafter through FY 2019-20.

**Mayor's Office of Housing and Community Development - HOPE SF and the Local Operating Subsidy Program:** Over the next five years, costs related to HOPE SF and the Local Operating Subsidy Program will require an increase in General Fund support of \$1.8 million in FY 2016-17, \$2.3 million in FY 2017-18, \$4.6 million in FY 2018-19, and \$2.7 million in FY 2019-20.

**Human Services Agency – Aid:** The Human Services Agency projects that aid payments (including programs such as IHSS, CalWORKS, Care Not Cash, and others) will require increases in General Fund support of \$1.8 million in FY 2016-17, \$2.7 million in FY 2017-18, \$2.8 million in FY 2018-19, and \$2.7 million in FY 2019-20. These changes are primarily due to the Maintenance of Effort (MOE) of the In-Home Support Services program, which mandates that local support for the IHSS program increase by 3.5% each year. In addition, there are changes in support related to state policy changes in the Foster Care program, as well as projected changes in caseloads.

**Navigation Center:** The Navigation Center is the City's pilot, low-threshold homeless service engagement facility which targets street encampments and chronically homeless individuals. The Center opened in April 2015 with the infusion of a \$2.9 million anonymous private donation to fund the operations and initial housing exits from the Center. In the FY 2015-16 and FY 2016-17 budget, \$1.5 million was budgeted in each year to support the operations of the existing site and fund the move from its temporary location. Due to the expiration of the onetime donated funds, an additional \$1 million is needed to continue operations starting in FY 2016-17.

**Public Health – Operating and One-Time Costs:** One-time and on-going costs for Zuckerberg San Francisco General Hospital (SFGH) and the Southeast Health Center are accounted for in this report. Assumed costs are inclusive of the expiration of one-time expenditures for furniture, fixtures and equipment (FF&E) and new ongoing operating funds to support additional staff and expanded services in the new facility. Additionally, the City's 10 Year Capital Plan includes \$311.0 million for a Public Health and Safety Bond that will be considered by the voters in June 2016. The costs of one-time expenditures for FF&E as well as on-going operating costs for the Department of Public Health projects in the bond, which include making essential earthquake safety improvements at the SFGH campus as well as the renovation of the Southeast Health Center, are accounted for. Together these operating and one-time costs are projected to decrease by \$7.2 million in FY 2016-17, increase by \$10.2 million FY 2017-18, increase by an additional \$2.9 million in FY 2018-19, and decrease by \$9.6 million in FY 2019-20.

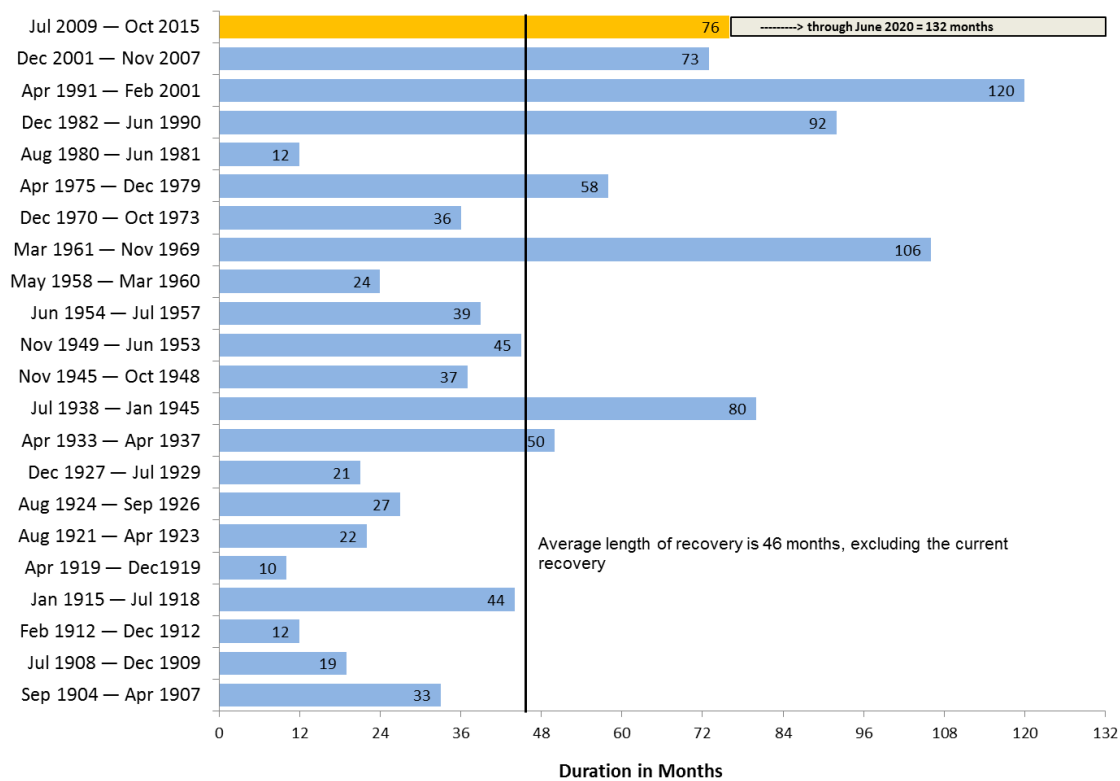
**All Other Departmental Savings/(Costs):** This section includes other smaller departmental changes including the expiration of limited-term project costs; costs and savings associated with collective bargaining, and several other small changes.

## Planning Scenario: Economic Recession

Due to the difficulty of predicting recessions, the base case of this report does not anticipate a recession in any of the next four years. However, it would be an historical anomaly if the City did not experience an economic downturn within this timeframe.

As Figure A-3 shows, since 1900, the average length of time between recessions in the United States has been 46 months. The current economic expansion has lasted over 76 months. The base case in this report assumes declining rates of revenue growth from FY 2016-17 to FY 2019-20. At no time during the forecast period are revenues projected to decline. If there is no recession through FY 2019-20, as the projection assumes, it will mark the longest economic expansion since 1900.

**Figure A-3: Number of Months between Recessions in the U.S. (1904 to 2015)**



Source: National Bureau of Economic Research (NBER)

The biggest impact on the City's budget deficits in a time of recession comes from reduced revenue and increased employer contribution rates for employee retirement benefits. The City's revenues are affected by the overall business cycle; the international, national, and regional economies; consumer confidence and spending; employment rates; and travel and tourism. Historically, projection variances follow the economic cycle, and revenues tend to outperform expectations in times of expansion and underperform in times of recession: actual revenues exceeded budgeted revenues by over 6% in FY 2005-06 and FY 2010-11, both years of rapid revenue growth; while actual revenues were more than 4% below budgeted revenues in FY 2002-03 and FY 2008-09, years of sharp economic contraction.



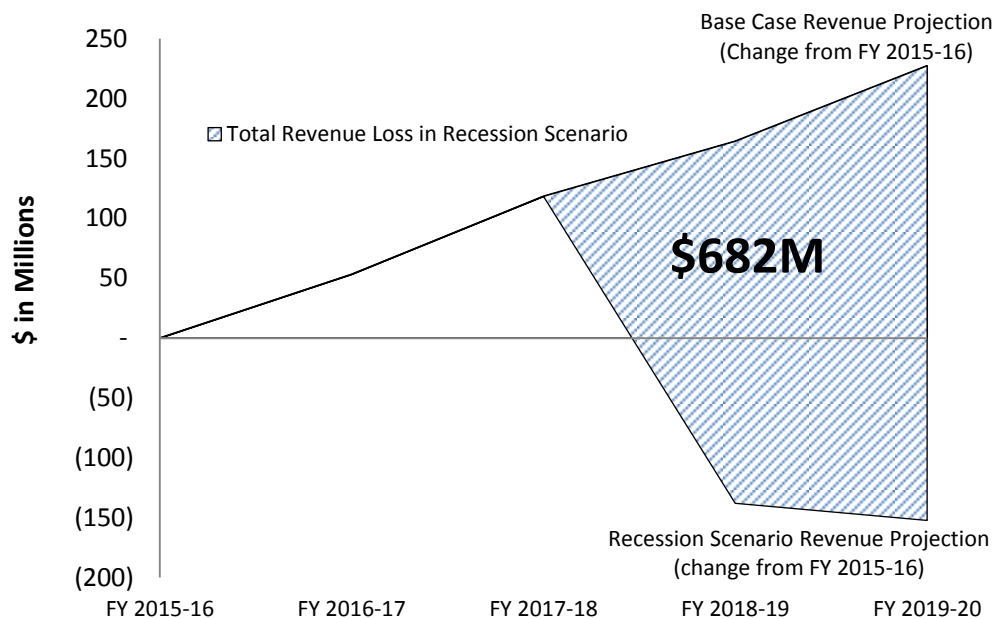
To illustrate the effect of a hypothetical slowdown on San Francisco’s financial outlook, this section describes a recession scenario that assumes weakness in the California and San Francisco economies beginning in FY 2017-18

**Economic Assumptions included in the Recession Scenario**

**Recession Scenario – Impacts on Revenue Projections:** To develop a recession scenario for financial planning purposes, this report assumes reductions to major local tax sources consistent with the averaged impact of the City’s actual revenue performance during the last two major economic downturns - from FY 2001-02 through FY 2003-04 (the dot-com / September 11th recession) and FY 2008-09 through FY 2010-11 (the 2008 Financial Crisis). Declines in the City’s projected aggregate discretionary revenue will result in reduced contributions to baselines and set-asides, which are also assumed in the recession scenario (affecting the MTA, DCYF, the Library, Recreation and Parks, First Five Commission, and the School District). If the City were to experience a recession similar in magnitude to either of the last two recessions beginning during FY 2017-18, it would lose approximately \$682 million in revenue over the two final years of this report in comparison to the base case described in this Plan.

Figure A-4 shows the difference between the base case and recession scenario revenue projections. In the latter, revenue drops below current year (FY 2015-16) budgeted value in the final two years of this report.

**Figure A-4: Comparison of Revenue in Base Case and Recession Scenarios**



**Recession Scenario – Impacts on Pension Contributions:** An economic recession would also be expected to result in a significant increase in the employer share of retirement contribution rates. The recession scenario therefore assumes a loss in the value of the Retirement System’s (SFERS) assets during FY 2017-18, which first affects contribution rates in

FY 2019-20 as the valuation at 7/1/2018 determines the contribution rates for the fiscal year beginning 7/1/2019. The return assumed is -27.5%, the level of returns experienced in FY 2007-08 and FY 2008-09. The FY 2017-18 asset loss is then smoothed into the July 1, 2018 actuarial value of assets, and employer contribution rates would increase over a five year period beginning in FY 2019-20. In this scenario, employer contribution rates would rise by 3.8% in FY 2019-20 (and by 8% in FY 2020-21, which is outside of the projection period), adding \$70.3 million to the costs anticipated in the base case scenario. This estimate is intended to demonstrate sensitivity to a large negative return and should not be relied upon for any other purpose.

This report projects that if an economic downturn similar to the two most recent recessions were to begin in FY 2017-18, it would increase the City's projected deficits from the combination of lost revenue and retirement cost increases, by \$119.8 million in FY 2018-19 and \$319.5 million in FY 2019-20.

**Table A-7: Projected General Fund Shortfall in Recession Scenario**

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
Base Case Deficit Projection	(99.8)	(240.2)	(474.5)	(538.4)
<b>Updated Projection - Savings/(Cost)</b>				
Reduction in base case revenue available	-	-	(302.4)	(379.6)
Reduction in mandatory baseline spending	-	-	44.4	55.7
Max permissible withdrawal from reserves	-	-	138.2	74.7
Increase employer share of retirement rates	-	-	-	(70.3)
<b>Updated Projection - Savings/(Cost)</b>	(99.8)	(240.2)	(594.3)	(857.9)
<b><i>Increase in the Deficit Projection</i></b>	-	-	<b>(119.8)</b>	<b>(319.5)</b>

San Francisco's Charter requires that each year's budget be balanced. The incremental shortfalls shown in Table A-7 assume the City makes the maximum permissible withdrawals from its reserves of \$138.2 million in FY 2018-19 and \$74.7 million in FY 2019-20. Balancing the budget under this recession scenario would require a combination of expenditure reductions and/or additional revenues beyond those needed to close the gap projected in the base case.

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