Budget Outlook & Department Instructions

December 2016

Agenda

- Post-Election Re-balancing Plan
- Five Year Projection
- Budget Instructions for Departments

Summary

- Post-Election Re-balancing plan
- Deficit projection approx. $400 million over the upcoming two years
- Projected deficits into the future are on the rise again
- Employee costs are largest driver of deficits
- Additional revenue will not close the deficit – as it has in recent years

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- We are not in a recession or cutting service or doing layoffs, but we are seeing indicators of slowing growth
- Uncertainty with Federal election
- We need to be disciplined, responsible, and make trade-offs
- Reduction targets – 3% in each year; instruction of no growth in employees

Post-Election Fiscal Impact

Surplus / (Shortfall)	FY 16-17	FY 17-18
Budget as of July 2016	-	-
Street resurfacing	(8.1)	(33.4)
Transit affordability, muni fleet and facilities	(7.4)	(30.9)
Regional transit, complete streets, transit expansion	(8.7)	(36.0)
Homelessness & mental health	(12.1)	(50.2)
Reserves	(1.2)	(4.8)
Budget out of Balance:	**(37.5)**	**(155.3)**

- Mayor terminated Proposition J set-aside for homelessness and transportation 11/10/16.
- Other priority areas identified: Free City College, street trees and immigration services.

Post-Election Re-Balancing Plan

Expenditures:	FY 16-17	FY 17-18	FY 18-19	Total:
Homelessness (Nav Centers, rental subsidies, supportive housing)	(6.50)	(19.85)	(19.85)	(46.20)
Street Trees - Prop E	-	(12.75)	(12.75)	(25.50)
Free City College	(0.50)	(4.25)	(4.25)	(9.00)
Legal services / comprehensive support for immigration	(1.50)	(3.00)	(3.00)	(7.50)
Subtotal Expenditures:	**(8.50)**	**(39.85)**	**(39.85)**	**(88.20)**

Revenue:	FY 16-17	FY 17-18	FY 18-19	Total:
Transfer Tax increase (net of baselines) - Prop W	14.10	27.00	27.00	68.10
Whole Person Care - Medi-cal Waiver funding	11.80	4.20	4.10	20.10
Subtotal Revenue Generated:	**25.90**	**31.20**	**31.10**	**88.20**

Re-balancing letter sent to the Controller and the Board of Supervisors today, 12/8/16.

Five Year Projection Assumptions

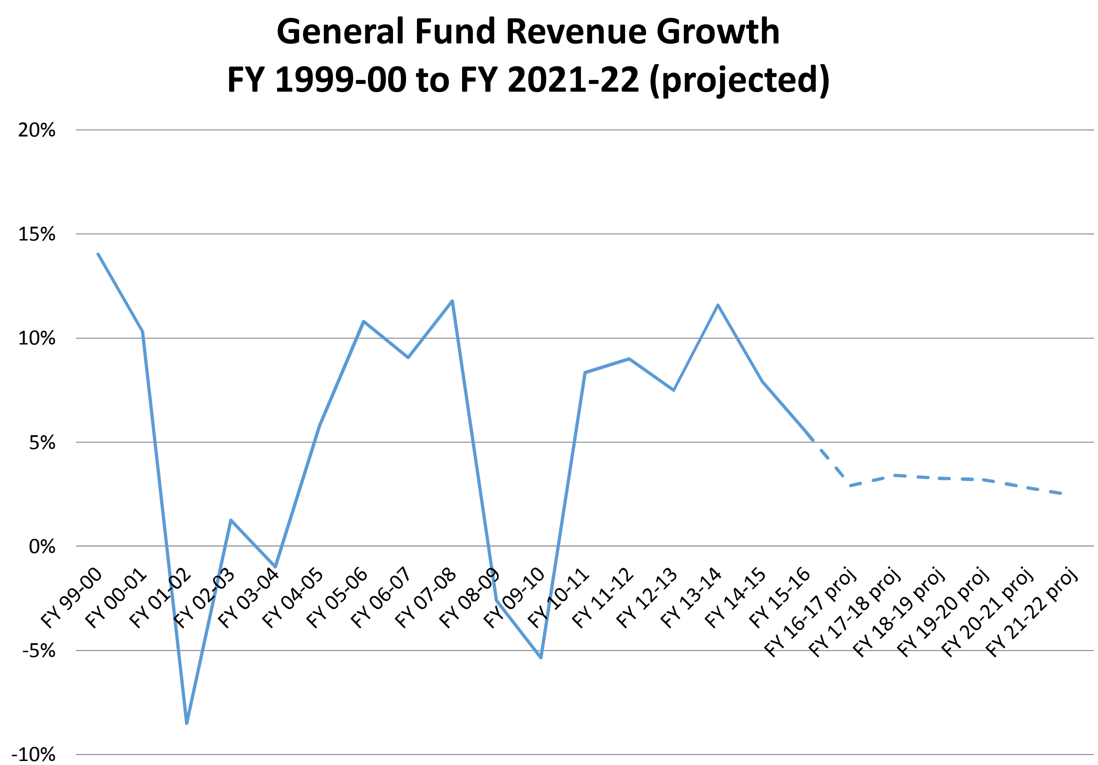
- “Base case” projection
- Election outcome – budget is “re-balanced”
- Revenue - Economy is strong but revenue growth slowing and signs of growth constraints
- Salary and Benefits –
  - Benefit cost increases – health and pension
  - CPI increase on personnel (average of Moody’s & CA DOF)
- Citywide Costs
  - CPI on nonpersonnel (including grants for nonprofits)
  - Fully fund the capital and information technology plans in the out years

Slowing Revenue Growth

Local Economy is strong but there are constraints to continued growth

- Slowed job growth:
  - Employment growth in the technology industry has slowed from a 15.4% annual rate in August 2015 to a 4.4% annual rate in August 2016.
  - The growth rate for all private employment has also dropped: from a 5.3% annual rate in August 2015 to a 2.4% annual rate in August 2016.
- The city's unemployment was <3.5% for all of 2016, below what most economists consider the "full employment" rate.
- Limited housing and office space supply means that the labor force cannot be readily expanded.
- Limited infrastructure, particularly regional transportation capacity limit the city's ability to grow at rates experienced earlier in this decade.
- Leading indicators of the tech sector, like the stock market and venture capital, have slowed.

Slowing Revenue Growth



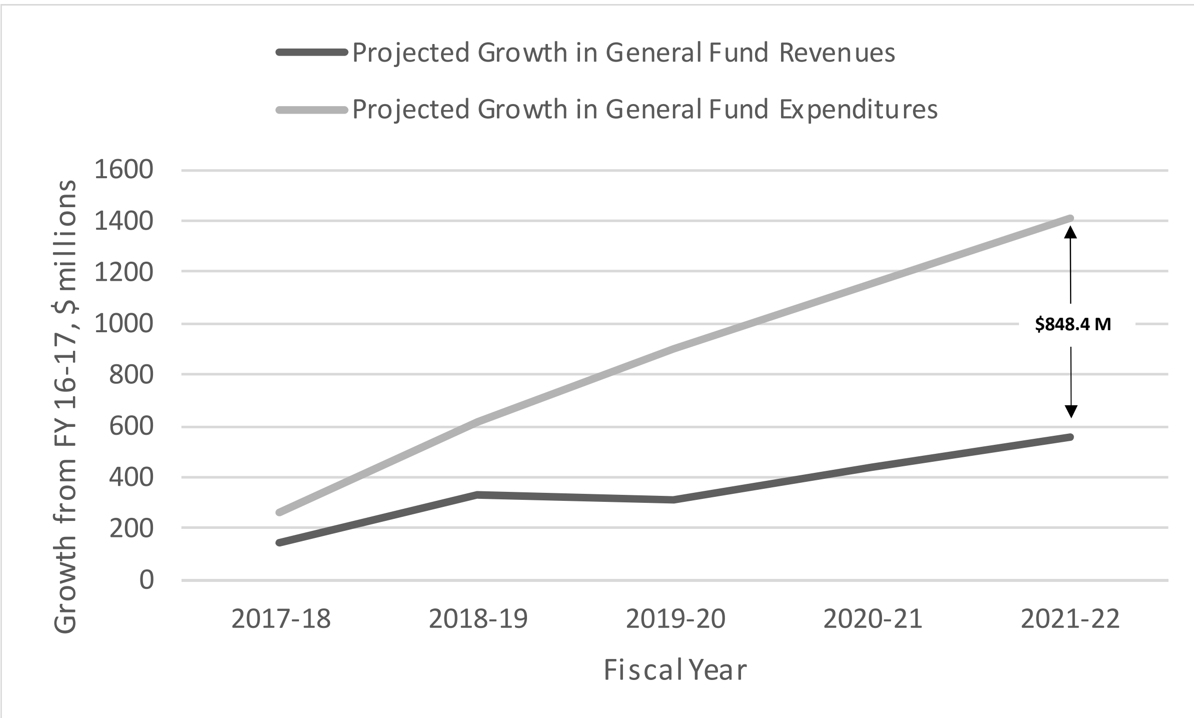
Note: Includes local sales tax (adjusted for 1% Triple Flip, parking, business, and utility user taxes).

Five Year Projection

Five Year Projection:	2017-18	2018-19	2019-20	2020-21	2021-22	% Growth
SOURCES Increase / (Decrease)	*143.9*	*328.7*	*312.4*	*442.4*	*559.9*	
Baselines and Reserves	(46.7)	(116.1)	(150.3)	(188.9)	(212.3)	15%
Salaries & Benefits	(145.8)	(273.1)	(428.2)	(574.0)	(698.0)	50%
Citywide Operating Budget Costs	(48.5)	(193.8)	(274.7)	(350.2)	(450.1)	32%
Departmental Costs	(21.9)	(29.1)	(43.8)	(42.7)	(48.0)	3%
USES Increase / (Decrease)	*(262.9)*	*(612.1)*	*(897.1)*	*(1,155.8)*	*(1,408.3)*	*100%*
Projected Surplus / (Shortfall):	**(119.0)**	**(283.4)**	**(584.7)**	**(713.4)**	**(848.4)**	

Approx $400 million for the upcoming two year budget. Mayor & BOS adopt a balanced budget each year.

Five Year Projection

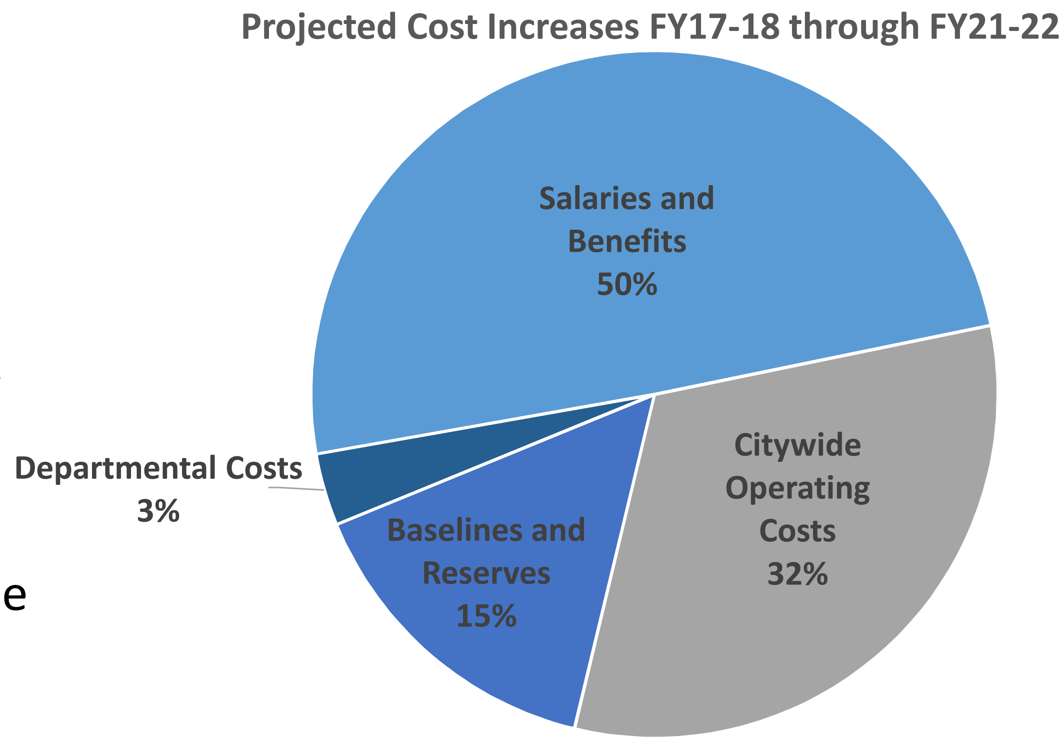


Projected revenue growth of 11% and expenditure growth 29% over the period.

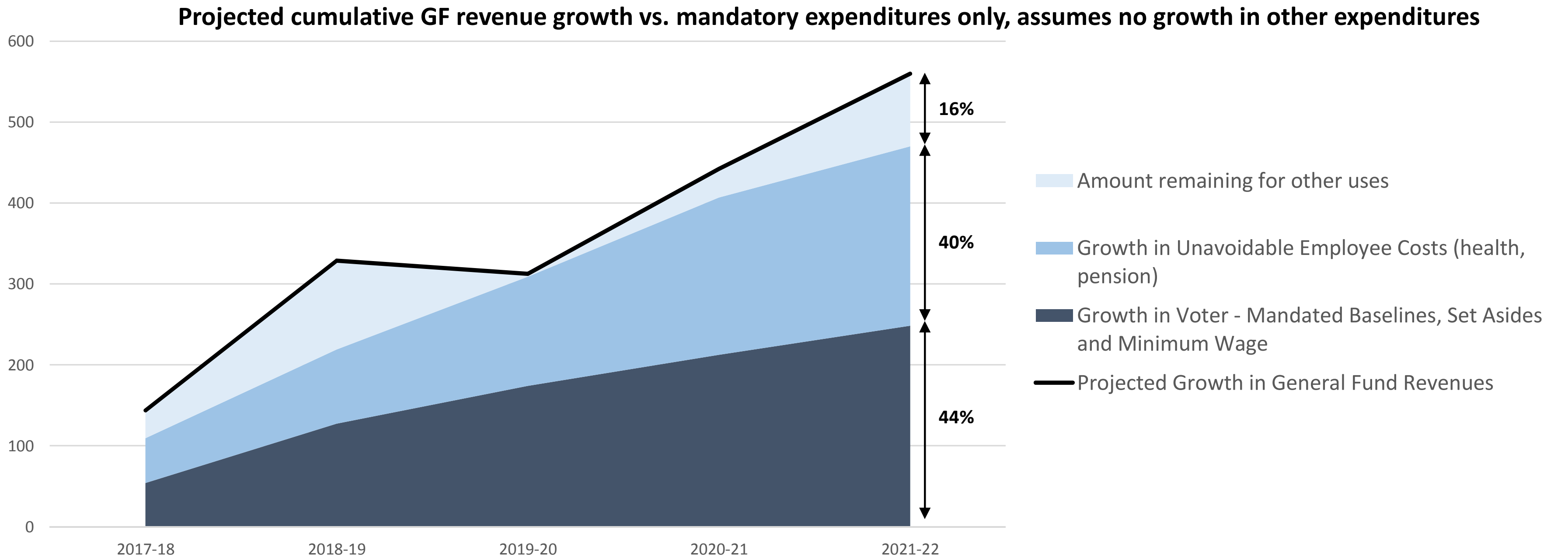
In other words, expenditures are projected to grow almost three times as fast as revenues.

Projected Expenditure Growth

- Total projected expenditure growth over the five year period is $1.4 billion
- Of salaries and benefits, 85% of the projected growth is wage increases and health benefits
- For Citywide operating costs, 81% of this growth is inflation on non-personnel & grants to nonprofits, capital / IT and equipment, debt service and real estate
- For baselines and set asides, MTA and the Children's Fund make up 76% of the growth



Only 16% of projected new revenue is available



Mandatory spending takes up 84% of projected revenue growth over the five year period. This leaves only 16% of revenue left over other uses, for example on employee wage increases, COLA increases for nonprofits, capital and technology investments, and improving services to the public.

Historical Deficit Projections

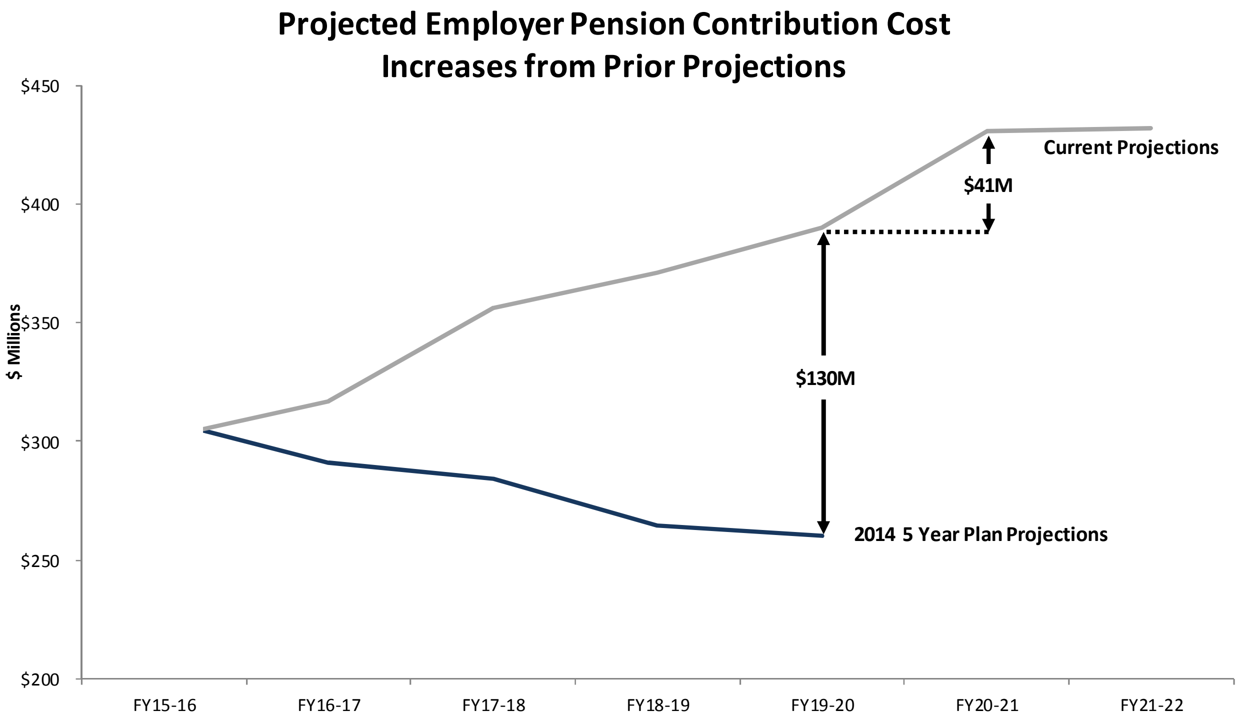
Projection Issued	FY11-12	FY12-13	FY13-14	FY14-15	FY15-16	FY16-17	FY17-18	FY18-19	FY19-20	FY20-21	FY21-22
5/2011	(283.1)	(457.5)	(619.4)	(745.7)	**(829.1)**						
3/2013			(123.6)	(256.1)	(367.7)	(423.2)	**(487.2)**				
12/2014					(15.9)	(88.3)	(274.8)	(366.1)	**(417.9)**		
12/2016							(119.0)	(283.4)	(584.7)	(713.4)	**(848.4)**

Historical Deficit Projections

Why are deficits on the rise again? 3 main reasons:

1. Rising employee costs (largely related to pension)
2. New baselines and set asides
3. Increases in services, positions, on-going costs that grow

Rising Pension Costs



- The December 2014 Five Year Financial Plan projected costs declining, reaching $260 million in FY 2019-20. However, current projections are for costs to increase through FY 2021-22 to $431 million.
- **This $171 million difference is equivalent to a 8.6% wage increase.**

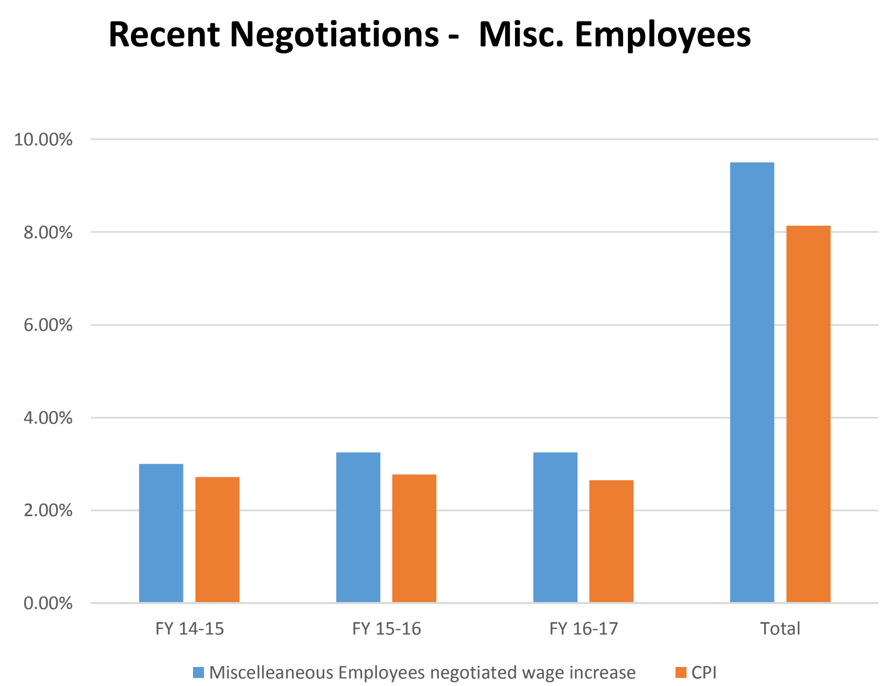
Rising Pension Costs

- Why?
  - Mortality tables / people are living longer
  - Loss of the supplemental COLA lawsuit
  - Rate of return less than 7.5%

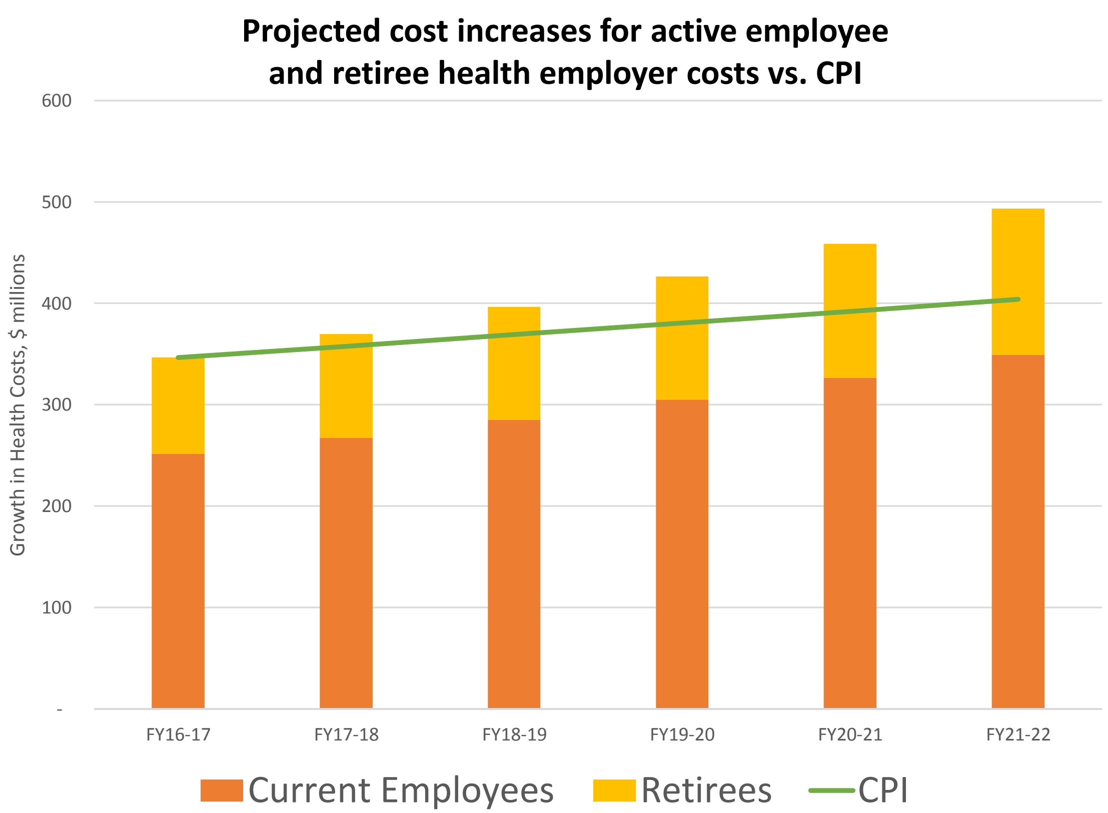
Rising Employee Costs - Salaries

Labor negotiations:

- CPI assumptions included in the report
- All contracts but Police and Fire negotiating in FY16-17 for FY 17-18
- Police and Fire negotiating in FY17-18 for FY 18-19
- 1% change in employee wages – approx. $20 million General Fund impact
- Over the past three years, wage growth for misc. employees has more than kept pace with inflation



Health Cost Increases



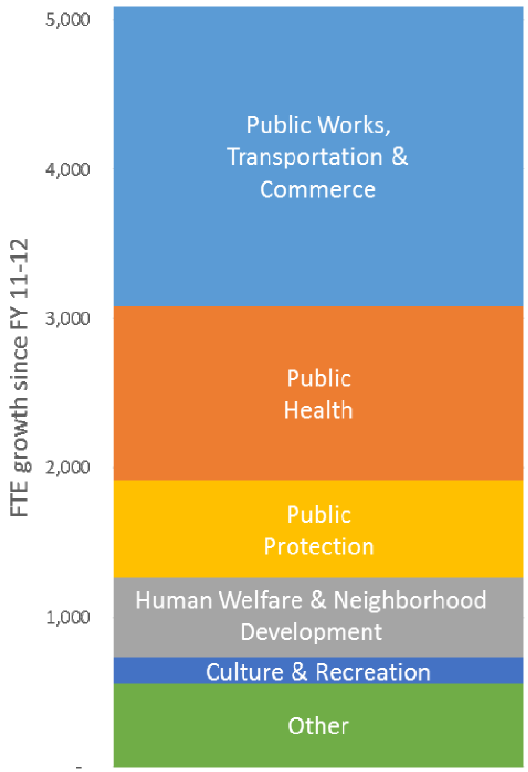
Employer health costs are expected to rise by 7% per year for active employees and 9% per year for retirees, significantly outpacing inflation.

New Baselines and Set-asides added since 2011

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	TOTAL:
Housing Trust Fund 2011	(2.8)	(2.8)	(2.8)	(2.8)	(2.8)	(2.8)	(2.8)	(19.6)
MTA population growth 2014	(25.9)	(12.1)	(2.5)	(4.2)	(5.3)	(7.0)	(3.8)	(60.8)
Children's Fund Increase 2014	(8.3)	(12.7)	(11.8)	(9.9)	(3.4)	(3.2)	(3.4)	(52.7)
Minimum Wage 2014	(11.5)	12.8	(6.7)	(10.3)	(3.2)	(0.6)	(0.6)	(20.1)
Recreation & Parks Baseline 2016	-	(3.0)	(3.0)	(3.0)	(3.0)	(3.0)	(3.0)	(18.0)
Street Trees Set-Aside 2016	-	-	(12.8)	(0.9)	(0.6)	(0.6)	(0.6)	(15.4)
Dignity Fund 2016	-	-	(6.0)	(3.0)	(3.0)	(3.0)	(3.0)	(18.0)
Subtotal:	(48.5)	(17.8)	(45.5)	(34.1)	(21.3)	(20.2)	(17.2)	
Cumulative:	**(48.5)**	**(66.2)**	**(111.7)**	**(145.9)**	**(167.2)**	**(187.4)**	**(204.6)**	**(204.6)**

New Services Lead to Higher On-Going Costs

Drivers of FTE Growth since FY 11-12

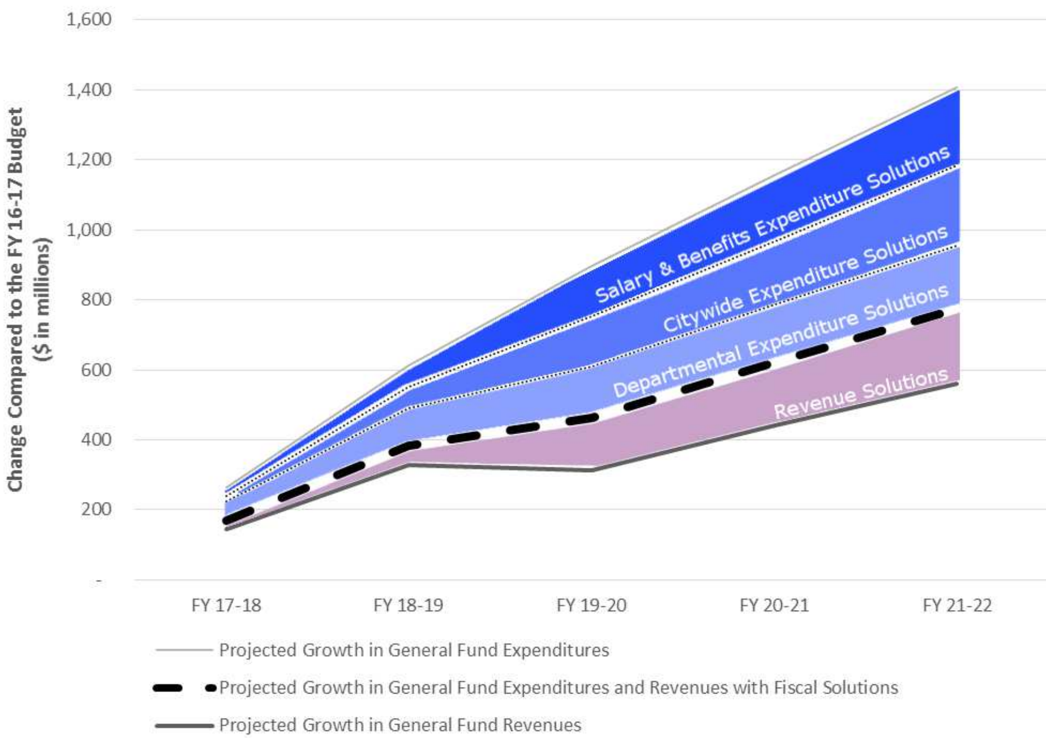


- The City has added 5,090 FTE (18% growth) since FY 2011-12
- 86% of FTE growth is in:
  - Transportation, public works and commerce
  - Public health and human welfare and neighborhood development
  - Public protection
- New FTEs also contribute to overall future deficits as employee benefits are rising faster than inflation
- We must take a disciplined approach to future growth to ensure this level of total FTEs is sustainable

Fiscal Strategies

Base Case Outlook ($ millions)	FY 17-18	FY 18-19	FY 19-20	FY 20-21	FY 21-22
Cumulative Projected Surplus / (Shortfall)	(119)	(283)	(585)	(713)	(848)
Proposed Fiscal Strategies - Sources Growth faster and Expenditure Growth slower than Base Case					
Sources - Taxes, Fees & Other Revenues	26	53	152	181	216
Salaries and Benefits - Manage Employee Costs	25	60	145	190	225
Citywide - Limit Non-Personnel Inflation, Capital, Debt Service and Real Estate	14	62	144	180	227
Departmental - On-Going Revenues & Savings Initiatives	54	108	144	162	180
Adjusted Outlook	**0**	**0**	**0**	**0**	**0**

Fiscal Strategies



- The Mayor's Office is proposing a balanced approach to closing our deficits – Salary and Benefit, Citywide, Departmental and Revenue Solutions each represent about 25% of our total solutions
- These Fiscal Strategies show that we can grow, but we must grow more slowly over time than we are currently projecting
- We also need to keep our economy strong to ensure revenue continues to help balance the City's budget

Budget Instructions for Departments

- Deficit projection for the upcoming two fiscal years is approximately $400 million
- FY 2017-18 & FY 2018-19: Propose **on-going reductions** and revenues equal to 3% of adjusted General Fund support in each year (growing to 6% in the second year of the budget)
- Departments **should not grow** budgeted and funded FTE count
- Enterprise / self supporting must absorb all known cost increases

Budget Instructions for Departments

Citywide Strategic Initiatives – reflect the strategic vision (outlined below), derived from the Citywide Strategic Planning process, in budget submissions:

1. Residents and families that thrive
2. Clean, safe and livable communities
3. A diverse, equitable and inclusive City
4. Excellent City services
5. A City and region prepared for the future

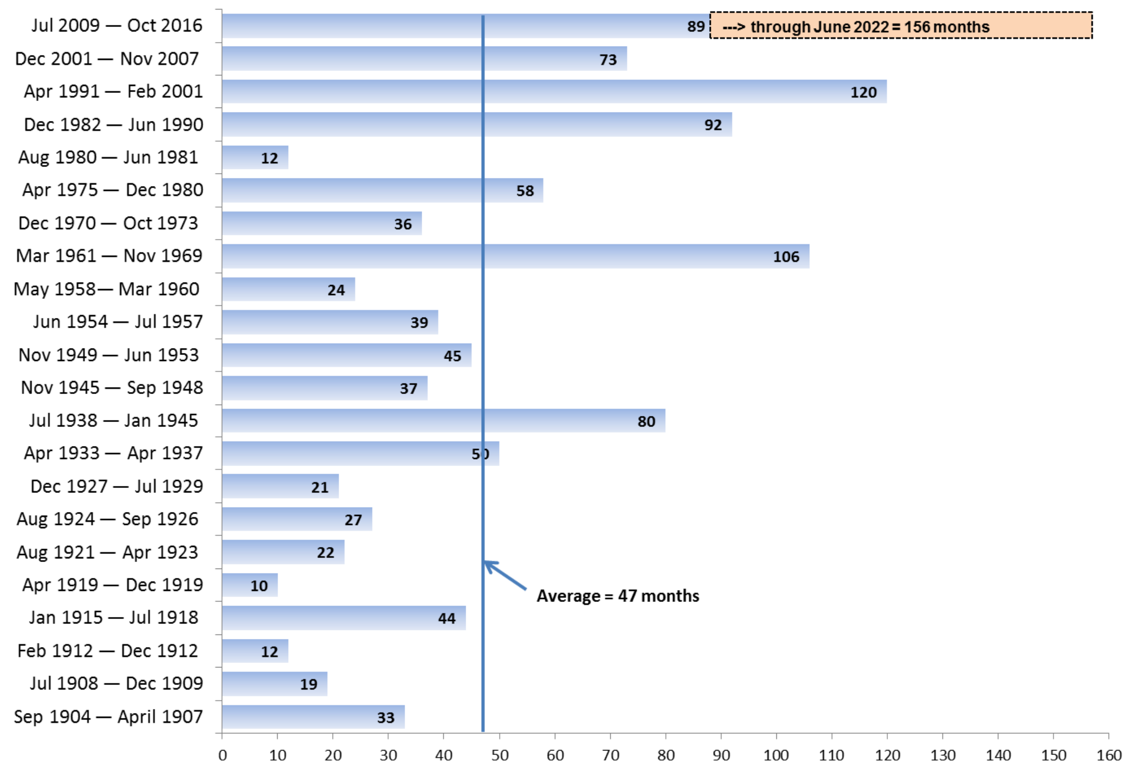
Risks

Key factors that could affect the forecast:

- Federal funding uncertainty
- Changes in the economy
- Outcome of labor negotiations
- Any new budgetary commitments made
- Current year overspending or supplemental appropriations

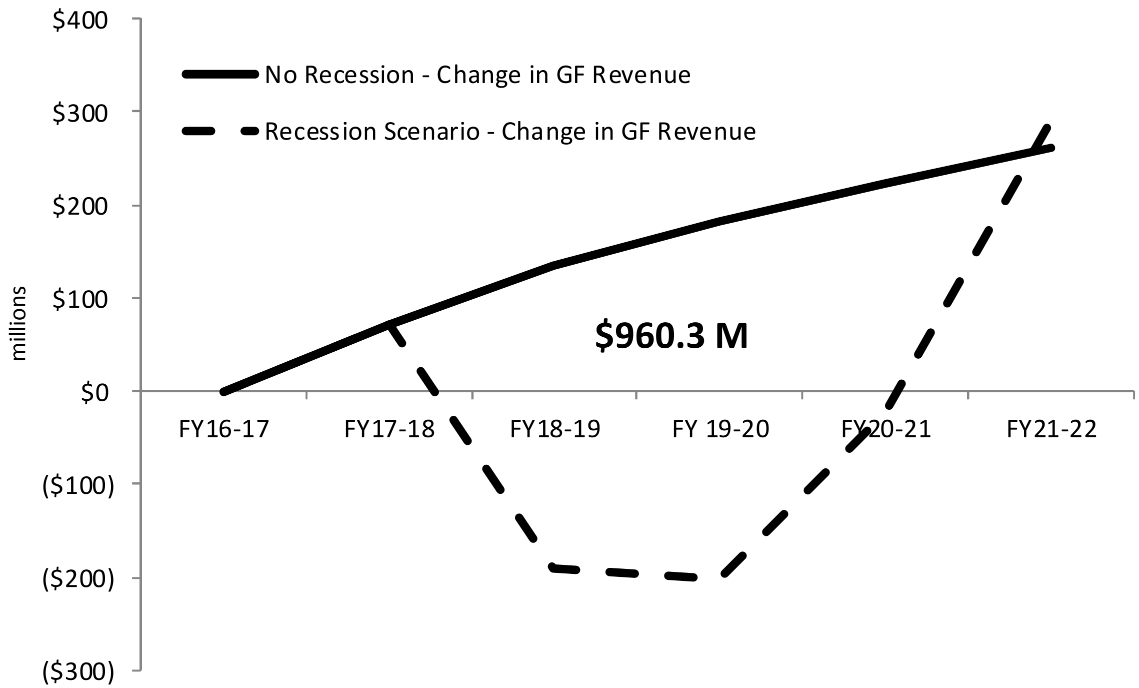
Risks: Economic Climate

- Since 1900, average length of time between recessions has been 47 months. The current economic expansion has lasted over 89 months.
- No recession projected during forecast period of FY 2017-18 through FY 2021-22.
- No recession through FY 2021-22 would mark the longest expansion since 1900 and exceed it by three years.



Source: National Bureau of Economic Research (NBER)

Risks: Recession Scenario



Cumulative Projected Change to General Fund Revenue in Recession

For five General Fund revenues – Business, Hotel, Sales, Transfer and Parking tax

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- Employee costs are largest driver of deficits

- We are not in a recession or cutting service or doing layoffs, but we are seeing indicators of slowing growth
- We need to be disciplined, responsible, and make trade-offs
- Uncertainty with Federal election
- Reduction targets – 3% in each year; instruction of no growth in employees

Calendar / Key Dates

Dec 8	Budget Outlook & Instructions Issued
Dec 13	Budget system opens to departments
January 13	IT Plans and Capital Budget Requests Due
February 21	Budget Submissions Due
May	Controller’s 9-Month Report
	Governor’s May Revise
May 15	Labor agreements must be finalized
June 1	Mayor Proposes Balanced Budget to Board of Supervisors
June	Department Budget Committee Hearings
July	Budget Considered at Board of Supervisors

Questions?