



**SAN FRANCISCO'S 2010-11 BUDGET DEFICIT:  
PROJECTIONS, FINANCIAL FORECASTS  
& SHORTFALL STRATEGIES**

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**Summary and Findings.** In 2009, Mayor Gavin Newsom projected that San Francisco would face a \$522.2 million deficit in 2010-11. This year, the Mayor revised his deficit downward on two occasions to reflect more current information: on March 10 to \$515.1 million (“Board of Supervisors Budget and Finance Committee Fiscal Year 2010-11 Budget Update”), and again on April 2 to \$482.7 million (“Three-Year Budget Projection for General Fund Operations FY 201011 through FY 2012-13”). The amounts and components of the deficit are likely to change many times before solutions are adopted by the Board of Supervisors, but overall, the current estimates do not appear to be unreasonable. The deficit figure represents a starting point in the 2010-11 budget discussion and a variety of options for increasing revenues and cutting costs are available to reduce the shortfall. **However, even after assuming difficult decisions regarding revenue and spending options, a substantial and ongoing budget gap --- likely totaling \$100 million or more ---- will confront City decision makers this summer.**

The following summary highlights San Francisco’s 2010-11 deficit projections and explores other potential short and long term issues that will continue to impact the City’s ability to maintain its fiscal health, and funding priorities, including its ability to maintain jobs and services.

**Deficit Estimates, Components & Revisions.** The Mayor’s original 2010-11 deficit estimate of \$522.2 million consists of the following anticipated revenue shortfalls and increased spending requirements (dollars in millions):

**Revenue shortfalls:**

- General tax, federal, state, and other revenue weakness (\$81.4)
- Loss of rainy day reserves (\$49.2)
- Loss of stimulus funds (\$62.2)
- Loss of starting fund balances (\$35.4)
- Estimated state budget impact (\$40.0)
- Other (\$22.5)

**TOTAL REVENUE SHORTFALL \$290.7 MILLION**

**Additional spending requirements:**

- Expiration of labor concessions (\$41.3)
- Increased benefit costs (\$63.3)
- Loss of 1x savings - capital & equipment (\$57.5)
- Other (\$69.4)

**TOTAL EXPENDITURE INCREASES \$231.5 MILLION**

**GRAND TOTAL ALL REVENUE SHORTFALLS AND EXPENDITURE INCREASES: \$522.2 MILLION**

The Mayor’s March 10 report to the Supervisors’ Budget and Finance Committee updated the deficit projection to \$515.1 million to reflect the following:

**Revenue increases and expenditure reductions:**

- Departmental balances left over from 2009-10 (\$4.6 million).
- Ongoing savings from 2009-10 mid-year budget reductions (\$12.5 million).

- Health and dental costs for active and retired employees (\$11.9 million).
- CalPERS contribution rates (\$2.2 million).

***Spending increases:***

- Recalculation of costs associated with labor agreements (\$3.9 million).
- SFERS contribution rates (\$20.2 million).

On April 2, 2010, the Joint Report issued by the Mayor, Controller, and Board of Supervisors provided another, more current deficit estimate of \$482.7 million, down from the original \$522.2 million projection, and reflecting the following additional revenues and expenditure reductions:

- \$17.1 million in departmental balances left over from 2009-10 and annualized savings from the 2009-10 mid-year balancing plan (these figures were incorporated into the March 10, \$515.1 million budget revision).
- \$22.5 million in additional federal (FMAP) stimulus funds (recently passed by Congress and awaiting the President's signature).
- \$12.3 million in rainy day reserve funds.
- \$30.2 million in new revenues anticipated from additional supplemental property tax collections, higher federal and state reimbursements for health care-related overhead, and better than expected collections from public and private health insurance companies.
- \$2.1 million in reduced transfers to mandated programs due to decreased General Fund balances.
- \$2.0 million in other new revenues and reduced costs.

The new revenues and spending reductions identified in the April 2 Joint Report are anticipated to be offset by the following additional costs and revenue reductions:

- \$20.5 million in additional cost-of-living increases for City contracts based on upward revisions to the Consumer Price Index.
- \$8.3 million in additional tax increment payments to the redevelopment agency for debt repayment.
- \$11.2 million in additional salary and fringe benefit costs for current and retired employees (all but \$800,000 of this figure was reflected in the May 10, \$515.1 million deficit estimate).
- A \$4.6 million reduction in General Fund costs offset by the Open Space and Golf Fund.
- \$2.0 million in additional costs for the public defender's office (continuing a 2009-10 mid-year appropriation intended to reduce the need for hiring outside lawyers).
- \$2.0 million in other cost increases and revenue reductions.

## **Financial Figures & Economic Assumptions.**

According to City staff and other experts, most economic indicators and revenue trends seem to suggest that the worst of the recession is over and that the City will begin to see a slow-paced recovery in 2010-11 and following years. Positive trends developing in the second half of the 2009-10 budget year are consistent with overall economic indicators that many City revenues are beginning a slow but steady return to positive growth.

The City's Chief Economist and other experts predict an emerging recovery in 2010-11 characterized by a halt in the decline of most revenue sources and modest increases for each of the next several years. Though property tax revenues are expected to be down in 2010-11, many other revenues are likely to grow slightly, with healthier returns in the following two fiscal years. Some revenue collections will lag behind others, particularly those that are based on prior years' activities and conditions or are collected in arrears, like property taxes and payroll taxes. On the state level, some revenues that support local programs (such as sales taxes for health care and public safety services) are showing stronger than expected returns in recent months, while others (including vehicle license fees) are below forecasted levels. Though experts predict positive economic growth in 2010-11 and following years, they do not expect a return to the substantial revenue spikes that occurred in 2007 and 2008. Instead, the depth of the recession and the relatively slow pace of recovery has resulted in a long-term lowering of the City's revenue base that necessitates a reevaluation of City budget priorities.

**Shortfall Strategies.** The Mayor has outlined a variety of balancing options that are available to help close the budget shortfall. Some of these options, such as using additional rainy day funds, spending leftover departmental balances from 2009-10, and capturing new federal (FMAP) stimulus revenues, are already incorporated into the current \$482.7 million budget deficit estimate. Other potential options to bridge the gap between revenues and expenditures, such as exchanging full-time employees with part-time workers, reducing General Fund support for City departments, decreased spending for capital programs, deferring payments to schools, and reopening labor contracts have been identified for discussion and debate. Some of the potential options identified by the Mayor are more realistic than others, some are unlikely to produce the desired revenues or spending relief, and others would need to overcome stiff political opposition. **But even if the Board of Supervisors adopted every balancing option described publicly to date, and these options produced their anticipated level of deficit relief, the City likely would still face a budget shortfall in the \$100 million range.** Additional solutions for closing the City's budget gap will be needed.

As budget talks proceed, this year and in the future, participants may wish to consider the following aspects of the City's long-term finances:

- Reductions to the number, hours, and pay of the City’s workforce are a frequent target of budget cost-containment discussions. When the City reduces its labor force, these decreases can result in less sales tax, parking fees, stadium admissions, fees and charges, and potentially, property taxes and other sources of City revenues and may add to City social service costs. The City does not currently have a formula for measuring the effects of public employment changes on City revenue sources and program costs. The City should attempt to quantify this “multiplier effect” to better understand the full financial impacts of changes to its labor force.
- The City charter and administrative code specify funding levels and allocations for a wide variety of City activities, including children’s services, museum and cultural venues, libraries, public education, the Municipal Symphony, human services and homelessness, police staffing, and other programs and facilities. These earmarks have the cumulative effect of decreasing overall revenue and flexibility within the City’s General Fund, and make solving City budget deficits more challenging. Set-asides mandated in City governing documents could be reviewed to assess their ongoing relevance, relative level of priority, and cumulative impact on the General Fund.
- Proposition H requires the City to use General Fund revenues to support the SFUSD but allows deferral of payments if the City’s budget deficit is over \$100 million. Last year the City deferred a portion of its Proposition H payments to schools; this year, additional deferments are proposed. What is the City’s plan for paying back these and any future years’ deferred sums?
- When the state repeals funding or eliminates mandates for local service and program requirements, local governments sometimes face new costs (such as additional expenses related to administration), or can achieve savings if they eliminate the program or activity. The state is considering a variety of program cuts that will impact county services. Policy makers may want to consider which programs are worth continuing, and at what costs, if state budget cuts reduce funding levels or mandates.
- Some surrounding counties have made reductions to their social service safety net that may lead to migration into San Francisco in pursuit of services. The City may want to review and discuss regional decisions that may affect San Francisco services and costs.
- Over the last 10 years, the City’s success in collecting property tax revenues has eroded from nearly 99% in 2000 to just under 97% in 2009. As the largest single source of local tax revenues, even small decreases in collection efficiency are cause for concern. Decision makers and stakeholders that rely on General Fund resources to accomplish their goals may want to investigate revenue collection improvements for property taxes and other local revenues.
- The City has significant unfunded costs associated with retired employee benefits. Policy makers and current and future retirees may want to explore how the City will finance this liability.
- In February 2010, Fitch credit rating service downgraded certain City bonds and changed the City’s overall outlook from “stable” to “negative” due to chronic budget deficits, use of one-time funds for ongoing spending, a drawdown of reserves, expenditure of rainy

day resources for schools, dependence on labor concessions, exposure to state funding cuts, political pressure to avoid service reductions, and sizeable pension liabilities. This downgrade, and any future negative ratings, can decrease investor confidence and increase borrowing costs. Stakeholders in the City's financial health may want to explore alternatives to increase confidence in City government finance.

**Conclusion.** As stated above, the City is likely to face a significant 2010-11 budget deficit ---- \$100 million or more --- even if Supervisors adopt the lengthy list of budget balancing options outlined by the Mayor. City staff and outside experts predict some relief in the form of increased receipts from local revenue sources in 2010-11 and the next two budget cycles. Labor groups that may be asked to consider a variety of concessions, give-backs, and contract re-negotiations in 2010-11 should be mindful that the City's revenues may look better in one or two years. But despite modest optimism associated with near-term revenue growth, ongoing financial pressures associated with expenses that exceed available revenues are expected to continue to plague the City in both 2011-12 and 2012-13. Though these out year forecasts will require close scrutiny and frequent updates, they presents an opportunity for City staff, citizens, taxpayers, service recipients, businesses and other stakeholders to have a candid discussion about the relative priority of City activities and the trade-offs associated with the zero-sum choices available. Working together, these parties should strive for consensus on core City functions and purposes and align City resources to those priorities through some combination of new revenues, expenditure reductions, cost-shifting, increased efficiencies, and other reforms.