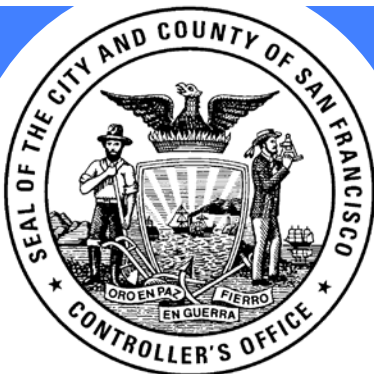


Controller's Review

Mayor's Proposed Budget for
FY 2021-22 and FY 2022-23



CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

6.9.2021

Summary

The proposed balanced budget relies on reasonable but highly uncertain estimates of tax revenues and other sources that correspond to an overall assumption that the public health crisis continues to depress local economic activity through much of fiscal year (FY) 2020-21. A gradual recovery is assumed to begin in FY 2020-21 followed by a more robust rebound in FY 2021-22.

Great uncertainty remains regarding the future shape of the pandemic and the corresponding implications for economic and tax revenue growth. This risk is heightened by the reliance on federal revenue sources during the emergency.

We will report regularly on the status of the budget in the fiscal year ahead. The Mayor and Board of Supervisors should plan to actively manage the budget, including work to develop contingency plans in the event that mid-year adjustments will be required.

Key Findings...

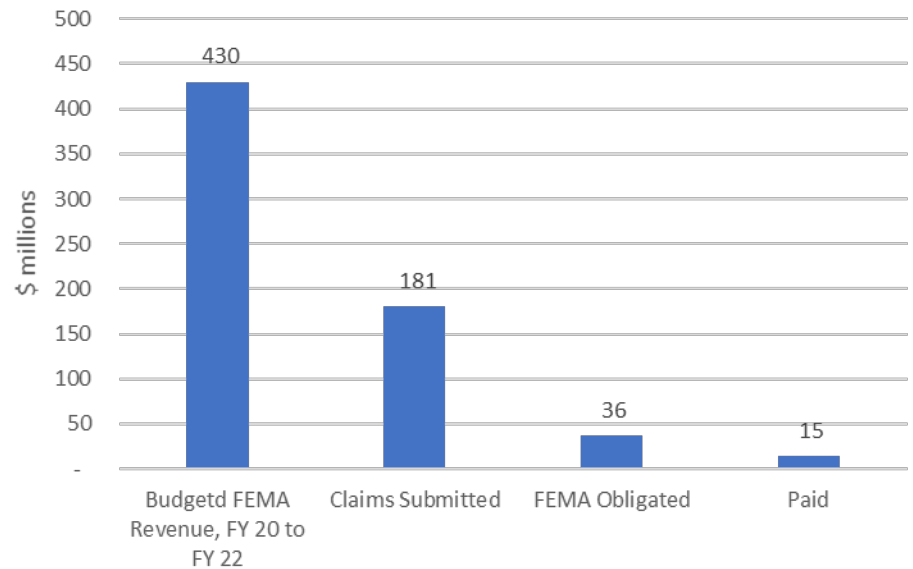
- **Baselines:** The financial baselines include mandated spending for transit, libraries, schools, early childhood education, homelessness housing and services, street trees, and other programs. Several programs are funded above the required levels, including the Children’s Services baseline, Transitional Aged Youth baseline, Recreation and Parks baseline, the Our City, Our Home Baseline (November 2018 Prop C), and the Early Care and Education baseline (June 2018 Prop C). Finally, the budget prefunds \$17.6 million of future Housing Trust Fund requirements in FY 2021-22, which will reduce payments over a five year term beginning in FY 2023-24.
- **Preserves the balances of the City’s economic stabilization reserves, and code-mandated reserves are funded and maintained at required levels.** Due to the extraordinary level of federal stimulus funding, the Mayor’s proposed budget maintains a balance of \$380.3 million in the combined Rainy Day and Budget Stabilization reserves (also known as combined “Economic Stabilization Reserves”), as well as \$54.8 million in the Budget Stabilization One-Time reserve. Pursuant to the City’s financial policies, Economic Stabilization Reserves can be fully drawn by FY 2022-23, split 50% in each of the budget years, and the Budget Stabilization One-Time Reserve can be used on one-time uses at any time. General Reserve funding levels in the budget are at code-mandated levels.

...Key Findings

- **Budget includes several new general and special purpose taxes**
 - The City has experience collecting and projecting some of these new sources:
 - Transportation network tax (Nov 2019 Prop D, eff. FY 2019-20)
 - Transfer tax rate increase (Nov 2020 Prop I, eff. FY 2020-21)
 - Business tax overhaul which adjusted gross receipts tax and business registration rates (Nov 2020 Prop D, eff. FY 2021-22)
 - Commercial rents tax (June 2018 Prop C, eff. FY 2020-21)
 - Homeless gross receipts tax (Nov 2020 Prop C, eff. FY 2020-21)
 - The City has little to no experience collecting or projecting these others:
 - Retail vacancy tax (Mar 2020 Prop D, eff. FY 2022-23)
 - Cannabis tax (Nov 2018 Prop D, eff. FY 2021-22)
 - Tax on executive pay (Nov 2020 Prop L, eff. FY 2022-23)

Key Risks: Federal Revenue

From the start of the pandemic, the City has budgeted to receive \$430 million of reimbursements from FEMA, including \$49.5 million in the proposed FY 2021-22 budget. Of this total, the City has submitted claims of \$180.5 million, of which \$36.3 million have approved and \$14.6 million have been paid. The balance is subject to risk of both lower claiming than that assumed and potential disallowance of claimed costs. Reimbursement and auditing processes will continue for the coming fiscal and likely longer, leaving a key risk to budgeted revenues.

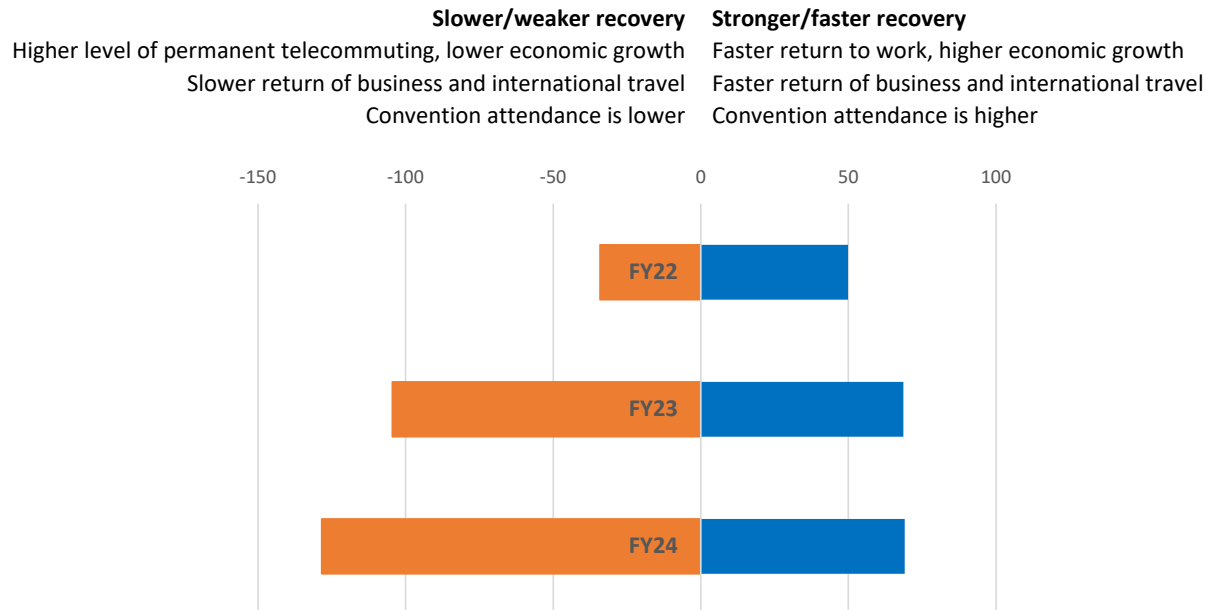


Key Risks: Economic Recovery

Budget assumes economic recovery drives tax revenue growth of \$251.2 million in FY 2021-22 and \$502.7 million in FY 2022-23. Assumptions are subject to significant uncertainty. Key factors to monitor:

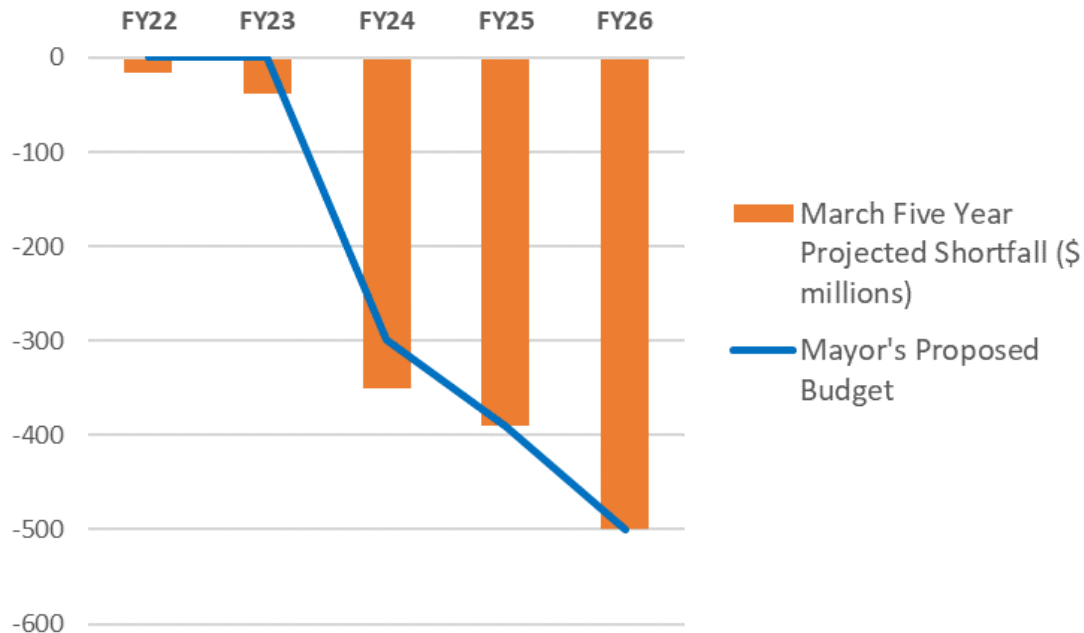
- whether conditions continue to permit resumption of economic activity
- whether large-scale telecommuting will wane rapidly as assumed
- whether hospitality and convention industries recover assumed pace

Changes in these factors would drive variances in revenue performance:



Key Risks: Reliance on One-Time Sources

The Mayor's proposed budget is balanced with a heavy reliance on one-time sources, most notably \$624.8 million in federal stimulus funds allocated to the City under the ARPA. These funds would be depleted over the two-year budget period, leaving a structural budget shortfall of \$350 million in FY 2023-24 and \$499.3 million in FY 2025-26, as projected in the March 2021 update to the Five-Year Financial Plan.



Budget Overview

FY 2021-22

\$13.1 billion

FY 2022-23

\$12.8 billion

- **Total, All Funds** sources are decreasing by \$532.9 million (3.9%) in FY 2021-22 and decreasing by \$323.5 million (2.5%) in FY 2022-23
- **General Fund** sources are increasing by \$108.3 million (1.7%) in FY 2021-22 and decreasing by \$2.5 million (0.0%) in FY 2022-23

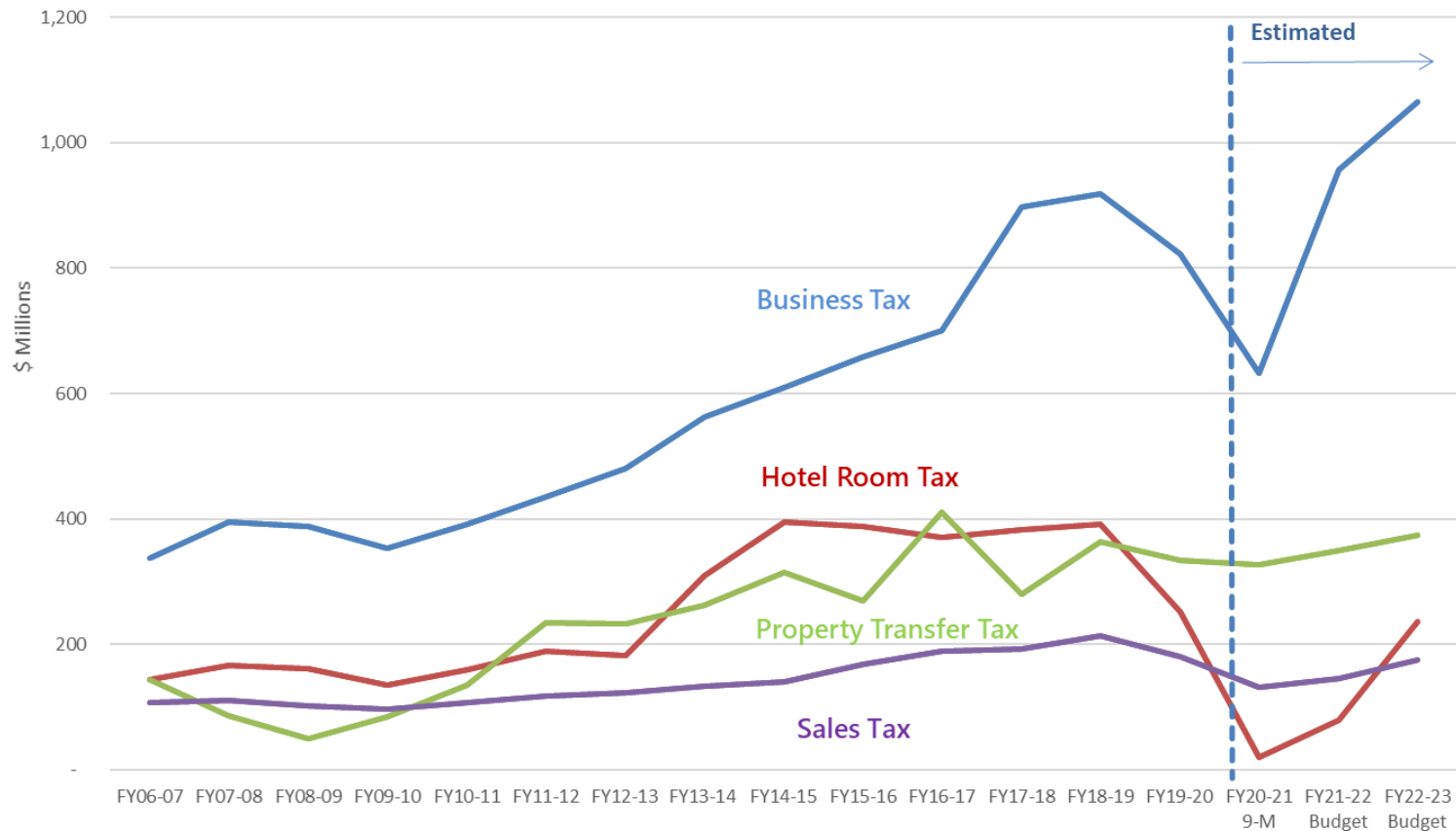
Key General Fund Tax Revenues (\$ millions)

| General Fund Tax | Actual FY 2018-19 | Actual FY 2019-20 | 9-Month FY 2020-21 | Proposed FY 2021-22 | Proposed FY 2022-23 |
|-------------------------------|----------------------|----------------------|-----------------------|------------------------|------------------------|
| Property Tax (No Excess ERAF) | 1,698.3 | 1,833.6 | 1,935.0 | 1,870.6 | 1,951.6 |
| Business Tax | 917.8 | 822.2 | 632.4 | 957.1 | 1,065.4 |
| Hotel Tax | 392.3 | 252.2 | 20.6 | 78.5 | 235.3 |
| Sales Tax | 213.6 | 180.2 | 132.2 | 145.7 | 174.9 |
| Real Property Transfer Tax | 364.0 | 334.5 | 326.3 | 350.1 | 373.9 |

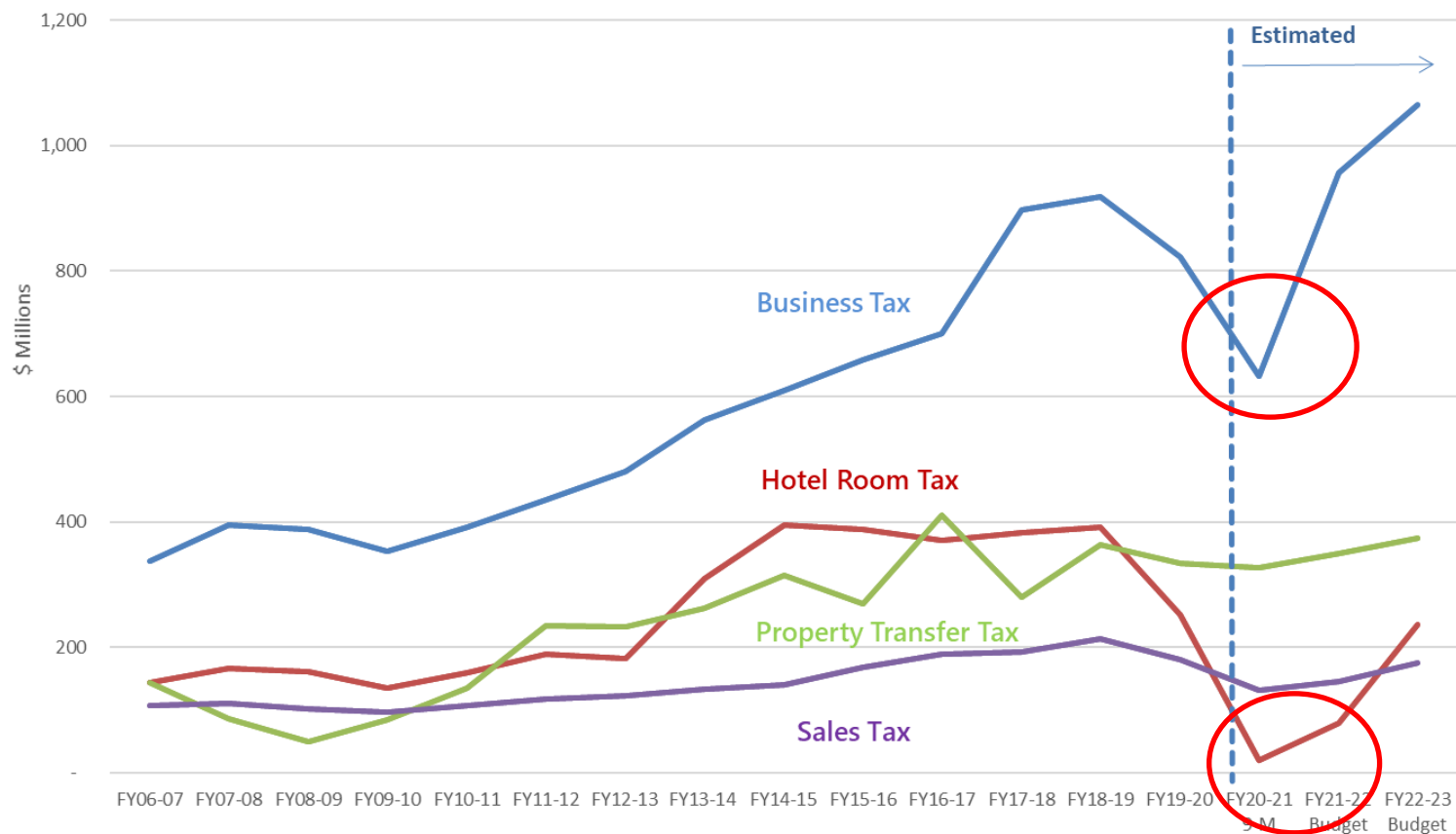
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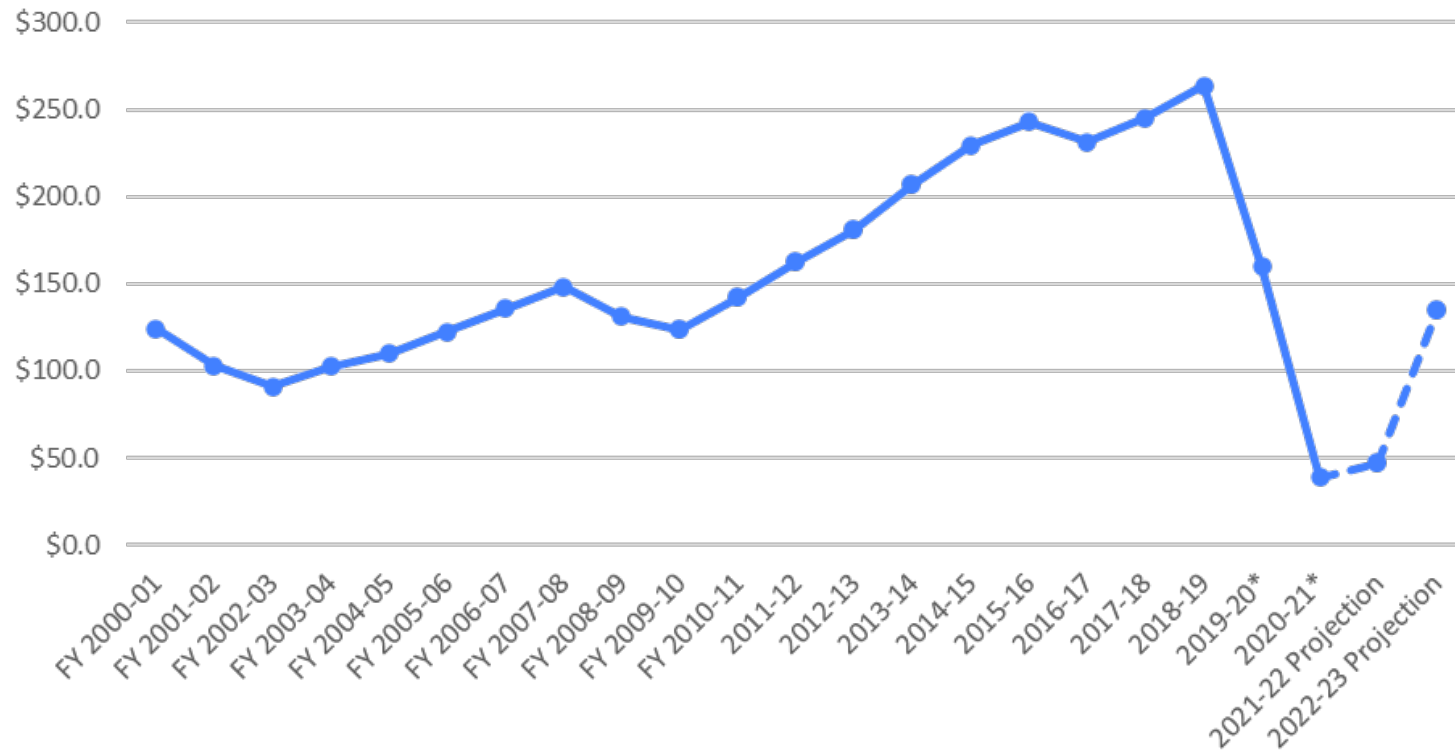
General Fund Taxes

- **Property Tax** lags other recessionary revenue losses.
 - Roll growth of secured property assessments is assumed to be 3.2% in FY 2021-22
 - Hotel, retail, office, and multi-family housing assessed values are assumed reduced by \$10.0 billion, reflecting declines of 20%, 20%, 5%, and 3% respectively in FY 2021-22, and unsecured business property tax assessments are assumed to decline 20%.
- **Business Tax** receipts are projected to begin its recovery in the budget years
 - Underlying economic growth of 6% and 4% is assumed for tax years 2021 and 2022. The unemployment rate peaked at 12.6 percent in April 2020 and declined steadily since then, reaching 5.4 percent in March 2021
 - Assumes 50% of nonresident office workers return to office by December 2021. By July 2022, assumes 75% of non-resident workers return to office, and the remaining 25% permanently telecommute.
 - Includes rate changes from November 2020 Proposition F (Business Tax Overhaul) and deferral of some business registration fees

General Fund Taxes

- General Fund **Hotel Tax** are projected to increase by 280% in FY 2021-22, then by 200% in FY 2022-23 after an anticipated decline of 92% in FY 2020-21. Despite rapid growth in the budget years, hotel tax receipts are not anticipated to recover to their prior peak until FY 2025-26.

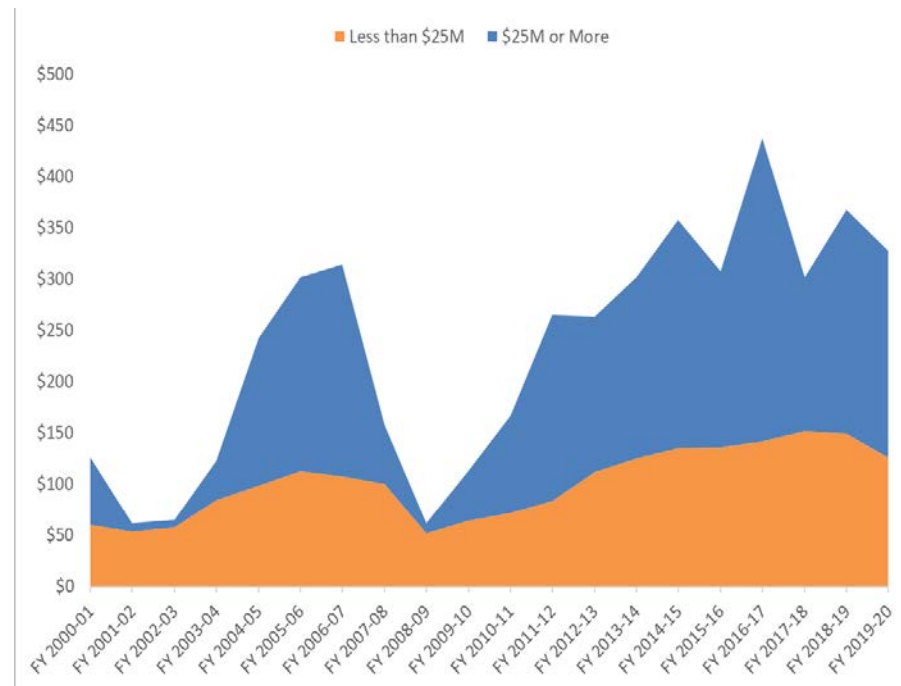
Average Annual Revenue Per Available Room (RevPAR)



General Fund Taxes

- Sales Tax** is projected to grow 10% in FY 2021-22 and 20% in FY 2022-23 after an anticipated decline of nearly 27% in FY 2020-21. Return of the City's daytime and residential population is critical to this source's recovery.
- Transfer Tax** is assumed to return to its rate-adjusted historic average by FY 2023-24. This is the General Fund's most volatile revenue source, with <1% of transactions driving >50% of revenue.

Real Property Transfer Tax Rate-Adjusted Revenue by Transaction Size (\$ millions)



Excess ERAF

- **Excess ERAF property tax funds** are budgeted in both budget years. Property tax allocations to schools that exceed State revenue limits must be returned to the City.
 - Total benefit: \$505.1 million over two years
 - Drives mandated baseline spending and reserve deposits: ~\$100 million
 - Net discretionary revenues: ~\$400 million.

Baseline Spending Requirements

| Charter-Mandated Baselines | Requirement | FY 2021-22 Proposed | FY 2022-23 Proposed |
|---------------------------------------|---|---|---|
| Children | Appropriations equal to FY 2000-01 plus discretionary revenue growth (4.830% ADR) | \$ 37.3 million above required level (\$185.8 million) | \$0.1 million above required level (\$210.3 million) |
| Disconnected Transitional-Age Youth | Appropriations equal to FY 2013-14 plus discretionary revenue growth (0.580% ADR) | \$13.9 million above required level (\$22.3 million) | \$11.0 million above required level (\$25.3 million) |
| Municipal Transportation Agency (MTA) | 1) 9.193% ADR + Central Subway 2) Population Adjustment 3) 80% Parking Tax | At required level (\$467.7 million) | At required level (\$531.7 million) |
| Recreation & Park | Increase General Fund Support \$3.0 million annually | \$14.3 million above required level (\$79.2 million) | \$3.8 million above required level (\$82.2 million) |
| Dignity Fund | Increase General Fund Support \$3.0 million annually | At required level (\$53.1 million) | At required level (\$56.1 million) |
| Street Tree Maintenance | Increase General Fund Support by changes in Aggregate Discretionary Revenue | At required level (\$19.8 million) | At required level (\$22.4 million) |
| Housing Trust Fund | Increase General Fund Support \$2.8 million annually | \$17.6 million above required level (\$42.4 million) | At required level (\$45.2 million) |
| Our City, Our Home (Nov, 2018) | Appropriations equal to FY 2017-18 amount of \$215.0 million. | \$51.8 million above required level (\$215.0 million) | \$122.2 million above required level (\$215.0 million) |
| Early Care and Education (Jun, 2018) | Appropriations equal to FY 2017-18 amount plus discretionary revenue growth (2.2122% ADR) | \$6.2 million above required level (\$85.1 million) | \$0.1 million above required level (\$96.3 million) |
| Other | Varies | Funded at required level | Funded at required level |

For more information on baselines, please see Appendix 4 of the Revenue Letter.

Reserve Status

| | FY 2020-21 | FY 2021-22 | | FY 2022-23 | | | |
|--|--------------------------------|-------------|----------------|--------------------------------|-------------|---------------|--------------------------------|
| | Projected Ending Balance | Deposits | Withdrawals | Projected Ending Balance | Deposits | Withdrawals | Projected Ending Balance |
| General Reserve | 78.3 | 3.1 | - | 81.4 | 5.8 | - | 87.3 |
| Rainy Day Economic Stabilization City Reserve | 114.5 | - | - | 114.5 | - | - | 114.5 |
| Budget Stabilization Reserve | 265.8 | - | - | 265.8 | - | - | 265.8 |
| Subtotal Economic Stabilization Reserves | 380.3 | - | - | 380.3 | - | - | 380.3 |
| Percent of General Fund Revenues | 6.9% | | | 7.0% | | | 6.5% |
| Rainy Day Economic Stabilization SFUSD Reserve | 1.0 | - | - | 1.0 | - | - | 1.0 |
| Budget Stabilization Reserve - One Time Reserve | 54.8 | - | - | 54.8 | - | - | 54.8 |
| COVID Response and Economic Loss Reserve | 113.5 | - | (99.5) | 14.0 | - | (14.0) | - |
| Federal and State Emergency Grant Disallowance Reserve | 100.0 | - | - | 100.0 | - | - | 100.0 |
| Fiscal Cliff Reserve | 293.9 | - | - | 293.9 | - | - | 293.9 |
| Business Tax Stabilization Reserve | 149.0 | - | (149.0) | - | - | - | - |
| Public Health Management Reserve | 59.5 | - | - | 59.5 | - | - | 59.5 |
| Other Reserves | 14.5 | 2.5 | (5.0) | 12.0 | - | - | 12.0 |
| Subtotal | 786.2 | 2.5 | (253.5) | 535.2 | - | (14.0) | 521.2 |
| Annual Operating Reserves | | | | | | | |
| Litigation Reserve | - | 11.0 | (11.0) | - | 11.0 | (11.0) | - |
| Reserve for Technical Adjustments | - | 5.0 | (5.0) | - | 5.0 | (5.0) | - |
| Salary and Benefits Reserve | - | 37.3 | (37.3) | - | 40.9 | (40.9) | - |
| Subtotal | - | 53.3 | (53.3) | - | 56.9 | (56.9) | - |
| Total, All Reserves | 1,244.9 | 58.9 | (306.8) | 997.0 | 62.8 | (70.9) | 988.8 |

For more information on reserves, please see Appendices 2 and 3 of the Revenue Letter.

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Great uncertainty remains regarding the future shape of the pandemic and the corresponding implications for economic and tax revenue growth. This risk is heightened by several other non-economic sources assumed in the budget.

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Any questions?

Ben Rosenfield

Controller

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