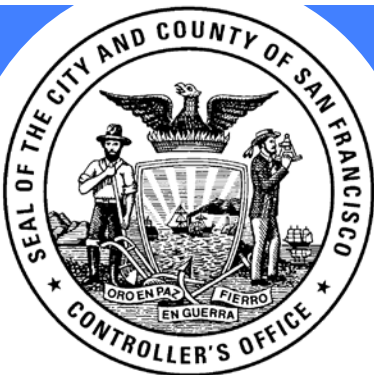


Controller's Review

Mayor's Proposed Budget for
FY 2023-24 and FY 2024-25



CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

6.14.2023

Summary

The proposed balanced budget relies on reasonable but uncertain estimates of tax revenues and other sources that correspond to an overall assumption of a slow and gradual recovery in San Francisco's economy, with the help of recently adopted new sources of revenue. The budget relies heavily on one-time funds to support operations during the two-year budget period, and a structural gap in excess of \$500 million is likely to persist following the exhaustion of those funds.

Uncertainty remains regarding the pace of economic recovery, status of Laguna Honda Hospital, and state and federal revenue risk. This risk is heightened by the budget's reliance on one-time sources, including federal disaster relief, fund balance, project closeouts, funding shifts and reserves.

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.

Findings...

- Tax revenue projections generally assume a continuing but slow economic recovery from the pandemic, with a significant drag created by the continuing effect of remote office work on economic activity in the City. Most economically sensitive taxes, such as sales and hotel taxes, are projected to grow during the coming two years, but in most cases remain below pre-pandemic levels.
- **The budget assumes nearly \$1 billion of General Fund one-time solutions over the two budget years**, including drawdown of \$405.0 million in prior year fund balance, \$117.2 million in prior continuing appropriations the Mayor's budget proposes to close; \$250.0 million of FEMA reimbursement for previously incurred emergency response costs; \$172.3 million of reserve drawdowns; and other one-time solutions. Additionally, the budget proposes \$125.9 million of short-term shifts of costs in other funds, with a significant portion designed to achieve General Fund savings.
- **The budget further draws on available reserves but maintains the City's economic stabilization reserves.** The budget uses \$172.3 million of reserves established in prior years. By the end of the two-year budget period, the City will have used approximately \$620 million (or 43%) of its \$1.4 billion of pre-pandemic reserves to support on-going operations.

...Findings

- **The proposed budget makes some limited progress towards projected structural budget gaps in years beyond the coming two-year budget period.** This forecast, published in March 2023, forecast a structural budget gap of \$724 million in FY 2025-26, growing in subsequent years, absent ongoing corrective action by policy makers. Given our preliminary review of the mix of ongoing and one-time solutions proposed in the Mayor's budget, our office would estimate a likely shortfall in excess of \$500 million in FY 2025-26, growing in subsequent years.
- **The final adopted budget will require active monitoring and management by the Mayor and Board of Supervisors given a number of economic and financial risks.** These risks include the possibility of a slowing economic recovery or a recession, delays in the recertification of Laguna Honda Hospital, and risks associated with both State and Federal revenues streams.

Key Requirements and Legislative Proposals

- Three business tax proposals are assumed to be adopted in the Mayor's proposed budget, with an all funds impact of \$31.8 million and \$38.8 million in FY 2023-24 and FY 2024-25, respectively.
- The Mayor's proposed budget adheres to voter-adopted spending mandates, provided modifications to two requirements are adopted by the Board of Supervisors. With the adoption of budget trailing legislation to temporarily amend the Early Care and Education baseline, voter-adopted spending requirements would be met, or exceeded, at a total cost of \$2.1 billion and \$2.2 billion in the two fiscal years. The March Update to the Five-Year Financial Plan forecasted a deficit of \$290.9 million, resulting in the suspension of required growth to several baselines in the FY 2023-24 budget: Early Care and Education baseline, Dignity Fund, Recreation and Parks baseline, and the Street Tree Maintenance Fund.
- **Minimum Compensation Rate.** The Mayor introduced legislation that would increase the minimum compensation rates in steps. For nonprofit organizations, the rate would be set at \$18.93 on July 1, 2023, and increased to \$20.25 on July 1, 2024. For public entities, the rate would be \$19.25 on July 1, 2023, and increased to \$22.50 by January 1, 2025. The budget is sufficient to fund the direct wage impacts of the minimum compensation increases. These compensation increases, therefore, will be effective July 1, 2023.

Selected General Fund Tax Revenues (\$ millions)

Selected General Fund Taxes	Actual FY 2018-19	Actual FY 2019-20	Actual FY 2020-21	Actual FY 2021-22	Nine-Month FY 2022-23	Proposed FY 2023-24	Proposed FY 2024-25
Property Tax (No Excess ERAF)	1,698.3	1,833.6	1,974.0	1,971.3	2,111.0	2,145.0	2,152.0
Business Tax	917.8	822.2	722.6	861.2	878.2	846.7	930.5 *
Hotel Tax	392.3	252.2	33.2	158.2	254.2	302.9	342.0
Sales Tax	213.6	180.2	146.9	188.3	200.0	200.0	205.2
Real Property Transfer Tax	364.0	334.5	344.7	520.3	174.3	222.0	269.6 *
Executive Compensation	-	-	-	-	190.0	100.0	100.0 *
Total	3,586.1	3,422.6	3,221.4	3,699.3	3,807.7	3,816.6	3,999.4
					Growth Since FY 2018-19		11.5%

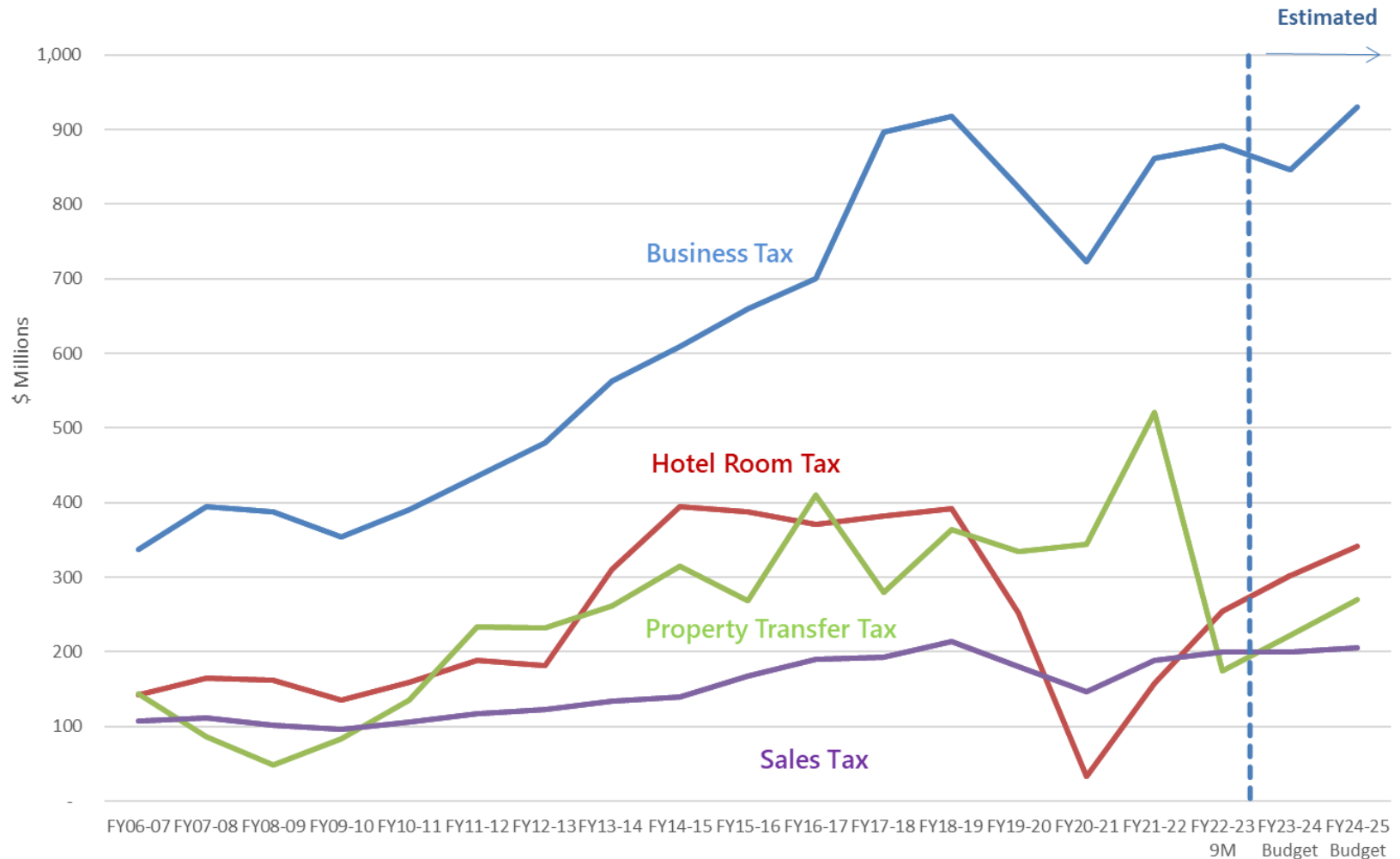
* These sources new or had had rate changes during the period.

General Fund Tax Revenues (\$ millions)

	Actual	Actual	Actual	Actual	Nine-Month	Proposed	Proposed
Recently Adopted Tax Measures	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24	FY 2024-25
Business Tax - 2020 Prop F	-	-	-	-	11.7	11.7	49.8
Transfer Tax - 2020 Prop I	-	-	62.8	171.8	101.3	95.4	115.9
Executive Compensation - 2020 Prop L	-	-	-	-	190.0	100.0	100.0
Total	-	-	62.8	171.8	303.0	207.1	265.7
Total Without New Revenue	3,586.1	3,422.6	3,158.7	3,527.5	3,504.7	3,609.5	3,733.6
					Growth Since FY 2018-19		4.1%

Values shown are before Charter-mandated baseline spending requirements.

General Fund Tax Revenue (\$ millions)



General Fund Taxes, Detail

▪ **Property Tax**

- Roll growth of secured property assessments is assumed to be 4.0% in FY 2023-24 and 2.5% in FY 2024-25.
- \$90.0 million in FY 2023-24 and \$96.0 million in FY 2024-25 of property tax is assumed to be diverted from the General Fund for tax increment financing districts.
- Assume refunds of \$64.0 million in FY 2023-24 and \$103.0 million in FY 2024-25, to be paid when the Assessment Appeals Board determines reductions.

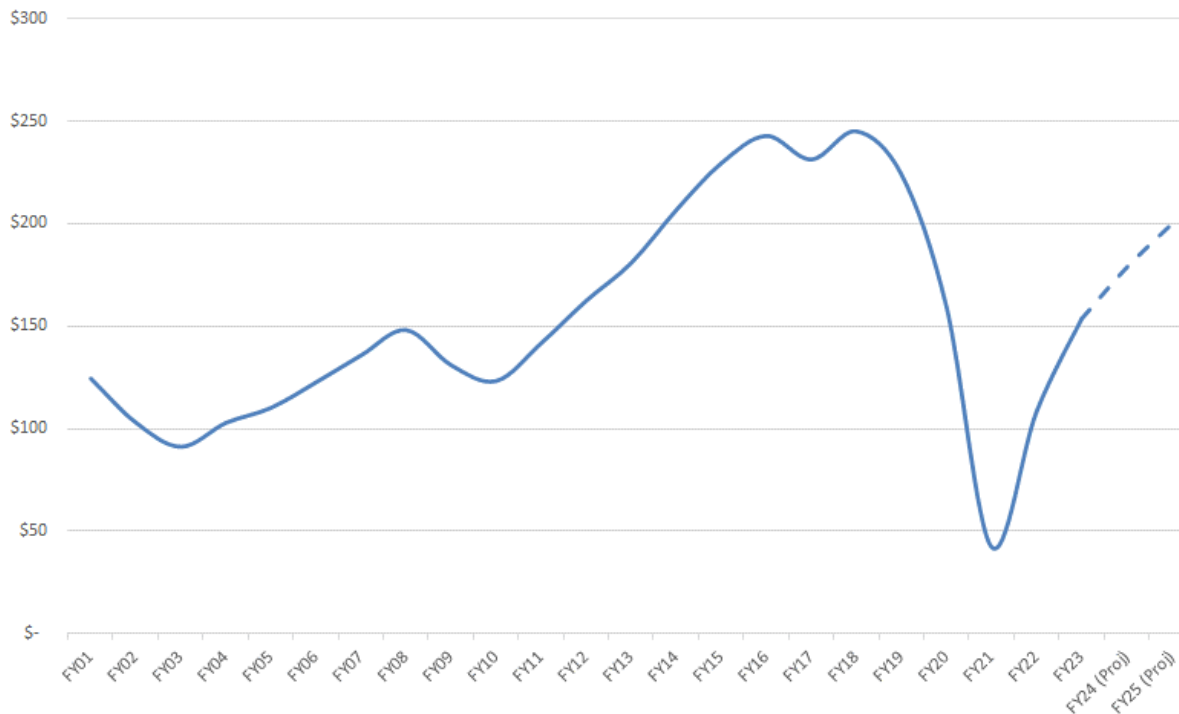
▪ **Business Tax**

- Underlying economic growth of 0% and 1% is assumed for tax years 2023 and 2024.
- Remote office work is assumed to continue indefinitely.
- Policy changes to (1) delay tax increase on gross receipts for certain business categories and (2) gross receipts tax credit for businesses with new physical locations

General Fund Taxes, Detail

General Fund **Hotel Tax** is projected to increase by ~60% in FY 2023-24 and ~13% in FY 2024-25 after a historic drop 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 2027-28.

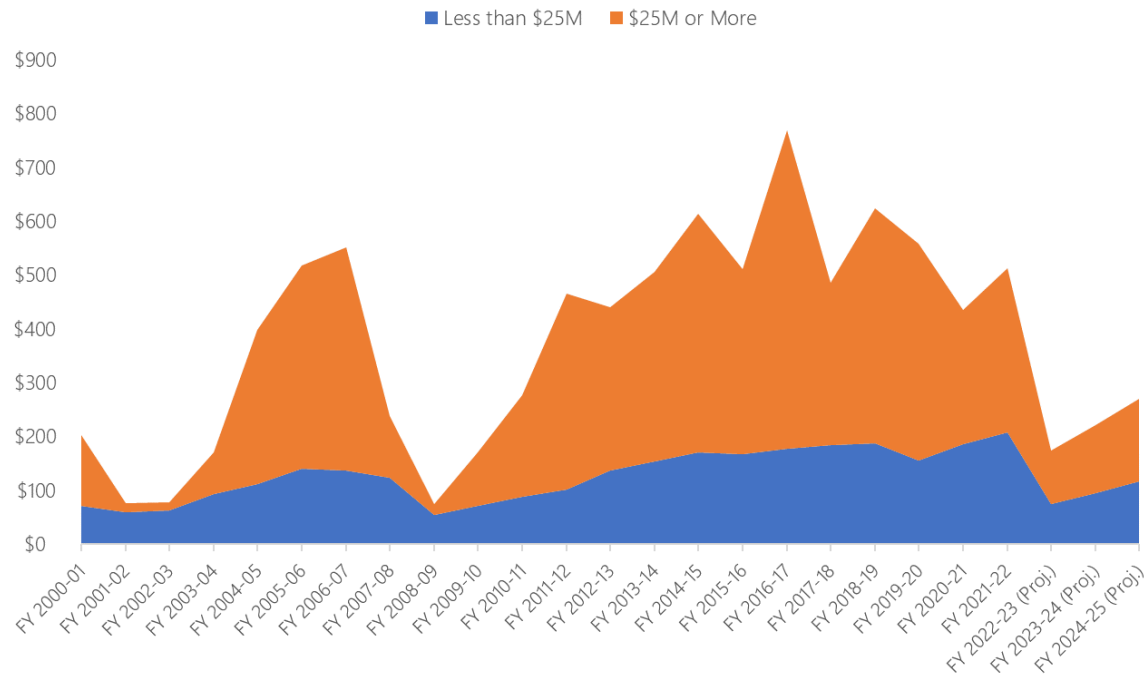
Average Annual Revenue Per Available Room (RevPAR)



General Fund Taxes, Detail

Transfer Tax in FY 2022-23 has dropped precipitously, as rising interest rates and remote office work have impacted sales of both residential and commercial real estate. FY 2023-24 and FY 2024-25 revenues are assumed to begin a four-year return to a new steady state by FY 2026-27. This is the General Fund's most volatile source, with <1% of transactions driving >50% of revenue.

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



Voter-Adopted Spending Requirements

- The budget supports over \$2.0 billion of baseline spending mandates. These mandates include spending for transit, libraries, schools, early childhood education, recreation and parks, among others.
- Legislation temporarily lowers the Early Care and Education baseline (June 2018 Prop C) by \$20 million in FY 2023-24 and \$10 million in FY 2024-25.
- The budget includes \$11.0 million in FY 2023-24 and \$35.0 million for the new Student Success Fund (Prop G, Nov 2022) baseline to support San Francisco schools.
- Several baselines are funded above the required levels, including Children's Services and Transitional Aged Youth baseline; Recreation and Parks baseline; Our City, Our Home Baseline (November 2018 Prop C); Early Care and Education baseline (June 2018 Prop C)
- Growth of several baselines suspended in FY 2023-24 due to size of deficit projected in March 2023: Early Care and Education baseline, Dignity Fund, Recreation and Parks baseline, and the Street Tree Maintenance Fund.

Reserve Status

	FY 2022-23	FY 2023-24			FY 2024-25			Note
	Projected Balance	Deposit	Use	Projected Balance	Deposit	Use	Projected Balance	
General Reserve	\$ 57.8	\$ 70.8	-	\$ 128.6	\$ 17.3	-	\$ 145.9	1
Rainy Day Economic Stabilization City Reserve	114.5	-	-	114.5	-	-	114.5	2
Budget Stabilization Reserve	265.8	-	-	265.8	-	-	265.8	3
Economic Stabilization Reserves	380.3	-	-	380.3	-	-	380.3	
<i>Percent of General Fund Revenues</i>	<i>6.2%</i>			<i>5.9%</i>			<i>5.9%</i>	
Rainy Day Economic Stabilization SFUSD Reserve	1.0	-	-	1.0	-	-	1.0	2
Federal and State Emergency Grant Disallowance	81.3	-	-	81.3	-	(41.3)	40.0	4
Fiscal Cliff Reserve	220.4	-	(90.2)	130.3	-	-	130.3	5
Business Tax Stabilization Reserve	29.5	-	-	29.5	-	(29.5)	-	6
Public Health Revenue Management Reserve	116.9	-	-	116.9	-	-	116.9	7
Free City College Reserve	6.9	-	(6.9)	-	-	-	-	8
Mission Bay Transportation Improvement Fund	1.0	-	(1.0)	-	-	-	-	9
Hotel Tax Loss Contingency Reserve	3.5	-	(3.5)	-	-	-	-	10
Other Reserves	460.5	-	(101.5)	359.0	-	(70.8)	288.2	
Litigation Reserve	-	11.0	(11.0)	-	11.0	(11.0)	-	11
Technical Adjustment Reserve	-	5.0	(5.0)	-	5.0	(5.0)	-	12
Salary and Benefits Reserve	-	7.0	(7.0)	-	31.0	(31.0)	-	13
Annual Operating Reserves	-	23.0	(23.0)	-	47.0	(47.0)	-	
TOTAL, General Fund Reserves	898.7	93.8	(124.5)	867.9	64.3	(117.8)	814.4	

Any questions?

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