



Edward Harrington
Controller

June 11, 2002

The Honorable Board of Supervisors
City and County of San Francisco
City Hall, Room 244
San Francisco, California 94102

Re: Controller's Discussion of Fiscal Year 2002-03 Budget

Dear Members of the Board:

The Controller's Office has prepared a review of the Mayor's proposed budget for fiscal year (FY) 2002-03. This letter addresses the following issues:

- Provides an analysis of the major sources of funds in the Mayor's proposed budget.
- Reports on the required baselines for Children's Services, the Library and the Municipal Transportation Agency (MTA, including both MUNI and the Department of Parking & Traffic).
- Reports on department appropriations that our office is reserving pending the receipt of actual revenue by the departments.

The Controller's discussion of the Mayor's FY 2002-03 proposed budget is organized as follows:

- I. General Fund Sources of Funds
- II. General Fund Subsidized Departments
- III. Baselines
- IV. Self-Supporting Enterprise Departments
- V. Controller's Reserves

I. GENERAL FUND SOURCES OF FUNDS

Charter Section 9.102 requires that the Controller "provide the Board of Supervisors with an opinion regarding the accuracy of economic assumptions underlying the revenue estimates [in the Mayor's proposed budget] and the reasonableness of such estimates and revisions." My office and the Mayor's Budget Office have worked very closely to prepare the FY 2002-03 proposed budget revenue estimates. **In my opinion, the revenue estimates contained in the Mayor's FY 2002-03 proposed budget are reasonable based on our knowledge of current and projected economic conditions.** As detailed below, the proposed budget assumes a gradual recovery in discretionary General Fund revenues from the FY 2001-02 projected levels.

The revenue estimates are largely based on the 9-Month Report and the Joint Budget Report issued by the Mayor's Budget Office, the Controller's Office, and the Board of Supervisors Budget Analyst. This three-year budget projection report was developed in consultation with

economic advisors of the Municipal Fiscal Advisory Committee. The Mayor's proposed budget also includes updated revenue projections for both Business Tax and Sales Tax from those included in the 9-Month and Joint Budget Reports. These changes are, however, offsetting with Payroll Tax revised upward and Sales Tax revised downward.

Overall discretionary revenues are expected to grow from their FY 2001-02 estimated year-end levels as the economic recovery continues. The projected growth, however, is not strong enough in a number of revenue categories to even get back up to FY 2001-02 budget levels, including for example Sales Tax, Property Transfer Tax, Hotel Room Tax, Parking Tax, and Public Safety Sales Tax. Chart A provides both historical and budgeted amounts for the General Fund's major discretionary revenues.

Chart A: General Fund Discretionary Revenues

	FY 2000-01 Actual	FY2001-02		FY2002-03
		Original Budget	Year-End Projection (1)	Proposed Budget (2)
Property Taxes (3)	\$461,937,818	\$461,549,756	\$500,022,609 8.2%	\$513,023,000 2.6%
Business Taxes (4)	277,094,218	275,669,000	271,669,000 -2.0%	282,110,000 3.8%
Sales Tax	143,815,095	155,190,000	125,190,000 -13.0%	130,529,000 4.3%
Utility Users Tax	77,170,418	77,346,000	76,901,000 -0.3%	78,208,000 1.7%
Property Transfer Tax	62,335,132	48,000,000	43,000,000 -31.0%	45,150,000 5.0%
Hotel Room Tax (5)	131,402,044	141,634,414	83,132,678 -36.7%	97,070,000 16.8%
Parking Tax (6)	33,831,603	35,022,000	33,022,000 -2.4%	34,350,000 4.0%
Public Safety Sales Tax	71,637,691	75,066,000	69,061,000 -3.6%	71,864,000 4.1%
Motor Vehicle In-Lieu	97,306,597	102,171,000	102,171,000 5.0%	105,645,000 3.4%
Total - Discretionary Revenues	\$1,356,530,616	\$1,371,648,170	\$1,304,169,287	\$1,357,949,000
	\$ Change		(\$52,361,329)	\$53,779,713
	% Change		-3.9%	4.1%

NOTES

- (1) Percentage change is the change in FY 2001-02 year-end projection from FY 2000-01 actual revenues. The FY 2001-02 year-end projections are based on the Controller's 9-Month Report, dated April 29, 2002.
- (2) Percentage change is the change in FY 2002-03 proposed budget from FY 2001-02 year-end projection.
- (3) The proposed budget is adjusted for growth in assessed valuation, delinquencies, projected assessment appeals and estimated tax increment required for Redevelopment Agency projects.
- (4) Projected growth of 4.0 percent includes impact of tax credits and refunds.
- (5) Includes both General Fund Unallocated (discretionary) and Allocated Hotel Room Tax revenues. Of the \$97.07 million, \$70.07 million is Unallocated (discretionary).
- (6) Includes both General Fund Unallocated and Commission on Aging share of parking tax. Of the \$34.35 million, \$22.90 million is Unallocated (discretionary).

Discussion of Budget Estimates for General Fund Discretionary Revenues

Property Taxes: The General Fund share of property tax revenue is projected to increase by 2.6 percent. Preliminary estimates from the Assessor’s Office indicate that the FY 2002-03 tax roll will likely increase between 6.0 and 7.0 percent from the FY 2001-02 certified tax roll. For purposes of projecting the General Fund property tax revenues, several additional factors are taken into consideration. First, some of the increase in the Assessor’s tax roll is already reflected in the FY 2001-02 year-end projection, due to mid-year reassessments and subsequent supplemental tax revenues. In addition, we factor in likely appeals, refunds, reassessments, delinquencies, tax increment allocation to the Redevelopment Agency and major property transactions. Typical for this revenue, the final result is a percentage revenue increase that is less than the percentage increase in the value of the tax roll.

As illustrated in Chart B below, property tax delinquencies have decreased from prior recession highs. The estimates contained in the Mayor’s proposed budget assume a 2.0 percent (weighted average) delinquency rate, which is a level reasonable in our opinion given the present economic conditions.

Chart B: Property Tax Delinquencies¹

	SECURED		UNSECURED		WEIGHTED
	CCSF	Statewide	CCSF	Statewide	AVERAGE
					CCSF
FY1990-91	3.73%	3.90%	4.83%	4.80%	3.84%
FY1991-92	4.00%	4.10%	4.22%	4.22%	4.02%
FY1992-93	3.23%	3.24%	4.58%	4.58%	3.35%
FY1993-94	2.81%	3.50%	4.36%	4.40%	2.96%
FY1994-95	2.52%	2.50%	4.75%	4.60%	2.73%
FY1995-96	1.92%	1.90%	3.68%	3.60%	2.07%
FY1996-97	1.68%	1.80%	3.21%	3.20%	1.82%
FY1997-98	1.45%	1.80%	2.29%	2.30%	1.52%
FY1998-99	1.35%	1.60%	2.94%	2.90%	1.49%
FY1999-00	1.42%	1.90%	2.11%	2.10%	1.49%
FY2000-01	1.33%	1.50%	2.98%	3.00%	1.48%
Projected FY2001-02	1.80%	1.90%	4.00%	4.00%	2.00%
Projected FY2002-03	1.80%	1.90%	4.00%	4.00%	2.00%

Business Taxes: Business taxes are projected to increase by 3.8 percent. This projection continues to include the elimination of the gross receipts tax, the reduction of the business registration fees that were linked to gross receipts, as well as tax credit programs. The largest tax credit, the New Jobs Tax Credit, is slated to sunset December 31, 2002. The impact of the sunset will not be felt until FY 2003-04.

On a related note, the proposed budget continues to include the debt service for the business tax (gross receipts) judgement bonds pertaining to the litigation settlement previously adopted by the

¹ Source: San Francisco Treasurer/Tax Collector, California Controller’s Office, San Francisco Controller’s Office (Projected)

Board of Supervisors. FY 2002-03 debt service on the judgement bonds is \$7.26 million, compared to the FY 2001-02 amount of \$7.08 million. The judgement bonds are fixed rate bonds with a maximum annual debt service of \$7.26 million. The debt service is payable through FY 2010-11, assuming no prepayment or refunding occurs.

Sales Tax: Sales tax revenue growth is projected to be 4.3 percent. The FY 2001-02 receipts clearly illustrated the dependency of this revenue on tourism, business travel and the recent economic activity related to the dot-com bubble. A 4.3 percent growth rate is less than the growth rate being assumed in the Governor’s May Revise (6.6 percent); however, it appears consistent with the projected return of tourism, business travel and a gradual recovery in the Bay Area. Additional reasons for the difference include the increase in the statewide sale tax rate of 0.25 percent, the slowdown affecting various regions of California differently (e.g. the Bay Area has seen a larger decline in sales tax receipts than has Southern California), and the unsustainable levels attributed to the recent high-tech / dot-com boom.

Utility Users Tax: Utility users tax revenue growth is projected to be 1.7 percent overall. This is comprised of both volume and commodity price changes for telecommunications, electricity, natural gas, steam and water. Telecommunication-related revenues are projected to increase 3.5 percent mainly due to commodity price increases. Electricity-related revenues are projected to decrease by 2.5 percent due to lower consumption. Natural gas-related revenues are projected to increase 10.5 percent due primarily to increasing commodity prices. Water-related revenues, which represent approximately 2.0 percent of utility user tax revenues, are projected to grow with the proposed rate increase and water usage.

Real Property Transfer Tax: Real property transfer tax revenues are expected to increase 5.0 percent in FY 2002-03. Since December 2001, the number of real estate transactions generating real estate transfer tax revenues has increased. Most activity has been in the mid-market, that is, transactions between \$250,000 and \$1,000,000. With some weakness still present in the high-end segment, a \$45.15 million proposed budget estimate appears reasonable and consistent with recent transaction activity.

Chart C: Real Property Transfer Tax Revenues

Fiscal Year	Total Property Transfer Tax Revenue	Increase/ (Decrease)
FY 1985-86	18,785	
FY 1986-87	19,056	1.4%
FY 1987-88	19,185	0.7%
FY 1988-89	24,788	29.2%
FY 1989-90	20,717	(16.4%)
FY 1990-91	13,695	(33.9%)
FY 1991-92	13,798	0.8%
FY 1992-93	13,065	(5.3%)
FY 1993-94	15,857	21.4%
FY 1994-95	20,038	26.4%
FY 1995-96	22,968	14.6%
FY 1996-97	33,573	46.2%
FY 1997-98	44,007	31.1%
FY 1998-99	56,133	27.6%
FY 1999-00	69,882	24.5%
FY 2000-01	62,335	(10.8%)
FY 2001-02 Projection	43,000	(31.0%)
FY 2002-03 Budget	45,150	5.0%

Hotel Room Tax: Overall hotel room tax revenue growth is projected to be 14.0 percent. The General Fund portion is projected to have 16.8 percent growth. Hotel room tax revenue growth is the result of occupancy rate growth of 12 to 13 percent, average daily room rate growth of 0.0 to 1.0 percent and approximately 1.0 percent growth in room supply. While 14.0 percent may seem like a large increase, it follows a 28.0 percent decline in total hotel room tax revenue (which equates to a 36.7 percent decline in the portion budgeted in the General Fund). This large swing is due to the economic slowdown, as well as plummeting business and tourist travel following the September 11th terrorist attacks.

As illustrated in Chart D, hotel room tax revenues experienced significant growth during the 1990s. Chart D illustrates both allocated and discretionary hotel room tax revenues since FY 1978-79. By ordinance, a portion of the hotel room tax is allocated for specific purposes. For the portion that is allocated for specific purposes, generally the year-to-year change cannot exceed 10 percent.²

Chart D: Hotel Room Tax Revenues

Fiscal Year	Total Hotel Room Tax Revenue (All Funds)	Increase / (Decrease)	Increase / (Decrease) Adjusted For Tax Rate Changes
FY 1978-79	19,014		
FY 1979-80	23,819	25.27%	25.27%
FY 1980-81	32,558	36.69%	14.81%
FY 1981-82	36,858	13.21%	13.21%
FY 1982-83	35,272	(4.31%)	(4.31%)
FY 1983-84	38,323	8.65%	8.65%
FY 1984-85	44,711	16.67%	16.67%
FY 1985-86	47,981	7.31%	7.31%
FY 1986-87	53,099	10.67%	4.26%
FY 1987-88	60,921	14.73%	8.71%
FY 1988-89	67,102	10.15%	10.15%
FY 1989-90	63,414	(5.50%)	(5.50%)
FY 1990-91	69,557	9.69%	9.69%
FY 1991-92	72,032	3.56%	3.56%
FY 1992-93	76,246	5.85%	5.85%
FY 1993-94	86,481	13.42%	5.47%
FY 1994-95	94,101	8.81%	7.76%
FY 1995-96	102,960	9.41%	9.41%
FY 1996-97	137,649	33.69%	18.41%
FY 1997-98	150,163	9.09%	7.89%
FY 1998-99	161,518	7.56%	7.56%
FY 1999-00	182,102	12.74%	12.74%
FY 2000-01	195,140	7.16%	7.16%
FY 2001-02 Projection	140,501	(28.00%)	(28.00%)
FY 2002-03 Budget	160,171	14.00%	14.00%

The net result is that for FY 2002-03 the amount of hotel room tax budgeted in the General Fund is \$97.07 million, of which \$70.07 million is Unallocated or discretionary. Chart E illustrates how the hotel room tax revenues are allocated for FY 2002-03.

Chart E: Hotel Room Tax Revenue Allocation, FY 2002-03

	\$ Allocation	%	Budgeted in GF
General Fund Unallocated (discretionary)	\$ 70,073,000	43.7%	Yes
Moscone / Convention Facilities	\$ 33,124,000	20.7%	No
Grants for the Arts	\$ 15,868,000	9.9%	Yes
War Memorial & Performing Arts	\$ 9,380,000	5.9%	No
Convention & Visitors Bureau	\$ 8,169,000	5.1%	No
Yerba Buena Gardens (SFRA)	\$ 6,392,000	4.0%	No
Low-Income Housing Programs	\$ 6,036,000	3.8%	No
Fine Arts Museum	\$ 4,955,000	3.1%	Yes
Cultural Equity Endowment	\$ 2,162,000	1.3%	Yes
Asian Art Museum	\$ 1,965,000	1.2%	Yes
Cultural Centers	\$ 1,910,000	1.2%	Yes
Administration (Tax Collector)	\$ 137,000	0.1%	Yes
TOTAL	\$ 160,171,000	100.0%	
Budgeted in General Fund	\$ 97,070,000	60.6%	
Budgeted outside of the General Fund	63,101,000	39.4%	
	\$ 160,171,000	100.0%	

Parking Tax: Parking tax revenues are projected to increase 4.0 percent. This projected level of growth assumes a gradual economic recovery during FY 2002-03 with limited rate increases. Collection efforts by the Tax Collector and increased compliance by operators are also factored into this growth estimate. The amount in Chart A includes only the portion of the parking tax accruing to the General Fund and the Commission on Aging. Chart A does not include the portion of parking tax revenue that accrues to the Municipal Transportation Agency, as it is budgeted in MUNI’s enterprise fund.

Public Safety Sales Tax: Public safety sales tax (Proposition 172) is projected to grow 4.1 percent. These revenues are allocated to counties by the State separately from local sales tax discussed above. Public safety sales tax revenues depend on the State’s allocation formula, which includes statewide sales tax activity, local sales tax activity and population factors.

Motor Vehicle In Lieu: Motor vehicle in lieu (MVL) subventions are projected to grow 3.4 percent. In recent history, new vehicle sales and registrations have helped to keep this revenue growing. The Mayor’s proposed budget reflects growth from new vehicle sales and the continued backfill from the State for the vehicle license fee (VLF) offset. The Governor’s May Revise maintains the backfill of the VLF offset to local governments; however, it also included a partial

² Article 7 of San Francisco’s Business and Tax Regulations Code outlines the annual adjustments required for the allocated portions of the hotel room tax. Most allocated portions of the hotel room tax revenue allocations are limited by a 10 percent cap (either up or down) in the change from the prior year. See Section 5.515 for details.

roll-back of the VLF offset, which will result in higher registration fees for automobile owners. It is not, however, expected to adversely impact local government revenues.

Current Year-End Surplus

Each year, the budget includes the City’s estimated year-end surplus from the prior year as a source of revenue. The final reconciliation of the FY 2001-02 year-end surplus will not be known until the independent audit is completed in late 2002.

The Mayor’s budget proposes to use \$136.29 million of projected year-end surplus to support General Fund expenditures in FY 2002-03. With a few exceptions, the Mayor’s Office relies on the Controller’s 9-Month Report for the projected FY 2001-02 fund balance. The Mayor’s proposed budget amount is \$19.73 million over the \$116.56 million reported in the 9-Month Report. Differences from the nine-month estimate are summarized below.

**Chart F: FY 2001-02 Projected Year-End Surplus
 Fund Balance Available to Support FY 2002-03 Proposed Budget**

Nine-Month Report Estimated Fund Balance	\$ 116.56
Net Impact to GF from Increased Tax Increment Shift to SFRA	5.00
TANF Incentive Revenue Spend Down in FY 2001-02	4.40
Unspent Health Care Accountability Ordinance at SFGH	4.00
Additional Capital Project Reductions	3.50
Additional Savings at Department of Human Services	1.20
Additional Savings at Department of Public Health (SFGH)	1.00
No Ryan White Supplemental	0.74
Additional Fire Department Savings	0.50
Starting Balance on LAFCO Project	0.24
Retain Portion of E-Government Reserve	(0.35)
Lower Planning Department Revenues	(0.50)
Total Surplus / Fund Balance Available for Appropriation	<u>\$ 136.29</u>

Use of Reserves

The Mayor’s budget proposes to use approximately \$49.25 million in reserves established in prior years. A summary of these reserved funds and their proposed uses are noted below.

Chart G: Use of Prior Year Reserves

Cash Reserve Reduction	\$ 37.06
Investment Reserve	5.09
Rec & Park - Prop C Reserve	3.50
Budget Incentive Reserve	2.22
One-Time Reserve	1.38
Total	<u>\$ 49.25</u>

Cash Reserve: The San Francisco Charter, as outlined in Section 9.113 Cash Reserves, establishes the requirements pertaining to the Cash Reserve Fund. The Charter mandates the Cash Reserve be funded at *10 percent of the current or the last preceding [property] tax levy*. The requirement resulted in a FY 2000-01 Cash Reserve of \$93.29 million.³ The proposed \$37.06 million reduction in reserves, outlined above in Chart G, keeps in place the portion the Cash Reserve based on the property tax levies of the General Fund, the Children's Fund, the Library Fund, and the Open Space Fund. The Mayor's proposed budget is predicated upon the Cash Reserve requirement no longer being based on the remainder of the property tax levy. This means that, hereafter, the calculation will exclude property tax levies pertaining to voter-approved debt overrides, the Educational Revenue Augmentation Fund (ERAF), Bay Area Rapid Transit (BART), Bay Area Air Quality Management District (BAAQMD), San Francisco Unified School District (SFUSD) and San Francisco Community College District (SFCCD)).

City Investment Reserve: The Mayor's proposed budget uses the remaining \$5.09 million of the \$15 million Investment Reserve established in the FY 1998-99 budget. This reserve was established to guard against economic downturns and to be used for investment in cost-saving initiatives. The Mayor budget proposes to use this \$5.09 million to, in part, fund the \$20.00 million State Revenue Stabilization Reserve.

Recreation & Parks' Proposition C Reserve: The Mayor's proposed budget includes the use of the projected \$3.50 million in Park & Recreation expenditure savings outlined in the 9-Month Report. Under Section 16.107 of the San Francisco Charter, Proposition C reserves must be retained by the Recreation & Parks Department and be dedicated to one-time expenditures. The Mayor's proposed budget includes \$3.50 million in expenditures for capital, technology and equipment.

Budget Incentive Reserve: Administrative Code Section 3.17 requires that 10 percent of departments' year-end balances be set aside in a savings incentive account to be used only to *reduce the cost of service delivery and make departmental activities more efficient*. The Mayor's proposed budget uses the projected balance of \$2.22 million for technology and equipment upgrades.

Other Reserves. The Mayor's budget proposes to reappropriate other reserved funds totaling \$1.38 million for general reserve purposes. This was used, in part, to fund the \$20.00 million State Revenue Stabilization Reserve.

³ The Cash Reserve is one of the categories of reserved fund balance. For additional information please see the FY 2001-02 Comprehensive Annual Financial Report (CAFR), pages 21, 47 and 56.

Changes Since The Mayor's Proposed Budget Was Submitted

As technical adjustments are introduced, my office will summarize the impact for the Mayor and the Board of Supervisors.

State Budget Estimates

The City's budget includes funding from the State for a number of City programs. At this time, the State's budget is still pending before the Legislature budget conference committee, and is subject to revision as well as line-item veto by the Governor.

The Governor's FY 2001-02 May Revise is projected to have a significant impact on the local programs. In light of this pending uncertainty, a \$20.00 million State Revenue Stabilization Reserve was included in the Mayor's Proposed Budget.⁴

Until the State Legislature passes the budget and the Governor signs it, these and other provisions of the State budget are still subject to change. State allocation estimates change frequently and may even differ based on which organization is providing the estimate. We recognize that some revenue allocations from the State may change due to revised economic forecasts or based on budget negotiations in Sacramento. As additional information becomes available, and as we are able to verify state revenue allocations, we will advise the Board of those changes.

II. GENERAL FUND SUBSIDIZED DEPARTMENTS

Several departments, in addition to receiving General Fund support, have revenue sources specific to their functions. Departments with significant non-General Fund revenues include the Department of Public Health, which operates the city's two hospitals, San Francisco General Hospital (SFGH) and Laguna Honda Hospital (LHH); and the Department of Human Services. Increases or decreases in their revenue sources may directly affect the General Fund support to these departments. Revenue projections were developed individually by the departments and reviewed by the Controller's Office for reasonableness. These departments' sources of funds are discussed below.

PUBLIC HEALTH

The Department of Public Health, which consists of both the Community Health Network Division and the Public Health Division, has total budget sources of funds of \$1,037.76 million in FY 2002-03 and is projected to receive \$665.53 million in non-General Fund sources, primarily from federal and state sources.

⁴ Page 119 in the proposed Annual Appropriation Ordinance.

Chart H: Public Health’s Sources of Funds

Sources of Funds	FY2001-02 Revised Budget	FY2002-03 Proposed Budget	Increase / (Decrease)	% Increase / (Decrease)
Patient Revenues	\$ 388,452,001	\$ 420,563,468	\$ 32,111,467	8.3%
General Fund Support	306,808,794	286,512,536	(20,296,258)	-6.6%
State Intergovernmental	242,805,309	246,560,925	3,755,616	1.5%
Health & Welfare Realignment-MVL	70,410,438	76,510,438	6,100,000	8.7%
Health & Welfare Realignment-Sales Tax	69,298,054	68,498,054	(800,000)	-1.2%
Short-Doyle MediCAL	36,540,066	44,273,820	7,733,754	21.2%
State Alcohol Funds	22,895,125	19,632,217	(3,262,908)	-14.3%
Community Mental Health	10,945,717	11,712,684	766,967	7.0%
Prop 99 - Tobacco Tax	5,525,879	5,476,676	(49,203)	-0.9%
Other State	27,190,030	20,457,036	(6,732,994)	-24.8%
Federal Intergovernmental	57,316,871	79,464,187	22,147,316	38.6%
Fund Balance	29,646,297	48,011,650	18,365,353	61.9%
Other Revenue	40,543,456	39,571,852	(971,604)	-2.4%
Service Charges	15,162,652	15,295,104	132,452	0.9%
Departmental Transfer Adjustment	(98,224,658)	(98,224,658)	-	0.0%
Total Sources of Funds	\$ 982,510,722	\$ 1,037,755,064	\$ 55,244,342	5.6%

Overall, public health revenues are projected to increase by approximately \$55.24 million in FY 2002-03 over the FY 2001-02 revised budget. Federal revenue is \$22.15 million higher than the FY 2001-02 revised budget due to increased Federal Grants and the reclassification of Federal Grants passed through the State that were previously classified as State Grants. State revenues are \$3.76 million higher than FY 2001-02 due to increases in allocations for Mental Health, California Children’s Services, and State Health & Welfare Realignment dollars. These increases are counterbalanced by reductions in allocations for Substance Abuse and the reclassification of Federal Grants passed through the State. Patient Revenues are \$32.11 million higher in FY 2002-03 due to increased revenues related to volume at San Francisco General Hospital, increased reimbursement for the Community Health Centers, and increased reimbursement for skilled nursing services at Laguna Honda Hospital. The use of the Fund Balance has increased by \$18.37 million due to an increase in seismic funds for capital projects and increased Tobacco Settlement funds for the rebuilding of Laguna Honda Hospital. General Fund support to the two Health Department divisions is projected to decrease by \$20.30 million in the FY 2002-03 proposed budget.

HUMAN SERVICES

The Department of Human Services has a total budget of \$476.64 million in the Mayor’s FY 2002-03 proposed budget. This includes a \$8.36 million increase in General Fund Support to the department. Most Human Service sources of funding comes from the Federal and State

governments. The department's sources of funds are used to fund programs including child care and Children's Services, Foster Care, Adoption Assistance, California Work Opportunities and Responsibility to Kids (CalWORKs), County Adult Assistance Programs, Food Stamps, Medi-Cal, In-Home Support Services (IHSS), Housing and Homeless Services, Temporary Assistance for Needy Families (TANF), and other public assistance. Chart I summarizes Human Service's sources of funds.

The increasing sources of funding (including General Fund support) are related to expected increases in aid costs for the County Adult Assistance Program, In-Home Support Services, Foster Care, CalWORKs, and Adoption Assistance. Federal and State Aid revenues are projected to increase by \$14.43 million for the same reason. The \$1.53 million increase in Federal and State operating revenues is primarily due to an \$8 million expected increase in State closeout disbursements for San Francisco originating from remaining FY 2000-01 county welfare program allocations; however, this is offset by a reductions in availability of TANF incentive revenues and other federal and state allocation reductions and adjustments, leaving the \$1.53 million net increase. The \$1.43 million increase in State Health and Welfare Realignment is due to anticipated increases in the department's allocation.

Other changes in sources of funding include the \$5.75 million increase in Interdepartmental Recovery, which is due to transfers from the Department of Children, Youth and Families to fund childcare programs, an agreement with the Department of Aging and Adult Programs to reimburse the Human Services Department for overhead costs associated with supporting the Adult Protective Services program, and a new effort to obtain Medi-Cal Targeted Case Management revenues from the Department of Public Health.

Chart I: Human Services' Sources of Funds

Sources of Funds	FY 2001-02 Revised Budget	FY 2002-03 Proposed Budget	Increase / (Decrease)	% Increase / (Decrease)
Federal & State Operating	\$ 183,527	\$ 185,055	\$ 1,528	0.8%
Federal & State Aid	86,965	101,396	14,431	16.6%
State Health & Welfare Realignment	41,439	42,868	1,429	3.4%
Subtotal Federal & State	311,931	329,319	17,388	5.6%
Interdepartmental Recovery	3,278	9,029	5,750	175.4%
Other Revenue	-	330	330	n/a
Total Non-GF Support Sources	\$ 315,209	\$ 338,678	\$ 23,468	7.4%
General Fund Support	129,601	137,960	8,360	6.5%
Total Sources of Funds	\$ 444,810	\$ 476,638	\$ 31,828	7.2%

III. BASELINES

The Mayor's FY 2002-03 proposed budget includes four baselines. Three of the four, including the Children's Baseline, the Library Baseline and the Municipal Railway Baseline, have been included in prior years. FY 2002-03 will include, for the first time, a Parking & Traffic Baseline. Chart J identifies the minimum funding level (required baseline funding) for each baseline based on projected aggregate City discretionary revenues.

Chart J: Baselines
 (thousands)

Baseline	FY 2002-03 Required Baseline	FY 2002-03 Mayor's Proposed	Surplus / (Shortfall) Contribution
Children	\$ 68,595	\$ 74,909	\$ 6,314
Library	\$ 29,101	\$ 29,101	\$ -
MTA - Municipal Railway	\$ 100,792	\$ 100,792	\$ -
MTA - Parking & Traffic	\$ 36,341	\$ 36,341	\$ -
	\$ 234,829	\$ 241,143	\$ 6,314

CHILDREN'S BASELINE

The Mayor's FY 2002-03 proposed budget includes a Children's Baseline funding at \$74.91 million. This is \$6.31 million greater than the \$68.60 million required baseline. Proposition D, adopted by the voters on November 7, 2000, amended Charter Section 16.108 and required the City to maintain a baseline level of appropriation for children's services at no less than the level of City appropriations budgeted in Fiscal Year 2000-01. The original Charter Section 16.108 (established by Proposition J in 1991) required the Controller's Office to establish the Children's Baseline on FY 1991-92 appropriations. In addition to designating FY 2000-01 as the new base year, Proposition D slightly broadens the criteria for the inclusion of City appropriations in the children's baseline. In addition to the \$74.91 million, the Mayor's FY 2002-03 proposed budget includes \$4.13 million in prior year surpluses to fund children's programs.

LIBRARY BASELINE

The Mayor's FY 2002-03 proposed budget includes Library Baseline funding at \$29.10 million. The Charter specifies that the Library Preservation Fund shall receive at least a minimum level of funding (required baseline) from the General Fund (Section 16.109). This minimum funding level is adjusted by any change in aggregate city appropriations from the base year. As a result, as General Fund revenues increase, the minimum baseline funding level for the Library Preservation Fund also increases.

MUNICIPAL TRANSPORTATION BASELINES

Charter section 8A.105 established a Municipal Transportation Fund to provide a predictable, stable and adequate level of funding for the Municipal Transportation Agency. Consistent with the Charter, in FY 2000-01 a Base Amount of funding was established. Charter subsection (c)(1) requires the Controller's Office to adjust the Base Amount from year to year by the percent increase or decrease in aggregate City discretionary revenues. Beginning in FY 2002-03, this Charter section also establishes a level of funding (required baseline) for the Parking and Traffic Commission based upon FY 2001-02 appropriations.

IV. SELF-SUPPORTING ENTERPRISE DEPARTMENTS

Enterprise departments such as Airport, Hetch Hetchy, Water, Clean Water, and the Port are supported by user fees and are generally not supported by the City's General Fund. As is summarized in Chart K, total enterprise sources of funds are projected to decrease by \$298.93 million. Operating revenues are projected to decline for all five of these enterprise funds as well. The underlying assumptions of the Mayor's FY 2002-03 proposed budget for these departments are highlighted in the narrative following Chart K.

Chart K: Enterprise Sources of Funds

<u>Enterprise</u>	<u>FY 2000-01 Actual</u>	<u>FY2001-02 Revised Budget</u>	<u>FY2002-03 Proposed Budget</u>	<u>Increase / (Decrease)</u>	<u>% Increase / (Decrease)</u>
Airport Commission					
Operating Revenues	\$ 446,981,507	\$ 646,895,613	\$ 618,718,512	(28,177,101)	-4.4%
Other Sources [^]	19,457,662	(18,176,632)	(35,218,048)	(17,041,416)	93.8%
Subtotal	\$ 466,439,169	\$ 628,718,981	\$ 583,500,464	\$ (45,218,517)	-7.2%
Hetch Hetchy					
Operating Revenues	124,639,204	137,617,130	127,753,474	(9,863,656)	-7.2%
Other Sources [^]	79,734,625	93,745,873	92,080,164	(1,665,709)	-1.8%
Subtotal	\$ 204,373,829	\$ 231,363,003	\$ 219,833,638	\$ (11,529,365)	-5.0%
Water Department					
Operating Revenues	224,637,546	244,443,436	170,751,012	(73,692,424)	-30.1%
Other Sources [^]	(2,883,561)	119,605,244	6,049,990	(113,555,254)	-94.9%
Subtotal	\$ 221,753,985	\$ 364,048,680	\$ 176,801,002	\$ (187,247,678)	-51.4%
Clean Water					
Operating Revenues	150,738,841	153,309,000	141,622,882	(11,686,118)	-7.6%
Other Sources [^]	11,613,119	27,664,369	17,895,222	(9,769,147)	-35.3%
Subtotal	\$ 162,351,960	\$ 180,973,369	\$ 159,518,104	\$ (21,455,265)	-11.9%
Port					
Operating Revenues	50,645,879	50,516,000	49,172,500	(1,343,500)	-2.7%
Other Sources [^]	9,437,329	38,537,029	6,402,566	(32,134,463)	-83.4%
Subtotal	\$ 60,083,208	\$ 89,053,029	\$ 55,575,066	\$ (33,477,963)	-37.6%
TOTAL	\$1,115,002,151	\$1,494,157,062	\$1,195,228,274	(\$298,928,788)	-20.0%

[^] Other Sources may include Expenditure Recovery, Fund Balance, Departmental Transfer Adjustment, and General Fund Support. A detailed breakdown of these items is provided in the Mayor's FY 2002-03 Proposed Budget Book.

AIRPORT

The Airport's budget includes \$45.22 million less in total sources of funds. Key changes in the Airports sources of funds include a \$28.18 million reduction in operating revenues principally attributed to weakness in parking, concessions, rental fees and passenger transportation-related revenues. The single largest decline is due to weakness in parking garage, lot and permit revenues, which is projected to be \$53.50 million, i.e. \$28.59 million less than the \$82.09 million FY 2001-02 budget. Other operating revenue increases and decreases are largely offsetting. However, concession revenue, which drives the transfer into the General Fund, is projected to grow 18.9 percent from the projected FY 2001-02 year-end level. Even with this growth, the Mayor's FY 2002-03 proposed budget shows concession revenue approximately 25 percent under what was budgeted in FY 2001-02. This is explained by the economic slowdown and traffic declines, followed by the assumed gradual recovery in passenger traffic and the impact of the new federal regulation that limit only ticketed passengers past security checkpoints. Additionally, the \$17.04 million reduction in other sources is due to greater use of fund balance being budgeted in FY 2001-02 as compared to that of the FY 2002-03 proposed budget.

The Airport publishes their *Airport Rates and Charges* manual each year. This manual includes all major revenue assumptions used in the creation of their proposed budget and is developed in collaboration with John F. Brown Company and staff of the San Francisco International Airport. The key assumptions used in developing the Mayor's FY 2002-03 proposed budget are summarized on pages 22 to 23 of the manual. The major assumption pertaining to air traffic is enplaned passengers. The Mayor's FY 2002-03 proposed budget projects enplaned passenger growth of 13.8 percent (14.7 percent for domestic and 10.7 percent for international). This compares to projected FY 2001-02 enplaned passenger growth of -22.2 percent (-23.8 percent for domestic and -16.1 percent for international).

HETCH HETCHY

Hetch Hetchy's budget includes \$11.53 million less in total sources of funds. Operating revenues, specifically electricity/power sales revenue, are projected to decrease \$9.86 million. Additionally, the \$1.67 million decrease in other sources is due to a decline in recoveries principally offset by greater use of fund balance. As was the case in FY 2001-02, the FY 2002-03 budget does not include a transfer from the power utility to the General Fund. In FY 2000-01 the transfer had been \$29.9 million.

Revenues are generated from the sale of power to city departments (General Fund and Enterprise), the Modesto Irrigation and Turloch Irrigation Districts and excess power sold to the Western States Power Pool (WSPP). Hetch Hetchy charges its customers in accordance with existing rate policies and contractual requirements. Rates are based on comparable PG&E rates to city enterprises and a flat rate of \$0.0375/kwh to general fund operations. Power consumption for existing service is not expected to grow much over the next few years because of energy conservation. Hetch Hetchy's customer and revenue base will grow mainly by new projects the City is planning, including for example the Municipal Railway 3rd street project.

WATER

The Water Department's FY 2002-03 proposed budget is \$187.25 million less in total sources of funds than the FY 2001-02 budget. The operating revenues reflect increasing water rates (up 8.6 percent), a decrease in anticipated interest earning due to lower rates and cash balances, as well as a decrease in amount of new debt proceeds. Additionally, the \$113.56 million reduction in other sources is due to greater use of fund balance in FY 2001-02 as compared to the FY 2002-03 proposed budget. The FY 2001-02 budget included significant capital project appropriations, which were supported through new debt proceeds and the use of fund balance.

The Public Utilities Commission recommended to the Board of Supervisors that retail water rates be increased 8.6 percent effective July 1, 2002. If adopted, the recommended rate adjustment is projected to increase revenues from retail water sales by \$6.13 million. The Public Utilities Commission determined that no change in the rate applicable to suburban resale water sales was required for the FY 2002-03 period.⁵ The Mayor's FY 2002-03 proposed budget includes the 8.6 percent rate increase, as well as a projected increase in retail water usage of 0.5 percent and an increase in suburban resale usage of 1.0 percent. Historically, retail water usage has varied from an increase of 1.9 percent to a decrease of 0.1 percent annually but has averaged 0.3 percent over the past five years. Suburban resale water usage has shown considerable variation. Annual changes in suburban water sales have ranged from a decrease of 7.2 percent to an increase of 6.5 percent. In general, suburban customers use more water for landscape irrigation than do urban customers, and suburban resale water sales are more sensitive to changes in temperature and rainfall.

CLEAN WATER

Clean Water's budget includes \$21.46 million less in total sources of funds. Clean Water's operating revenues reflect an \$11.69 million reduction from FY 2001-02 budget due to lower estimated sewer service charge revenues (as usage was over estimated in the FY 2001-02 budget) and reduced interest income due to lower fund balance and interest yields. Additionally, other sources of funds reflect a \$9.77 million reduction from FY 2001-02 due principally to greater use of fund balance in FY 2001-02 as compared to the FY 2002-03 proposed budget.

No sewer service charge rate increase is assumed in the Mayor's FY 2002-03 proposed budget. Proposition H, approved by the voters in 1998, allows rate increases to pay the debt service on voter-approved bonds and to fund the costs of emergencies declared by the Mayor pursuant to Charter Section 3.100. Although the FY 2002-03 proposed budget shows an operating revenue shortfall, the shortfall is not the result of additional debt service on bonds or a declaration of emergency. Consequently, no rate adjustment is proposed in the FY 2002-03 budget year, and the budget is balanced with available fund balance.

Sewer service charges are assessed on the basis of water use. It is assumed that 90 percent of the volume of water measured at the customer meter is returned to sewerage system as sanitary wastes. Customers who can demonstrate a higher rate of consumptive uses can apply for a lower

⁵ The water utility's current schedule of retail rates was adopted by the Commission on May 8, 2001 and became effective with water bills rendered on or after July 1, 2001. The current schedule of rates for residential, commercial and industrial service has a monthly service charge based on meter size and a two-tiered volume charge.

flow factor (i.e. percentage of metered water returned to the sewerage system). Clean Water's sewer service charge revenues are based on projected water use growing at a 0.5 percent annual rate. Contributed wastewater volumes are projected to grow at the same 0.5 percent rate.

The existing schedules of rates include rates applicable to residential, commercial and industrial dischargers. The FY 2002-03 proposed budget includes sewer service charges for commercial and residential customers of \$138.33 million, compared to the \$147.67 million included in the FY 2001-02 budget, a 6.3 percent decline. The decline pertains to the FY 2001-02 budget being based on over estimated usage. The Clean Water Enterprise also earns interest income from the investment of available funds by the City Treasurer, projected to be \$2.87 million in FY 2002-03. Other operating income also includes property rentals, which includes Clean Water's rental activity for the use of the Southeast Community Center where the rental charge is intended to recover the costs of support services provided at the facility. Total projected rental revenue charged at the Southeast Community Facility and other Enterprise properties is projected to be \$0.43 million.

PORT

The Port's budget includes \$33.48 million less in total sources of funds. The Port's operating revenues are projected to decline \$1.34 million or 2.7 percent. Operating revenues are projected to be lower due to reduced activity in the following areas: permits, interest income, negotiation fees, commercial rent, parking, ship repair, fishing and marine services, and filming and special events fees. These reductions are partially offset by strength in cargo, cruise and harbor service revenues. Additionally, other sources of funds reflect a \$32.13 million reduction from FY 2001-02 due principally to greater use of fund balance in FY 2001-02 as compared to the FY 2002-03 proposed budget.

Commercial Property. The leasing of Port facilities continues to generate the majority of its operating revenues. While there has been a significant downturn in the San Francisco commercial real estate market, with commercial vacancy rates increasing, demand for space along the waterfront has only been moderately affected. This downturn has been primarily limited to demand for the Port's commercial office space; demand for its warehouse and industrial space has remained strong. The Port has, however, seen a marked decrease in its percentage lease income. Percentage leases, unlike fixed leases, are based in part upon the tenant's revenue, and is a common component of our agreements with its retail business tenants. The decrease is not surprising in light of the softening economy and significant decrease in the tourist business throughout San Francisco.

Maritime. The Port is working to expand its maritime business in both cargo and cruise. They have secured a home port vessel from Princess Cruise lines for the 2002 season and project an increase in traffic of 20,000 passengers over the 2001 season. While the Port has been successful in increasing the number of cruise calls for next year, cargo continues to be a tough market given the regional competition. With the Port of Oakland opening a new terminal and the continued consolidation of the commercial shipping industry, the Port has seen erosion in its containerized cargo volume. Fortunately, this loss in container business has been offset by growth in the break-bulk and bulk commodity cargo.

V. CONTROLLER'S RESERVES

Occasionally, departments will include a revenue source where some additional action is required in order to secure the revenues. In those cases, the Controller will reserve expenditures equal to revenues until the required action is taken and the revenues are secured. In the Mayor's FY 2002-03 proposed budget, the Controller has reserved \$3.59 million in expenditures. Chart L lists those reserves and the action required for the department to expend funds that are supported by the proposed revenue.

Chart L: Controller's Reserves

Department	Reserve	Explanation for Reserve and Required Action
Public Health	\$ 2,782,168	Laguna Honda Hospital Improvement, subject to available capital project proceeds
General Government	\$ 411,902	Computer Store Oversight, subject to revenue performance
Juvenile Probation	\$ 400,000	Title 4E Program, subject to realized grant proceeds
Total	<u>\$ 3,594,070</u>	

The Mayor's FY 2002-03 proposed budget reflects all labor contracts that have been passed by the Board of Supervisors. No outstanding labor contract costs are set-aside in reserves in the FY 2002-03 proposed budget as there are no outstanding labor negotiations for FY 2002-03. Negotiated MOU costs are reflected in department budgets.

In preparing this report, the Controller's Office has attempted to conduct a thorough review of budgeted revenues. As additional information becomes available, and as we are able to verify state revenue allocations, we will advise the Board of those changes. If you have any questions or concerns regarding the information presented in this report please feel free to contact me or Peg Stevenson, Acting Chief Assistant Controller at (415) 554-7522.

Sincerely,

EDWARD HARRINGTON
Controller

cc: Mayor Willie L. Brown, Jr.
Ben Rosenfield, Mayor's Budget Office
Harvey Rose, Board of Supervisors Budget Analyst