



Edward Harrington
Controller

Matthew Hymel
Chief Assistant Controller

June 20, 2000

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 2000-01 Budget (*Revenue Letter*)

Dear Members of the Board:

The Controller's Office has prepared a review of the Mayor's proposed budget for fiscal year 2000-01. This letter addresses the following issues:

- Provides an analysis of budgeted revenues and expresses the Controller's opinion that the Mayor's revenue estimates for the General Fund and General Fund-supported departments are reasonable;
- Presents our findings of the required baselines for Children's and Library funds and shows the budget exceeds those requirements;
- Discloses the new baseline requirement for the Municipal Transportation Agency and indicates that the Agency has balanced its own budget within the definition of Proposition E, which means that the Board of Supervisors cannot modify that budget, but can only reject it by a two-thirds vote, should the Board so desire; and
- Indicates that several items have arisen since the Mayor proposed his budget on June 1 that could affect the amount of revenues in the budget. However, until the state budget is completed we cannot certify that additional funds will be available over and above what is contained in the budget.

The Controller's discussion of the Mayor's proposed budget is organized as follows:

- I. General Fund Revenues
- II. General Fund Subsidized Departments
- III. Municipal Transportation Agency Base Budget
- IV. Baseline Contributions
- V. Self-Supporting Enterprise Departments
- VI. Controller's Reserves



I. GENERAL FUND REVENUES

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 proposed 2000-01 budget revenue estimates. **In my opinion, the proposed revenue estimates contained in the Mayor's 2000-01 budget are based on a reasonable assumption of moderate economic growth.** For the \$1.3 billion in General Fund revenues, the projected growth rates generally range from 4.0% to 7.5%.

The General Fund revenue estimates are based on the three-year budget projection developed jointly by the Mayor's Budget Office, the Controller's Office, and the Board of Supervisors Budget Analyst, as updated by the Controller's nine-month report and other information. The Controller's nine-month report provides year-end estimates of General Fund revenues for 1999-2000. These amounts are combined with the projected growth rates from the three-year budget projection to determine the revenue estimates for the 2000-01 budget. Growth rates were developed in consultation with economic advisors of the Municipal Fiscal Advisory Committee.

Chart A presents historical and projected estimates for major General Fund revenue sources. These revenue sources represent the city's discretionary revenue base of approximately \$1.3 billion. In general, the city has experienced strong growth in most general city revenues, with total growth of 6.9% and 8.1% in the past two years, respectively. Overall, in the 2000-01 budget these General Fund revenue sources are projected to increase 4.6% over the current year-end revenues. Without the projected decrease in the property transfer tax, the growth in General Fund revenues would be 5.3%.

Discussion of Budget Estimates for Major Revenues

Property tax estimates are based in part on the Assessor's projected tax roll for 2000-01. According to the Assessor's estimates, the tax roll will increase by 9.0% from the 1999-2000 roll to the 2000-01 roll. For purposes of projecting the General Fund portion of property taxes, we take several other factors into consideration as well. First, some of the increase in the Assessor's tax roll is already reflected in the 1999-2000 year-end revenue projection, due to mid-year reassessments and other transactions. As a result, the percentage increase in property tax revenues in 2000-01 is less than the percentage increase in the value of the tax roll. In addition, we factor in likely appeals, reassessments, and major property transactions. Finally, we take into account changes in the allocation of the property tax to other non-General Fund departments. Overall, the General Fund share of property taxes is projected to increase by 6.8% over 1999-2000 year-end estimates.

Business taxes are projected to increase by 4.2% in the budget year after adjustments. Payroll and gross receipts activities are projected to increase by 6.0%, reflecting continuing growth in business and employment in San Francisco. Revenues from the business license fee are projected to remain constant at \$10.1 million. However, because business taxes in the current year (1999-2000) are very likely to increase by more than 7.5% over prior year revenues, businesses will once again be entitled to the surplus business tax credit of \$500 each. As a result, we have factored the estimated \$4.0 million credit into the revenue projection for 2000-01.

Sales tax receipts have continued to increase in the current year, and at a faster rate than in the past several years. For fiscal year 2000-01, we are increasing the projected growth rate to 5.0%.

Utility users tax receipts have been relatively flat over the last three years. While some utility taxes are increasing (primarily telephone services) others are declining, particularly gas and electric utilities. Further, deregulation in the electric utility industry is likely to affect tax revenues. As a result, we are projecting little change in utility taxes for 2000-01.

Real property transfer tax revenues have increased substantially in the last five years, as illustrated in the table below. These increases are due to higher property values, a large volume of sales transactions, and the sale of several large commercial properties. Because of the uncertainty and fluctuation in real estate transactions, the projection for the 2000-01 budget is based on the average revenues for the past three years, after adjusting for extraordinary transactions.

Chart B: Real Property Transfer Tax Revenues
(figures in thousands of dollars)

<u>Fiscal Year</u>	<u>Revenues</u>	<u>% Change</u>
1995-96	\$22,968	---
1996-97	33,573	46.2%
1997-98	44,007	31.1%
1998-99	56,133	27.6%
1999-00 (est.)	59,039	5.2%

Hotel taxes have shown significant growth in the past three years, reflecting higher occupancy rates and higher room prices. The rate of growth, however, has slowed in the last year, reflecting natural limits such as short-term capacity constraints. We project that hotel tax receipts will increase by 4.8% in 2000-01. Because a portion of the hotel tax is designated for specific purposes, as specified by ordinance, the unallocated portion of hotel tax revenues that is available to the General Fund is \$93.1 million.

Parking tax revenues have increased over the past two years due to continuing strong economic activity and enhanced enforcement activity. In 2000-01, we project continued growth of 6.4% in receipts. The amount in Chart A reflects only the portion of parking tax revenues that remains in the General Fund; the Municipal Transportation Agency and the Commission on Aging also receive a portion of parking tax revenues.

Public safety sales tax (Proposition 172) is expected to grow at the same rate as statewide sales, which is projected to be 5.0%.

Motor vehicle in lieu subventions are experiencing substantial growth in the current fiscal year because of a boom in vehicle sales and registration. We expect these revenues to increase at a rate of 7.5% in the 2000-01 fiscal year, based on information from the State Board of Equalization.

Current Year-End Surplus

Each year, the budget includes the city's estimated year-end surplus from the prior year as a source of revenues. The final reconciliation of the 1999-2000 year-end surplus won't be known until the independent audit is completed in the fall. As a result, the Mayor and the Board of Supervisors must rely on an estimate of the available surplus. In a budget of more than \$4.2 billion, there are many things that can change on a daily basis that will affect the surplus estimate. Generally, the Mayor's Office relies on the Controller's nine-month report for the projected value of the surplus. At the same time, the Controller's Office advises the Mayor and the Board of significant changes since that report was published in May so that any new information can be factored into the budget process. The estimate of the 1999-2000 year-end surplus, and changes in that estimate, are described in greater detail below.

Mayor's budget assumed \$116.1 million surplus. The proposed budget includes a projected current year surplus of \$116.1 million. The Controller's nine-month report initially estimated the year-end surplus for 1999-2000 at \$113.7 million. Subsequent to the publication of that report, we identified an additional \$2.4 million in state realignment revenues that will be allocated to the city by year-end, for a total year-end surplus of \$116.1 million.

As noted in the Controller's nine-month report, the 1999-2000 year-end surplus is a result of three factors. First, prior year (1998-99) actual revenues were higher than projected, increasing the balance available at the beginning of the current year (1999-2000). Second, current year revenues continue to be strong, and are projected to be \$90 million higher than originally budgeted. Third, current year expenditures are somewhat lower than budgeted. The resulting year-end balance of \$116.1 million will be carried forward into the 2000-01 budget.

Changes since the Mayor's budget was submitted. For your information, we reviewed the year-end projections of major General Fund revenues for significant changes since the Mayor's budget was completed. We identified three changes of significance that could affect the projected year-end surplus and revenues in the 2000-01 budget.

First, in the month of May the Assessor's Office recorded property transfer tax payments of \$5.4 million on four large transactions primarily in the South-of-Market area. These payments, together with continued strong real estate activity, lead us to increase our year-end projection for property transfer taxes by \$8.0 million. We have not, however, factored the anticipated increase in year-end revenues into the projection for the 2000-01 budget. As illustrated in Chart B, the rate of growth in real property transfer tax revenues has decreased in the last few years. Given higher interest rates and the recent cooling off in housing sales, we are reluctant to project continued growth in property transfer tax revenues.

Second, the City Attorney's Office has advised us that we owe refunds of business tax payments based on a court ruling in the General Motors II case, in which the city's gross receipts tax as it was structured prior to 1997 was found to be unconstitutional. According to records from the Tax Collector's Office, the amount of the refunds from 1995 and 1996 (the two tax years in question) is \$2.1, which would reduce projected business tax receipts for 1999-2000.

Third, a portion of the city's property taxes is based on the state Board of Equalization's assessment roll for utility properties. On May 30, the Board of Equalization voted to change the methodology for determining the value of utility properties. The effect of this change could reduce utility property taxes by \$24 million state-wide in 2000-01. While the Board of Equalization is still determining the allocation of the revised property values to local governments, the loss to San Francisco's General Fund could be \$2.1 million. This potential adjustment is not yet reflected in the projected property tax estimates for 2000-01.

State Budget Estimates

The city's budget includes funding from the state for a number of new and existing programs. At this time, the state's budget is still pending before the legislature, and is subject to revision or line-item veto by the governor. Nevertheless, two significant items have changed since the Mayor's budget was submitted on June 1; both changes are reflected in the Mayor's technical corrections submitted to the Board.

In 1999-2000, the state budget included \$150 million in so-called "local government relief" (AB1661). San Francisco received \$5.0 million using the state's allocation formula that was based on population and the amount of local property taxes transferred to schools under the Educational Revenue Augmentation Fund (ERAF). At the time the Mayor's budget was prepared, the governor had earmarked \$250 million for local government relief using the same formula as AB1661. As a result, the Mayor's Budget Office estimated that the city would receive \$8.3 million in 2000-01. Now, however, the budget before the legislature includes only \$200 million for local government relief, and may change the allocation formula to be based on population only. Under these new terms, San Francisco would receive \$6.0 million, a reduction of \$2.3 million from the original budget estimate. This revenue reduction is reflected in the Mayor's technical corrections to the 2000-01 budget.

The state budget also includes a provision that would increase Medi-Cal reimbursement levels for the city's hospitals by approximately \$10.2 million, of which \$4.8 million was recognized in the Mayor's June 1 budget. A portion of the increase would be dedicated to increase the salaries of nurses at Laguna Honda. Given provisions of the recent labor negotiations with nurses, the city will pass through this dedicated revenue to nurses in the form of a premium. The Mayor's technical corrections include an increase in the salary reserve to cover this anticipated expense. The remaining \$5.4 million is a one-time allocation from the state to compensate for frozen reimbursement rates over the last several years, and has also been included in the Mayor's technical corrections. The one-time funding of \$5.4 million was added by the legislature but was not part of the governor's May budget proposal; as such, it is potentially subject to veto by the governor.

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. We recognize that some allocations may be increased while others may be reduced, depending on final 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 and Laguna Honda; 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' non-General Fund revenue sources are presented below.

Public Health

The Department of Public Health, which consists of both the Community Health Network Division and the Public Health Division, has a total budget of \$860.2 million in 2000-01 and expects to receive more than \$612.5 million in non-General Fund revenues, primarily from federal and state sources. In the past two years, the department suffered serious erosion in its revenue base, primarily as a result of reductions in reimbursements and an increase in indigent and uninsured cases. As a result, the department is projecting almost no change in revenues from non-General Fund sources, as illustrated in Chart C.

Chart C: Health Department Revenue Sources
 (figures in thousands of dollars)

<u>Revenue Source</u>	<u>FY1999-2000 Budget</u>	<u>FY2000-01 Budget</u>	<u>FY2000-01 v. FY1999-2000</u>
Federal Intergovernmental	\$55,987	\$57,246	\$1,259
State Intergovernmental	216,245	218,545	2,300
Service Charges	21,467	15,425	(6,042)
Patient Revenues	277,283	279,856	2,573
Other Revenue	36,271	41,458	5,187
General Fund Support	<u>229,468</u>	<u>247,668</u>	<u>18,200</u>
Total Revenues	<u><u>\$836,721</u></u>	<u><u>\$860,198</u></u>	<u><u>\$23,477</u></u>

The General Fund support to the two Health Department divisions is projected to increase by \$18.2 million in the 2000-01 budget. In addition, funds will be transferred to the Health Department from the General Fund salary reserve once all remaining contract negotiations are completed and the value of the agreements has been calculated. As a result, while other revenue sources remain relatively flat, the General Fund will absorb much of the salary and other increases in the Health Department's budget.

Human Services

The Department of Human Services expects to receive more than \$319 million in non-General Fund revenues in 2000-01, primarily federal and state funding for specified programs, as illustrated in Chart D. These programs include child care and children's services, foster care, adult services, food stamps, temporary assistance for needy families (TANF), in-home supportive services (IHSS), California Work Opportunities and Responsibility to Kids (CalWORKs), Medi-Cal, Cash Assistance Program to Indigents (CAPI), and other public assistance.

Chart D: Department of Human Services Revenue Sources
 (figures in thousands of dollars)

<u>Revenue Source</u>	<u>FY1999-2000 Budget</u>	<u>FY2000-01 Budget</u>	<u>FY2000-01 v. FY1999-2000</u>
State Intergovernmental	\$33,300	\$37,568	\$4,268
Federal Administrative	66,197	79,957	13,760
Federal Aid	56,489	50,151	(6,338)
State Administrative	82,386	95,500	13,114
State Aid	41,701	52,363	10,662
Other Revenue	4,614	3,909	(705)
General Fund Support	120,942	115,280	(5,662)
Total Revenues	\$405,629	\$434,728	\$29,099

The department's non-General Fund revenues are projected to increase by nearly \$35 million in 2000-01. In particular, the department anticipates receiving an additional \$21.2 million for its Welfare-to-Work program and \$10.6 million for CAPI. At the same time, the department is anticipating receiving \$6.5 million less for the CalWORKs program because of a decrease in caseload. Actual program funding is expenditure driven, so 2000-01 receipts will be dependent on program expenditures. With the exception of \$20.2 million (which is being placed on reserve), these revenue projections are supported by allocation letters from the granting federal or state agency.

The department's expenditures for General Fund supported programs are anticipated to decrease by nearly \$5.7 million in the 2000-01 budget. This reduction reflects a continuing decline in the city's general assistance program (CAAP). The department's savings in general assistance payments are partially offset by a wage increase to childcare workers.

III. MUNICIPAL TRANSPORTATION AGENCY BASE BUDGET

In November 1999, voters approved Proposition E to create a Municipal Transportation Agency. The proposition requires the Controller's Office to determine whether the Agency has satisfied the requirements of Proposition E with respect to its annual budget submission.

Requirements for the Base Amount

The proposition specifies that beginning in fiscal year 2000-01, there would be set aside for the Municipal Transportation Fund a "base amount" no less than the amount of all of the appropriations from the General Fund, including all supplemental appropriations, for the fiscal year 1998-99 or 1999-2000, whichever is higher. The base amount would include amounts for

the Municipal Railway and other city departments providing services to the Municipal Railway. Proposition E also provides that when new parking revenues increase due to policy changes (including an increase in staffing levels), the base amount will be reduced by 50% of the increase to reduce the Municipal Transportation Agency's reliance on the General Fund.

Determination of the Base Amount

The General Fund appropriation to the Municipal Transportation Agency is \$97.3 million in the 2000-01 budget. Chart E lists the adjustments that were made to the 1999-2000 appropriation to reach the base amount. Each of the adjustments is explained below.

**Chart E: Municipal Transportation Agency Base Amount
(figures in thousands of dollars)**

<u>Item</u>	<u>Amount</u>
FY1999-2000 General Fund Support (per AAO)	\$84,433
FY99-00 Platform COLA and fringe adjustments	8,660
FY2000-01 Services of Other City Departments	5,228
FY2000-01 Adjustment for Parking Fines	<u>(1,000)</u>
FY2000-01 General Fund Support (per AAO)	<u>97,321</u>

Salary and fringe adjustments. The 1999-2000 General Fund appropriation to the Municipal Railway was \$84.4 million, as shown in the Final Consolidated Budget and Annual Appropriations Ordinance (AAO) for the fiscal year ending June 30, 2000. At the time the AAO was published, the city had not concluded negotiations with the Transport Workers Union and others. During the year, the Controller's Office calculated the additional value of the salary and fringe benefit adjustments of \$8.7 million, and this amount was transferred to the Municipal Railway's budget from the salary reserve.

Services of other city departments. Subsequent to the passage of Proposition E, the Municipal Transportation Agency worked with several departments to determine the value of services performed on behalf of the agency but budgeted directly in those departments. At this time, the agency has reached agreement with departments on the value of two service areas: the claims functions performed by the City Attorney's office and the employee relations functions performed by the Department of Human Resources. These two services are valued at \$5.2 million. The Municipal Transportation Agency is continuing to work with city departments, such as Purchasing and Health Services, to determine the value of services performed for the agency. As those negotiations are completed, the Controller will make adjustments to the Municipal Transportation Agency's base amount to reflect the full cost of the current level of services in the agency's budget.

Policy changes affecting revenues. The Parking and Traffic Commission proposes to increase the number of parking control officers to expand enforcement of neighborhood residential parking violations. The Commission estimates that this expansion will generate \$2.0 million in parking ticket revenues, which are dedicated to the Municipal Transportation Agency. As a result, we have reduced the General Fund support by 50%, or \$1.0 million.

Satisfaction of Proposition E Requirements

Based on this analysis, we conclude that the requirements of Proposition E are satisfied. The Agency has submitted a base budget that is balanced without the need for additional funds over the base amount, as identified above. Per Proposition E, the Board of Supervisors *may reject but not modify* the agency's base budget by a two-thirds' vote.

IV. BASELINE CONTRIBUTIONS

The Charter specifies that the Children's Fund and the Library Preservation Fund shall receive at least a minimum level of funding from the General Fund (Sections 16.108 and 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 expenditures increase, the minimum funding levels for the Children's Fund and the Library Preservation Fund also increase. Chart F identifies the minimum funding level (baseline) for each fund based on projected aggregate City expenditures in the 2000-01 budget and the actual funding levels in the proposed budget.

Chart F: Baseline Funding Levels
 (figures in thousands of dollars)

	<u>Required Baseline</u>	<u>Actual G.F. Contribution</u>	<u>Excess G.F. Contribution</u>
Children's Fund	\$63,742	\$65,730	\$1,988
Library Fund	28,735	29,334	599

In determining the 2000-01 baseline requirements, the Controller's Office removed Municipal Transportation Fund revenues from the calculation of "aggregate city appropriations" because these revenues are no longer discretionary under Proposition E. In making this change, we ensured that the baseline funding requirements were not reduced from the previous methodology. In the proposed 2000-01 budget, the General Fund contributions to both funds exceed the baseline requirements. The Controller's Office monitors changes to aggregate city expenditures and the corresponding impact on the baseline requirements to these two funds, and reports those changes during the course of the year to ensure that the baseline requirements are satisfied.

V. SELF-SUPPORTING ENTERPRISE DEPARTMENTS

Enterprise departments such as Water, Clean Water, Hetch Hetchy, the Port and the Airport are supported by user fees and are not supported by the City's General Fund. Overall, these enterprise revenues and expenditures are projected to increase by \$33.4 million in 2000-01, as illustrated in Chart G. The underlying assumptions of the 2000-01 proposed revenues for these departments are highlighted below.

Chart G: Enterprise Revenues
(figures in thousands of dollars)

Enterprise	FY98-99 Actual	FY1999-2000 Revised Budget	FY2000-01 Proposed Budget	FY2000-01 v. FY1999-2000
Clean Water Program	\$227,838	\$169,468	\$167,772	(\$1,696)
Water Department	146,967	278,616	270,279	(8,337)
Hetch Hetchy	101,325	120,708	118,834	(1,874)
Airport Commission	318,357	452,456	496,611	44,155
Port	41,745	49,586	50,786	1,200
Total	\$836,232	\$1,070,834	\$1,104,282	\$33,448

- The Clean Water Program will continue to operate at roughly the same level as last year. The budget includes a modest capital program funded with \$9.5 million in previously-approved revenue bonds and a repair and replacement program funded with \$12.5 million in operating revenues. The program will draw \$7.4 million from fund balances to support continuing operations. The program does not include an increase in sewer service charges for San Francisco residents.
- The Water Department also does not include a rate increase for San Francisco residents, but it has increased water rates for suburban customers by 4.4% for 2000-01. The department is planning a \$131 million capital program, which is slightly smaller than last year's appropriation. The capital program is funded with \$103 million in voter-approved revenue bonds and \$28 million in operating revenues. The department will also draw \$14 million from fund balances to support continuing operations.
- Hetch Hetchy revenues are projected to decline slightly; the transfer from the power utility to the General Fund will be reduced from \$39.9 million to \$29.9 million in 2000-01. The utility has a \$19 million capital plan for 2000-01.
- The Airport's budget includes increases in almost every revenue category, including landing fees, concessions, facility rentals, and parking fees. These increases are attributable to expanded airport facilities. In addition, the department intends to use \$16.7 million from fund balances to support operations. The Airport's budget increase over the prior year is attributable to both the continuing capital program as well as expanded operations in its new facilities.
- The Port will continue operations at the same level as the prior year.

VI. CONTROLLER'S RESERVES

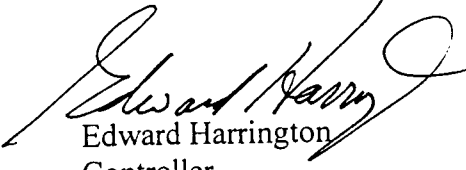
Occasionally, departments will include a revenue source where some additional action is required in order to secure the revenues. In those cases, the Controller will reserve expenditures equal to revenues until the required action is taken and the revenues are secured. In the 2000-01 budget, the Controller has reserved \$118.7 million in expenditures. Chart H lists those reserves and the action required to secure the revenues.

**Chart H: Controller's Reserves
(figures in thousands of dollars)**

<u>Department</u>	<u>Reserve</u>	<u>Explanation for Reserve and Required Action</u>
Adult Probation	\$961	Awaiting final approval of state grant
Community Health Network	1,200	Reimbursement for acute psychiatric care
Economic Development	7,000	State grant for Ocean Avenue light rail project
Human Services	20,200	Awaiting final state allocation for expanded programs
Water	89,300	Commercial paper sales (pending approvals)
Total Reserves	<u>\$118,661</u>	

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 Ann Carey of my staff at 554-7500.

Sincerely,


Edward Harrington
Controller

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