



**London N. Breed,
Mayor**

**Jenny Louie,
Chief Financial Officer**

MEMORANDUM

To: President Laurie Green and Honorable Members of the Health Commission

Through: Dr. Grant Colfax, Director of Health
Greg Wagner, Chief Operating Officer
Jenny Louie, Chief Financial Officer

From: Emily Gibbs, Deputy Finance Officer

Date: January 10th, 2024

Scheduled for the January 16th Commission meeting is the first hearing on the Department of Public Health's proposed budget for fiscal year 2024-25 and fiscal year 2025-26 (FY 2024-26). A second hearing is planned for the February 6th Commission meeting, followed by periodic updates throughout the budget process. These two hearings will comply with Section 3.3 of the Administrative code which requires City departments to have at least two public hearings on budget prior to February 14th, one week before department budget submissions are due.

Subject matter to be addressed at the two budget hearings will be as follows:

January 16

- The City's Five-Year Financial Projection and Mayor's Budget Instructions
- Projection on current year salary spending (also required under Section 3.3)
- Overview of FY 2024-25 approved budget and approach to budget planning

February 6

- Proposed balancing plan with detailed initiatives
- Request for Health Commission approval of proposed budget for submission to Controller and Mayor's Office

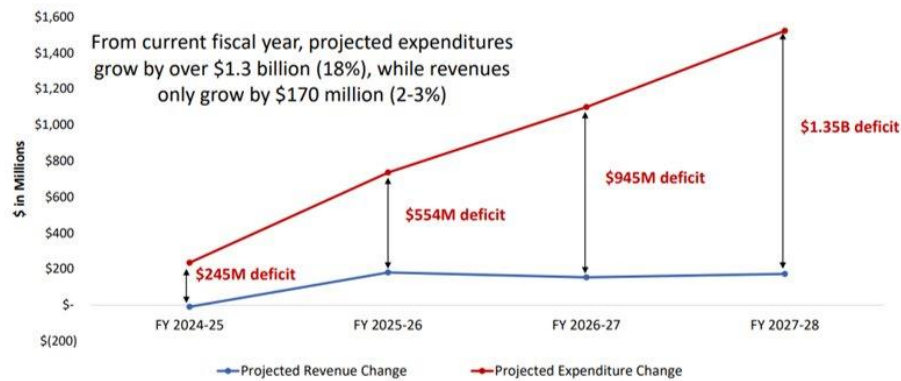
A third meeting will be scheduled for February 20th, if needed, to address any follow-up issues raised at the second meeting, as well as additional meetings as necessary throughout the spring to keep the Commission apprised of the latest developments.

The City's Five-Year Financial Projection and Mayor's Budget Instructions

In December, the Mayor's Office issued its five-year financial outlook for the City and budget instructions for City departments. The adopted FY 2023-24 and FY 2024-25 budget made limited progress toward the City's structural budget gap, resulting in continued, large shortfalls during the forecast period. Since then, the fiscal picture has worsened as revenue growth has further slowed and some expenditure costs, notably for employee health care, have grown faster

than previously projected. Ongoing patterns of remote work in San Francisco, along with high interest rates, are expected to lead to declining commercial and residential real estate values, affecting property and transfer taxes. High interest rates have also had an outsized effect on San Francisco’s economy by making venture capital less attractive, which in turn has slowed investment and growth in the technology sector. Further, while the local tourism and hospitality sector continue to recover, it is at a slower pace than previously anticipated. This is still not a recession scenario – growth continues, but at slower pace than projected and significantly slower than growth in costs.

Fiscal Outlook – Deficit Grows to \$1.3 billion



Source: Mayor’s Office of Public Policy and Finance

As a result, the City now projects the general fund deficit will grow to \$1.35 billion in FY 2027-28 if no corrective action is taken. The two-year deficit that must be solved for in this upcoming budget process is \$799.2 million. To address these shortfalls, departments have been instructed to submit budget proposals that reflect an ongoing, 10% General Fund reduction for FY 2024-25 and FY 2025-26. The Mayor’s Office also has instructed departments not to add new positions, as growing salary, health care, and pensions costs for employees are primary drivers of the structural deficit.

For DPH, this target translates to \$93.8 million in savings in each year. The City’s projections also assume that DPH’s baseline patient revenues will grow by \$16.8 million in FY 2024-25 and a further \$34.2 million in FY 2025-26, in line with inflation and as a partial offset to inflationary cost growth built into the budget. As a result, compared to the current base budget, DPH must identify \$110.6 million in increased revenues or General Fund reductions in FY 2024-25 and \$128.0 million in FY 2025-26 to meet the initial 10% target.

Even assuming departments meet these instructions, considerable uncertainty about the deficit and fiscal picture remains, including a significant State budget shortfall and upcoming negotiations with labor unions. To address this, the Mayor is also asking for departments to propose another 5% in General Fund contingency reductions that could be taken should the fiscal picture worsen. For DPH, this represents an additional \$46.9 million in general fund reductions in each year. The Mayor is also convening cross-departmental working groups to look at opportunities for efficiency and consolidation in service delivery.

While this is a challenging and uncertain fiscal situation, the Mayor remains committed to her core policy priorities, which are unchanged from the prior year. These are:

- (1) improving public safety and street conditions;
- (2) Citywide economic vitality;
- (3) reducing homelessness and transforming mental health service delivery;
- (4) accountability and equity in delivery of programs, services, and spending.

Summary of Targets and Mid Year Reductions

As the Commission is aware, because of this challenging picture, the Mayor issued instructions to departments in October to start making budget reductions in the current fiscal year. Reductions taken in response to the mid-year instructions represent a first step towards meeting the Department’s target reductions.

As noted in a prior Director’s Report, DPH’s accepted general fund savings from the mid-year reduction comprised of \$23 million in one-time revenue in the current fiscal year and then nearly \$8 million annual ongoing savings, starting in FY 2024-25. The Mayor’s Office will count these savings towards the General Fund reductions to meet budget reduction targets, representing a first step in slowing growth.

Description	FTE Change	FY 2024-25 Net GF Impact Favorable/ (Unfavorable)	FY 2025-26 Net GF Impact Favorable/ (Unfavorable)
MAYOR'S INSTRUCTIONS			
GF Reduction Target		(93,820,000)	(93,820,000)
DPH Revenue Assumed in City Projection		(16,776,176)	(34,216,796)
Total Targets		\$ (110,596,176)	\$ (128,036,796)
FY 2023-24 Mid Year Savings			
55 Vacant FTE from Mid-year	(55.5)	4,666,094	4,782,746
Additional attrition savings	-	2,050,000	2,101,250
Pause on Uninitiated Programs	-	\$1,175,000	\$1,175,000
Total Mid-Year Savings		7,641,094	7,808,996
Total Remaining Target		\$ (102,955,082)	\$ (120,227,800)
5% Contingency		\$(46,910,000)	\$(46,910,000)
Total Target with Contingency		\$(149,865,082)	\$(167,137,800)

Approach and Context to FY 2024-25 and FY 2025-26 Budgeting

These instructions are the most significant the City has seen in quite some time and will require increased revenue as well as expenditure reductions to meet the targets. Unlike in recent years, DPH does anticipate that this year’s proposal will require some targeted reductions.

Given the tightening budget picture as well as the significant level of programmatic and staffing level growth approved in the last several budgets, DPH plans to focus on the following strategies

for its FYs 2024-2026 budget proposal:

1. Maximizing revenue to meet general fund targets as well as support long-term financial stewardship
2. Focus on core priorities and services and slow or scale back unimplemented plans for growth
3. Focus on implementation of new initiatives already funded in prior budgets
4. Limit growth of new expenditures
5. Coordinate with the Mayor's Office on processes they are convening to look at Citywide savings ideas and opportunities for efficiencies across departments

Because of the City's substantial investment in DPH program expansion over the last several years, the department believes it can continue to make significant progress on its key programmatic priorities by focusing on implementation and refinement of the new services budgeted in recent years. DPH will make every effort to leverage anticipated revenue growth to meet its reduction target and address any internal revenue shortfalls, minimizing any planned service impacts. To the extent reductions are necessary, the Department is working to minimize the impact on clients and on key priorities.

DPH is also mindful in its planning of a number of uncertainties in its financial situation. These include:

- State Budget: The Governor will release his initial budget proposal on January 10th that will balance a significant State shortfall. Staff will be closely analyzing that proposal to understand potential impacts on the department's State revenues and the Medi-Cal program. In addition, there may be additional impacts to other City departments and to the City's revenues that may impact the City's financial outlook.
- Laguna Honda Hospital: Medicare recertification is still underway. Once recertification is complete, the Finance team will work closely with Laguna Honda Hospital and San Francisco Health Network leadership on updating its operating budget assumptions. In addition, the State is adjusting its funding application for supplemental payments for all Distinct Part Nursing Facilities (DP/NF) in California. The impact of this new formula, which would be retroactive to January 2023, is unknown.
- The Our City, Our Home (OCOH) fund: Established by the voters through Proposition C, the OCOH fund supports services for people experiencing homelessness and those living in supportive housing through programs in Behavioral Health Services and Whole Person Integrated Care. Revenues to Proposition C, which are based on a gross receipts tax of the largest companies in San Francisco, have been coming in below earlier projections and the Controller's Office has now downgraded its projections for the next few years. This change leaves a significant shortfall in the fund. As in years past, DPH will be working closely with the Mayor's Office, Department of Homelessness and Supportive Housing, and the OCOH Advisory Committee to develop a balancing plan for the fund.

- Epic Wave 3 Implementation: Scheduled for May 2024, this third wave of Epic implementation will be the largest expansion of our Epic Electronic Health Record (EHR) since our initial go live in August of 2019. While many areas of DPH are already live on our Epic EHR, the 'Wave 3' phase of the project includes a number of new modules and will bring a large part of our organization, Behavioral Health Services, into the shared Epic record for the first time. As with any implementation of an EHR there will be dips in productivity and revenue immediately following go-live and sufficient resources will be required to ensure that the impacts are limited and not sustained.

As part of its development process, DPH Leadership and Finance staff are working proactively to communicate with internal leaders and external partners. In mid-December, DPH Chief Financial Officer Jenny Louie hosted two briefings, first with approximately 75 DPH managers and directors, then with approximately 100 partner community-based organizations, to review the City's current economic landscape, communicate the department's approach and priorities as we prepare our budget proposal, review next steps in the budget process, and hold time to answer initial questions and concerns. The DPH budget team has also proactively set up an email address for to submit budget-related questions and substantial savings ideas.

Budget Submission at the Next Health Commission

At the next Health Commission meeting, staff will provide a budget proposal which addresses the Mayor's reduction targets and these strategic goals, including detailed initiatives, for your approval. Should additional review and or changes be necessary, a third hearing at the Health Commission will be scheduled for February 20th.