

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: January 19, 2024

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Council District: All

To: The City Council

From: Matthew W. Szabo, City Administrative Officer



Reference: The Second Financial Status Report for 2023-24

Subject: **FISCAL CONCERNS AND PRIORITIZATION OF CRITICAL HIRING**

RECOMMENDATION

That the City Council:

1. Instruct all City Departments to limit all hiring to the critical areas that this report identifies;
2. Instruct the City Administrative Officer, in collaboration with the Office of the Mayor and the Chief Legislative Analyst, to develop and implement a process for prioritizing critical hiring, as described in this report;
3. Instruct the City Administrative Officer to report monthly to the City Council following the implementation of the priority critical hiring process described in this report on positions that departments have filled through the process described in this report;
4. Instruct the City Administrative Officer to propose the elimination of all non-critical vacant positions, as defined in this report;
5. Instruct the City Administrative Officer to report on the restructuring of services, programs, and/or other organizational components of the City that will be necessitated by the elimination of positions; and
6. Instruct the City Administrative Officer, with assistance of various City departments, to report on opportunities to update fees for service and other revenue enhancement opportunities including ballot measures.

SUMMARY

In the Second Financial Status Report (FSR) of 2023-24, this Office reported General Fund revenues below plan of \$93 million and overspending of \$297 million. The largest area of overspending was sworn salaries within the Police Department due to costs associated with the

labor agreement reached with the Los Angeles Police Protective League (LAPPL) earlier this fiscal year. The agreement with LAPPL was projected to increase direct spending by a total of \$97 million in the Salaries Sworn (\$80 million) and Overtime Sworn (\$17 million) in 2023-24.

Based on the revenue data at that time, in the Second FSR we expressed reasonable expectations that certain revenues would catch up to plan later in the year. However, our revenue expectations have not been fulfilled and the General Fund revenues have fallen further behind plan. After accounting for December 2023 receipts, General Fund revenues are now \$158 million below plan with the downside risk to several revenue sources if an economic downturn occurs.

Relative to our overspending, in the Second FSR we recommended \$43 million in solutions to partially address the projected \$297 million overspending and identified \$111 million in potential future actions to further reduce the remaining year-end overspending to \$143 million. We now expect this projected year-end overspending amount to increase with the approval of tentative agreements reached with the Coalition of City Unions (Coalition). If approved, the fiscal impact of these labor agreements will commence in the current fiscal year and result in unbudgeted expenditures for departments in 2023-24. The extent of the overspending increase will depend on the departments' ability to absorb their respective costs.

The collective fiscal impacts of a revenue shortfall, overspending, and the ongoing risk of an economic downturn require the City to take immediate actions to curtail spending. Furthermore, the magnitude of the revenue shortfall and overspending gap combined, underscores the need for actions beyond the customary approach of requiring departments to absorb or manage remaining costs within existing funds. The City needs to generate additional savings to bring expenditures and revenues back in balance. Therefore, we recommend that the City Council prioritize critical hiring for the remainder of 2023-24 starting with the select number of critical positions for hiring prioritization identified in this report. All other vacant positions requested to be filled will undergo further review based on a process that this Office develops in collaboration with the Office of the Mayor and the Chief Legislative Analyst (CLA), and which considers the prioritization categories detailed in this report. In prioritizing the hiring of critical positions, the majority of the City's current vacant positions will remain unfilled and thus generate the needed salary savings to address the current year revenue shortfall and overspending gap.

Additionally, the ongoing impact of the tentative agreements are projected to create substantial challenges for the fiscal outlook of the City. As we reported in the First FSR, our current projections for the cost of continuing current service levels exceeds projected revenues by \$192 million in 2024-25, taking into account the approved police labor contract. Incorporating the tentative agreements with the Coalition into the outlook, as well as potential impacts from yet to be negotiated agreements, widens the gap to a range between \$350 million to \$400 million in 2024-25. Thus, rather than extending hiring limitations into 2024-25, this Office recommends that all non-critical vacant positions be eliminated from the City's budget. By eliminating vacant positions, the City will match ongoing expenditures with ongoing savings on both salary and pension costs in 2024-25 and subsequent fiscal years.

The identification of non-critical vacant positions to eliminate will occur as part of the prioritized hiring review process and extend through the budget development process. Criteria including length of the vacancy, source of funding, ability of the department to absorb the work, service level data, and other variables will factor into the decisions to eliminate positions. Furthermore, the elimination of positions at the level anticipated will necessitate a review of services, programs, and other organizational components of the City. This Office plans to evaluate service impacts resulting from position eliminations and report with proposed restructuring or reconstitution plans to enable departments to continue their service delivery despite reduced resources.

Finally, bringing in new revenues to the City to specifically fund certain programs, services, or projects or as General Fund receipts to fund general operating expenditures will provide the City with the flexibility and adaptability it needs to address its challenges. Moreover, new revenue sources will diversify the pool of revenue the City relies on for its everyday expenditures. As part of the recommended actions, this Office will report on opportunities to update fees for service and other revenue enhancement opportunities including ballot measures.

Current Financial Challenges

General Fund revenues below plan: While the City may be able to recover a portion of the \$158 million that General Fund revenues are below budgeted plan through December 2023, we are concerned that the largest shortfalls are economically sensitive taxes. Specifically, business and sales taxes are \$32 million and \$18 million below plan, respectively, due in part to recent strikes and declining demand under inflation. Transient occupancy tax is estimated to be \$15 million below plan, with lower international tourism receipts attributed to China's economic slowdown. Documentary transfer tax is \$25 million below plan with higher interest rates continuing to impact sales volume and price.

We believe that revenues from each of these taxes faces additional downside risk as future receipts are anticipated to remain below plan absent a sharp rebound in business activity, consumer spending, tourism, and the real estate market. Three of these taxes (sales, transient occupancy, and documentary transfer taxes) are remitted to the City monthly, and their respective shortfalls are indicative of challenges in the current economy. As such, not only is it less likely that the City will recover unrealized receipts from the prior months, these lower receipts suggest the City may be experiencing economic conditions that will further reduce monthly General Fund revenues. If revenues do not recover by the end of the fiscal year, the City would either have to reduce appropriations by a like amount or cover those costs using the Reserve Fund. At this time, however, we do not anticipate being able to reduce appropriation without taking proactive steps to do so.

Unsolved overexpenditures: In the Second FSR, we projected overspending of \$297 million. After the adoption of the budget balancing recommendations from that report and anticipating potential future actions, we projected that the City would need to identify \$143 million in budget balancing actions by the end of the fiscal year. If approved, the fiscal impact of the tentative agreements with

the Coalition will commence in the current fiscal year and increase the City's overspending in 2023-24. In the FSR we recommended that, to the extent possible, departments take steps to mitigate this overspending to mitigate the need to rely on the Reserve Fund. The additional unbudgeted expenditures tied to the Coalition will likely be more than what many departments can absorb. Without immediate actions to address the overspending, the City will have to use the Reserve Fund.

In the Second FSR, we stated that as of November 16, 2023, the Reserve Fund balance was \$582 million. This is approximately \$187 million above the 5 percent policy minimum balance. We identified an additional \$27 million in likely or pending transfers from the Reserve Fund, which if approved would leave the Reserve Fund \$160 million above its minimum balance. With \$143 million in anticipated remaining overspending and downside risk to General Fund revenues, it is possible that absent other actions this amount would not be sufficient to both balance the budget and maintain the 5 percent policy minimum.

If the City uses the Reserve Fund to address its current fiscal challenges, the City will be less well prepared to address potential upcoming fiscal challenges including those rising from an economic downturn and to address any unanticipated fiscal challenges while minimizing service disruptions, as we recently experienced in our response to the COVID pandemic.

Addressing the Challenges

In addressing its financial challenges, the City should pursue multiple strategies for long-term financial health aside from simply expenditure reductions. Nonetheless, the City's efforts must start by curtailing spending and realigning its expenditures with reduced revenues. The sooner that we implement cost saving measures, the more ability that we have to do so strategically and the less severe they will have to be.

Many departments are generating significant surpluses as a result of high vacancy rates. The Citywide vacancy rate as of August was 19 percent. We recommend that the City Council instruct departments to limit hiring and promotions for full-time vacant positions, as well as as-needed and hiring hall employees, in order to use those savings to address our financial challenges. To implement this policy, this Office will restrict the filling of all vacant and vacated positions, including for promotions, in Workday with some exceptions for the most critical positions.

Many of these vacant positions would perform critical services once filled and departments should continue to actively hire for the most critical of these positions. We therefore recommend that the City Council instruct this Office, in collaboration with the Office of the Mayor and the CLA, to design a process to prioritize the hiring of these most critical positions. This process could include both a full exemption from hiring limitations for selected classifications and departments and a mechanism for departments to seek approval to hire for other positions that they identify as critical. We encourage departments to continue to use Targeted Local Hire and Bridge to Jobs programs for the hiring of all eligible classifications in the critical positions and departments identified below.

Prioritized Critical Positions not requiring additional review: We recognize that positions in the following categories are either all critical for public health and safety or are fully funded by special funds that do not require a General Fund subsidy. We therefore recommend implementing a process that does not place any additional limits or impact current hiring plans in any way without further review:

Critical Public Health and Safety

- Police Department: Sworn positions, Detention Officers, Senior Detention Officers, Police Service Representatives I-III, and Senior Police Service Representatives I-II.
- Personnel Department: Correctional Nurses I-III and Advance Practice Providers.
- Fire Department: Sworn positions, EMS Advanced Providers, and EMS Advanced Provider Supervisors.
- Public Works - Bureau of Sanitation: Livability Services Division positions, Refuse Collection Truck Operator II, Wastewater Collection Worker I-II, Wastewater Collection Supervisor, Wastewater Treatment Operator I-III, and Senior Wastewater Treatment Operator.

Proprietary and Special Funded Departments

- Department of Building and Safety: all positions.
- Library Department: all positions.
- Proprietary departments: Airports, Harbor, Department of Water and Power, Los Angeles City Employees' Retirement System, and Los Angeles Fire and Police Pensions.

Categories of prioritized critical hiring requiring review process: In addition to the positions listed above, there may be positions that are critical to a department's operation that also require prioritized hiring. We recommend that departments submit a request and justification for filling these critical positions to the CAO and that the CAO review these in conjunction with the Office of the Mayor and the CLA based on criteria applied evenly across departments. These criteria could include:

- Positions required for public health or public safety.
- Positions that must be filled to address a legal mandate.
- Positions that mitigate risk and address liabilities.
- Positions directly involved with addressing the City's homelessness crisis.
- Positions directly involved with the implementation of the Human Resources Payroll Project.
- Positions to be hired through the Targeted Local Hire and Bridge to Jobs programs for critical services.
- Positions fully paid for by special funds that are not subsidized by the General Fund.
- Revenue generating positions, where the revenue generated exceeds the full cost of the position.
- Technical or administrative transactions, which are typically done in accordance with the City's Civil Service Rules and/or Memoranda of Understanding (MOU) provisions.
- Positions that provide both unique and critical services that a department cannot otherwise provide using existing resources.

This Office will report monthly, or on a periodic basis as appropriate, to the City Council following the implementation of the prioritized critical hiring process on the status of positions that departments have requested for critical hiring and positions prioritized to fill through the review process described in this report.

Elimination of vacant positions: While prioritizing critical hiring will help the City to address the current year overspending and revenue challenges, the City must still take steps to address the 2024-25 \$350 million to \$400 million estimated gap between the costs of continuing current level services and projected revenues. If this gap is not addressed in 2024-25 with ongoing solutions, it will continue to pose budget challenges in future years. Therefore, we propose eliminating positions and their ongoing funding from the 2024-25 Budget.

In order to minimize the impact on current level services, the CAO will propose eliminating positions that are currently vacant as well as those that become vacant through the prioritized critical hiring process. We will also leverage our work on the development of the Proposed 2024-25 Budget to identify all non-critical vacant positions for elimination. No layoffs will occur due to the elimination of these positions. This Office will take all necessary administrative actions required to prevent layoffs.

We recognize that while eliminating vacant positions may have minimal immediate impact on services, it could have an impact on departments' plans for service improvements or for initiating new programs. Therefore, this Office will evaluate these types of service impacts and report with proposed restructuring or reconstitution plans to enable departments to pursue service enhancements despite reduced resources. We expect to be able to begin this analysis after the Mayor and City Council have approved position eliminations as part of the 2024-25 Budget and based on those reductions. We intend to work with departments to develop these proposals.

Revenue exploration: The identification of new revenue sources is one strategy that the City must embrace in order to become more resilient in its ability to adapt to severe economic adjustments or other forces beyond the control of the City. Keeping in mind the obstacles for new revenues in the State of California through Propositions 218 and 26, the City must consider new revenue sources as part of its long-term financial planning.

This Office, with assistance of various City departments, plans to report on opportunities to update fees for service and other revenue enhancement opportunities including ballot measures for new revenue sources for the General Fund.

FISCAL IMPACT STATEMENT

Adopting the recommendations in this report will mitigate the City's current unresolved overexpenditures totaling \$143 million, provide additional protection against a potential General Fund revenue shortfall currently estimated at \$158 million, support the City's efforts to maintain a Reserve Fund balance above the five percent policy minimum, and facilitate the development of a

2024-25 Budget that maintains critical service levels.

FINANCIAL POLICIES STATEMENT

The recommendations in this report are consistent with the City's Financial Policies insofar as they would help to ensure that current appropriations are limited to the sum of available cash and revenues to be received this fiscal year.

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