

MESSAGE FROM THE DIRECTOR OF HEALTH ON FY 05-06 BUDGET

Introduction

In this first budget report to the Health Commission for FY 05-06, we are presenting an overview of the citywide budget shortfall, and its likely impact on the amount of General Fund available to the Health Department. We are also presenting Health Department forecasts of revenue increases, and unavoidable increases in the costs of doing business. We plan to present the Department's budget reduction proposals to the Commission in February.

The Citywide Shortfall

The Mayor's budget staff is projecting a \$130 million General Fund shortfall for FY 05-06. This shortfall assumes full implementation of the \$97 million mid-year reduction plan. While this shortfall is significantly less than the \$260 million shortfall we faced last year, the reductions made last year and at mid-year limit the options that remain to effect further reductions.

Although the local economy is showing modest growth, the City is facing a revenue shortfall over the next 18 months due to the failure of Propositions J and K. In addition, employee costs for salary and benefits are projected to increase substantially in the coming year. Unlike the State and Federal government, the County is strictly forbidden by the State Constitution from borrowing money for operating expenses and therefore must take action to reduce spending or increase revenues to balance its budget.

The \$130 million citywide shortfall is comprised of the following components.

Revenues – 18 months

Projected revenue growth	\$ 42M
Loss of Propositions J & K	<u>(\$ 97M)</u>
Revenue Decrease	(\$ 55M)

Expenditures – 18 months

Closed MOU costs	(\$ 52M)
Employee benefit costs (retirement and health/dental benefits)	(\$ 56M)
Non-salary costs	<u>(\$ 64M)</u>
Expenditure Increase	(\$172M)

Eighteen month shortfall	(\$227M)
Effect of mid-year reductions	<u>\$ 97M</u>

Remaining shortfall	<u>(\$ 130M)</u>
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This computation does not consider wage increases on open labor contracts, such as Health Department contracts for nursing, nursing supervisors, and interns and residents. It also excludes funding for COLA adjustments to contractors. In addition, the above shortfall assumes that city employees continue to pay the 7.5% of their retirement contribution. If this were not the case the deficit would be greater.

The Health Department's General Fund subsidy represents approximately 20% of the City's discretionary General Fund budget. Twenty percent of the projected shortfall is \$26M.

Although the County will undoubtedly be looking at new fees or increasing existing fees, it is important to remember that tax increases require approval of the voters. The next election on which a County revenue measure could be placed would be November 2006. It is therefore unlikely that the City will be able to budget significant additional increases to revenues for the coming year.

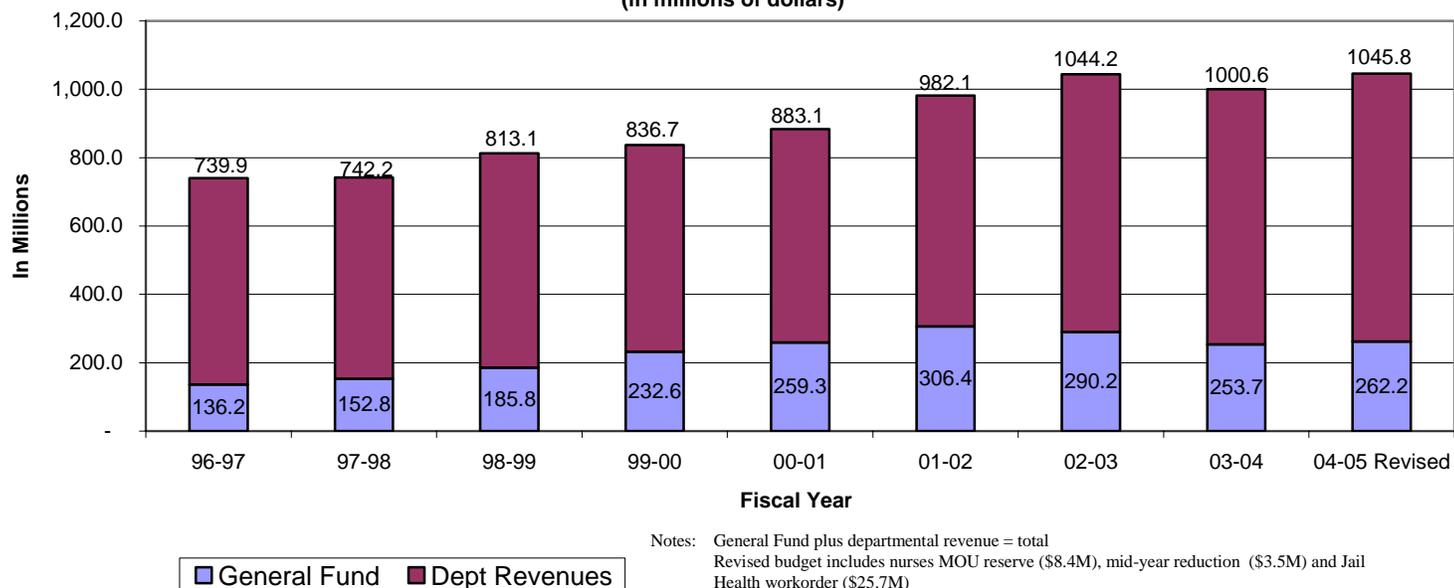
Mayor's Instructions

As of the date of this report, the Department has not been given a specific General Fund reduction target. Smaller departments have been given targets to absorb their cost increases within their existing General Fund and also to provide an additional contingency plan for a 5% General Fund reduction. If DPH were similarly required to absorb the costs of our known MOUs and benefits, similar to those smaller departments, we have been advised that the amount would total \$32 million. Because the Mayor's Finance Office understands the effect a reduction of this size would have on health care services they are carefully considering all available options prior to giving us a target.

Health Department General Fund

The following chart summarizes the changes in total expenditures and General Fund for the nine-year period ending with the current year.

**Figure 1
Department of Public Health
Budget History
(in millions of dollars)**



During the last four years, the General Fund budget has declined \$44.2 million from \$306.4 million in 2001-02 to \$262.2 million in the current year when the Jail Health workorder, \$25.7 million, is added to our General Fund. Total budgeted appropriations have increased \$63.7 million during the same period. If 2001-02 figures were adjusted for inflation, the impact becomes far more dramatic. A \$306.4 million General Fund in 2001-02 is equivalent to \$421.6 million in the current year. \$982.1 million in appropriations is equivalent to \$1,351 million. This is based on a 37.6% increase in the medical care component of the consumer price index between June of 2001 and June of 2004.

Despite the declines in General Fund support and the cost pressure of inflation, we have been able to preserve a full range of services to our clients. This has been accomplished through a combination of increasing revenues, decreasing administrative expenses, the sensible consolidation /restructuring of programs, and the continued willingness of our staff to pay their portion of the retirement (7.5%) which was previously picked up by the City.

For fiscal year 04-05, the decline in General Fund budget was balanced through the following methods:

Table I - Initiatives to Balance the FY 2004-05 Budget

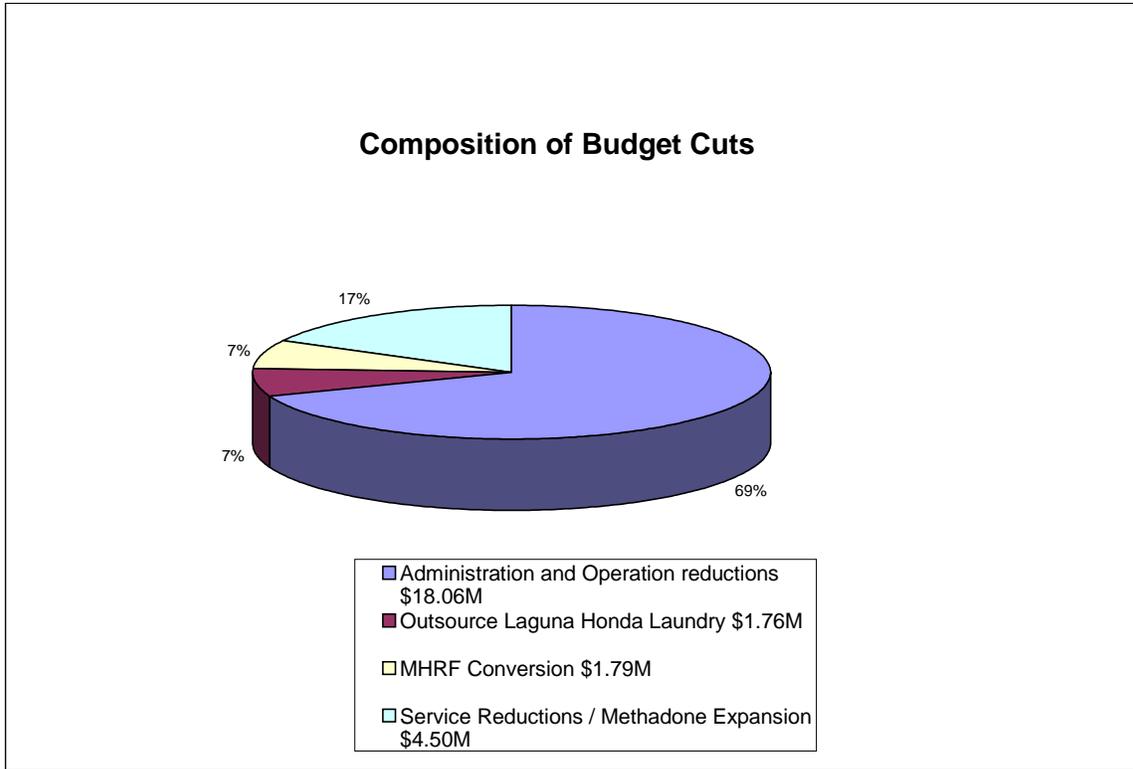
<u>Initiatives</u>	<u>FTEs</u>	<u>General Fund</u> <u>(000)</u>
Cost increases due to structural, inflationary and regulatory issues	15.60	\$19.68
Increased Revenues	21.31	(\$19.22)
Administration and Operation reductions	(125.24)	(\$18.00)
Outsource Laguna Honda Laundry	(52.40)	(\$1.76)
MHRF Conversion	(22.30)	(\$1.79)
Methadone Expansion	5.00	\$1.24
Service Reductions	(3.00)	(\$3.70)
New Funding		\$1.80
Budget Committee Actions	<u>(4.35)</u>	<u>(\$0.45)</u>
Total	(165.38)	(\$22.20)

In addition, on January 15th of this year, the Department made \$3.45 million in mid-year reductions, as follows:

Table II - Mid - Year Reductions Initiatives (FY 2004-05 Value)

<u>Initiatives</u>	<u>FTEs</u>	<u>General Fund</u> <u>(000)</u>
Departmental Initiatives		
Administration and Operation reductions		(\$0.06)
Service Reductions	<u>(34.73)</u>	<u>(\$3.39)</u>
Total	(34.73)	(\$3.45)

The majority of the reductions in the FY 2004-05 budget were in administration and operations. Service reductions were minimized and, in fact, several programs were expanded. The following graph combines mid-year and full year reductions and illustrates the composition of the budget cuts.



Before we can begin to address the requirement to decrease our general fund, we must first take into account unavoidable increases in the cost of doing business that result from structural, inflationary, and regulatory issues. These are discussed below and shown in greater detail on the attached spreadsheets.

Inflationary Increases/Unavoidable Increases in doing business

In building the FY 05-06 budget we are challenged by significant inflationary increases in the cost of providing health care. Inflationary increases occur due to unavoidable price increases on products or services that we currently rely on. National reports show that health care inflation is running at a rate greater than 10% per year.

Wherever possible we have tried to deal with inflationary costs by decreasing our level of utilization. But in several areas, that is impossible. The largest inflationary increases are employee salary increases approved by the Board of Supervisors and increases in retirement and health benefits for all employees. These increases are estimated to cost \$32 million.

In addition to these costs we project \$1.6 million in inflationary increases for a total of \$33.6 million as shown below.

Inflationary Increases

MOU increase to salaries and increase in cost of benefits to staff	\$32,000,000
Increased Pharmaceutical Utilization at SFGH, Community Behavioral Health Services Mental Health, LHH and Jail Health	\$2,050,951
Increases in Rent – Housing and Urban Health and Environmental Health	\$57,800
Savings in Natural Gas Utilization– LHH	<u>(\$500,000)</u>
Total Inflationary Increases	\$33,608,751

Structural Issues

We also recognize the need to address significant structural issues that cause projected expenditures to exceed budget. A structural problem exists when the dollars budgeted are less than funding required to support the level of compensation to employees or services to clients currently being provided. We have identified \$11.7 million that will need to be funded in the coming year.

Structural Issues

Position Corrections and Salary Savings Deficit – Community Behavioral Health Services (Mental Health)	\$2,779,416
IMD Alternatives Program Grant Replacement – Community Behavioral Health Services (Mental Health)	\$399,444
Private Provider Network (PPN) Shortfall – Community Behavioral Health Services (Mental Health)	\$690,000
Contractor Indirect – Community Behavioral Health Services (Mental Health and Substance Abuse)	\$1,500,000
Mobile Methadone Van Counseling Office Space and Van Parking – Community Behavioral Health Services (Substance Abuse)	\$42,900
Professional and Specialty Services Structural Shortfall - SFGH	\$5,000,000
Sheriff Workorder Underfunding – SFGH	\$100,000
Pharmaceutical Care Network (PCN) – SFGH	\$190,000

Structural Issues (Continued)

Workers Compensation Charges – SFGH	(\$200,000)
Position Corrections – Housing and Urban Health	\$143,260
Direct Access to Housing Support Services Contract Shortfall at Star and Camelot Hotels – Housing and Urban Health	\$121,194
Direct Access to Housing Building Maintenance – Housing and Urban Health	\$50,000
Annualization of Contract for Supportive Senior Housing – Housing and Urban Health	\$46,000
Homeless Stabilization Units – Housing and Urban Health	\$129,000
Consumer Assurance Operating Shortfall –Environmental Health	\$40,000
Premium Pay and Position Corrections – Primary Care	\$508,693
Salary Savings Deficit –Health Promotion and Prevention	\$100,000
Utilities Shortfall – Emergency Medical Services Administration	<u>\$13,000</u>
Total Structural Issues	\$11,652,907

Revenue Neutral Programs

One fortuitous aspect of our ability to generate revenue is that in a few cases we are able to create new services, which are funded entirely through revenues linked to the services. In this budget we propose to include the following 15 initiatives.

<u>Revenue Neutral Programs</u>	<u>Expenditure</u>	<u>Revenue</u>	<u>General Fund</u>
23-Hour Chest Pain Unit – SFGH	\$490,220	\$509,473	(\$19,253)
Expansion of Operating Room – SFGH	\$4,480,862	\$4,675,905	(\$195,043)
Elimination of Clinical Lab Helper Positions – SFGH	(\$87,726)	0	(\$87,726)

<u>Revenue Neutral Programs (Continued)</u>	<u>Expenditure</u>	<u>Revenue</u>	<u>General Fund</u>
Antibiotic Infusion and Therapy Services – SFGH	\$135,414	\$160,709	(\$25,295)
Dispensing Buprenorphine Pharmacy Positions – Community Behavioral Health Services (Substance Abuse)	\$57,384	\$57,384	0
Improved Pharmacy TAR Approval and Collection – LHH	\$59,695	\$202,500	(\$142,805)
Ancillary Reorganization – LHH	(\$21,740)	0	(\$21,740)
Managed Care Growth – Primary Care	\$292,111	\$397,805	(\$105,694)
Expanding Home Rehabilitation Services to Chronically Ill Clients of CHN – Health at Home	\$125,666	\$125,666	0
Short Doyle MediCal Increase to Offset State Funding Losses	\$326,748	\$326,748	0
MediCal Eligibility Determination at Housing and Urban Health clinic – Housing and Urban Health	\$62,519	\$62,519	0
HUH Clinic Operating Costs – Housing and Urban Health	\$93,715	\$93,715	0
Folsom-Dore Hotel Rooms for Chronic Homeless	\$227,766	\$227,766	0
Adjustment of Fees for Adult Immunization Clinic to Cover Costs – Public Health	\$278,641	\$278,641	0
California Children Services Medical Therapy Program – Maternal and Child Health	<u>\$129,260</u>	<u>\$129,260</u>	<u>0</u>
Total Revenue Neutral Programs	\$6,650,535	\$7,248,091	(\$597,556)

Increased Revenues

Increasing revenue enables us to absorb inflationary and structural costs and offset the decrease in General Fund reductions that we are asked to make. This is consistent with our Strategic Planning initiative to adopt a financial strategy that enhances revenue and reduces expenditures to ensure that the overall public health system operates cost-effectively.

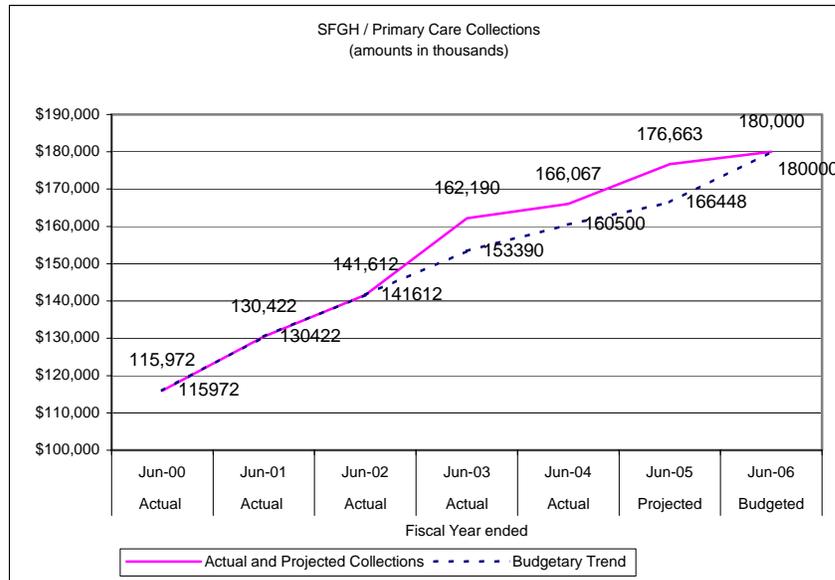
I am proud that the Department is increasing revenues in the following areas:

Increased Revenues

Community Behavioral Health Services (Mental Health). Due to a change (\$969,817) in the MediCal to County sharing ratio, there is a shortfall in revenues of \$1,119,817 that is offset by a \$150,000 increase in third party reimbursement revenues.

SFGH	\$18,410,682
LHH	\$374,803
Environmental Health	<u>\$374,108</u>
Total Increased Revenues	\$18,189,776

The large projected increase in revenues at SFGH reflects the continuation of trends seen over the past several years. The following chart details the trends in collections in our hospital and clinic on which our forecast is based:



Cost of living adjustments for our community providers

We also recognize the necessity of addressing the effects of inflation on community providers and on the cost of services paid through the UC Affiliation Agreement. The Mayor's Office of Finance agrees that this is a structural issue that must be addressed in the budget and wishes to address the budgetary issues related to COLAs on a citywide basis. They plan to provide separate instructions related to how COLAs will be financed as well as how a COLA will affect the reduction targets. Based on our internal analysis, we estimate that each 1% in contractor COLAs (including the UC affiliation agreement) will add \$2.2 million to Health Department expenses.

Summary

The net effect of inflationary, regulatory, structural, revenue neutral, and revenue increases results in a shortfall of \$26.5 million of funding as follows:

	<u>Amount</u>
Inflationary Increases	\$33,608,751
Structural Issues	\$11,652,907
Total Revenue Neutral Programs	(\$597,556)
Revenue Increases	<u>(\$18,189,776)</u>
Totals	\$26,474,326

Next Steps

As soon as we have further instructions from the Mayor's Finance Office we will make two full presentations to the Health Commission. We hope the first presentation will be at the February 15th meeting.