COUNCIL AGENDA: 1/27/09
ITEM: 3.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **FOLLOW-UP DISCUSSION ON THE GENERAL FUND STRUCTURAL DEFICIT ELIMINATION PLAN**

DATE: December 17, 2008

RECOMMENDATION

(a) Accept staff's presentation on the City's Outsourcing Policies; and
(b) Accept staff's presentation on the Analytical Framework for Service Reductions and Eliminations.

BACKGROUND

On December 5, the Council held a Study Session to discuss the City Manager's Structural Deficit Elimination Plan (Plan) and Asset Management. At the Study Session, Council directed staff to return with information regarding the City's outsourcing policies and the draft Analytical Framework for Service Reductions and Eliminations proposed in the Plan.

ANALYSIS

The Plan contains strategies for the City Council to consider to close an estimated $106 million deficit in the General Fund over the next five years. The Plan contained 13 strategies that fell into three separate categories: Cost Savings, Revenue, and Service Reductions/Eliminations. As stated in the Plan, these strategies present the Council with difficult choices. After seven consecutive years of budget cuts, which have resulted in the elimination of 468 positions (6.3%) city-wide and addressed budget shortfalls totaling $363 million in the General Fund, the message is clear: we must confront our new fiscal reality and cannot continue to operate "business as usual." Every service and service delivery method should be reviewed.

At the December 5 Study Session, Council asked to continue to discuss outsourcing and the Analytical Framework for Service Reductions and Eliminations. Staff will be prepared on January 13 to further engage Council in a discussion of these topics and respond to questions. Attached are excerpts from the Plan on Competitive Sourcing and the Analytical Framework.

PUBLIC OUTREACH

The General Fund Structural Deficit Elimination Plan Stakeholder Group discussed Competitive Sourcing on July 21, 2008 and had a preliminary discussion regarding City priority services on September 8, 2008. Additionally, the City Council held a study session on December 5, 2008 where both topics were discussed.

COORDINATION

This memorandum was coordinated with the Finance Department.

Christine F. Shippey

Debra Figone
City Manager

Attachments

b) **Use of Technology to Achieve Efficiencies:** The Information Technology (IT) Department is examining ways to streamline and optimize the City's IT infrastructure with a goal of reducing costs to maintain and operate internal City technology. There are several specific areas of internal IT infrastructure that can first be examined for optimization including:

- Desktop standardization;
- Voice over Internet Protocol (VoIP) for remote City locations; and
- Server consolidation.

Several other IT projects for optimization have been indentified such as the Police Department records management system, but the projects are expected to require five to seven years of work and investment before significant results are seen.

The analysis of fiscal impact and implementation feasibility of those projects are in early stages. It is clear that IT projects will require an initial investment to produce a Return on Investment (ROI) but initial analysis indicates an investment in IT infrastructure would produce strong results for the City and should be considered for optimization study as a part of this Plan.

c) **Competitive Sourcing:** One approach suggested by Management Partners in its January 2008 report to achieve optimization and improve service delivery models is through competitive sourcing. The concept of competitive sourcing is an umbrella term for a variety of service delivery models including traditional outsourcing, managed competition, privatization, private-public partnerships, and government franchising. Examples of competitive sourcing are found throughout government entities but do have mixed results. The lessons learned are important areas for success in any competitive sourcing model. The San Diego Institute for Policy Research reviewed over 100 studies of competitive sourcing and established the following keys to success:

- **Trained Procurement Staff:** Staff must be properly trained in contracting best practices and, in particular, how to build service level standards into agreements and monitor provider performance.
- **Centralized Managed Competition Unit:** The City should develop an expert team of procurement and competition officials to guide other departments in developing their managed competition initiatives.
- **Performance Measures:** It is crucial that the City identify good performance measures to fairly compare competing bids and accurately evaluate provider performance after the contract is awarded.
- **Reliable Cost Comparisons:** The City must establish formal guidelines for cost comparisons to make sure that all costs are included in the unit cost of providing services so that an apples-to-apples comparison of competing bidders may be made.
- **Implementing Performance-Based Contracts:** Performance-based contracts should be used as much as possible to place the emphasis on obtaining the results the City wants achieved, rather than focusing merely on inputs and trying to dictate precisely how the service should be performed. Performance standards should be included in contracts and tied to compensation through financial incentives.

- **Vigilant Monitoring and Evaluation:** Regular monitoring and performance evaluations are essential to ensure accountability and transparency, and that City's management and the service provider are on the same page.
- **Employee Communication and Relations:** Managed competition may encounter opposition from public employee unions. The current San José policy provides extensive communication opportunities so that employees and their representatives are appropriately involved in the managed competition process.

The key difference between competitive sourcing and traditional outsourcing is that competitive sourcing allows City employees to also bid for contracts. The City should support the internal City employee bids by providing training in optimization including business redesign, streamlining and other ways to achieve efficiencies. With this knowledge and support from the City to make changes, departments, divisions and other groups providing specific services can develop independent bids and submit responses to City-issued request for proposals (RFPs). The City entities are then considered along with private companies to provide the services.

Another competitive strategy to explore is a bid-to-goal program. Bid-to-Goal is a program originally developed by the City of San Diego as an optimization strategy to more cost-effectively implement of city services. This approach starts with a pair of consultants who know the service in question. One gives the city a "market price" for a service—what it could expect to pay if it contracted the service out to a private company—the other double-checks it for accuracy. The work unit that delivers the service then creates a labor-management team to figure out how to get their costs under that price. Once they have done so, they sign a memorandum of understanding with the city defining the results they will produce and the price. If they fail to deliver the results at that price, the city then evaluates whether the service should indeed be contracted out. Within the parameters of the program, employees continue to hold preferred status in performing the service, but are now held accountable to a precise "validated competitive standard," where performance is expected to be at least on par with that of comparable private sector service providers.

In 1997, the City adopted a Public Private Competition Policy for the City which allowed the City to put services out to bid to private entities and internal City providers. The intent was to create a competitive process between public and private entities to provide services to the community on behalf of the City. Since its adoption, the City has seldom used the system.

d) **Streamlining:** In the fall of 2008, an organizational improvement effort began an internal process of identifying opportunities for streamlining City processes. The effort intends to help the City identify areas where the City can improve its customer satisfaction, efficiency, performance and adaptability through organizational change and capacity building. Five internal teams have been formed and are underway towards this effort.

e) **Third Party Program Auditing:** The City of San José's Auditor's Office has conducted performance audits of City Departments since May 1985. Historically, the City Auditor's audits have produced $8 in cost savings and revenues enhancements for each $1 spent to

During the Stakeholder Group meetings and subsequent internal City meetings, the City has begun a process by which "core" or priority services can be identified. The Stakeholder Group reviewed the legal requirements of cities, other municipal examples of priority service identification and the three dimensions of priority identification: (1) What services? (2) At what service level? and (3) How to provide services? The Stakeholder Group had a preliminary discussion about developing a framework for the City to identify priority services.

Current Service Categorization in Use: The City currently employs a model of service categorization that begins with the City's policy priorities as identified by the City Council. From the priorities, City services which help reach the priorities are categorized into City Service Areas (CSAs) with associated performance measures. Specific activities in each CSA are identified as either "core services" or "operational services" meaning the service delivers a result to the community or the service enables the result to be delivered. For example, a core service is the response to a 911 emergency call. A corresponding operational service would be the maintenance of vehicles which allow the emergency response to occur. The CSAs, "core services," and "operational services" have corresponding performance measures to measure outcomes. What the current City model does not address is whether the City should be providing a specific service to the community.

City of Austin, Texas Prioritization Criteria: In conducting best practice research on priority service identification, the City of Austin's criteria was discussed internally. The City of Austin, Texas has established a series of criteria which categorize services as one of the following: primary core services, secondary core services, or service enhancements. **Primary core services** generally include life and safety, services which meet regulatory mandates, long term avoidance of catastrophic harm, benefit a significant portion of the community, provide revenue that covers cost of service and are vital to the direct support of another primary core service. **Secondary core services** include those for which the loss of the activity would not have catastrophic harm for life and safety in the long term, supplementing services above regulatory mandated levels, are beneficial to community but is a core service to another entity, provide revenue but do not cover cost of service, and provide indirect support for primary core services. **Service enhancements** include all services that do not meet the criteria for the first and second categories. The City of Austin utilizes the categorization of services when considering service reductions. The City of San José considered utilizing the City of Austin's prioritization criteria but when applied to specific San José programs and services, the criteria did not meet the needs of the City from staff's perspective.

Analytical Framework for Service Reductions and Elimination: In mid-October 2008, a Senior Staff team, in conjunction with Management Partners, began to meet. The group has been tasked by the City Manager with creating an Analytical Framework to Address Service Reductions and Elimination. The intent of the Framework is to provide a consistent framework that the City can use to identify services which could be reduced or eliminated, to prioritize among competing demands and to develop meaningful data that can be used to improve or optimize service delivery.

The Framework will be used at the program level to illuminate opportunities for eliminating or reducing services and to channel programs to an appropriate optimization venue. Because the deficit reduction Plan is likely to unfold over a four or five year time horizon, application of the framework will be phased in and include Citywide trainings on its use. In 2009-2010 it has been proposed that Departments will prioritize programs to be analyzed with the Framework and the City Manager will identify other programs that could pilot the use of this program in 2009-2010.

The Framework is a set of questions which will help identify and segregate programs according to various attributes which have a bearing on relative priority. Questions are essentially designed to elicit facts and other evidence that can be used to logically evaluate what the City does by importance and measurable impact. By spending time to develop a relatively objective and rational evaluation tool, the changes recommended in the budget will have more internal consistency and a stronger analytical foundation. Policymakers will make the final decisions in which a community values perspective will likely play a role, however, the analytical framework is intended to provide a relatively empirical orientation and enhanced transparency in budget discussions.

Critical Assumptions and Principles of the Analytical Framework:

The basic model is intended to be flexible enough to be used on all City programs. However, there will probably be a slightly different variant used in evaluating support service programs. Important assumptions are as follows:

1. Status quo for a program is not an option. This means that either a program will be reduced or eliminated or it will be subject to some type of an optimization approach, the nature of which will be defined by the evaluation (e.g., competitive sourcing, business process redesign etc.).
2. There will be a series of primary "gatekeeper" questions as well as secondary (and probably tertiary) evaluative questions. The primary questions and the basic principle behind each are shown in the table below. Each question will need to be accompanied by instructions and examples.

Gatekeeper Questions

Gatekeeper Question	Principle
Is this a municipal service typically provided by California cities?	The City of San José may provide some services which are atypical and for that reason alone are ripe for further scrutiny. "Yes" answers proceed to further screening. "No" answers move to an evaluation process.
Is the City the primary provider of the service to the community?	This question is designed to identify services for which the City is not an exclusive provider to further evaluative analysis to document if the service is supplemental to another primary provider or if a competitive provider exists.
Does the entire population of the City benefit from the service?	This is designed to identify programs which serve some subset of the City population for further evaluation.

Gatekeeper Question	Principle
Is the service funded either in whole or in part by the General Fund?	This is designed to cull "revenue neutral" programs from further analysis and to identify possible candidates for user fee application.
Can the service level be reduced and still provide minimally acceptable service level?	This is the penultimate "gatekeeper" question preceding consideration of how to best optimize the service. It is designed to document what are minimally acceptable service levels, which must be specified in some empirical fashion.
What alternative service delivery approaches are applicable to this service which might reduce unit costs?	This is designed to channel programs into one of several optimization approaches.

Application of these questions will serve several purposes. It will provide a new cross-section for looking at City services (e.g., what services does the City deliver that benefit special need populations or which supplement another primary service provider), but the main value will be in directing the program into an appropriate evaluative framework for possible reduction or elimination or for an appropriate optimization.

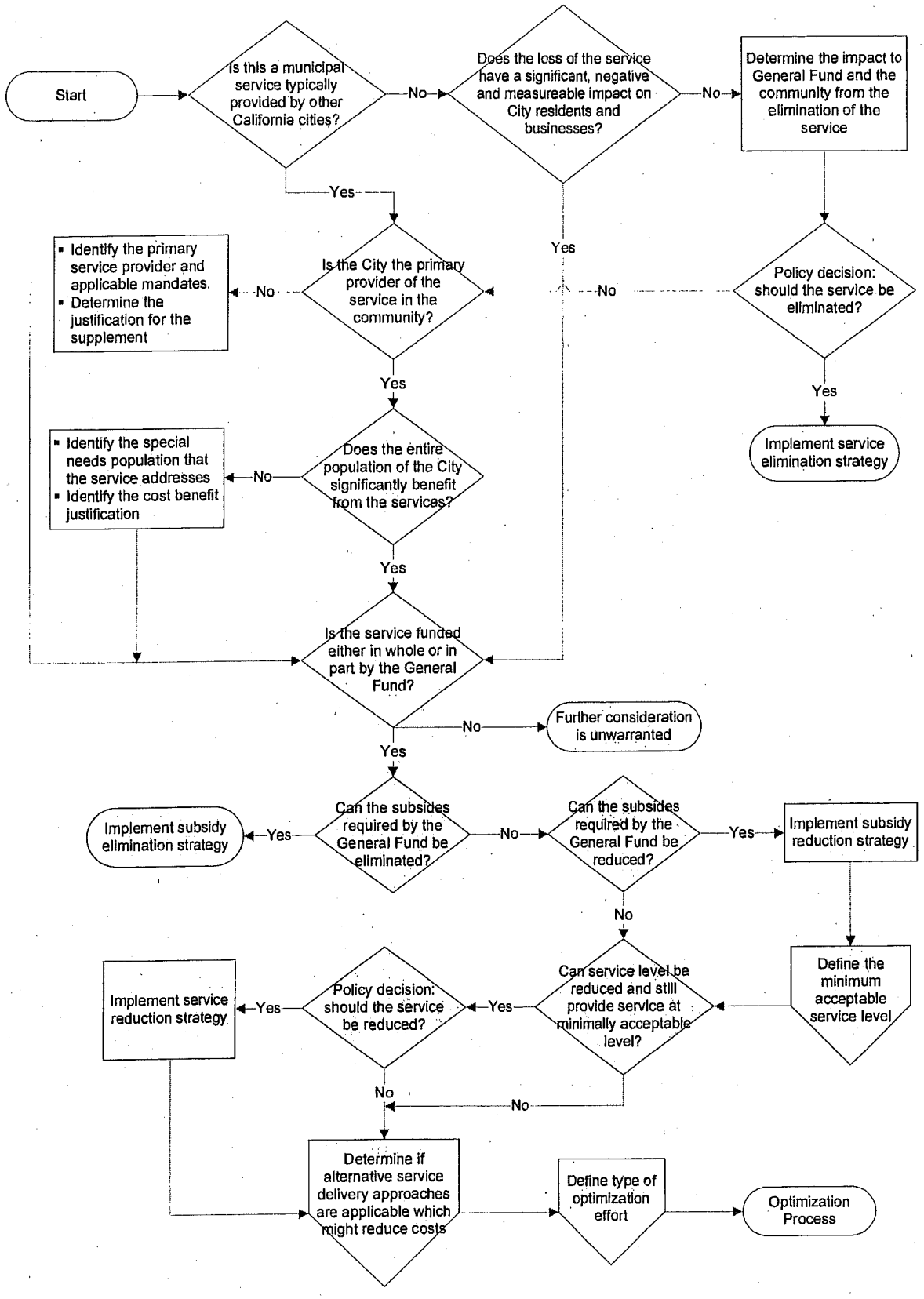
The next level in the model is the evaluative level. The evaluative branches quickly become relatively complex and are best displayed on a flow chart. The results of further evaluation may move a program back to the "gate-keeper" level for further categorization or on to further levels of analysis.

The basic evaluative question and the principle behind each are shown on the table below. There will be additional questions below this level, but the general thrust of the evaluation is clear from the "main branch."

Evaluative Questions

Evaluative Question	Principle
Does loss of the service have a significant, negative and measurable impact on City residents or businesses?	Atypical services are directed to this evaluation. Positive responses go back into categorization. Negative responses become possible targets for service reductions.
Does the service supplement a primary service provider?	This is designed to cull services which are being provided as a supplement to a primary provider. The evaluative aspect is the identification of a service which the City is not obligated to provide and which may not be provided in other similar settings. Either a negative or positive response requires further (but different) analysis.

Evaluative Question	Principle
Does the service address a special needs population and have measurable benefits which exceed costs to the City?	This is used to evaluate services which do not benefit the City at large. The criterion is to help the City gauge its ROI versus that of the community or other government entity. In cases where the City's ROI is not positive, externalities should be present to justify the expenditure.
Can subsidies required by the General Fund to provide the service be reduced or eliminated?	This is an evaluative tool to be used on a subset of services for which a fee or other revenue may be collected. It is used to feed the City's annual fee updating process.

An internal working group of Senior Staff has begun meeting to refine and improve the Framework. The group has already identified a need to integrate the City Service Area (CSA) outcomes and performance measures, consider how Strategic Support CSA programs could be evaluated in the Framework, and how non-General Fund funded program and services can be integrated.

Draft Analytical Framework for General Fund Service Reductions and Eliminations