



OFFICE OF THE CONTROLLER

CITY AND COUNTY OF SAN FRANCISCO

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Policy on Multi-Year Contracting with Inflation Rates for Nonprofit Suppliers

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OVERVIEW OF POLICY

In October 2023, the Board of Supervisors adopted an ordinance amending the Administrative Code to require the Controller to prepare an initial base budget to guide each City agency in preparation of its proposed two-year budget; to provide that these base budgets include anticipated cost increases in agreements with nonprofit organizations to reflect inflation; and to adopt a City policy that departments will enter into multi-year grants when the need for a grant program will extend beyond a single year.¹

This policy establishes the expectation that City departments that enter into contracts or grant agreements ("agreements") with nonprofit suppliers should use multi-year agreements when services are expected to extend beyond one year. Further, City departments should consider inflationary and programmatic changes to costs in subsequent years of multi-year agreements and account for these changes within agreement budgets.

To address the impacts of inflation on ongoing nonprofit services, this policy establishes that, beginning with the base budget for fiscal year 2024-2025 (FY24-25), the Controller's Office will apply a standard inflation factor to General Fund nonprofit services during the development of the City's base budget each fall. After the Controller's Office develops the base budget, the proposed budget for such services may be adjusted by departments, the Mayor's Office and/or the Board of Supervisors throughout the budget process.

Authority of the Mayor and Board of Supervisors

This policy does not bind the Mayor or Board of Supervisors in their budget process. All agreements continue to be subject to funding availability. Should funding changes or reductions be confirmed through the City's annual budget process, nonprofit agreements may be modified to account for approved changes or reductions.

¹ <https://sfgov.legistar.com/LegislationDetail.aspx?ID=6188919&GUID=CDAB8839-8266-4505-A780-B9D99693B5AE&Options=ID|Text|&Search=nonprofit>

Background and Rationale

In prior City practice, the Cost of Doing Business (CODB) adjustment has been an annual budget allocation for nonprofit suppliers. The Mayor or Board of Supervisors determined the increased rate during the budget process - typically 2-4% of the General Fund portion of nonprofit agreements. The CODB is flexible funding and aims to help nonprofit suppliers address inflationary pressures. The CODB is often applied to salaries, but nonprofit suppliers can use the funding for other adjustments as needed.

The annual CODB allocation process has led to various implementation challenges across City departments and nonprofit suppliers. City departments typically created multi-year budgets with flat funding each year since the exact amount of the CODB has not been known in advance. By the time the City budget is final in July, many nonprofits have already planned budgets for the fiscal year. Departments needed to modify agreement budgets each year to account for the CODB, and nonprofits did not have the ability to invoice for the CODB portion until these modifications were complete, often months into the fiscal year. This required nonprofits to spend funds with delayed reimbursement or delay employee wage increases. This policy aims to mitigate many of these operational challenges.

PROCEDURES AND IMPLEMENTATION

Establishing an Inflationary Rate

Each year, the City's adopted two-year budget includes a specific budget for the fiscal year in question, and an initial budget for the following fiscal year. Upon adoption, the second budget year ("BY+1") becomes the starting point for planning the subsequent two-year budget. Each fall, the Controller's Office updates the prior approved budget with known changes to create a "base budget" and initiate the next budget cycle.

The Controller's Office already applies certain mandated adjustments to each base budget, such as adjustments to mandatory fringe benefit rates. This policy instructs the Controller's Office to apply a standard and reasonably consistent inflation rate to General Fund nonprofit services when developing the base budget for the coming fiscal year.

Each year, and at various points in the year, the Controller's Office prepares projection reports that project expenditures and revenues, including inflation, in future years. In the fall, the Controller's Office develops multi-year forecasts that include inflation used in the Five-Year Financial Plan published each January. The Controller's Office will use this fall forecast to inform the inflationary rate included in the base budget and applied to the General Fund costs of nonprofit agreements for each department.

For stability within nonprofit agreements that span multiple years and which may be initiated or amended at various times, a reasonably consistent rate must be incorporated into the base budget each year. Projections of inflation may shift by small amounts over time, particularly

when projecting several years into the future. The Controller’s Office has created an index to stabilize how inflation will be applied both within the base budget and across agreements with nonprofits.

By October annually, beginning in October 2023, the Controller’s Office will develop inflation forecasts for a multi-year period for inclusion in the Five-Year Financial Plan. The Controller’s Office will compare the actual forecasted rate for the Budget Year (BY) and subsequent year (BY+1) to the index below, and will apply the indexed rate to the base budget.

For example, if the forecasted rate for BY is 2.56%, the Controller’s Office will apply an indexed rate of 3.00% in the base budget. Similarly, the Controller’s Office will calculate and incorporate the indexed rate for BY+1.

FIGURE 1: INFLATION RATE INDEX FOR BASE BUDGET COST OF DOING BUSINESS ADJUSTMENT

Low	High	Index Rate
-0.50%	0.49%	0.00%
0.50%	1.49%	1.00%
1.50%	2.49%	2.00%
2.50%	3.49%	3.00%
3.50%	4.49%	4.00%
4.50%	5.49%	5.00%
5.50%	6.49%	6.00%
6.50%	7.49%	7.00%
7.50%	8.49%	8.00%
8.50%	9.49%	9.00%
9.50%	10.49%	10.00%

In the subsequent year’s base budget development process, the indexed rate already applied to BY+1 in the prior year will remain as-is. The Controller’s Office will calculate the indexed rate for the new BY+1 and incorporate it into the new base budget. This process repeats annually.

Application in the Base Budget

The Cost of Doing Business adjustment applies to continuing General Fund agreements with nonprofit organizations. In most cases, the Controller’s Office calculates the department portion against the value of contract costs for each department using specific parameters within the financial system. In some cases, the Controller’s Office will request that departments provide similar information with any necessary manual adjustments to address specific programs or services that should be included or excluded from the calculation.

Each year, the Controller’s Office will update the base budget by taking the following steps:

- Use the financial system or request submissions from key departments in order to validate the General Fund budget amounts for nonprofit agreements in BY+1.
- Update the index table with new five-year inflation forecast numbers.
- Apply the indexed rate to all the relevant budget codes in the system and add that value to each department’s base budget.

For Budget Year 2024-2025, the Controller’s Office will not apply the inflation rate to enterprise departments or special funds; the Controller’s Office intends to conduct additional research into how and whether to incorporate these departments and special funds in the coming year(s). In the meantime, enterprise departments and departments managing special funds should continue any existing budget practices for addressing inflation in nonprofit agreements and should adopt multi-year contracting policies per the instructions below.

Budget Development Process

Once the Controller's Office establishes the base budget, the Mayor's Office and the Controller's Office issue budget instructions to departments, opening the Department Phase. Departments gain access to the budget system for the next two years' budgets and begin determining the proposed funding for services. Each department's consideration of cost should account for known General Fund costs of nonprofit agreements in the coming and subsequent budget years, including known increases due to inflation or programmatic changes already included within multi-year contract budgets, as well as adjustments for underspending, as relevant.

The Controller's Office has built assumed inflationary costs into the base before the Mayor's Office establishes budget targets, and it will be up to departments to develop budget submissions that account for the proposed cost and level of planned services for the coming years. In a year when the budget instructions include making reductions, departments should consider the full cost of nonprofit services when developing strategies to achieve reduction targets across their entire budget. If reductions of nonprofit agreements are needed, departments must identify strategies to cut costs aligned with business needs and funding availability.

Departments should also consider that BY+1 already includes an assumption of inflation. As the budget moves through its phases, any changes departments, the Mayor or the Board make to nonprofit agreement costs in the first year of the budget should be considered in development of BY+1.

Authority of the Mayor and Board of Supervisors

Nothing in the rate determination process binds the Mayor or Board of Supervisors in their budget negotiations. All contracts continue to be subject to funding ability through the annual budget process. Additionally, the Mayor and Board of Supervisors may approve additional inflationary increases through the budget process.

Multi-Year Contracts

The approved ordinance establishes the expectation that City departments that enter into agreements with nonprofit suppliers use multi-year contracts or grants when services are expected to extend beyond one year. Further, City departments should consider inflationary and programmatic changes to costs in subsequent years of multi-year contracts and account for these changes within contract budgets.

Each fall, the Controller's Office will establish its Five-Year Forecast of inflation and develop a parallel Five-Year Indexed Rate Summary for publication in the budget instructions for that BY (beginning fall 2024). Departments should use the Indexed Rate Summary Table to develop multi-year contract budgets that account for known inflation and programmatic cost changes across the term of the contract.

The Controller's Office designed the index to establish reasonable stability and consistency in the rate used in agreements year to year. However, the forecast may occasionally indicate that

contract budgets could include an indexed inflation rate that differs from year to year. Similarly, the indexed rate for the second or third year of an established agreement may change if there is a significant shift in the City’s economic position. The Controller’s Office anticipates such shifts during the term of a contract will be rare, but if the change occurs, it may require contract modifications to implement the changed rate.

In addition to considering the cost of inflation in multi-year contracts with nonprofits, departments should also plan ahead and account for other expected changes to the cost or level of services in subsequent years of these agreements.

FY24-25 Implementation

For planning nonprofit agreements active in FY24-25, departments should use the Indexed Rate Summary Table below. The Inflation Forecasts are subject to change. The Indexed Rates for FY24-25 and FY25-26 have been loaded into the base budget for BY and BY+1 and will not be adjusted. The Indexed Rate for FY26-27 and beyond may be adjusted and are not final until loaded into the base budget.

FIGURE 2: INDEXED RATE SUMMARY FOR FY24-25 THROUGH FY28-29					
	FY24-25	FY25-26	FY26-27	FY27-28	FY28-29
Inflation Forecasts	2.65%	2.57%	2.23%	2.21%	TBD
Indexed Rate	3.00%	3.00%	2.00%	2.00%	TBD

Provisions for agreements go into effect beginning July 1, 2024. Departments must ensure that as of July 1, 2024, all services that are expected to extend beyond FY24-25 are delivered through a multi-year agreement.

For new General Fund contracts initiating as of July 1, 2024, departments should include the indexed inflation rate for FY25-26 and any subsequent years within the contract, as well as any other necessary changes to service levels and contract costs.

Departments with existing, active multi-year agreements with General Fund sources established within FY23-24 or earlier should initiate any necessary amendments or modifications to incorporate the indexed inflation rate for FY24-25, as well as the rate for any subsequent years of the contract and any other expected changes to costs and services.

Departments should incorporate information about the indexed inflation rate within any solicitations to allow nonprofit bidders to submit budget proposals aligned to these guidelines. If departments have already processed solicitations for contracts anticipated to begin as of July 1, 2024, departments should notify awardees about these provisions and incorporate the indexed inflation rate and any other expected changes to costs and services in relevant years of the agreement per the table above.

Minimum Compensation Ordinance

Process for Legislated Increases

During the FY23-24 and FY24-25 budget process, the Mayor and Board of Supervisors approved [legislation](#) to increase the nonprofit wage threshold for the Minimum Compensation Ordinance (MCO) beyond the standard inflationary amount.² In FY23-24, the required minimum compensation for workers paid through City agreements with nonprofit organizations is \$18.93 per hour. The legislation further increases the MCO's nonprofit wage threshold in subsequent years, as follows:

- \$20.25 per hour as of July 1, 2024 (the total assumed cost of \$7.6 million was included in the FY24-25 budget)
- \$21.55 per hour as of July 1, 2025
- \$23.00 per hour as of January 1, 2026

The Mayor and Board of Supervisors have included distinct allocations within the City budget for these legislatively-mandated wage levels separate from the Cost of Doing Business allocation in FY23-24 and the new inflation rate included within the base budget in FY24-25. The Mayor and the Board of Supervisors have applied separate funding for raising the MCO's nonprofit wage threshold above the inflationary level, as the cost of raising wage levels for employees earning less than the MCO wage threshold may require funding beyond the inflationary increase included in the base budget and incorporated into nonprofit agreements.

Departments should review contract and grant budgets to identify whether any include worker wages below the MCO threshold for a given year, and/or departments may request nonprofit suppliers identify which relevant agreements may require an adjustment to account for changes to the MCO threshold across the contract term. In cases where adjustments exceed what is available through the inflationary percentage, departments may request MCO funding from the Mayor's Budget Office.

The MCO funding allocation does not mandate wage levels or allocate any specific funding for nonprofit workers above the MCO wage threshold. Departments and nonprofit suppliers may address issues of wage compaction (i.e., for staff at or immediately above the new wage threshold) using the inflation allocation as applicable.

The ordinance mandating new MCO wage levels does not bind the Mayor or Board of Supervisors in their budget negotiations. Should the Mayor and Board of Supervisors reduce the funding available for MCO wage increases in future budget years, this will impact whether and how MCO wage increases go into effect.

² <https://sfgov.legistar.com/LegislationDetail.aspx?ID=6248098&GUID=0446CF80-AA0D-4222-BE01-ECAE727A5D95&Options=ID|Text|&Search=230646>

Process for Inflationary Increases

Beginning July 1, 2026, the MCO's nonprofit wage threshold must again increase according to inflation. The Office of Labor Standards Enforcement (OLSE) publishes wage increases per the MCO instructions. These wage increases are tied to inflation with the caveat that the City may fund the inflationary increase, or not, in order for it to go into effect. A proportional increase may apply if the City only funds a portion of the cost of the MCO.

The Controller's Office uses analysis of inflation as part of the Five Year Financial Plan to establish the inflation rate to be used within nonprofit contracts, and incorporates sufficient funding with each department's base budget to fund this inflationary percentage for General Fund agreements. By funding inflation in the base budget, the City generally meets the criteria for MCO increases tied to inflation to go into effect.

However, because the Controller's Office has indexed the inflation rate to create a more consistent and stable rate within multi-year contracts, this means that in some years, the Controller's Office will increase funding in the base budget slightly less than the actual inflation rate. For example, if the actual inflation rate is 3.4%, the index will round down to a rate of 3.0%.

The MCO nonprofit rate may only increase based on the amount funded by the Board of Supervisors and certified by the Controller, and thus, in years where inflation is slightly higher than the indexed rate applied within the City's base budget and within contracts with nonprofits, the Controller's Office may only certify an increase in the MCO rate for nonprofits by the indexed amount.

Information about MCO requirements can be found on the Office of Labor Standards Enforcement website: <https://sfgov.org/olse/minimum-compensation-ordinance-mco>.

QUESTIONS AND CURRENT GUIDANCE

1. How should departments calculate and apply inflation within an agreement's budget?

When issuing solicitations for new General Fund services expected to last more than one year to be delivered by nonprofit suppliers, City departments should include information about the standard indexed inflation rate, and request bidders to include assumptions of the rate in budget proposals.

When a nonprofit supplier is selected to receive a contract or grant, departments often use a "funding notification" process to confirm the funding amount. When developing the multi-year agreement, the department should also notify the nonprofit of funding sources included in their agreement and the total value of the contract each year inclusive of the indexed inflation amount and any other expected changes to costs or services. The total not-to-exceed amount of the agreement should be inclusive of the cumulative value of inflation over the term of the contract, other expected changes to the cost of services, as well as any contingency the department may include.

2. Does this policy guarantee funding increases for contracts and grants each year?

No. All agreements clearly specify that budgets are contingent upon funding availability, as determined through the annual City budget process. Should the Mayor and Board of Supervisors approve a budget that requires reductions to nonprofit services, departments will apply these reductions based on holistic strategies that consider service priorities and the needs of each of their portfolios. For example, departments may make targeted cuts to delay or eliminate certain services or may apply an across-the-board reduction to all agreements. In these cases, nonprofits may be asked to produce amended budgets determining where and how to apply necessary reductions.

Additionally, this policy does not mandate departments increase total contract funding levels each year to incorporate the indexed inflation rate. At their discretion and based on business needs, departments may negotiate multi-year contracts to allow for inflationary increases to certain line items (such as wages) paired with service level decreases to maintain a flat rate of funding each year.

3. Does this policy apply to other funding sources and to contracts with blended funding?

City departments use funding from a variety of sources to fund nonprofit services, including state, federal, and private sources. Departments typically “blend” funding from multiple sources within a given agreement.

Consistent with past protocol for CODB implementation, it will not be City policy to subsidize inflationary increases for other funding sources with the General Fund. As such, there may be varying approaches to applying the inflation adjustments to blended nonprofit contracts and grants based on funding availability and requirements of the funding sources used for a given agreement.

- When a non-General Fund source has its own inflation rate or when the source has flexible funding (e.g., the source can increase to match the General Fund inflation rate), departments should continue to use these sources to match the indexed inflation rate applied to the General Fund.
- Departments with more restrictive non-General Fund sources should endeavor to identify available funding when possible, such as by using prior year savings, to apply a similar inflation rate to these sources.
- Among agreements where funding sources are not flexible and no other funding can be identified, the inflation rate will only apply to the General Fund sources within the agreement budget, and departments should develop total agreement budgets reflecting this.
- Departments should conduct ongoing monitoring of agreements with blended funding to ensure parity in increases across agreements. For agreements primarily funded through inflexible and restrictive funding sources, departments may need to assess supplier need and apply other structural solutions (e.g., one-time supports, restructuring of sources, etc.) to address inflationary pressures nonprofits face.

4. What happens when new funding is added to an agreement mid-year?

Departments add funding to existing multi-year agreements at various points during the contract term. This includes add-backs approved by the Board of Supervisors, mid-year enhancements approved by the Mayor's Office, and/or new state or federal grants.

- If a single year of new funding is added to an existing agreement, no inflation rate applies to this funding.
- If the new funding has been appropriated for two or more years, the first year of that funding is added to the base General Fund amount of the contract, and the inflation rate should be applied to the new base amount for the subsequent year(s).

5. How is an embedded inflation rate implemented when a multi-year agreement is amended to extend the term?

City departments may develop a multi-year agreement for two or more years, and in many cases may use an amendment to extend the term of that agreement for additional years, subject to the terms of the solicitation and funding availability.

- In cases where an amendment is simply extending the same service for an additional year or more, departments should calculate the first year of that amendment with the inflation rate applied to the prior year's base (i.e., as a continuation of the prior year's contract budget).
- In cases where the amendment includes significant changes to the scope of services being delivered and/or the cost structure for the services, this could be considered a new negotiation, and departments and nonprofit suppliers may need to adopt a new base budget for the amendment that assumes any inflationary increases within the new cost structure of the contract. The inflation rate would then apply in the second year of that amended agreement.

6. Should City departments provide guidance to nonprofit suppliers on where to apply the inflation rate within the contract budget?

The indexed inflation rate is considered flexible funding. Nonprofit suppliers must make business decisions on how to address the inflationary pressures their organization faces, and may use the indexed inflation rate for salaries or other operating expenses as deemed necessary by the organization. However, budgets within agreements are a negotiation between City departments and nonprofit suppliers. City departments should communicate any spending priorities with nonprofit suppliers when negotiating agreement budgets.

7. How does the inflation rate impact the indirect rate applied within nonprofit agreements?

City departments typically fund indirect costs using a rate of 10-15% or more, though this may vary case by case. This policy does not change indirect rate calculation procedures. The indirect rate is typically calculated off the total value of the contract with certain types of uses excluded from the calculation (e.g., subcontracts). The inflation rate will increase the total value of subsequent years of a multi-year contract from which the indirect rate is typically calculated. See [Cost Categorization Guidelines for Nonprofit Contracts and Grants](#) for more on indirect costs.

8. Policy Exceptions: what types of agreements or costs are exceptions to this policy?

As a general rule, the same inflation rate will be applied uniformly and consistently across all City agreements with nonprofit suppliers, with the rate calculated off the General Fund portion of the agreement. However, there are several "outlier" agreements or cost types that are an exception to the policy. Specific instructions for these cases are outlined below:

- Housing Subsidy Agreements: Several departments have agreements with nonprofit suppliers that fund the administration and disbursement of rental subsidies for various housing programs. Within these agreements, the inflation rate only applies to the administrative costs of the agreement; the calculation should not include the cost of the subsidies themselves. Increases to the value of rental subsidies would be a budget enhancement to be considered through the annual budget process and in negotiations between the department and nonprofit.
- In Home Supportive Services Public Authority: The Human Services Agency conducts separate budget negotiations on wage levels and other inflationary increases with this entity, and the policy around the specific inflation rate to include in the base budget and in this agreement will not apply. The policy does apply to all other agreements with IHSS service providers.
- Nonprofits Delivering Professional Services to the Department: In some cases, departments fund nonprofits to deliver professional services to the City government, such as consulting services. The indexed inflation rate should only be included in nonprofit agreements for services delivered to the public (including professional services contracts for services delivered to the public). Departments should individually negotiate each professional service agreement for services to their own department, including any inflationary increases that may be required.
- Other Exceptions: This policy may be amended to include additional exceptions.

Questions?

Department staff with questions about the base budget development process should contact your assigned staff person at the Controller's Office Budget Analysis Division.

Department staff with questions about contracting practices should contact Laura.Marshall@sfgov.org.

Nonprofit service providers should contact assigned program managers at funding departments with questions about this policy or other issues or concerns related to contracts and grants.