

**MID-YEAR**  
**BUDGET REVIEW**

---

**2011-2012**

OFFICE OF THE CITY MANAGER  
JANUARY 2012

2011-2012

MID-YEAR  
BUDGET  
REVIEW

TABLE OF CONTENTS

	MEMORANDUM OF TRANSMITTAL	1
I.	GENERAL FUND STATUS REPORT	I - 1
	A. GENERAL FUND SOURCE AND USE OF FUNDS	I - 2
	B. STATUS OF GENERAL FUND REVENUES	I - 4
	C. STATUS OF GENERAL FUND EXPENDITURES	I - 22
II.	SELECTED SPECIAL/CAPITAL FUNDS STATUS REPORT	II - 1
III.	RECOMMENDED BUDGET ADJUSTMENTS AND CLEAN-UP ACTIONS	III - 1
IV.	APPENDICES	
	A. FINANCIAL RESULTS	1

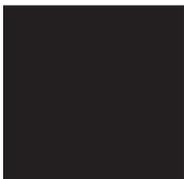


2011-2012

MID-YEAR  
BUDGET  
REVIEW



MEMORANDUM OF  
TRANSMITTAL



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Debra Figone

**SUBJECT: 2011-2012 MID-YEAR  
BUDGET REVIEW REPORT**

**DATE:** January 31, 2012

---

## **RECOMMENDATIONS**

- A. Approval of the 2011-2012 Mid-Year Budget Review Report.
- B. Adoption of related Appropriation Ordinance and Funding Sources Resolution amendments in various funds as detailed in Section III (Recommended Budget Adjustments and Clean-Up Actions) of the 2011-2012 Mid-Year Budget Review Report.

## **OUTCOME**

The Mid-Year Budget Review Report provides an explanation of the City's budget condition in the current fiscal year as compared to the 2011-2012 Modified Budget based on actual performance during the first six months of 2011-2012. Based on this analysis, budget revisions are recommended to address projected revenue and expenditure variances, account for new grants and reimbursements, and better position the City to address our ongoing budget challenges.

## **EXECUTIVE SUMMARY**

Over the last decade, the City has addressed persistent and severe budget shortfalls, with one of the largest General Fund deficits of \$115 million solved in 2011-2012. To address this shortfall, significant service reductions and changes to service delivery models were implemented across the organization. Active management of these changes has been a focus this year.

Against this backdrop, the Administration is closely monitoring the City's budget to ensure that current year revenues and expenditures are meeting expectations, which is necessary to avoid further disruptions in service during the year. I am pleased to report that through the first half of the year, almost all City funds are performing within expected 2011-2012 budgeted levels and, in some cases, revenues are outperforming expectations. There are isolated instances where current year performance is not meeting budgeted estimates, such as in the Municipal Golf Course Fund. Budget actions are recommended to address these problems without any service impacts.

### *Mid-Year Budget Highlights*

#### **General Fund**

- If current collection trends continue, General Fund revenues are expected to slightly exceed the budgeted estimate by year-end. This is the result of stronger performance in several categories, such as Sales Tax, Transient Occupancy Tax, Business Taxes, and Utility Taxes, partially offset by lower collections in other revenue categories. Overall, General Fund expenditures are also tracking within estimated levels and are projected to generate savings by year-end.
- A series of Mid-Year Budget Review actions are recommended based on actual performance through December and projected activity through the remainder of the year. Major actions include the following:
  - Establish a \$12.0 million 2011-2012 Ending Fund Balance Reserve from excess revenues (\$3.7 million) and expenditure savings (\$8.3 million). This action proactively sets aside and secures the excess revenues and expenditure savings assumed to be available in 2011-2012 and used as a funding source for 2012-2013 as projected in the 2012-2013 Preliminary General Fund Forecast.
  - Increase the 2012-2013 Future Deficit Reserve by \$10 million (to \$22 million). Convention Center Lease Payments were originally anticipated to be funded by the City (\$10 million) and the San Jose Redevelopment Agency (SJRA) (\$5.4 million). However, the SJRA was able to directly assume the entire debt service payment as a result of higher than estimated tax increment revenue, eliminating the need for the General Fund to assist with the payment. As a result, budget actions are recommended to eliminate the debt service payments in the General Fund and the associated SJRA reimbursement, resulting in net General Fund savings of \$10 million.
  - Rebalance the Medical Marijuana Regulatory Fee Program (\$1.4 million) by eliminating the fee revenue that currently cannot be collected, increasing the Marijuana Business Tax revenue based on higher actual collections and decreasing program expenditures in the Police Department, the City Manager's Office, the Finance Department, and City-Wide Expenses.
  - Establish a \$2.1 million Fiscal Reform Plan Implementation Reserve to fund future ballot measures, polling, studies, and/or potential litigation related to the implementation of the City Council approved Fiscal Reform Plan. In May 2011, the City Council approved a Fiscal Reform Plan, as amended, to achieve savings and/or new revenues to eliminate the General Fund structural deficit, restore services to the January 2011 level, and open facilities built or under construction within five years. The reserve would be funded by eliminating the Retirement Reform Election City-Wide Expenses appropriation of \$3.4 million set aside for the March Retirement Reform Ballot Measure. The remaining funding of \$1.3 million (combined with City Clerk election funding of \$500,000) is recommended to be allocated to a new City-Wide Expenses appropriation for Elections and Ballot Measures to provide for City Council District elections, a June Retirement Reform Ballot Measure, and up to two additional ballot measures.

- Address a limited number of urgent program/fiscal needs, technical adjustments and rebalancing actions, as well as net-zero grants/reimbursement/fee adjustments. These actions include a \$25.0 million reduction to the Tax Revenue Anticipation Notes (TRANs) Debt Service appropriation and associated revenue based on the lower actual issuance required for City cash flow purposes in 2011-2012. Also recommended is an increase of \$400,000 to the Unanticipated/Emergency Maintenance appropriation to address failures in large systems and critical maintenance needs, particularly in the City Hall facility. Additionally, funding of \$450,000 is recommended for Labor/Employee Relations Consultant and Actuarial Services and \$150,000 is proposed for Police Officer Recruit Academy support to maximize the potential of obtaining highly qualified candidates to fill vacancies for the upcoming July Academy.

### **Special/Capital Funds**

- The revenues and expenditures in the City's special and capital funds are generally performing within expected levels through December. Budget adjustments are recommended in the special and capital funds to adjust for revised cost and revenue estimates, to address critical current year funding needs, and to recognize various grants and reimbursements. Some of the major recommended adjustments include:
  - In the Municipal Golf Course Fund, increase the Transfer from the General Fund by \$300,000 to address higher net costs in that fund and ensure a healthy fund balance.
  - In the Construction Excise Tax Fund, the Building and Structures Construction Tax Fund, the Convention and Cultural Affairs Fund, and the Transient Occupancy Tax Fund, increase the revenue estimates and allocates those funds based on current collection trends and estimated activity through the remainder of the fiscal year.

Looking forward, a preliminary General Fund budget shortfall of \$25 million is projected for 2012-2013 as of December 2011. The Administration has started the planning process to address this shortfall for next year and will release a 2013-2017 General Fund Forecast in late February and the 2012-2013 Proposed Budget in May. The 2012-2013 Proposed Budget that will factor in City Council direction provided through the Mayor's March Budget Message.

### **BACKGROUND**

The annual Adopted Budget is a financial plan predicated on the best information available at the time it is prepared. As with any budget, however, changing conditions create the need to modify the original plan. Through its budget policies, the City Council has designated mid-year as the appropriate time to perform a comprehensive review of the current year's budget, and the Mid-Year Budget Review as the appropriate vehicle for consideration of any revisions to the budget. This Mid-Year Budget Review Report complies with that policy. It contains a comprehensive review of the status of the City's 2011-2012 Operating and Capital Budgets. City Council review of this report is agendaized for the February 14, 2012 Council meeting.

The Mid-Year Budget Review Report includes the following sections:

- **Transmittal Memorandum** – An overall summary of the contents of the Mid-Year Budget Review Report.
- **Section I: General Fund Status Report** – A review of the General Fund revenues and expenditures through Mid-Year.
- **Section II: Selected Special/Capital Funds Status Report** – A review of selected special and capital funds that have revenue and/or expenditure variances from the modified budget or other issues of interest.
- **Section III: Recommended Budget Adjustments and Clean-up Actions** – The Recommended Budget Adjustments detail the proposed budget augmentations/reductions in the General Fund and special/capital funds. The Clean-up Actions detail the technical appropriation and revenue estimate adjustments for the General Fund and special/capital funds.
- **Section IV: Appendix** – This section includes the financial results, prepared by the Finance Department, for all budgeted fund groups for the first six months of the year.

## ANALYSIS

The Analysis section includes the following: an overview of the current economic environment; a discussion of General Fund performance through December; a summary of recommended General Fund budget adjustments included in the Mid-Year Budget Review Report; and a status report on selected special and capital funds.

## **ECONOMIC ENVIRONMENT**

The 2011-2012 revenue estimates were built on the assumption that the economy would continue its slow recovery from the 2007-2009 recession. Economic indicators and actual revenue performance support the continuance of the slow economic recovery with some improvement in recent months.

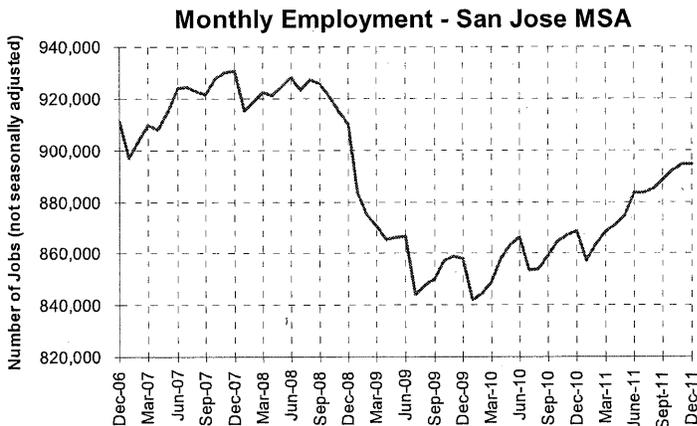
On a national level, real gross domestic product (GDP) picked up in the third quarter of 2011 (ending September 30, 2011) growing at an annual rate of 1.8%. According to the “advance” estimate release by the Bureau of Economic Analysis, GDP grew by an annual rate of 2.8% in the fourth quarter of 2011. The Bureau emphasized that the fourth quarter advance estimate is based on source data that are incomplete or subject to further revision. The “second” estimate for the fourth quarter 2011, based on more complete data, will be released on February 29, 2012<sup>1</sup>. Both quarters reflect an improvement from the 1.3% GDP growth rate in the second quarter 2011. Consumer confidence has also shown improvement in recent months as reflected by The Conference Board Consumer Confidence Index, which experienced increases in both November and December. According to Lynn Franco of The Conference Board, “After two

---

<sup>1</sup> Bureau of Economic Analysis, U.S. Department of Commerce, News Release: Gross Domestic Product, January 27, 2012

months of considerable gains, the Consumer Confidence Index is now back to levels seen last spring (April 2011, 66.0). Consumers' assessment of current business and labor market conditions improved again. Looking ahead, consumers are more optimistic that business conditions, employment prospects, and their financial situations will continue to get better. While consumers are ending the year in a somewhat more upbeat mood, it is too soon to tell if this is a rebound from earlier declines or a sustainable shift in attitudes."

The economic performance in Silicon Valley continues to show some strength. In its most recent update, Beacon Economics described Silicon Valley as a bright spot in a grey economy. "The South Bay/Silicon Valley continues to be one of the regions leading California's economic recovery. This is not surprising due to strong demand for the area's technology products at the state, national, and international levels"<sup>2</sup>.



Employment in this region continues to experience gains. The December 2011 employment level in the San Jose Metropolitan Statistical Area (MSA) of 894,500 was 2.9% above the December 2010 level of 868,900. While the employment level has experienced steady growth, it remains below the recent peak of 930,500 experienced in December 2007.

high, but has now dipped below the double-digit levels that had been experienced in recent years. The December 2011 unemployment rate of 8.9% decreased from the November rate of 9.2% and is lower than the 10.6% rate experienced a year ago. The December 2011 unemployment rate in this region is less than the unadjusted unemployment rate for the State

(10.9%), but continues to track above the nation, which currently has an unadjusted unemployment rate of 8.3%.

**Unemployment Rate (Unadjusted)**

	Dec. 2010	Nov. 2011	Dec. 2011
San José Metropolitan Statistical Area*	10.6%	9.2%	8.9%
State of California	12.3%	10.9%	10.9%
United States	9.1%	8.2%	8.3%

\* San Benito and Santa Clara Counties  
 Source: California Employment Development Department

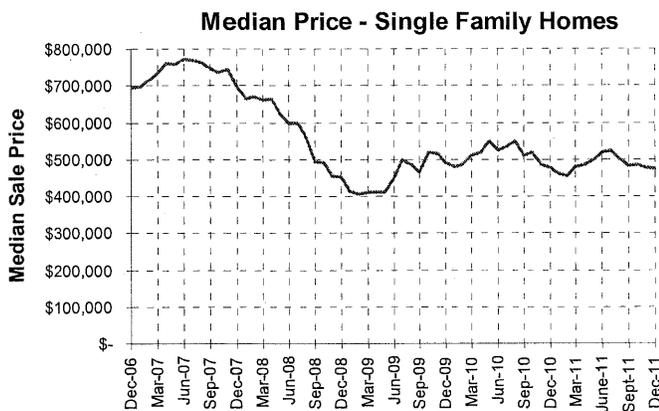
Through December, permit valuation for residential construction activity is tracking below prior year levels. Permits for 996 dwelling units have been issued through December, which is well below 2,158 units issued during

the same period last fiscal year. In 2010-2011, however, there was a surge in activity in December 2010 in which 1,641 permits (74% of the annual total) were issued. Permit valuation

<sup>2</sup> Beacon Economics, The Regional Outlook – South Bay, Quarterly Update – December 2011

for commercial and industrial construction activity is tracking above last year. Commercial activity is higher, with valuation for commercial permit activity at \$117.3 million through December, compared to \$102.7 million through the same period last year. Industrial permit activity is up significantly, with valuation at \$69.8 million through December, compared to \$24.1 million collected through the same period last year. The increases in commercial and industrial permit activity are primarily due to alterations, as new construction activity remains weak. This permit activity drives the revenue collection in several construction tax categories and is an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

The housing market appears to be somewhat stable. The December 2011 median single-family home price of \$474,500 was within 1% of the December 2010 price of \$478,000. The number of property transfers (sales) for all types of residences totaled 713 in December 2011, which was also within 1% of the December 2010 figure of 718. The average days-on-market for single-family and multi-family dwellings totaled 84 days in December 2011, which is a slight drop from the 87 days experienced in December 2010.



Economic conditions will continue to be closely monitored and factored into the final 2013-2017 General Fund Forecast, due to be released February 27, 2012, and the development of the 2012-2013 Proposed Budget, due to be released May 1, 2012.

**GENERAL FUND PERFORMANCE**

General Fund revenues and transfers through December totaled \$394.3 million, or 43.7% of the budgeted estimate. Excluding two large downward adjustments discussed below, General Fund revenues are tracking to end the year \$4 million to \$8 million above expected levels. Higher than budgeted collections are expected in a number of categories, including: Sales Tax, Utility Taxes, Business Taxes, Transient Occupancy Tax, and Other Revenue. The higher collections in these categories are expected to be partially offset by lower collections in a few categories, including Transfers and Reimbursements, Licenses and Permits, and Fines and Forfeitures.

In this document, a large net downward adjustment of \$22.7 million to the General Fund revenue estimate is recommended. This large decrease primarily reflects a \$25.0 million reduction in the anticipated revenue from the TRANs (and associated expenditures) based on the actual debt issuance required for City cash flow purposes this year. A reduction of \$5.4 million to the Revenue from Local Agencies reflects the SJRA now directly assuming the entire Convention Center Lease Payment as a result of higher than estimated tax increment revenue, eliminating the need for the General Fund to assist with the payment. Excluding these actions, net upward

adjustments total \$7.7 million and reflect higher current year collections (\$5.4 million) and various grants, reimbursements, and fee adjustments (\$2.3 million). The additional \$5.4 million is recommended to be allocated to the 2011-2012 Ending Fund Balance Reserve (\$3.7 million) and to address various urgent expenditure needs identified in this document (\$1.7 million). The revenue estimates for this year will continue to be updated as part of the final 2013-2017 General Fund Forecast, due to be released on February 27, 2012, as well as the 2012-2013 Proposed Budget, scheduled to be released on May 1, 2012.

General Fund expenditures through December of \$374.6 million were 7.4% below the December 2010 expenditure level of \$404.3 million. Encumbrances totaling \$35.5 million were \$1.0 million (2.9%) above the December 2010 level of \$34.5 million. Expenditures and encumbrances through December of \$410.0 million constituted 41.7% of the total 2011-2012 modified budgeted use of funds amount (excluding reserves) of \$982.7 million. Overall, expenditures are tracking within anticipated levels and are expected to generate savings by year-end. Budget actions are recommended in this document to set aside \$8.3 million of those savings into a 2011-2012 Ending Fund Balance Reserve.

There are a limited number of budget adjustments recommended to address potential overages that may occur by year-end and address urgent program and fiscal needs. Other technical/rebalancing actions, clean-up actions, and net-zero grants, reimbursements, and fee actions are also recommended in this document. A summary of these transactions is provided below and a more detailed discussion of both the General Fund revenue and expenditure performance is provided in Section I of this document.

#### **RECOMMENDED GENERAL FUND BUDGET ADJUSTMENTS**

The recommended Mid-Year Budget Review actions accomplish the following: 1) funds urgent program or fiscal needs 2) implements required technical/rebalancing adjustments; 3) recognizes various revenue-supported grants, reimbursement, and fee activity adjustments; and 4) implements clean-up actions.

The following chart summarizes these recommended adjustments.

**2011-2012 MID-YEAR BUDGET REVIEW  
 RECOMMENDED GENERAL FUND BUDGET ACTIONS**

<b>GENERAL FUND REVENUES</b>	<b>(\$ in Millions)</b>
Urgent Program/Fiscal Needs	\$ 0.061
Required Technical/Rebalancing Actions	(0.205)
Grants/Reimbursements/Fees	2.295
Clean-Up Adjustments	(24.807)
<b>Total Revenue Adjustments</b>	<b>(\$ 22.656)</b>
<b>GENERAL FUND EXPENDITURES</b>	<b>(\$ in Millions)</b>
Urgent Program/Fiscal Needs	\$ 1.061
Required Technical/Rebalancing Actions	(0.972)
Grants/Reimbursements/Fees	2.295
Clean-Up Adjustments	(25.040)
<b>Total Expenditure Adjustments</b>	<b>(\$ 22.656)</b>

It is important to note that actions included in the Required Technical/Rebalancing Actions category will help prepare the City for the 2012-2013 budget process. As part of the General Fund Forecast development, an estimate on the current year expenditure savings, as well as any excess revenue and funding from the liquidation of prior year carryover encumbrances, is included as a funding source for the next year. In the 2012-2013 Preliminary General Fund Forecast issued in November, it was assumed that \$13.0 million would be available at the end of 2011-2012 for use in 2012-2013. The recommended Mid-Year Budget Review actions identify \$12 million in expenditure savings and additional revenues that are recommended to be placed in a 2011-2012 Ending Fund Balance Reserve. Combined with anticipated liquidations of carryover encumbrances (\$1.0 million), this Reserve will ensure the necessary fund balance is available by year-end to meet the Forecast estimate. In addition, this document recommends an increase to the 2012-2013 Future Deficit Reserve by \$10 million to address the projected General Fund shortfall in that year. This action reflects the SJRA assuming the entire Convention Center Lease Payment as a result of higher than estimated tax increment revenue, eliminating the need for the General Fund to assist with the payment.

The budget actions recommended in the Mid-Year Budget Review result in a net reduction of \$22.7 million to General Fund revenues and expenditures. Following is a brief description of the General Fund revenue and expenditure adjustments recommended in this report. Additional information on these adjustments is provided in Section III of this document.

<b>URGENT PROGRAM/FISCAL NEEDS</b>
------------------------------------

- **Revenue Adjustments (\$60,500):** Increased revenue estimates are recommended to recognize additional revenue anticipated at the Lake Cunningham Skate Park from fees (\$50,500) and donations (\$10,000) in order to keep the park operational through June 2012.

- **Net Expenditure Augmentations (\$1.1 million):** Increases to expenditures are recommended based on an evaluation of urgent program or fiscal needs. These include the following actions:
  - *Fiscal Reform Plan Implementation/Elections and Ballot Measures* – A reallocation of \$3.4 million from the Retirement Reform Election appropriation to a new Fiscal Reform Plan Implementation Reserve (\$2.1 million) and an Elections and Ballot Measures City-Wide Expenses appropriation (\$1.3 million) is recommended. As part of the 2011-2012 Mayor’s June Budget Message, the City Council allocated \$3.4 million for a potential Retirement Reform ballot measure to be considered by the voters in March 2012. On December 6, 2011, the City Council instead approved placing the Retirement Reform measure on the June 5, 2012 ballot for voter consideration at a significant reduction in costs. The \$2.1 million Fiscal Reform Plan Implementation Reserve would fund future ballot measures, polling, studies, and/or potential litigation related to the implementation of the City Council approved Fiscal Reform Plan. The remaining funding of \$1.3 million (combined with City Clerk election funding of \$500,000) is recommended to be allocated to a new City-Wide Expenses appropriation for Elections and Ballot Measures to provide for City Council District elections, a June Retirement Reform Ballot Measure, and up to two additional ballot measures.
  - *Other Expenditure Adjustments* – Additional funding is recommended for Labor/Employee Relations Consultant Services (\$400,000), Unanticipated/Emergency Maintenance (\$400,000), Police Officer Recruiting Support (\$150,000), Retirement Actuarial Services (\$50,000), Lake Cunningham Skate Park Operations (\$57,500) and Reserves (\$3,000), and support for the Police Department Horse Mounted Unit (\$10,000 - shift from Personal Services to Non-Personal/Equipment).

<b>REQUIRED TECHNICAL/REBALANCING ACTIONS</b>
-----------------------------------------------

- **Revenue Adjustments (-\$205,000):** Based on a detailed review of all of the General Fund revenues, a net downward adjustment of \$205,000 is recommended. This includes the following net upward adjustments of \$5.2 million based on current collection trends:
  - *Sales Tax* (up \$3.3 million) based on higher first quarter performance and 3% growth assumption for the remaining three quarters;
  - *Utility Tax* (up \$2.2 million) to reflect a final settlement payment from PG&E of \$1.56 million and higher Gas and Telephone Utility Tax collections;
  - *Business Taxes* (up \$1.6 million) to reflect higher collections in the Marijuana Business Tax (\$850,000) and the Cardroom Tax (\$729,000);
  - *Transient Occupancy Tax* (up \$1.1 million) based on current collection trends;
  - *Other Revenue* (up \$282,000) primarily due to higher Arena Rental Revenue (\$307,000), higher SB 90 reimbursements from the State (\$286,000), and higher Lake Cunningham donations (\$10,000), partially offset by a reduced estimate for Sale of Property revenues (-\$300,000);

- *Departmental Charges* (up \$50,500) to reflect additional fee revenue generated at the Lake Cunningham Skate Park;
- *Transfers and Reimbursements* (down \$1.4 million) to reflect lower overhead reimbursements;
- *Licenses and Permits* (down \$1.4 million) to reflect the loss in Medical Marijuana Regulatory Program Fees adopted in the 2011-2012 Budget and other minor adjustments; and
- *Fines and Forfeitures* (down \$500,000) based on current collection trends.

The net upward adjustments of \$5.4 million are almost entirely offset by a reduction of \$5.36 million to the Revenue from Local Agencies category to account for the loss of reimbursement from the SJRA associated with the Convention Center debt service payments. As discussed above, the General Fund transactions associated with the Convention Center Lease Payments are recommended to be eliminated in this document as the SJRA will cover this cost directly in 2011-2012.

- ***Net Expenditure Adjustments (-\$972,000):*** To implement required technical/rebalancing actions, a net decrease in General Fund expenditures of \$972,000 is recommended and includes the following:
  - *2011-2012 Ending Fund Balance Reserve (\$12.0 million):* The establishment of 2011-2012 Ending Fund Balance Reserve is recommended, offset by additional revenue and expenditure savings. As discussed above, in the 2012-2013 Preliminary General Fund Forecast, it was assumed that General Fund expenditure savings, excess revenues, and the liquidation of prior year carryover encumbrances would generate \$13.0 million in savings in 2011-2012 that would be available as a funding source in 2012-2013. This reserve, in addition to the anticipated liquidation of carryover encumbrances, meets this target. This Reserve will be funded from excess revenues (\$3.7 million) based on updated projections (discussed above) and expenditure savings in the City-Wide Expenses appropriations (\$3.55 million), departmental personal services and non-personal/equipment allocations (\$2.85 million), and Earmarked Reserves (\$1.9 million).
  - *2012-2013 Future Deficit Reserve (\$10.0 million):* Increases the 2012-2013 Future Deficit Reserve by \$10 million because SJRA was able to directly assume the Convention Center Lease Payments as a result of higher than anticipated tax increment revenue, eliminating the need for the General Fund to assist with the payment. The Convention Center debt service payments were originally anticipated to be funded by the City (\$10 million) and the SJRA (\$5.4 million). A corresponding reduction to the estimate for Revenue from Local Agencies (\$5.4 million) and the Convention Center Lease Payments appropriation (\$15.4 million) are also recommended in this document.
  - *Other Expenditure Adjustments (\$1.3 million):* Additional funding is recommended in this document for the following: Property Tax Administrative Fees (\$540,000) based on a recent notification from the County of a projected 20% cost increase in the current year; transfer to the Municipal Golf Course Fund (\$300,000) to ensure the fiscal health of that

fund; Community Re-Use Centers facilities maintenance and custodial needs (\$300,000) based on actual implementation in 2011-2012; and City Attorney's Office personal services (\$200,000) to avoid a year-end overage. Lastly, net-zero technical adjustments are recommended for a Habitat Conservation Plan (\$100,000 from reserves), City Attorney's Office Personal Services (\$125,000 from Non-Personal/Equipment), and to reallocate Public Works utility savings to fund Public Works facilities maintenance and custodial needs (\$400,000).

- *Convention Center Lease Payments (-\$15.4 million)* – The elimination of the Convention Center Lease Payments appropriation is recommended. In the 2011-2012 Adopted Budget, the debt service payment for the Convention Center of \$15.4 million was budgeted in the General Fund, with partial reimbursement from the SJRA (\$5.4 million). However, the SJRA was able to directly assume the entire debt service payment as a result of higher than anticipated tax increment revenue, eliminating the need for the General Fund to assist with the payment. As discussed above, a corresponding reduction to the estimate for Revenue from Local Agencies is also recommended. The resulting \$10 million in General Fund savings is recommended to be allocated to the 2012-2013 Future Deficit Reserve.
- *City-Wide Expenses Savings (-\$3.6 million)* – Based on recent tracking, reductions to the Sick Leave Payment Upon Retirement (\$2.3 million) allocation is recommended. In addition, anticipated savings are expected in the Workers' Compensation Claims (\$1 million) and TRANs Debts Service (\$250,000 – lower issuance costs) appropriations. These savings are recommended to be allocated to the 2011-2012 Ending Fund Balance Reserve.
- *Departmental Savings (-\$2.9 million)* – Based on recent information regarding vacancy savings and vehicle replacement savings, decreases to the Police Department Personal Services (\$1 million) and Non-Personal/Equipment (\$1 million), Planning, Building and Code Enforcement Personal Services (\$350,000), Office of Economic Development Non-Personal/Equipment (\$300,000), and Finance Department Personal Services (\$200,000) allocations are recommended. These savings are recommended to be allocated to the 2011-2012 Ending Fund Balance Reserve.
- *Reserves Savings (-\$1.9 million)* – As a result of lower than anticipated rate increases for health premiums (7.2% increase compared to 14% forecasted) and dental rates (0% increase compared to 3.5% forecasted) a reduction to the Salaries and Benefits Reserve (\$1.2 million) is recommended. The elimination of the Filled Position Elimination Expenditure Impacts Reserve (\$700,000) is also included in this document. These savings are recommended to be allocated to the 2011-2012 Ending Fund Balance Reserve.
- *Medical Marijuana Regulatory Fee Program Rebalancing (-\$630,000)*: Decreases to the Medical Marijuana Regulatory Fee Program are recommended in this document to rebalance the program for \$1.4 million in cost recovery regulatory fees that are not anticipated to be received. On January 10, 2012, the City Council accepted the Certificate of Sufficiency issued by the County of Santa Clara Registrar of Voters for the

referendum to repeal the Regulatory Ordinance for the Medical Marijuana Regulatory Fee Program. As a result, the \$1.4 million in cost recovery regulatory fees established under the Regulatory Ordinance are not anticipated to be received in 2011-2012. Reductions to the City-Wide Expenses (\$148,000), City Manager's Office (\$51,000), Finance Department (\$182,000), and Police Department (\$249,000) program allocations are recommended in this document.

#### GRANTS/REIMBURSEMENTS/FEEES

- A series of revenue-supported adjustments totaling \$2.3 million are recommended to reflect new or updated revenues and expenditures for grant, reimbursement and/or fee activities. The largest grants and reimbursements support the following: Senior Nutrition Program (\$665,000); Parks, Recreation, and Neighborhood Services Fee Activity (\$600,000); Sidewalk Repair Program (\$500,000); and the Communities Putting Prevention to Work Grant – Obesity Prevention Initiative (\$105,000). A complete listing of these actions can be found in Section III of this document.

#### CLEAN-UP ACTIONS

- **Revenue Adjustments (-\$24.81 million):** A decrease of \$24.8 million to General Fund revenue estimates are recommended to reflect the following:
  - *TRANS Proceeds* - a reduction in the anticipated revenue from the TRANS (from \$125 million to \$100 million) based on the actual issuance needed this year to address the City's cash flow needs.
  - *San Jose After School – Year Five District Contracts* - a downward adjustment of \$21,000 to the Revenue from Local Agencies is recommended to reflect lower actual San Jose After School - Year Five District Contracts.
  - *Beginning Fund Balance Reconciliation* (up \$213,000) based on the final reconciliation to the audited 2010-2011 Comprehensive Annual Financial Report.
- **Net Expenditure Adjustments (-\$25.04 million):** To implement a variety of clean-up actions, a net decrease in General Fund expenditures of \$25.04 million is recommended and includes the following:
  - *TRANS Debt Service:* A decrease of \$25.0 million to TRANS Debt Service appropriation is recommended to reflect the lower debt issuance required for City cash flow purposes.
  - *Cal-Gang Program:* A \$20,000 reduction to the Police Department Non-Personal/Equipment appropriation to reflect a corrected funding amount for the Cal-Gang Program.
  - *San Jose After School – Year Five District Contracts:* A \$20,593 reduction to the City-Wide Expenses appropriation to reflect close-out of the program.

- *Net-Zero Adjustments:* Adjustments including funding for health rate increases effective January 1, 2012, recognition of voluntary furlough/reduced work week program savings, and reallocation of program costs between department and non-department allocations to better align costs with services provided. A complete listing and further detail is discussed in Section III of this document.

## STATUS OF SELECTED SPECIAL AND CAPITAL FUNDS

A comprehensive review of the special and capital funds as well as all of the capital projects is conducted as part of the Mid-Year Budget Review. On an overall basis, revenues and expenditures in the special and capital funds are tracking within estimated levels through December. Section II of this report contains the status of selected special and capital funds with issues of interest or variances.

### Special Funds

Following is a summary the activity in selected special funds through December.

- *Airport Funds* – The Airport projected an approximate 2% increase in airline passenger activity for 2011-2012. This increase was based both on activity trends in 2010-2011 and projected flight schedules. However, passenger activity at the Airport through the first half of 2011-2012 is tracking lower than projected as well as lower than 2010-2011 mid-year levels (-0.7% or decrease of 32,000 passengers). The overall operating revenues through December 2011 totaled \$82.9 million which includes \$24.9 million in reimbursement of eligible Terminal Area Improvement Program (TAIP) expenditures from bond proceeds. While passenger activity is below projections, revenues are tracking within estimated levels due to conservative budgeting. The Airport's fiscal challenges, however, are expected to continue in the future as a result of the lack of passenger growth and debt service costs associated with TAIP. Use of one-time savings from 2010-2011 and the application of unspent bond proceeds will both be factored into the development and balancing of the 2012-2013 Proposed Budget, as well as future budgets.
- *Transient Occupancy Tax Fund* – Transient Occupancy Tax (TOT) collections are tracking 12.9% above the prior year. The 2011-2012 Adopted Budget allowed for a decline of approximately 1%. As a result of the higher than anticipated collections, an increase to the budgeted TOT revenue estimate is recommended. Increasing the estimate from \$10.8 million to \$12.5 million will also result in higher allocations for the three recipients (\$824,000 for the Convention and Cultural Affairs Fund, \$412,000 for the San Jose Convention and Visitors Bureau (CVB), and \$412,000 for Cultural Development). TOT receipts will continue to be closely monitored as 2011-2012 progresses.
- *Convention and Cultural Facilities Fund* – Operating revenues in this fund are tracking well above anticipated levels and are projected to exceed the revenue estimate by the end of the year. This increase is primarily due to contract labor and food and beverage revenues, which also have corresponding expenditures. As a result of the higher than anticipated

activity, an increase of \$3.5 million to both the revenue estimate and the Non-Personal/Equipment appropriation are recommended in this document.

As a result of the higher than anticipated TOT receipts being realized in the TOT Fund, the transfer from that fund to the Convention and Cultural Affairs Fund is recommended to be increased by \$824,000. This additional funding will be allocated to the ending fund balance and will be available for future use. A recommendation to decrease the CVB Marketing appropriation in this fund is also recommended. As a result of the higher TOT receipts in the TOT Fund, additional resources are available for the CVB (\$412,000 identified above), enabling a reduction to the marketing allocation in this fund. Lastly, a recommendation to allocate \$250,000 towards minor facility improvements is recommended.

- ***Municipal Golf Course Fund*** –Through December, activity at all three of the courses – Los Lagos, Rancho del Pueblo, and San José Muni Golf Courses – has shown slight improvement from 2010-2011 levels. Rounds of golf played through December 2011 increased by 3.6% at Los Lagos and by 1.3% at Rancho del Pueblo. A slight uptick in the economy and a very mild and dry first half of this year contributed to the improved performance. These modest increases, however, fall below the projected levels of growth for this year, since 2011-2012 was built with the assumption that activity levels would perform better than 2010-2011 and move closer to 2009-2010 levels. Actual performance remains below 2009-2010 levels.

While revenue from San José Muni Golf Course is expected to increase in 2011-2012 by 3.8% from 2010-2011, this level of growth is not sufficient to meet the budgeted estimate and a downward adjustment to the revenue estimate of \$39,000, from \$475,000 to \$436,000 is recommended. Similarly, at Los Lagos Golf Course, although rounds of golf played have slightly increased, these favorable circumstances do not appear sufficient to meet the revenue estimate assumed in the 2011-2012 budget, and a mid-year adjustment to reduce the budgeted revenue estimate from \$200,000 to \$110,000 (45% reduction) is recommended. Rancho del Pueblo Golf Course is projected to not generate a profit and net costs from this course are tracking to end the year above budgeted levels. To address this higher cost, a \$90,000 increase to the Course Expenditure appropriation is recommended. To ensure that a stable fund balance is maintained in this fund, a \$300,000 increase in the Transfer from the General Fund (from \$1.5 million to \$1.8 million) is also recommended.

### **Capital Funds**

Following is a discussion of the major construction related revenues that support the capital program and the major capital program expenditure revisions recommended in this document.

#### *Construction Related Revenues*

Through December, overall permit valuation is lower than prior year levels by 20% due to a drop in residential permit activity from the extremely high levels experienced last fiscal year. Permit valuation for industrial and commercial construction activity is above the prior year levels. As expected, activity continues to be strong in the North San José area but not as strong as the

comparable period last year. A large number of permits were issued for Crescent Village, Epic Apartments and Vista Montana Apartments. The total number of residential permits pulled through December 2011 was 996, compared to 2,158 permits pulled through December 2010 and the majority of the units were for multi-family dwellings. It should be noted that residential permit activity in December 2010 spiked to its highest level in over a decade (1,641 units). Receipts of \$2.5 million through December for the North San José Impact Fee were unanticipated and the revenue is recommended to be recognized in this report. No estimated revenue collection was assumed in the 2011-2012 Adopted Budget as a result of the uncertainty of the development activity in this area. Commercial activity had moderate growth from last year with valuations for commercial permit activity at \$117.3 million through December compared to \$102.7 million at this point last year. Industrial permit activity had strong growth with valuation at \$69.8 million through December compared to \$24.1 million through the same period last year. These permit activities drive the revenue collections in several categories, including the Construction Excise Tax, the Building and Structure Construction Tax, and the Residential Construction Tax, and are an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

Following is a discussion of the performance for Building and Structure Construction Tax and Construction Excise Tax, the two largest construction-related revenue sources.

- Building and Structures Construction Tax – The revenue estimate of \$6.0 million is recommended to be revised upward to \$9.0 million based on current collection trends. Compared to last year, tax receipts of \$6.2 million are down 17%; however, the Adopted Budget allowed for a decline of 36% from the 2010-2011 collections of \$9.4 million to account for the large one-time revenues received in 2010-2011. The recommended budget action would allow for a 4% decline from the prior year.
- Construction Excise Taxes – The revenue estimate of \$8.0 million is recommended to be revised upward to \$12.0 million based on current collection trends. Compared to last year, tax receipts of \$7.7 million are down 21%; however, the Adopted Budget allowed for a decline of 40% from the 2010-2011 collections of \$13.3 million to account for the large one-time revenues received in 2010-2011. The recommended budget action would allow for a 10% decline from the prior year.

#### *Construction and Conveyance Taxes*

After experiencing moderate declines compared to prior year activity levels in the first few months of the fiscal year, Construction and Conveyance (C&C) Tax revenues are showing signs of growth. Receipts in November and December 2011 increased by 10% and 8%, respectively, compared to prior year levels. In addition, the City has received January Conveyance receipts, which represents an impressive 28% growth compared to prior year receipts. The 2011-2012 C&C Tax estimate of \$21 million allows for a 1.8% drop from the 2010-2011 collection level. Through the first six months of the fiscal year receipts have totaled \$11.9 million and appear to be on par to meet or slightly exceed budgeted levels.

Nearly 99% of the total Construction and Conveyance (C&C) Taxes are comprised of conveyance receipts, a tax based on the value of property transfers. Property transfers (sales) for all types of residences appear to be stabilizing with only a 1% decline from 718 in December 2010 to 713 in December 2011. The December 2011 median single-family home price of \$474,500 is also down almost 1% from the December 2010 price of \$478,000. While this decline is very small, it marks the 15<sup>th</sup> consecutive month in which the median single-family home price has dropped compared to the same month in the previous year. The average days-on-market for single-family and multi-family dwellings totaled 84 days in December 2011, which is a slight drop from the 87 days experienced in December 2010.

### *Major Capital Program Expenditure Revisions*

A series of recommended Appropriation Ordinance and Funding Sources Resolution amendments to the Adopted Capital Budget are included in Section III of this report. Following is a summary of the most significant adjustments:

- In the *Airport Capital Program*, funding increases in the amount of \$280,000 are recommended to replace two critical safety equipments (one Manager-on-Duty vehicle and one airfield mower). Savings from the Wildlife Hazard Management Plan (\$50,000), as well as existing funding in the Airfield Improvements (\$135,000 reallocated) and the Equipment, Operating (\$95,000) appropriations would fund the replacements.
- In the *Traffic Capital Program*, an augmentation is recommended for the North San José Traffic Impact Fee Reserve (\$2.5 million) as a result of recognizing traffic impact fees collected year-to-date. This report also includes a recommendation to allocate \$500,000 for the Autumn Street Expansion project to design a railroad crossing at the new Autumn Street extension, which is a requirement for Downtown expansion and the proposed ballpark.
- In the *Parks and Community Facilities Development Capital Program*, funding in the amount of \$1.7 million is recommended to be allocated for the design of Commodore Children's Park. This funding was previously allocated in a reserve of funds due to the significant operating and maintenance impact the completed facility would have on the General Fund. However, the project is now ready to move forward as the City has entered into an agreement with a developer to provide a credit to the parkland in lieu fees in exchange for an equivalent contribution to provide 10 years of maintenance funding for the Commodore Children's Park once it is constructed and open to the public.
- In the *Public Safety Capital Program*, delaying the issuance of \$3.3 million in general obligation bonds from this year to next fiscal year is recommended due to current financial market conditions, the City's timing need for these funds, and the cost/savings benefit of issuing multiple bond sales together. This will not negatively impact the bond projects since the award for Fire Station 21 Relocation project will not occur until next fiscal year due to project delays. This report also provides funding in the amount of \$340,000 to fund urgent facility maintenance needs at Fire Station 11 (\$240,000) and Fire Station 15 (\$100,000) with a corresponding decrease to the Fire C&C Ending Fund Balance.

- In the *Library Capital Program*, delaying the issuance of \$5.9 million in general obligation bonds from this year to next fiscal year (as discussed in the Public Safety Capital Program section) will not negatively impact the design and construction schedule for the Southeast Branch Library since there is a delay in acquiring the land. There is sufficient funding this year to begin the design phase of the project.
- In the *Municipal Improvements Capital Program*, an augmentation to the Unanticipated/Emergency Maintenance appropriation (\$400,000) is recommended. Public Works Department facility management continues to experience high levels of unanticipated failures in large systems. In order to address the most severe issues, additional funding is recommended to replace the boiler tubes at City Hall to ensure proper heating, replace stolen lightning rods on the City Hall roof, replace damaged exterior lighting at City Hall due to vandalism, remove and replace the pavers around City Hall, and set aside funding for future unexpected failures.

## **LOOKING FORWARD**

As of December 2011, a General Fund shortfall of approximately \$25 million is projected for 2012-2013. The formal 2013-2017 General Fund Forecast is scheduled to be released on February 27, 2012 and will contain a comprehensive update to all revenue and expenditure projections contained in the Preliminary Forecast, including any additional updates to City retirement contributions approved for 2012-2013 and forecasted for the next four years.

In February, a Mayor/City Council Budget Study Session will be held and results from the Community Budget Survey will be available. In March, the Mayor's 2012-2013 Budget Message will be released and approved that will provide policy direction for the development of the Proposed Capital and Operating Budgets, which are scheduled to be released on April 25<sup>th</sup> and May 1<sup>st</sup>, respectively.

## **PUBLIC OUTREACH/INTEREST**

- ✓ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.

This document is posted on the City's website for the February 14, 2012 Council agenda.

## CONCLUSION

Through December, the City's over 100 operating and capital funds are generally performing within expected levels. The 2011-2012 Adopted Budget was built on the assumption that the economy would continue its slow recovery from the 2007-2009 recession. Economic indicators and actual revenue performance support this assumption with some improvement in recent months. As part of the Mid-Year Budget Review, budget adjustments are recommended in the General Fund and many special and capital funds to bring projected revenues and expenditures into alignment based on performance through the first half of the fiscal year, to account for updated cost projections, to implement technical adjustments, and to recognize various grants and reimbursements. Major actions in the General Fund include the establishment of the 2011-2012 Ending Fund Balance Reserve of \$12.0 million funded by excess revenue and expenditure savings, and a \$10 million increase to the 2012-2013 Future Deficit Reserve (increase from \$12 million to \$22 million) funded by the net savings generated from the SJRA assuming the full Convention Center Lease Payments in 2011-2012.

The adjustments brought forward in this report reflect our best estimate of the financial performance for the City's funds through the end of the fiscal year. The Administration will continue to closely monitor performance and provide status reports on the City's finances through the Bi-Monthly Financial Reports. These reports will highlight any significant developments as well as identify any potential budget actions necessary to ensure the City's funds remain in balance by year-end. Diligent monitoring, continued fiscal discipline, and timely actions will be critical to maintain the City's fiscal health.

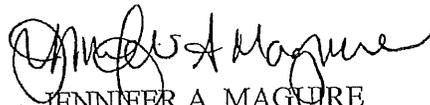


Debra Figone  
City Manager

**Certification of Funds**

I hereby certify that there will be available for appropriation in the designated funds and in the amounts as listed below in fiscal year 2011-2012 monies in excess of those heretofore appropriated therefrom:

Airport Capital Improvement	\$ 211,000
Benefit	1,000,000
Building & Structures Construction Tax	3,030,000
Construction & Conveyance Tax – Library	42,138
Construction Excise Tax	6,591,426
Convention and Cultural Affairs	4,324,000
Dental Insurance	111
Edward Byrne Memorial Justice Assistance Grant Trust	70
Gift Trust	125,596
Home Investment Partnership Program Trust	115,000
Integrated Waste Management	340,140
Multi-Source Housing	1,000,000
Municipal Golf Course	129,500
Parks & Recreation Bond Projects	387,000
Sewer Service & Use Charge	37,546
SJ-SC Treatment Plant Operating	1,020,269
Storm Drainage Fee	3,000
Supplemental Law Enforcement Services	63,198
Transient Occupancy Tax	1,648,000
Workforce Investment Act	671,209

  
JENNIFER A. MAGUIRE  
Budget Director