

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Debra Figone

**SUBJECT: 2012-2013 CITY MANAGER'S  
BUDGET REQUEST AND  
2013-2017 FIVE-YEAR FORECAST**

**DATE:** February 29, 2012

## INFORMATION

### EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council's Adopted Budget process, this document provides both the recommended 2012-2013 City Manager's Budget Request (Budget Balancing Strategy Guidelines and Principles for Restoring City Service Levels) and the 2013-2017 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. Following are the major highlights of this report:

- As shown in the chart below, a small General Fund surplus of \$10.0 million is projected for 2012-2013. This projection is derived by comparing the estimated revenues with the cost of delivering existing services as well as the services for which the City has already committed, such as the operation of new facilities. In the remaining years of the Forecast, General Fund shortfalls are projected for the following two years, while surpluses are projected for the final two years. The shortfalls and surpluses range from -\$22.5 million to \$19.0 million annually. These margins are very narrow when put into context of the size of the projected General Fund budget, ranging from -1.3% to 1.1% of the projected annual budget (revenues and expenditures). Over the five-year period, a total surplus of \$15.9 million is anticipated, or approximately \$3.2 million annually. This average surplus figure equates to only approximately 0.2% of the projected General Fund annual budget.

#### **2013-2017 General Fund Forecast Incremental General Fund Surplus/(Shortfall)**

<b>2012-2013</b>	<b>2013-2014</b>	<b>2014-2015</b>	<b>2015-2016</b>	<b>2016-2017</b>
\$10.0 M	(\$22.5 M)	(\$1.3 M)	\$19.0 M	\$10.7 M

- This Forecast reflects the Administration's best estimates on the projected revenues and expenditures over the next five years based on the information currently available. It does not, however, incorporate several elements that would impact the General Fund over the Forecast period, including: 1) salary increases, which are not included for any employee in any year of the Forecast, with the exception of salary steps for eligible non-management employees and management performance pay; 2) costs associated with fully funding the annual required contributions for police and fire retiree healthcare; 3) impacts associated with the implementation of the Fiscal Reform Plan (cost savings, such as retirement reform, and

additional revenues); 4) costs associated with the restoration of key services to January 1, 2011 levels; 5) costs associated with services that were funded on a one-time basis in 2011-2012; 6) costs associated with unmet/deferred infrastructure and maintenance needs; and 7) one-time revenue sources or expenditure needs.

- As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. As seen in the recent changes in projections, retirement costs have been fluctuating and will likely continue to experience upward or downward swings based on actual performance of the retirement funds and changes in actuarial assumptions (demographic and investment returns) approved by the Federated and Police and Fire Retirement Boards. Also, impacts related to the dissolution of the San Jose Redevelopment Agency will change as more is known regarding the legislation and the wind-down. Consistent with past practice, as part of the preparation for the 2012-2013 Proposed and Adopted Budgets, the Administration will continue to update the City Council on both the revenue and expenditure estimates as new information becomes available.
- While the projected 2012-2013 General Fund surplus is small (0.6%), it is welcomed news after ten consecutive years of General Fund shortfalls. Over the past decade, the City has addressed General Fund budget shortfalls totaling \$680 million and eliminated over 2,000 positions (all funds), with staffing now at 1988-1989 levels. The difficult cuts experienced over the past several years have played a critical role in bringing revenues and expenditures into closer alignment in this Forecast. These reductions, however, have come at a significant price, with deep service reductions impacting our community, employee layoffs and demotions, a large reduction in employee total compensation, and an increasing backlog of unmet/deferred infrastructure and maintenance needs.
- As shown in the chart on the following page, when comparing next year's Forecast to the 2011-2012 Adopted Budget, the projected surplus of \$10.0 million for 2012-2013 is the result of improved revenues of \$23.7 million, decreased costs of \$21.2 million, offset by the carryover of a shortfall from the 2011-2012 Adopted Budget of \$34.9 million. In 2011-2012, the General Fund budget gap of \$115 million was solved with ongoing solutions of \$80 million and one-time solutions of \$35 million. Therefore, the portion of the shortfall solved with one-time solutions (\$34.9 million) is carried forward to 2012-2013.

**2012-2013 General Fund Forecast  
Reconciliation from 2011-2012 Adopted Budget**

<b>2012-2013 General Fund Forecast Components (Ongoing)</b>	<b>\$ in Millions</b>
<b>Carry-Over from 2011-2012 Adopted Budget</b>	<b>(\$ 34.9)</b>
<b>Major Revenue Changes</b>	
- Sales Tax Increase	11.7
- Utility Tax/Franchise Fees Increase	5.5
- Beginning Fund Balance Increase	5.0
- Property Tax Increase	3.3
- Business Tax Increase	1.7
- Transient Occupancy Tax Increase	1.5
- San Jose Redevelopment Agency Reimbursement Elimination	(6.2)
- Revenue from the State of California Decrease	(3.4)
- Other Revenue Net Increases	4.6
<b>Total Revenue Changes (Increase)</b>	<b>\$ 23.7</b>
<b>Major Expenditure Changes</b>	
- Convention Center Lease Payment Elimination	15.4
- Retirement Contributions Net Savings* (Federated/Other (\$7.7 million), Police (-\$9.7 million), Fire (-\$9.7 million))	11.7
- Sick Leave Payments Upon Retirement Savings	5.3
- Unemployment Insurance Savings	2.9
- Debt Service/Subsidy Net Savings	2.1
- Worker’s Compensation Claims Savings	1.4
- Successor Agency to the Redevelopment Agency Transfer	(8.6)
- 2012-2013 Committed Additions (capital projects scheduled to come on-line)	(4.3)
- Salary Step/Performance Pay Increases	(2.0)
- Health Care Increase	(0.2)
- Other Expenditure Net Costs	(2.5)
<b>Total Expenditure Changes (Savings)</b>	<b>\$ 21.2</b>
<b>Total 2012-2013 Projected General Fund Surplus</b>	<b>\$ 10.0</b>

\* Reflects \$4.5 million in savings from the final reconciliation of the 2011-2012 Adopted Budget (brought forward in the 2010-2011 Annual Report) and \$7.2 million in savings from the 2011-2012 Modified Budget to the 2012-2013 General Fund Forecast.

- The 2012-2013 projected surplus of \$10.0 million reflects an improvement from both the \$25 million budget shortfall projected in December 2011 and the \$80.5 million shortfall projected in the Preliminary General Fund Forecast that was issued in early November 2011. The improvement from November 2011 to December 2011 reflected lower projected Police and Fire pension contributions based on updated information provided by Cheiron, the actuary for the Police and Fire Retirement Board. The improvement in this Forecast reflects 1) a reduced impact from the dissolution of the San Jose Redevelopment Agency (\$10.6 million); 2) improved revenue projections (\$7.5 million); 3) a reduction in estimated retirement costs, primarily retiree healthcare-related (\$7.0 million); 4) a reduction in estimated sick leave payments upon retirement, health care, and workers’ compensation costs (7.0 million); 5) and other miscellaneous changes (\$2.9 million). The improved revenue projections and the lower

costs for sick leave payments upon retirement, health care, and workers' compensation costs were discussed as part of the 2011-2012 Mid-Year Budget Review.

- Retirement costs (pension and retiree healthcare) remain a major cost driver in this Forecast. In fact, the primary reason for the shortfall in the second year of the Forecast is due to a \$29.5 million increase in retirement expenses alone. For 2012-2013, retirement costs are projected to be \$185.6 million in the General Fund representing a decrease of \$7.2 million from the 2011-2012 Modified Budget level of \$192.8 million. This net decrease is due to retirement cost increases in the Federated Retirement System that are more than offset by retirement cost reductions in the Police and Fire Retirement Plan. During the forecast period, General Fund retirement contributions will increase by \$48.3 million, or 26%, from \$185.6 million in 2012-2013 to \$233.9 million in 2016-2017. For all funds, the City retirement contribution will increase by \$68.2 million, or 28%, from \$245.8 million in 2012-2013 to \$314.0 million in 2016-2017. Over the five-year period for the Federated Retirement System, budgetary City contribution rates are projected to increase from 50.5% in 2012-2013 to 66.2% in 2016-2017; for the Police Retirement Plan, rates are projected to increase from 65.7% in 2012-2013 to 78.8% in 2016-2017; and for the Fire Retirement Plan, rates are projected to increase from 64.0% in 2012-2013 to 78.1% in 2016-2017. It should be noted that retirement contribution costs and rates for the Police and Fire Retirement Plans do not reflect full funding of the annual required contribution for retiree healthcare.
- As is customary in the Forecast, two alternative forecasts have been developed to model the range of financial scenarios possible under varying economic conditions. "Optimistic" and "Pessimistic" Cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". In 2012-2013, the Optimistic Case results in a projected surplus of \$13.5 million, while the Pessimistic Case results in a surplus of \$1.9 million.
- In approaching the 2012-2013 budget, the Administration proposes the use of the budget balancing strategy guidelines as well as the principles for restoring service levels (2012-2013 City Manager's Budget Request) outlined in this memorandum. The City Council priorities identified in prior policy sessions will also guide the City's budget development efforts. The Administration recommends City Council approval of the proposed City Manager's Budget Request, with any desired revisions, as part of the Mayor's March Budget Message review process.
- Looking forward, the Administration's goal is to build capacity to meet the City's basic service delivery needs, maintain competitiveness as an employer, and address the significant backlog of unmet/deferred infrastructure and maintenance needs. For reference, estimated funding of \$33 million would be necessary to meet the Fiscal Reform Plan goal to restore key services to the January 1, 2011 level, a 1% increase in total compensation granted to all employees would result in a \$5.8 million increase (General Fund only), and the annual funding needed to address unmet/deferred infrastructure needs is currently estimated at \$105 million (\$474 million one-time backlog; General Fund only; figures will be updated in March 2012). This will require continued diligence on controlling the City's costs and pursuing

increased revenues to support City services. The Fiscal Reform Plan issued in May 2011 and approved by the City Council as part of the adoption of the 2011-2012 Adopted Budget outlined cost reduction and revenue strategies to help build this capacity. As discussed at the February 13, 2012 Budget Study Session, a total of \$122 million could be generated over a three-year period from the various cost reduction (\$72.5 million) and revenue strategies (\$49.5 million).

- Projections for the selected Capital Improvement Program (CIP) revenues are also included in this document. These revenues total \$228 million over the five-year period and are up 23% from the \$186 million included in the 2012-2016 Adopted CIP. Significant growth is anticipated for the Building and Structure Construction Tax (65% increase) and the Construction Excise Tax (49% increase) primarily due to expected housing developments in North San José. Construction and Conveyance (C&C) Tax receipts, however, are projected to remain at the 2012-2016 Adopted CIP levels.

## **BACKGROUND**

In compliance with City Charter Section 1204, and the City Council's Adopted Budget process, this document provides both the recommended 2012-2013 City Manager's Budget Request (Budget Balancing Strategy Guidelines and Principles for Restoring City Service Levels) and the 2013-2017 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process and critical steps in developing both the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP).

The City Manager's Budget Request includes budget balancing strategy guidelines and principles for restoring City services that the Administration recommends be used in developing the 2012-2013 Proposed Budget. These guidelines and principles are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's anticipated fiscal status for 2012-2013 is an integral part of the Administration's proposed approach to preparing the 2012-2013 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2012-2013, and the subsequent four years, is provided as part of this document.

## **ANALYSIS**

This overview includes the following: a discussion of the 2012-2013 City Manager's Budget Request, including a description of the proposed budget balancing guidelines and principles for restoring City service levels; an overview of the 2013-2017 General Fund Five-Year Forecast and Revenue Projections; a summary of the Capital Revenue Forecast; and a description of the next steps in the 2012-2013 budget process.

## **2012-2013 CITY MANAGER'S BUDGET REQUEST**

The City Manager's Budget Request includes a set of general budget balancing strategy guidelines as well as guiding principles for restoring City service levels. The Budget Request is used in preparing the 2012-2013 budgets for the General Fund and selected Capital Funds. The proposed guidelines and principles contained in the 2012-2013 City Manager's Budget Request have been formulated in the context of projections for small General Fund surpluses and deficits over the Forecast period. The over-arching goal of these strategies and principles is to reach fiscal and operational stability, delivering the services our community deserves in a cost-effective manner while compensating our employees appropriately. As outlined in the Fiscal Reform Plan approved by the City Council with the adoption of the 2011-2012 Budget, this includes addressing the General Fund structural deficit as well as restoring service levels in high priority service areas that have been impacted by the budget balancing actions required in recent years.

In accordance with the City Charter, the City is required to adopt a balanced budget each year, addressing any projected shortfall or allocating any surplus. In 2012-2013, a General Fund surplus of \$10.0 million is projected, representing 0.6% of the General Fund annual budget (revenues and expenditures). However, in the out years of the Forecast, General Fund shortfalls and surpluses range from -\$22.5 million to \$19.0 million annually. These surplus and shortfall amounts are very small when put into context of the size of the projected General Fund budget, ranging from -1.3% of the budget to 1.1% of the projected annual budget. For the first time in recent history, over the five-year period, an overall General Fund surplus of \$15.9 million is projected, with an average surplus of approximately \$3.2 million annually (0.2% of the annual budget).

With a small surplus projected next year, the City is not anticipated to have to endure another year of painful service reductions in 2012-2013. However, the organization will continue to pursue cost reduction strategies and more efficient ways to provide City services while evaluating operations for potential restructuring and reprioritizing of services to more effectively meet service needs and avoid risk based on actual experience. Changes in service delivery may, on a case-by-case basis result in some position reductions and layoffs. Although overall service levels are not at adequate levels for our community, the administration cautions against adding ongoing new service commitments until the General Fund structural deficit is resolved and fiscal reforms are in place. Given the projected shortfall in the second year (2013-2014) of the Forecast of \$22.5 million, the \$10.0 million surplus will likely be recommended by the Administration to be set-aside to partially address that year's deficit. In addition, the one-time 2012-2013 Future Deficit Reserve should be strategically invested, with at least half reserved in order to also address the 2013-2014 projected shortfall. Some of the areas to consider for the remaining one-time funding anticipated to be available is the continuation of services that were restored on a one-time basis in 2011-2012, infrastructure and maintenance needs, the pay down of debt, and a small number of critical service needs.

Moving forward, challenges remain in achieving long-term fiscal stability and the City's service level goals. When evaluating the annual General Fund shortfalls or surpluses projected in this Forecast, it is important to keep in mind that these figures do not include the following:

- With the exception of salary step increases related to eligible non-management employees and management pay for performance, there are no salary increases assumed in any year of the Forecast. The labor agreements for the various employee groups specify no general salary increase for 2012-2013. For 2013-2014 through 2016-2017, there are no negotiated agreements covering those years. The consideration of salary increases is being treated as a resource allocation policy decision. This decision will need to be made in the context of what is affordable given the competing demands for resources and the need to retain an effective workforce that is compensated appropriately. For reference, a 1% increase in total compensation granted to all employees would result in a \$5.8 million increase in the General Fund only.
- The costs associated with fully funding retiree healthcare in the out years of the forecast period for the Police and Fire Retirement Plan. Per the Memoranda of Agreements (MOAs) with the San Jose Police Officers' Association and the San José Fire Fighters, IAFF Local 230, the City and employee retiree healthcare contribution percentage has a limit which, if reached, results in the meet and confer process. Retiree medical costs are shared 50/50 between City and employees and these MOAs expire on June 30, 2013. Per Cheiron, the Board's actuary, in order to fully fund the annual retirement contribution for police and fire retiree healthcare benefits, preliminary results indicate that the City's annual contribution would be in excess of the current limit of the percentage contribution of 11%. In order to fully understand the out year projections, the Administration recently requested that the Board's actuary prepare the annual required contribution for retiree healthcare so that the full amount can be analyzed.
- The results associated with the implementation of the Fiscal Reform Plan that are currently underway. The Fiscal Reform Plan, issued in May 2011 and approved by the City Council as part of the adoption of the 2011-2012 Adopted Budget, outlined cost reduction and revenue strategies to eliminate the General Fund structural deficit, restore selected services to January 1, 2011 levels, and open facilities that have been recently completed or are under construction. As discussed at the February 13, 2012 Budget Study Session, a total of \$122 million could be generated over a three-year period from the various cost reduction (\$72.5 million) and revenue strategies (\$49.5 million).
- The costs to restore service levels in critical service areas, including police, fire, libraries, and community centers as outlined in the Fiscal Reform Plan. The net cost to restore those services to January 1, 2011 levels is estimated at \$33 million.
- The costs to continue services funded on a one-time basis in 2011-2012. Services that fall in this category include: Safe School Campus Initiative, School Crossing Guard Program, Senior Wellness activities, Police Officer staffing, Code Enforcement activities, Park Ranger services, Sign Ordinance planning support, and legal support.

- The costs associated with ongoing unmet/deferred infrastructure and maintenance needs that were last calculated in April 2011 at \$105 million annually in the General Fund (\$114 million in all funds) are not factored into the Forecast. In addition, there is a one-time backlog of infrastructure needs totaling \$474 million in the General Fund (\$754 million in all funds). These figures will be updated in March 2012 and presented to the Transportation and Environment Committee in April 2012.
- One-time revenues that may become available or one-time expenditure needs. Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding elements that may be available or required in any given year.

### ***2012-2013 Budget Balancing Strategy Guidelines***

The 2012-2013 Budget Balancing Strategy Guidelines on the following page provide direction on the general approaches to use in the development of the 2012-2013 Proposed Budget. While these guidelines are similar to those adopted by the Mayor and City Council last year as part of the 2011-2012 Mayor's March Budget Message, they have been modified to address City Council direction, such as implementation of the Fiscal Reform Plan, and incorporate the latest information on the status of the General Fund.



## 2012-2013 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of the most essential services to the community with the resources available.
2. Balance ongoing expenditure needs with ongoing revenues to ensure no negative impact on future budgets and to maintain the City's high standards of fiscal integrity and financial management.
3. Focus on protecting vital core City services for both the short- and long-term. Analyze existing service levels and focus on delivering those services that are most essential.
4. As outlined in the Principles for Restoring City Service Levels, allocate additional resources with the following goals in mind: ensure the fiscal soundness of the City; choose investments that achieve significant outcomes; and improve efficiency and effectiveness of service delivery.
5. Explore personal services cost savings, including overtime, subject to the meet and confer process where applicable. The Fiscal Reform Plan approved by the City Council with the adoption of the 2011-2012 budget outlined a number of cost reduction strategies, including several retirement-related reforms, that continue to be pursued.
6. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
7. Engage employees in department budget balancing idea development.
8. Focus on business process redesign in light of the severe staff reductions during the last three fiscal years in order to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, simplifying, reorganizing functions, and reallocating resources).
9. Explore alternative service delivery models (e.g., partnerships with the non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use our resources more efficiently and effectively. The City Council Policy on Service Delivery Evaluation provides a decision-making framework for evaluating a variety of alternative service delivery models.
10. Identify City policy changes that would enable/facilitate service delivery changes or other budget balancing strategies.
11. Explore redirecting and/or expanding existing revenue sources and/or adding new revenue sources as outlined in the Fiscal Reform Plan.
12. Establish a fee structure to assure that operating costs are fully covered by fee revenue and explore opportunities to establish new fees for services, where appropriate.
13. Make every effort, if operationally feasible and needed for cost-effective service delivery, to eliminate vacant positions, rather than filled positions, to minimize the number of employee layoffs. As service levels change, ensure that management and administration are re-sized as appropriate.
14. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.
15. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.

### ***Guiding Principles for Restoring City Service Levels***

In addition to the Budget Balancing Strategy Guidelines, the Administration developed preliminary Guiding Principles for Restoring City Service Levels that were presented to the City Council at the Budget Study Session on February 13, 2012. As the City brings the General Fund revenues and expenditures into balance and continues its cost reduction and revenue strategies, there is expected to be some capacity to restore City service levels in the future. With limited funds, a key consideration for the Mayor and City Council will be “how do we invest in the City we want?” Important policy questions revolve around what kinds of services the City should restore and how should services be provided. As discussed above, one of the goals of the Fiscal Reform Plan is to restore services to January 1, 2011 levels and open facilities that have been recently completed or are under construction (see Appendix A for Baseline Services as of January 1, 2011). The Guiding Principles for Restoring City Service Levels broaden that approach to include considerations such as infrastructure maintenance, technology improvements, and alternative service delivery models.

The preliminary Principles for Restoring City Service Levels were revised slightly based on City Council feedback from the February 13, 2012 Budget Study Session. The revised principles below fall into three general categories: ensure the fiscal soundness of the City, choose investments that achieve significant outcomes, and improve the efficiency and effectiveness of service delivery. These principles provide a solid guide to help the City determine not only the appropriate service levels and most cost-effective method for service delivery, but also the critical areas for investment needs.

When considering any additions to the budget, it is important to consider the overall City of San José Budget Principles (see Appendix A) that were initially developed as part of the General Fund Structural Deficit Elimination Plan work. These principles were approved as part of the City Council's approval of the Mayor's March Budget Message for Fiscal Year 2008-2009, and subsequently amended on September 9, 2008. These principles provide a meaningful framework for maintaining the financial discipline crucial to a large organization like the City of San José.

## Guiding Principles for Restoring City Service Levels

### Ensure the Fiscal Soundness of the City

1. Develop the General Fund budget to support the City's mission and use the City Council-approved Budget Principles to ensure the long term fiscal health of the City (*City of San Jose Budget Principles: Appendix A to this Forecast*)
2. Ensure services that are restored can be sustained over the long-run to avoid future service disruption (Use Five-Year General Fund Forecast as one tool)
3. If possible, defer adding new permanent positions until new retirement system is in place

### Choose Investments that Achieve Significant Outcomes

4. Ensure restored services represent City Council priorities and the highest current need in the community
5. Balance investments among three categories:
  - Restoration of services (public safety and non-public safety services, including critical strategic support services)
  - Opening of new facilities
  - Maintenance of City infrastructure and assets
6. Prioritize baseline service level restorations using performance goals (*Fiscal and Service Level Emergency Report – Appendix C, Appendix A to this Forecast*)
7. Focus funding on areas where there is a high probability of success and/or high cost of failure
  - Focus funding on infrastructure needs where there is a significant increase in cost if maintenance is delayed (such as street maintenance)
  - Focus investments in technology that have the greater return on investment in terms of services to the public and employee productivity

### Improve the Efficiency and Effectiveness of Service Delivery

8. Before restoring prior service methods, evaluate options to determine if alternative service delivery models would be more cost effective.
9. Ensure strategic support and technology resources are capable of supporting direct service delivery and effective management of the organization
10. Prioritize organizational investments that maximize workforce productivity, efficiency, and effectiveness.
11. Pursue opportunities and methods, including performance, to retain, attract, and recognize employees within resource constraints.

### *Incorporating Strategies into the 2012-2013 Budget Process*

As noted above, the Administration proposes the use of the general budget balancing strategy guidelines and the guiding principles for restoring City services outlined above to approach the 2012-2013 budget development process. In December 2011, the Administration directed the City departments to develop 2012-2013 budget proposals using a draft version of the 2012-2013 Budget Balancing Strategy Guidelines. For planning purposes, General Fund budget reduction targets were set at levels to generate approximately \$15 million in General Fund proposals to address a portion of the \$25 million General Fund shortfall projected at that time. While a deficit

is no longer projected for 2012-2013, the budget balancing strategy guidelines and budget proposals generated from departments will still provide a good starting point for developing the 2012-2013 budget. The Administration will continue to pursue cost reductions and service delivery efficiencies that make sense, but will strive to avoid any further direct service reductions in 2012-2013.

As part of the 2012-2013 Mayor's March Budget Message, the Administration requests confirmation of the budget balancing guidelines as well as the guiding principles for restoring service levels, with any desired revisions. These guidelines and principles incorporate both short-term and long-term approaches to budget balancing efforts and service level restoration and reflect the City's sound fiscal principles.

City Council priorities and goals identified in prior policy sessions will also guide the City's budget balancing efforts. Input from the community through community surveys, various City Councilmember and stakeholder outreach activities, and the San José Neighborhood Association/Youth Commission 2012-2013 Priority Setting Session will serve as an important tool in this process.

The Mayor is scheduled to issue a proposed March Budget Message on March 9, 2012, which will then be discussed, amended if necessary, and adopted by the City Council. The contents of that Message will provide specific guidance for the preparation of the City Manager's 2012-2013 Proposed Capital and Operating Budgets currently scheduled to be submitted on April 25, 2012 and May 1, 2012, respectively. As required by City Charter, those Proposed Budgets will contain comprehensive plans for how the City organization will address the highest priority needs of the community while maintaining the fiscal integrity of the City.

After the release of the Proposed Budgets, there will be a series of Proposed Budget Study Sessions and Public Hearings to discuss the budget proposals and the associated impacts on performance measures and service delivery. The Administration will also work with the City Council to provide informational meetings on the Proposed Budget in each City Council District in April and May 2012. Additional input by the City Council and community will be incorporated into the budget through these Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message during the months of May and June 2012.

### **2013-2017 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS**

The 2013-2017 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with information regarding the projected General Fund operating margin for each of the five years included in the forecast period.

2. **Base General Fund Forecast** – The forecast model is presented in this section. It includes projections for each of the General Fund revenue and expenditure categories. The expenditure summary is divided into two sections:
  - *Base Case without Committed Additions* – This section describes projections associated with existing expenditures only.
  - *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed by previous City Council direction and has less discretion, such as maintenance and operating costs for capital projects scheduled to come on-line during the next five years.

The Five-Year Forecast discussion is based on the Base Case with Committed Additions scenario, which is considered the most likely scenario for the upcoming year.

3. **Committed Additions to the Base General Fund Forecast** – This section describes the committed additions per previous City Council direction considered in the Forecast, including the financial impact in each year of the Five-Year Forecast. This section also includes a discussion of Budget Principle #8, which pertains to capital projects with General Fund operating and maintenance costs in excess of \$100,000.
4. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an Optimistic Case and a Pessimistic Case that modify revenue assumptions. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.
5. **Capital Revenue Forecast** – This section describes the estimates for construction and real estate related revenues that are major sources of funding for the City's Five-Year Capital Improvement Program.
6. **Appendices** – Three appendices are also included in this document. Appendix A provides the City of San Jose Budget Principles that were initially developed as part of the General Fund Structural Deficit Elimination Plan work. These principles were approved as part of the City Council's approval of the Mayor's March Budget Message for Fiscal Year 2008-2009, and subsequently amended on September 9, 2008. This appendix also includes a listing of baseline services as of January 1, 2011 that were presented in the Fiscal and Service Level Emergency Report issued in November 2011. Appendix B provides descriptions of the City's major General Fund revenue categories. Appendix C, prepared by the Planning, Building and Code Enforcement Department, documents the basis for that department's five-year projections for construction activity.

***2013-2017 General Fund Five-Year Forecast***

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative surplus. In addition to the cumulative surplus, the incremental surplus or shortfall (assuming each preceding surplus or deficit is addressed completely with ongoing solutions in the year it appears) for each year of the forecast is included. Because it is the City's goal to remain in balance on an ongoing basis, the incremental figure is useful in that it shows the additional shortfall and/or surplus attributed to a particular fiscal year. To the extent that a surplus is not expended or a shortfall is not resolved on an ongoing basis, it is important to understand that the remaining budget surplus or gap will carry over to the following year.

**2013-2017 GENERAL FUND FIVE-YEAR FORECAST\***  
**(\$ in Millions)**

	<b>2012- 2013</b>	<b>2013- 2014</b>	<b>2014- 2015</b>	<b>2015- 2016</b>	<b>2016- 2017</b>
<b>Projected Revenues</b>	\$807.3	\$828.7	\$853.0	\$879.0	\$905.0
<b>Projected Expenditures</b>	\$797.3	\$841.2	\$866.8	\$873.8	\$889.1
<b>Total Cumulative Surplus/(Shortfall)</b>	\$10.0	-\$12.5	-\$13.8	\$5.2	\$15.9
<b>Total Incremental Surplus/(Shortfall)</b>	<b>\$10.0</b>	<b>(\$22.5)</b>	<b>(\$1.3)</b>	<b>\$19.0</b>	<b>\$10.7</b>

\* Does not incorporate salary increases, with the exception of salary steps for eligible non-management employees and management performance pay; costs associated with fully funding the annual required contributions for police and fire retiree health care; impacts associated with the implementation of the Fiscal Reform Plan; costs associated with restoration of key services to January 1, 2011 levels; costs associated with services funded on a one-time basis in 2011-2012; costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses.

In the 2013-2017 Forecast, incremental General Fund surpluses are anticipated for three of the five years. In contrast to the Forecasts issued in recent years, overall revenue growth is generally in line with expenditure growth over the forecast period. However, as stated previously, there are significant expenditure components that are not incorporated into the Forecast, including salary increases, the full funding of police and fire retiree healthcare, the restoration of key services to January 1, 2011 levels; services funded on a one-time basis in 2011-2012; and unmet/deferred infrastructure and maintenance needs. The Forecast also does not reflect the Fiscal Reform Plan cost reduction and revenue generation strategies that have not yet been implemented.

Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the significance of the projections in the out years is not so much in terms of their absolute amounts, but rather in the relative size of the decrease or increase from the prior year. This information should be used to provide a multi-year perspective to budgetary decision-making, rather than as a precise prediction of what will occur.

The fiscal outlook for the City reflected in this Forecast is significantly better when compared to both the Preliminary 2012-2013 General Fund Forecast released in November 2011 and the final 2012-2016 General Fund Forecast that was issued in February 2011. The largest single factor

contributing to this improvement is the reduction in retirement costs projected over the next five years. Retirement costs in the last five year forecast were projected to reach \$304.5 million in the General Fund (\$400.7 million all funds) by 2015-2016. In this updated Forecast, retirement costs are now estimated by Cheiron, the Retirement Boards' actuary, to reach \$233.9 million in the General Fund (\$314.0 million all funds) by 2016-2017.

When comparing the General Fund shortfall of \$25 million that was projected in December 2011 to this February Forecast, the following major factors have contributed to the resulting \$10.0 million surplus now estimated for 2012-2013: 1) a reduced impact from the dissolution of the San Jose Redevelopment Agency (\$10.6 million); 2) improved revenue projections (\$7.5 million); 3) a reduction in estimated retirement costs, primarily retiree healthcare-related (\$7.0 million); 4) a reduction in estimated sick leave payments upon retirement, health care, and workers' compensation costs (\$7.0 million); 5) and other miscellaneous changes (\$2.9 million). The improved revenue projections and the lower costs for sick leave payments upon retirement, health care, and workers' compensation costs were discussed as part of the 2011-2012 Mid-Year Budget Review.

When reconciling next year's Forecast to the 2011-2012 Adopted Budget, the projected surplus of \$10.0 million for 2012-2013 is the result of improved revenues of \$23.7 million, decreased costs of \$21.2 million, offset by the carryover of a shortfall from the 2011-2012 Adopted Budget of \$34.9 million. In 2011-2012, the General Fund budget gap of \$115 million was solved with ongoing solutions of \$80 million and one-time solutions of \$35 million. Therefore, the portion of the shortfall solved with one-time solutions (\$34.9 million) is carried forward to 2012-2013.

General Fund revenues are estimated to improve \$23.7 million when compared to the ongoing revenue performance assumed in the 2011-2012 Adopted Budget. Revenue performance in 2011-2012 continues to reflect moderate growth and is estimated to at least meet current budgeted levels. Revenue categories that have improved year-over year include: Sales Tax to reflect improved growth rates (\$11.7 million); Utility Tax and Franchise Fees (\$5.5 million) due to approved rates increases and new calculation methodologies; Beginning Fund Balance based on updated estimates for year-end expenditure savings (\$5.0 million); Property Tax based on the most recent information provided by the County of Santa Clara (\$3.3 million); Business Tax based on improved Cardroom Tax and Marijuana Tax collections (\$1.7 million); Transient Occupancy Tax receipts based on current year activity levels (\$1.5 million); and miscellaneous categories that have experienced a net increase based on actual collections experience (\$4.6 million). A few revenue categories have experienced declines, including San Jose Redevelopment Agency reimbursements (\$6.2 million) to reflect the dissolution of the Agency; Revenue from the State of California (\$3.4 million) due primarily to the loss of Motor Vehicle In-Lieu payments and an estimated reduction in the Tobacco Settlement funds.

On the expenditure side, several upward and downward adjustments have been incorporated into this Forecast resulting in a net decrease of \$21.2 million in 2012-2013. The most significant expenditure changes are Convention Center Lease Payment savings (\$15.4 million), reflecting the assumption that funding from the Successor Agency to the San Jose Redevelopment Agency will directly pay for this debt service payment and City's retirement contribution year-over-year

savings (\$11.7 million) primarily due to cost revisions by the Retirement Boards' actuary, as approved by the two Retirement Boards. Other savings are expected in sick leave payments upon retirement (\$5.3 million), unemployment insurance (\$2.9 million), debt service/subsidy payments (\$2.1 million), and workers' compensation claims (\$1.4 million).

Other major expenditure increases include a transfer to the Successor Agency of the San Jose Redevelopment Agency (\$8.6 million) based on the current estimated impact to provide for the current cost level for enforceable obligations, the inclusion of Committed Additions (\$4.3 million) that reflect the cost of new or renovated facilities scheduled to come on-line in 2012-2013, salary step and pay for performance increases (\$2.0 million), increases to health premiums (\$0.2 million), and other net expenditure costs (\$2.5 million).

In the four out years of the General Fund Forecast, retirement costs (pension and retiree healthcare) remain a major cost driver. These costs assume the pre-payment of the annual required City contribution to the retirement funds. As detailed in the table below, General Fund retirement contributions will increase by \$48.3 million, or 26%, from \$185.6 million in 2012-2013 to \$233.9 million in 2016-2017. For all funds, the City retirement contribution will increase by \$68.2 million, or 28%, from \$245.8 million in 2012-2013 to \$314.0 million in 2016-2017. Over the five-year period for the Federated Retirement System, budgetary City contribution rates are projected to increase from 50.5% in 2012-2013 to 66.2% in 2016-2017; for the Police Retirement Plan, rates are projected to increase from 65.7% in 2012-2013 to 78.8% in 2016-2017; and for the Fire Retirement Plan, rates are projected to increase from 64.0% in 2012-2013 to 78.1% in 2016-2017.



**2013-2017 CITY RETIREMENT CONTRIBUTION COSTS  
AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES  
(\$ in Millions and with Pre-Payment Discount)**

Retirement Plan	2011- 2012	2012- 2013	2013- 2014	2014- 2015	2015- 2016	2016- 2017
Federated Ret. System – Pension	\$44.3	\$54.5	\$58.1	\$61.2	\$61.1	\$61.7
Fed. Ret. System – Retiree Healthcare	\$10.9	\$9.7	\$20.8	\$22.3	\$23.1	\$23.8
<b>Federated Retirement Plan - Total</b>	<b>\$55.2</b>	<b>\$64.2</b>	<b>\$78.9</b>	<b>\$83.5</b>	<b>\$84.2</b>	<b>\$85.5</b>
<b><i>Budgetary Contribution Rates</i></b>	<b>43.7%</b>	<b>50.5%</b>	<b>61.8%</b>	<b>65.2%</b>	<b>65.4%</b>	<b>66.2%</b>
Police Retirement Plan – Pension	\$74.8	\$66.8	\$74.6	\$79.9	\$78.6	\$79.2
Police Ret. Plan – Retiree Healthcare	\$11.5	\$10.5	\$12.2	\$13.4	\$13.8	\$14.3
<b>Police Retirement Plan – Total</b>	<b>\$86.3</b>	<b>\$77.3</b>	<b>\$86.8</b>	<b>\$93.3</b>	<b>\$92.4</b>	<b>\$93.5</b>
<b><i>Budgetary Contribution Rates</i></b>	<b>75.1%</b>	<b>65.7%</b>	<b>73.5%</b>	<b>78.9%</b>	<b>78.1%</b>	<b>78.8%</b>
Fire Retirement Plan – Pension	\$46.0	\$39.2	\$43.6	\$46.6	\$45.9	\$46.3
Fire Ret. Plan – Retiree Healthcare	\$4.7	\$4.4	\$5.3	\$6.4	\$7.6	\$8.1
<b>Fire Retirement Plan - Total</b>	<b>\$50.7</b>	<b>\$43.6</b>	<b>\$48.9</b>	<b>\$53.0</b>	<b>\$53.5</b>	<b>\$54.4</b>
<b><i>Budgetary Contribution Rates</i></b>	<b>74.0%</b>	<b>64.0%</b>	<b>71.3%</b>	<b>76.9%</b>	<b>77.2%</b>	<b>78.1%</b>
<b>Other Retirement Costs</b>	<b>\$0.6</b>	<b>\$0.5</b>	<b>\$0.5</b>	<b>\$0.5</b>	<b>\$0.5</b>	<b>\$0.5</b>
<b>Total General Fund</b>	<b>\$192.8</b>	<b>\$185.6</b>	<b>\$215.1</b>	<b>\$230.3</b>	<b>\$230.6</b>	<b>\$233.9</b>
<b>Total All Funds</b>	<b>\$245.5</b>	<b>\$245.8</b>	<b>\$288.9</b>	<b>\$308.4</b>	<b>\$309.3</b>	<b>\$314.0</b>

Source: 2011-2012 Modified Budget; Cheiron Letters dated February 8, 2012 and February 21, 2012 with applied pre-payment discount

In order to begin to addressing the significant unfunded actuarial liability for retiree healthcare costs, at the direction of the City Council, the Administration worked with employee bargaining groups to begin a five-year phase-in to fully fund the annual required contribution (ARC). In 2009, the City and bargaining units in the Federated Retirement System reached an agreement to begin a five-year phase-in to fully fund the ARC for retiree healthcare benefits. The last year of the phase-in is 2012-2013 with the full funding of the ARC starting with 2013-2014. Based on Cheiron's projections, in order to fully fund the ARC for retiree healthcare benefits in 2013-2014, the City's contribution will more than double from \$9.7 million in 2012-2013 to \$20.8 million in 2013-2014, from a 7.9% to 16.8% contribution rate. The employees' contribution rate is projected to more than double as well from 7.3% in 2012-2013 to 15.5% in 2013-2014. For the Police and Fire Retirement Plan, the last year for the Police phase-in of the ARC is 2014-2015 and for Fire it is 2016-2017. It should be noted that in the out years of the Forecast period, the retiree healthcare contribution percentage for the Police and Fire Retirement Plan has a limit of 11%, which, if reached, results in the meet and confer process per the Memoranda of Agreements with the San Jose Police Officers' Association and the San José Fire Fighters, IAFF Local 230. Retiree medical costs are shared 50/50 between City and employees and these MOAs expire June 30, 2013. Per Cheiron, in order to fully fund the ARC for retiree healthcare benefits, preliminary results indicate that the City's annual contributions would be in excess of the current limit of the percentage contribution of 11%. In order to fully understand the out year projections, the Administration recently requested that the Board's actuary prepare the annual required contribution for retiree healthcare so that the full amount can be analyzed.

It is important to note that the projected General Fund shortfall for 2012-2013 does not factor in impacts from the four Development Fee Programs (Building, Fire, Planning, and Public Works). These programs are designed to be 100% cost recovery and have been programmed to have a neutral impact on the Forecast by adjusting the revenue and costs to be equal. In the Fire and Public Works Fee Programs, revenues are sufficient to cover the Base Budget costs. In the Planning and Building Fee Programs, however, small budget gaps are currently projected for 2012-2013. Sufficient Fee Program Reserves are available in each of these programs to address these small variances.

***General Fund Committed Additions***

Cost estimates for a number of specific “Committed Additions” that address previous City Council direction are included in this Forecast in the years that they are projected to be required. The Committed Additions category, summarized in the chart below, reflects projected additional operating and maintenance costs for new or renovated capital projects in the 2012-2016 Adopted Capital Improvement Program or for projects approved by the City Council during 2011-2012. The costs of the additions total \$4.3 million in 2012-2013 and increase to approximately \$11.0 million by the end of the Forecast period.

**2013-2017 GENERAL FUND COMMITTED ADDITIONS**

	<b>2012-2013</b>	<b>2013-2014</b>	<b>2014-2014</b>	<b>2015-2016</b>	<b>2016-2017</b>
<b>Police Maintenance &amp; Operations</b>	\$0	\$335,000	\$438,000	\$461,000	\$376,000
<b>New Parks and Recreation Facilities Maintenance &amp; Operations</b>	49,000	131,000	234,000	294,000	521,000
<b>New Traffic Infrastructure Assets Maintenance &amp; Operations</b>	49,000	82,000	107,000	124,000	127,000
<b>Measure O (Library) Maintenance &amp; Operations</b>	1,185,000	3,106,000	3,160,000	3,851,000	3,962,000
<b>Measure P (Parks) Maintenance &amp; Operations</b>	653,000	712,000	720,000	774,000	810,000
<b>Measure O (Public Safety) Maintenance &amp; Operations: Fire</b>	0	0	2,503,000	2,474,000	2,618,000
<b>Measure O (Public Safety) Maintenance &amp; Operations: Police</b>	2,393,000	2,465,000	2,504,000	2,545,000	2,585,000
<b>Total</b>	<b>\$4,329,000</b>	<b>\$6,831,000</b>	<b>\$9,666,000</b>	<b>\$10,523,000</b>	<b>\$10,999,000</b>

Some of the larger facilities expected to come on-line during this forecast period include: Bascom Branch Library, Calabazas Branch Library, Educational Park Branch Library, Seven Trees Branch Library, Southeast Branch Library, Softball Complex, Soccer Complex, Bascom Community Center, Fire Station 37 (South Willow Glen), and the South San José Police Substation. A detailed listing of all capital project operating and maintenance costs included in this 2013-2017 General Fund Forecast can be found in the Committed Additions Section of this document.

### ***General Fund Capital Operating and Maintenance Costs/Budget Principle #8***

General Fund Capital Operating and Maintenance/Budget Principle #8 requires City Council certification that funding will be made available in the General Fund for capital projects with an estimated operating budget impact greater than \$100,000 at the time of taking beneficial use of the facility or project. Capital projects with operating and maintenance costs over \$100,000 and previously certified are included in the Capital Improvement Program and displayed in Chart A in Section III. There are no potential projects where operating and maintenance funding has not yet been certified. Certification for potential new projects or modifications to existing projects identified after the release of this Forecast that have not been approved by the City Council may be recommended for certification as part of the 2013-2017 Proposed Capital Improvement Program. If certified by the City Council, the operating and maintenance costs associated with these facilities would then be included in subsequent General Fund Five-Year Forecast documents.

### ***Alternative Forecast Scenarios***

In order to model the range of budgetary scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the "Base Case." "Optimistic" and "Pessimistic" cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case." These alternatives are presented to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario and is being used for planning purposes for the 2012-2013 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios.

The Base Case scenario is built on the assumption of a continued slow recovery from the deep global recession on a national level. At the local level, positive near term growth is estimated in the Silicon Valley as a result of the strength in the technology industry. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to decrease, but ultimately remain above the historical normal levels. Home values are anticipated to improve at a slow pace over the five years. In the Base Case forecast, General Fund revenue collections are anticipated to experience moderate growth over the forecast period.

The Optimistic Case assumes a much faster and more robust recovery than currently anticipated. When compared to the Base Case scenario, Gross Domestic Product (GDP) increases substantially and much greater job creation is anticipated. In turn, the real estate market improves significantly with increases not only in the price of housing but also the volume of homes sales, outpacing the growth rates assumed in the Base Case. This vigorous recovery results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax. By the end of the five-year period, revenues under this scenario would be \$50.3 million higher than in the Base Case. In the Optimistic Case, the City would experience annual surpluses ranging from \$10.0 million to \$34.5 million in four years of the Forecast, but would have a shortfall of \$15.8 million in the 2013-2014.

The Pessimistic Case assumes that a combination of adverse factors interact to impede the moderate recovery underlying the Base Case and potentially lead the economy into another recession. Under this scenario, looming impacts in the world economy in areas such as Europe and China are anticipated to ripple through to the U.S. economy at a national level as well as at the State and local levels. A contraction in State and local government spending is anticipated that will impede job growth and increase unemployment levels. Housing prices are also anticipated to remain stagnant as the inventory of bank-owned properties enters the for-sale housing market. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would be severely impacted by an economic slowdown. By the end of the five-year period, revenues under this scenario would be \$58.9 million lower than in the Base Case. In the Pessimistic Case, there are annual deficits in three of the five years of the Forecast ranging from \$36.0 million in 2013-2014 to \$3.7 million in 2016-2017. Surpluses are projected in two years, including a \$1.9 million surplus in 2012-2013 and a \$10.2 million surplus in 2015-2016.

### *Capital Revenue Forecast*

Section V of this report describes the 2013-2017 Capital Budget Revenue Forecast that will be used to develop several major elements of the Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement (PBCE) Department and an analysis of actual collection patterns. The projections and their basis are described in a report prepared by the PBCE Department, which is included as Appendix C of this document (Development Activity Highlights and Five-Year Forecast [2013-2017]). This activity forecast includes a review of specific projects that are in progress as well as a general prediction of expected levels of new construction.

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2012-2016 Adopted CIP. As can be seen, there are significant improvements expected during this Forecast period.

### **CAPITAL FORECAST COMPARISON SUMMARY** (\$ in Thousands)

	<b>2012-2016 CIP</b>	<b>2013-2017 Forecast</b>	<b>Difference</b>	<b>% Change</b>
<b>Construction and Conveyance Tax</b>	\$109,000	\$109,000	\$0	0%
<b>Building and Structure Construction Tax</b>	31,500	52,000	20,500	65%
<b>Construction Excise Tax</b>	41,500	62,000	20,500	49%
<b>Municipal Water System Fees</b>	600	750	150	25%
<b>Residential Construction Tax</b>	200	500	300	150%
<b>Sanitary Sewer Connection Fee</b>	2,700	3,000	300	11%
<b>Storm Drainage Connection Fee</b>	530	700	170	32%
<b>TOTAL</b>	<b>\$186,030</b>	<b>\$227,950</b>	<b>\$41,920</b>	<b>23%</b>

Real estate activity (primarily housing resales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance Tax. As projected in the last Forecast, Construction and Conveyance Tax revenues appear to have stabilized as collections have leveled off from the sharp declines experienced after the collapse of the financial market. Construction and Conveyance Tax revenues are currently expected to meet or slightly exceed budgeted estimates for 2011-2012. This category is projected to generate \$109 million over the next five years, which is consistent with the estimates assumed in the 2012-2016 Adopted Capital Improvement Program. The average annual collection level of \$21.8 million projected in 2013-2017 Forecast is, however, well below the actual collection levels in the mid-2000's that reached a peak of \$49 million in 2005-2006.

The remaining economically sensitive capital revenue categories are directly linked to development activity. Based on projections provided by the Planning, Building and Code Enforcement Department, construction activity valuation is projected to continue at slightly lower levels than experienced last year (\$675 million for 2011-2012 or a 3% decrease compared to \$699 million in 2010-2011). This level of activity is expected to remain flat for 2012-2013 through 2014-2015 and then increase slightly to \$700 million in 2015-2016 and 2016-2017. These assumptions show a slight improvement of 7% or \$225 million from the levels presented in the 2012-2016 Forecast where activity ranged from \$600 million in 2011-2012 and 2012-2013 and increase to \$675 million in 2015-2016.

Based on the construction activity estimates and a review of revenue collection patterns, a significant increase in construction-related taxes and fees of \$42.0 million, or 23%, is expected when comparing the 2013-2017 Forecast to the 2012-2016 Adopted CIP estimates. Significant increases over the 2012-2016 Adopted CIP are expected for the Building and Structure Construction Tax (\$20.5 million) and the Construction Excise Tax (\$20.5 million) primarily due to expected housing developments in North San José.

### **NEXT STEPS IN THE 2012-2013 BUDGET PROCESS**

The next major steps in the budget development process include the following:

#### ***March 2012***

- 2012-2013 Mayor's March Budget Message Released with Public Hearing; Amended/Approved by City Council

#### ***April 2012***

- 2012-2013 Proposed Capital Budget and 2013-2017 Capital Improvement Program Released

#### ***April-May 2012***

- Community Budget Meetings in Each City Council District

### ***May 2012***

- 2012-2013 Proposed Operating Budget and 2012-2013 Proposed Fees and Charges Released
- City Council Study Sessions and Initial Public Hearing on 2012-2013 Proposed Operating Budget, 2013-2017 Proposed Capital Budget and Capital Improvement Program, and 2012-2013 Proposed Fees and Charges

### ***June 2012***

- 2012-2013 Mayor's June Budget Message Released with Final Public Hearing; Amended/Approved by City Council
- 2012-2013 Operating Budget, 2012-2013 Capital Budget and 2013-2017 Capital Improvement Program, and 2012-2013 Fees and Charges adopted by City Council

## **CONCLUSION**

This document compares the projected revenues and expenditures for the General Fund over the next five years as well as provides estimates for some of the key revenues that support the City's Capital Improvement Program. In 2012-2013, a small General Fund surplus of \$10.0 million is projected. In the remaining years of the Forecast, General Fund shortfalls are projected for the following two years, while surpluses are projected for the final two years. The shortfalls and surpluses range from -\$22.5 million to \$19.0 million annually. These margins are very narrow when put into context of the size of the projected General Fund budget, ranging from -1.3% to 1.1% of the projected annual budget (revenues and expenditures).

As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document and it is important to keep in mind that this Forecast does not reflect several elements that would impact the General Fund over the Forecast period, including: 1) salary increases, which are not included for any employee in any year of the Forecast, with the exception of salary steps for eligible non-management employees and management performance pay; 2) costs associated with fully funding the annual required contributions for police and fire retiree healthcare; 3) impacts associated with the implementation of the Fiscal Reform Plan (cost savings, such as retirement reform, and additional revenues); 4) costs associated with the restoration of key services to January 1, 2011 levels; 5) costs associated with services that were funded on a one-time basis in 2011-2012; 6) costs associated with unmet/deferred infrastructure and maintenance needs; and 7) one time revenue sources or expenditure needs.

The revenue and expenditure projections for 2012-2013 will continue to be refined over the next several months as additional information becomes available. This is particularly important in the areas of Sales Tax and Property Tax. Sales Tax data for the second quarter of 2011-2012, which covers the 2011 holiday period will be received in March 2012. Based on this additional data, any necessary adjustments will be incorporated into the 2012-2013 Proposed Operating Budget. Similarly, as additional Property Tax data becomes available, it may be necessary to adjust the 2012-2013 revenue estimates.

HONORABLE MAYOR AND CITY COUNCIL

February 29, 2012

**Subject: 2012-2013 City Manager's Budget Request and Five-Year 2013-2017 Forecast**

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This document also provides the recommended 2012-2013 City Manager's Budget Request (Budget Balancing Strategy Guidelines and Principles for Restoring City Service Levels) for consideration by the City Council as part of its review of the Mayor's March Budget Message. With a small surplus projected next year, the City is not anticipated to have to endure another year of painful service reductions in 2012-2013. However, the organization will continue to pursue cost reduction strategies and more efficient ways to provide City services while evaluating operations for potential restructuring and reprioritizing of services to more effectively meet service needs and avoid risk based on actual experience. Changes in service delivery may, on a case-by-case basis result in some position reductions and layoffs. Although overall service levels are not at adequate levels for our community, the administration cautions against adding ongoing new service commitments until the General Fund structural deficit is resolved and fiscal reforms are in place.



Debra Figone  
City Manager