

# Memorandum

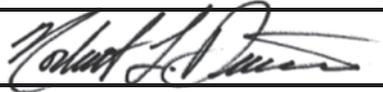
**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Jennifer A. Maguire

**SUBJECT:** 2016-2017 ANNUAL REPORT

**DATE:** September 29, 2017

Approved



Date

09/30/2017

## **RECOMMENDATION**

It is recommended that the City Council:

- (a) Accept the 2016-2017 City Manager's Annual Report of the Finances of the City of San José in compliance with City Charter Section 701 (F).
- (b) Adopt Appropriation Ordinance and Funding Sources Resolution amendments in various operating and capital funds to implement the 2016-2017 Annual Report recommendations, including appropriate technical adjustments, as detailed in Section IV (Recommended Budget Adjustments and Clean-Up/Rebudget Actions).
- (c) Approve the addition of 1.0 Planner IV, limit-dated through February 28, 2019, to the Planning, Building and Code Enforcement Department.

## **OUTCOME**

In accordance with Section 701 (F) of the San José City Charter, the 2016-2017 Annual Report describes the financial status of the City at the end of the 2016-2017 fiscal year. As specified in the City Charter, the focus of the City Manager's Annual Report is a comparison of actual revenue collections and expenditures to projections and appropriations included in the City's budget. This will provide the City Council with the information necessary to review the financial performance of all City funds. In addition, this report provides a comparison of the actual 2016-2017 Ending Fund Balance for each fund to the estimate used in the development of the 2017-2018 Adopted Budget as well as information on the status of the year-end reserve levels for each of the City's budgeted funds.

Approval of the recommended budget actions will implement required fund balance reconciliations as well as necessary rebudget and clean-up adjustments based on the final 2016-2017 financial performance (unaudited). The document also includes actions that are necessary to revise the 2017-2018 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, recognize new or adjust existing grant, reimbursement or fee activity revenues and expenditures, fund a very limited number of urgent fiscal/program needs in the General Fund, and reflect changes in project and program allocations based on revised cost estimates as well as establish a limited number of new projects and programs in special and capital funds.

**EXECUTIVE SUMMARY**

The Administration proactively managed the City's 116 budgeted funds in 2016-2017. Budget actions were brought forward during the year to ensure that revenues and expenditures remained in alignment with actual performance. Through this careful management, the various City funds generally ended the year with revenues close to the budgeted estimates and expenditures below the budgeted allocations.

With the local economy's sustained growth over the past several years, and as expenditures were closely forecasted and monitored, the City's budget remained stable. Accordingly, the 2016-2017 Adopted Budget maintained existing service levels while also providing limited enhancements to service delivery in priority areas and providing some investments in City infrastructure. The Adopted Budget allocated a small General Fund surplus of \$6.9 million along with the new local Sales Tax. As always, the City will maintain its focus on rebuilding services within available resources to meet the needs of the San José community.

In the General Fund, both the revenues and expenditures ended the year very close to budgeted expectations. At the end of 2016-2017, there was \$24.6 million (0.9% of the 2016-2017 Modified Budget total sources and uses) in additional General Fund 2016-2017 Ending Fund Balance above the level assumed in the development of the 2017-2018 Adopted Budget. These funds are recommended to be allocated in the 2016-2017 Annual Report as shown below.

**PROPOSED 2017-2018 GENERAL FUND ADJUSTMENTS (\$000s)**

<b>Additional 2016-2017 Ending Fund Balance for Annual Report</b>	<b>\$24,565</b>
<b>Clean-Up Actions</b>	
Development Fee Programs Reconciliation	(4,404)
Rebudgets/Clean-Up Adjustment	(12,463)
<b>Sub-total Clean-Up Actions</b>	<b>(\$16,867)</b>
<b>Fund Balance Available After Clean-up Actions</b>	<b>\$7,698</b>
<b>Recommended Budget Adjustments</b>	
Required Technical/Rebalancing Actions	(5,045)
Grants/Reimbursements/Fee Activities (Sources = \$1.87M; Uses = \$1.81M)	62
Urgent Fiscal/Program Needs	(2,365)
<b>Sub-total Recommended Budget Adjustments</b>	<b>(\$7,348)</b>
<b>Remaining Balance After Clean-ups/Recommended Adjustments</b>	<b>\$350</b>
<b>2018-2019 Future Deficit Reserve</b>	<b>(\$350)</b>

## **EXECUTIVE SUMMARY**

When bringing forward recommendations for the use of the additional 2016-2017 Ending Fund Balance, the Administration considers clean-up actions associated with the close-out of the 2016-2017 fiscal year to be essentially non-discretionary and the highest priority. These clean-up actions result in a net decrease to the available fund balance of \$16.9 million and are broken down into two categories: changes to the Development Fee Programs reserves to reconcile actual 2016-2017 performance (decrease to fund balance of \$4.4 million); and adjustments to rebudget amounts that were carried over to 2017-2018 to complete projects and technical adjustments to other revenue and expenditure line items (increase to fund balance of \$12.5 million). After accounting for those clean-up actions, the additional General Fund 2016-2017 Ending Fund Balance was within \$7.7 million (0.3%) of the 2016-2017 Modified Budget (sources and uses). The \$7.7 million positive fund balance variance is comprised of net additional revenues of \$1.06 million (0.1%), net expenditure savings of \$6.68 million (0.5%), and higher than estimated liquidation of prior year encumbrances of \$1.26 million, partially offset by a lower 2016-2017 Beginning Fund Balance of \$1.3 million. The remaining General Fund balance of \$7.7 million is recommended to fund various required technical/rebalancing actions (\$5.0 million), a small number of recommended actions to address urgent fiscal/program needs (\$2.4 million), and an increase to the 2018-2019 Future Deficit Reserve (\$350,000).

The largest actions in the General Fund include funding for the purchase of a replacement helicopter for the Police Department (\$1.6 million), an increase to the Contingency Reserve (\$500,000) to ensure compliance with the 3% funding requirement for the 2017-2018 Budget, funding for contractual and temporary staffing costs associated with the Google development in the Diridon Station Area (\$415,000), an increase of \$392,000 to fully fund the FMC Debt Service Payment owed by the City, an increase of \$350,000 to the 2018-2019 Future Deficit Reserve, an increase to the City Manager's Office Personal Services appropriation to support and assist with executing the Office of Emergency Management Work Plan (\$250,000), and an increase of \$150,000 to the Planning, Building and Code Enforcement Department for temporary staffing to support the Multiple Housing Occupancy Program. In addition, net adjustments of \$62,000 to various grants, reimbursements and fee activities are included along with a series of technical adjustments.

This report also addresses immediate needs in various special and capital funds, including adding resources to support the development of the San José Regional Transportation Hub; allocating funding to address urgent needs at the Convention Center and other cultural facilities; replacing the artificial turf of the main field at the Leland Sports Field facility; receiving an insurance reimbursement for Family Camp repairs related to the Rim Fire of 2013; and allocating additional Fire Construction and Conveyance Tax proceeds to the Fire Station 37 (Construction) Reserve.

As we move forward, the Administration will continue to monitor and report on the City's financial performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. With an early anticipated 2018-2019 General Fund shortfall of \$35.2 million, the Administration will be proactively controlling costs to the extent possible for the remainder of 2017-2018. The financial results of 2016-2017 will also be factored into the development of the 2019-2023 General Fund Five-Year Forecast that will be released in February 2018.

## **BACKGROUND**

Each year the City issues the Annual Report at the end of September, three months after the close of the fiscal year, as required by the City Charter. Following is a description of the various sections of the Annual Report document.

- **Transmittal Memorandum** – This section provides an overall summary of the 2016-2017 Annual Report.
- **Section I: Financial Performance Summary (All Funds)** – This section provides a comparison of the 2016-2017 budget to actual revenues received and expenditures incurred by fund as well as an explanation of revenue and/or expenditure variances of 10% or greater to the budget. This section also provides a comparison of the year-end actual 2016-2017 Ending Fund Balance by fund to the 2016-2017 Ending Fund Balance/2017-2018 Beginning Fund Balance estimate used in the development of the 2017-2018 Adopted Budget. In addition, a listing of the Earmarked and Contingency Reserves that were available at the end of 2016-2017 by fund is included.
- **Section II: General Fund Financial Performance** – This section provides a summary of the General Fund performance in 2016-2017, including the following: Results of Operations in the General Fund; Revenue Performance; and Expenditure Performance.
- **Section III: Selected Special/Capital Funds Financial Performance** – This section provides financial information on the 2016-2017 year-end performance for selected special and capital funds that represent major City operations. It includes a discussion of variances between actual and budgeted revenues and expenditures as well as a comparison between the actual ending fund balance and the fund balance estimated for 2016-2017 in the development of the 2017-2018 Adopted Budget.
- **Section IV: Recommended Budget Adjustments and Clean-Up/Rebudget Actions** – This section provides a description of the recommended budget adjustments and clean-up actions for City Council consideration. The proposed actions generally fall into three categories: (1) adjustments to the 2017-2018 Beginning Fund Balance amounts in various funds, including the General Fund, based on the final reconciliation of 2016-2017; (2) upward and downward adjustments to the rebudget figures to ensure the appropriate amount of unexpended funds are carried over to 2017-2018 to complete projects; and (3) actions based on more recent information that are necessary to revise the 2017-2018 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, recognize new or adjust grant, reimbursement or fee activity revenues and expenditures, fund a very limited number of urgent fiscal/program needs in the General Fund, and reflect changes in project and program allocations based on revised cost estimates as well as establish a limited number of new projects and programs in special and capital funds.

**BACKGROUND**

- **Section V: Financial Statements** – This section provides the financial results (unaudited), prepared by the Finance Department, for all budgeted fund groups for 2016-2017. It should be noted that audited financial results will be released later in the fall as part of the 2017 Comprehensive Annual Financial Report (CAFR) for Fiscal Year Ended June 30, 2017. Final fund balance reconciliations to the CAFR will be conducted for all funds and, while very few adjustments are typically necessary, any final adjustments will be brought forward for City Council consideration as part of the 2017-2018 Mid-Year Budget Review.

**ANALYSIS**

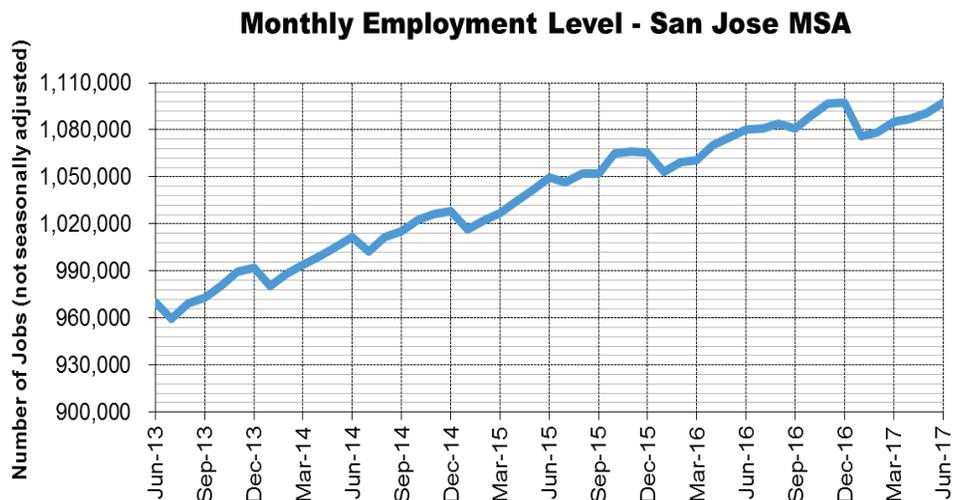
This Analysis section includes the following:

- an overview of the economic environment;
- a discussion of the 2016-2017 budget performance of all City funds;
- a discussion of the 2016-2017 budget performance for the General Fund;
- a discussion of the components of the 2016-2017 General Fund ending fund balance;
- an analysis of the impact of the General Fund performance on the 2017-2018 Adopted Budget; and
- a discussion of the 2016-2017 budget performance of selected special and capital funds.

**Economic Environment**

When the 2016-2017 Adopted Budget was developed, economic growth was expected to continue throughout the year. This assumption has proven true, with continued improvement in economic indicators and actual revenue performance during 2016-2017. Employment indicators, construction activity, median single-family home prices, and the number of days it took to sell these homes all performed well in 2016-2017.

The June 2017 employment level in the San José, Sunnyvale, Santa Clara Metropolitan Statistical Area (MSA) of 1.097 million was 1.6% above the June 2016 level of 1.080 million. This represents the seventh consecutive year of sustained growth



**ANALYSIS**

**Economic Environment**

from June to June. The growth is underscored by the current low unemployment that the San José – Sunnyvale – Santa Clara MSA is experiencing.

The unemployment rate in the San José metropolitan area continued to improve in 2016-2017, dropping from 4.0% in June 2016 to 3.6% in June 2017. These rates remain well below the double digit levels that had been experienced during the Great Recession. The June 2017 unemployment rate in this region was well below the unadjusted rate for the State (4.9%) and the nation (4.5%).

**Unemployment Rate (Unadjusted)**

	<b>June 2016</b>	<b>June 2017</b>
SJ Metropolitan Statistical Area*	4.0%	3.6%
State of California	5.6%	4.9%
United States	5.1%	4.5%

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

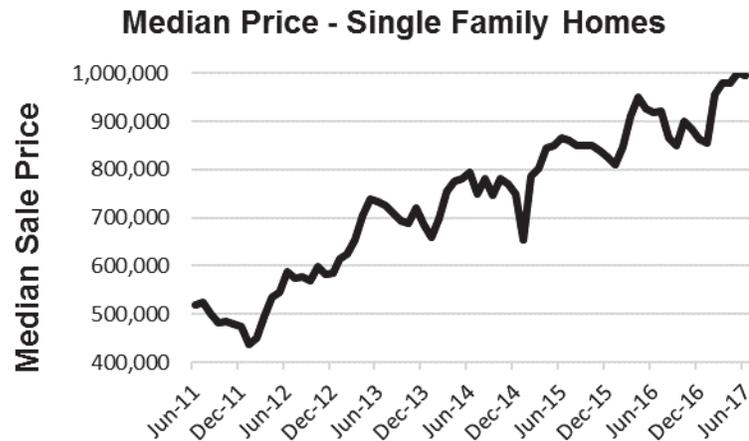
Led by the commercial and residential sectors, overall construction activity was especially strong in 2016-2017 at \$1.9 billion, exceeding 2015-2016 levels of \$1.5 billion and the peak of \$1.7 billion experienced in 2013-2014. Commercial valuation of \$702.6 million ended above the prior year level of \$474.0 million. Residential valuation of \$599.1 million also exceeded the prior year total of \$440.9 million. Industrial activity of \$574.5 million fell slightly from prior year actuals of \$594.7 million.

Major projects contributing to the tax receipts in 2016-2017 were Silvery Towers, a 640 unit condominium and loft high rise on St. James Street; Hanover Cannery Park Apartment Building, a 403 unit apartment complex on Taylor Street; Ohlone Block C Apartment Building; a 268 unit apartment building on Sunol Street; Marshall Squares Apartment Building, a 190 unit apartment building on North 1<sup>st</sup> Street; Balbach Condos, a 101 unit condominium complex on Balbach Street; and two Hyatt Hotels, a 7-story building on Karina Court and a 5-story building on North 1<sup>st</sup> Street. Overall, this construction activity drives the revenue collection in several construction tax categories such as the Building and Structure Construction Tax and Construction Excise Tax and is an indicator of future activity for other categories such as storm and sanitary sewer system fees.

## ANALYSIS

### **Economic Environment**

The housing market also remained strong in 2016-2017. The median price for single family homes increased in value, with a median home price in June 2017 of \$996,000, up 8.3% from the June 2016 price of \$920,000. The May and June 2017 median home prices of \$1.0 million and \$996,000, respectively, represent the highest home prices recorded for San José. However, the number of property transfers in 2016-2017 was 7,883, which represents a 4.1% decrease



from the number of sales that occurred during the prior year. The amount of inventory available in the real estate market has been steadily decreasing, with the number of new listings for single-family and multi-family dwellings totaling 878 in June 2017, a 9.2% drop from 967 in June 2016. Finally, the amount of time it is taking to sell these homes has remained fairly consistent with the average days-on-market for single-family and multi-family dwellings in 2016-2017 totaling 26 days, compared to 24 days during the previous year.

### **2016-2017 Budget Performance (All Funds)**

As shown in Section I of this document, City revenues (excluding Beginning Fund Balances) totaled \$3.34 billion in 2016-2017, which was 1.4% (\$45.8 million) below the budgeted estimate of \$3.39 billion.

In 2016-2017, expenditures (excluding Reserves and Ending Fund Balances) totaled \$3.69 billion, which was \$479.7 million (11.5%) below the modified budget of \$4.17 billion. At the end of 2016-2017, the Contingency and Earmarked Reserves for all City funds totaled \$789.6 million, which represented 15.4% of the total 2016-2017 Modified Budget of \$5.1 billion (including interfund transfers, loans, and contributions). In the General Fund, Reserves totaled \$150.7 million.

The financial performance in 2016-2017 is used as the starting point for 2017-2018. The collective 2016-2017 Ending Fund Balances for all City funds totaled \$1.4 billion, which was \$97.8 million above the 2016-2017 Ending Fund Balance estimates of \$1.3 billion used in the development of the 2017-2018 Adopted Budget. After adjusting for additional rebudgets of \$9.87 million recommended in this report, the adjusted 2016-2017 Ending Fund Balance variance for all funds falls to \$87.9 million, or 1.7% of the 2016-2017 Modified Budget. The adjusted fund balance variance totaled \$7.7 million in the General Fund, \$50.5 million in the special funds, and \$29.7 million in the capital funds.

**ANALYSIS**

**2016-2017 General Fund Budget Performance**

The City's General Fund ended the 2016-2017 fiscal year within budgeted levels. As shown in the chart below, the General Fund Ending Fund Balance of \$241.8 million was \$24.6 million (0.9% of the 2016-2017 Modified Budget total sources and uses) above the fund balance estimate assumed when the 2017-2018 Adopted Budget was developed. The following table summarizes the General Fund performance in 2016-2017, comparing the actual results to the modified budget and the estimates used to develop the 2017-2018 Adopted Budget.

**Table 1**  
**General Fund Year-End Status**  
**For the Year Ended June 30, 2017**  
 (\$000s)

<b>Sources</b>	<b>2016-2017 Modified Budget</b>	<b>2016-2017 Year-end Estimate</b>	<b>2016-2017 Budgetary Basis Actual</b>	<b>Actual to Budget Variance</b>	<b>Actual to Estimate Variance</b>
<i>Beginning Fund Balance</i>	255,207	255,207	253,903	(1,304)	(1,304)
<i>Carryover Encumbrances</i>	37,500	37,500	37,502	2	2
<i>Liquidation of Carry- over Encumbrances</i>	-	1,000	2,256	2,256	1,256
<i>Revenue</i>	<u>1,109,678</u>	<u>1,109,678</u>	<u>1,108,260</u>	<u>(1,418)</u>	<u>(1,418)</u>
<i>Total Sources</i>	<u><u>1,402,385</u></u>	<u><u>1,403,385</u></u>	<u><u>1,401,921</u></u>	<u><u>(464)</u></u>	<u><u>(1,464)</u></u>
<b>Uses</b>					
<i>Expenditures/Transfers</i>	1,251,651	1,181,710	1,160,152	(91,499)	(21,558)
<i>Reserves</i>	<u>150,734</u>	<u>4,471</u>	<u>-</u>	<u>(150,734)</u>	<u>(4,471)</u>
<i>Total Uses</i>	<u><u>1,402,385</u></u>	<u><u>1,186,181</u></u>	<u><u>1,160,152</u></u>	<u><u>(242,233)</u></u>	<u><u>(26,029)</u></u>
<i>Ending Fund Balance</i>	<u><u>-</u></u>	<u><u>217,204</u></u>	<u><u>241,769</u></u>	<u><u>241,769</u></u>	<u><u>24,565</u></u>

Note: In the chart above, the General Fund excludes the Emergency Reserve Fund and the Cash Reserve Fund, which are budgeted as separate funds and reflected separately in this document. In the 2016-2017 Comprehensive Financial Report (CAFR), the Emergency Reserve Fund and Cash Reserve Fund will be displayed as part of the General Fund to comply with GASB 54 reporting requirements.

In 2016-2017, General Fund revenues of \$1.1 billion ended the year \$1.4 million (0.1%) below both the modified budget and the estimate used to develop the 2017-2018 Adopted Budget. Other funding sources included the liquidation of prior year carryover encumbrances totaling \$2.3 million, which was \$1.3 million above the estimate used to develop the 2017-2018 Adopted Budget, partially offset by a downward adjustment of \$1.3 million to the 2016-2017 Beginning Fund Balance. General Fund expenditures/transfers of \$1.2 billion were \$91.5 million (7.3%) below the 2016-2017 Modified Budget level of \$1.3 billion and \$26.1 million (1.8%) below the estimate used to develop the 2017-2018 Adopted Budget. Budgeted reserves of \$150.7 million remained unexpended at year-end.

## ANALYSIS

### **2016-2017 General Fund Budget Performance**

When comparing the actual revenue and expenditure performance to the estimates used to develop the 2017-2018 Adopted Budget, a portion of these variances is related to various grants and reimbursements that were not received in 2016-2017, but are expected to be received in 2017-2018. A total of \$3.8 million of grant and reimbursement revenues and expenditures were rebudgeted to 2017-2018 in the 2017-2018 Adopted Budget. This resulted in lower actual revenues and expenditures in 2016-2017, with no net impact to the General Fund. After factoring out the lower revenues and expenditures associated with these grants and reimbursements, revenues were above the estimate by \$2.4 million (0.1%) and expenditures savings totaled \$22.2 million (1.6%). In addition, the 2016-2017 Beginning Fund Balance was \$1.3 million below the estimate due to final accounting adjustments, but the liquidation of carryover encumbrances exceeded the \$1.0 million estimate by \$1.3 million. Further adjustments to these figures are necessary to account for the recommended clean-up and rebudget actions in the Annual Report.

In this Annual Report document, budget actions are recommended to distribute the additional fund balance of \$24.6 million. Per City Council Policy 1-18, when determining the proposed distribution of these funds, the first priority is to complete clean-up actions associated with the final reconciliation of 2016-2017. Recommended clean-up actions result in net decrease of \$16.9 million to the amount of funding available to distribute, and reflect the allocation of \$4.4 million to reconcile the actual performance of the Development Fee Programs for 2016-2017 and an adjustment of \$12.5 million in required expenditure rebudgets and other clean-up adjustments to close-out 2016-2017. The adjusted figure of \$7.7 million in additional funding available to distribute was generated from net additional revenues of \$1.05 million and net expenditure savings of \$6.7 million, a Beginning Fund Balance downward adjustment of \$1.3 million, and higher than estimated liquidation of prior year encumbrances (\$1.3 million).

The additional General Fund balance of \$7.7 million (0.3%) available for distribution is recommended to be allocated to address various required technical and rebalancing actions (\$5.4 million), and recommended urgent fiscal/program needs (\$2.3 million), which are described later in this transmittal memorandum.

To identify revenue and expenditure trends, Table 2 below compares the City's budget performance in 2016-2017 with the budget performance of the prior year.

**ANALYSIS**

**2016-2017 General Fund Budget Performance**

**Table 2  
 General Fund  
 Comparison of Year-End Actuals With Prior Year  
 (\$000s)**

	<b>2015-2016</b>	<b>2016-2017</b>		
	<b>Actuals</b>	<b>Actuals</b>	<b>Change</b>	<b>% Change</b>
<b>Source of Funds</b>				
Beginning Fund Balance	265,855	253,903	(11,952)	-4.5%
Revenues	1,055,518	1,108,260	52,742	5.0%
<b>Total Source of Funds</b>	<b>1,321,373</b>	<b>1,362,163</b>	<b>40,790</b>	<b>3.1%</b>
<b>Use of Funds</b>				
Personal Services	692,220	729,913	37,693	5.4%
Non-Personal/Equipment/Other	129,244	135,728	6,484	5.0%
City-Wide Expenses	223,639	217,142	(6,497)	-2.9%
Capital Contributions	38,308	49,301	10,993	28.7%
Transfers	27,150	28,068	918	3.4%
Reserves	-	-	-	N/A
<b>Total Use of Funds</b>	<b>1,110,561</b>	<b>1,160,152</b>	<b>49,591</b>	<b>4.5%</b>

As shown in Table 2, 2016-2017 General Fund revenues of \$1.1 billion represent an increase of 5.0% from the 2015-2016 collection level of \$1.05 billion. The categories that experienced the largest increases included: Property Tax, Business Taxes, Utility Taxes, Use of Money/Property, and Revenue from Local Agencies. The largest declines from the prior year were experienced in the Departmental Charges (reduced revenue from Transportation and Library fees). In addition, although Sales Tax revenue reflects a 2.9% (\$5.9 million) increase from the prior year (from \$201.8 million to \$207.7 million), a higher collection level (\$224.7 million) was anticipated in development of the 2016-2017 Adopted Budget due to the implementation of the voter-approved ¼ cent sales tax, which was approved in June 2016 and implemented in October 2016.

General Fund expenditures of \$1.16 billion in 2016-2017 were 4.5% (\$49.6 million) above prior year expenditure levels of \$1.11 billion. This increase is due to higher Personal Services (\$37.7 million), Capital Contributions (\$11.0 million), Non-Personal/Equipment/Other (\$6.5 million), and Transfers (\$918,000), partially offset by lower City-Wide Expenses (\$6.5 million).

A detailed discussion of the General Fund revenue and expenditure performance is provided in Section I of this document.

**ANALYSIS**

**2016-2017 General Fund Ending Fund Balance**

The current budgeting practice of the City is to use the projected level of fund balance expected to remain in the General Fund at the end of any fiscal year as a funding source for the following year. The Ending Fund Balance estimate always contains two components: the portion of the fund balance that needs to be rebudgeted for completing projects or retaining reserves; and the portion which is undesignated and available as a general funding source in the coming year. In the 2017-2018 Adopted Budget, a total fund balance estimate of \$217.2 million was included as a funding source. As discussed earlier, the 2016-2017 General Fund Ending Fund Balance of \$241.8 million was \$24.6 million above this estimate.

The components of the 2016-2017 General Fund Ending Fund Balance include additional funding sources, expenditure/transfer savings, and unexpended reserves as described below:

**2016-2017 General Fund  
Ending Fund Balance Components**

<b>Fund Balance Component</b>	<b>\$ Amount (\$ in 000s)</b>
Additional Funding Sources	(464)
Expenditure/Transfer Savings	91,499
Unexpended Reserves	150,734
<b>TOTAL</b>	<b>\$ 241,769</b>

The total Sources of Funds ended the year \$464,000 million below the modified budget as a result of lower revenues (\$1.4 million) and a negative correction to the 2016-2017 Beginning Fund Balance (-\$1.3 million), that were partially offset by a higher liquidation of carryover encumbrances (\$2.3 million). After net-zero revenue rebudgets and additional rebudget and clean-up actions recommended in the Annual Report, there is an adjusted revenue surplus of \$1.06 million (0.1%) from the modified budget.

For the Uses of Funds, expenditure and transfer savings totaled \$91.5 million, while unexpended reserves totaled \$150.7 million, representing the largest component of the 2016-2017 Ending Fund Balance. Of the \$91.5 million in expenditure savings, a majority of funding was rebudgeted in the 2017-2018 Adopted Budget (\$73.4 million) with additional funding being recommended for rebudget or clean-up as part of this report (\$8.6 million). In addition, clean-up actions of \$2.8 million are recommended in this document to reconcile the Development Fee Programs for 2016-2017. After accounting for these technical adjustments, the remaining General Fund expenditures and transfer savings totaled \$6.7 million, or 0.5% of the modified budget.

## ANALYSIS

### **2016-2017 General Fund Ending Fund Balance**

General Fund Reserves, totaling \$150.7 million at the end of 2016-2017, include two categories: Earmarked Reserves (\$115.2 million) established to address specific needs per City Council direction; and the Contingency Reserve (\$35.5 million) set at a minimum of 3% of expenditures per City Council policy.

Following is additional information regarding the two reserve categories.

- ***Earmarked Reserves (\$115.2 million)*** – At the end of 2016-2017, the most significant reserves included the following: the Building Development Fee Program Reserve (\$22.4 million); Budget Stabilization Reserve (\$16.3 million); Workers Compensation/General Liability Catastrophic Reserve (\$15.0 million); 2016-2017 Ending Fund Balance Reserve (\$11.0 million), Fire Development Fee Program (\$7.3 million); Cultural Facilities Capital Maintenance Reserve (\$6.9 million); Retiree Healthcare Solutions Reserve (\$6.1 million); Sick Leave Payments Upon Retirement Reserve (\$6.0 million); Public Works Development Fee Program Reserve (\$5.5 million); and Salaries and Benefits Reserve (\$5.0 million). The majority of the Earmarked Reserves were either approved for rebudget or used as a funding source in the 2017-2018 Adopted Budget.

The 2016-2017 Ending Fund Balance Reserve of \$11.0 million was proactively set aside to help ensure sufficient fund balance would be available at the end of 2016-2017 to meet the budgeted estimate used in the development of the 2017-2018 Adopted Budget. Annually, as part of the development of the General Fund Forecast and Adopted Budget for the following year, a certain amount of current year unrestricted ending fund balance is estimated to be available at the end of the year as a funding source for the following year's budget. This ending fund balance is expected to be generated from additional revenues above budgeted levels, expenditure savings, and the liquidation of carryover encumbrances during the year. In the 2017-2018 Adopted Budget, it was assumed that \$18.6 million would be generated from these sources. The establishment of the 2016-2017 Ending Fund Balance Reserve set aside a portion of this funding, with the assumption that the remaining amount would be realized by year-end primarily from expenditure savings and the liquidation of prior year carryover encumbrances.

## ANALYSIS

### **2016-2017 General Fund Ending Fund Balance**

- **Contingency Reserve (\$35.5 million)** – The City Council has established a budget policy of maintaining a minimum 3% Contingency Reserve in the General Fund. At the end of 2016-2017, the Contingency Reserve totaled \$35.5 million and had remained unspent during the year. As part of the 2017-2018 Adopted Budget, the full Contingency Reserve was rebudgeted and funding of \$500,000 was added (bringing the Reserve to \$36.0 million) in order to comply with the Council Policy of maintaining a minimum 3% Contingency Reserve in the General Fund. As part of this report, an additional \$500,000 is recommended to comply with the 3% funding requirement and would bring the 2017-2018 Contingency Reserve to \$36.5 million. It is important to note, however, that if this Contingency Reserve is ever needed, it is only sufficient to cover General Fund payroll expenditures for approximately two and a half weeks in the event of an emergency.

As discussed above, it was assumed that \$217.2 million would remain in the General Fund at the end of 2016-2017 and would be carried over to 2017-2018 as Beginning Fund Balance as part of the adoption of the 2017-2018 Budget. These funds, which were expected to be generated from unexpended reserves, unexpended funds that were rebudgeted to 2017-2018, additional revenue, expenditure savings and the liquidation of carryover encumbrances, were programmed for use in the 2017-2018 Adopted Budget. The actual General Fund Ending Fund Balance was above the estimate used in the 2017-2018 Adopted Budget by \$24.6 million, due to excess revenues and additional expenditure savings, a majority of which are recommended to be rebudgeted as part of this report.

The following chart details the recommended uses of the \$24.6 million additional fund balance as well as other budget adjustments that are recommended as part of this report. Recommended clean-up actions will result in a decrease to the available fund balance by \$16.9 million, reflecting a downward adjustment of \$4.4 million to reconcile the actual performance of the Development Fee Programs in 2016-2017 and a net downward adjustment of \$12.5 million to account for additional rebudget and clean-up actions to close-out 2016-2017. Once these adjustments have been accounted for, the net available fund balance available for allocation totals \$7.7 million. This additional fund balance is proposed to be allocated to address required technical/rebalancing needs as well as a very limited number of urgent fiscal/program needs in the current year.

**ANALYSIS**

**Impacts on the 2017-2018 General Fund Budget**

**PROPOSED 2017-2018 GENERAL FUND ADJUSTMENTS (\$000s)**

**Additional 2016-2017 Ending Fund Balance** **\$ 24,565**

**Clean-Up Actions**

Development Fee Programs Reconciliation (4,404)  
 Rebudgets/Clean-Up Adjustments (12,463)  
**Sub-total Clean-Up Actions** **\$ (16,867)**

**Fund Balance Available After Clean-Up Actions** **\$ 7,698**

**Recommended Budget Adjustments**

**Required Technical/Rebalancing Actions**

- Successor Agency to the Redevelopment Agency PERS Levy Settlement Agreement (Interest Earnings) 232  
 - Air Service Incentive Program Reserve 24  
 - Finance Department Temporary Staffing Funding Reallocation (\$100,000 fr Pers Svcs to Non-Pers/Equip) 0  
 - Police Department Overtime Reallocation (\$13.0 million from Salaries and Benefits to Overtime) 0  
 - Sales Tax (4,000)  
 - Contingency Reserve (500)  
 - FMC Debt Service Payment (392)  
 - Planning, Building and Code Enforcement Temporary Staffing (Multiple Housing Program) (150)  
 - Business Tax System (145)  
 - Animal Care and Services Washer/Dryer Replacement (50)  
 - Insurance Premiums (Hayes Mansion) (33)  
 - Mayor/City Council Salary Increases (31)

**Sub-total Required Technical/Rebalancing Actions** **\$ (5,045)**

**Grants/Reimbursements/Fee Activities** (Sources = \$1.87M; Uses = \$1.81M) **\$ 62**

**Urgent Fiscal/Program Needs**

- Police Helicopter Replacement (1,600)  
 - Google Development Planning (415)  
 - Office of Emergency Management Work Plan (250)  
 - VEBA Opt-In Program Implementation (100)

**Sub-total Urgent Fiscal/Program Needs** **\$ (2,365)**

**Total Recommended Budget Adjustments** **\$ (7,348)**

**Remaining Balance After Recommended Adjustments** **\$ 350**

**2018-2019 Future Deficit Reserve\*** **\$ (350)**

\* This action is reflected in the Recommended Budget Adjustments and Clean-Up/Rebudget Actions section of this report under Required Technical/Rebalancing Actions.

## ANALYSIS

### **Impacts on the 2017-2018 General Fund Budget**

Following is a summary of the recommended actions. These adjustments are described in more detail in Section IV of this report.

#### **Clean-Up Actions (-\$16.9 million)**

- **Development Fee Programs Reconciliation (-\$4.4 million)** –Year-end reconciliations of the revenues and expenditures in the Development Fee Programs are conducted to determine if revenues exceeded or fell below costs. To meet the commitment to the development community that all development fees will be used solely to support development fee activities, any excess revenues and interest earnings above actual costs are placed in Development Fee Program Reserves. Based on 2016-2017 results, \$4.4 million is recommended to be added to the Development Program Fee Reserves (Building, Fire, Planning, and Public Works), preserving any net savings between revenues and expenditures in these programs.
- **Rebudgets/Clean-Up Adjustments (-\$12.5 million)** – A series of adjustments are recommended to complete existing projects in 2017-2018 and to reflect any necessary technical budget adjustments or reconciliation actions. The Annual Report is the point in the budget process where action is required to rebudget unexpended funds from the prior year that were not anticipated when the Adopted Budget was approved, but are required to complete a project in the current year. Also recommended are actions that reduce previous rebudgets to reflect instances where expenditures, for which rebudgets were approved, actually occurred in 2016-2017, therefore, the funds are not available for rebudget to 2017-2018. Other technical adjustments include the reconciliation of restricted program or grant funding (e.g. Artificial Turf Capital Replacement, General Plan Update, Maddie Lifesaving Grant, Public, Education, and Government Access activities) and the adjustments to allocate revenues received in 2016-2017 to support special events in Council Districts #01, #02, and #10.

#### **Recommended Budget Adjustments (-\$7.3 million)**

A number of General Fund budget adjustments, with a total net cost of \$7.3 million are recommended and can be classified under three categories: 1) Required Technical/Rebalancing Actions (net cost of \$5.0 million) that align already approved revenue estimates and expenditure budgets with the most current tracking information, reallocate funding among appropriations based on updated needs, to correct technical problems in the 2017-2018 Adopted Budget, or comply with actions previously authorized by the City Council; 2) Grants/Reimbursement/Fee Activities that have a net savings of \$62,000, recognizing new or adjusted grant, reimbursement, or fee activity revenue, and adjust the appropriations for these purposes as appropriate; and 3) Urgent Fiscal/Program Needs (cost of \$2.4 million) brought forward for City Council consideration as part of this report, rather than later through the annual budget process, because the Administration has deemed the need cannot or should not wait until later in the year.

## ANALYSIS

### Impacts on the 2017-2018 General Fund Budget

A summary of these adjustments include:

- **Required Technical/Rebalancing Actions (-\$5.0 million)**
  - This action recognizes interest earnings of \$232,000 paid to the City as part of the *Successor Agency to the Redevelopment Agency PERS Levy Settlement Agreement*. As part of the agreement, a payment of \$12.9 million was included in the 2017-2018 Adopted Budget. Final negotiations with the County of Santa Clara, however, resulted in the payment of interest earnings which were not included in the final budget. (\$232,000)
  - This action eliminates the *Air Service Incentive Program Reserve* of \$1.15 million and decreases the overhead reimbursement from the Airport Maintenance and Operation Fund to the General Fund by \$1.13 million, resulting in net savings of \$24,000. The Municipally-Funded Air Service Incentive Program, a provision in the Airline-Airport Lease and Operating Agreements that was approved by the City Council in March 2007, requires that, should the percentage growth in annual enplanements at the Airport exceed the growth in annual enplanements nationwide, the City shall reduce the amount of its indirect overhead expenses in the following fiscal year by a corresponding percentage. In 2016-2017, the percentage growth in annual enplanement at the Airport was 12.8%, which exceeded the Federal Aviation Administration's projection of 2.2% for national growth. In anticipation of this overhead reduction, the 2017-2018 Adopted Budget included an Air Service Incentive Program reserve to offset the projected loss in revenue. (\$24,000)
  - This action reallocates funding of \$100,000 from the Finance Department's Personal Services appropriation to their Non-Personal/Equipment appropriation to provide funding for *Finance Department Temporary Staffing* to assist the Accounting Division with the consolidation of the financial statements for the City's Comprehensive Annual Financial Report due to position vacancies and staff tenure. (\$0)
  - This action increases *Police Department Overtime* funding by \$13.0 million (from \$17.3 million to \$30.3 million). This funding will primarily be used to continue to backfill for vacant sworn and civilian positions and continue the expanded targeted enforcement efforts for high crime activity. To better align anticipated actual costs with expenditure line items, this action reallocates \$13.0 million in estimated 2017-2018 vacancy savings from the salary and benefits line items to the overtime line item in the Police Department Personal Services appropriation. (\$0)

## ANALYSIS

### Impacts on the 2017-2018 General Fund Budget

- This action decreases the revenue estimate for ***Sales Tax*** by \$4.0 million, from \$228.0 million to \$224.0 million. When the 2017-2018 Adopted Budget was developed, the General Sales Tax estimate of \$187.0 million reflected growth of 3.0% (after accounting for prior year accrual corrections and the reversal of a large one-time negative adjustment) from the 2016-2017 year-end estimate of \$180.0 million. However, because actual General Sales Tax receipts ended 2016-2017 below estimated levels, a decrease to the 2017-2018 estimate of \$4.0 million (from \$187.0 million to \$183.0 million) is recommended. The resulting modified 2017-2018 estimate continues to reflect underlying 3% growth (after accounting for prior year accrual corrections and the reversal of a large one-time negative adjustment) from the 2016-2017 actual collection level. (-\$4.0 million)
- This action increases the ***Contingency Reserve*** by \$500,000, from \$36.0 million to \$36.5 million. Per City Council Policy I-18, Operating Budget and Capital Improvement Program Policy, the General Fund Contingency Reserve is to be set at a minimum of 3% of the operating budget. This action will ensure compliance with the 3% funding requirement for the 2017-2018 Budget. The purpose of this reserve is to meet unexpected circumstances arising from financial and/or public emergencies that require immediate funding that cannot be met by any other means. (-\$500,000)
- This action increases the ***FMC Debt Service Payment*** appropriation by \$392,000 to cover the debt service payments due from the City. As part of the 2017-2018 Adopted Budget, the incorrect amount was included and this action will correct the error. (-\$392,000)
- This action increases the ***Planning, Building and Code Enforcement*** Personal Services appropriation in the amount of \$150,000 for ***Temporary Staffing*** to support the Code Enforcement Multiple Housing Occupancy Program. The funding will provide for an experienced code enforcement inspector on a temporary basis who can provide inspections, train the mostly new staff, and assist in meeting performance targets for the Multiple Housing Occupancy Program. (-\$150,000)
- This action increases the ***Business Tax System*** appropriation in the amount of \$145,000 to address higher than anticipated project costs. The project will allow the City to use a single tax billing and management application and businesses to pay self-reporting taxes online rather than through paper submissions. This funding will provide for an in-house Information Technology Project Manager that will be dedicated to lead the team towards meeting the new go-live period of 4<sup>th</sup> Quarter of 2017-2018. In addition, this funding will provide for a change order to add an online payment function and accommodates the recent voter-approved tax modernization ballot measure and project contingency. (-\$145,000)

## ANALYSIS

### Impacts on the 2017-2018 General Fund Budget

- This action increases the *Animal Care and Services Washer/Dryer Replacement* appropriation by \$50,000 to address an unanticipated increase in project costs related to the removal and replacement of a wall. The initial project scope inadvertently omitted the removal and replacement of a wall adjacent to the new washer and dryer. (-\$50,000)
- This action increases the *Insurance Premiums* appropriation by \$33,000 (from \$607,000 to \$640,000) to replace an amount that had been removed in the 2017-2018 Proposed Budget due to the expected sale of Hayes Mansion in 2016-2017, but which was inadvertently not included in the 2017-2018 Adopted Budget after the sale did not occur as anticipated. (-\$33,000)
- This action increases the *Office of the Mayor* and each *Council District* appropriation to reflect the *Salary Increases* for the Mayor and each City Councilmember as recommended by the Salary Setting Commission, which was approved by the City Council on June 27, 2017. The City Charter requires the Commission to recommend salaries and benefits for the Mayor and City Councilmembers, and for 2017-2018, the Commission unanimously adopted the recommendation to increase the salary by 3%, the Mayor by \$3,750 (from \$125,000 to \$128,750) and Councilmembers by \$2,760 (from \$92,000 to \$94,760). It should be noted that the Administration was formally notified that the Councilmember for Council District #06 has voluntarily elected to waive her base salary increase for 2017-2018, therefore, her salary will remain at \$92,000. These additional funds will be used instead for general expenses for the Council District. (-\$31,350)
- **Grants/Reimbursements/Fees (\$62,000)**
  - A series of net adjustments totaling \$62,000 (revenues of \$1.868 million offset by expenditures of \$1.806 million) are recommended to reflect new or updated revenues and expenditures for *Grants, Reimbursements, and/or Fees* for the following Departments: Parks, Recreation and Neighborhood Services (revenues of \$834,000, expenditures of \$815,000), Planning, Building and Code Enforcement (revenues of \$432,000, expenditures of \$389,000), Police (revenues and expenditures of \$242,000), Environmental Services (revenues and expenditures of \$200,000), Office of Economic Development (revenues and expenditures of \$128,000), Mayor and City Council (revenues and expenditures of \$16,000), and Fire (revenues and expenditures of \$15,000). These adjustments are further described in *Section IV. Recommended Budget Adjustments and Clean-Up/Rebudget Actions*.

## ANALYSIS

### Impacts on the 2017-2018 General Fund Budget

- **Urgent Fiscal/Program Needs (-\$2.4 million)**

- This action establishes the ***Police Helicopter Replacement*** appropriation for \$1.6 million to partially fund the purchase of a replacement helicopter. The Police Department's current helicopter has been in use for 16 years, while the typical useful life span of a helicopter is six to eight years. The Department identified a replacement plan as described in a City Information Memorandum distributed on September 7, 2017 with a total funding need of approximately \$4.8 million. A revised replacement plan was developed, which includes \$1.8 million from the General Fund (\$200,000 of which is already budgeted, leaving the remaining balance of \$1.6 million appropriated in this action) and the remaining \$3.0 million from various special funds. (-\$1.6 million)
- This action establishes the ***Google Development Planning*** appropriation in the amount of \$415,000 to fund the 2017-2018 costs associated with the Google development in the Diridon Area. In June 2016, the City Council approved an Exclusive Negotiating Agreement with Google, which anticipates the sale of City and Successor Agency to the Redevelopment Agency owned properties to Google. This funding will allow for the negotiations involved with this multi-year project, a consultant agreement for Diridon development standards/design guidelines, a legal advisor to support the City Attorney's Office in development of the Memorandum of Understanding with Google, a community engagement advisor to assist with community engagement, and temporary staffing for CEQA and development review beginning in April 2018. It is anticipated that the City will enter into a reimbursement agreement with Google to cover the City's costs. Additional budget actions are expected to be brought forward in 2018-2019 to continue work on this project. (-\$415,000)
- This action increases the City Manager's Office Personal Services appropriation by \$250,000 to support and assist with executing the ***Office of Emergency Management Work Plan***, which was approved by City Council on August 8, 2017. The City Council directed the City Manager to begin executing a work plan of roughly 150 work items, including absorbing the Office of Emergency Management into the City Manager's Office. This funding will be used for temporary staffing to assist in these efforts as well as the development of the Joint Emergency Action plan with the Santa Clara Valley Water District. (-\$250,000)

## ANALYSIS

### **Impacts on the 2017-2018 General Fund Budget**

- This action increases the City Manager's Office Non-Personal/Equipment appropriation by \$100,000 to provide funding for one-time costs associated with the *Voluntary Employee Beneficiary Association (VEBA) Opt-In Program Implementation*, as a result of the passage of Measure F in November 2016. This funding will be used for two temporary employees who will be supporting the VEBA implementation, a Retiree Health Decision-Making Independent Benefit Consultant to provide educational and counseling services to employees considering opting-out of the current defined benefit retiree healthcare plan and into VEBA, and one-time start-up insurance premium cost for Federated and Sworn VEBA Health Savings Trust. (-\$100,000)

### **2018-2019 Future Deficit Reserve (-\$350,000)**

An increase of \$350,000 to the 2018-2019 Future Deficit Reserve, bringing it to a total of \$9.5 million, is recommended. Per Council Policy I-18, Operating Budget and Capital Improvement Program Policy, any ending fund balance that may be available after the close of the 2016-2017 fiscal year will be allocated 50% for unmet/deferred infrastructure and maintenance needs and 50% to offset any projected deficit for the following fiscal year. Based on the actions taken as part of the 2017-2018 Adopted Budget, it is currently estimated that the General Fund will face a shortfall of approximately \$35.2 million for 2018-2019. Given this projected shortfall, the remaining ending fund balance, after required technical and clean-up adjustments, is recommended to be allocated to the 2018-2019 Future Deficit Reserve.

### **2016-2017 Selected Special/Capital Funds Budget Performance**

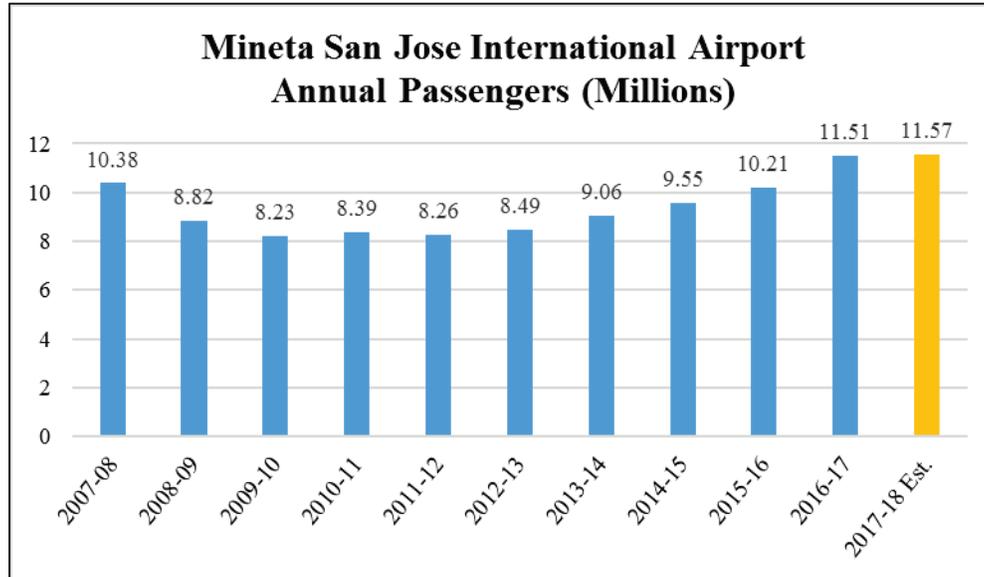
#### **Airport Operating Funds**

The Airport served 11.5 million passengers in 2016-2017, which was an overall increase of 12.7% from 2015-2016. Moreover, the percentage growth in annual enplanements at the Airport in 2016-2017 was 12.8% compared to an estimated level of 2.5%, which exceeded the Federal Aviation Administration's projection of 2.2% for national enplanement growth for 2016-2017. This increase in passenger enplanements triggered the activation of the Municipally-Funded Air Service Incentive Program, a provision in the Airline-Airport Lease and Operating Agreements that was approved by the City Council in March 2007. Under this provision, if the percentage growth in annual enplanements at the Airport exceeds the growth in annual enplanements nationwide, the City shall reduce the amount of its indirect overhead expenses in the following fiscal year by a corresponding percentage and the money is refunded to the City's airline partners in recognition of their achievement in increasing passenger levels. Budget actions are recommended in this document to reduce the 2017-2018 overhead expenses to the Airport Maintenance and Operation Fund by \$1,126,026 to reflect a reduction of the overhead rate by 6.13 points (from the adopted overhead rate of 21.13% to the floor rate of 15.00%). With the amendment to the Airline Lease and Operating Agreements, which removed the Municipally-Funded Air Service Incentive Program, this is the last year the General Fund will have an obligation for this program.

**ANALYSIS**

**2016-2017 Selected Special/Capital Funds Budget Performance**

For 2017-2018, passenger growth is anticipated to increase by 3.0% over the 11.5 million passengers in 2016-2017.



Additional airport activity categories that demonstrated growth as compared to last year include pounds of mail/freight/cargo, traffic operations, landed weights, parking exits, gallons of aviation fuel sold, and ground transportation trips.

Overall, revenue performance exceeded budget by \$7.9 million (5.4%). Airline Rates and Charges (combined total of landing fees and terminal rents) and all other operating categories, excluding transfers, ended the year at \$153.9 million, which was \$7.9 million above the budget of \$146.0 million. The positive variance is mainly attributed to the Airfield revenue category, which was above the budgeted estimate by \$2.4 million (49.0%) due to higher revenues from in-flight kitchen and ground support tenants as well as Terminal Building Concession revenue, which was above the budgeted estimate by \$1.6 million (8.0%) associated with increased passenger levels.

The Airport Customer Facility and Transportation Fee Fund (Fund 519) and Airport Maintenance and Operating Fund (Fund 523) had a combined year-end expenditure savings of \$4.0 million (3.8%) compared to the budgeted levels of \$106.1 million. The \$1.9 million in personal services savings were the result of position vacancies experienced during the year. The non-personal/equipment expenditure savings of \$940,000 resulted primarily from prioritizing needs and the parking program.

## **ANALYSIS**

### **2016-2017 Selected Special/Capital Funds Budget Performance**

The higher revenue and expenditure savings resulted in a lower than anticipated transfer from the Airport Revenue Fund to the Airport Maintenance and Operating Fund. This allowed for paying down some variable rate commercial paper debt, which resulted in interest savings.

#### **Self-Insured Medical Fund**

The Self-Insured Medical Fund was established in January 2017. Revenue in 2016-2017 ended the year below estimated levels in the City and Retirement Reimbursements categories (down \$843,000), due primarily to the assumption of the additional month of retiree contributions (\$861,000). When the fund was established, it was assumed that Retirement contributions would start being paid into the fund in December 2016, providing an extra month of receipts to the fund, mitigating the need for any potential pre-funding. However, at the end of the year, it was realized that the seventh month of retiree receipts into the fund for the month of July (received in June) would have to be deferred to align the revenues with the appropriate fiscal year. Expenditures ended the year as expected at \$6.6 million, slightly above the estimate (0.3%). As a result, the actual 2016-2017 total ending fund balance ended at \$84,000 with no Claims Reserve, compared to what had been estimated (\$695,000 for the Claims Reserve, and \$250,500 for the Ending Fund Balance). In order to increase the fund balance in 2017-2018 to healthier levels, a planned 10% rate increase for the self-funded PPO starting January 1, 2018 is recommended. According to actuaries, the 10% rate increase may result in an estimated 2% decrease to the enrollment starting January 1, 2018. Based on these assumptions and year-to-date data through August, as well as fund performance in 2016-2017, a series of actions are recommended to bring the budget in line with actual experience and projected performance in 2017-2018.

**ANALYSIS**

**2016-2017 Selected Special/Capital Funds Budget Performance**

**Capital Fund Major Revenues**

A number of taxes and fees levied on construction and property resale (conveyance) activity provide a large source of revenue to the City’s Capital program. The 2016-2017 actual collections in all major capital revenue categories, except Construction and Conveyance Tax, ended the year below budgeted estimates. The chart below provides a comparison of estimated revenues to actual revenues for these types of revenues, and a discussion of the three largest revenue sources follows.

**Construction-Related Capital Program Revenues Comparison  
 (\$ in Thousands)**

	<b>2016-2017 Estimate*</b>	<b>2016-2017 Actuals</b>	<b>% Variance</b>
Construction and Conveyance Tax	\$38,000	\$43,301	13.9%
Building and Structure Construction Tax	\$24,000	\$23,343	(2.7%)
Construction Excise Tax	\$32,000	\$30,188	(5.7%)
Municipal Water System Fees	\$75	\$21	(72.4%)
Residential Construction Tax	\$275	\$256	(6.9%)
Sanitary Sewer Connection Fee	\$800	\$649	(18.8%)
Storm Drainage Connection Fee	\$250	\$210	(16.1%)

\* Revenue estimate used in the development of the 2017-2018 Adopted Capital Budget.

• **Construction and Conveyance Tax**

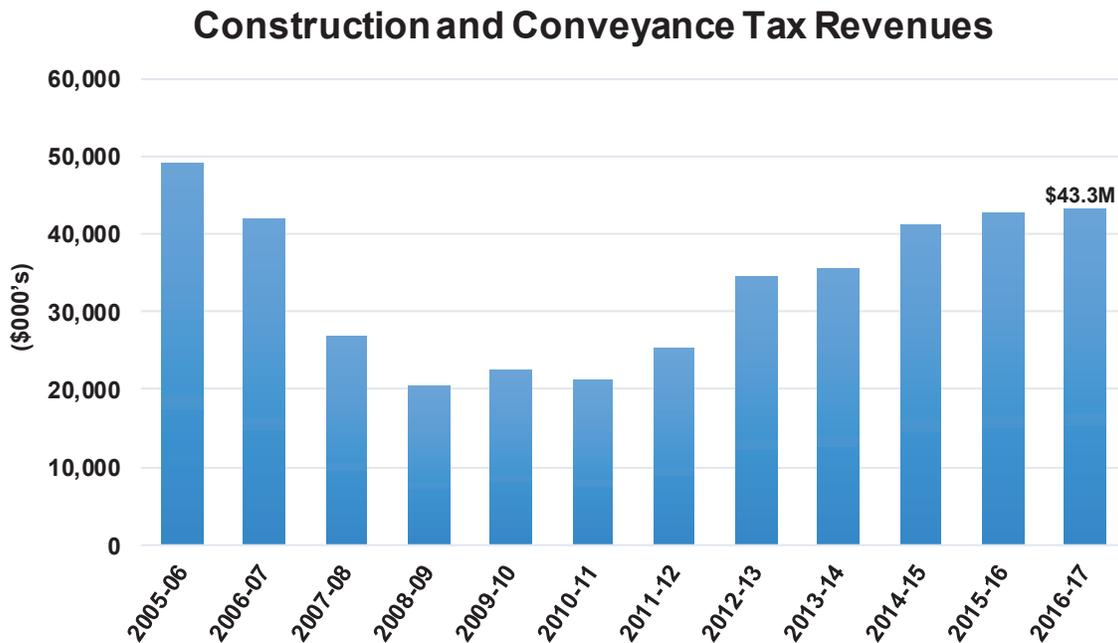
Real estate activity (primarily housing re-sales) determines the collection level of one of the major capital revenue sources, the Construction & Conveyance (C&C) Tax. Approximately 96% of C&C Tax is derived from a tax imposed upon each transfer of real property, with the remaining 4% generated from a construction tax levied on most types of construction. C&C Tax revenues, which are a significant source of funds for the Parks and Community Facilities Development, Library, Fire, Service Yards, and Communications capital programs, totaled \$43.3 million in 2016-2017. This collection level was \$601,000 (1.4%) above 2015-2016 collections of \$42.7 million, and \$5.3 million (13.9%) above the estimate of \$38.0 million that was assumed in the development of the 2017-2018 Adopted Capital Budget.

**ANALYSIS**

**2016-2017 Selected Special/Capital Funds Budget Performance**

**Capital Fund Major Revenues**

The following graph displays the collection history of Construction and Conveyance (C&C) Tax receipts.



The 2016-2017 tax receipts represent the highest collection level since the peak years of 2003-2004 through 2006-2007 (when annual collections exceeded \$38 million in each of those years, peaking at \$49 million in 2005-2006). Changes in home prices and the number of sales are major drivers of C&C Tax receipts. The median home price for single family homes within the City increased from \$920,000 in June 2016 to \$966,000 in June 2017, which represents a 5.0% increase. However, the number of home sales (single-family and multi-family dwelling units) decreased 4.1% from 8,223 in 2015-2016 to 7,883 in 2016-2017. Finally, the amount of time it takes to sell a home (single-family and multi-family dwelling units) slightly increased from an average 25 days in 2015-2016 to an average 26 days in 2016-2017.

## ANALYSIS

### **2016-2017 Selected Special/Capital Funds Budget Performance**

#### **Capital Fund Major Revenues**

The 2016-2017 Adopted Capital Budget was developed with the assumption that C&C Tax receipts would total \$38.0 million in 2015-2016 and dip slightly to \$36.0 million in 2016-2017; however, tax receipts had a stronger than expected performance, which resulted in 2015-2016 receipts totaling \$42.7 million. Due to the unanticipated high collections in 2015-2016, the 2016-2017 C&C Tax Adopted Budget estimate of \$36.0 million proved to be conservative as compared to the actual 2016-2017 collection level of \$43.3 million. The 2017-2018 C&C Tax estimate of \$36.0 million now allows for a 16.9% decline in tax revenue from the 2016-2017 actual tax collection. Receipts in 2017-2018 will be closely monitored, and an upward adjustment to the estimated revenue may be recommended at a later date, with corresponding adjustments to fund balances as appropriate. It is important to note that tax receipts in this category have been volatile in the past with large swings in collections based on economic conditions.

- **Building and Structure Construction Tax and the Construction Excise Tax**

The Building and Structure Construction Tax and the Construction Excise Tax are major sources of funding for the Traffic Capital Program. Year-end collections in the Building and Structure Construction Tax category totaled \$23.3 million in 2016-2017. This collection level was 2.7% (\$655,000) below the revenue estimate of \$24.0 million used to develop to the 2017-2018 Adopted Capital Budget, yet represents a 20.4% (\$4.0 million) increase from 2015-2016 collections of \$19.4 million. Construction Excise Tax receipts for 2016-2017 totaled \$30.2 million, 5.7% (\$1.8 million) below the revenue estimate of \$32.0 million used to develop the 2017-2018 Adopted Capital Budget, representing a 34.4% (\$7.7 million) increase from 2015-2016 collections of \$22.5 million.

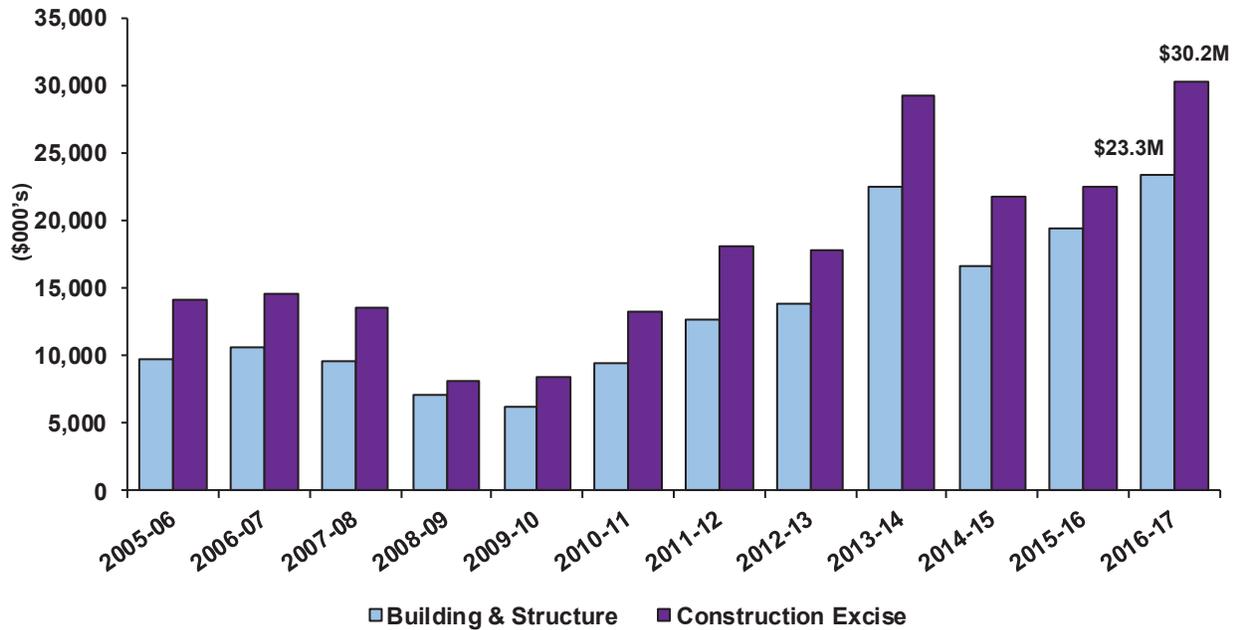
The graph on the following page displays the collection history of both the Building and Structure Construction Tax and Construction Excise Tax receipts. Valuation activity in 2016-2017 surpassed the historically high levels of 2013-2014, setting a new peak, and revenue growth has continued its upward trend from the low in 2009-2010.

**ANALYSIS**

**2016-2017 Selected Special/Capital Funds Budget Performance**

**Capital Fund Major Revenues**

**Construction Tax Revenues**



Building and Structure Construction Tax receipts (\$23.3 million) and Construction Excise Tax receipts (\$30.2 million) represent the highest collection level in recent history. However, it is important to note that actual collections fell slightly below budgeted estimates. While these shortfalls were absorbed within the Traffic Capital Program without impacting project delivery, these volatile taxes will be closely monitored throughout 2017-2018 to determine if budget actions are necessary to revise the revenue estimates.

**Special and Capital Funds Budget Adjustments**

Several budget adjustments for both special and capital funds are included in this report, including recognition of grants, net-zero transfers/reallocations, new allocations for a small number of high priority projects and programs, and required fund rebalancing activity.

## ANALYSIS

### **2016-2017 Selected Special/Capital Funds Budget Performance**

#### **Special and Capital Funds Budget Adjustments**

In the Convention and Cultural Affairs Fund, due to the high level of activity at the Convention Center and cultural facilities managed by Team San Jose in 2016-2017, the operating subsidy typically provided to Team San Jose – originally budgeted at \$3.4 million – was not needed in 2016-2017. These savings, together with a combination of other expenditure savings, and the additional transfer of Transient Occupancy Tax proceeds based on 2016-2017 actual collections (\$241,000), allow for a recommended \$3.0 million increase to the Capital Reserve (from \$500,000 to \$3.5 million) for future capital rehabilitation and replacement needs at the Convention Center and cultural facilities managed by Team San Jose, additional capital investment of \$480,000 for a small number of urgent capital rehabilitation and upgrade projects in the current year (including a phone system upgrade, a new trash compactor, and enhanced WiFi), coordination and review of the Museum Place development to minimize impact on the Civic Auditorium (\$300,000), and a net increase to the Ending Fund Balance of \$56,000.

Included in this report are several recommended adjustments in the Parks and Community Facilities Development Capital Program. A notable adjustment is the allocation of \$700,000 – matched by San José Unified School District – for artificial turf replacement of the main field at the Leland Sports Field facility, offset by a reduction to the corresponding reserve from \$1.2 million to \$539,000. Other actions include recognizing an insurance reimbursement of \$467,000 for repair costs associated with the 2013 Rim Fire at San José Family Camp along with an additional expense of \$100,000 for fire-related repairs to roadways and pathways within the facility, and an allocation of \$205,000 to support completion of a feasibility study for the Calabazas Community Center, which will evaluate possible renovations to the interior and exterior of the community center, men’s and women’s bathroom buildings, and the concrete patio area.

Due to increased Construction and Conveyance Tax proceeds, an action is recommended to increase the Fire Station 37 (Construction) Reserve by \$300,000 (from \$2.2 million to \$2.5 million). This will result in a five year CIP total of \$4,560,000 for this project reserve. Because Fire Station 37, the last project to be completed under the Public Safety Bond Program, is not moving forward at this time due to capital and operating funding gaps, a funding shift was made to reallocate the project intended Bond funds of \$5.5 million to eligible fire station remediation projects that would otherwise be funded in the Fire C&C Tax Fund and allocate the C&C funds to a Fire Station 37 Reserve. This allowed the Bond funds to be used for urgent fire station repairs while preserving funding for Fire Station 37 until that project can move forward. This action is consistent in keeping with the City's commitment to prioritize any additional Fire-related Construction and Conveyance Tax Revenues received to the reserve in order to backfill the bond funds as soon as practical. With this action a total of \$900,000 in additional funding is to be prioritized to bring the reserve to the intended bond funded level.

## **ANALYSIS**

### **2016-2017 Selected Special/Capital Funds Budget Performance**

In the General Purpose Parking Fund, a \$500,000 reserve is recommended for the preliminary planning and program design for the San José Regional Transportation Hub, including access planning. The City will seek matching funding from Caltrain, High Speed Rail and VTA for a joint contract with a specialized consultant to perform extensive preliminary planning and design work to ensure that the future transportation hub meets all partners' needs, including access and integration with the surrounding cityscape.

Finally, the rebudget of unexpended funds for projects and programs extending into 2017-2018 is recommended in this report. Details of these adjustments can be found in Section IV of this report.

## **NEXT STEPS**

The results of the 2016-2017 Annual Report will provide an updated starting point for monitoring 2017-2018 financial performance. The revenue and expenditure trends will be factored into the analysis of the General Fund and the numerous special and capital funds. Information on the City's budget for 2017-2018 will be provided in Bi-Monthly Financial Reports and the 2017-2018 Mid-Year Budget Review. These reports will also provide information on the current economic environment and its impact on the City's revenue collections.

The 2016-2017 Annual Report results will also be factored into the 2018-2019 budget development process. The General Fund Five-Year Forecast is scheduled to be released in late February 2018. The 2018-2019 Proposed Capital and Operating Budgets are scheduled to be released on April 23, 2018 and May 1, 2018, respectively.

## **PUBLIC OUTREACH/INTEREST**

This document is posted on the City's website for the October 17, 2017, City Council agenda.

## **COORDINATION**

The City Manager's Budget Office coordinated with the Finance Department on the reconciliation of the City's funds and coordinated with all City Departments and City Council appointees, as applicable, on recommended budget adjustments that are brought forward in this document.

## **COMMISSION RECOMMENDATION/INPUT**

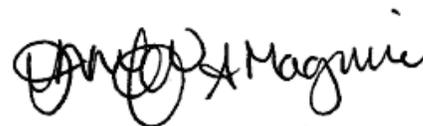
No commission recommendation or input is associated with this action.

## CONCLUSION

Through careful fiscal management, overall revenues for the various City funds ended the year close to estimated levels and expenditures were below budgeted allocations. When the 2016-2017 Adopted Budget was developed, it was assumed that economic growth would continue in 2016-2017. Economic indicators and actual revenue performance supported this general assumption, with a number of revenue categories, such as Property Tax, Transient Occupancy Tax, and Construction and Conveyance Tax, experiencing strong growth. Those revenue categories associated with private development and construction projects, such as development-related fees and taxes, also continued to experience solid performance in 2016-2017.

In the General Fund, the additional fund balance at the end of 2016-2017 after considering clean-up adjustments totaled \$7.7 million. Recommendations are included in this report to allocate those funds to various required technical and rebalancing actions (\$5.0 million), to address urgent fiscal/program needs (\$2.4 million), and to increase the 2018-2019 Future Deficit Reserve (\$350,000). The largest actions include funding for the replacement purchase of a helicopter for the Police Department (\$1.6 million), an increase to the Contingency Reserve by \$500,000 to ensure compliance with the 3% funding requirement for the 2017-2018 Budget, funding for contractual and temporary staffing costs associated with the Google development in the Diridon Station Area (\$415,000), an increase of \$392,000 to fully fund the FMC Debt Service Payment owed by the City, an increase of \$350,000 to the 2018-2019 Future Deficit Reserve, an increase to the City Manager's Office Personal Services appropriation to support and assist with executing the Office of Emergency Management Work Plan (\$250,000), and an increase of \$150,000 for the Planning, Building and Code Enforcement Department for temporary staffing to support the Multiple Housing Occupancy Program. In addition, net adjustments of \$62,000 to various grants, reimbursements and fee activities are included along with a series of technical adjustments.

The Administration will continue to monitor and report on the City's budget performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2016-2017, as well as the actual performance in 2017-2018, will be factored into the development of the 2018-2019 budget. With an early anticipated 2018-2019 General Fund shortfall of \$35.2 million, the Administration will be proactively controlling costs to the extent possible for the remainder of 2017-2018. The 2019-2023 General Fund Five-Year Forecast will be released in February 2018 for budget planning purposes.



Jennifer A. Maguire  
Senior Deputy City Manager/  
Budget Director

**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 2017-2018 monies in excess of those heretofore appropriated therefrom:

General Fund	\$22,294,543
Airport Customer Facilities and Transportation Fee Fund	\$1,334,265
Airport Fiscal Agent Fund	\$11,604,713
Airport Passenger Facility Charge Fund	\$2,331,993
Airport Renewal and Replacement Fund	\$3,383,754
Airport Revenue Bond Improvement Fund	\$5,252,688
Airport Surplus Revenue Fund	\$1,713
Branch Libraries Bond Projects Fund	\$65,997
Building and Structure Construction Tax Fund	\$6,888,208
Business Improvement District Fund	\$355,132
Cash Reserve Fund	\$16
City Hall Debt Service Fund	\$258,298
Community Development Block Grant Fund	\$1,021,179
Community Facilities Revenue Fund	\$2,337,336
Community Facilities District Fund #1	\$126,626
Community Facilities District Fund #2 and #3	\$115,031
Community Facilities District Fund #8	\$53,621
Community Facilities District Fund #11	\$2,000
Community Facilities District Fund #12	\$31,089
Community Facilities District Fund #13	\$51,151
Community Facilities District Fund #15	\$958
Construction and Conveyance Tax – Central Fund	\$449,292
Construction and Conveyance Tax – Communications	\$436,273
Construction and Conveyance Tax – Fire	\$625,460
Construction and Conveyance Tax – Library	\$996,571
Construction and Conveyance Tax – Council District 2	\$271,668
Construction and Conveyance Tax – Council District 3	\$227,425
Construction and Conveyance Tax – Council District 5	\$1,134,085
Construction and Conveyance Tax – Council District 6	\$507,942
Construction and Conveyance Tax – Council District 7	\$873,513
Construction and Conveyance Tax – Council District 8	\$488,555
Construction and Conveyance Tax – Council District 9	\$393,058
Construction and Conveyance Tax – Council District 10	\$423,017
Construction and Conveyance Tax – City-Wide	\$2,318,577
Construction and Conveyance Tax – Parks Yards	\$32,381
Construction and Conveyance Tax – Service Yards	\$769,297
Construction Excise Tax Fund	\$13,539,044

**CERTIFICATION OF FUNDS**

Contingent Lien District Fund	\$93,406
Convention and Cultural Affairs Fund	\$1,135,494
Convention Center Facilities District Revenue Fund	\$1,304,947
Downtown Property and Business Improvement District Fund	\$13,478
Economic Development Administration Loan Fund	\$8
Emergency Reserve Fund	\$2,353
Federal Drug Forfeiture Fund	\$1,095,430
General Purpose Parking Fund	\$2,330,728
Gift Trust Fund	\$249,346
Home Investment Partnership Program Fund	\$2,661,371
Housing Trust Fund	\$1,843,136
Ice Centre Revenue Fund	\$392,716
Integrated Waste Management Fund	\$3,327,987
Library Parcel Tax Fund	\$1,969,094
Maintenance District Fund #1	\$16,625
Maintenance District Fund #2	\$8,982
Maintenance District Fund #8	\$87,923
Maintenance District Fund #15	\$5,421
Maintenance District Fund #18	\$12,387
Maintenance District Fund #19	\$41,535
Maintenance District Fund #20	\$30,465
Maintenance District Fund #21	\$19,581
Major Collectors and Arterials Fund	\$197,018
Major Facilities Fund	\$157,783
Multi-Source Housing Fund	\$5,823,712
Municipal Golf Course Fund	\$24,076
Neighborhood Security Bond	\$15,514
Parks and Recreation Bond Projects Fund	\$2,738,500
Public Works Program Support Fund	\$237,144
Residential Construction Tax Contribution Fund	\$278,118
San José Arena Capital Reserve Fund	\$3,354,695
San José Municipal Stadium Capital Fund	\$35,190
Sewer Service and Use Charge Fund	\$823,188
Sewer Service and Use Charge Capital Improvement Fund	\$4,275,569
San Jose-Santa Clara Treatment Plant Capital Fund	\$3,208,477
San Jose-Santa Clara Treatment Plant Operating Fund	\$501,668
San Jose-Santa Clara Treatment Plant Income Fund	\$161,304
Sewage Treatment Plant Connection Fee Fund	\$414,603
St. James Park Management District Fund	\$217,487
Storm Drainage Fee Fund	\$15,591
Storm Sewer Capital Fund	\$2,959,713
Storm Sewer Operating Fund	\$1,085,377
Subdivision Park Trust Fund	\$4,170,571

**CERTIFICATION OF FUNDS**

Transient Occupancy Tax Fund	\$2,756,499
Underground Utility Fund	\$729,975
Vehicle Maintenance and Operations Fund	\$43,843
Water Utility Capital Fund	\$1,006,393
Water Utility Fund	\$4,391,203
Workforce Development Fund	\$3,012,921



Jennifer A. Maguire  
Senior Deputy City Manager/  
Budget Director