# *Five-Year Economic Forecast and Revenue Projections*

## *2019-2023*

Section 1

Elements of the General Fund Forecast

# ELEMENTS OF THE GENERAL FUND FORECAST

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Overview

This document provides three alternative Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2018-2019 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast, however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment that affect the City's revenue collections.

- **Base Case** – The Base Case Forecast is built on the assumption of slowing, but still positive, economic growth. In recent years, several of the City's economically sensitive revenues experienced strong growth as the City recovered from the severe recession that started in the latter half of the last decade. This region has also benefitted from continued venture capital investment in the technology industry, solid employment growth, and a strong real estate market. Over the forecast period, activity in most of these areas is expected to moderate, which will result in a slowing rate of local expansion and ultimately lower growth in the City's revenues. In the Base Case Forecast, General Fund revenue collections are anticipated to experience slow growth over the forecast period, with lower growth in the out-years of the Forecast.

- **Optimistic Case** – The Optimistic Case assumes somewhat faster economic growth than anticipated in the Base Case, but still slower than that experienced in recent years. On a national level, economic growth is slightly higher with increased defense spending. This increased defense spending positively impacts technology sectors, which benefits the local economy. Local conditions are very strong and the area's largest technology employers are doing much better than in the Base Case scenario. Venture capital expenditures are steady, as is the flow of foreign funds into the region. Local employment continues to expand at a high rate and, because of this solid employment growth, housing prices remain at high levels and grow through the entire forecast period. Inflation is also expected to be higher than in the Base Case. This stronger growth results in increased collections in the economically sensitive revenue categories, such as Property Tax and Transient Occupancy Tax.

- **Pessimistic Case** – The Pessimistic Case assumes that a combination of adverse factors results in lower economic growth rates than in the Base Case. Significantly lower growth is assumed for several of the key determinants of the City's revenue; local employment, local housing prices and number of sales, and local inflation are all lower than those of the Base Case. However, this scenario does not assume an economic crash at the local, national, or international levels. In this scenario, the City's revenues, particularly Property Tax, Sales Tax, and Transient Occupancy Tax, are significantly impacted by an economic slowdown.

# ELEMENTS OF THE GENERAL FUND FORECAST

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, both now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2018-2019 Proposed Operating Budget, scheduled to be published on May 1, 2018.

The following is a discussion of both the national and local economic outlooks used to develop the revenue estimates for the Base Case Forecast. Various economic forecasts are reviewed in the development of the revenue estimates, including the national and State economic forecasts produced by the Anderson School of Management at University of California – Los Angeles (UCLA). The City also uses an economic forecasting consultant to assist in the development of this Forecast, particularly the modeling of the growth in the out-years of the Forecast. In addition, consultants that focus on particular revenue categories such as Sales Tax and Transient Occupancy Tax were asked to weigh in on the current projections and future outlooks in these areas.

### Current National Economic Conditions

The U.S. economy is performing at a level not achieved for nearly a decade. Real U.S. Gross Domestic Product (GDP) increased by 2.3% in 2017, compared with an increase of 1.5% in 2016. The increase in real GDP in 2017 primarily reflected positive contributions from personal consumption expenditures, nonresidential fixed investment, and exports that were partly offset by a negative contribution from private inventory investment. Imports, which are a subtraction in the calculation of GDP, increased.[1] The U.S. unemployment rate declined further over the past year, standing at 4.1% in January 2018 compared to 4.8% in January 2017, according to the U.S. Department of Labor's Bureau of Labor Statistics February 2, 2018 report. A contributing factor to this job growth on the national level was reconstruction following the summer hurricanes in Texas, Florida, and Puerto Rico and tax cuts to businesses, which is prompting businesses to increase investment, wages, and employment.

Some of the key drivers to the U.S. economy include new housing construction, automotive manufacturing and sales, and a robust technology sector. The housing construction sector is currently strong. One of the contributing factors for this performance is due to the summer hurricanes in Texas, Florida, and Puerto Rico resulting in the need to repair and build new houses. The continued expansion in the housing sector is crucial to long-term economic growth. Car sales are estimated at slightly below 17 million cars per year, which is marginally below recent levels, but still represents strong performance. The automotive sector represents a large and important employment sector in the economy and a base component of the U.S.'s industrial

[1] U.S. Department of Commerce Bureau of Economic Analysis, GDP: Fourth Quarter and Annual 2017 (Second Estimate), February 28, 2018

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Base Case Forecast

production sector. It is important to note that the housing and automobile sectors are highly sensitive to interest rates, which rose three times in 2017 and are anticipated to rise again in 2018. While rates have not yet increased enough to significantly affect these two sectors, future increases may impact auto sales. It is not anticipated interest rate increases will significantly impact housing sales due to the strong demand in the real estate market.

On a national level in 2017, the real estate market experienced the highest level of housing sales in eleven years. Home sales (including single-family homes and multi-dwelling homes) in 2017 totaled 5.51 million, which surpassed 2016 sales of 5.45 million, and represents the highest level of sales since 2006 (6.48 million). Although the housing market continued to perform strongly in 2017, December sales showed signs of decreased activity, which is likely the result of unprecedented high prices and a historically low housing supply. According to Lawrence Yun, National Association of Realtors Chief Economist, "Existing sales concluded the year on a softer note, but they were guided high these last 12 months by a multi-year streak of exceptional job growth, which ignited buyer demand. At the same time, market conditions were far from perfect. New listings struggled to keep up with what was sold very quickly, and buying became less affordable in a large swath of the country. These two factors ultimately muted what should have been a stronger sales pace. Closings scaled back in most areas last month for the same reason. Affordability pressures persisted, and the pool of interested buyers at the end of the year significantly outweighed what was available for sale." [2] The trend of extremely low levels of inventory, rising mortgage rates, and increased home prices will continue in 2018. Regarding new housing inventory, privately owned housing starts were at a seasonally adjusted annual rate of 1.302 million in December 2017. This activity level was 0.1% below the revised November rate of 1.303 million, but is 2.8% above the December 2016 rate of 1.266 million.[3] Although housing starts have been increasing over the past several years, they continue to be lower than historical levels, which averaged 1.5 million to 1.6 million units per year.

The energy sector is one of the backbones of the U.S. economy, with petroleum accounting for almost one-third of the nation's energy production. While oil production had been generally decreasing for many years, beginning in 2009, more cost-effective drilling and improvements in extraction technology has helped boost oil production.[4] The average U.S. crude oil price had experienced sharp declines in 2015 and 2016, with the average price per barrel dropping from $96 in 2014 to $49 in 2015 and $41 in 2016. In late 2016, the Organization of the Petroleum Exporting Countries (OPEC) agreed to production decreases, which helped drive the average oil price up to $54 in 2017 and it is currently anticipated the average price per barrel will be approximately $60 in 2018.[5]

[2] National Association of Realtors, News Release, January 24, 2018
[3] U.S. Census Bureau and U.S. Department of Housing and Urban Development, News Release, January 18, 2018
[4] U.S. Energy Information Administration, U.S. Energy Facts Explained, Updated May 19, 2017
[5] U.S. Energy Information Administration, News Release, January 11, 2018

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Base Case Forecast

Venture capital, the driving force of the technology sector, finished extremely strong in 2017 with $84 billion invested, the largest amount since the dot-com era in the early 2000's. Over the past several years, the Venture Capital industry has evolved as venture capital-backed companies stay private longer and require larger deal sizes. Therefore, fewer transactions are occurring, but more capital is being deployed into higher valued companies. In 2017, deal counts dropped to the lowest figure since 2012, however, median and average deal sizes reached a decade-high.[6]

### National Economic Outlook

Moderate continued economic growth appears likely for the next several years, driven by growth across most sectors of the economy. The December 2017 UCLA Anderson Business School Forecast, assumes continued job growth along with wage increases will power consumption in 2018. Tax cuts (particularly corporate tax cuts) coupled with recent aggressive infrastructure expenditures has resulted in real GDP growth being close to 3%. However, in 2018 as the unemployment rate drops below 4% and employment growth stalls in the face of a labor shortage, the GDP is anticipated to decrease back to 2% in 2018. GDP could potentially decline to 1.5% in 2019 due to the economy continuing to operate at full employment coupled with anticipated additional increases to interest rates.

Higher wages along with a continued rebound in oil prices and continued high housing costs is anticipated to result in the inflation rate exceeding 2%. A modest rate of inflation is a key driver for business and consumer demand and for future property and sales taxes. The Consumer Price Index (CPI) increased 0.1% in December 2017 (seasonally adjusted) and increased 2.1% over the last 12 months (before seasonal adjustment).[7] In 2017, the Federal Reserve raised interest rates three times to allow economic growth to continue to expand at a moderate pace. In addition, to keep inflation rates at target levels, it is anticipated the Federal Reserve will raise interest rates again in 2018, thereby reducing monetary policy support and allowing consumer spending to drive the economy.

### Current City of San José Economic Conditions

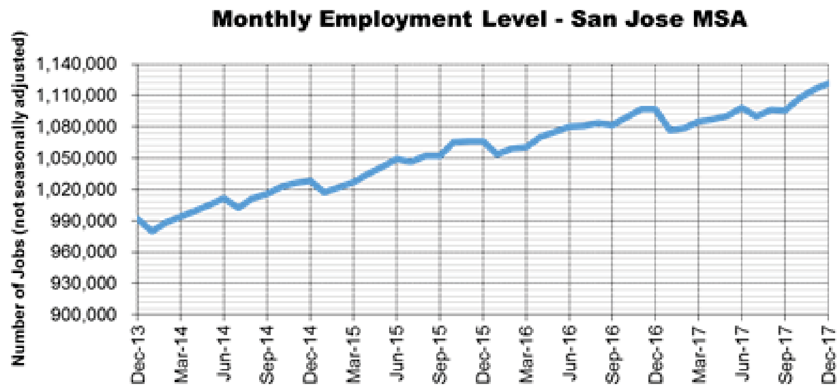
The Silicon Valley continues to show positive economic performance, but some economic indicators are beginning to moderate from the extremely strong performance experienced in recent years.

The December 2017 employment level in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (San José MSA) of 1.12 million was 2.2% higher than the December 2016 level of 1.10 million. Between December 2016 and December 2017, 23,900 jobs were added.

[6] National Venture Capital Association, News Release, January 9, 2018
[7] U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index Detailed Report, December 2017

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Base Case Forecast




This includes 9,100 jobs in private educational and health services (predominatly within health care and social assistance), and 7,700 jobs in leisure and hospitality services, marking the 88th consecutive monthly gain on a year-over-year basis.[8]

As noted in the January 2018 Beacon Employment Report, however, while California continued to have year-over-year employment growth in 2017 (2.1%), this growth has begun to moderate with the employment growth in 2017 being the lowest level since 2011. Robert Kleinhenz, Executive Director of Research at Beacon Economics and the UC Riverside School of Business Center for Economic Forecasting, stated "Payroll growth in California accelerated in the final months of 2017, giving the state a strong finish for the year. Job gains and overall economic growth were constrained throughout this year, however, by limited expansion of the labor force, which is something that is likely to continue in 2018."[9]

In December 2017 the unemployment rates at the local, State, and national levels continued to drop from prior year levels. In December 2017, the unemployment rate for the San José Metropolitan Statistical Area was 2.7%, which is consistent with the November 2017 rate, and is below the 3.4% rate experienced a year ago. In this region, the December 2017 unemployment rate continues to be lower than the unadjusted unemployment rate for the State (4.2%) and the nation (3.9%).

**Unemployment Rate (Unadjusted)**

| | Dec. 2016 | Nov. 2017 | Dec. 2017** |
|---|---|---|---|
| San José Metropolitan Statistical Area* | 3.4% | 2.7% | 2.7% |
| State of California | 5.0% | 4.0% | 4.2% |
| United States | 4.5% | 3.9% | 3.9% |

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

Local construction activity remained very strong through December 2017; and is tracking well above prior year levels. Residential permits for new dwelling units through December totaled 1,809 versus 1,424 in the prior year. Correspondingly, the valuation of new residential construction and alteration activity have also increased compared to prior year levels ($394.1 million in 2017-2018 vs. $328.1 million in 2016-2017). Combined residential valuation of $394.1 million through December is 20.1% above the prior year level of $328.1 million.

[8] State of California Employment Development Labor Market Information Division Press Release, January 19, 2018
[9] Beacon Economics, Employment Report, January 2018

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

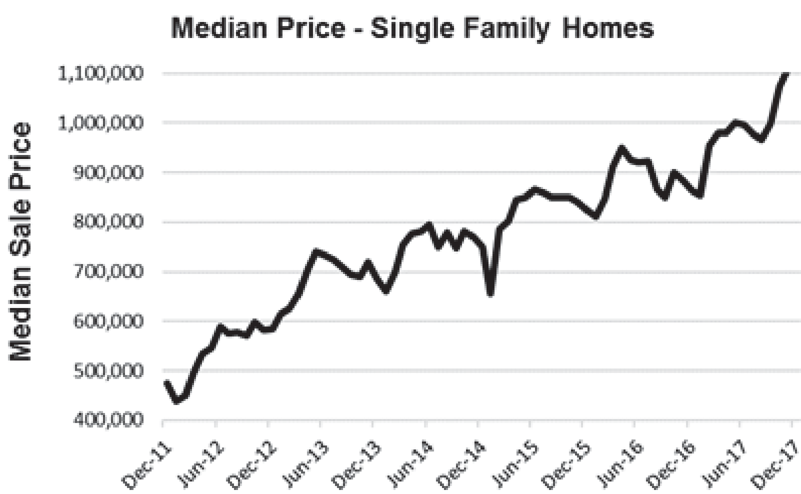
### Base Case Forecast

**Private Sector Construction Activity (Valuation in $ Millions)**

| | July-Dec. 2016 | July-Dec. 2017 | % Increase/ (Decrease) |
|---|---|---|---|
| Residential | $ 328.1 | $ 394.1 | 20.1% |
| Commercial | $ 394.5 | $ 406.3 | 3.0% |
| Industrial | $ 275.5 | $ 291.9 | 6.0% |
| **Total** | **$ 998.1** | **1,092.3** | **9.4%** |

Overall commercial valuation through December is 3% above the 2016-2017 level ($406.3 million in 2017-2018 vs $394.5 million in 2016-2017). New commercial construction increased slightly ($291.7 in 2017-2018 vs. $272.8 in 2016-2017) while alteration activity decreased slightly ($114.7 in 2017-2018 vs. $121.7 in 2016-2017). Industrial construction valuation through December is 6.0% above the 2016-2017 level ($291.9 million in 2017-2018 vs. $275.5 million in 2016-2017).

The local real estate market continues to experience strong growth in home prices compared to prior year levels. The median single-family home price in December 2017 of $1.14 million was up 32.1% from the December 2016 price of $863,000. The December 2017 level represents the highest single-family median home price in the City of San José's history. It is also taking significantly less time to sell these homes, with the average days-on-market for single-family and multi-family dwellings in December 2017 totaling 16 days, a 52.2% drop from the 34 days experienced in December 2016. Also of interest is the continued tightening of inventory available in the housing market. The average number of new listings in the first half of 2017-2018 totaled 681, which is 13.2% below the average number of new listings recorded in the same time period of the prior fiscal year. While the median home price has risen and the length of time to sell these more expensive homes has decreased, the number of property transfers (sales) has dropped slightly. The number of property transfers in 2017 totaled 7,791 which represents a 1% drop from the 7,869 transfers that occurred in 2016.




### City of San José Economic Outlook

While most of the above metrics have improved or remained at elevated levels when compared to the previous year, the local economy is expected to enter a period of slower economic growth. Unemployment levels, which have consistently been well below national levels are anticipated to remain low. While the employment growth level is a bit slower than was previously experienced,

## Assumptions Regarding the Economic Environment

### City of San José Economic Outlook

it is still positive. Employment levels in Silicon Valley are determined largely by the flow of venture capital funding and the overall health of the U.S. economy. As both of these contributors continue to remain healthy, local employment levels are projected to remain at low levels.

Many policies and decisions made at the national level significantly influence the local economy. Defense spending continues to be a high priority for the current administration and is anticipated to continue for several years. As modern defense is extremely reliant on technology, increased defense spending positively impacts the local economy. Foreign investment, primarily in technology and real estate, are vital to the local economy. If trade policies, especially with China, are significantly altered or eliminated the results could adversely impact the Silicon Valley.

### Base Case Forecast

Taken together, San José can expect a moderate slowdown in economic growth rates throughout the forecast period among economically sensitive revenues such as Sales Tax, Property Tax, and Transient Occupancy Tax receipts.

### Optimistic Case Forecast

In the Optimistic Case Forecast, local conditions are very strong and the area's largest tech employers are doing much better than the Base Case Forecast. Local economic conditions are extremely strong and the area's largest technology employers continue to expand at a very high rate, which results in rapid employment increases. In addition, venture capital investments are extremely high and there is higher foreign investment, which helps propel the economy. In this scenario, local employment continues to expand at a high rate and, because of this solid employment growth, housing prices remain at high levels and grow through the entire forecast period. Also in this scenario, the growth in the national economy is a bit higher than that of the Base Case Forecast. As a result of the positive national outlook, local inflation is also higher.

The Optimistic Case Forecast is based partly on the assumption that the real estate sector, nationally and locally, continues to increase due to higher home prices and an increase in the number of new home starts over the next several years. While mortgage rates will be higher, employment increases and higher wages will spur a greater number of home purchases. As a partial result of more rapid new home construction, the country's overall employment levels continue to improve.

Under the Optimistic Case Forecast, the economically sensitive revenues are expected to experience somewhat stronger performance as general increases in employment, wages, and consumer attitudes offset the negative influences of higher interest rates and promotes increased spending, which generates Sales Tax for the City. Improvement in the real estate market will result in higher Property Tax revenues. Conversely, Gasoline taxes decline significantly in the Optimistic Case Forecast.

# ELEMENTS OF THE GENERAL FUND FORECAST

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

### Pessimistic Case Forecast

The Pessimistic Case Forecast assumes that a combination of adverse factors results in lower economic growth rates than in the Base Case Forecast. Both domestic and foreign venture capital expenditures in the local economy and real estate market decline significantly compared to those presented in the Base Case Forecast. Under the Pessimistic Case Forecast, there is a rapid decline of employment and home prices. Further, much more vigorous enforcement of immigration laws and the reduced number of visa permits being authorized impact the local labor force much greater than in the Base Case Forecast.

The Pessimistic Case Forecast assumes home prices and related construction activity decline deeper than in the Base Case Forecast. In addition, these decreases would happen earlier (late 2018) and would occur very quickly. While the decline in economic activity is relatively deep, it is still softer than experienced during the dot-com bust and the Great Recession. Decreased revenue collections in categories such as Property Tax and Transient Occupancy Tax would be realized when compared to the Base Case Forecast. Lower employment levels, along with very low inflation also impact these revenues. Conversely, Gas Tax revenues are higher in the Pessimistic Case Forecast.

Given current economic conditions and outlooks, the Pessimistic Case Forecast is likely more plausible than the Optimistic Case Forecast.

### Impact of Forecasted Economic Conditions on Revenue Collections

The economic conditions discussed above are the primary drivers for the economically sensitive revenues, with the most significant impacts in the Property Tax and Sales Tax categories. Performance in other areas, however, is primarily driven by other factors. For example, the Franchise Fee and Utility Tax categories are more heavily impacted by utility rate changes and energy prices. Collections from local, State, and federal agencies are primarily driven by the grant and reimbursement funding available from these agencies. As a result, these General Fund revenues experience no significant net gain or loss in times of an economic expansion or slowdown, respectively. Because these revenue sources do not track directly with the performance of the economy, the growth in these areas, even in times of economic strength, can dampen the City's overall revenue growth. Conversely, in an economic slowdown, these categories can act as a buffer, easing the impact of declines in the economically sensitive revenue categories.

### Impact of Forecasted Economic Conditions on Revenue Collections

An in-depth analysis of the General Fund revenue categories was completed to develop 2018-2019 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2017-2018 and build upon those projections to develop the 2018-2019 revenue estimates. These estimates are based on the Base Case Forecast economic scenario described in this section. These revenue estimates will be closely examined and updated again during the preparation of the 2018-2019 Proposed Operating Budget scheduled to be released on May 1, 2018.

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

As displayed in the General Fund Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from $1.1 billion in 2018-2019 to $1.2 billion in 2022-2023, for an average growth rate of 2.9% per year.

**General Fund 2019-2023 Forecast**
**Revenue Summary**

| | Modified Budget | Forecast | | | | |
|---|---|---|---|---|---|---|
| General Fund Revenue Category | 2017-2018 | 2018-2019 | 2019-2020 | 2020-2021 | 2021-2022 | 2022-2023 |
| | | | | | | |
| General Revenues | | | | | | |
| Property Tax | 288,990,000 | 317,600,000 | 333,988,000 | 350,955,000 | 366,713,000 | 382,188,000 |
| Sales Tax | 224,000,000 | 232,100,000 | 238,506,000 | 244,969,000 | 249,967,000 | 253,891,000 |
| Transient Occupancy Tax | 18,720,000 | 19,600,000 | 20,374,000 | 21,097,000 | 21,638,000 | 22,174,000 |
| Franchise Fees | 50,813,083 | 50,230,000 | 51,149,000 | 51,932,000 | 50,790,000 | 49,580,000 |
| Utility Tax | 101,320,000 | 102,400,000 | 103,700,000 | 105,339,000 | 107,088,000 | 109,197,000 |
| Telephone Line Tax | 20,000,000 | 20,000,000 | 20,040,000 | 20,076,000 | 20,110,000 | 20,142,000 |
| Business Tax | 63,385,000 | 67,000,000 | 67,607,000 | 68,147,000 | 68,643,000 | 69,103,000 |
| Licenses and Permits | 59,669,916 | 58,530,000 | 60,344,000 | 62,758,000 | 64,955,000 | 67,098,000 |
| Fees, Rates, and Charges | 49,431,983 | 45,779,000 | 47,198,000 | 49,086,000 | 50,804,000 | 52,481,000 |
| Fines, Forfeitures and Penalties | 15,336,284 | 14,283,000 | 14,430,000 | 14,688,000 | 14,740,000 | 14,883,000 |
| Money and Property | 5,705,000 | 6,779,000 | 6,948,000 | 7,171,000 | 7,379,000 | 7,637,000 |
| Revenue from Local Agencies | 23,741,738 | 10,822,000 | 11,199,000 | 11,589,000 | 11,951,000 | 12,307,000 |
| Revenue from the State | 14,182,228 | 10,590,000 | 10,590,000 | 10,590,000 | 10,590,000 | 10,590,000 |
| Federal Revenue | 5,661,954 | - | - | - | - | - |
| Other Revenue | 183,958,167 | 9,298,000 | 8,789,000 | 8,837,000 | 8,900,000 | 8,963,000 |
| Gas Tax | 17,300,000 | 17,300,000 | 16,703,000 | 16,489,000 | 17,118,000 | 17,712,000 |
| Total General Revenues | 1,142,215,353 | 982,311,000 | 1,011,565,000 | 1,043,723,000 | 1,071,386,000 | 1,097,946,000 |
| | | | | | | |
| Transfers & Reimbursements | | | | | | |
| Overhead Reimbursements | 45,467,418 | 48,522,000 | 49,978,000 | 51,477,000 | 53,021,000 | 54,612,000 |
| Transfers | 24,981,465 | 24,457,000 | 25,173,000 | 25,861,000 | 26,478,000 | 26,573,000 |
| Reimbursements for Services | 670,000 | 731,000 | 753,000 | 776,000 | 799,000 | 823,000 |
| Total Transfers & Reimbursements | 71,118,883 | 73,710,000 | 75,904,000 | 78,114,000 | 80,298,000 | 82,008,000 |
| | | | | | | |
| Total General Fund Revenues | 1,213,334,236 | 1,056,021,000 | 1,087,469,000 | 1,121,837,000 | 1,151,684,000 | 1,179,954,000 |
| | | | | | | |
| Beginning Fund Balance | 241,172,873 | 65,644,000 | 67,632,000 | 68,070,000 | 68,472,000 | 68,865,000 |
| | | | | | | |
| Grand Total Sources | 1,454,507,109 | 1,121,665,000 | 1,155,101,000 | 1,189,907,000 | 1,220,156,000 | 1,248,819,000 |
| Growth % | | | 2.98% | 3.01% | 2.54% | 2.35% |

Understanding the basis for the revenue estimates included in this Forecast requires a discussion of the assumptions used for estimating each of the revenue categories. The following discussion focuses on estimates used for the 2019-2023 General Fund Forecast.

## REVENUE FORECAST

### Property Tax

Property Tax receipts of $301.0 million are projected for 2017-2018, which is $12.0 million (4.2%) above the modified budget estimate of $289.0 million and $24.6 million (8.9%) above the 2016-2017 actual collection level of $276.4 million. A significant portion of the growth from both the prior year and the modified budget is due to the Successor Agency to the Redevelopment Agency (SARA) bond refunding in December 2017 that is projected to result in additional property tax distribution to City of $8.8 million in 2017-2018. In 2018-2019, Property Tax collections are expected to increase 5.5% to $317.6 million. This includes general growth of 4.6% in the City's property taxes and additional growth associated with the Successor Agency to the Redevelopment Agency (SARA) bond refunding that is expected to generate $12.0 million in 2018-2019. Additional information about each of the Property Tax sub-categories is provided below.

**Secured Property Taxes** account for over 90% of the revenues in this category. In 2017-2018, Secured Property Tax receipts are expected to total $276.5 million, reflecting an increase of 9.6% from the 2016-2017 collection level. This growth reflects the additional revenue of $8.8 million generated from the SARA bond refunding, additional revenue resulting from excess Educational Revenue Augmentation Fund (ERAF) funds, as well as general projected growth in Secured Property Tax receipts of 5.2% in 2017-2018. The general growth primarily reflects an increase in assessed value for 2017-2018, due to the California Consumer Price Index (CCPI) increase of 2%, and increased valuation due to changes in ownership or new construction. On a County-wide basis, the 2017-2018 roll growth was driven primarily by changes in ownership (46.8%), new construction (19.4%), and change in the CCPI (16.5%). In addition to the changes in assessed value, collections in this category are impacted by the ERAF payment. Beginning in 1992, agencies have been required to reallocate a portion of property tax receipts to the ERAF, which offsets the State's General Fund contributions to school districts under Proposition 98. However, once there are sufficient funds in ERAF to fulfill obligations, the remainder is to be returned to the taxing entities that contributed to it. In 2016-2017, the City received $4.4 million from excess ERAF funds from 2015-2016. In 2017-2018, the ERAF payment is projected to total $6.9 million and reflect the excess funds from 2016-2017.

In 2018-2019, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2018, are expected to increase by 5.8% to $292.6 million. This reflects the net impact of the following: a general increase of 5.5% in Secured Property Tax receipts, an increase in collections due to the SARA refunding from $8.8 million in 2017-2018 to $12.0 million in 2018-2019, partially offset by a potential decline in the ERAF payment from $6.9 million in 2017-2018 to $5.5 million in 2018-2019.

The general increase in Secured Property Tax receipts of 5.5% is driven by two factors: the change in the CCPI and the net change in residential and commercial valuation. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. The CCPI adjustment for the 2018-2019 tax roll is 2%; consistent with the prior year level. A net increase in

## REVENUE FORECAST

### Property Tax

residential and commercial valuation is also anticipated from the combination of changes in ownership and new construction. The increases in property sale prices will continue to be a positive factor driving growth in this category. In calendar year 2017, residential real estate experienced significant gains as the December 2017 median single-family sales price of $1.14 million was up 32.1% from the December 2016 price of $863,000. The number of sales, however, has declined which will negatively impact growth. The total number of property transfers for single-family and multi-dwelling homes declined approximately 1%, from 7,869 sales in calendar year 2016 to 7,791 sales in calendar year in 2017.

Due to the uncertainty of the ERAF receipt each year, a payment of $5.5 million is incorporated into the 2018-2019 Secured Property Tax estimate, which represents a 20% decrease from the 2017-2018 estimated collection level of $6.9 million. However, this collection level is well above the 2015-2016 ERAF payment of $4.4 million.

It should be noted that final data on the actual tax levy for 2017-2018 is not yet available as adjustments are made through June 30, 2018. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Some of the adjustments, however, are not reflected until the latter months of a given fiscal year, such as the reassessments of commercial property. As this information becomes available, refinements to the Property Tax estimates may be brought forward during the 2018-2019 budget process.

**Unsecured Property Taxes** are the second largest revenue source in this category. Growth in this category is driven primarily by increases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections through December, Unsecured Property Tax receipts are estimated at $14.0 million in 2017-2018, which is 4.7% above the prior year level of $13.4 million. Collections are expected to increase approximately 3% in 2018-2019 to $14.5 million based on the current economic conditions.

For the other Property Tax categories, 2018-2019 collections are estimated at $6.9 million for **SB 813 Property Taxes** (supplemental taxes that represent payments for taxes owed on recent housing resales), $2.7 million for **Aircraft Property Tax**, and $1.0 million for **Homeowners Property Tax Relief**. These collection levels are consistent with the 2017-2018 estimates.

In the out years of the Forecast, annual Property Tax receipts are projected to increase approximately 4.2% to 5.2% annually over the five-year period. A portion of this growth is due to an estimated 2% CCPI increase annually.

## REVENUE FORECAST

### Sales Tax

The Sales Tax category includes General Sales Taxes, Local Sales Tax, and Proposition 172 Sales Taxes. In 2017-2018 collections are projected to reach $228.1 million, which is 1.8% above the 2017-2018 Modified Budget of $224.0 million. The higher estimated collection level is primarily due to strong Local Sales Tax revenue (positive variance of $6.0 million), partially offset by lower General Sales Tax revenue (negative variance of $2.0 million). Following is a discussion of the Sales Tax sub-categories.

Information on actual receipts for the first quarter of General Sales Tax for the current year was received in December 2017 and represented activity for July through September 2017. The first quarter 2017-2018 General Sales Tax revenues reflected growth of 8.8% from the same quarter in the prior year. However, the first quarter of 2016-2017 included a one-time negative $2.7 million correction from prior year payments that were made in error, resulting in a decline of 9.4% in that quarter. Factoring out that adjustment, receipts in the first quarter of 2017-2018 reflect growth of 2.1% from the prior year. Based on current collection trends, it is estimated General Sales Tax will grow by 2% in the remaining three quarters of 2017-2018 and end the year at $181.0 million, which is $2.0 million below the budgeted estimate of $183.0 million. In 2018-2019, it is anticipated that General Sales Tax will continue to have modest growth of 2% and total $184.1 million.

The City's Sales Tax consultant, MuniServices, provides economic performance data to the City, which is considered to be a more accurate measure of the actual sales tax activity in San José for a particular period. This growth analysis measures sales tax receipts, excluding State and county pools, and adjusts for anomalies, payments to prior periods, and late payments. On an economic basis, growth of 0.5% was realized in the most recent quarter. The chart below outlines the various sectors of sales tax and the percentage of the total receipts received in the most recent quarter.

**Sales Tax Revenue Economic Performance**
**July – September 2017**

| Economic Sector | % of Total Revenue | % Change July – Sept 2016 to July – Sept. 2017 |
|---|---|---|
| General Retail | 24.8% | -0.6% |
| Transportation | 23.5% | +1.5% |
| Business-to-Business | 20.0% | -2.2% |
| Food Products | 18.1% | +3.0% |
| Construction | 12.8% | +1.2% |
| Miscellaneous | 0.8% | +6.1% |
| **Total** | **100.0%** | **+0.5%** |

Information on the second quarter collections (October-December sales activity) for this fiscal year will be received in March 2018.

# Elements of The General Fund Forecast

## Revenue Forecast

### Sales Tax

Starting in 2016-2017, the Sales Tax category includes **Local Sales Tax**. In June 2016, San José voters approved a ¼ cent local sales tax that was estimated to generate $30.0 million in 2016-2017 (October 2016 implementation) and $40.0 annually beginning 2017-2018. However, based on the lower than anticipated performance during the first two quarters of 2016-2017, the 2016-2017 revenue estimate was lowered from $30.0 million to $26.0 million. Actual collections ended 2016-2017 at $26.5 million, which reflected actual performance for the first two quarters ($8.7 million and $8.9 million) and estimated receipts of $8.9 million for the final quarter. Actual Local Sales Tax results for the final quarter of 2016-2017 totaled $10.2 million, which is $1.3 million above the amount assumed for the 2016-2017 accrual. The additional revenue generated from this difference is reflected in 2017-2018.

Information on actual receipts for the first quarter of Local Sales Tax for the current year was received in December and represented activity for July through September 2017. The first quarter 2017-2018 Local Sales Tax revenues totaled $10.5 million. Based on 2016-2017 collection trends as well as the receipts for first quarter of 2017-2018, it is estimated Local Sales Tax will end the year at $41.0 million on an annualized basis, factoring out one-time accrual adjustments. In 2018-2019 it is estimated Local Sales Tax receipts will grow by 2% and total $41.8 million.

**Proposition 172 Sales Tax** collections (representing the ½ cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total $6.1 million in 2017-2018, which represents a 5.8% decline from 2016-2017 collection levels. In 2018-2019, collections are projected to increase by 2%, to $6.2 million.

In the out years of the Forecast, annual Sales Tax performance is expected to show growth of 1.6% to 2.8% annually.

### Transient Occupancy Tax

In 2017-2018, Transient Occupancy Tax (TOT) receipts in the General Fund are projected to reach $18.7 million, reflecting an increase of 2.4% from the 2016-2017 collection level. The increase anticipated in 2017-2018 represents the eight year of consecutive growth in this category, reflective of continued development and economic growth in the region. Occupancy levels through January 2018 have decreased slightly, from 75.55% to 75.25%, relative to January 2017 levels. This decrease has been offset by increased average room rates, up 1.2% through January 2018 from $201.48 to $203.82. Average revenue-per-available room also showed growth, with an increase of approximately 0.8%, from $152.69 through January 2017 to $153.90 through January 2018.

In 2018-2019, TOT receipts are projected at $19.6 million, reflecting growth of 4.5% from the 2017-2018 estimate. This figure incorporates information received from the City's consultant, Conventions, Sports and Leisure (CSL) including the number of hotel rooms expected to come on-

## REVENUE FORECAST

### Transient Occupancy Tax

line, however, the growth assumptions used in the development of the Forecast are more conservative than those projected by CSL. CSL assumes annual growth ranging from 3% to 13%, however, as TOT can experience wide swings of positive and negative growth, and given the historically high average daily room rates and hotel occupancy, the Forecast assumes steady annual growth ranging from 2.5% to 4.0% per year.

### Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Commercial Solid Waste, Cable, City-Generated Tow, Water, and Nitrogen Gas Pipeline categories. Overall, collections are projected at $50.2 million in 2017-2018, an increase of 1.1% from prior year receipts of $49.6 million. The projected increase in 2017-2018 is primarily due to higher collections in Gas and Electricity receipts. In 2018-2019, Franchise Fees are expected to remain at $50.2 million, which reflects growth in Electricity receipts (2%) offset by decreased revenue related to City Generated Tow receipts.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2017-2018 are based on calendar year 2017 and revenues in 2018-2019 will be based on calendar year 2018). Year-end estimates are typically based upon an examination of electricity and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. The reconciliation of annual receipts from PG&E for 2017-2018 will be received in April 2018.

In the **Electricity Franchise Fee** category, collections in 2017-2018 are expected to reach $22.3 million, reflecting growth of approximately 2.8% compared to actual receipts in 2016-2017. This estimate takes into consideration the actual collection patterns for electricity utility tax receipts in calendar year 2017. In 2018-2019, Electricity Franchise Fee collections are projected to increase by approximately 2% to $22.7 million and reflects rate increases in January 2018 (average system-wide 0.4%) and March 2018 (average system-wide 3.4%), allowing for a slight reduction in consumption. In May 2016, San José City Council established the San José Clean Energy (SJCE), the City of San José's community Choice Energy (CCE) program, which allows governments to purchase electricity for their business and residents. SJCE will provide the same electricity service currently provided but with more renewable energy options at competitive rates. It is currently anticipated the SJCE municipal launch will occur in summer 2018 and the commercial and residential launch will occur in early 2019. Since Electricity Franchise Fees are calculated on a calendar year basis, the Electricity Franchise Fee estimate for 2018-2019 does not assume any change in revenue related to the new City Energy program.

In the **Gas Franchise Fee** category, the 2017-2018 estimated collections of $5.0 million reflect an increase of 4.4% from the $4.8 million received in the prior year. This estimate takes into consideration the actual collection patterns for gas utility tax receipts in calendar year 2017. In

## REVENUE FORECAST

### Franchise Fees

2018-2019 collections are projected to remain at $5.0 million, however, receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

**Commercial Solid Waste** (CSW) Franchise Fee collections are estimated to reach budgeted levels of $11.5 million in 2017-2018, 1.24% above the prior year collections, which is primarily due to the 2017-2018 CPI-based increase of 1.3%. Collections reflect the revised methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010, the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The fee structure is a base of $5 million per year for each of two geographic collection districts plus a supplemental fee of $1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the CPI rate during the prior two calendar years. It should be noted that this increase is not automatic, and is subject to City Council approval each year. Therefore, the 2018-2019 estimate of $11.5 million is consistent with the 2017-2018 estimate and does not automatically assume a CPI adjustment. These adjustments are brought forward as proposed changes in the Proposed Operating Budget.

In the **Cable** Franchise Fee category, the estimated 2017-2018 collections of $10.4 million is consistent with the prior year receipts. In addition, revenue in 2018-2019 is anticipated to remain at $10.4 million.

**City Generated Tow Fees** in 2017-2018 are projected at $628,000, reflecting a 37% decline from the 2016-2017 actual collection level and the 2017-2018 Adopted Budget estimate of $1.0 million. As detailed in the Amendments to City Generated Tow Agreements memorandum that was approved by the City Council on October 31, 2017, City Generated Tow Fees have significantly declined. Fee amendments approved as part of that memorandum became effective January 1, 2018. Based on current collection trends and anticipated impacts of the approved fee amendments, revenues are estimated to end 2017-2018 at $628,000 and drop to $256,000 in 2018-2019.

Remaining categories, including **Water and Nitrogen Gas Pipeline**, are estimated to end 2017-2018 at $354,000 and increase to $360,000 in 2018-2019. In 2018-2019, collections are anticipated to remain flat for Nitrogen Gas Pipeline ($60,000) and increase 5.0% for Water ($300,000).

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase in the range of 1.53% to 1.83% annually through 2020-2021, then decrease 2.2% in 2021-2022 and 2.4% in 2022-2023 due to the sunsetting of a gas and electricity surcharge in the last half of 2021-2022. On February 9, 2010, the City Council approved ordinances amending the franchises within PG&E for the sale of natural gas and electricity. These amendments added a franchise fee surcharge of 0.3%, resulting in a total franchise fee remitted to the City of 2.3% of gross receipts from the sale of gas and electricity through 2021. It is important to keep in mind that there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels.

## REVENUE FORECAST

### Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2017-2018 are anticipated to total $100.9 million, representing a minimal increase of less than 1% from the 2016-2017 collection level of $100.8 million. In 2018-2019, Utility Tax collections are projected to increase approximately 1.5% to $102.4 million. Due to the uncertainty regarding the outcome of rate cases, the Forecast generally does not assume revenue increases associated with pending rate cases; however, it does take into account changes already approved. Rate cases will continue to be monitored and adjustments will be brought forward as appropriate based on the final outcomes.

The **Electricity Utility Tax** is anticipated to generate $48.0 million in 2017-2018, a 4.4% increase from prior year levels. This reflects actual collection patterns as well as rate increases in January 2018 (0.4% system-wide) and March 2018 (3.4% system-wide). In 2018-2019, revenues are estimated to increase an additional 2% to $49.0 million, reflecting only the annualization of rate increases in 2017-2018. In May 2016, San José City Council established the San José Clean Energy (SJCE), the City of San José's community Choice Energy (CCE) program, which allows governments to purchase electricity for their business and residents. SJCE will provide the same electricity service currently provided but with more renewable energy options at competitive rates. It is currently anticipated the SJCE municipal launch will occur in summer 2018 and the commercial and residential launch will occur in early 2019.

**Gas Utility Taxes** are projected at $10.0 million in 2017-2018, a 10% decrease from 2016-2017 levels based on actual collection patterns and anticipated consumption levels. In 2018-2019 collections are projected to remain at $10.0 million, however, receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

**Water Utility Tax** receipts of $16.7 million are anticipated to be received in 2017-2018, an increase of approximately 13% from 2016-2017 collection levels. In 2018-2019, receipts are projected to increase approximately 3% to $17.2 million based on the continued rising wholesale price of water and anticipated increased water usage.

In the **Telephone Utility Tax** category, revenues are collected on landlines, wireless, VoIP, and prepaid wireless services sold at retail locations. Receipts in 2017-2018 and 2018-2019 are projected at $26.2 million, a 9.3% decrease from 2016-2017 collection levels. The decline in this revenue category is the result of wireless consumers shifting to less expensive prepaid wireless plans and consumers continuing to permanently disconnect landlines in favor of cellular phones and internet phones.

In the out years of the Forecast, conservative growth ranging from 1.3% to 2.0% annually is projected overall in the Utility Tax category. There is significant volatility and uncertainty regarding the performance in this category based on potential changes in rates and consumption levels, as well as the establishment of the SJCE. In addition, the Water and Gas Utility Tax categories are significantly influenced by weather conditions.

## REVENUE FORECAST

### Telephone Line Tax

Based on the current collection trend, receipts in 2018-2019 are estimated to total $20.0 million, which is consistent with the 2017-2018 estimate. Given the steady nature of collections in this category, receipts are anticipated to remain relatively flat (growth of less than 1%) in the out years of the Forecast as well.

### Business Taxes

This category includes General Business Tax, Cardroom Tax, Disposal Facility Tax, and Marijuana Business Tax. Business Taxes are estimated to reach $66.4 million in 2017-2018, a 22.6% increase from prior year levels, then grow slightly to $67.0 million in 2018-2019. The significant increase estimated in 2017-2018 is primarily due to a change in the General Business Tax, which is discussed below.

In 2017-2018, **General Business Tax** proceeds are anticipated to reach $23.7 million, an 81.7% increase from the 2016-2017 collection level of $13.0 million. The significant growth in revenue in 2017-2018 reflects the modernization of the San José business tax, which was approved by San José voters on November 8, 2016 and took effect on July 1, 2017. The adjustments to the business tax included increasing the base tax, increasing the incremental tax and making it more progressive, increasing the cap (the maximum amount of the tax affecting large businesses), updating the application of the tax to more classes of business, and adding inflation based adjustments for future tax rates. In 2018-2019 General Business Tax revenues are anticipated to grow by 2% to $24.2 million.

Based on current performance, collections in the **Cardroom Tax** category are estimated at $18.7 million in 2017-2018, a 1.2% increase from the prior year collection level of $18.5 million. In 2018-2019, receipts are anticipated to remain steady at $18.7 million.

**Disposal Facility Taxes** (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream can vary due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. Based on current collection trends and the anticipation of a recycling plant closing for several months in the current year (resulting in higher solid waste being diverted to the landfill), 2017-2018 DFT collections are estimated at $12.0 million, representing a 1.3% decline from 2016-2017 collection levels. In addition, the 2018-2019 estimate decreases further to $11.5 million as the recycling plant reopens and solid waste is diverted from the landfill. DFT revenues have declined over time as a result of continued waste diversion efforts. For instance, a decade ago in 2007-2008, DFT receipts totaled $13.9 million and two decades ago in 1997-1998, receipts totaled $19.5 million.

## REVENUE FORECAST

### Business Taxes

**Marijuana Business Tax** collections reflect marijuana business tax as well as marijuana business tax compliance revenues. Marijuana Business Taxes are currently being collected at a 10% rate on gross receipts as approved by the voters in Ballot Measure U in 2010 on medical and non-medical, legal and illegal sales. In 2017-2018, collections are anticipated to increase to approximately $12.0 million, an increase of 14.6% from prior year levels of $8.9 million. In 2018-2019 Marijuana Business Tax collections are anticipated to increase an additional 5% to $12.6 million. In November 2016, the California Marijuana Legalization Initiative (Proposition 64) legalized recreational marijuana use in the State of California. As a result, the sale of recreational cannabis at the 16 licensed dispensaries in San José began in January 2018. With limited information currently known, additional revenue has not been incorporated in the current year revenue estimate based on the legalization of recreational marijuana. Activity and potential increased revenue associated with the sale of recreational cannabis will continue to be closely monitored and any recommended adjustments will be brought forward later in the 2018-2019 budget process.

In the remaining years of the forecast, overall, the Business Tax category is expected to experience very minimal growth of less than 1% per year.

### Licenses and Permits and Fees, Rates, and Charges

The Licenses and Permits and Fees, Rates, and Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. In 2018-2019, the Licenses and Permits category is estimated at $58.5 million and the Fees, Rates, and Charges category is estimated at $45.8 million.

For the Development Fee Programs, the Forecast assumes no net impact on the General Fund based on the assumption that these programs will remain at 100% cost recovery. For 2018-2019, the Building Fee Program, Planning Fee Program, Fire Fee Program, and Public Works Fee Program base expenditures are projected to exceed the base revenue estimates. For all the fee programs except the Planning Fee Program, there are sufficient earmarked reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact in 2018-2019. This Forecast assumes that Fee Program Reserves will be used to address these shortfalls as outlined in the Beginning Fund Balance section below. The Planning Fee Program earmarked reserves are anticipated to be insufficient to align projected revenues and expenditures for a net zero General Fund impact in 2018-2019. However, the Planning Fee Program Forecast continues to be assumed to remain at 100% cost recovery. Fee increases and/or expenditure changes will likely be recommended as part of the 2018-2019 budget process to maintain 100% cost-recovery for the Planning Fee Program. For the non-development-related fees and charges, the 2018-2019 estimates are based on current collection trends.

## REVENUE FORECAST

### Licenses and Permits and Fees, Rates, and Charges

In the out years of the Forecast, both the Licenses and Permits and Fees, Rates, and Charges categories are expected to experience growth ranging from 3.1% to 4.0%. The growth rates in the out years are tied to the expected increases in personnel costs, which the fees are designed to recover, including salary, retirement, and health costs.

In 2017-2018, the Fines, Forfeitures and Penalties category is expected to generate $15.0 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately $10.4 million in 2017-2018 and 2018-2019. These estimates reflect a 12.0% decline from 2016-2017 receipts of $11.8 million. The estimated decrease in citation revenue is primarily attributable to ongoing turnover among Parking and Traffic Control Officers and the prioritization of vehicle abatement to address increased service request volumes. Total revenue in 2018-2019 is estimated at $14.3 million in the Fines, Forfeitures, and Penalties category. In the out years of the Forecast, annual growth of approximately 0.4% to 1.8% is projected.

### Money and Property

This category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, and interest income and is projected to generate $6.8 million in 2017-2018. In 2018-2019, revenue is expected to remain at $6.8 million, which reflects reduced revenue related to rental of communications facilities, offset by higher interest earnings, which are anticipated as a result of increased interest rates. In the out years of the Forecast, growth of 2.5% to 3.5% annually is assumed in the Money and Property category.

### Revenue from Local Agencies

In 2017-2018, revenue of $23.7 million is projected from other local agencies, such as the Successor Agency to the Redevelopment Agency of San Jose and the Central Fire District. In 2018-2019, revenue in this category is projected at $10.8 million, which is $12.9 million below the 2017-2018 estimate. The decrease in 2018-2019 revenue is primarily due to one-time reimbursement funding for enforceable obligations totaling $10.8 million reimbursement in 2017-2018, but reducing to $1.0 million in 2018-2019. In addition, the 2018-2019 figure eliminates reimbursements and grants that are not secured on an ongoing basis.

In 2017-2018, a reimbursement from the Successor Agency to the Redevelopment Agency of San José (SARA) for enforceable obligations is estimated at $10.8 million, with additional funding of $1.0 million anticipated to be received in 2018-2019. The $10.8 million reimbursement accounts for costs the City incurred supporting SARA since dissolution of the San José Redevelopment Agency in 2012. The 2018-2019 reimbursement of $1.0 million is lower because it accounts for only one year of support services.

## REVENUE FORECAST

### Revenue from Local Agencies

The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. Based on information provided by the Central Fire District staff, payments of $7.0 million are anticipated in 2017-2018. This reflects a 7.5% increase from the prior year level. In 2018-2019, collections are projected to increase 5.5% to $7.3 million. In 2018-2019, reimbursement totaling $970,000 is also expected from local agencies for services provided by the Animal Care and Services Program. This collection level is consistent with the 2017-2018 estimate.

The Forecast assumes reimbursement from the County of Santa Clara for the first responder advanced life support program (Paramedic Program), which totals $1.5 million in 2017-2018 and $1.3 million in 2018-2019. The reimbursement associated with the Paramedics Program was eliminated from the budget beginning in 2014-2015. Because the City's performance fell slightly below the performance standards set forth in the agreement with the County, no reimbursement was provided for either the equipment reimbursement component (Annex B, Category A funds) or the service-related component (Annex B, Category B funds). However, based on recent information received from the County, revenue is anticipated to be received in 2017-2018 totaling $1.5 million for Category A funds ($1.3 million) and Category B funds ($224,000). The category B funds are based on actual performance for the first quarter, however, additional reimbursement may be received based on performance for the remainder of the year. Due to uncertainty related to future reimbursements for Category B funds, the 2018-2019 estimate is decreased to $1.3 million and only incorporates Category A reimbursement. It should be noted that the direct incremental cost to the City to provide the paramedic program totals over $5.0 million annually. If the County were to assume responsibility for this program, its costs are estimated to far exceed this amount.

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 3.0% to 3.5%.

### Revenue from the State of California

The Revenue from the State of California category includes Tobacco Settlement payments, State grant revenues, and other State reimbursements. Collections in this category are estimated to reach $10.6 million in 2018-2019 and remain flat through the out years of the Forecast. Tobacco Settlement payments account for the majority of revenue in this category and are estimated at $9.0 million in 2018-2019, consistent with the amount projected for 2017-2018.

The State grants and reimbursements total $1.1 million, with the largest reimbursement for the Abandoned Vehicles Abatement Program ($680,000). Vehicle License Fees Collection in Excess are also estimated at $500,000 annually and account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures that are equally apportioned to counties and cities on a population basis.

## REVENUE FORECAST

### Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues and rental income. In 2018-2019 and the out years of this Forecast, there is no funding assumed for this revenue category.

### Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and proceeds from the Sale of Surplus Property. In 2017-2018, this category is expected to generate $185.3 million.

The 2017-2018 estimate includes a number of adjustments not included in the 2018-2019 Forecast, the largest of which include: 1) $150.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension benefits that are brought forward for City Council approval in August of each year along with the associated expenditure; and 2) one-time PERS Levy Litigation Settlement funds of $13.1 million.

In 2018-2019, the revenue estimate of $9.3 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2018-2019 costs or agreements and the elimination of one-time funding sources. This figure will increase significantly during 2018-2019 once the revenues associated with the issuance of the TRANs are brought forward with an offsetting expenditure based on estimated cash flow needs.

The Arena Fixed Fee, which was previously allocated at $5.05 million is decreasing to $375,000 beginning in 2018-2019 in accordance with the term sheet with Sharks Sports Entertainment approved in May 2015. Payments from Comcast and AT&T are estimated at $2.1 million. As defined in the Franchise Agreement, these funds will be used to support the Public, Education, and Government (PEG) Access facilities. There are associated City-Wide Expenses allocations for this purpose. The cost reimbursement for the Investment Program is estimated at $1.3 million based on the current allocation of staff to this function. In addition, the proceeds from the Sale of Surplus Property category is estimated at $1.0 million in 2018-2019 based on the anticipated assets that will be sold next fiscal year.

In the out years of the Forecast, annual collections are expected to experience growth and declines ranging from -5.5% (reduction is related to one-time grants) to 0.7% annually.

## Revenue Forecast

### Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2017-2018 are projected to reach $17.3 million, which is consistent with the prior year actuals. Several factors impact collections, including falling gas prices that would support increased consumption and, as an offsetting factor, the move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In 2018-2019, collections in this category are projected to remain at $17.3 million. In the out years of the Forecast, collections are expected to experience growth and declines ranging from -3.5% to 3.8% annually.

### Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2018-2019, a total of $48.5 million in reimbursements are projected based on 2018-2019 overhead rates for the majority of City funds prepared by the Finance Department applied against the projected 2018-2019 salaries for those positions for which an overhead rate is applied. In the remaining years of the Forecast, annual increases of 3.5% are assumed, reflecting increases in costs, which the overhead rate is designed to recover, including increased personal services costs.

### Transfers

The Transfers category is projected at $24.5 million in 2018-2019, which is slightly below the 2017-2018 modified budget estimate of $25.0 million. The largest component of this category ($15.1 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2018-2019, these reimbursements have been built to cover the direct base costs as well as indirect costs.

Additional large transfers programmed for 2018-2019 include the Construction and Conveyance Tax Fund transfer ($3.7 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer ($1.8 million) for general use and pavement maintenance activities; the General Purpose Parking Fund ($707,000); and the transfer from the Convention and Cultural Affairs Fund ($473,000) for reimbursement of City oversight of the fund.

In the remaining years of the Forecast, annual increases range from 2.1% to 3.0%. The reimbursement from the Airport Maintenance and Operation Fund for police and fire services is expected to increase in the out years based on the increased costs for those services.

### Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2018-2019 of $743,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases from 2.1% to 3.0%.

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

### Beginning Fund Balance

The $65.6 million forecast estimate of available 2018-2019 Beginning Fund Balance is based on the following assumptions:

- The current Contingency Reserve of $36.5 million is carried forward at the current level based on the assumption that this amount will not be used in 2017-2018 and will be available for use in 2018-2019. The current funding level is approximately enough to cover General Fund payroll costs for approximately two weeks in an emergency. (On the expenditure side, the Contingency Reserve is increased to $36.5 million in 2018-2019 and grows to $41.0 million by 2022-2023, which complies with the City Council policy to set aside at least 3% of expenditures in this Reserve.)

- A total of $18.0 million in fund balance will be achieved in 2017-2018 for use in 2018-2019 from a combination of excess revenues and expenditure savings as well as the liquidation of prior-year carryover encumbrances. Consistent with past practice, the Administration will closely monitor actual General Fund performance through the remainder of the year and may bring forward adjustments to this estimate as appropriate later in the budget process.

- An additional $11.1 million reflects the anticipated liquidation of reserves. Of this amount, $10.8 million will be used to support the Development Fee Programs as follows: $5.7 million from the Building Development Fee Program Reserve; $3.2 million from the Planning Development Fee Program Reserve (this reserve is currently not sufficient to cover this amount; fee increases and/or cost reductions will be necessary to close the funding gap for this program); $1.1 million from the Public Works Development Fee Program Reserve; and $787,000 from the Fire Development Fee Program Reserve. The use of Development Fee Program reserves is assumed to cover a portion of the 2018-2019 base costs associated with these programs that cannot be addressed with base fee revenue to keep the Development Fee Programs 100% cost recovery in the Forecast. Other current year reserves that will be used to support base costs programmed in 2018-2019 include the San Jose Environmental Sustainability Program Reserve ($297,000), and the 2018-2019 Cinequest Reserve ($50,000).

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue and expenditure savings, including liquidations of carryover encumbrances will generate $20 million annually for use in the following year. In addition, it is assumed that the Contingency Reserve of $36.5 million will be carried over each year; and the use of the Development Fee Program Reserves for Building, Planning, Public Works, and Fire continue in the out years to support projected development fee program costs in excess of revenues. For the Development Fee Programs, a combination of fee increases, cost reductions, and/or use of reserves may be used to close gaps between revenues and expenditures, as needed. In total, the Beginning Fund Balance ranges from $65.6 million in 2018-2019 to $68.9 million in 2022-2023.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2018-2019 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2018-2019 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from $1.1 billion in 2018-2019 to $1.3 billion in 2022-2023, for an average growth rate of 3.3% per year.

### 2019-2023 General Fund Forecast Expenditure Summary

| | Modified Budget | Forecast | | | | |
|---|---|---|---|---|---|---|
| **Expenditure Category** | **2017-2018** | **2018-2019** | **2019-2020** | **2020-2021** | **2021-2022** | **2022-2023** |
| Personal Services | | | | | | |
| Salaries and Other Compensation | $ 473,466,433 | $ 497,206,000 | $ 520,840,000 | $ 539,070,000 | $ 557,937,000 | $ 577,465,000 |
| Retirement | 301,440,205 | 314,761,000 | 329,400,000 | 346,398,000 | 358,718,000 | 352,174,000 |
| Health and Other Fringe Benefits | 57,235,454 | 56,755,000 | 59,707,000 | 62,191,000 | 64,916,000 | 67,895,000 |
| **Total Personal Services** | **$ 832,142,092** | **$ 868,722,000** | **$ 909,947,000** | **$ 947,659,000** | **$ 981,571,000** | **$ 997,534,000** |
| **Total Non-Personal/Equipment** | **$ 124,019,581** | **$ 114,007,000** | **$ 115,266,000** | **$ 118,732,000** | **$ 121,968,000** | **$ 122,059,000** |
| City-Wide | | | | | | |
| City-Wide Expenses | $ 267,544,922 | $ 68,411,000 | $ 72,902,000 | $ 73,705,000 | $ 75,408,000 | $ 77,043,000 |
| Capital Projects | 46,158,854 | 5,580,000 | 5,580,000 | 5,580,000 | 5,580,000 | 5,580,000 |
| Transfers | 32,476,596 | 33,239,000 | 33,837,000 | 34,357,000 | 34,683,000 | 34,210,000 |
| Earmarked Reserves | 115,665,064 | 1,880,000 | 1,080,000 | 1,080,000 | 1,080,000 | 1,080,000 |
| Contingency Reserve | 36,500,000 | 36,500,000 | 38,000,000 | 39,000,000 | 40,500,000 | 41,000,000 |
| **Total City-Wide** | **$ 498,345,436** | **$ 145,610,000** | **$ 151,399,000** | **$ 153,722,000** | **$ 157,251,000** | **$ 158,913,000** |
| Committed Additions | | | | | | |
| New Parks and Recreation Facilities Maint. & Operations | | 216,000 | 523,000 | 667,000 | 725,000 | 809,000 |
| New Traffic Infrastructure Assets Maint. & Operations | | 22,000 | 45,000 | 69,000 | 82,000 | 95,000 |
| Measure P (Parks) Maint. & Operations | | 381,000 | 677,000 | 715,000 | 755,000 | 790,000 |
| **Total Committed Additions** | | **$ 619,000** | **$ 1,245,000** | **$ 1,451,000** | **$ 1,562,000** | **$ 1,694,000** |
| **Total Base Exp. w/ Committed Additions** | **$ 1,454,507,109** | **$ 1,128,958,000** | **$ 1,177,857,000** | **$ 1,221,564,000** | **$ 1,262,352,000** | **$ 1,280,200,000** |
| **Growth %** | | | **4.3%** | **3.7%** | **3.3%** | **1.4%** |

It is important to note that adjustments are made to the Forecast to eliminate one-time additions/deletions and annualize partial-year allocations that were included in the 2017-2018 Adopted Budget. Various one-time additions totaling over $11 million are scheduled to expire in June 2018. The major items funded on a one-time basis include the following: San José Works, Pavement Maintenance Program, San José Learns, Parks, Recreation and Neighborhood Services Placemaking and Parks Activation, Police Department Downtown Foot Patrol, Urban Village Planning Staffing, Office of Emergency Management Disaster Plans and Community Emergency Response Team (CERT) Program, Greenhouse Gas Reduction Strategy Update, Human Resources Department Workers' Compensation Program Temporary Staffing, Police Department Recruiting Program, Business Development and Economic Strategy Activities, and Policy and Ordinance Support Staffing. Many of these programs and services will likely need to be re-evaluated for continued funding beyond 2017-2018. This analysis will be conducted during the 2018-2019 budget process and funding recommendations for these programs and services will be included in the 2018-2019 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

Understanding the basis for the expenditure estimates included in this Forecast requires discussion of the assumptions used for estimating each of the expenditure categories. The following discussion focuses on the individual expenditure components in the General Fund.

### Personal Services

As is the usual practice, the first year (2018-2019) projection for personal services costs in this Forecast has been calculated at a detailed level, using a January 2018 extract from the City's payroll system as the starting point. This included the most recent retirement plan and health plan information for each position. The individual position-level information was then reviewed, corrected, and updated to ensure accurate salary step and bi-weekly salary, as well as any position reallocations. Further, 2017-2018 ongoing position additions (cost increases) and reductions (cost savings), as appropriate, were annualized and all categories of benefit costs in the coming year were projected.

For the 2018-2019 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the total cost in the General Fund. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the $868.7 million projected personal services total for 2018-2019, salaries and other compensation costs amount to $497.2 million (57.2% of projected personal services), retirement costs amount to $314.8 million (36.3% of projected personal services), and health and other fringe benefits costs amount to $56.8 million (6.5% of projected personal services).

Following is a discussion of the factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. The out-years are projected to inflate at an average annual rate of approximately 3.7%.

*Salaries and Other Compensation*:

Pay increases for all employees, salary step increases for current non-management employees, and pay for performance for management employees are assumed in each year of this Forecast. The only negotiated pay increase included in this Forecast is based on the current agreement reached between the City and the San José Police Officers' Association (SJPOA); this increase totals 6% in 2018-2019 (3.25% pensionable and 2.75% non-pensionable). With the remaining bargaining unit contracts set to expire in June 2018, Salaries and Benefits Reserve funding is included in each year of this Forecast in order to set aside funds for potential employee pay increases. This reserve allocation includes $14.6 million for 2018-2019, and would require City Council labor negotiations direction and discussion with the City's bargaining groups before any form of distribution could be made. As contracts in the out-years of the forecast are determined, subsequent Forecast documents will be updated to reflect the latest information at that time. With the exception of employees represented by SJPOA and the International Association of Fire Fighters (IAFF), Local 230, non-management step increases have been calculated at a 2.5% step increase rate. For SJPOA and IAFF, a 5% step increase rate was applied in this Forecast. The out-years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

The Overtime budget in the General Fund totals $29.9 million for 2018-2019, with most of these funds allocated to Police Department ($17.8 million) and Fire Department ($10.5 million) operations. The out-years of the Forecast continue these costs, with small adjustments using salary step as the inflationary factor.

*Retirement:*

The City's two retirement systems, the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan, provide defined retirement benefits to eligible employees. Both retirement plans use investment income and employer and employee contributions to provide eligible retirees with pensions and retiree healthcare benefits. Both systems were modified by the passage of a pension reform ballot measure known as Measure B in June 2012 and the subsequent Alternative Pension Reform measure (Measure F) in November 2016. The retirement systems and their modifications are discussed in more detail below.

Employees represented by SJPOA and IAFF, Local 230 are members of the Police and Fire Department Retirement Plan and have different retirement benefits with the corresponding different City contributions and rates. Within the Police and Fire Department Retirement Plan, effective August 4, 2013, the City provides for a lower defined benefit plan (Tier 2) for new and rehired police members. Effective January 2, 2015, a lower defined benefit plan (Tier 2) was implemented for new and rehired Fire members. With the passage of Measure F, former Tier 1 members previously or newly rehired to the City are placed within the Tier 1 defined benefit plan.

Within the Federated Retirement System, effective September 30, 2012, the City provides for a lower defined benefit plan (Tier 2) for new employees in that system. Federated employees who joined the City between September 30, 2012 and September 27, 2013 are eligible for retiree healthcare coverage (Tier 2A). Effective September 27, 2013, however, new employees no longer receive retiree healthcare coverage (Tier 2B). With the passage of Measure F, former Tier 1 members previously or newly rehired to City are placed within the Tier 1 defined benefit plan.

Effective March 31, 2017 for members of the Police and Fire Department Retirement Plan and June 18, 2017 for members of the Federated City Employees' Retirement System, employees with previous CalPERS or reciprocal retirement system experience are eligible to join the Tier 1 defined benefit pension plan for their respective retirement systems. These employees need to have been employed at their previous agency before January 1, 2013, have less than a six (6) month break in service before joining the City, and not have concurrent service.

## EXPENDITURE FORECAST

On December 4, 2012, a defined contribution plan (Tier 3) for new employees in Unit 99 (Senior Staff, Executive Staff, and senior managers under the City Manager's Appointing Authority; City Council Office staff; professional and management employees under the appointing authority of the City Attorney, City Auditor, and Independent Police Auditor; and some employees in the City Clerk's Office) was approved. Effective February 4, 2013, new employees to the City hired directly into Unit 99 have the ability to make the one-time election to participate in the defined benefit Tier 2B plan or the Tier 3 plan. The Tier 3 plan provides for a City contribution of 3.75%.

For 2018-2019, retirement costs total $314.8 million for the General Fund, which are up $13.3 million from the 2017-2018 Modified Budget of $301.4 million. These costs represent 27.9% of the total General Fund base expenditure budget with committed additions and reflect the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. To generate budgetary savings, this cost assumes the pre-payment of the City's annual required contribution (ARC) for Federated Retirement System Tier 1 members and contributions for the Police and Fire Department Retirement Plan for Tier 1 police and fire members. For 2018-2019, net budgetary savings from the pre-payment, including borrowing costs, are estimated at approximately $3.3 million in the General Fund ($4.6 million in all funds). The pre-payment savings figure reflects a 45% reduction in accordance with the Prefunding Risk Mitigation Process approved by the Federated and Police and Fire Retirement Boards in 2015.

In 2010-2011, the Retirement Boards adopted an annual required contribution methodology that established that the City's contribution to the retirement systems be based on a dollar value that is the greater of 1) the employer ARC amount contained in the actuarial valuation (applied in cases where the City's payroll is at or lower than the payroll assumed by the actuary) or 2) the contribution rate contained in the actuarial valuation multiplied by the actual payroll for the Fiscal Year (applied in cases where the City's payroll is above the amount assumed by the actuary). This concept is referred to as the "floor methodology". In January 2016, at the City's recommendation, the Retirement Boards approved a change in the methodology used to calculate the Federated and Police and Fire pension contributions. This methodology, applied to the Federated Tier 1 and Police and Fire Tier 1 plans, uses different calculations for the unfunded actuarial liability (UAL) portion of the contribution and for the normal cost portion of the contribution. The UAL portion is calculated as a dollar amount and the normal cost (including the administrative expense) is calculated as a percent of pay. This change decreases the disparity between retirement contribution calculations that arise from different City and actuarial payroll projections to avoid a potential overpayment of the UAL by the City in any given year.

In September 2014 and October 2014, the Federated Retirement System Board and the Police and Fire Department Retirement Plan Board, respectively, approved that for Tier 2 members, the City's contribution shall only be based on a percentage of payroll.

## EXPENDITURE FORECAST

On June 5, 2012, voters approved a pension reform ballot measure known as Measure B. Measure B has been subsequently subject to various forms of litigation. In an effort to settle this case for budget stability and to provide certainty to the City's workforce, the City Council directed the City Administration to make any and all reasonable efforts to reach and implement a settlement. In August 2015 and December 2015, terms for the alternative pension reform settlement framework agreements with the Police and Fire and Federated bargaining units, respectively, were reached regarding Measure B, which included impacts to retiree healthcare. In November 2016, voters approved the Alternative Pension Reform measure (Measure F) that was consistent with the pension reform settlement framework.

The actuarial reports for both the Federated and Police and Fire Retirement Systems used to prepare this Forecast incorporate changes associated with the implementation of Measure F. This includes changes in the calculation of City contributions associated with retiree healthcare, which prior to Measure F, were frozen at certain levels for Federated and Police and Fire systems. Subsequent to the passage of Measure F, the methodology approved by the Federated Retirement Board had the impact of lowering the annual contribution from previous levels, while the Police and Fire Retirement Board's impact slightly increased the previous contribution. When compared to the retiree healthcare contribution rates used by the City to forecast 2017-2018 to projections for 2018-2019, the Federated contribution decreased across all categories: Tier 1 contribution rates decreased from 9.24% to 6.65%, Tier 2a decreased from 9.41% to 6.65%, and Tier 2b decreased from 12.66% to 6.65%. The average contribution rate assumed in 2017-2018 for Police and Fire members, averaging 10.37%, remained relatively unchanged. However, as the final decision by the Police and Fire Retirement Board did not occur until after development of the City's forecast model, projections in this Forecast assume a rate of 11.0%.

Based on projections received from the Retirement Boards' actuary (Cheiron) and the City Manager's Budget Office's independent analysis, Table 1 details the General Fund's retirement costs and budgetary retirement contribution rates for the Federated Retirement System and the Police and Fire Department Retirement Plan and the respective pension and retiree healthcare costs for the forecast period. Over this Forecast, the General Fund retirement costs are expected to grow from $314.8 million ($404.4 million in all funds) in 2018-2019 to $352.2 million ($453.7 million in all funds) in 2022-2023. When compared to the previous Forecast, these amounts are lower due to both the change in retiree healthcare contribution as described above and to the updated calculation of the unfunded actuarial liability as determined by the Retirement Boards' actuary.

For illustration purposes only, Table 2 depicts the Retirement Board approved contribution rates for 2018-2019 and the Cheiron projected rates for the out-years of the Forecast. It should be noted that the City budgetary rates differ from the Federated and Police and Fire Retirement Board approved rates to reflect the application of the City's methodology to fund the Board approved UAL amounts, and the application of a pre-payment discount for Federated as well as Police and Fire Tier 1 contributions.

## EXPENDITURE FORECAST

**TABLE 1 – 2019-2023 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES**
**($ in Millions and with Pre-Payment Discount) ***

| Retirement Plan | 2017-2018 | 2018-2019 | 2019-2020 | 2020-2021 | 2021-2022 | 2022-2023 |
|---|---|---|---|---|---|---|
| Fed. Ret. System Tier 1 – Pension | $84.0 | $88.7 | $92.7 | $96.5 | $99.2 | $100.5 |
| Fed. Ret. Syst. Tier 1 – Ret. Healthcare | $9.3 | $6.4 | $5.8 | $5.4 | $4.7 | $4.4 |
| **Fed. Retirement Plan Tier 1 – Total** | **$93.3** | **$95.1** | **$98.5** | **$101.9** | **$103.9** | **$104.9** |
| ***Budgetary Contribution Rates*** | *92.4%* | *98.3%* | *109.1%* | *123.5%* | *137.9%* | *152.1%* |
| Fed. Ret. System Tier 2A – Pension | $0.5 | $0.6 | $0.7 | $0.8 | $0.9 | $1.0 |
| Fed. Ret. Syst. Tier 2A – Ret. Healthcare | $0.7 | $0.5 | $0.6 | $0.7 | $0.7 | $0.8 |
| **Fed. Retirement Plan Tier 2A – Total** | **$1.2** | **$1.1** | **$1.3** | **$1.5** | **$1.6** | **$1.8** |
| ***Budgetary Contribution Rates*** | *15.7%* | *14.9%* | *14.9%* | *14.9%* | *14.6%* | *14.7%* |
| Fed. Ret. System Tier 2B – Pension | $4.2 | $8.2 | $9.0 | $10.1 | $11.2 | $12.3 |
| Fed. Ret. Syst. Tier 2B – Ret. Healthcare | $8.5 | $6.6 | $6.8 | $7.8 | $8.4 | $9.4 |
| **Fed. Retirement Plan Tier 2B – Total** | **$12.7** | **$14.8** | **$15.8** | **$17.9** | **$19.6** | **$21.7** |
| ***Budgetary Contribution Rates*** | *18.9%* | *14.9%* | *14.9%* | *14.9%* | *14.6%* | *14.7%* |
| Fed. Ret. System Tier 2C – Pension ** | $0.1 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Fed. Ret. Syst. Tier 2C – Ret. Healthcare ** | $0.2 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| **Fed. Retirement Plan Tier 2C – Total** | **$0.3** | **$0.0** | **$0.0** | **$0.0** | **$0.0** | **$0.0** |
| ***Budgetary Contribution Rates*** | *19.1%* | *14.9%* | *14.9%* | *14.9%* | *14.6%* | *14.7%* |
| Police Ret. Plan Tier 1 – Pension | $90.3 | $95.7 | $95.2 | $97.7 | $98.1 | $85.2 |
| Police Ret. Plan Tier 1 – Ret. Healthcare | $11.1 | $12.2 | $11.2 | $10.2 | $9.2 | $8.2 |
| **Police Retirement Plan Tier 1 – Total** | **$101.4** | **$107.9** | **$106.4** | **$107.9** | **$107.3** | **$93.4** |
| ***Budgetary Contribution Rates*** | *92.7%* | *97.3%* | *105.0%* | *116.5%* | *127.7%* | *126.0%* |
| Police Retirement Plan Tier 2 – Pension | $3.4 | $5.1 | $8.3 | $9.5 | $11.4 | $13.6 |
| Police Ret. Plan Tier 2 – Ret. Healthcare | $3.0 | $4.1 | $6.7 | $7.6 | $9.2 | $10.9 |
| **Police Retirement Plan Tier 2 – Total** | **$6.4** | **$9.2** | **$15.0** | **$17.1** | **$20.6** | **$24.5** |
| ***Budgetary Contribution Rates*** | *21.6%* | *24.7%* | *24.6%* | *24.6%* | *24.6%* | *24.7%* |
| Fire Retirement Plan Tier 1 – Pension | $71.5 | $74.6 | $79.3 | $85.8 | $89.9 | $88.7 |
| Fire Ret. Plan Tier 1 – Retiree Healthcare | $8.0 | $8.5 | $8.2 | $7.9 | $7.6 | $7.1 |
| **Fire Retirement Plan Tier 1 – Total** | **$79.5** | **$83.1** | **$87.5** | **$93.7** | **$97.5** | **$95.8** |
| ***Budgetary Contribution Rates*** | *103.9%* | *107.9%* | *116.8%* | *129.8%* | *142.0%* | *148.4%* |
| Fire Retirement Plan Tier 2 – Pension | $0.9 | $1.5 | $2.3 | $3.1 | $4.1 | $5.2 |
| Fire Ret. Plan Tier 2 – Retiree Healthcare | $0.9 | $1.1 | $1.6 | $2.3 | $3.0 | $3.8 |
| **Fire Retirement Plan Tier 2 – Total** | **$1.8** | **$2.6** | **$3.9** | **$5.4** | **$7.1** | **$9.0** |
| ***Budgetary Contribution Rates*** | *22.4%* | *26.1%* | *26.1%* | *26.1%* | *26.1%* | *26.0%* |
| **Other Retirement Costs** | $1.0 | $1.0 | $1.0 | $1.0 | $1.1 | $1.1 |
| **Total General Fund** | **$297.6** | **$314.8** | **$329.4** | **$346.4** | **$358.7** | **$352.2** |
| | | | | | | |
| **Total All Funds** | **$386.8** | **$405.6** | **$419.6** | **$442.8** | **$458.0** | **$453.7** |

* City budgetary rates differ from the Federated and Police and Fire Retirement Boards approved rates to reflect the application of the City's methodology to fund the Board approved UAL amounts and the application of a pre-payment of Federated, Police, and Fire Tier 1 member contributions.
** In accordance with the passage of Measure F, Tier 2C members were moved to Tier 1.

Source: 2017-2018 Modified Budget; Cheiron Letters dated February 15, 2018 (Federated) and February 16, 2018 (Police and Fire) and Cheiron presentation slides dated February 15, 2018 (Federated) and March 1, 2018 (Police and Fire).

## EXPENDITURE FORECAST

### TABLE 2 – 2019-2023 BOARD APPROVED CITY CONTRIBUTION RATES

| Retirement Plan | 2017-2018 | 2018-2019 | 2019-2020 | 2020-2021 | 2021-2022 | 2022-2023 |
|---|---|---|---|---|---|---|
| Fed. Ret. System Tier 1 – Pension | 94.0% | 99.2% | 111.3% | 127.1% | 143.1% | 158.7% |
| Fed. Ret. Syst. Tier 1 – Ret. Healthcare* | 9.4% | 6.7% | 6.7% | 6.7% | 6.7% | 6.7% |
| **Fed. Retirement Plan Tier 1 – Total** | **103.4%** | **105.9%** | **118.0%** | **133.8%** | **149.8%** | **165.4%** |
| | | | | | | |
| Fed. Ret. System Tier 2A – Pension | 6.3% | 8.3% | 8.4% | 8.4% | 8.4% | 8.3% |
| Fed. Ret. Syst. Tier 2A – Ret. Healthcare* | 9.4% | 7.4% | 7.2% | 7.3% | 7.0% | 7.2% |
| **Fed. Retirement Plan Tier 2A – Total** | **15.7%** | **15.7%** | **15.6%** | **15.7%** | **15.4%** | **15.5%** |
| | | | | | | |
| Fed. Ret. System Tier 2B – Pension | 6.3% | 8.3% | 8.4% | 8.4% | 8.4% | 8.3% |
| Fed. Ret. Syst. Tier 2B – Ret. Healthcare* | 12.7% | 7.4% | 7.2% | 7.3% | 7.0% | 7.2% |
| **Fed. Retirement Plan Tier 2B – Total** | **19.0%** | **15.7%** | **15.6%** | **15.7%** | **15.4%** | **15.5%** |
| | | | | | | |
| Fed. Ret. System Tier 2C – Pension | 6.3% | 8.3% | 8.4% | 8.4% | 8.4% | 8.3% |
| Fed. Ret. Syst. Tier 2C – Ret. Healthcare* | 12.9% | 7.4% | 7.2% | 7.3% | 7.0% | 7.2% |
| **Fed. Retirement Plan Tier 2C – Total** | **19.2%** | **15.7%** | **15.6%** | **15.7%** | **15.4%** | **15.5%** |
| | | | | | | |
| Police Ret. Plan Tier 1 – Pension | 95.3% | 97.6% | 107.2% | 120.9% | 134.1% | 132.0% |
| Police Ret. Plan Tier 1 – Ret. Healthcare** | 10.3% | 11.3% | 11.3% | 11.3% | 11.3% | 11.3% |
| **Police Retirement Plan Tier 1 – Total** | **105.6%** | **108.9%** | **118.5%** | **132.2%** | **145.4%** | **143.3%** |
| | | | | | | |
| Police Retirement Plan Tier 2 – Pension | 11.3% | 13.7% | 13.6% | 13.6% | 13.6% | 13.7% |
| Police Ret. Plan Tier 2 – Ret. Healthcare** | 10.3% | 11.3% | 11.3% | 11.3% | 11.3% | 11.3% |
| **Police Retirement Plan Tier 2– Total** | **21.6%** | **25.0%** | **24.9%** | **24.9%** | **24.9%** | **25.0%** |
| | | | | | | |
| Fire Retirement Plan Tier 1 – Pension | 96.1% | 98.5% | 107.6% | 120.8% | 133.2% | 139.7% |
| Fire Ret. Plan Tier 1 – Ret. Healthcare** | 10.6% | 10.6% | 10.6% | 10.6% | 10.6% | 10.6% |
| **Fire Retirement Plan Tier 1 – Total** | **106.7%** | **109.1%** | **118.2%** | **131.4%** | **143.8%** | **150.3%** |
| | | | | | | |
| Fire Retirement Plan Tier 2 – Pension | 11.8% | 15.1% | 15.1% | 15.1% | 15.1% | 15.0% |
| Fire Ret. Plan Tier 2 – Retiree Healthcare** | 10.6% | 10.6% | 10.6% | 10.6% | 10.6% | 10.6% |
| **Fire Retirement Plan Tier 2 – Total** | **22.4%** | **25.7%** | **25.7%** | **25.7%** | **25.7%** | **25.6%** |

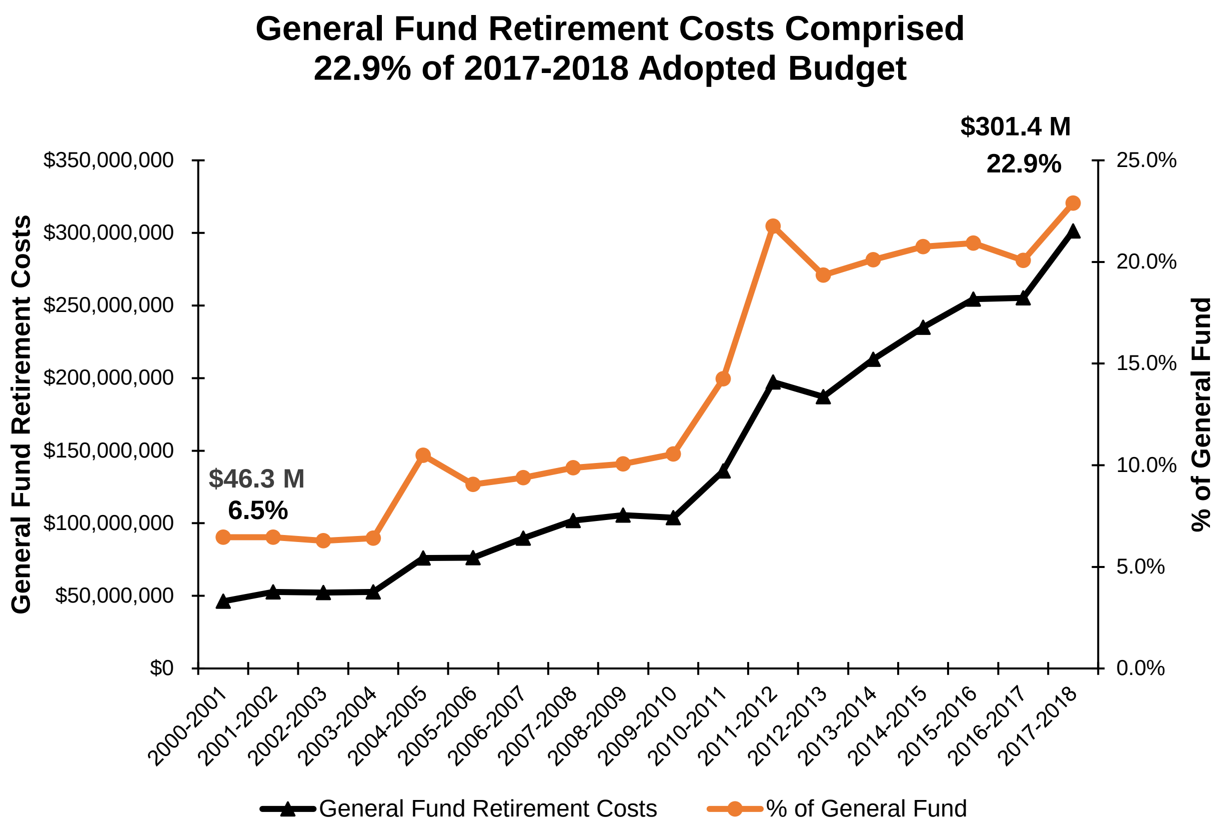
* The Federated Retirement Board approved an annual contribution amount for Retiree Healthcare over a 20-year amortization period. This amount has been converted into percentages as shown above for display purposes.

** The Police and Fire Retirement Board approved an annual contribution amount for Retiree Healthcare over a 25-year amortization period. The amount has been converted into percentages as shown above for display purposes.

Source: Cheiron Letters dated February 15, 2018 (Federated) and February 16, 2018 (Police and Fire) and Cheiron presentation slides dated February 15, 2018 (Federated) and March 1, 2018 (Police and Fire).

## EXPENDITURE FORECAST

It is important to note that retirement costs continue to account for a growing share of the total General Fund budget as shown in the chart below. In 2001-2002, retirement costs of $46.3 million accounted for 6.5% of the General Fund, while in 2017-2018, those costs totaled 22.9% of the General Fund Adopted Budget.




*Health and Other Fringe:*

A projected health rate increase of 5.0% is included in the 2018-2019 Forecast effective January 2019 based on national and City trend information received from the City's Human Resources Department benefits consultant. The annual health increase assumptions are held constant at 5.0% annually for the out-years of the forecast.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, a dental rate increase of 5.0% is anticipated in 2018-2019. For the out-years, the Forecast assumes annual dental rate increases of 3% based on City trends and actuarial analysis. There are no changes to the life insurance rates in this Forecast based on projected provider charges. For the payment of unemployment benefit claims, the City is self-insured. Based on actual claims experienced in 2017-2018, current funding available in the Unemployment Insurance Fund, and projected future claims, an unemployment insurance rate of 0.08% is included in this Forecast.

## EXPENDITURE FORECAST

### Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total $114.0 million in 2018-2019. In general, the process used by the City Manager's Budget Office to calculate this amount includes: adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2017-2018, projecting increases or decreases for specific large non-personal/equipment allocations (e.g., utilities, contractual services, vehicle maintenance and operations costs, and Police Department vehicle replacement) and reviewing past spending patterns and needs. The resulting 2018-2019 estimates represent a decrease of $10.0 million from the 2017-2018 Modified Budget level of $124.0 million, primarily due to the elimination of rebudgeted or carryover projects.

Departmental gas and electricity funding for 2018-2019 totaling $14.5 million has been adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes. Major non-personal/equipment increases are included, primarily in the Information Technology Department for Microsoft Office 365 licenses ($656,000), Parks, Recreation and Neighborhood Services Department for changes in water costs ($538,000), and Library Department for the anticipated increased costs associated with the cost share agreement with San José State University ($340,000). Vehicle maintenance and operations costs in the General Fund, including fuel, inventory, and fleet staffing, total $14.1 million and reflect an increase of $448,000 from the 2017-2018 Adopted Budget, primarily due to increased consumption and fuel costs. The 2018-2019 non-personal/equipment base includes an adjustment for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of $3.7 million to $4.9 million based on the current replacement schedules and projected costs for these vehicles. Police vehicle replacement costs are expected to increase in the remaining years of the Forecast, based on the anticipated replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total $23.3 million.

For the out-years of the Forecast, growth rates ranging from 1.1% to 3.0% have been assumed from the 2018-2019 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. Excluding the police vehicle replacement cost adjustment, the average growth rate for the non-personal/equipment category is 2.0% annually.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

### City-Wide

**City-Wide Expenses** in the first year of the Forecast (2018-2019) total $68.4 million, a decline from the 2017-2018 Modified Budget of $267.5 million. This large reduction primarily reflects the impact of deleting the $150.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; eliminating one-time allocations that were rebudgeted to 2017-2018 ($28.2 million); deleting the Convention Center lease payment of $15.2 million to reflect the recent Successor Agency to the Redevelopment Agency (SARA) bond refunding (offset by a corresponding reduction in the reimbursement from SARA for this payment); and eliminating one-time budget actions ($6.7 million).

The line-items in this category are primarily made up of cross-departmental, large grant, and general city-wide expenditures. The 2018-2019 allocation includes anticipated cost adjustments based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2018-2019 allocations in the City-Wide Expenditures category include: Workers' Compensation Claims ($20.2 million); San José BEST and Safe Summer Initiative Programs ($5.7 million); General Liability Claims ($5.0 million); Sick Leave Payments Upon Retirement ($5.0 million); ESCO Debt Service ($3.1 million); FMC Debt Service Payments ($2.9 million); Banking Services ($2.2 million); Elections and Ballot Measures ($1.9 million); Property Tax Administration Fee ($1.8 million); Sidewalk Repairs ($1.8 million); Public, Educational and Government Access Facilities – Capital ($1.6 million); Homeless Response Team ($1.5 million); Property Leases ($1.5 million); Workers' Compensation State License ($1.2 million); and Tech Museum of Innovation Subsidy ($1.0 million).

In 2019-2020, City-Wide Expenses increase by approximately $4.5 million to $72.9 million, primarily due to the reestablishment of the annual $4.0 million General Fund contribution for Homeless Rapid Rehousing as approved by the City Council with the adoption of the 2017-2018 budget. The Homeless Rapid Rehousing Program is funded by the Multi-Source Housing Fund for two years. In the out-years of the Forecast, City-Wide Expenses are projected to increase minimally at a growth rate range of 1-2%. While the majority of the individual line-items are expected to remain at 2018-2019 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from $21.2 million to $24.4 million), Elections and Ballot Measures (from $1.9 million to $2.1 million), the Property Tax Administration Fee (from $1.9 million to $2.1 million), Property Leases (from $1.6 million to $1.7 million), and Insurance Premiums (increase from $739,000 to $807,000). Debt service of this five-year period remain stable, with both ESCO and FMC debt service remaining at approximately $3 million annually. Funding for many non-grant related City-Wide expenses has stabilized, including ongoing allocations for the San José BEST and Safe Summer Initiative Programs that includes a 3% COLA applied in each year ($5.9 million to $6.4 million).

## EXPENDITURE FORECAST

The General Fund **Capital Projects** category totals $5.6 million in 2018-2019 and remains at this level in each of the out-years of the Forecast. The largest item in this category is fire apparatus replacement ($4.0 million annually), increased from the previous $3.4 million allocation due to an updated analysis of replacement schedules, replacement costs, and apparatus changes to meet safety needs. It also assumes that the Fire Construction and Conveyance Tax Fund will contribute $400,000 annually for these costs over the five-year period. The Capital Projects category also includes the continuation of annual allocations for unanticipated maintenance of City facilities ($900,000), fuel tanks and methane monitoring control and replacement ($350,000, previously at $400,000), annual capital expenditures ($200,000) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building, and Arena repairs ($100,000).

The **Transfers** category totals $33.2 million in 2018-2019 and averages $34.2 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for the construction of City Hall is the largest line-item in this category at $21.5 million in 2018-2019 ($21.7 million in each of the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Hayes Mansion Conference Center ($3.5 million in 2018-2019 and $3.4 million - $3.9 million in the remaining years of the Forecast) and Rancho del Pueblo and Los Lagos Golf Courses ($2.7 million in each year of the Forecast); transfers for Arena capital rehabilitation and enhancements in accordance with the San José Arena Management agreement extension at $2.3 million annually; a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement ($1.2 million annually); and a transfer to the Construction and Conveyance Tax Fund – Communications to support the Silicon Valley Regional Interoperability Authority ($1.0 million in 2018-2019, rising to $1.3 million at the end of the Forecast).

All of the debt service and maintenance and operations costs for the Hayes Mansion Conference Center and golf courses are funded in the Community Facilities Revenue and Municipal Golf Course Funds, respectively; however, revenues in those funds are not projected to be sufficient to completely cover these costs. The transfer from the General Fund for the Hayes Mansion Conference Center in 2018-2019 remains at 2017-2018 levels of $3.5 million, and averages $3.6 million throughout the remaining four years primarily based on projected debt service payments for that facility. The transfer for the golf course subsidy also remains steady with 2017-2018 levels of $2.7 million annually throughout the Forecast.

The payments for Arena capital rehabilitation and enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. In accordance with the term sheet with Sharks Sports and Entertainment approved in May 2015 that alters the City's capital transfer obligations, annual funding increases from $750,000 in 2017-2018 to $2.3 million through 2024-2025.

## EXPENDITURE FORECAST

This Forecast includes transfers to the Service Yards Construction and Conveyance Tax (C&C) Fund to cover Central Service Yards Phase 1 debt service payments ($500,000 annually starting in 2019-2020) as there is not sufficient revenue in that fund to cover all required costs.

The Transfers category also includes payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas ($898,000 to $1.0 million annually).

The **Earmarked Reserves** category totals $1.9 million in 2018-2019 and decreases to $1.1 million in 2019-2020 and throughout the Forecast. This category includes the Deferred Infrastructure and Maintenance Reserve of $800,000 in 2018-2019 to fund critical capital maintenance or address urgent technology needs; these resources will be allocated as part of the 2018-2019 Proposed Budget. The annual allocation to the Cultural Facilities Maintenance Reserve remains at a constant annual contribution of $450,000 throughout the Forecast in accordance with City Council direction included in the 2017-2018 Adopted Operating Budget. In addition, annual funding of $240,000 is allocated to the General Plan Update Reserve to set aside fees collected by developers toward the future update or revision of the General Plan.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2017-2018 and later recommended for rebudget or use in 2018-2019. Some of the larger current Earmarked Reserves include the Development Fee Program Reserves, Budget Stabilization Reserve, Workers' Compensation/General Liability Catastrophic Reserve, Retiree Healthcare Solutions Reserve, Sick Leave Payments Upon Retirement Reserve, Salaries and Benefits Reserve, and Cultural Facilities Capital Maintenance Reserve.

Per City Council policy, the **Contingency Reserve** ($36.5 million) is projected at the level necessary to comply with the City Council policy to maintain a minimum 3% Contingency Reserve and allows for anticipated rebudget adjustments that will be incorporated into the 2018-2019 budget. This amount would be sufficient to cover approximately one pay period of payroll costs (two weeks). This amount steadily increases each year of the Forecast, ending at $41.0 million in 2022-2023 to remain in compliance with the reserve policy.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

### Committed Additions to the Base General Fund Forecast

In this Forecast, projected additions to the base expenditure level have been included as **Committed Additions**. Although all are subject to further review during the budget process, Committed Additions are additional expenditures to which the City is considered to be committed by prior City Council action, such as the costs related to maintaining and operating capital projects previously approved by the City Council. The Forecast Base Case, considered most likely to occur, includes ongoing program costs plus Committed Additions. Committed Additions total $619,000 in 2018-2019 and increase to approximately $1.7 million by 2022-2023. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

The approved bond measure from the November 2000 election for parks (Measure P) includes the Arcadia Softball Complex that will require additional maintenance and operations funding ($381,000 in 2018-2019, increasing to approximately $790,000 in 2022-2023).

Also included in the Committed Additions are maintenance and operations costs associated with non-bond projects such as new parks and recreation facilities and new traffic infrastructure assets. The non-bond projects committed additions costs in the Forecast range from $238,000 in 2018-2019 to $904,000 by 2022-2023.

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

Budget Principle #8 states that Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding $100,000 without City Council certification that funding will be made available in the applicable year of the cost impact. Certification shall demonstrate that funding for the entire cost of the project, including operations and maintenance costs, will not require a decrease in existing basic neighborhood services. Consistent with that direction, this Forecast includes a detailed list and discussion of capital projects that were previously certified by the City Council with annual operating and maintenance costs in the General Fund greater than $100,000. Capital funding for these projects have been included as part of approved Capital Improvement Programs or approved by City Council in 2017-2018. It should be noted that the maintenance and operations costs for the Arcadia Softball Complex (previously titled Softball Complex are estimated to exceed $100,000; however, this projects was established prior to the adoption of Budget Principle #8 and did not need to be certified by the City Council.

## OPERATING MARGIN

The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the Forecast, assuming the Base Case with Committed Additions. In 2018-2019, a deficit of $7.3 million is projected, followed by additional deficits through 2021-2022: $15.5 million in 2019-2020, $8.9 million in 2020-2021, and $10.5 million in 2021-2022. In the final year of the forecast period, 2022-2023, a surplus of $10.8 million is projected. Base Case expenditures, including committed additions, increase from $1.1 billion in 2018-2019 to $1.3 billion in 2022-2023, for an average annual growth rate of approximately 3.3%. The sources of revenue total $1.12 billion in 2018-2019 and grow to $1.25 billion in 2022-2023, increasing at a slightly lower average annual growth rate of 2.9%.

The following table shows how the projected surpluses and shortfalls have changed in the most recent forecasts. It is assumed that each preceding surplus or shortfall is addressed completely with ongoing solutions in the year it appears. Each year of the February 2018 Forecast is compared to the corresponding year in the February 2017 Forecast.

**2019-2023 General Fund Forecast**
**Changes in Operating Margin**
**($ in Millions)**

| | 2018-2019 | 2019-2020 | 2020-2021 | 2021-2022 | 2022-2023 |
|---|---|---|---|---|---|
| **February 2017** Incremental Surplus/(Shortfall) | **($34.8)** | **($11.5)** | **($17.4)** | **($12.8)** | **N/A** |
| **June 2017** Incremental Surplus/(Shortfall) | $0.4 | N/A | N/A | N/A | N/A |
| **February 2018** Incremental Surplus/(Shortfall) | **($7.3)** | **($15.5)** | **($8.9)** | **($10.5)** | **$10.8** |

Note: Does not include 1) costs associated with services that were funded on a one-time basis in 2017-2018; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

For the February 2018 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2018-2019 and the remaining four years of the forecast period. The 2018-2019 projected deficit of $7.3 million reflects an increase from the $416,000 budget deficit projected in June 2017 (2017-2018 Adopted Budget). This change is the net result of numerous revenue and expenditure changes as described in this document.

## OPERATING MARGIN

In the out-years of this Forecast, the General Fund position is better than that presented in the previous Forecast with shortfalls ranging from a deficit of $15.5 million to a surplus of $10.8 million annually. Major factors contributing to this improvement are lower retirement costs and higher growth in several revenue categories, including Property Tax and Business Tax. These margins are extremely narrow when put into context of the size of the projected General Fund budget of over $1 billion.