

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

**SUBJECT: 2010-2011 CITY MANAGER'S
BUDGET REQUEST AND
2011-2015 FIVE-YEAR FORECAST**

DATE: February 28, 2010

INFORMATION

EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council's adopted budget process, this document provides both the recommended 2010-2011 City Manager's Budget Request (Budget Balancing Strategy Guidelines) and the 2011-2015 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. Following are the major highlights of this report:

- A substantial General Fund base budget shortfall of \$116.2 million is now projected for 2010-2011. This shortfall reflects the projected cost of delivering existing services as well as the services for which the City has already committed, such as the operation of new facilities under construction and the addition of 25 police officers for next year. The revised shortfall estimate is well above the already very large shortfall of \$96.4 million projected as part of the Preliminary 2010-2011 General Fund Forecast which was released in October 2009 and far exceeds the \$36.7 million budget gap estimated for 2010-2011 at this time last year (February 2009).
- Almost two-thirds of the 2010-2011 General Fund shortfall of \$116.2 million is attributed to increased expenditures, with decreased revenues accounting for the remaining portion of the shortfall as shown in the following chart.

2010-2011 Shortfall Component	\$ in Millions
Expenditure Changes	
- Increased Retirement Contribution Rates (estimate) (Police/Fire Plans: \$43.6 million; Federated Plan: \$9.3 million)	(\$52.9)
- Increased Expenditures (primarily personnel-related)	(10.2)
- 2010-2011 Committed Additions (new Police Officers/facilities)	(7.5)
- Carry-over from 2009-2010 Adopted Budget	(3.1)
Sub-Total Expenditure Changes	(\$73.7)
Decreased Revenue Estimates	(\$42.5)
Total 2010-2011 Projected General Fund Shortfall	(\$116.2)

- Over the Forecast period, General Fund budget shortfalls are projected for each year and total \$181.6 million over the next five years. Increased retirement plan costs coupled with weak

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economic performance are the primary drivers for the enormous General Fund budget gap facing the City. In 2010-2011 alone, the City contribution rates for the retirement plans (pension and medical costs) are expected to increase significantly from the 2009-2010 contribution rates as follows: increase from 23.12% to 28.70% for the Federated Retirement Plan; increase from 25.92% to 43.64% for the Police Retirement Plan; and increase from 27.29% to 45.48% for the Fire Retirement Plan. These retirement plan contributions are expected to increase \$52.9 million in 2010-2011 and will total 17% of the General Fund base budget. To put these costs into perspective, for every \$100 of salary paid to an active Federated employee, an additional \$29 will go toward paying for retirement costs in 2010-2011. For employees in the Police and Fire Retirement Plans, these costs will total approximately \$44 to \$45 for every \$100 of salary in 2010-2011. The retirement costs are expected to continue to increase substantially over the Forecast period and by 2014-2015, these costs will represent almost 25% of the total General Fund base budget. By 2014-2015, for every \$100 in salary, \$43 and \$72 will be allocated to retirement plan costs for the Federated and Police/Fire Retirement plans, respectively.

- 2010-2011 is the ninth consecutive fiscal year for which budget actions will be necessary to address a General Fund shortfall and represents the most significant gap in recent history. The severity of this shortfall as well as the continuing budget gaps expected over the Forecast period are sobering and will require bold actions to balance the General Fund budget. In one of the first such steps, I will be urging an acceleration of pension/retiree health care reform as one of the major elements needed to ensure long-term sustainability of the City's cost structure. This, however, will not address the immediate fiscal challenges for 2010-2011.
- In October 2009, the Preliminary 2010-2011 General Fund Forecast projected a shortfall of \$96.4 million in 2010-2011. This shortfall figure has increased \$19.8 million to \$116.2 million due to downward adjustments to revenue estimates of \$8.2 million and increases to the base expenditure budgets of \$11.6 million. Revenue estimates for 2010-2011 have been adjusted downwards based on an analysis of current revenue performance and the continued impacts of the severe economic downturn. Expenditure adjustments primarily reflect an additional increase to the City's required contribution rates for the Federated, Police, and Fire Retirement Plans (\$14.7 million; Police/Fire - \$11.1 million; Federated - \$3.6 million), partially offset by lower expenditure budgets in other areas (\$3.1 million) that reflect updated information and a more in-depth review of base costs.
- Approved in the 2009-2010 Adopted Budget, the Forecast incorporates service reductions or eliminations totaling \$7.5 million and the elimination of 77.9 positions effective July 1, 2010.
- In this Forecast, a 2% cost-of-living salary increase has been included in 2010-2011 for employees represented by the Municipal Employees' Federation (MEF) and Confidential Employees' Organization (CEO) as approved in their contract agreement with the City, resulting in increased General Fund costs of \$2.4 million. The only other salary increases in this Forecast are salary step increases related to eligible non-management employees, with an estimated General Fund cost of \$2.5 million in 2010-2011. There are no cost-of-living salary increases assumed in 2010-2011 for any other employee groups, reflecting the fact that there are no other negotiated agreements covering this period. It also needs to be emphasized that

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no salary adjustments for any employees are factored into the out years of the Forecast. The consideration of salary increases is being treated in this Forecast as a resource allocation policy decision. At current rates, each 1% increase in salary for all employees has a General Fund cost of \$5.8 million.

- It is important to note that this Forecast does not reflect: the impact of unanticipated compensation changes resulting from negotiations or arbitration awards, where applicable, with the City's various employee bargaining groups; potential State budget actions; funding for unmet/deferred infrastructure and maintenance needs; potential impacts from San Jose Redevelopment Agency budget balancing actions; and one-time revenue sources or one-time expenditure needs. In addition, any gaps between revenues and expenditures in the Planning, Building, Public Works or Fire Development Fee Programs are not reflected. It is assumed that these programs will be adjusted to recover 100% of their costs.
- As is customary in the Forecast, two alternative forecasts have been developed to model the range of financial scenarios possible under varying economic conditions. "Optimistic" and "Pessimistic" Cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". In 2010-2011, the projected deficits range from \$112.1 million to \$126.6 million, with the Base Case totaling \$116.2 million.
- In approaching the 2010-2011 budget, the Administration proposes the use of the budget balancing strategy guidelines (2010-2011 City Manager's Budget Request) outlined in this memorandum. The City Council priorities identified in prior policy sessions will also guide the City's balancing strategy efforts. In addition, the Program Dictionary and Pilot Program Prioritization effort will inform the development of the 2010-2011 Proposed Budget. The Administration recommends City Council approval of the proposed City Manager's Budget Request (Budget Balancing Strategy Guidelines), with any desired revisions, as part of the Mayor's March Budget Message review process.
- When the unmet/deferred infrastructure and maintenance needs are added to the Base General Fund shortfall, the City's General Fund Structural Deficit is expected to total \$124.3 million in 2010-2011 and reach \$222.3 million over the Forecast period. Given the severity of the General Fund base budget shortfall for 2010-2011 and the significant changes that will be necessary to balance this budget, the General Fund Structural Deficit Elimination Plan, which was last updated in February 2009, has not been revised as part of this document. The plan is still a relevant guide for eliminating the structural deficit and many of the strategies outlined in General Fund Structural Deficit Elimination Plan are being pursued as part of the 2010-2011 budget process. This plan will be updated after the extensive budget actions necessary to balance the current budget are approved to provide a revised starting point to address this deficit.
- Also detailed in this document, construction-related Capital Program revenues are projected to decline significantly from the estimates provided in the 2010-2014 Adopted Capital Improvement Program due to the steep declines in development activity.

EXECUTIVE SUMMARY (CONT'D.)

- While this Forecast focuses on the General Fund and key revenues that support the City's Capital Improvement Program, many other City funds are expected to be negatively impacted by escalating costs and, in some cases, declining revenues. This is particularly the case for the Airport funds, which are expected to face severe financial challenges over the next several years. Increased costs may necessitate rate increases in those funds supported by rate-payers to maintain existing service levels.

BACKGROUND

In compliance with City Charter Section 1204, and the City Council's adopted budget process, this document provides both the recommended 2010-2011 City Manager's Budget Request (Budget Balancing Strategy Guidelines) and the 2011-2015 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process, and critical steps in the development of both the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP).

The City Manager's Budget Request includes budget balancing strategy guidelines that the Administration recommends be used in developing the 2010-2011 Proposed Budget. These guidelines are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's anticipated fiscal status for 2010-2011 is an integral part of the Administration's proposed approach to preparing the 2010-2011 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2010-2011, and the subsequent four years, is provided as part of the 2011-2015 Five-Year Forecast and Revenue Projections section of this document.

ANALYSIS

This overview includes the following: a discussion of the 2010-2011 City Manager's Budget Request, including a description of the proposed budget balancing guidelines; an overview of the 2011-2015 Five-Year Forecast and Revenue Projections; a summary of the Capital Revenue Forecast; and a description of the next steps in the 2010-2011 budget process.

2010-2011 CITY MANAGER'S BUDGET REQUEST

This document provides a set of budget balancing strategy guidelines (these encompass the 2010-2011 City Manager's Budget Request) recommended by the City Administration for use in preparing the 2010-2011 budgets for the General Fund and selected Capital Funds. The proposed guidelines contained in the 2010-2011 City Manager's Budget Request have been formulated in the context of projections for substantial General Fund shortfalls throughout the Forecast period. With weak revenue growth and significant increases in projected retirement costs, expenditure levels of existing General Fund programs are expected to exceed revenue sources in all years of this Forecast. It is important to note that a 2% cost-of-living salary

ANALYSIS (CONT'D.)

2010-2011 CITY MANAGER'S BUDGET REQUEST (CONT'D.)

increase has been included in 2010-2011 for employees represented by the Municipal Employees' Federation (MEF) and Confidential Employees' Organization (CEO) as approved in their labor agreement with the City. With the exception of salary step increases related to eligible non-management employees, these are the only salary increases assumed in this Forecast reflecting the fact that there are no other negotiated agreements covering this period. Approval of any negotiated salary or benefit increases in those years, without any offsetting increase in revenues or reduction in costs, will have the effect of driving up the City's shortfall. The consideration of salary increases is being treated as a resource allocation policy decision. This decision will need to be made in the context of what is affordable in light of the City's many service delivery priorities and the large shortfalls projected.

This forecast updates the October 2009 Preliminary General Fund Forecast that projected a \$96.4 million shortfall next year. The updated projections indicate an even larger General Fund base shortfall of \$116.2 million in 2010-2011. Over the five-year forecast period, the General Fund base shortfalls are expected to total \$181.6 million. The City is required to address these shortfalls each year in order to develop a balanced budget. The base shortfall figures, however, do not include the unmet/deferred infrastructure and maintenance needs that are included in the broader General Fund Structural Deficit definition. Once those costs are added, the General Fund structural budget deficit climbs to \$222.3 million over the next five years. These additional costs, while not required to be addressed in the annual budget, represent a long-term unfunded need.

Projections for the selected Capital Improvement Program (CIP) revenues included in this Forecast have also been adjusted downwards significantly from the last Forecast. Large downward adjustments are recommended for the major development-related capital budget revenues (which primarily support the Traffic Capital Budget) based on the dismal performance in these areas and the development activity projections provided by the Planning, Building and Code Enforcement Department. For the Construction and Conveyance (C&C) Tax, which supports a number of capital programs, it is anticipated that collections will remain relatively flat over the Forecast period at a level that is less than half of the revenue collected at the peak in 2005-2006. As noted above, the Administration proposes the use of the budget balancing strategy guidelines (2010-2011 City Manager's Budget Request) outlined on the following page to approach the 2010-2011 budget development process. As part of the 2010-2011 Mayor's March Budget Message, the Administration requests confirmation of these guidelines, with any desired revisions. These guidelines incorporate both short-term and long-term approaches to budget balancing efforts and reflect the City's sound fiscal principles.

The Proposed Budget Balancing Strategy Guidelines are similar to those adopted by the Mayor and City Council last year as part of the 2009-2010 Mayor's March Budget Message. A few modifications, however, have been incorporated into the proposed strategies to address City Council direction and to continue to position the City to address the significant General Fund shortfalls projected over the Forecast period. For example, Budget Balancing Strategy Guideline

ANALYSIS (CONT'D.)

2010-2011 CITY MANAGER'S BUDGET REQUEST (CONT'D.)

#3 has been added to reflect the current City Council direction to develop strategies to address the projected 2010-2011 General Fund shortfall targeted equally in the following three areas: one-third from employee wage and benefit concessions, one-third from revenues; and one-third from one-time revenues, alternative service delivery proposals and efficiencies in operations (with a request to refrain from using one-time revenues for budget balancing, but instead for one-time needs; and to consider renegotiating existing service contracts to reduce costs). If the shortfall can not be covered with these three categories, service reductions/eliminations will be used to address any gaps. At the City Council/Senior Staff Study Session on 2010-2011 Budget Planning held on February 16, 2010, it was discussed that the 1/3, 1/3, 1/3 strategy would most likely not be attainable due to difficulties in generating substantial additional revenue without bringing forward new taxes that require voter approval at the June 2010 election and the meet and confer requirements associated with employee concessions. It was acknowledged that service reductions and eliminations will be necessary to fill the remaining budget gaps. In addition, the projected budget shortfall has now increased from \$96.4 million to \$116.2 million, further impacting the City's ability to meet these targets.

Budget Balancing Strategy #7 adds the new Program Mapping and Program Prioritization process as tools to identify alternative service delivery opportunities and services that should be reduced or eliminated. Budget Balancing Strategy Guidelines #12 was also added to focus on the importance of analyzing non-personal/equipment and other costs, including consultant services for cost savings opportunities.

In addition to the Budget Balancing Strategy Guidelines, City Council priorities and goals identified in prior policy sessions will guide the City's budget balancing efforts. Input from the community through community surveys, various City Councilmember and stakeholder outreach activities, and the San José Neighborhood Association/Youth Commission 2010-2011 Priority Setting Session will serve as an important tool in this process. In January 2010, the Administration also released the 2010-2011 Base Budget Program Dictionary, which provides a listing and basic description of over 550 discrete programs provided by the City as reflected in the 2010-2011 Base Budget, including program cost, staff, and associated resources managed. These programs were then prioritized as part of a pilot Program Prioritization effort and the results were distributed as a reference document for the February 16, 2010 City Council/Senior Staff Study Session on the 2010-2011 Budget Planning. It is anticipated that feedback from these efforts will be incorporated into the Mayor's March Budget Message and the 2010-2011 Proposed Budget.

ANALYSIS (CONT'D.)

2010-2011 CITY MANAGER'S BUDGET REQUEST (CONT'D.)

2010-2011 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of essential services to the community with the resources available.
2. Every effort should be made to resolve the projected budget deficit with ongoing revenue and expenditure solutions to ensure no negative impact on future budgets to maintain the City's high standards of fiscal integrity and financial management.
3. Develop strategies to resolve the projected 2010-2011 General Fund shortfall targeted equally in the following three areas: one-third employee wage and benefit concessions; one-third from revenues; one-third from one-time revenues, alternative service delivery proposals and efficiencies in operations (with a request to refrain from using one-time revenues for budget balancing, but instead for one-time needs; and to consider renegotiating existing service contracts to reduce costs). If the shortfall can not be covered with these three categories, service reductions/ eliminations will be used to address any gaps.
4. Engage the community and employees for generation of budget balancing ideas.
5. Explore expanding and/or redirecting existing revenue sources and/or adding new revenue sources for addressing both the General Fund structural deficit and unfunded needs as outlined in the General Fund Structural Deficit Elimination Plan and related updates to the Plan.
6. Use fee increases to assure that operating costs are fully covered by fee revenue and explore opportunities to establish new fees for services, where appropriate.
7. Focus on protecting vital core City services for both the short- and long-term. Analyze all existing services and target service reductions or eliminations in those areas that are least essential. To the extent possible, use the Analytical Framework for Service Reductions/Eliminations, Program Mapping, and results from the Program Prioritization process to assist in identifying alternative service delivery opportunities and services that should be reduced or eliminated.
8. Explore alternative service delivery models (e.g., partnerships with the non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use our resources more efficiently and effectively. The City Council Policy on Service Delivery Evaluation will serve to provide a decision-making framework for evaluating a variety of service delivery models.
9. Focus on business process redesign to improve employee productivity and the quality, flexibility, and cost-effectiveness of business practices (e.g., streamlining and simplifying City operations) through engagement of employees and use of technology.
10. Make every effort, if operationally feasible, to eliminate vacant positions, rather than filled positions, to minimize the number of employee layoffs. As programs are reduced or eliminated, ensure that management and administration are reduced accordingly.
11. Explore personal services cost savings, subject to the meet and confer process where applicable, by 1) considering further incorporation of total compensation bargaining concepts into the meet and confer process and focusing on all personal services cost changes (e.g., salary step increases, benefit cost increases), 2) civilianizing sworn positions, 3) exploring alternate benefit structures for new employees, and 4) changing employee/retiree health care benefit plan designs.
12. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
13. Defer any new program commitments and initiatives or program expansions, unless those programs stimulate the local economy, job creation, new revenues, have a significant return on investment for the General Fund, and/or are funded through redeployment of existing resources.
14. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.

ANALYSIS (CONT'D.)

2010-2011 CITY MANAGER'S BUDGET REQUEST (CONT'D.)

In light of the current forecasted budgetary situation, the Administration directed each of the six current City Service Areas (CSAs) (Community and Economic Development, Environmental and Utility Services, Neighborhood Services, Public Safety, Transportation and Aviation Services, and Strategic Support) to develop 2010-2011 budget proposals using these guidelines. For planning purposes, General Fund budget reduction targets were set at 7.5% of General Fund Base Budget amounts for the Public Safety CSA and 35.3% for the remaining five CSAs (adjusted for reimbursement-related costs and costs beyond the control of the CSA). These targets were set at levels to generate approximately \$100 million in General Fund proposals. Based on the revised General Fund shortfall figure of \$116.2 for 2010-2011, additional budget proposals are likely to be necessary to close the budget gap.

The Mayor is scheduled to issue a proposed March Budget Message on March 12, 2010, which will then be discussed, amended if necessary, and adopted by the City Council. The contents of that Message will provide specific guidance for the preparation of the City Manager's 2010-2011 Proposed Capital and Operating Budgets currently scheduled to be submitted on April 19, 2010 and May 3, 2010, respectively. As required by City Charter, those Proposed Budgets will contain comprehensive plans for how the City organization will address the highest priority needs of the community while maintaining the fiscal integrity of the City. Given the magnitude of the shortfall, significant service reductions and eliminations are expected to be necessary.

After the release of the Proposed Budgets, there will be a series of Proposed Budget Study Sessions and Public Hearings to discuss the budget proposals and the associated impacts on performance measures and service delivery. The Administration will also work with the City Council to provide informational meetings on the Proposed Budget in each City Council District in March and April 2010. Additional input by the City Council and community will be incorporated into the budget through these Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message during the months of May and June 2010.

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS

The 2011-2015 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with information regarding the projected General Fund operating margin for each of the five years included in the forecast period.
2. **Base General Fund Forecast** – The forecast model is presented in this section. It includes projections for each of the General Fund revenue and expenditure categories. The expenditure summary is divided into two sections:

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

- *Base Case without Additions* – This section describes projections associated with existing expenditures only.
- *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed by previous Council direction and has less discretion, such as maintenance and operating costs for capital projects scheduled to come on-line during the next five years.

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

3. **Committed Additions to the Base General Fund Forecast** – This section describes the committed additions considered in the Forecast, including the financial impact in each year of the Five-Year Forecast. This section also includes a discussion of Budget Principle #8, which pertains to capital projects with General Fund operating and maintenance costs in excess of \$100,000.
4. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an Optimistic Case and a Pessimistic Case that modify the revenue assumptions. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.
5. **Capital Revenue Forecast** – This section describes the estimates for construction and real estate related revenues that are major sources of funding for the City's Five-Year Capital Improvement Program.

Two appendices are also included in this document. The first appendix, prepared by the Planning, Building and Code Enforcement Department, documents the basis for that department's five-year projections for construction activity. The second appendix provides descriptions of the City's major General Fund revenue categories.

2011-2015 Five-Year General Fund Forecast

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative shortfall. In addition to the cumulative shortfall, the incremental shortfall (assuming each preceding deficit is solved completely with ongoing solutions in the year it appears) for each year of the forecast is included. Because it is the City's goal to solve each deficit with ongoing solutions, the incremental shortfall figure is useful in that it shows the additional shortfall and/or surplus attributed to a particular fiscal year. If those shortfalls are not solved with ongoing solutions, however, the remaining budget gap will carry over to the following year.

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ANALYSIS (CONT'D.)**2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)**

**2011-2015 GENERAL FUND FIVE-YEAR FORECAST
BASE BUDGET SHORTFALL
(\$ in Millions)**

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
Projected Revenues	\$790.1	\$816.1	\$847.8	\$879.4	\$911.8
Projected Expenditures	\$906.3	\$952.4	\$1,002.1	\$1,055.2	\$1,093.4
Total Cumulative Shortfall	(\$116.2)	(\$136.3)	(\$154.3)	(\$175.8)	(\$181.6)
Total Incremental Shortfall	(\$116.2)	(\$20.1)	(\$18.0)	(\$21.5)	(\$5.8)

The fiscal outlook for the City reflected in this Forecast is worse when compared to both the Preliminary 2010-2011 General Fund Forecast released in October 2009 and particularly the final 2010-2014 General Fund Forecast that was issued in February 2009. It should be noted again that this Forecast does not presume cost-of-living salary increases in any of the years beyond that currently committed to for two bargaining groups for 2010-2011.

It is also important to note that the service reductions and eliminations under consideration to address the 2010-2011 General Fund budget shortfall do not include the service reductions and eliminations that are effective July 1, 2010 as approved by the City Council through the 2009-2010 budget process. These service reductions/eliminations are identified in the table below.

Service	Savings	Positions
Six Satellite/Neighborhood Center Closures	\$1,710,000	23.04
Horse Mounted Unit Elimination	1,330,000	8.00
Branch Library Hours Reduction (8 hours less)	1,199,000	16.40
Crime Prevention Unit Reduction *	673,000	6.00
Convention and Visitors' Bureau Subsidy	337,000	
Strong Neighborhoods Initiative Staffing **	321,000	9.94
Central Service Warehouse Concourse	300,000	5.00
Wellness Program Pilot for City Employees	300,000	2.00
Transfer to Convention/Cultural Affairs Fund	250,000	
Community Based Organizations Reduction (additional 8%)	210,000	
Dr. Martin Luther King Jr. Library Service Point Reductions	190,000	2.50
Mexican Heritage Plaza Maintenance and Operations	156,000	
Audit Staffing Reduction	130,000	1.00
Rose Garden Maintenance Reduction	126,000	1.96
Police Management Consolidation	125,000	1.00
Fire Data Management Staffing	119,000	1.00
Total	\$7,476,000	77.84

* Per City Council approval of the Mayor's June Budget Message for 2009-2010, prior to implementing the Crime Prevention Unit Reduction, the City Manager was to explore and report to the Public Safety, Finance and Strategic Support Committee on alternative service delivery models. This report was approved at the February 2010 Committee Meeting.

** This reduction includes the reduction of expanded Neighborhoods Initiative Staffing funded in 2009-2010 through a reduction of the Neighborhood Investment Fund Earmarked Reserve.

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

Major changes to the assumptions for revenue and expenditure growth have been incorporated into the Forecast, reflecting the impact of the deep global recession and updated expenditure information. The first two quarters of 2009 continued the precipitous economic contraction that began in 2008, with drops in Gross Domestic Product (GDP) of 6.4% and 0.7%. In the last two quarters of 2009, the national economy began to grow again with GDP increases of 2.2% and 5.9%, respectively, at least partly attributable to the Federal stimulus program. Although the turn-around in economic growth is heartening, the damage to households has been profound and is continuing. City revenues can not be expected to recover significantly for several years.

Since the start of the recession in December 2007, payroll employment nationwide has fallen by 8.4 million and the January 2010 national unemployment rate stood at 10.6% (not seasonally adjusted). In the San José region, the number of jobs dropped by 36,200 in 2009, and the unemployment rate reached 12.1% in August before dropping back to 11.5% in December. The median price for single family homes within San José dropped to a low of \$410,000 in April and May 2009, a level not seen since January 2000, before recovering to \$481,100 in January 2010 (still far below the January 2008 median price of \$664,000). It may be the case that the economy has turned the corner, but from the perspective of households the future still remains uncertain.

That uncertainty is evidenced by the disappointing results of The Conference Board Consumer Confidence Index for February 2010. The Index declined sharply in February and, according to Lynn Franco, Director of The Conference Board Consumer Research Center, "Concerns about current business conditions and the job market pushed the Present Situation Index [one component of the Consumer Confidence Index] down to its lowest level in 27 years.... Consumers also remain extremely pessimistic about their income prospects. This combination of earnings and job anxieties is likely to continue to curb spending."

Given the uncertain economic environment and the expectation that the after-effects of the severe recession will continue to impact this region through at least 2010 and probably beyond, a number of revenue categories have been adjusted downwards as part of the Forecast. The Preliminary 2010-2011 General Fund Forecast issued in October 2009 incorporated downward revenue adjustments of \$34.2 million from the estimates developed in February 2009, updated for 2009-2010 Adopted Budget actions, highlighting the significant shift in the City's economic situation over the last year. This final Forecast includes additional downward revenue revisions of \$8.2 million from the Preliminary Forecast, for a total drop of \$42.4 million.

When comparing to the February 2009 Forecast, the largest declines are in the Sales Tax (-\$17.1 million), Other Licenses and Permits (-\$6.2 million), Property Tax (-\$5.8 million), Money and Property (-\$5.2 million), and Overhead Reimbursements (-\$3.2 million) categories. The large decline in the Other Licenses and Permits category is primarily due to drastic reductions in the Fire and Building Development Fee Programs and reflects the sharp drop-off of development activity. The only large increase from the February 2009 Forecast was in the Utility Tax (\$5.0 million) category, reflecting anticipated electric, gas, and water rate increases as well as a

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

significant increase in Telephone Utility Tax collections due to the November 2008 ballot measure which modernized the Telephone Utility Tax.

On the expenditure side, several upward and downward adjustments have been incorporated into this Forecast. The most significant change includes the projected increase in the City's retirement contributions assumed for 2010-2011. In March 2009, after the release of the February 2009 Forecast, a very preliminary estimate on the increase in the City's retirement contributions for 2010-2011 totaled \$51.7 million. The estimated impact was reduced to \$38.2 million in the Preliminary 2010-2011 General Fund Forecast issued in October 2009 based on revised preliminary estimates from the Retirement Department. In this Forecast, these estimates have again been revised and result in a total increase of \$52.9 million (\$43.6 million for Police/Fire and \$9.3 million for Federated) for 2010-2011. It is important to note that these preliminary contribution rates are still not final and have not yet been approved by the two retirement boards (approval expected March 2010). To the extent the final rates approved by the retirement boards vary from these projections, the General Fund costs are expected to change by \$2.4 million for the Police and Fire Retirement Plans and by \$1.7 million for the Federated Retirement Plan for every 100 basis point change in the rates.

Other expenditure adjustments have been factored into the Forecast, including MEF and CEO negotiated salary increases, health rate increases, increased costs due to lower budgeted vacancy factors, projected unemployment cost increases, increased workers' compensation claims payments, and increased transfers to other funds (Hayes Mansion). These higher costs are partially offset by miscellaneous expenditure savings primarily in the areas of debt service costs, utility costs, fuel costs, and development fee program costs. Since the release of the Preliminary Forecast, these costs are slightly lower due primarily to lower utility and fuel costs, and lower debt service costs for City Hall and the Airport West properties.

The four out-years of the forecast have changed dramatically to reflect the retirement plans' actuaries' projected change in retirement rates. In the past, retirement rates were adjusted every two years after actuary studies were completed and due to the volatility of retirement rates, no specific predictions for the retirement rate contribution adjustments were assumed in the out-years of the Forecast. Due to steep declines in the global financial markets negatively impacting performance in the two retirement systems as well as the impacts of actuarial assumption changes, the rates are projected to increase significantly. Rates in the Federated Retirement Plan in 2010-2011 are proposed to increase to 28.70% (from 23.12% in 2009-2010) and up to 43.42% in 2014-2015. Even greater increases are projected in the Police/Fire Retirement Plan with rates increasing to 43.64% and 45.48% for Police and Fire, respectively (from 25.92% and 28.34%) and up to a staggering 72.05% in 2014-2015. In 2014-2015, the General Fund base budget retirement costs would increase to \$271.4 million (up from 2010-2011 of \$155.5 million) and would represent almost 25% of the total General Fund base budget.

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

It does need to be noted that the projected General Fund shortfall for 2010-2011 does not factor in impacts from the four Development Fee Programs (Building, Fire, Planning, and Public Works). These programs are designed to be 100% cost recovery and have been programmed to have a neutral impact on the Forecast by adjusting the revenue and costs to be equal. In each of these programs, Building, Planning, Public Works, and Fire, there are gaps between the projected revenues and expenditures. The Administration will be working with the development community to develop recommendations to close these gaps through a combination of fee adjustments and cost reductions.

The incremental changes in this Forecast range from a deficit of \$116.2 million in 2010-2011 to a deficit of \$5.8 million in 2014-2015. Consistent with prior forecasts, expenditure growth continues to outpace revenue growth. Caution is in order, however, when considering the significance of out-year projections. Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the significance of the projections in the out-years is not so much in terms of their absolute amounts, but rather in the relative size of the decrease or increase from the prior year. This information should be used to provide a multi-year perspective to budgetary decision-making, rather than as a precise prediction of what will occur. This is particularly the case in this Forecast given the extreme level of uncertainty regarding future economic performance and the absence of projected salary cost-of-living adjustments in the Forecast.

General Fund Committed Additions

Cost estimates for a number of specific "Committed Additions" that address previous City Council direction are included in this Forecast in the years that they are projected to be required. The Committed Additions category, summarized in the chart below, primarily reflects projected additional funding required for additional Police Officers and operating and maintenance costs for new capital projects in the 2010-2014 Adopted Capital Improvement Program. The costs of the additions, which total \$7.5 million in 2010-2011 and \$28.6 million by the end of the Forecast period, are obviously a significant component of the City's projected General Fund deficits during these years.

ANALYSIS (CONT'D.)**2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)****2011-2015 General Fund Committed Additions**

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
Additional Police Officers (25 positions/year through 2011-	\$ 1,647,000	\$ 5,419,000	\$ 8,050,000	\$ 8,862,000	\$ 9,533,000
County Pocket Annexations (Transportation)	180,000	180,000	180,000	180,000	180,000
New Parks and Recreation Facilities Maintenance & Operations	828,000	1,356,000	2,207,000	2,904,000	3,234,000
New Traffic Infrastructure Assets Maintenance & Operations	111,000	274,000	380,000	479,000	577,000
Measure O (Library) Maintenance & Operations	2,420,000	4,629,000	5,621,000	6,186,000	6,255,000
Measure P (Parks) Maintenance & Operations	828,000	1,281,000	2,211,000	2,259,000	2,307,000
Measure O (Public Safety) Maintenance & Operations: Fire	40,000	815,000	3,186,000	3,488,000	3,737,000
Measure O (Public Safety) Maintenance & Operations: Police	1,464,000	2,522,000	2,601,000	2,690,000	2,761,000
Total	\$7,518,000	\$16,476,000	\$24,436,000	\$27,048,000	\$ 28,584,000

There are no new Committed Additions that have been added when compared to the February 2009 Forecast. As approved by the City Council in the 2008-2009 Adopted Operating Budget, the addition of 25 Police Officers in 2010-2011 and 2011-2012 (50 total) is included in this category. The cost of these positions is projected at \$1.6 million in 2010-2011 based on a January 2011 start date in the Police academy (\$3.7 million full year cost) and is expected to increase to \$9.5 million by 2014-2015.

Operating and maintenance costs related to currently budgeted capital projects are expected to total \$5.7 million in 2010-2011 and increase to \$18.9 million by 2014-2015. Some of the larger facilities expected to come on-line during this forecast period include the South San José Police Substation; Fire Station 37 (Silver Creek/Yerba Buena Road), Seven Trees Community Center and Library, Southeast Branch Library, Soccer Complex, and Bascom Library and Community Center. A detailed listing of all capital project operating and maintenance costs included in this 2011-2015 General Fund Forecast can be found in the Committed Additions Section of this document.

General Fund Capital Operating and Maintenance Costs/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. 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. Funding for these projects have been included as part of

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

approved Capital Improvement Programs or Redevelopment Agency Budgets. The majority of these costs are associated with the voter-approved General Obligation bonds for Park, Library, and Public Safety facilities. The operating and maintenance costs for these facilities are included in the figures presented in this General Fund Forecast.

In addition, one additional potential project (Vietnamese Heritage Garden) where funding has not yet been certified has been identified. This project is under very preliminary development and if approved, is anticipated to have an annualized operating and maintenance impact of \$198,000 by 2014-2015. Consistent with the direction approved as part of Budget Principle #8, for purposes of this Forecast, the operating and maintenance cost for this project is not included as part of the General Fund Five-Year Forecast "Committed Additions" category. Certification for this project and other identified projects that have not been certified by the City Council may be sought as part of the 2011-2015 Proposed Capital Improvement Program. If certified by the City Council, the operating and maintenance costs associated with these facilities would then be included in subsequent General Fund Five-Year Forecast documents.

Alternative Forecast Scenarios

In order to model the range of financial scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the "Base Case". "Optimistic" and "Pessimistic" cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". These alternatives are presented to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario and is being used for planning purposes for the 2010-2011 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios.

The Optimistic Case assumes a quicker and more robust recovery than the Base Case. When compared to the Base Case scenario, Gross Domestic Product (GDP) increases substantially, more jobs are created, and the unemployment rate is significantly lower. The increased economic activity also results in higher inflation than assumed in the Base Case. The combination of higher employment and higher inflation results in increased collections in the economically sensitive revenue categories, such as Property Tax and Sales Tax.

By the end of the five-year period, revenues under this scenario would be \$48.4 million higher than in the Base Case. In the Optimistic Case, the City would experience annual deficits ranging from \$5.1 million to \$112.1 million in the first four years of the Forecast, but would have a surplus of \$7.4 million in the last year, assuming the deficits in the previous years were solved with ongoing solutions.

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

The Pessimistic Case, alternatively, attempts to model the potential outcome of a deeper and longer-lasting recession. Under this scenario, job growth is delayed and then recovers more slowly, the unemployment rate stays high longer, and housing prices remain low with sluggish sales activity. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would continue to be severely impacted by the high unemployment rates, very low consumer confidence, low inflation, and falling home prices. By the end of the five-year period, revenues under this scenario would be \$58.7 million lower than in the Base Case. In the Pessimistic Case, there are annual deficits in each year of the Forecast ranging from \$126.6 million in 2010-2011 to \$16.7 million in 2014-2015.

Revenues/Expenditures Not Reflected in Forecast Model

It is important to note that there are a number of significant factors that may well impact the City's General Fund condition during the five-year period that are not reflected in this forecast model. These include the following:

- *Negotiated Labor Agreements:* As discussed previously, there are no cost-of-living salary increases assumed in this Forecast unless there are approved contract agreements with the employee bargaining groups. In this Forecast, the only salary adjustments include a 2% cost-of-living salary increase in 2010-2011 for employees represented by the Municipal Employees' Federation (MEF) and Confidential Employees' Organization (CEO) as approved in their contract agreement with the City. It is also important to note that the City and the International Association of Firefighters (IAFF), Local 230 whose contract expired June 30, 2009, are proceeding to binding interest arbitration, and the City and the Association of Building, Mechanical and Electrical Inspectors (ABMEI) whose contract expired December 10, 2009, are at impasse in negotiations. This Forecast does not assume that any additional costs would result from the outcome of those negotiations.
- *Unmet/Deferred Infrastructure and Maintenance Needs:* The ongoing General Fund costs for unmet/deferred infrastructure and maintenance needs are expected to total \$8.1 million to \$8.2 million annually and reach \$40.7 million over the five-year period. This figure does not include the one-time backlog of approximately \$821 million, of which \$446 million is in the General Fund.
- *State Budget Actions:* The Forecast does not assume any financial impact from State budget balancing actions that may negatively impact the City.
- *San Jose Redevelopment Agency Funding:* The Forecast assumes continued San Jose Redevelopment Agency funding for City support services as well the reimbursement for the Convention Center debt service payment. Given the fiscal challenges facing the Redevelopment Agency, it is likely that funding budgeted for City support services will be reduced in 2010-2011. The proposed funding levels for 2010-2011 will be refined and updated based on discussions with the Redevelopment Agency. Any corresponding budget

ANALYSIS (CONT’D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT’D.)

proposals based on these discussions will be brought forward for City Council consideration as part of the 2010-2011 Proposed Operating and Capital Budgets. Consistent with the City Council/Redevelopment Agency Board approval of the Mayor’s Budget Message Fiscal Year 2009-2010 Redevelopment Agency Capital and Operating Budget and 2010-2015 CIP on December 15, 2009, the Administration’s goal will be to minimize any General Fund impacts from those potential actions.

- *One-Time Revenues/Expenses:* Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding sources or one-time expenditure needs.

General Fund Structural Deficit Elimination Plan

Given the severity of the General Fund budget shortfall for 2010-2011 and the significant changes that will be necessary to balance this budget, the General Fund Structural Deficit Elimination Plan, which was last updated in February 2009, has not been revised as part of this document. This plan will be updated after the extensive budget actions necessary to balance the current budget are approved to provide a revised starting point to address the structural deficit. It should be noted that a number of the strategies outlined in the General Fund Structural Deficit Elimination Plan are being pursued as part of the 2010-2011 budget process. Many of the other ideas will be pursued over a longer time period. For instance, proposed tax measures that require voter approval are expected to be brought over a multi-year period after appropriate outreach and polling regarding these various ideas. In addition, several of the proposals to reduce the rate of increase in personnel costs are subject to meet and confer and will be pursued as part of the contract negotiation process with the City’s bargaining units.

The projected General Fund Structural Deficit has been updated to reflect revised revenue and expenditure projections in the 2011-2015 General Fund Forecast and revised unmet/deferred infrastructure and maintenance needs costs. Based on these revised projections, the General Fund structural deficit is expected to total approximately \$222.3 million over a five-year period as shown in the table below:

2011-2015 General Fund Structural Deficit Projection (February 2010)
(\$ in Millions)

	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	Total
Projected Base Shortfall (Feb 2010 Forecast)*	(\$116.2)	(\$20.1)	(\$18.0)	(\$21.5)	(\$5.8)	(\$181.6)
Unmet/Deferred Infrastructure & Maintenance Needs**	(\$8.1)	(\$8.1)	(\$8.1)	(\$8.2)	(\$8.2)	(\$40.7)
Total Incremental Deficit	(\$124.3)	(\$28.2)	(\$26.1)	(\$29.7)	(\$14.0)	(\$222.3)
Total Cumulative Deficit	(\$124.3)	(\$152.5)	(\$178.6)	(\$208.3)	(\$222.3)	(\$222.3)

* Funding for cost-of-living (COLA) salary increases not factored into the Forecast unless there is an approved contract agreement. For this Forecast, 2% COLAs are assumed for the Municipal Employees’ Federation and Confidential Employees’ Organization in 2010-2011 only. The Forecast includes committed additions previously agreed upon by Council, such as the addition of 25 Police Officers in 2010-2011 and 2011-2012 (50 total) and operating and maintenance funding for capital projects coming on line.

** Does not address one-time needs of \$446 million in the General Fund (\$821 million all funds).

ANALYSIS (CONT'D.)**2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS** (CONT'D.)**Capital Revenue Forecast**

Section Five of this report describes the 2011-2015 Capital Budget Revenue Forecast that will be used to formulate several major elements of the Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement (PBCE) Department and an analysis of actual collection patterns. The projections and their basis are described in a report prepared by the PBCE Department, which is included as Appendix A of this document (Development Activity Highlights and Five-Year Forecast [2011-2015]). This activity forecast includes a review of specific projects that are in progress as well as a general prediction of expected levels of new construction.

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2010-2014 Adopted CIP. As can be seen, reflecting the economic slowdown, revenue estimates are down significantly in all but one category.

Forecast Comparison Summary
(\$ in Thousands)

	2010-2014 CIP	2011-2015 Forecast	Difference	% Change
Construction and Conveyance (C&C) Tax	\$ 106,000	\$ 107,000	\$ 1,000	1%
Building and Structure Construction Tax	47,000	27,500	(19,500)	(41%)
Construction Excise Tax	50,500	33,000	(17,500)	(35%)
Municipal Water System Fees	4,760	1,510	(3,250)	(68%)
Residential Construction Tax	600	345	(255)	(43%)
Sanitary Sewer Connection Fee	3,750	2,100	(1,650)	(44%)
Storm Drainage Connection Fee	1,050	650	(400)	(38%)
TOTAL	\$ 213,660	\$ 172,105	(\$ 41,555)	(19%)

Real estate activity (primarily housing resales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance (C&C) Tax. As projected in the 2010-2014 Forecast, the bottoming and stabilizing of these revenues from the extreme distress in both the national and local real estate markets have seen collections level off from the sharp declines over the previous three years. After almost 43 months of consecutive decline when comparing to collections in the same month of the prior year, collections received in December 2009 and January 2010 reflected approximately 24% growth compared to the same period last year. As a result, in this Forecast, this category is projected to generate \$107 million over the next five years, an increase of \$1 million from the estimates assumed in the 2010-2014 Adopted Capital Improvement Program (CIP). The average annual collection level of \$21.4 million projected in the 2011-2015 Forecast is, however, well below the actual collection levels in recent years that reached a peak of \$49 million in 2005-2006.

ANALYSIS (CONT'D.)

2011-2015 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS (CONT'D.)

The remaining economically sensitive capital revenue categories are directly linked to development activity. Based on projections provided by the Planning, Building and Code Enforcement Department, construction activity valuation is projected to drop to a 17-year low of \$575 million during 2009-2010 and gradually increase to only slightly higher levels throughout the forecast period. These assumptions are significantly reduced from the levels presented in the 2010-2014 Forecast. Construction activity peaked in 2000-2001 at \$1.9 billion, followed by a decline that reached a low point of approximately \$800 million in 2003-2004. From that low point, a modest recovery occurred in 2004-2005 with 14% growth in that year. However, in 2005-2006, construction activity dipped again, to \$851 million (adjusted to 2009 dollars), primarily due to a decrease in multi-family development to a ten-year low. A modest rebound driven primarily by commercial and industrial development and residential high rise construction in the Downtown area occurred in 2006-2007. Due to a marked slowdown in residential construction which has continued to this day, 2007-2008 experienced a 9% decline and an additional 26% decline in 2008-2009 with total projected valuation of \$643 million. In this Forecast, activity is expected to drop to \$575 million in 2009-2010 and recover to \$675 million in 2012-2013 before flattening out in 2013-2014 at \$725 million. Based on the construction activity estimates and a review of revenue collection patterns, a decrease in construction-related taxes and fees of \$41.6 million, or 19%, is expected when comparing the 2011-2015 Forecast to the 2010-2014 Adopted CIP estimates. The steep declines in the Construction Excise Tax and the Building and Structure Construction Tax, which support the Traffic Capital Program, are expected to seriously hamper the City's ability to develop and maintain the transportation infrastructure, such as street pavement, which already suffers from a substantial backlog of unmet and deferred infrastructure needs.

NEXT STEPS

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

March 2010

- 2010-2011 Mayor's March Budget Message released with public hearing; amended/approved by City Council

April 2010

- 2010-2011 Proposed Capital Budget and 2011-2015 Capital Improvement Program released

March-April 2010

- Community budget meetings in each City Council District

May 2010

- 2010-2011 Proposed Operating Budget and 2010-2011 Proposed Fees and Charges released
- City Council Study Sessions and initial Public Hearing on 2010-2011 Proposed Operating Budget, 2011-2015 Proposed Capital Budget and Capital Improvement Program, and 2010-2011 Proposed Fees and Charges

NEXT STEPS (CONT'D.)

June 2010

- 2010-2011 Mayor's June Budget Message released with final Public Hearing; amended/approved by City Council
- 2010-2011 Operating Budget, 2010-2011 Capital Budget and 2011-2015 Capital Improvement Program, and 2010-2011 Fees and Charges adopted by City Council

CONCLUSION

This document compares the projected revenues and expenditures for the General Fund over the next five years as well as provides estimates for some of the key revenues that support the City's Capital Improvement Program. The estimated 2010-2011 General Fund deficit of \$116.2 million is very severe and will clearly necessitate very difficult choices in order to bring projected revenues and expenditures into balance. Unfortunately, the huge budget shortfall projected for 2010-2011 is followed by large deficits in the remaining years of the Forecast due primarily to the anticipated increases in retirement costs coupled with low revenue growth. While this Forecast focuses primarily on the General Fund, many other City funds are expected to face financial difficulties as a result of escalating costs and declining revenues.

The revenue and expenditure projections for the 2010-2011 fiscal year will continue to be refined over the next couple of months as additional information becomes available. This is particularly important in the areas of Sales Tax and Property Tax. Sales Tax data for the second quarter of 2010-2011, which covers the 2009 holiday period will be received in March 2010. Based on this additional data, any necessary adjustments will be incorporated into the 2010-2011 Proposed Operating Budget. Similarly, based on the timing of the Property Tax data which will indicate the impact of the re-examination of commercial and residential property values now being undertaken by the County Assessor, additional adjustments may also have to be factored into the 2010-2011 Adopted Operating Budget.

Given the scope of the fiscal challenges that the City faces, it is important that we remain committed to the sound fiscal policies and practices that have served the City well in the past. A combination of strong leadership from the Mayor and City Council, collaboration with the City's many stakeholders, and a strategic approach to determining how to significantly scale back the organization based on the available resources will be necessary in order to prepare a 2010-2011 budget that will both preserve our fiscal integrity and meet the most critical needs of the residents and businesses we serve. Discipline and focus will be needed to align the City's limited resources with the highest value, priority needs.

Action will also be necessary as we move forward to develop a sustainable cost structure. In particular, I view the huge escalation of retirement costs as a major threat to the long-term fiscal health of the City. To start addressing this threat, I urge an acceleration of pension/retiree health care reform.



Debra Figone
City Manager