

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Jennifer A. Maguire

**SUBJECT: 2024-2025 CITY MANAGER’S  
BUDGET REQUEST AND  
2025-2029 FIVE-YEAR FORECAST**

**DATE:** March 1, 2024

## INFORMATION

### EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council’s Adopted Budget process, this document provides both the recommended 2024-2025 City Manager’s Budget Request (2024-2025 Budget Balancing Strategy Guidelines) and the 2025-2029 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program (CIP). Major highlights of this report follow.

As shown in the chart below, a small General Fund shortfall of \$3.6 million is projected for 2024-2025, which constitutes approximately 0.2% of the General Fund Base Budget. This projection is derived by comparing estimated ongoing revenues with the cost of delivering City Council-approved ongoing services in the General Fund as well as the services for which the City has already committed, such as the operation of new facilities or other capital projects scheduled to come on-line next year, and new Police Department staffing. If the 2024-2025 shortfall is fully resolved on an ongoing basis, a larger shortfall of \$37.6 million (2.3%) would still need to be addressed in 2025-2026, followed by moderate to small shortfalls over the remaining three years of the Forecast. Over the five-year period, a total net General Fund shortfall of \$79.6 million translates to an average annual shortfall of \$15.9 million, which equates to 0.9% of the projected average annual General Fund Base Budget. When comparing to the 2024-2028 Five-Year Forecast, the overall increased five-year shortfall in the 2025-2029 Forecast is primarily due to the inclusion of interim housing costs and increased salaries and retirement costs.

### **2025-2029 General Fund Forecast Incremental Surplus**

|  | <b>2024-2025</b> | <b>2025-2026</b> | <b>2026-2027</b> | <b>2027-2028</b> | <b>2028-2029</b> | <b>Five-Year (Shortfall)</b> |
|--|------------------|------------------|------------------|------------------|------------------|------------------------------|
| Incremental Surplus/(Shortfall) <sup>1</sup> | (\$3.6 M)        | (\$37.6 M)       | (\$17.8 M)       | (\$13.9 M)       | (\$6.7 M)        | <b>(\$79.6 M)</b>            |
| % of Budget (Based on Expenditures)          | 0.2%             | 2.3%             | 1.0%             | 0.8%             | 0.4%             |                              |

Note: Does not include 1) costs associated with services that were funded on a one-time basis in 2023-2024; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.

- This Forecast reflects the Administration’s best estimates of projected revenues and expenditures over the next five years based on the information currently available. It does not, however, incorporate several elements that would impact the General Fund over the forecast period, including: 1) costs associated with services that were funded on a one-time basis in 2023-2024; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.
- The Forecast also excludes the cost to provide new services related to homeless residents living along waterways, which are necessary to implement a Direct Discharge Plan that meets the State of California’s regulatory requirements for the new Municipal Regional Stormwater Permit. While there are other important new services that the City Council may prioritize during the budget development process (e.g., regulation of oversized vehicles and automated speed enforcement), the City must comply with stormwater regulations that could otherwise result in fines, penalties, and litigation<sup>1</sup>. As a result, the tentative estimated cost of implementing the Direct Discharge Plan of \$25.0 million (an extremely preliminary figure that is currently under review) and the cost of programs funded on a one-time basis in 2023-2024 of approximately \$23.5 million – whose discontinuation would likely cause negative service impacts that no one would want<sup>2</sup> – are shown below to demonstrate a significant service level/structural shortfall that the City will need to address in the 2024-2025 Proposed Budget.

**Estimated Service Level/Structural Shortfall in 2024-2025 for Planning Purposes  
(\$ in Millions)**

|  | <b>2024-2025</b>  |
|--|-------------------|
| February 2024 Incremental Surplus/(Shortfall)  | (\$3.6 M)         |
| Tentative Estimated Cost to Address Stormwater Permit Requirements Related to Individuals Experiencing Homelessness Living Adjacent to Waterways | (\$25.0 M)        |
| 2023-2024 Programs Funded on a One-Time Basis in the General Fund  | (\$23.5 M)        |
| <b>Estimated Service Level/Structural Shortfall for Planning Purposes</b>  | <b>(\$52.1 M)</b> |

Moreover, assuming that this estimated service level/structural shortfall of \$52.1 million is resolved, an additional \$37.6 million shortfall will need to be resolved in 2025-2026.

- As with all forecasts, there is a level of uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. The City’s

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<sup>1</sup> For additional information, please see Item 3.5 on the March 5, 2024 City Council agenda: <https://sanjoseca.primegov.com/api/compilemeetingattachmenthistory/historyattachment/?historyId=ce42c605-e8a6-4763-926a-9cbe667346ba>

<sup>2</sup> Please see Attachment A to this transmittal a listing of programs funded on a one-time basis in the General Fund in 2023-2024.

two largest General Fund revenue sources, Property Tax and Sales Tax, are sensitive to changes in the local economy and may fluctuate to a significant degree depending on future conditions. Various cost elements can also vary from year to year, including retirement contributions that are based on actual performance of the retirement funds and changes in actuarial economic and demographic assumptions approved by the Federated and Police and Fire Department Retirement Boards.

- Two alternative forecasts have been developed to model the range of budgetary 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". Over the five-year period, the Optimistic Case would generate a shortfall of \$3.5 million and the Pessimistic Case would result in a shortfall of \$125.8 million. It is important to note that due to the significant swings the pandemic has had on the local economy and the anticipated future weakening, it is challenging to forecast economic conditions over the next five years.
- The chart on page 4 compares the 2024-2025 General Fund Forecast to the 2023-2024 Adopted Budget. The combined result of the Adopted to Forecast changes is a General Fund shortfall of \$3.6 million. Of the \$35.3 million ongoing surplus that was available for allocation in 2023-2024, with their approval of the 2023-2024 Adopted Operating Budget, the City Council deliberately did not spend \$18.8 million which fully resolved the then projected shortfall for 2024-2025, which has been carried forward as the starting point for next year. The next major comparison element is the change in revenue sources year-over-year. Ongoing revenues are projected to increase by \$69.72 million, driven primarily by increases in Property Tax, Transfers and Reimbursements, Utility Tax, Sales Tax, and changes in the Beginning Fund Balance. When comparing expenditures, Base Budget costs are expected to increase by \$92.1 million from 2023-2024 ongoing budget levels, with the majority of the net cost increases associated with anticipated increases to employee compensation and retirement contributions, contributions to the City's interim housing portfolio, utility costs and vehicle maintenance and replacement costs, vacancy factor adjustments in various departments, including a lowered vacancy factor for the Fire and Police Departments to better align with actual staffing deployment, adjustments to the Contingency Reserve to maintain required levels, as well as future staffing costs in the Police Department as previously authorized by the City Council and planned costs for the operation of new facilities and infrastructure coming online in 2024-2025.

**2024-2025 General Fund Forecast  
Reconciliation from 2023-2024 Adopted Budget**

| 2024-2025 General Fund Forecast Components (Ongoing)                           | \$ in Millions   |
|--|------------------|
| <b>Carry-Over from 2023-2024 Adopted Budget</b>                                | <b>\$ 18.80</b>  |
| <b>Revenue Changes</b>   |                  |
| - Property Tax   | 31.60            |
| - Transfers and Reimbursements   | 11.87            |
| - Utility Tax  | 9.45             |
| - Beginning Fund Balance   | 8.82             |
| - Sales Tax  | 7.60             |
| - Other Net Revenue Changes  | 0.38             |
| <b>Total Revenue Changes (Increase)</b>  | <b>\$ 69.72</b>  |
| <b>Expenditure Changes</b>   |                  |
| - Employee Compensation  | 25.30            |
| - Interim Housing  | 25.00            |
| - Retirement Contributions   | 14.32            |
| - Vehicle O&M, Electricity, Gas, and Police Fleet                              | 4.10             |
| - Vacancy Factor Adjustment  | 4.03             |
| - Contingency Reserve  | 3.00             |
| - Non-Management Step and Management-Pay-for-Performance Program               | 2.56             |
| - Committed Additions: Operations & Maintenance and Police Department Staffing | 2.47             |
| - Living Wage/Minimum Wage Program   | 2.27             |
| - Janitorial Services  | 2.10             |
| - Security Services  | 0.71             |
| - Workers’ Compensation Claims – Fire  | 0.50             |
| - Fire Equipment Sinking Fund Reserve  | 0.50             |
| - Property Tax Administration Fee  | 0.44             |
| - San José BEST and Safe Summer Initiative Programs                            | 0.44             |
| - Employee Health Services   | 0.38             |
| - Workers’ Compensation Claims and State License Fee                           | 0.35             |
| - Police Taser Equipment   | 0.35             |
| - Animal Care and Services Supplies  | 0.30             |
| - Information Technology Sinking Fund Reserve                                  | 0.30             |
| - Elections and Ballot Measures  | 0.25             |
| - City Owned Property Management and Maintenance                               | 0.20             |
| - Sick Leave Payments Upon Retirement  | (0.65)           |
| - Transfer to City Hall Debt Service Fund                                      | (0.32)           |
| - Council District Outdoor Activation  | (0.25)           |
| - Mayor/City Council District Budgets  | (0.20)           |
| - Other Net Expenditure Changes  | 3.66             |
| <b>Total Expenditure Changes (Increase)</b>                                    | <b>\$ 92.11</b>  |
| <b>2024-2025 Projected General Fund Deficit</b>                                | <b>(\$ 3.59)</b> |

- For the 2024-2025 General Fund Forecast, personal services costs continue to account for nearly three-quarters of the total cost in the General Fund. The personal services category is broken down into three major components: salaries and other compensation, retirement, and health and other fringe benefits. Of the \$1.1 billion projected personal services total for 2024-

2025, salary and other compensation costs total \$653.6 million (59.3% of projected personal services), retirement costs total \$364.8 million (33.1% of projected personal services), and health and other fringe benefits costs total \$84.0 million (7.6% of projected personal services). In the out years of the forecast, annual personal services growth ranging from 3.3% to 6.0% is projected.

- For the first time, the Forecast includes ongoing General Fund contributions to support the construction and continued operations of the City's interim housing portfolio that, once fully built out in accordance with City Council direction, will consist of approximately 1,279 bridge/emergency interim housing site beds, 280 hotel room beds, and 127 supportive parking spaces. Based on an analysis of available resources from the State and other external resources, revenues available from Measure E in accordance with City Council Policy 1-18, Section 22, and the projected spend down of prior one-time allocations from the General Fund, an ongoing General Fund contribution of \$25.0 million will be necessary to support to the buildout and operations of the interim housing portfolio in 2024-2025. This contribution grows to \$40 million in 2025-2026 and increases each year to a level of \$70.0 million in 2028-2029. As previously directed by the City Council, the Administration will continue to pursue alternative funding sources to the extent feasible, including from regional partners that are impacted and have responsibility for reducing and addressing unsheltered homelessness. If identified in time, any additional revenue sources will be brought forward as part of the 2024-2025 Proposed Budget.
- Committed Additions<sup>3</sup>, expenses that address previous City Council direction, are included and total \$2.5 million in 2024-2025, rising to \$42.4 million by the end of the forecast period. The largest expenses in this category are the operating and maintenance costs for new facilities and public infrastructure that will come online within the next five years – including for Measure T bond projects approved by voters in November 2018, and the addition of 15 positions (a combination of sworn and civilian) in the Police Department each year of the Forecast, as authorized by the City Council with their adoption of the 2022-2023 Operating Budget.
- In approaching the 2024-2025 Proposed Budget, the Administration recommends the use of the budget balancing strategy guidelines outlined in this memorandum (2024-2025 City Manager's Budget Request). The *City of San José Budget Principles and Service Delivery Framework* (Appendix A) combined with City Council approval of the Mayor's March Budget Message will also guide the City's budget development efforts. The Administration recommends City Council approval of the Proposed 2024-2025 City Manager's Budget Request, with any desired revisions, as part of the Mayor's March Budget Message review and approval scheduled for March 19, 2024.
- Consistent with last year, the City Manager's Budget Request also includes guidelines for the process whereby City Councilmembers submit cost estimate requests to the Administration in preparation for their Budget Documents that are ultimately submitted to the Mayor's Office for potential inclusion in the Mayor's June Budget Message. First implemented last year, this

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<sup>3</sup> For ease of reference, the costs associated with Committed Additions related to the operations of new interim housing facilities are included in the paragraph above and not duplicated here.

revised process was extremely beneficial in focusing the work of the Administration on feasible and implementable programs and services, and also ensured the delivery of meaningful budgetary information for City Council decision-making.

- Projections for the selected CIP revenues are also included in this document. These revenue estimates of \$423.2 million are 6.7% higher than the estimate used to develop the 2024-2028 Adopted CIP (\$396.6 million), as the real estate market – while still relatively weak – is expected to improve in the out-years of the Forecast. When comparing the revenue estimates in this forecast to the 2024-2028 Adopted CIP, Construction and Conveyance Tax projections increased by \$25.0 million or 11.6%, Building and Structure Construction revenue estimates decreased slightly by \$1.0 million or 1.1%, and Construction Excise Tax revenue estimates increased by \$3.0 million or 3.7%. These three revenue estimates have a combined total of \$419.0 million.
- As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document and projections are based on incomplete information. For example, Property Tax roll growth data is updated each month and the City only recently received sales tax data from the State for the period of October 2023 through December 2023 – the analysis associated with this data is still forthcoming. Other information, such as final overhead reimbursement rates and information related to Franchise Fee revenues will be received in the coming weeks and months. As seen in recent years, retirement costs fluctuate and will likely continue to experience upward or downward swings based on actual performance of the retirement funds and changes in actuarial economic and demographic assumptions as approved by the Federated and Police and Fire Department Retirement Boards. Consistent with past practice, any new information impacting revenue and expenditure estimates will be brought forward as part of the preparation for the 2024-2025 Proposed Budget, or as a Manager's Budget Addendum as part of the Adopted Budget process, as appropriate.

## **BACKGROUND**

In compliance with City Charter Section 1204 and the City Council's Adopted Budget process, this document provides both the 2024-2025 City Manager's Budget Request and the 2025-2029 Five-Year Forecast and Revenue Projections for the General Fund and CIP. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process and are critical steps in developing the City's annual Operating and Capital Budgets and the Five-Year CIP.

The City Manager's Budget Request includes budget balancing strategy guidelines that the Administration recommends for use in developing the 2024-2025 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 budgetary status for 2024-2025 is an integral part of the Administration's proposed approach to preparing the 2024-2025 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2024-2025, and the subsequent four years, is provided as part of this document.

## **ANALYSIS**

This section includes the following: a discussion of the 2024-2025 City Manager's Budget Request, including recommended guidelines for the Cost Estimate and City Council Budget Document Process; an overview of the 2025-2029 Five-Year Forecast and Revenue Projections for the General Fund and CIP; and a description of the next steps in the 2024-2025 Budget Process.

### **2024-2025 CITY MANAGER'S BUDGET REQUEST**

The City Manager's Budget Request includes a set of general budget balancing strategy guidelines recommended to be used in the development of the 2024-2025 Proposed Budget. The overarching goals of these guidelines are to align the ongoing limited resources in the General Fund with the strategic allocation of ongoing expenditures to address the City Council's most important priorities. In addition to City Council's approval of the Mayor's March Budget Message and priorities identified in prior City Council sessions, these budget balancing strategy guidelines will be used with the overall City Council-approved *City of San José Budget Principles* and *Service Delivery Framework* that are attached as Appendix A to this document.

These proposed guidelines were formulated in the context of General Fund projections that include an incremental ongoing shortfall in each year of the Forecast for a cumulative shortfall over the five-year period of nearly \$80 million. While the shortfalls are very small in context of the overall General Fund Base Budget, ranging from 0.2% to 2.3%, it is important to keep in mind that these figures do not incorporate impacts associated with:

- The cost to implement a Direct Discharge Plan that meets the State of California's regulatory requirements of the new Municipal Regional Stormwater Permit related to individuals experiencing homelessness living adjacent to waterways. The extremely preliminary estimated ongoing cost of this work is approximately \$25 million.
- The costs to continue services funded on a one-time basis in 2023-2024 in the General Fund that totaled approximately \$23.5 million. Major items funded on a one-time basis that need to be evaluated for continued funding include the following: Police Department Sworn Backfill Reserve, Police Recruiting and Backgrounding, Coyote Creek and Guadalupe River Trail Patrol, the continuation of various pilot programs overseen by Beautify San José (e.g., RV Pollution Prevention, Waterways, Gateways, and Beautify Your Block), Child and Youth Programming, Supplemental Arts and Cultural Funding, Recruitment Centralization Pilot Program, Climate and Seismic Resilience Planning, and Disability Community Engagement and Service Evaluation. Please see Attachment A to this transmittal for a listing of programs funded on a one-time basis in the General Fund in 2023-2024.
- The costs associated with ongoing unmet/deferred infrastructure and maintenance needs that were last updated and presented to the Transportation and Environment Committee on April 4, 2022, at \$17.6 million annually in the General Fund (\$91.5 million all funds). In addition, there is a one-time backlog of infrastructure needs totaling \$98.2 million in the General Fund (\$1.7 billion all funds). An updated backlog assessment will be released in the coming weeks.

- One-time revenues that may become available or one-time expenditure needs. Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding elements that may be available or required in any given year.

Due to the above critical needs that are not captured in the \$3.6 million General Fund ongoing shortfall projected for 2024-2025, the Administration considers that the General Fund is experiencing a substantial ongoing service level/structural shortfall as shown in the table below.

**Estimated Service Level/Structural Shortfall in 2024-2025 for Planning Purposes  
(\$ in Millions)**

|  | <b>2024-2025</b>  |
|--|-------------------|
| February 2024 Incremental Surplus/(Shortfall)  | (\$3.6 M)         |
| Tentative Estimated Cost to Address Stormwater Permit Requirements Related to Individuals Experiencing Homelessness Living Adjacent to Waterways | (\$25.0 M)        |
| 2023-2024 Programs Funded on a One-Time Basis in the General Fund  | (\$23.5 M)        |
| <b>Estimated Service Level/Structural Shortfall for Planning Purposes</b>  | <b>(\$52.1 M)</b> |

Moreover, assuming that this estimated service level/structural shortfall of \$52.1 million is resolved, an additional \$37.6 million shortfall will need to be resolved in 2025-2026.

The Administration looks to City Council’s upcoming approval of the Mayor’s March Budget Message to identify the most critical priority areas to allocate limited General Fund resources. The 2024-2025 Proposed Budget will focus on addressing those priority areas within available funding levels, including the reallocation of funding among City services to meet the City Council’s highest priority objectives. As this Forecast anticipates that the small shortfall in 2024-2025 will be followed by a more substantial shortfall in 2025-2026, the budget-balancing strategy should take a two-year approach to try and partially address the shortfall in 2025-2026 to better position the City should economic conditions worsen.

As in past years, the Administration also recommends that one-time funding identified in the budget process be strategically invested to address one-time needs, such as addressing a portion of the City’s unmet/deferred infrastructure and maintenance needs, providing for limited technology investments, and/or building reserves to cushion against future budget uncertainties.

***2024-2025 Budget Balancing Strategy Guidelines***

The 2024-2025 Budget Balancing Strategy Guidelines, as shown below, provide recommended direction to the Administration on the general approaches to use in the development of the 2024-2025 Proposed Budget.



## 2024-2025 Budget Balancing Strategy Guidelines

1. As directed by the priorities identified in the City Council-approved Mayor's March Budget Message, develop a budget that balances the City's delivery of the most essential services to the community with the resources available. Consider current needs in the context of long-term service delivery priorities.
2. Pose explicit questions of equity – including who benefits and who is burdened – when considering changes to City services to achieve a balanced budget.
3. Balance ongoing expenditures with ongoing revenues to maximize service delivery within existing resources, to ensure no negative impact on future budgets, and to maintain the City's high standards of fiscal integrity and financial management. As appropriate, establish a Future Deficit Reserve in the General Fund to cover any projected budgetary shortfall in the following year as a stopgap measure; and, maintain or increase the Budget Stabilization Reserve as a buffer against a further weakening of future economic conditions or unanticipated cost increases.
4. Evaluate program-level budgets and identify opportunities to shift resources or reconfigure operations from the least influential contributors to the strongest contributors of achieving outcomes related to City Council-approved Focus Areas, critical CSA services and programs, and Foundational Strategic Support Focus Areas.
5. Prioritize limited resources to address truly significant community or organizational risks, critical services funded on a one-time basis in 2023-2024 in the General Fund, and/or respond to specific City Council direction.
6. Review existing vacancies for opportunities to reorganize work groups to realize cost savings or to achieve current service level demands through alternative means. Factor in performance measure data in proposal development.
7. Focus on business process redesign to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, reorganizing functions, and reallocating resources).
8. Explore alternative service delivery models (e.g., partnerships with non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use City resources more efficiently and effectively.
9. Identify City policy changes that would enable/facilitate service delivery improvements or other budget balancing strategies to ensure equity and inclusion for how services are delivered.
10. Analyze non-personal/equipment/other costs for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
11. Explore expanding existing revenue sources and/or adding new revenue sources.
12. Establish a fees, charges and rates structure designed to fully recover operating costs, while considering the impacts on fee and rate payers whereby a cost recovery structure may be lower in certain circumstances, and explore opportunities to establish new fees and charges for services, where appropriate.
13. Focus any available one-time resources on investments that 1) continue a very small number of high-priority programs funded on a one-time basis in 2023-2024 for which ongoing funding is not available; 2) address the City's unmet or deferred infrastructure needs; 3) leverage resources to improve efficiency/effectiveness through technology and equipment or other one-time additions; 4) accelerate the pay down of existing debt obligations where applicable and appropriate; 5) increase budget stabilization reserves to address future budget uncertainty; and/or 6) provide for funding needs for non-bond eligible furniture, fixtures, and equipment associated with the continued implementation of Measure T.
14. Engage employees in department and/or city-wide budget proposal idea development.
15. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.
16. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.

### ***City of San José Budget Principles, Service Delivery Framework, and Performance and Resource Alignment***

When considering changes to the budget, it is important to consider the overall City of San José Budget Principles (included in *Appendix A*) that were initially developed as part of the General Fund Structural Deficit Elimination Plan effort when the City struggled with significant, persistent deficits. These principles, which were approved as part of the City Council's approval of the Mayor's March Budget Message for Fiscal Year 2008-2009 and subsequently amended on September 9, 2008, provide a meaningful framework for maintaining the fiscal discipline crucial to a large organization like the City of San José.

As the City Council is aware, it is important that the City take a holistic approach when either reducing or adding resources and programs. The Service Delivery Framework (included in *Appendix A*) provides a multi-pronged approach to delivering direct services to the community that takes into consideration various factors, including adequate strategic support resources, adequate infrastructure, service delivery methods to ensure efficient and effective operations, service delivery goals and current performance status, service sustainability, and staffing resources.

### ***Cost Estimate Request and City Council Budget Document Guidelines***

Consistent with last year, the City Manager's Budget Request also includes guidelines for the process whereby City Councilmembers submit cost estimate requests to the Administration in preparation for their Budget Documents that are ultimately submitted to the Mayor's Office for potential inclusion in the Mayor's June Budget Message. First implemented last year, this revised process was extremely beneficial in focusing the work of the Administration on feasible and implementable programs and services. The Administration recommends that the following definitions and guidelines – which provide definitions and limits to the Cost Estimate Request and Budget Document process to ensure the delivery of meaningful budgetary information for City Council decision-making – again be incorporated into City Council's approval of the Mayor's March Budget Message.

**Cost Estimate Request:** A request by a Councilmember to the Administration seeking the cost of a new project or program to be performed by City. The request from the Councilmember should include a clear description of the work to be performed and the anticipated outcomes that identifies how the change would affect services for San José residents, businesses, community groups, etc. Each Councilmember should submit no more than five Cost Estimate Requests.

The request must have a modest scope so that a reliable cost estimate response can be quickly and accurately completed. The anticipated scope should be a small-scale project that the City has delivered in the past, or an extension of a service that already exists that would only require a modest staffing addition on a one-time basis. Recent examples include the installation of targeted neighborhood traffic calming improvements, a radar speed display sign along a neighborhood street, or additional street tree plantings within a City Council District.

Requests that involve complex service delivery and/or large ongoing staffing resources for new programs (e.g., at-home STEM educational programs for children in Title I schools supplemented with free Wi-Fi hotspots), or large capital construction projects that require extensive design (e.g., new streetlight infrastructure, highway overpasses, etc.) are not appropriate for this process.

The request should identify the anticipated funding source to pay for the program (though City staff may suggest alternative funding sources in its response) and indicate if the project/program is a one-time or ongoing effort. To keep the budget structurally balanced, one-time expenditure requests should be offset by one-time funding sources, while ongoing expenditure requests should be offset by ongoing funding sources.

**Cost Estimate Response:** A response by the Administration to the Councilmember's request that clearly identifies the one-time and ongoing costs, as appropriate, any additional full-time equivalent positions that would be needed, and eligible funding sources. Explanatory notes are provided only if necessary to clarify what is included in the cost estimate response.

**Budget Documents:** Memoranda issued by a Councilmember to the Mayor recommending adjustments to the City Manager's Proposed Budget. Typically, Budget Documents are based on the information received in a Cost Estimate Request and Response, but they may also recommend targeted funding for community groups whose programs or actions serve the public interest, but would not be performed by City staff. All Budget Documents that recommend a City-provided service or project must be based on a Cost Estimate Response.

As the Proposed Budget is fully balanced, Budget Documents must also identify the offsetting actions to pay for the recommended adjustment, such as the Essential Services Reserve. For example, if a Budget Document seeks to fund a \$50,000 project, then a typical offset would be a \$50,000 reduction to the Essential Services Reserve. It is important to note that the Essential Services Reserve is not an ongoing funding source. To pay for any ongoing costs, and to align within City of San José Budget Principles, the Budget Document would also need to identify an ongoing service in the Proposed Budget to defund.

**Submittal Dates:**

- **Wednesday, May 8** Deadline for Councilmembers to submit Cost Estimate Requests to the City Manager's Budget Office
- **Friday, May 17** Cost Estimate Responses returned to Councilmembers
- **Thursday, May 23** Budget Documents due to Mayor's Office

### ***2024-2025 Budget Process***

As noted above, in addition to the forthcoming direction in the Mayor's March Budget Message, the Administration proposes the use of the general Budget Balancing Strategy Guidelines outlined above in the 2024-2025 City Manager's Budget Request combined with the overall City of San José Budget Principles and Service Delivery Framework to approach the 2024-2025 budget development process.

In December 2023, the Administration directed City departments to develop budget proposals using a draft version of the 2024-2025 Budget Balancing Strategy Guidelines. At that time, the Administration anticipated that ongoing General Fund revenues and expenditures were in close alignment for 2024-2025, but a shortfall ranging from \$25 to \$35 million was preliminarily anticipated for 2025-2026. As a result, departments were directed to:

- Prioritize limited resources to support key outcomes related to City Council-approved Focus Areas, critical City Service Area (CSA) services and programs, and Foundational Strategic Support Focus Areas, including the ongoing continuation of a portion of one-time funded services/programs, and a very select set of new investments;
- Recommend ongoing reductions to lower priority services and programs that will be necessary to bring the General Fund into structural alignment and to fund a small number of targeted investments to support the City's highest priority objectives;
- Eliminate long-vacant positions to generate budgetary savings and to better align our position count with the work anticipated to be delivered; and
- Take a two-year approach that partially addresses the additional General Fund shortfall anticipated for 2025-2026.

Based on the updated information and analysis used to develop this document, including the size of the service level/structural shortfall the City is facing in 2024-2025, the sustained incremental ongoing General Fund shortfalls forecasted in subsequent years, and the potential for economic conditions or cost drivers to worsen, departments were recently directed to submit additional ongoing budget reduction proposals. These proposals will help ensure that the Administration has the capacity to recommend an implementable strategy to put forth a balanced budget that also aligns with the direction provided by the City Council in their approval of the March Budget Message scheduled for Tuesday, March 19.

Further, departments overseeing Special and Capital funds were directed to develop recommendations that balance the total resources of the fund, identify the impact on fees or rates and, to the extent possible, minimize fee and rate increases. For those programs that have historically allocated resources equally citywide, direction was given to work on enhancing or further developing a practice of place-based and equity-focused strategies to allocate these resources. The long-term goal is to fully align ongoing expenditures to ongoing revenues, as we also prioritize organizational stability to the extent feasible, to address our significant service delivery and infrastructure needs.

Consistent with the City Charter, the Mayor is currently anticipated to issue a March Budget Message on March 11, 2024, which will then be discussed, amended if necessary, and approved by the City Council on March 19, 2024. The contents of that Message will set forth key budget priorities for the preparation of the City Manager's 2024-2025 Proposed Capital and Operating Budgets currently scheduled to be released on April 26, 2024 and May 1, 2024, respectively. As part of the 2024-2025 Mayor's March Budget Message, the Administration requests confirmation of the proposed 2024-2025 Budget Balancing Strategy Guidelines, including the Cost Estimate Request and City Council Budget Document Guidelines, with any desired revisions. As required by City Charter, those Proposed Budgets will contain allocations that address the highest priority needs of the community while maintaining the fiscal integrity of the City.

After the release of the Proposed Budgets, there will be a series of Budget Study Sessions and Public Hearings to discuss the budget and associated impacts on performance and service delivery. The Administration will also work with the Mayor and City Council to provide informational community meetings on the Proposed Budget. 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 2024.

## **2025-2029 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS**

The 2025-2029 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

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

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.

- III. **Committed Additions to the Base General Fund Forecast** – This section describes the committed additions per previous City Council direction considered in the Forecast, including the financial impact in each year of the Five-Year Forecast. This section also includes a discussion of Budget Principle #8, which pertains to capital projects with General Fund operating and maintenance costs in excess of \$100,000.
- IV. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an Optimistic Case and a Pessimistic Case – that modify revenue assumptions. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.
- V. **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 CIP.
- VI. **Appendices** – Four appendices are also included in this document. *Appendix A* includes the following: City Council-approved City of San José Budget Principles and Service Delivery Framework. *Appendix B* provides descriptions of the City’s major General Fund revenue categories. *Appendix C* provides a detailed forecast of available revenues and costs associated with the construction, operation, and maintenance of the City’s interim housing portfolio. *Appendix D*, prepared by the Planning, Building, and Code Enforcement Department, documents the basis for that department’s five-year projections for construction activity.

### ***2025-2029 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 shortfalls (assuming each preceding shortfall is completely addressed with ongoing solutions in the year it appears) for each year of the forecast is shown below. Because it is the City’s goal to remain in balance on an ongoing basis, the incremental figure is useful in that it shows the additional shortfall attributed to a particular fiscal year. To the extent that a shortfall is not fully resolved on an ongoing basis, it is important to understand that the remaining ongoing budget shortfall will carry over to the following year.

**2025-2029 General Fund Five-Year Forecast**  
(\$ in Millions)

|  | <b>2024-2025</b> | <b>2025-2026</b> | <b>2026-2027</b> | <b>2027-2028</b> | <b>2027-2028</b> |
|--|------------------|------------------|------------------|------------------|------------------|
| <b>Projected Revenues</b>                    | \$1,543.7        | \$1,601.1        | \$1,661.9        | \$1,723.6        | \$1,788.3        |
| <b>Projected Expenditures</b>                | \$1,547.3        | \$1,642.3        | \$1,721.0        | \$1,796.6        | \$1,867.9        |
| <b>Total Cumulative Surplus/(Shortfall)</b>  | (\$3.6)          | (\$41.2)         | (\$59.0)         | (\$73.0)         | (\$79.6)         |
| <b>Total Incremental Surplus/(Shortfall)</b> | <b>(\$3.6)</b>   | <b>(\$37.6)</b>  | <b>(\$17.8)</b>  | <b>(\$13.9)</b>  | <b>(\$6.7)</b>   |
| <b>% of Budget (Based on Expenditures)</b>   | <b>(0.2%)</b>    | <b>(2.3%)</b>    | <b>(1.0%)</b>    | <b>(0.8%)</b>    | <b>(0.4%)</b>    |

Note: Does not include 1) costs associated with services that were funded on a one-time basis in 2023-2024; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.

In the 2025-2029 Forecast, a small General Fund shortfall of \$3.6 million is anticipated for 2024-2025, followed by incremental shortfalls ranging from \$37.6 million to \$6.7 million over the next four years. These margins are relatively modest when put into context of the size of the projected General Fund budget, ranging from 0.2% to 2.3% of the projected annual budget (based on expenditures), which ranges from \$1.5 billion to \$1.9 billion. However, as stated previously, there are significant expenditure components that are not incorporated into the Forecast, including expanded services to address stormwater permit requirements, programs funded on a one-time basis in 2023-2024, unmet/deferred infrastructure and maintenance needs, and one-time revenue sources or expenditure needs.

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 change 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.

When reconciling next year’s General Fund Forecast to the 2023-2024 Adopted Budget, the projected shortfall of \$3.6 million for 2024-2025 is the result of \$18.8 million of ongoing funding that was deliberately set aside in the 2023-2024 Adopted Operating Budget to resolve the then-projected shortfall in 2024-2025, improved revenues of \$69.7 million, and increased costs of \$92.1 million.

The largest revenue increases include: Property Tax (\$31.6 million), which is based on the most recent information provided by the County of Santa Clara; Transfers and Reimbursements (\$11.9 million), associated with various adjustments related to transfers from other City funds and overhead reimbursements; Utility Tax (\$9.5 million), based on rate increases and usage projections; Sales Tax (\$7.6 million), due to inflation and moderate levels of economic growth; and a larger anticipated Beginning Fund Balance (\$8.8 million). A description of major General Fund revenue categories is included in *Appendix B*.

On the expenditure side, several upward and downward adjustments have been incorporated into this Forecast resulting in a net increase of \$92.1 million in 2024-2025. The largest expenditure changes include: employee compensation increases (\$25.3 million) in accordance with existing

labor agreements and estimation of future salary costs; contributions to support the City's interim housing portfolio as previously approved by the City Council (\$25.0 million); an increase to retirement contributions in accordance with calculated pensionable payroll and actuarial assumptions approved by the City's Retirement Boards (\$14.3 million); city-wide vehicle operations and maintenance, electricity, gas, and police fleet replacements (\$4.1 million); vacancy factor adjustments in various department, including a lowered vacancy factor for the Fire and Police Departments to better align with actual staffing deployment (\$4.0 million); Contingency Reserve increase to set aside at least 3% of General Fund operating expenditures (\$3.0 million); non-management step and management pay-for-performance program (\$2.6 million); committed additions for Police Department staffing and anticipated completion of Measure T funded facilities (\$2.5 million); living wage/minimum wage adjustment (\$2.3 million); increased costs for janitorial services (\$2.1 million) and security services (\$710,000); workers' compensation expenditures for the Fire Department (\$500,000); establishing a fire equipment sinking fund reserve to replace aging equipment (\$500,000); property tax administration fee increase (\$440,000); various adjustments for San José BEST and Safe Summer Initiative Programs (\$440,000); employee health services for a third-party administrator (\$380,000); workers' compensation state license fee costs (\$350,000); police taser equipment (\$350,000); Animal Care and Services food, medical, and animal supplies (\$300,000); increase to the Information Technology Sinking Fund Reserve for aging information technology equipment (\$300,000); elections and ballot measures costs (\$250,000) anticipated for the upcoming November 2024 election; funding to maintain and improve city-owned lease and other properties (\$200,000); reduced Sick Leave Payments Upon Retirement allocation (-\$650,000) based on prior year actual expenditures and projected payments for 2024-2025; reduced transfer to the City Hall Debt Service Fund (-\$320,000) to align with the proportional cost allocation for 2020A lease-revenue bonds, which refunded debt related to the construction of City Hall; as well eliminating Council District Outdoor Activation funding (-\$250,000) and reducing Mayor/City Council District Budgets (-\$200,000) in accordance with prior City Council direction.

Further detailed information regarding the General Fund revenues and expenditures and the assumptions used in the development of the Forecast can be found in *Section I – Elements of the General Fund Forecast* of this document.

### ***General Fund Committed Additions***

Cost estimates for specific Committed Additions that address previous City Council direction are included in this Forecast in the years that they are projected to be required. It is important to note that the City Council has certified a number of interim housing facilities scheduled to begin operations between 2024-2025 and 2025-2026 as Committed Additions, including Branham-Monterey, Rue Ferrari Expansion, Via Del Oro, Cerone, Cherry Avenue, and the Berryessa Supportive Parking site. However, to provide a complete financial picture, the costs related to these sites, the cost of existing sites, and assumed revenues available for the City's interim housing portfolio are discussed in detail in *Appendix C, Interim Housing Forecast*. The amount of ongoing contributions from the General Fund necessary to support the interim housing portfolio are not reflected in the table below and are instead included in the *City-Wide Expenses – Interim Housing* line item within the Base Forecast model, as the required General Fund contribution supports both existing and new interim housing facilities. As referenced above, the required General Fund



contribution is \$25.0 million in 2024-2025 and increases in each year of the Forecast to reach \$70.0 million in 2028-2029.

As summarized in the chart below, the Committed Additions category reflects increases to Police Department staffing and projected operating and maintenance costs for new or renovated capital projects scheduled to come online after 2023-2024. The costs of the additions total \$2.5 million in 2024-2025 and increase to \$42.4 million by the end of the forecast period.

Costs in 2024-2025 are largely due to the expenses associated with additional positions in the Police Department. City Council's approval of the Mayor's June Budget Message for Fiscal Year 2022-2023 authorized, as Committed Additions to future Five-Year General Fund Forecasts, the annual addition of up to 15.0 positions in the Police Department in each year where the City Manager determines that the addition of the positions would not require a decrease in existing basic neighborhood services. The positions may be a mix of sworn and civilian positions depending upon the most pressing community safety needs. Given existing vacancy levels, the Forecast includes ongoing funding prorated in 2024-2025; new cohorts of 15 positions are assumed in subsequent years.

Committed Addition costs are expected to increase significantly due to the completion of several Measure T bond projects, including new Fire Station 32, the Police Training Facility, the Police Air Support Hangar (which will have an expanded footprint), and the 911 Call Center Expansion in 2025-2026, and the new Fire Station 36 at the end of 2027-2028. The Police Training Facility, now also expected to come online in 2025-2026, will trigger the activation a year later of the South San José Police Substation once recruit academies and training functions are transferred to the new Police Training Facility.

The Committed Additions also include maintenance and operations costs associated with non-Measure T projects, such as new parks and recreation facilities like Columbus Park Soccer Fields and new traffic infrastructure assets.

**2025-2029 General Fund Committed Additions**

|                                     | 2024-2025          | 2025-2026           | 2026-2027           | 2027-2028           | 2028-2029           |
|-------------------------------------|--------------------|---------------------|---------------------|---------------------|---------------------|
| Police Staffing Addition            | \$1,900,000        | \$4,500,000         | \$7,200,000         | \$10,000,000        | \$13,000,000        |
| Measure T Bond-Funded Facilities    | \$161,000          | \$7,699,000         | \$14,526,000        | \$15,894,000        | \$22,476,000        |
| New Public Safety Facilities        | \$0                | \$0                 | \$990,000           | \$2,558,000         | \$3,971,000         |
| New Parks and Recreation Facilities | \$247,000          | \$376,000           | \$1,805,000         | \$2,443,000         | \$2,618,000         |
| New Traffic Infrastructure Assets   | \$164,000          | \$247,000           | \$321,000           | \$353,000           | \$371,000           |
| <b>Total</b>                        | <b>\$2,472,000</b> | <b>\$12,822,000</b> | <b>\$24,842,000</b> | <b>\$31,248,000</b> | <b>\$42,436,000</b> |

A detailed listing of all Committed Additions costs is included in this 2028-2029 General Fund Forecast and can be found in *Section III - Committed Additions to the Base General Fund Forecast* of this document.

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

General Fund Capital Operating and Maintenance Costs/Budget Principle #8 requires City Council certification that funding will be made available in the General Fund for capital projects with an estimated operating budget impact greater than \$100,000 at the time of taking beneficial use of the facility or project, and that this operations and maintenance funding will not require a decrease in existing basic neighborhood services. Capital projects with operating and maintenance costs over \$100,000 that have been previously certified by the City Council, or are recommended for certification in the future, are shown in Chart A in *Section III - Committed Additions to the Base General Fund Forecast*.

***Alternative Forecast Scenarios***

To model the range of budgetary scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the Base Case. Optimistic and Pessimistic cases model economic scenarios considered possible, but less likely to occur than the Base Case. These alternatives are presented in *Section IV – Alternative Forecast Scenarios* of the report 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 2024-2025 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios.

**General Fund Operating Margins  
(Base, Optimistic, and Pessimistic Cases)**

|                  | 2024-2025        | 2025-2026         | 2026-2027         | 2027-2028         | 2028-2029        | Five-Year Surplus |
|------------------|------------------|-------------------|-------------------|-------------------|------------------|-------------------|
| <b>Base Case</b> | <b>(\$3.6 M)</b> | <b>(\$37.6 M)</b> | <b>(\$17.8 M)</b> | <b>(\$13.9 M)</b> | <b>(\$6.7 M)</b> | <b>(\$79.6 M)</b> |
| Optimistic Case  | \$17.3 M         | (\$28.4 M)        | (\$4.3 M)         | \$3.4 M           | \$8.4 M          | (\$3.5 M)         |
| Pessimistic Case | (\$25.9 M)       | (\$51.3 M)        | (\$26.3 M)        | (\$14.3 M)        | (\$8.1 M)        | (\$125.8 M)       |

- Base Case* – The Base Case Forecast is built on the assumption of a slowing economy that still has signs of moderate levels of growth. The local region is anticipated to slightly improve in 2024-2025, with unemployment levels expected to very modestly improve. While inflation has still not returned to pre-pandemic levels, due to the relative slowness of the economy, the Federal Reserve is anticipated to reverse course from the continuous interest rate hikes that were used in the past two years to combat the soaring inflation that was occurring. As interest rates level off and then decline, the real estate market is anticipated to improve. Median home prices have remained high over the past few years; however, activity levels have been declining. With the anticipation of declining mortgage rates, home sale activity levels are estimated to improve, which will positively impact the Real Property Transfer Tax. Property Tax receipts are anticipated to continue to grow but at a slower rate. Commercial property re-assessments are anticipated to negatively impact Property Tax growth, but due to the timing of re-assessments, that impact is not anticipated until 2025-2026. Other economically sensitive revenue categories, such as Sales Tax and Transient Occupancy Tax revenue are anticipated to have moderate growth throughout the forecast period.
- Optimistic Case* – The Optimistic Case Forecast assumes that the national economy grows at a faster pace in the Optimistic Case. Higher than forecasted national and local employment levels signify improved national economic conditions that will trickle down to local economies and, along with higher levels of inflation, result in higher tax revenues than the Base Case. Due to boosted economic activity, housing prices rise to higher levels through the entire forecast period. These growth factors result in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.
- Pessimistic Case* – The Pessimistic Case Forecast assumes a longer period of slow growth with a corresponding growth of unemployment rates. Decreases are assumed for several of the key determinants of the City’s revenues, including home prices and property sales. These factors further decrease national and local economic activity, which deepens into a recession scenario. However, this scenario does not assume an economic crash at local or national levels. In this scenario, economically sensitive revenues, particularly Property Tax and Sales Tax, are significantly negatively impacted by an economic slowdown.

***Capital Revenue Forecast***

*Section V – Capital Revenue Forecast* of this report describes the Capital Revenue Forecast that will be used to develop several major elements of the 2024-2025 Capital Budget and the 2025-2029 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 D* of this document (Development Activity Trends and Five-Year Forecast 2025-2029). 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 2024-2028 Adopted CIP. As shown below, revenues are anticipated to increase by 6.7% compared to the Adopted CIP, from \$396.6 million to \$423.2 million.

**Capital Revenue  
Forecast Comparison Summary  
(\$ in thousands)**

|  | <b>2024-2028<br/>Adopted</b> | <b>2025-2029<br/>Forecast</b> | <b>Difference</b> | <b>%<br/>Change</b> |
|--|------------------------------|-------------------------------|-------------------|---------------------|
| <b>Construction and Conveyance Tax</b>         | \$215,000                    | \$240,000                     | \$25,000          | 11.6%               |
| <b>Building and Structure Construction Tax</b> | 95,000                       | 94,000                        | (1,000)           | (1.1%)              |
| <b>Construction Excise Tax</b>                 | 82,000                       | 85,000                        | 3,000             | 3.7%                |
| <b>Municipal Water System Fees</b>             | 175                          | 225                           | 50                | 28.6%               |
| <b>Residential Construction Tax</b>            | 1,000                        | 1,000                         | 0                 | 0%                  |
| <b>Sanitary Sewer Connection Fee</b>           | 2,500                        | 2,500                         | 0                 | 0%                  |
| <b>Storm Drainage Connection Fee</b>           | 875                          | 500                           | (375)             | (42.9%)             |
| <b>TOTAL</b>                                   | <b>\$396,550</b>             | <b>\$423,225</b>              | <b>\$26,675</b>   | <b>6.7%</b>         |

Real estate activity (primarily housing sales) determines the collection level of the Construction and Conveyance Tax. After reaching a record setting high of \$64.5 million in 2021-2022, tax collections fell in 2022-2023 to \$38 million, and are anticipated to decline further to \$35.0 million in 2023-2024 due to a constrained real estate market, which is the primary driver of this tax. This collection level is 7.7% below the actual receipts received in 2022-2023 (\$37.9 million). Collections in this extremely volatile revenue category are forecasted to increase to \$40.0 million in 2024-2025, \$45.0 million in 2025-2026, \$50.0 million in 2027-2028, and \$55.0 million in 2028-2029.

Based on projections provided by PBCE, construction activity valuation is anticipated to be lower than the prior year at \$1.28 billion in 2023-2024, a 2% decrease compared to \$1.30 billion in 2022-2023. Construction valuation is projected to increase at a slower rate than the 2024-2028 Five-Year Forecast, with slight increases throughout the five-year forecast period, growing from \$1.24 billion in 2024-2025 to \$1.36 billion in 2028-2029. For the second fiscal year in a row, the City experienced a decline in the valuation of new construction permits in 2022-2023, specifically in both commercial and industrial sectors, which was most likely due to increased construction costs, sustained high-interest rates, and a more cautious approach toward capital investment decisions due to uncertainty about future workspace needs. However, construction valuation for additions and alterations in 2022-2023 decreased from the prior year yet remained higher than in fiscal years 2019-2020 and 2020-2021. There are various reasons behind the elevated additions and alterations activities. For commercial and industrial properties, the property owners are repositioning their properties to retain tenants and to fill vacant spaces for new tenants.

The five-year projection for the Building and Structure Construction Tax collections total \$94.0 million, \$1.0 million less than the estimate included in the 2024-2028 Adopted CIP. It is projected that collections will remain flat at \$17.0 million for this year and next year, increase to \$18.0 million in 2025-2026, \$19.0 million in 2026-2027, and \$20.0 million in 2027-2028 and remain at that level for the remainder of the forecast period. Construction Excise Tax collections are projected to total \$85.0 million over the five-year forecast period, \$3.0 million more than the estimate included in the 2024-2028 Adopted CIP. It is projected that collections will increase from the 2023-2024 estimate of \$15.0 million to \$16.0 million in 2024-2025, \$17.0 million in 2025-2026 and remain at that level through 2027-2028, and then increase to \$18.0 million in 2028-2029.

#### **NEXT STEPS IN THE 2024-2025 BUDGET PROCESS**

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

##### ***March 2024***

- 2024-2025 Mayor's March Budget Message Released with Public Hearing; Amended/Approved by City Council

##### ***April 2024***

- 2024-2025 Proposed Capital Budget and 2025-2029 Proposed CIP Released

### ***May 2024***

- 2024-2025 Proposed Operating Budget and 2024-2025 Proposed Fees and Charges Released
- 2024-2025 Community Budget Meetings
- City Council Study Sessions and Initial Public Hearing on 2024-2025 Proposed Operating Budget, 2024-2025 Proposed Capital Budget and 2025-2029 Proposed CIP, and 2024-2025 Proposed Fees and Charges

### ***June 2024***

- 2024-2025 Mayor's June Budget Message Released with Final Public Hearing; Amended/Approved by City Council
- 2024-2025 Operating Budget, 2024-2025 Capital Budget and 2025-2029 CIP, and 2024-2025 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 CIP. A small General Fund shortfall of \$3.6 million is projected for 2024-2025, which constitutes approximately 0.2% of the General Fund Base Budget, followed by a larger shortfall of \$37.6 million (2.3%) in 2025-2026, followed by incremental shortfalls ranging from \$17.8 million to \$6.7 million over the remaining years.

As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. It is also important to keep in mind that this Forecast does not reflect several elements that would impact the General Fund over the forecast period, including: 1) costs associated with services that were funded on a one-time basis in 2023-2024; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs. It also does not include new costs to meet the State of California's regulatory requirements of the new Municipal Regional Stormwater Permit related to homeless residents living along waterways.

As with all forecasts, there is uncertainty regarding the expenditure and revenue estimates contained in this document and projections are based on incomplete information. All expenditure and revenue projections for 2024-2025 will continue to be refined over the next several months as additional data becomes available, including data from recent Sales Tax receipts, Property Tax roll growth data, and any new economic data, which could substantially alter assumed revenue growth across economically sensitive categories. Based on this additional data, any necessary adjustments will be incorporated into the 2024-2025 Proposed and Adopted Operating Budgets, as appropriate.

HONORABLE MAYOR AND CITY COUNCIL

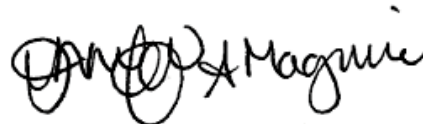
March 1, 2024

**Subject: 2024-2025 City Manager's Budget Request and 2025-2029 Five-Year Forecast**

Page 23

This document also provides the recommended 2024-2025 City Manager's Budget Request (Budget Balancing Strategy Guidelines and Cost Estimate Request and City Council Budget Document Guidelines) for consideration by the City Council as part of its review of the Mayor's March Budget Message. The over-arching goals of the Budget Balancing Strategy Guidelines are to continue operational and fiscal stability while delivering services to our community in a cost-effective manner.

Over the past many years, the Mayor and City Council have remained committed to ensuring the fiscal health of the City while delivering essential services in the most cost-effective manner. Continued adherence to these strategies will help ensure a responsible approach to budgeting to ensure that the City can sustain critical community services into the future.

A handwritten signature in black ink, appearing to read "Jennifer A. Maguire". The signature is stylized and cursive.

Jennifer A. Maguire  
City Manager

Attachment A

Programs Funded on a One-Time Basis in the General Fund in 2023-2024

# ATTACHMENT A

## 2023-2024 ADOPTED OPERATING BUDGET

### Services/Programs Funded on a One-Time Basis in the General Fund in 2023-2024\*

| DEPT    | PROPOSAL TITLE   | FTE   | AMOUNT     |
|---------|--|-------|------------|
| CAO     | Gun Violence Restraining Order Staffing                                  | 1.00  | 162,000    |
| CMO     | Climate and Seismic Resilience Planning                                  |       | 463,000    |
| CMO     | API - Disability Community Engagement and Service Evaluation             | 1.00  | 180,000    |
| ESD     | Climate Smart San Jose Contractual Services                              |       | 400,000    |
| Finance | Disaster Recovery and Grants Management Staffing                         | 4.00  | 693,000    |
| HR      | Recruitment Centralization Pilot Program                                 | 5.00  | 802,000    |
| HR      | Employee Training and Development Staffing NP/E                          |       | 200,000    |
| HR      | Classification and Compensation Staffing                                 | 1.00  | 157,000    |
| ITD     | San Jose 311 Program   | 3.00  | 563,000    |
| OEDCA   | Small Business Recovery - Supplemental Arts + Cultural Funding           |       | 1,000,000  |
| OEDCA   | Storefront Activation Grant Program                                      |       | 750,000    |
| PBCE    | Vacant Building Blight Enforcement                                       |       | 170,000    |
| Police  | Police Department Sworn Backfill Reserve                                 |       | 5,000,000  |
| Police  | Sworn and Non-Sworn Recruiting and Backgrounding                         |       | 1,250,000  |
| Police  | Coyote Creek and Guadalupe River Trail Patrol                            |       | 800,000    |
| Police  | Police Public Records Team Staffing                                      |       | 350,000    |
| Police  | Psychiatric Emergency Response Team                                      |       | 180,000    |
| Police  | Police Officer Lateral Incentive Program                                 |       | 150,000    |
| Police  | Traffic Safety and Illegal Sideshows                                     |       | 100,000    |
| PRNS    | CaliforniansForAll Youth Workforce Program - Climate Change Pathway      |       | 2,850,000  |
| PRNS    | Beautify San Jose - RV Pollution Prevention Pilot                        | 5.00  | 1,800,000  |
| PRNS    | Beautify San Jose - Waterways Trash Pilot                                | 4.00  | 1,600,000  |
| PRNS    | Beautify San Jose - Blight Reduction Gateways Team Pilot                 | 4.00  | 1,500,000  |
| PRNS    | Child and Youth Programming Staffing                                     | 4.25  | 529,000    |
| PRNS    | Beautify San Jose - Beautify Your Block                                  | 3.00  | 504,000    |
| PRNS    | Beautify San Jose - Cash for Trash Expansion                             | 2.00  | 382,000    |
| PRNS    | Enhanced Blight Response Near Emergency Interim Housing Communities      |       | 350,000    |
| PRNS    | Starbird Youth Center and Berryessa Youth Center Out of School Programmi | 3.75  | 267,000    |
| PRNS    | Alum Rock Park Staffing  | 1.00  | 169,000    |
| PRNS    | BeautifySJ Grant   |       | 150,000    |
| PRNS    | Senior Nutrition Program - Alviso  |       | 40,000     |
|         |  | 42.00 | 23,511,000 |

\*Not a comprehensive list. In addition, above items may not include all services captured by the rebudgeting funds intended to span a multi-year period.