Five-Year Economic Forecast and Revenue Projections

2017-2021

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Overview

This document provides three alternative Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2016-2017 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast, however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment that affect the City's revenue collections.

- **Base Case –** The Base Case Forecast is built on the assumption of slowing, but still moderate, economic growth. At the local level, venture capital investment in the technology industry is reduced, resulting in a slowing of job growth, employment levels, and real estate activity. However, this is balanced against near-term foreign investment in the technology industry and local real estate market. Overall, this will result in a subdued decline in the growth rate of the local economy and ultimately the City's revenues. In the Base Case Forecast, General Fund revenue collections are anticipated to experience slow growth over the forecast period.

- **Optimistic Case –** The Optimistic Case assumes somewhat faster economic growth than anticipated in the Base Case, but still slower than that experienced in recent years. When compared to the Base Case scenario, the real estate market remains strong with increased housing prices and increased non-residential construction. These factors contribute to higher inflation growth than in the Base Case. The optimistic case presumes that employment will continue to expand beyond what was included in the Base Case. This stronger growth results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.

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

Elements of The General Fund Forecast

Assumptions Regarding the Economic Environment

Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, both now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2016-2017 Proposed Operating Budget, scheduled to be published on May 1, 2016.

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

Current National Economic Conditions

The U.S. economy is currently growing at a relatively good pace. Real U.S. Gross Domestic Product (GDP) increased by 2.4% in 2015, similar to the rate in 2014. The real GDP in 2015 primarily reflected positive contributions from personal consumption expenditures, non-residential fixed investment, residential fixed investment, private inventory investment, state and local government spending, and exports.[1] The U.S. unemployment rate stood at 4.9% in January 2016, down from 5.7% in January 2015, according to the U.S. Department of Labor's Bureau of Labor Statistics February 5, 2016 report. The economy is operating at or very close to the traditional definition of full employment. However, because the employment to population ratio of 59.3% is four percentage points below the level prior to the start of the financial crisis in 2006, many residents across the country may feel that the job environment is less robust than compared to previous economic upswings.[2]

Some of the key drivers to the U.S. economy include new housing construction, automotive manufacturing and sales, and a still robust technology sector. Car sales are very strong at over 17 million cars per year, matching last year's pace. In addition to the relatively low unemployment rate, low interest rates and continued improvements in models, including electric vehicles, are pulling buyers into showrooms at a very strong pace. This high volume of sales is expected to continue into the foreseeable future. The automotive sector represents a large and important employment sector in the economy and a base component of the U.S.'s industrial production sector.

[1] U.S. Department of Commerce Bureau of Economic Analysis, GDP Increases in Fourth Quarter, January 29, 2016
[2] The UCLA Anderson Forecast for the Nation and California, December 2015 Report

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

The real estate market continues to improve on a national level, though new construction continues to lag. As the pace of nationwide sales slowed somewhat during the final three months of 2015, prices continued their upward trajectory in most of the U.S. According to Lawrence Yun, National Association of Realtors Chief Economist, "… [the] unshakeable trend of inadequate supply in relation to the overall pool of prospective buyers inflicted upward pressure on home prices…", as evidenced by a national median existing single-family home price in fourth quarter 2015 up 6.9% from the fourth quarter of 2014.[3] Regarding new housing stock, privately owned housing starts in December were at a seasonally adjusted annual rate of 1.15 million. This activity level was 2.5% below the revised November estimate of 1.18 million, but still 6.4% above the December 2014 rate of 1.08 million.[4] In a normal year, housing starts have historically averaged around 1.5 million to 1.6 million units per year.

Despite the strong growth in automotive sales, home sales, and large investments in the technology industry, the energy sector may be a potential economic drag. With recent improvements in extraction technologies, many countries have increased oil production, with the United States recently becoming one of the leading oil producers. The price of oil has seen a corresponding sharp decline from $90 a barrel for most of 2014 to around $30 a barrel (at the time of this forecast). There is both good and bad news about this radical shift; the price decline will free up consumer disposable income to spend on items other than gasoline and other petroleum products; however, the decline also means that some domestic oil producers cannot profitably extract oil and, in certain cases, creates a risk of loan defaults within the oil industry that may have some spillover effects into the broader economy.

National Economic Outlook

Moderate continued economic growth appears likely for the next several years, driven by growth across most sectors of the economy. According to the December 2015 UCLA Anderson Business School Forecast, continued job growth, along with wage increases, will power consumption in 2016, leading to a greater than 3% growth in real GDP for the first time since 2005. Higher wages along with a modest rebound in oil prices and higher housing costs will push the inflation rate above 2%. Strength is anticipated in housing and commercial construction along with a booming automobile market.

A modest rate of inflation is a key driver for business and consumer demand and for future property and sales taxes. The Consumer Price Index (CPI) declined 0.1% in December 2015 (seasonally adjusted) and increased 0.7% over the last 12 months (before seasonal adjustment).[5] The Federal Reserve Board continues to target a core annual inflation rate of 2% and continues to signal that it will begin to gradually raise interest rates in 2016, though will be influenced by any changes in economic conditions as they arise.

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[3] National Association of Realtors, News Release, February 10, 2016
[4] U.S. Census Bureau and U.S. Department of Housing and Urban Development, News Release, January 20, 2016
[5] U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index News Release, January 20, 2016

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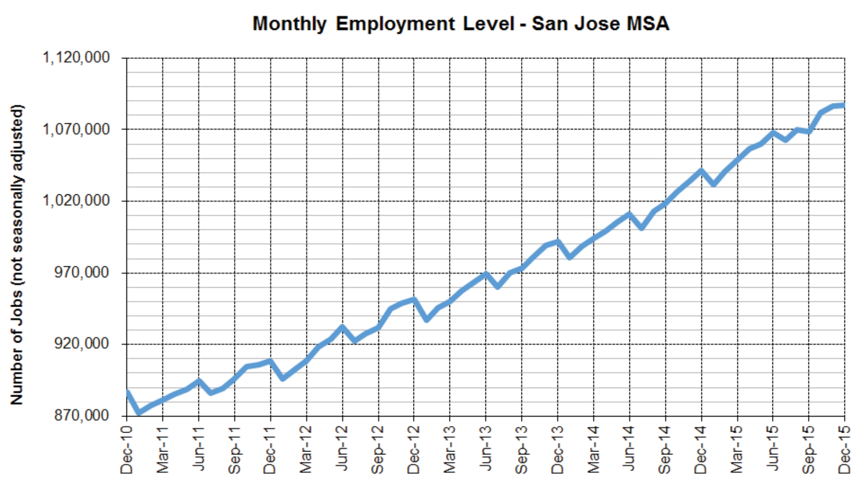
Base Case Forecast

The December 2015 UCLA Anderson Business School Forecast assumes that GDP growth will slow to 2.6% in 2017 as a result of the tightening labor market and the move towards interest rate normalization. The declining oil prices currently being experienced in the U.S. is dampening overall economic growth, however, oil prices will begin to rebound in 2016 as domestic output is cut back. Further, housing costs are rising, and inflation as measured by the core CPI, which excludes volatile food and energy prices, is projected to increase by 2.3% in 2016 and 2.6% in 2017.

At a global level, the significant slowdown of the Chinese economy and the continued weakness of many European economies should not be ignored; however, this forecast anticipates that those situations are managed without significant impact to the U.S. economy.

Current City of San José Economic Conditions

Economic performance in Silicon Valley continues to show strength above that experienced nationally and state-wide. Most local economic indicators, including employment, local construction, and real estate activity measures, show solid economic growth.



The San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (MSA) continues to report positive trends in employment. Total employment grew by 46,100, or 4.4%, above the 1.04 million jobs in December 2014 to a preliminary estimate of 1.09 million in December 2015. Professional and business services advanced by 17,200 jobs from last December, marking its 68th consecutive monthly gain on a year-over-year basis. Professional, scientific, and technical services posted more than four-fifths of the increase. Private educational and health services experienced an 8,600-job gain during 2015. Information (up 7,200 jobs), computer systems design (up 4,000 jobs), and computer and electronic products manufacturing (up 3,900 jobs), represented 15,100 jobs, or 32.8 percent of the net total job gain in the MSA.

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Unemployment Rate (Unadjusted)

	Dec. 2014	Nov. 2015	Dec. 2015**
San José Metropolitan Statistical Area*	4.5%	3.9%	3.8%
State of California	6.8%	5.7%	5.8%
United States	5.4%	4.8%	4.8%

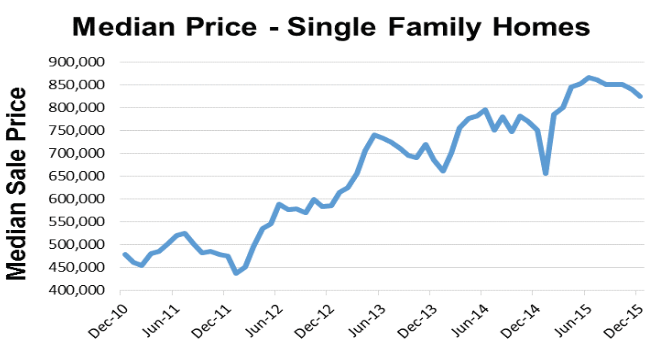
* San Benito and Santa Clara Counties
** Preliminary Estimate
Source: California Employment Development Department

The unemployment rates at the local, State, and national levels remain low. In December 2015, the unemployment rate for the San José MSA of 3.8% represents a slight decrease from the November 2015 rate of 3.9%, but is solidly below the 4.5% rate experienced a year ago. In this region, the December 2015 unemployment rate is less than the unadjusted unemployment rate for the State (5.8%) and the nation, which has a current unadjusted unemployment rate of 4.8%.

Private Sector Construction Activity (Valuation in $ Millions)

	July-Dec. 2014	July-Dec. 2015	% Increase/ (Decrease)
Residential	$ 363.3	$ 245.0	(32.6%)
Commercial	$ 130.7	$ 137.9	5.5%
Industrial	$ 138.2	$173.0	25.2%

Local construction activity remains relatively strong through December 2015; however, it is tracking below prior year levels, driven primarily by a significant drop in the residential sector. Although residential activity is significantly lower than the prior year, it is anticipated that activity will strengthen in the 3rd and 4th quarters of this fiscal year. Overall commercial valuation through December is above the 2014-2015 level ($137.9 million in 2015-2016 vs $130.7 million in 2014-2015). New industrial construction and alteration activity is up compared to prior year levels.



Performance in the housing market continues to be strong, with rising sale prices coupled with a high number of property transfers. The median single-family home price was $825,000 in December 2015, an increase of 10.0% from the median home price of $750,000 in December 2014. In addition, the number of property sales totaled 8,355 in 2015, an increase of 9.4% when compared to the 7,636 sales that occurred in 2014.

The number of listings of new single-family and multi-family dwellings has increased approximately 7.3%, from 300 listings in December 2014 to 322 listings in December 2015.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

City of San José Economic Outlook

While most of the above metrics have improved or remained at elevated levels when compared to the previous year, the local economy is expected to enter a period of slower economic growth, and as such the economic indicators driving this forecast are lower than the previous year's forecast. One of the notable changes in the local economy from last year's forecast is the decline in Silicon Valley venture capital investment that started in the 3rd quarter 2015 and, in the 4th quarter, dropped below 2014 levels. Due to the concentration of technology firms in the Silicon Valley, this region is heavily influenced by the technology sector. With venture capital investment in new technology companies declining and the downward revisions assessed to some technology startups' valuations, future employment levels and job growth are at risk of slowing or declining. Should job growth in the region slow significantly, a moderation or decline in housing prices would likely follow.

In the near term, foreign investment, primarily from China, is anticipated to help maintain investment levels in the technology industry and local real estate. However, the weakened economic environment in China will continue to be monitored. China is a large consumer of investments in technology companies and real estate in Silicon Valley. Should the economy in China deteriorate and government controls are placed on the outflow of money, a loss or slowed investment in Santa Clara County may occur.

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

Optimistic Case

In the Optimistic Case, the economy is assumed to continue to grow at a somewhat more rapid pace than assumed in the Base Case. This growth is primarily due to greater employment growth and greater inflation in both the national economy and at the local level.

The Optimistic Case is based partly on the assumption that the real estate sector, nationally and locally, continues to increase due to higher home prices and an increase in the number of new home starts over the next several years. With mortgage rates still low, employment increases and a well-performing stock market could spur a greater number of home purchases. As a partial result of more rapid new home construction, the country's overall employment and wage levels continue to improve.

Under the Optimistic Case, the economically sensitive revenues are expected to experience stronger performance as general increases in employment and consumer attitudes promote increased spending, which generates Sales Tax for the City. Improvement in the real estate market will result in higher Property Tax revenues. Conversely, Gas Taxes are slightly lower as a result of a faster return to normal oil prices and continued increases in mandated fuel economy, which is anticipated to cause the number of taxable gallons consumed to fall.

ELEMENTS OF THE GENERAL FUND FORECAST

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Optimistic Case

It should be noted that, as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve, therefore no change in Transient Occupancy Tax growth is modeled as part of this case as there is no impact to the operating margin.

Pessimistic Case

The Pessimistic Case assumes significantly lower growth for several of the key determinants of the City's revenues. Local employment, local housing, and local inflation are all lower than those of the Base Case. Like the Optimistic Case, the prospects for a lower scenario could still occur and are likely more plausible at this time than the optimistic case.

Under the Pessimistic Case, employment and home prices decline beyond those in the Base Case. As home prices and related construction activity decline, job growth would negatively impact all sectors of the economy. Decreased revenue collections in categories such as Property Tax, Sales Tax, and Transient Occupancy Tax would be realized when compared to the Base Case. Lower employment levels, along with very low inflation also impact these revenues. Conversely, Gas Taxes are slightly up due to projected reductions in oil prices which typically results in increased gas consumption.

As noted in the Optimistic Case, as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve, therefore no change in Transient Occupancy Tax growth is modeled as part of this case as there is no impact to the operating margin.

Impact of Forecasted Economic Conditions on Revenue Collections

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

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Impact of Forecasted Economic Conditions on Revenue Collections

An in-depth analysis of the General Fund revenue categories was completed to develop 2016-2017 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2015-2016 and build upon those projections to develop the 2016-2017 revenue estimates. These estimates are based on the Base Case Forecast economic scenario described in this section. These revenue estimates will be closely examined and updated again during the preparation of the 2016-2017 Proposed Operating Budget scheduled to be released on May 1, 2016.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

As displayed in the General Fund Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from $1.0 billion in 2016-2017 to $1.1 billion in 2020-2021, for an average growth rate of 2.67% per year.

February 2017-2021 Forecast
Revenue Summary

General Fund Revenue Category	Modified Budget 2015-2016	Forecast 2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
General Revenues						
Property Tax	255,210,000	270,625,000	284,914,000	298,704,000	311,279,000	322,672,000
Sales Tax	190,260,000	194,196,000	199,652,000	204,644,000	212,379,000	221,809,000
Transient Occupancy Tax	17,136,000	17,821,000	18,712,000	19,648,000	20,434,000	21,251,000
Franchise Fees	47,582,232	48,903,000	49,857,000	50,889,000	52,039,000	53,538,000
Utility Tax	93,825,000	95,750,000	95,970,000	96,757,000	97,657,000	99,219,000
Telephone Line Tax	21,000,000	21,614,000	21,679,000	21,727,000	21,770,000	21,809,000
Business Tax	44,425,000	48,450,000	48,673,000	48,916,000	49,195,000	49,525,000
Licenses and Permits	50,221,223	50,818,000	52,952,000	55,282,000	57,272,000	59,506,000
Departmental Charges	42,684,658	39,328,000	40,979,000	42,783,000	44,323,000	46,051,000
Fines, Forfeitures & Penalties	15,356,042	14,911,000	15,084,000	15,394,000	15,542,000	15,699,000
Money and Property	4,207,909	3,864,000	3,906,000	3,965,000	4,064,000	4,206,000
Revenue from Local Agencies	16,447,530	22,875,000	23,150,000	23,254,000	23,524,000	23,768,000
Revenue from the State	12,314,002	10,442,000	10,265,000	10,265,000	10,265,000	10,265,000
Federal Revenue	12,860,061	2,439,000	1,117,000	0	0	0
Other Revenue	129,530,651	14,828,000	14,922,000	9,335,000	8,795,000	8,915,000
Gas Tax	16,900,000	17,500,000	17,642,000	16,772,000	15,819,000	15,701,000
Total General Revenues	969,960,308	874,364,000	899,474,000	918,335,000	944,357,000	973,934,000
Transfers & Reimbursements						
Overhead Reimbursements	37,431,363	40,053,000	41,736,000	43,572,000	45,141,000	46,901,000
Transfers	21,241,793	20,856,000	21,406,000	21,811,000	22,238,000	22,793,000
Reimbursements for Services	757,341	667,000	695,000	725,000	751,000	781,000
Total Transfers & Reimbursements	59,430,497	61,576,000	63,837,000	66,108,000	68,130,000	70,475,000
Total General Fund Revenues	1,029,390,805	935,940,000	963,311,000	984,443,000	1,012,487,000	1,044,409,000
Beginning Fund Balance	265,520,448	65,826,000	65,648,000	66,803,000	67,808,000	68,908,000
Grand Total Sources	1,294,911,253	1,001,766,000	1,028,959,000	1,051,246,000	1,080,295,000	1,113,317,000
Growth %			2.71%	2.17%	2.76%	3.06%

Understanding the basis for the revenue estimates included in this Forecast requires a discussion of the assumptions used for estimating each of the revenue categories. The following discussion focuses on estimates used for the 2016-2017 General Fund Forecast.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

Property Tax receipts of $256.2 million are projected for 2015-2016, which is slightly above the modified budget estimate of $255.2 million. In 2016-2017, Property Tax collections are expected to increase 5.6% to $270.6 million. Additional information about each of the Property Tax sub-categories is provided below.

Secured Property Taxes account for over 90% of the revenues in this category. In 2015-2016, Secured Property Tax receipts are expected to total $234.0 million, reflecting an increase of 4.4% from the 2014-2015 collection level. Excluding the impact of payments resulting from excess Educational Revenue Augmentation Fund (ERAF) funds, Secured Property Tax receipts are projected to increase 6.4% in 2015-2016. This reflects an increase in assessed value for 2015-2016, due to the California Consumer Price Index (CCPI) increase of 1.998%, increased valuation due to changes in ownership or new construction, and the full or partial restoration of property values that were temporarily reassessed downwards under Proposition 8 due to the declining market value. On a County-wide basis, the 2015-2016 roll growth was driven primarily by changes in ownership (42.7%), new construction (15.8%), change in the CCPI (15.79%), and Proposition 8 adjustments (9.45%). In addition to the assessed value growth, a one-time payment of $2.0 million is currently projected in 2015-2016 as a result of excess ERAF funds. Beginning in 1992, agencies have been required to reallocate a portion of property tax receipts to the ERAF, which offsets the State's General Fund contributions to school districts under Proposition 98. However, once there are sufficient funds in ERAF to fulfill obligations, the remainder is to be returned to the taxing entities that contributed to it. In 2014-2015, the City received $6.0 million from excess funds in 2013-2014. Information regarding the payment this fiscal year is expected to be received from the County in March 2016 and could total last year's level, which would generate an additional $4.0 million in 2015-2016. The Administration will continue to monitor the distribution of ERAF receipts and may adjust the budget once further information is provided by the County.

In 2016-2017, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2016, are expected to increase by 6.0% to $248.3 million. Consistent with the current estimate for 2015-2016, an ERAF payment of $2.0 million is incorporated into the 2016-2017 Secured Property Tax estimate. This projected increase is related to two factors: the change in the CCPI and the net change in residential and commercial valuation. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. The CCPI adjustment for the 2016-2017 tax roll is 1.525%; below the prior year level of 1.998%. A net increase in residential and commercial valuation is also anticipated from the combination of changes in ownership, new construction, and the continued partial or full restoration of property values that had previously been reassessed downward under Proposition 8 due to declining home values. The majority of properties that had been adjusted downwards during the "Great Recession" have been fully or partially restored. As a result, these adjustments are expected to be less of a contributing factor to the growth in this category than experienced in recent years. The increases in property sale prices will continue to be a positive factor driving growth in this category. In

REVENUE FORECAST

Property Tax

calendar year 2015, residential real estate experienced gains as the December 2015 median sales price of $825,000 for single-family homes was 10.0% above the December 2014 level of $750,000.

It should be noted that final data on the actual tax levy for 2016-2017 is not yet available as adjustments are made through June 30, 2016. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Many of the adjustments, however, are not reflected until the latter months of a given fiscal year (April-June). The impact of reassessments of commercial property will not be known until the end of 2015-2016. As this information becomes available, refinements to the Property Tax estimates may be brought forward during the 2016-2017 budget process.

Unsecured Property Taxes are the second largest revenue source in this category. Growth in this category is driven primarily by increases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections through December, Unsecured Property Tax receipts are estimated at $14.0 million in 2015-2016, which is 5.7% above the prior year level of $13.2 million. Collections are expected to increase 2.0% in 2016-2017 to $14.2 million based on the current economic conditions.

SB 813 Property Taxes (supplemental taxes) represent payments for taxes owed on recent housing resales. In 2015-2016, receipts are estimated at $4.3 million, which is significantly below the prior year collection level of $6.3 million. In 2014-2015, the County continued to process a backlog of reassessments, resulting in higher collections in that year. The backlog has now been addressed, and receipts are expected to normalize in 2015-2016. In 2016-2017, collections in this category are projected to increase approximately 4.0% to $4.4 million.

The **Aircraft Property Tax** payment is estimated at $2.6 million in 2015-2016, a 12.9% increase from the 2014-2015 collection level. In 2016-2017, receipts are anticipated to remain flat at $2.6 million.

The **Homeowners Property Tax Relief** category is projected at $1.0 million for 2016-2017, which is consistent with the 2015-2016 revenue estimate and 2014-2015 actual collections.

In the out years of the Forecast, annual Property Tax receipts are projected to increase approximately 3.7% to 5.3% annually over the five-year period. A portion of this growth is due to an estimated 2% CCPI increase annually.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Sales Tax

The Sales Tax category includes General Sales Taxes and Proposition 172 Sales Taxes. Excluding all one-time revenues associated with the "Triple Flip[1]," 2015-2016 collections are expected to increase 3.6% over prior year levels to $187.6 million. In 2016-2017, year-over-year growth of 3.5% is expected, bringing the projected revenue to $194.2 million. Following is a discussion of the Sales Tax sub-categories.

For the General Sales Tax revenue category, only one quarter of 2015-2016 data is available. Based on this limited information, year-over-year growth of 3.7% is projected in 2015-2016 (excluding one-time Triple Flip payments), resulting in collections of $181.9 million. The 2015-2016 estimate reflects actual growth of 2.89% in the first quarter and projected underlying growth of 4.0% in the remaining three quarters based on recent sales tax performance and current economic conditions. In the 2015-2016 Adopted Budget, it was also assumed that $2.2 million would be received as a 2014-2015 Triple Flip true-up payment. With this true-up payment, collections in 2015-2016 are expected to reach the budgeted estimate of $184.1 million. This figure does not include the significant one-time funding that will be received with the wind down of the "Triple Flip".

While not assumed in the development of the 2015-2016 Adopted Budget due to uncertainty regarding the timing of the action, the Triple Flip wind down is now expected to occur in 2015-2016. On August 5, 2015, the Department of Finance notified the California State Board Equalization and the public that the State's Triple Flip "unwinding" process will be initiated with the defeasance of the Economic Recovery Bonds. It is estimated that the final true-up payment associated with the Triple Flip wind down will be made in August 2016 and will be accrued to 2015-2016. Based on information from the City's Sales Tax consultant, MuniServices, the anticipated final payments associated with Triple Flip are expected to generate additional revenue of $10.0 - $13.0 million above the budgeted estimate of $184.1 million.

For 2016-2017, the General Sales Tax revenue projection of $188.3 million assumes moderate growth of 3.5% in taxable sales from 2015-2016 levels. The Sales Tax revenue projections for 2015-2016 will continue to be refined over the next few months as additional information becomes available. Sales Tax data for the second quarter of 2015-2016, which covers the 2015 holiday period, will be received in March 2016. Based on this additional data, any necessary adjustments to the estimate will be incorporated into the 2016-2017 Proposed Operating Budget. Any further adjustments that may be recommended based on third quarter collections (January through March period) will be brought forward through a Manager's Budget Addendum in June or through the Annual Report that is released in September, as appropriate.

[1] As part of the Proposition 57 State fiscal recovery funding mechanism (passed by the voters in March 2004), one-quarter cent of the City's one cent Bradley Burns sales tax has been temporarily suspended and replaced dollar-for-dollar with property tax revenue. This action, which went into effect on July 1, 2004, remains in effect until the State's bond obligations have been satisfied, which is anticipated in 2016.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Sales Tax

Proposition 172 Sales Tax collections (representing the one-half cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total $5.7 million in 2015-2016, which is at the prior year collection level. In 2016-2017, collections are projected to increase 3.5%, to $5.9 million.

In the out-years of the Forecast, annual Sales Tax performance is expected to show growth of 2.5% to 4.4% annually over the five-year period.

Transient Occupancy Tax

Currently, Transient Occupancy Tax (TOT) receipts in 2015-2016 are projected to reach $17.1 million, reflecting an increase of 16.3% from the 2014-2015 collection level. Current year receipts mark the sixth year of growth and the fifth year of double-digit strong growth in this category. While TOT receipts are up from prior year, occupancy levels through January 2016 as compared to the prior year decreased slightly by approximately 1%, while average room rates were up 11.8% from $165.85 to $185.43. The average revenue-per-available room, however, increased by approximately 11%, from $123.79 through January 2015 to $137.28 through January 2016.

In 2016-2017, growth of 4.0% from the 2015-2016 estimate to $17.8 million is anticipated based on information received from the City's consultant, Conventions, Sports and Leisure (CSL), which reflects continued strong performance in this category. In the out years of the forecast, revenues are anticipated to grow between 3.0% to 5.0% annually. As directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve. In this Forecast, the annual amount allocated to this reserve increases from $5.9 million in 2016-2017 to $9.4 million in 2020-2021.

Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Commercial Solid Waste, Cable, Tow, Water, and Nitrogen Gas/Jet Fuel Pipeline categories. Overall, collections are projected at $48.2 million in 2015-2016, an increase of 2.7% from prior year receipts of $46.9 million. The projected increase in 2015-2016 is primarily due to higher collections in Cable and Electricity receipts. In 2016-2017, Franchise Fees are expected to increase 1.6% to $48.9 million, due to growth in Gas (2.0%), Electricity (2.0%), and Cable (2.0%) categories.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2015-2016 are based on the calendar year 2015). Year-end estimates are typically based upon an examination of electricity

REVENUE FORECAST

Franchise Fees

and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. The reconciliation of annual receipts from PG&E for 2015-2016 will be received in April 2016.

In the **Electricity Franchise Fee** category, collections in 2015-2016 are expected to reach $20.4 million, reflecting growth of approximately 3.0% compared to actual receipts in 2014-2015. In 2016-2017, growth of 2.0% from 2015-2016 estimates is projected. Based on the rate increases for January 2016 (average system-wide 6.2%) and March 2016 (average system-wide 1.5%), additional slight upward adjustments may be brought forward based on actual performance with these new rates.

In the **Gas Franchise Fee** category, the 2015-2016 estimated collections of $4.7 million reflect an increase of less than 1% from the $4.6 million received in the prior year. In 2016-2017, Gas Franchise Fee collections are projected to increase by approximately 2.0%. Rates are projected to increase in 2016, with the average residential gas bill expected to increase approximately 4%. However, actual collections can fluctuate significantly due to consumption changes associated with the weather as well as rate changes.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach budgeted levels of $11.4 million in 2015-2016, 2.0% above the prior year collections. Collections reflect the revised methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010, the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The new fee structure is a base of $5 million per year for each of two geographic collection districts plus a supplemental fee of $1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the CPI rate during the prior two calendar years. It should be noted that this increase is not automatic, and is subject to City Council approval each year. Therefore, the 2016-2017 estimate of $11.4 million does not automatically assume growth from 2015-2016 as City Council approval of a rate increase would be required.

In the **Cable** Franchise Fee category, the estimated 2015-2016 collections of $10.4 million reflect growth of 4.0% from the prior year receipts. In 2016-2017, additional growth of 2% is projected, bringing the estimate to $10.6 million.

In **City Generated Tow**, projected revenues of $900,000 in 2015-2016 are consistent with prior year levels. Collections are anticipated to remain flat at $900,000 in 2016-2017.

Remaining categories, including **Water, Nitrogen Gas Pipeline**, and **Jet Fuel Pipeline**, are estimated to end 2015-2016 at $342,000 and increase to $383,000 in 2016-2017. In 2016-2017, collections are anticipated to remain flat for Nitrogen Gas Pipeline and Jet Fuel Pipeline. It is anticipated that Water will increase 15.2% to $311,000 in 2016-2017.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Franchise Fees

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase from 2.0% to 2.9% annually. Over the next five years, however, there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels. In addition, it should be noted that the City's current Cable Franchise Fee agreement is scheduled to sunset in 2016, however as a new agreement is expected to be executed, these collections are assumed throughout the forecast period.

Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2015-2016 are anticipated to total $93.8 million, representing an increase of 2.4% from the 2014-2015 collection level. In 2016-2017, Utility Tax collections are projected to increase 2.1% to $95.8 million. Due to the uncertainty regarding the outcome of rate cases, the Forecast generally does not assume revenue increases associated with pending rate cases; however, it does take into account changes already approved. Rate cases will continue to be monitored and adjustments will be brought forward as appropriate based on the final outcomes.

The **Electricity Utility Tax** is anticipated to generate $43.9 million in 2015-2016, a 4.0% increase from prior year levels. In 2016-2017, revenues are estimated to increase 2.0% to $44.8 million. Based on rate increases for January 2016 (average system-wide 6.2%) and March 2016 (average system-wide 1.5%), slight additional upward adjustments may be brought forward based on actual performance with these new rates.

Gas Utility Taxes are projected at $8.8 million in 2015-2016, a 3.2% increase from 2014-2015 levels. In 2016-2017, revenues are projected to increase by approximately 2.0% to $8.9 million. Rates are projected to increase in 2016, with the average residential gas bill expected to increase approximately 4%, and the forecast reflects growth in both 2015-2016 and 2016-2017. However, actual collections can fluctuate significantly due to consumption changes associated with the weather as well as rate changes.

Water Utility Tax receipts of $12.0 million are anticipated to be received in 2015-2016, a 4.0% increase from 2014-2015. In 2016-2017, receipts are projected to increase 8.0% to $13.0 million based on the continued rising wholesale price of water with an estimated increase in price in April 2016, July 2016, and January 2017 totaling approximately 16% with continued dampened consumption levels.

In the **Telephone Utility Tax** category, revenues are collected on landlines, wireless, VoIP, and beginning January 1, 2016, prepaid wireless services sold at retail locations. Based on current tracking, receipts in 2015-2016 are anticipated to reach $29.1 million, which is close to the 2014-2015 actual collections of $29.3 million. Cellular receipts, however, are estimated to decline 8.0% compared to prior year actuals based on current collection trends.

Elements of The General Fund Forecast

Revenue Forecast

Utility Tax

Beginning January 1, 2016, AB 1717 (otherwise known as the Local Prepaid Mobile Telephony Services Collection Act) will require California retailers to collect the local utility users tax on prepaid wireless services at the same time it collects the sales tax on its other retail products. Under this new law, all local jurisdictions are required to contract with the Board of Equalization in order to receive their portion of local taxes imposed on prepaid wireless services sold by retailers. In 2015-2016, it is estimated that that new tax will generate approximately $650,000 ($1.2 million on an annual basis).

In 2016-2017, Telephone Utility Tax revenues are anticipated to remain relatively flat at $29.05 million. Based on collection trends in recent years, cellular receipts are expected to continue to decline. This drop is expected to be roughly offset by the addition of local prepaid mobile services tax application that was implemented beginning January 1, 2016. Ongoing implications of the changes in service delivery of telecommunication activities through alternative services such as Wi-Fi and broadband are unknown.

In the out years of the Forecast, growth ranging from 0.2% to 1.6% annually is expected in the Utility Tax category. As discussed above, there is significant volatility and uncertainty regarding the performance in this category based on outstanding rate cases as well as consumption levels. The Water and Gas Utility Tax categories are significantly influenced by weather conditions.

Telephone Line Tax

Based on the current collection trend, receipts in 2015-2016 are estimated to total $21.4 million, a 1.4% increase from prior year levels. In 2016-2017, receipts are anticipated to increase to $21.6 million. Given the steady nature of collections in this category, receipts are anticipated to remain relatively flat in the out years of the Forecast with annual growth ranging from 0.2% to 0.3%.

Business Taxes

This category includes General Business Tax, Disposal Facility Tax, Cardroom Tax, and Marijuana Business Tax. In 2015-2016, Business Taxes are estimated to reach $50.4 million, a 6.5% increase from prior year levels. In 2016-2017, revenues are estimated to decrease 3.9% to $48.5 million due to a decreases in Marijuana Business Tax compliance revenue and Disposal Facility Tax as discussed below.

In 2015-2016, **General Business Tax** proceeds are expected to reach $11.5 million, a decrease of 3.0% from the prior year level of $11.9 million and takes into consideration the remaining billing cycles, account closeouts and cleanups anticipated in 2015-2016, and the historical collections rates of invoices. In 2016-2017, revenues are anticipated to remain flat at $11.5 million.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Business Taxes

Based on current performance, collections in the **Cardroom Tax** category are estimated at $17.8 million in 2015-2016, an increase of 4.6% from the prior year collection level of $17.0 million. In 2016-2017, receipts are anticipated to remain at 2015-2016 levels.

In the **Disposal Facility Tax** category, collections are estimated at $12.3 million in 2015-2016 based on current collection trends, which assume a decline of 4.5% from the prior year collection levels of $12.9 million. Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream varies due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. In previous years, revenues in this category experienced year-over-year declines due, in large part, to increased waste diversion and the overall slowdown in the economy. However, in 2013-2014 and 2014-2015, collections increased due to increased activity from neighboring agencies dumping in San José landfills. In 2016-2017, revenues are projected to return to the former trend of slight declines as a result of waste diversion and fall 2.4% below estimated 2015-2016 levels to $12.0 million.

Marijuana Business Taxes are currently being collected at a 10% rate on gross receipts as approved by the voters in Ballot Measure U in 2010 on medical and non-medical, legal and illegal sales. In 2015-2016, collections are anticipated to increase to $8.8 million, an increase of approximately 57.3% from prior year levels of $5.6 million. A large portion of this increase is attributable to the compliance collections that are estimated at $1.8 million in 2015-2016, which is significantly above the prior year level of $115,000 ($1.2 million as of January 2016, compared to only $54,000 received in January 2015). Excluding compliance revenue, receipts are up projected to end the year at $7.0 million, which is 27.8% above the prior year level of $5.5 million. Beginning in June 2014, enforcement of the Medical Marijuana Regulatory Program decreased the number of collectives operating within San José. Only 16 collectives remain in operation to date, however, tax receipts have increased. In 2016-2017, regular collections are anticipated to remain flat at $7.0 million and compliance revenue is projected at $150,000.

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

Licenses and Permits and Departmental Charges

The Licenses and Permits and Departmental Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. In 2016-2017, the Licenses and Permits category is estimated at $50.8 million and the Departmental Charges category is estimated at $39.3 million.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Licenses and Permits and Departmental Charges

For the Development Fee Programs, the Forecast assumes no net impact on the General Fund based on the assumption that these programs will remain at 100% cost recovery. In cases where the development-related base costs are projected to exceed revenues, there are sufficient earmarked reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact. For 2016-2017, the Building Fee Program, Planning Fee Program, Fire Fee Program, and

Public Works Fee Program base expenditures are projected to exceed the base revenue estimates. This Forecast assumes that in 2016-2017 Fee Program Reserves will be used to address these shortfalls as outlined in the Beginning Fund Balance section below.

For the non-development-related fees and charges, the 2016-2017 estimates are based on current collection trends and an evaluation of program costs. The Departmental Charges category is anticipated to decrease 6.8% in 2016-2017 from $42.2 million to $39.3 million based on this review. The City Administration is in the process of examining various non-development-related fees to align costs with estimated revenue levels. Any revisions will be brought forward as part of the 2016-2017 Proposed Operating Budget, as well as the 2016-2017 Proposed Fees & Charges Report.

In the out years of the Forecast, both the Licenses and Permits and Departmental Charges categories are expected to experience growth ranging from 3.6% to 4.4%. The growth rates in the out years are tied to the expected increases in costs, which the fees are designed to recover, including increased retirement and health costs.

Fines, Forfeitures and Penalties

In 2015-2016, the Fines, Forfeitures and Penalties category is expected to generate $14.7 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately $11.0 million in 2015-2016, 3.6% higher than prior year collections of $10.6 million. In 2016-2017, Parking Fines are expected to increase by 1.1% to $11.1 million. Total revenue in 2016-2017 is estimated at $14.9 million in the Fines, Forfeitures, and Penalties category. In the out years of the Forecast, annual growth of approximately 1.0% to 2.1% is projected.

Money and Property

This category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, and interest income and is projected to generate $4.1 million in 2015-2016. In 2016-2017, revenue is expected to decline by 6.6% to $3.9 million, primarily due to the rental expiration of two leases for City-owned facilities. In the out years of the Forecast, growth of 1.1% to 3.5% annually is assumed.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Revenue from Local Agencies

In 2015-2016, revenue of $17.0 million is projected from other local agencies, such as the Successor Agency to the Redevelopment Agency of San Jose and the Central Fire District. This amount is significantly lower than levels received in prior years due to lower reimbursement from the Successor Agency to the Redevelopment Agency of San Jose.

The largest revenue estimate in this category is generally a reimbursement from the Successor Agency to the Redevelopment Agency for the payment of the Convention Center Debt Service. When the 2015-2016 Adopted Budget was developed, it was assumed that SARA would reimburse the City for the Convention Center Debt Service payment that is budgeted in the General Fund of $15.28 million. However, as part of the 2014-2015 Annual Report actions approved by the City Council in October 2015, the reimbursement was reduced by $9.8 million to $5.48 million as a result of Senate Bill 107 that disallowed the reimbursement mechanism used to pay this obligation. The General Fund has been advancing funds to SARA since 2012-2013 to pay debt service on certain City-backed debt, including the Convention Center payment. A reimbursement agreement was established between the City and SARA to reimburse the General Fund within the same fiscal year the advance was made for fiscal years 2012-2013 through 2014-2015, using redevelopment funds for the following period. Due to the passage of Senate Bill 107 on September 22, 2015, which amended redevelopment dissolution law, the mechanism allowing SARA to reimburse the City on an intra-year basis was disallowed. As such, the City did not receive reimbursement for the 2015-2016 loan from the General Fund of approximately $9.8 million in August 2015 to cover the Convention Center debt payment. The loan will not be repaid until there is sufficient property tax revenue to pay all other enforceable obligations, since obligations to the City are subordinate to all other enforceable obligations. Based on continued moderate tax increment growth, repayment is expected in 10 to 15 years. Using the current level of annual distributions from the Redevelopment Property Tax Trust Fund (RPTTF) and the continued ability to reserve RPTTF each year for debt service, it is anticipated SARA will be able to pay all of its debt service going forward. To technically account for the Convention Center Debt Service, there is a reimbursement from SARA of $15.3 million in 2016-2017 (with an offsetting expense in City-Wide Expenses).

The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. Based on information provided by the Central Fire District staff, payments of $5.8 million are anticipated in 2015-2016. This reflects a 2.2% increase from the prior year levels. In 2016-2017, collections are projected to increase 6.0% to $6.2 million.

The ongoing payment from the County of Santa Clara for the first responder advanced life support program (Paramedic Program) was eliminated from the budget beginning in 2014-2015 and this Forecast continues to assume no revenue collections in 2016-2017. Beginning in 2013-2014, the County began withholding payments for the first responder advanced life support program (Paramedic Program) because the City had not met the response time performance standards set forth in the agreement with the County. In 2014, the City and County continued to negotiate

REVENUE FORECAST

Revenue from Local Agencies

regarding this issue and executed a Second Agreement to the 911 Emergency Medical Services (EMS) Provider Agreement in December 2014 that expired December 2015. Under this agreement, additional Annex B, Category A funds totaling approximately $450,000 are expected to be received in 2015-2016 and $2.0 million was received in 2014-2015 to account for back payments from April 2013 through 2014-2015. If an agreement is extended through the remainder of the year, approximately $900,000 may be received in 2015-2016. For 2016-2017 and beyond, the City and County will begin discussions over the next several months on a new 911 EMS Provider Agreement as the primary agreement expires June 30, 2016. If an agreement is reached, corresponding reimbursements revenue for next year will be incorporated in the budget, as appropriate. It should be noted that the direct incremental cost to the City to provide the paramedic program totals over $5.0 million annually.

In addition, other projected payments from local agencies total $1.4 million in 2016-2017, the largest of which are reimbursements for services provided by the Animal Care and Services Program ($930,000), and payments associated with the annexation in the Cambrian area to the City of Campbell ($199,000).

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 0.45% to 1.2%.

Revenue from the State of California

The Revenue from the State of California category includes Tobacco Settlement payments, State grant revenues, and other State reimbursements. Collections in this category are estimated to reach $10.4 million in 2016-2017 and decline slightly to $10.3 million in 2017-2018 through 2020-2021. Tobacco Settlement payments account for the majority of revenue in this category and are estimated at $8.75 million in 2016-2017, consistent with the amount projected for 2015-2016.

The State grants and reimbursements expected in 2016-2017 include: Abandoned Vehicles Abatement Program ($675,000); Auto Theft reimbursement ($300,000); CALgrip Intervention Grant ($147,000); Highway Maintenance Charges reimbursement ($105,000); and Local Law Enforcement Agency Grant ($30,000). Vehicle License Fees Collection in Excess are also estimated at $435,000 annually and account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures that are equally apportioned to counties and cities on a population basis.

Adjustments to the grant amounts are reflected in the remaining years of the Forecast. A decrease of $177,000 is expected in 2017-2018 to reflect the elimination of the CALgrip Intervention Grant ($147,000) and the Local Enforcement Agency Grant ($30,000). No annual growth is projected in the remaining three out years of the Forecast.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues and rental income. The following grants are anticipated in 2016-2017: SAFER Grant ($1.8 million); Metropolitan Transportation Commission Grant ($422,000); Urban Area Security Initiative – Fire (UASI) ($195,000), and FEMA Training Reimbursement ($35,000).

In the out-years of the Forecast, SAFER grant funding of $1.1 million is reflected in 2017-2018 only.

Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including the Arena Fixed Fee, cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and proceeds from the Sale of Surplus Property. In 2015-2016, this category is expected to generate $131.0 million. The 2015-2016 estimate includes a number of adjustments not included in the 2016-2017 Forecast, the largest of which include: 1) $100.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits that are brought forward in August of each year; 2) $7.8 million in one-time financing proceeds associated with the Energy and Utility Conservation Measures Program; and 3) $1.0 million from a Calpine Settlement.

In 2016-2017, the revenue estimate of $14.8 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2016-2017 costs or agreements and the elimination of one-time funding sources. This figure excludes revenues associated with the issuance of the TRANs that will be brought forward in 2016-2017 with an offsetting expenditure based on estimated cash flow needs.

In 2016-2017, the Arena Fixed Fee will decrease by $750,000 to $5.1 million. Payments from Comcast and AT&T are estimated at $2.1 million. As defined in the Franchise Agreement, these funds will be used to support the Public, Education, and Government (PEG) Access facilities. There are associated City-Wide Expenses allocations for this purpose. The cost reimbursement for the Investment Program is estimated at $1.3 million based on the current allocation of staff to this function. In addition, the proceeds from the Sale of Surplus Property category has been set at $1.0 million based on the anticipated assets that will be sold next fiscal year. The Arena Fixed Fee is eliminated beginning in 2018-2019, which represents a significant decline in anticipated revenues in this category, to reflect the terms of a new agreement with Sharks Sports Entertainment to lease the San José Arena. Therefore, change in the out years range from a decline of 37.6% to a slight increase of 1.4%.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2015-2016 are projected to reach $16.9 million, a decline of 5.3% from prior year actuals of $17.8 million. Several factors impact collections, including falling gas prices that would support increased consumption and, as an offsetting factor, the move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In the out years of the Forecast, collections are expected to experience growth and declines ranging between -5.7% and 0.8% annually.

Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2016-2017, a total of $40.0 million in reimbursements are projected based on 2016-2017 overhead rates for the majority of City funds prepared by the Finance Department applied against the projected 2016-2017 salaries for those positions for which an overhead rate is applied. In the remaining years of the Forecast, annual increases ranging from 3.6% to 4.4% are assumed, reflecting increases in costs, which the overhead rate is designed to recover, including increased personal services costs.

Transfers

The Transfers category is projected at $21.0 million in 2016-2017, which is slightly below the 2015-2016 estimate of $21.6 million. The largest component of this category ($11.9 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2016-2017, these reimbursements have been built to cover the direct base costs as well as indirect costs. For the Fire Rescue reimbursement, the indirect costs have been discounted (to a cap of 25%) to help with cost competitiveness of this service.

Additional large transfers programmed for 2016-2017 include the Construction and Conveyance Tax Fund transfer ($3.5 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer ($1.8 million) for pavement maintenance activities; the General Purpose Parking Fund ($807,000); and the Workforce Investment Act Fund transfer ($548,000) for use of various community centers and Workforce Investment Act program services.

Annual increases in the out years range from 1.9% to 2.6%. The reimbursement from the Airport Maintenance and Operation Fund for police and fire services is expected to increase in the out years based on the increased costs for those services.

REVENUE FORECAST

Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2016-2017 of $667,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases from 3.6% to 4.4%.

Beginning Fund Balance

The $65.8 million forecast estimate of available 2016-2017 Beginning Fund Balance is based on the following assumptions:

- The current Contingency Reserve of $34.5 million is carried forward at the current level based on the assumption that this amount will not be used in 2015-2016 and will be available for use in 2016-2017. The current funding level is approximately enough to cover General Fund payroll costs for less than two and one-half weeks in an emergency. (On the expenditure side, the Contingency Reserve remains at $34.5 million in 2016-2017 and each of the out-years of the Forecast and complies with the City Council policy to set aside at least 3% of expenditures.)
- A total of $20.0 million in fund balance will be achieved in 2015-2016 for use in 2016-2017 from a combination of excess revenues and expenditure savings as well as the liquidation of prior-year carryover encumbrances.
- An additional $11.3 million reflects the liquidation of reserves: $6.8 million from the Building Development Fee Program Reserve; $1.5 million from the Salaries and Benefits Reserve; $1.4 million from the Public Works Development Fee Program Reserve; $939,000 from the Planning Development Fee Program Reserve; and $610,000 from the Fire Development Fee Program Reserve. The use of the Development Fee Program reserves have been included in the fund balance estimate to cover a portion of the 2016-2017 base costs associated with these programs that cannot be addressed with fee revenue.

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue of 1.0% and expenditure savings, including liquidations of carryover encumbrances, of 1.25% would be generated annually. The expenditure savings figure has been reduced from 1.75% in the 2016-2020 Forecast to 1.25% in this Forecast to reflect changes in retirement cost calculations to ensure the City does not over pay for unfunded liability. While this change lowered ongoing retirement costs, slightly lower expenditure savings, and subsequent ending fund balance will now be available as a funding source for the following year. In addition, it is assumed that the Contingency Reserve of $34.5 million would be carried over each year; and the use of the Development Fee Program Reserves for Building, Planning, Public Works, and Fire would continue in the out years to support projected development fee program costs in excess of revenues. In total, the Beginning Fund Balance ranges from $65.8 million in 2016-2017 to $68.9 million in 2020-2021.

EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2016-2017 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2016-2017 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from $996.1 million in 2016-2017 to $1.14 billion in 2020-2021, for an average growth rate of 3.5% per year.

February 2016 Forecast Expenditure Summary

Expenditure Category	Modified Budget 2015-2016	Forecast 2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Personal Services						
Salaries and Other Compensation	$ 424,846,881	$ 429,081,000	$ 444,027,000	$ 459,493,000	$ 475,500,000	$ 492,066,000
Retirement	242,390,719	253,335,000	267,179,000	276,948,000	284,256,000	296,578,000
Health and Other Fringe Benefits	53,315,056	54,580,000	58,079,000	61,803,000	65,765,000	69,982,000
Total Personal Services	**$ 720,552,656**	**$ 736,996,000**	**$ 769,285,000**	**$ 798,244,000**	**$ 825,521,000**	**$ 858,626,000**
Total Non-Personal/Equipment	**$ 114,296,568**	**$ 94,236,000**	**$ 95,926,000**	**$ 99,167,000**	**$ 102,340,000**	**$ 103,467,000**
City-Wide						
City-Wide Expenses	$ 234,525,646	$ 87,536,000	$ 88,111,000	$ 88,337,000	$ 88,691,000	$ 89,567,000
Capital Projects	57,487,599	5,250,000	5,250,000	5,250,000	5,250,000	5,250,000
Transfers	27,149,755	27,262,000	29,628,000	33,995,000	33,866,000	33,982,000
Earmarked Reserves	106,399,029	8,463,000	8,855,000	9,625,000	12,025,000	14,439,000
Contingency Reserve	34,500,000	34,500,000	34,500,000	34,500,000	34,500,000	34,500,000
Total City-Wide	**$ 460,062,029**	**$ 163,011,000**	**$ 166,344,000**	**$ 171,707,000**	**$ 174,332,000**	**$ 177,738,000**
Committed Additions						
New Police Maint. & Operations		$ 1,300,000	$ 1,339,000	$ 1,379,000	$ 1,420,000	$ 1,463,000
New Parks and Recreation Facilities Maint. & Operations		354,000	789,000	977,000	1,095,000	1,204,000
New Traffic Infrastructure Assets Maint. & Operations		199,000	237,000	243,000	250,000	259,000
New Library Maint. & Operations		11,000	11,000	11,000	11,000	11,000
Measure P (Parks) Maint. & Operations			435,000	738,000	783,000	830,000
Total Committed Additions		**$ 1,864,000**	**$ 2,811,000**	**$ 3,348,000**	**$ 3,559,000**	**$ 3,767,000**
Total Base Exp. w/ Committed Additions	**$ 1,294,911,253**	**$ 996,107,000**	**$ 1,034,366,000**	**$ 1,072,466,000**	**$ 1,105,752,000**	**$ 1,143,598,000**
Growth %			**3.8%**	**3.7%**	**3.1%**	**3.4%**

It is important to note that adjustments are made to the Forecast to eliminate one-time additions/deletions and annualize partial-year allocations that were included in the 2015-2016 Adopted Budget. Various one-time additions totaling over $5 million are scheduled to expire in June 2016. The major items funded on a one-time basis include San José Learns, San José Works, Police Department Downtown Foot Patrol and Police Video Unit, Office of Immigrant Affairs, Information Technology Department Critical Security Remediation, Small Business Activation and Assistance, Workers' Compensation Backlog and Pilot Program Extension, Business Development and Economic Strategy Activities, Manufacturing Jobs Initiative, Human Resources Department Employment Services and Service Delivery and Strategic Analysis Temporary Staffing, City Attorney's Office Training, Family College Success Center, and Silicon Valley Talent Partnership. Many of these programs and services will likely need to be re-evaluated for continued funding beyond 2015-2016. This analysis will be conducted during the 2016-2017 budget process and funding recommendations for these programs and services

EXPENDITURE FORECAST

will be included in the 2016-2017 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.

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

Personal Services

As is the usual practice, the first year (2016-2017) projection for personal services costs in this Forecast has been calculated at a detailed level. An extract of payroll system information as of August 2015 was used as the starting point. This individual position-level information was then reviewed, corrected, and updated by each department to include current vacancies and filled positions, ensure accurate salary step and bi-weekly salary, as well as any position reallocations. Also, 2015-2016 ongoing position additions (cost increases) and reductions (cost savings) were annualized and all categories of benefit costs in the coming year were projected. In January 2016, the most recent retirement plan and health plan information for each position was also updated from the payroll system.

For the 2016-2017 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the total cost in the General Fund. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the $737.0 million projected personal services total for 2016-2017, salaries and other compensation costs amount to $429.1 million (58.2% of projected personal services), retirement costs amount to $253.3 million (34.4% of projected personal services), and health and other fringe benefits costs amount to $54.6 million (7.4% of projected personal services). Over the forecast period, modest growth is expected in each of the personal services categories.

Following is a discussion of the specific factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. The out-years are projected to inflate at a composite rate of approximately 4.1%.

ELEMENTS OF THE GENERAL FUND FORECAST

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Salaries and Other Compensation:

Pay increases for all employees are assumed in each year of this Forecast. These pay increases total $20.8 million for 2016-2017 and are based on current agreements reached with each of the City's bargaining units. With the majority of contracts set to expire in June 2018, modest increases are assumed for all bargaining units in the out-years of the Forecast in anticipation of negotiations for years beyond the current contract period. As contracts in the out-years of the forecast are determined, subsequent Forecast documents will be updated to reflect the latest information at that time.

Total ongoing funding of $750,000 is also included in an Employee Market Competitiveness Reserve in 2016-2017 to provide funding for potential salary increases for specific job classifications where recruitment and retention issues are being experienced. Additional analysis is required to determine which classifications may be considered for a special employee compensation pay increase.

Salary step increases for current non-management employees and pay for performance for management employees for 2016-2017 are projected at $3.5 million, or an increase of 0.47%. With the exception of employees represented by the SJPOA and IAFF, non-management step increases have been calculated at a 2.5% step increase rate. For SJPOA and IAFF, a 5% step increase rate was applied in this Forecast. The out-years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

Overtime expenditures in the General Fund total $21.3 million for 2016-2017, with the majority of the expenditures for Police Department ($12.9 million) and Fire Department ($6.6 million) operations. The out-years of the Forecast continue these costs, with small adjustments using salary step growth as the inflationary factor.

Retirement:

The City's two retirement systems, the Federated Retirement System and the Police and Fire Department Retirement Plan, provide defined retirement benefits to eligible employees. Both retirement plans use investment income and employer and employee contributions to provide eligible retirees with pensions and retiree healthcare benefits. Employees represented by SJPOA and IAFF, Local 230 are members of the Police and Fire Department Retirement Plan and have different retirement benefits with the corresponding different City contributions and rates. Within the Police and Fire Department Retirement Plan, effective August 4, 2013, the City provides for a lower defined benefit plan (Tier 2) for new and rehired police members. Effective January 2, 2015, a lower defined benefit plan (Tier 2) was implemented for new and rehired Fire members.

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Within the Federated Retirement System, effective September 30, 2012, the City provides for a lower defined benefit plan (Tier 2) for new employees in that system. Federated employees who joined the City between September 30, 2012 and September 27, 2013 are eligible for retiree healthcare coverage (Tier 2A). Effective September 27, 2013, however, new employees no longer receive retiree healthcare coverage (Tier 2B). Effective January 18, 2015, Federated employees that had left City employment with prior dental coverage vesting and return to the City, retain that benefit (Tier 2C). On December 4, 2012, a defined contribution plan (Tier 3) for new employees in Unit 99 (Senior Staff, Executive Staff, and senior managers under the City Manager's Appointing Authority; City Council Office staff; professional and management employees under the appointing authority of the City Attorney, City Auditor, and Independent Police Auditor; and some employees in the City Clerk's Office) was approved. Effective February 4, 2013, new employees to the City hired directly into Unit 99 have the ability to make the one-time election to participate in the defined benefit Tier 2B plan or the Tier 3 plan. The Tier 3 plan provides for a City contribution of 3.75%.

For 2016-2017, retirement costs total $253.3 million for the General Fund, which are up $10.9 million from the 2015-2016 Modified Budget of $242.4 million (and include pay increase assumptions described earlier). These costs represent 25.4% of the total General Fund base expenditure budget with committed additions and are based on the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. To generate budgetary savings, this cost assumes the pre-payment of the City's annual required contribution (ARC) for Federated Retirement System Tier 1 members and contributions for the Police and Fire Department Retirement Plan for Tier 1 police and fire members. These figures reflect action approved by the Federated and Police and Fire Retirement Boards in October 2015 to reduce the pre-payment savings by 30%, or $1.4 million ($1.8 million all funds). For 2016-2017, net budgetary savings from the pre-payment are estimated at approximately $5.3 million in the General Fund (includes borrowing costs) ($7.0 million in all funds).

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

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

On June 5, 2012, voters approved a pension reform ballot measure known as Measure B. Measure B has been subsequently subject to various forms of litigation. In an effort to settle this case for budget stability and to provide certainty to the City's workforce, the City Council directed the City Administration to make any and all reasonable efforts to reach and implement a settlement this year. In August 2015 and December 2015, terms for the alternative pension reform settlement framework agreements with the Police and Fire and Federated bargaining units, respectively, were reached regarding Measure B, which included impacts to retiree healthcare. While the terms of the settlement have been reached, the implementation of the new agreements are underway. This Forecast assumes the extension of current retiree healthcare rates until actual implementation of the alternative pension reform settlement framework agreements.

Based on projections received from the Retirement Boards' actuary (Cheiron) and the City Manager's Budget Office's independent analysis, Table 1 details the General Fund's retirement costs and budgetary retirement contribution rates for the Federated Retirement System and the Police and Fire Department Retirement Plan and the respective pension and retiree healthcare costs for the forecast period.

For illustration purposes only, Table 2 depicts the Retirement Board approved contribution rates for 2016-2017 and the Cheiron projected rates for the out-years of the Forecast. It should be noted that the City budgetary rates differs from the Federated and Police and Fire Retirement Board approved rates to reflect the continuation of current retiree healthcare rates, apply the City's methodology to fund the Board approved UAL amounts, and the application of a pre-payment for Federated as well as Police and Fire Tier 1 contributions.

EXPENDITURE FORECAST

TABLE 1 - 2017-2021 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES
($ in Millions and with Pre-Payment Discount) *

Retirement Plan	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Fed. Ret. System Tier 1 – Pension	$67.7	$73.7	$78.0	$81.7	$82.6	$84.7
Fed. Ret. Syst. Tier 1 – Ret. Healthcare	$10.4	$9.9	$9.0	$8.3	$7.6	$6.9
Fed. Retirement Plan Tier 1 – Total	**$78.1**	**$83.5**	**$87.0**	**$90.0**	**$90.2**	**$91.6**
Budgetary Contribution Rates	*73.1%*	*77.8%*	*88.6%*	*99.3%*	*108.6%*	*121.1%*
Fed. Ret. System Tier 2A – Pension	$0.5	$0.5	$0.5	$0.5	$0.4	$0.4
Fed. Ret. Syst. Tier 2A – Ret. Healthcare	$0.9	$0.8	$0.7	$0.7	$0.7	$0.7
Fed. Retirement Plan Tier 2A – Total	**$1.4**	**$1.3**	**$1.2**	**$1.2**	**$1.1**	**$1.1**
Budgetary Contribution Rates	*15.9%*	*15.5%*	*15.5%*	*15.5%*	*15.5%*	*15.5%*
Fed. Ret. System Tier 2B – Pension	$2.1	$3.1	$3.9	$4.8	$5.6	$6.5
Fed. Ret. Syst. Tier 2B – Ret. Healthcare	$5.2	$6.4	$8.2	$9.9	$11.6	$13.4
Fed. Retirement Plan Tier 2B – Total	**$7.3**	**$9.4**	**$12.1**	**$14.7**	**$17.3**	**$19.8**
Budgetary Contribution Rates	*19.9%*	*18.7%*	*18.8%*	*18.8%*	*18.8%*	*18.8%*
Fed. Ret. System Tier 2C – Pension	$0.0	$0.1	$0.1	$0.1	$0.1	$0.1
Fed. Ret. Syst. Tier 2C – Ret. Healthcare	$0.0	$0.1	$0.1	$0.1	$0.1	$0.1
Fed. Retirement Plan Tier 2C – Total	**$0.1**	**$0.2**	**$0.2**	**$0.2**	**$0.2**	**$0.2**
Budgetary Contribution Rates	*20.1%*	*18.9%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*
Police Ret. Plan Tier 1 – Pension	$75.0	$74.8	$76.6	$76.0	$75.6	$77.4
Police Ret. Plan Tier 1 – Ret. Healthcare	$10.6	$9.7	$9.3	$8.7	$8.2	$7.6
Police Retirement Plan Tier 1 – Total	**$85.6**	**$84.5**	**$85.9**	**$84.7**	**$83.8**	**$85.0**
Budgetary Contribution Rates	*80.6%*	*87.5%*	*93.1%*	*98.0%*	*103.5%*	*112.2%*
Police Retirement Plan Tier 2 – Pension	$2.1	$3.1	$4.1	$5.2	$6.3	$7.4
Police Ret. Plan Tier 2 – Ret. Healthcare	$2.0	$2.9	$3.8	$4.9	$5.9	$7.0
Police Retirement Plan Tier 2 – Total	**$4.1**	**$5.9**	**$7.9**	**$10.1**	**$12.3**	**$14.4**
Budgetary Contribution Rates	*21.6%*	*21.3%*	*21.3%*	*21.3%*	*21.3%*	*21.3%*
Fire Retirement Plan Tier 1 – Pension	$56.2	$58.8	$62.4	$64.9	$67.4	$71.5
Fire Ret. Plan Tier 1 – Retiree Healthcare	$8.0	$7.9	$7.8	$7.7	$7.6	$7.4
Fire Retirement Plan Tier 1 – Total	**$64.2**	**$66.7**	**$70.3**	**$72.6**	**$75.0**	**$78.9**
Budgetary Contribution Rates	*82.7%*	*87.6%*	*92.9%*	*97.3%*	*102.2%*	*110.5%*
Fire Retirement Plan Tier 2 – Pension	$0.0	$0.5	$0.9	$1.3	$1.7	$2.3
Fire Ret. Plan Tier 2 – Retiree Healthcare	$0.0	$0.5	$0.9	$1.3	$1.7	$2.3
Fire Retirement Plan Tier 2 – Total	**$0.0**	**$0.0**	**$1.8**	**$2.6**	**$3.5**	**$4.6**
Budgetary Contribution Rates	*21.8%*	*21.2%*	*21.2%*	*21.2%*	*21.2%*	*21.2%*
Other Retirement Costs	$1.5	$0.8	$0.8	$0.8	$0.9	$0.9
Total General Fund	**$242.4**	**$253.4**	**$267.2**	**$276.9**	**$284.3**	**$296.6**
Total All Funds	**$316.3**	**$332.0**	**$351.0**	**$365.4**	**$375.1**	**$390.8**

* City budgetary rates differs from the Federated Retirement Board approved rates to reflect the continuation of current retiree healthcare rates, apply the City's methodology to fund the Board approved UAL amounts, and the application of a pre-payment of Federated, Police and Fire Tier 1 member contributions.

Source: 2015-2016 Modified Budget; Cheiron Letters dated January 13, 2016 and January 27, 2016 with applied City methodology to fund the Board approved UAL amounts and pre-payment discount for Federated Retirement System Tier 1, the Police Retirement Plan Tier 1, and the Fire Retirement Plan Tier 1.

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TABLE 2 - 2017-2021 BOARD APPROVED CITY CONTRIBUTION RATES

Retirement Plan	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Fed. Ret. System Tier 1 – Pension	66.2%	78.1%	90.7%	103.4%	114.3%	129.0%
Fed. Ret. Syst. Tier 1 – Ret. Healthcare*	9.4%	11.9%	11.8%	11.6%	11.3%	11.0%
Fed. Retirement Plan Tier 1 – Total	**75.6%**	**90.0%**	**102.5%**	**115.0%**	**125.6%**	**140.0%**
Fed. Ret. System Tier 2A – Pension	5.7%	6.0%	6.1%	6.1%	6.1%	6.1%
Fed. Ret. Syst. Tier 2A – Ret. Healthcare*	9.4%	11.9%	11.8%	11.6%	11.3%	11.0%
Fed. Retirement Plan Tier 2A – Total	**15.1%**	**17.9%**	**17.9%**	**17.7%**	**17.4%**	**17.1%**
Fed. Ret. System Tier 2B – Pension	5.7%	6.0%	6.1%	6.1%	6.1%	6.1%
Fed. Ret. Syst. Tier 2B – Ret. Healthcare*	12.7%	16.7%	16.6%	16.1%	15.5%	15.0%
Fed. Retirement Plan Tier 2B – Total	**18.4%**	**22.7%**	**22.7%**	**22.2%**	**21.6%**	**21.1%**
Fed. Ret. System Tier 2C – Pension	5.7%	6.0%	6.1%	6.1%	6.1%	6.1%
Fed. Ret. Syst. Tier 2C – Ret. Healthcare*	12.9%	16.7%	16.6%	16.0%	15.5%	15.0%
Fed. Retirement Plan Tier 2C – Total**	**18.6%**	**22.7%**	**22.7%**	**22.1%**	**21.6%**	**21.1%**
Police Ret. Plan Tier 1 – Pension	73.0%	80.4%	86.4%	91.4%	97.2%	106.3%
Police Ret. Plan Tier 1 – Ret. Healthcare	10.3%	10.3%	10.3%	10.3%	10.3%	10.3%
Police Retirement Plan Tier 1 – Total	**83.3%**	**90.7%**	**96.7%**	**101.7%**	**107.5%**	**116.6%**
Police Retirement Plan Tier 2 – Pension	11.3%	11.0%	11.0%	11.0%	11.0%	11.0%
Police Ret. Plan Tier 2 – Ret. Healthcare	10.3%	10.3%	10.3%	10.3%	10.3%	10.3%
Police Retirement Plan Tier 2– Total	**21.6%**	**21.3%**	**21.3%**	**21.3%**	**21.3%**	**21.3%**
Fire Retirement Plan Tier 1 – Pension	75.0%	81.6%	87.3%	92.0%	97.5%	106.3%
Fire Ret. Plan Tier 1 – Ret. Healthcare	10.6%	10.6%	10.6%	10.6%	10.6%	10.6%
Fire Retirement Plan Tier 1 – Total	**85.6%**	**92.2%**	**97.9%**	**102.6%**	**108.1%**	**116.9%**
Fire Retirement Plan Tier 2 – Pension	11.2%	10.6%	10.6%	10.6%	10.6%	10.6%
Fire Ret. Plan Tier 2 – Retiree Healthcare	10.6%	10.6%	10.6%	10.6%	10.6%	10.6%
Fire Retirement Plan Tier 2 – Total	**21.8%**	**21.2%**	**21.2%**	**21.2%**	**21.2%**	**21.2%**

* Federated Retiree Healthcare reflects the full annual required contribution. However, this Forecast (budgetary contribution rates in Table 1) assumes the 2015-2016 retiree healthcare rates throughout the forecast period.

Source: Cheiron Letters dated January 13, 2016 and January 27, 2016.

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Health and Other Fringe:

A projected health rate increase of 7.5% is included in the 2016-2017 Forecast based on national and City trend information received from the City's Human Resources Department benefits consultant. The annual health increase assumptions are held constant at 7.5% annually for the out-years of the forecast.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, a no dental rate increase is anticipated in 2016-2017. For the out-years, the Forecast assumes annual dental rate increases of 3% based on City trends and actuarial analysis.

There are no changes to the life insurance rates in this Forecast based on projected provider charges. For the payment of unemployment benefit claims, the City is self-insured. Based on actual claims experienced in 2015-2016, current funding available in the Unemployment Insurance Fund, and projected future claims, the unemployment insurance rate continues to be suspended through the five-year forecast period.

Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total $94.2 million in 2016-2017. In general, the process used by the City Manager's Budget Office to calculate this amount includes: adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2015-2016, projecting increases or decreases for specific large non-personal/equipment allocations (e.g., utilities, contractual services, vehicle maintenance and operations costs, and Police Department vehicle replacement) and reviewing past spending patterns and needs. The resulting 2016-2017 estimates represent a decrease of $20.1 million from the 2015-2016 Modified Budget level of $114.3 million, primarily due to the elimination of rebudgeted or carryover projects.

Departmental gas and electricity funding for 2016-2017 totaling $13.6 million has been slightly adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes; this funding assumes anticipated energy savings related to Energy Services Company (ESCO) funded projects that are projected to come online by July 1, 2016. Major non-personal/equipment increases are included, primarily in the Parks, Recreation and Neighborhood Services Department for changes in water costs ($844,000), Finance Department for Human Resources/Payroll/Budget Systems maintenance ($600,000), and Planning, Building and Code Enforcement Department for grant-funded urban village development ($422,000). Vehicle maintenance and operations costs in the General Fund including fuel, inventory, and fleet staffing reflect a $772,000 decrease (total of $13.6 million) from the 2015-2016 Adopted Budget, primarily due to decreased fuel costs, partially offset by increases in parts and personnel costs. The 2016-2017 non-personal/equipment base includes an adjustment for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of $2.7 million to $2.3 million based on the current replacement schedules and projected costs for these vehicles. Police vehicle replacement costs are expected to increase in the remaining years of the Forecast, based on the anticipated replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total $19.1 million.

For the out-years of the Forecast, growth rates ranging from 1.1% to 3.4% have been assumed from the 2016-2017 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. With this adjustment, the average growth rate for the non-personal/equipment category is 2.4% annually.

City-Wide

City-Wide Expenses in the first year of the Forecast (2016-2017) total $87.5 million, a decline from the 2015-2016 Modified Budget of $234.5 million. This large reduction primarily reflects the impact of deleting the $100.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; of eliminating one-time allocations that were rebudgeted to 2015-2016 ($33.4 million); and the elimination of one-time budget actions ($6.7 million).

The line-items in this category are primarily made up of cross-departmental, grant, and general city-wide expenditures. The 2016-2017 allocation includes anticipated cost adjustments based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2016-2017 allocations in the City-Wide Expenditures category include: Workers' Compensation Claims ($21.2 million); Convention Center Lease Payments ($15.3 million); San José BEST and Safe Summer Initiative Programs ($5.6 million); Sick Leave Payments Upon Retirement ($5.0 million); General Liability Claims ($4.0 million); ESCO Debt Service ($3.1 million); Homeless Rapid Rehousing ($2.5 million); FMC Debt Service Payments ($2.2 million); Parking Citations/Jail Courthouse Fees ($2.2 million); Banking Services ($1.9 million); Property Tax Administration Fee ($1.9 million); Sidewalk Repairs ($1.8 million); Public, Educational and Government Access Facilities – Capital ($1.6 million); Homeless Response Team ($1.5 million); Property Leases ($1.4 million); and Successor Agency City Subsidy ($1.2 million) (administrative support costs).

In the out-years of the Forecast, City-Wide Expenses are projected to increase minimally at an average growth rate of less than 1%. While the majority of the individual line-items are expected to remain at 2015-2016 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from $21.2 million to $23.9 million). Also increasing over the next five years is the FMC debt service payment, which is expected to go up in the out-years (from $2.1 million to $2.7 million) based on higher variable interest rate assumptions. Property leases, which grow over the five year period (from $1.4 million to $1.6 million), reflect an annual increase of 3%. Insurance Premiums (increase from $554,000 to $645,000) and the Property Tax Administration

Fee (increase from $1.8 million to $2.2 million) are increasing over the five years to reflect additional costs to administer these city-wide programs. Funding for many non-grant related City-Wide expenses has stabilized, and include ongoing allocations for the Homeless Rapid Rehousing ($2.5 million), Homeless Response Team ($1.5 million), and San José BEST and Safe Summer Initiative Programs ($5.6 million).

The General Fund **Capital Projects** category totals $5.3 million in 2016-2017 and remains at this level in each of the out-years of the Forecast. The largest item in this category is fire apparatus replacement ($3.75 million annually). The investment in fire apparatus replacement in this Forecast is based on an analysis of projected replacement schedules, replacement costs, and apparatus changes to meet safety needs. It also assumes that the Fire Construction and Conveyance Tax Fund will contribute $400,000 annually for these costs over the five-year period. The Capital Projects category also includes the continuation of annual allocations for Arena repairs ($100,000), unanticipated maintenance of City facilities ($800,000), fuel tanks and methane monitoring control and replacement ($400,000), and annual capital expenditures ($200,000) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building.

The **Transfers** category totals $27.3 million in 2016-2017 and increases to $29.6 million in 2017-2018 and approximately $34.0 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for the construction of City Hall is the largest line-item in this category and totals $19.1 million in 2016-2017 ($19.8 million to $21.4 million in the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Hayes Mansion Conference Center ($3.4 million in 2016-2017) and Rancho del Pueblo and Los Lagos Golf Courses ($2.2 million in 2016-2017); payments in accordance with the San José Arena Management agreement extension ($750,000 in 2016-2017 and 2017-2018 and $2.3 million in the remaining years of the Forecast) for Arena capital rehabilitation and enhancements; and a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement ($1.0 million annually).

All of the debt service and maintenance and operations costs for the Hayes Mansion Conference Center and golf courses are funded in the Community Facilities Revenue and Municipal Golf Course Funds, respectively, however, revenues in those funds are not projected to be sufficient to completely cover these costs. The transfer from the General Fund for the Hayes Mansion Conference Center decreased from a $4.9 million subsidy level in 2016-2017 in the last forecast to $3.4 million required in 2016-2017 in this Forecast. In the out-years of the Forecast, the subsidy totals $4.4 million in 2017-2018, $4.7 million in 2018-2019, $3.8 million in 2019-2020 and $3.9 million in the last year of this Forecast based on projected debt service payments for that facility. These transfers are lower than those projected in the last Forecast due to better recent performance of the facility. The transfer for the golf course subsidy decreased from a $2.6 million subsidy level in the out-years of the last Forecast to $2.2 million required in 2016-2017 ($2.4 million to $2.5 million in the remaining years of the Forecast) also due to slightly better recent performance by the City's two golf courses.

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The payments for Arena capital rehabilitation and enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. Annual funding of $750,000 is maintained through 2017-2018 of the Forecast for this agreement expiring on June 30, 2018. Due to a new agreement beginning in 2018-2019 that alters the City's capital payment obligations, annual funding increases to $2.3 million in the remaining years of the Forecast.

This Forecast includes transfers to the Service Yards Construction and Conveyance Tax (C&C) Fund to cover Central Service Yards Phase 1 debt service payments ($650,000 annually starting in 2019-2020) as there is not sufficient revenue in that fund to cover all required costs.

The transfer to the Vehicle Maintenance and Operations Fund ($1.0 million annually) is included to fund a vehicle replacement schedule for the General Fleet as well as transfers to the Communications C&C Fund ($400,000 in 2017-2018 to $1.3 million in the out-years) to fund the City's share of capital costs for the Silicon Valley Regional Interoperability Authority.

The Transfers category also includes payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas ($850,000 to $928,000 annually).

The **Earmarked Reserves** category totals $8.5 million in 2016-2017 and increases to $14.4 million in 2020-2021. This category includes a Deferred Infrastructure and Maintenance Reserve of $800,000 to fund critical capital maintenance or address urgent technology needs. These resources will be allocated as part of the 2016-2017 Proposed Budget. In addition, annual funding of $240,000 is allocated to the General Plan Update Reserve to set aside fees collected by developers toward the future update or revision of the General Plan.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2015-2016 and later recommended for rebudget or use in 2016-2017. Some of the larger current Earmarked Reserves include the Development Fee Program Reserves, Workers' Compensation/General Liability Catastrophic Reserve, Budget Stabilization Reserve, Salaries and Benefits Reserve, Retiree Healthcare Solutions Reserve, and Sick Leave Payments Upon Retirement Reserve.

Per City Council policy, the **Contingency Reserve** ($34.5 million) is projected at the level necessary to comply with the City Council policy to maintain a minimum 3% Contingency Reserve and allows for anticipated rebudget adjustments that will be incorporated into the 2016-2017 budget. This amount would be sufficient to cover approximately one pay period of payroll costs (two and one-half weeks). This amount is carried in the remaining four years of the Forecast and remains in compliance with the reserve policy.

Committed Additions to the Base General Fund Forecast

In this Forecast, projected additions to the base expenditure level have been included as **Committed Additions**. Although all are subject to further review during the budget process,

Elements of The General Fund Forecast

Expenditure Forecast

Committed Additions are additional expenditures to which the City is considered to be committed by prior City Council action, such as the costs related to maintaining and operating capital projects previously approved by the City Council. The Forecast Base Case, considered most likely to occur, includes ongoing program costs plus Committed Additions. Committed Additions total $1.9 million in 2016-2017 and increase to approximately $3.8 million by 2020-2021. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

The approved bond measure from the November 2000 election for parks (Measure P) has only one remaining project, the Arcadia Softball Complex, and will require additional maintenance and operations funding ($435,000 in 2017-2018, increasing to approximately $830,000 in 2020-2021).

Also included in the Committed Additions are maintenance and operations costs associated with non-bond projects such as Body Worn Cameras in the Police Department ($1.3 million in 2016-2017 and increasing to $1.5 million in 2020-2021), the Library's Mobile Maker[Space]ship, new parks and recreation facilities, and new traffic infrastructure assets. The non-bond projects committed additions costs in the Forecast range from $1.9 million in 2016-2017 and increases to $2.9 million by 2020-2021.

General Fund Capital Operating and Maintenance/Budget Principle #8

Budget Principle #8 states that Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding $100,000 without City Council certification that funding will be made available in the applicable year of the cost impact. Certification shall demonstrate that funding for the entire cost of the project, including operations and maintenance costs, will not require a decrease in existing basic neighborhood services. Consistent with that direction, this Forecast includes a detailed list and discussion of capital projects that were previously certified by the City Council with annual operating and maintenance costs in the General Fund greater than $100,000. Capital funding for these projects have been included as part of approved Capital Improvement Programs or approved by City Council in 2015-2016. It should be noted that the maintenance and operations costs for the Arcadia Softball Complex (previously titled Softball Complex) and Vietnamese Cultural Heritage Garden projects are estimated to exceed $100,000; however, these projects were established prior to the adoption of Budget Principle #8 and did not need to be certified by City Council.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the Forecast, assuming the Base Case with Committed Additions. In 2016-2017, a surplus of $5.7 million is projected, followed by deficits in 2017-2018 ($11.1 million), 2018-2019 ($15.8 million), 2019-2020 ($4.2 million), and 2020-2021 ($4.8 million). Base Case expenditures, including committed additions, increase from $996.1 million in 2016-2017 to $1.14 billion in 2020-2021, for an average annual growth rate of approximately 3.7%. The sources of revenue total $1.00 billion in 2016-2017 and grow to $1.11 billion in 2020-2021, increasing at a slightly lower average annual growth rate of 2.8%.

The following table shows how the projected surpluses and shortfalls have changed in the most recent forecasts. It is assumed that each preceding surplus or shortfall is addressed completely with ongoing solutions in the year it appears. Each year of the February 2016 Forecast is compared to the comparable year in the February 2015 Forecast.

2017-2021 General Fund Forecast
Changes in Operating Margin
($ in Millions)

	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
February 2015 Incremental Surplus/(Shortfall)	**$5.2**	**$0.3**	**($1.4)**	**$5.8**	**N/A**
June 2015 Incremental Surplus/(Shortfall)	$5.2	N/A	N/A	N/A	
February 2016 Incremental Surplus/(Shortfall)	**$5.7**	**($11.1)**	**($15.8)**	**($4.2)**	**($4.8)**

Note: Does not incorporate impacts associated with any new revenue measures; the implementation of the alternative pension reform settlement framework agreements approved in August 2015 and December 2015 with the City's bargaining units; costs associated with services funded on a one-time basis in 2015-2016; costs associated with restoration of key services (police, fire, community centers, and street maintenance) to January 1, 2011 levels; costs associated with a Police Staffing Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions); costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

Elements of The General Fund Forecast

Operating Margin

For the February 2016 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2016-2017 and the remaining four years of the forecast period. The 2016-2017 projected surplus of $5.7 million reflects a slight improvement from the $5.2 million budget surplus projected in June 2015 (2015-2016 Adopted Budget). This change is the net result of numerous revenue and expenditure changes as described in this document.

In the out years of this Forecast, the General Fund position is worse than that presented in the previous Forecast with shortfalls ranging from -$4.2 million to -$15.8 million annually. In the prior Forecast, a small shortfall of $1.4 million was projected in only one year. This change reflects lower growth rates in the economically sensitive revenues, such as Property Tax and Sales Tax, due to an expected economic slowdown along with an overall increase in the expenditure growth rates. For example, retirement costs are increasing at a faster rate than in the prior Forecast and the Committed Additions are higher. While the General Fund position is weaker than in the prior Forecast, the margins in this Forecast are still relatively narrow when put into context of the size of the projected General Fund budget.

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