2019-2020

Operating Budget

Mayor's March Budget Message

City Council Agenda:
Item: 3.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: CITY COUNCIL

FROM: Mayor Sam Liccardo

SUBJECT: **MARCH BUDGET MESSAGE FOR FISCAL YEAR 2019-2020**

DATE: March 8, 2019

Approved:

Date: 3/8/19

RECOMMENDATION

Direct the City Manager to submit a balanced budget for Fiscal Year 2019-2020, guided by the policy direction and framework of priorities outlined in this March Budget Message.

* * *

In accordance with Section 1204 of the San José City Charter, I present my Fiscal Year 2019-2020 March Budget Message for consideration by the City Council, and the residents of San José. With Council approval, this initial framework provides the City Manager with direction to prepare proposals for the Council's budget deliberations in May, and to formulate the Fiscal Year 2019-2020 Proposed Budget.

OVERVIEW

Budgetary Resilience: A Strategy for Spending in Uncertain Times

We will sit at the zenith of the longest economic climb in our nation's modern history, having benefitted from continuous job growth each year since 2010.

History teaches—too well—what comes after the summit.

We have succeeded in many ways in the last four years in our efforts to "right the ship" fiscally with belt-tightening, focused spending, strategic investments, and restoration of key services. We can celebrate a modest, $3.5 million surplus in the coming year, spurred by a uniquely helpful confluence of fiscal news, including record revenues in several key categories, the passage of several ballot measures, and relatively buoyant financial markets. In the fiscal terrain of big U.S. cities, surpluses are species rarely sighted, and even more elusive to corral for any length of time.

Yet the recent release of the City's five-year general fund forecast shows sources of strain, with combined deficits of approximately $16 million in the half-decade ahead. While small, those projections do not account for variables not captured by standard fiscal modeling, such as inevitable recessions, implicit wage increases within tight labor and housing markets, and accelerated growth in retirement costs with declining discount rate assumptions or bear markets.

For all of these reasons, this Budget Message triggers the foghorn to prepare for the dangers in the misty months ahead. Above all, it emphasizes savings. Savings can take two forms: building reserves, and paying down debt that will sap the General Fund with future interest expense. Where the Council chooses to spend, we must invest strategically so as to provide long term cost-savings, efficiency improvements, and the highest-priority services to our residents. Expanding our efforts to leverage external resources—such as with State grants, private-sector partnerships, philanthropic commitments, or volunteer energy—will enable us to stretch our limited dollars the farthest, and should inform our budgetary choices. To the extent possible we must also limit expenditures within the General Fund to one-time sources of funding that will not require ongoing, multiple-year obligations that cannot be credibly sustained. Adhering to these principles will enable our City to remain resilient through tough times.

Through this Budget Message, I seek my colleagues' support for a strategy emphasizing what I call five basic principles of budgetary resilience:

1. **SAVE**: as the clouds emerge, prepare for the storms by increasing reserves and paying down debt;
2. **ONLY MAKE COMMITMENTS WE CAN KEEP**: when a downturn is likely, either limit General Fund spending to one-time expenditures not requiring ongoing commitments or else find ongoing, stable sources outside of the General Fund;
3. **USE LEVERAGE**: maximize leverage of external resources, including private-public partnerships, philanthropy, and volunteer energy;
4. **SPEND ON SUSTAINABILITY**: invest in programs likely to provide countervailing long-term savings or greater efficiencies; and
5. **FOCUS**: scarce dollars should target on our residents' highest priorities.

I'll now identify the factors shaping the recommendations in this message.

Restoring Core City Services

Following a difficult decade punctuated by the Great Recession, we have continued to restore key core City services every year since my first Budget Message.

In our first Budget Message in Fiscal Year 2015-2016, the Council agreed to add firefighters, restore library hours to six days a week, enhance gang prevention, accelerate homeless rehousing, and combat illegal dumping. We then prepared and secured voter support for two measures on the 2016 ballots — a one-quarter cent sales tax (Measure B) in June and a modernization of the City's business tax (Measure G) in November—that together boosted revenues approximately $60 million annually. That year, we added 41 authorized sworn police officers, restored all "browned out" fire stations, added two-person "squad" cars to boost emergency medical response, invested in emergency vehicle signal preemption technology, bolstered our community service officer team to improve response to burglaries and neighborhood crime, expanded crime analysis capability at

SJPD, allocated $4 million to provide "rapid response" housing for homeless residents, and committed $17.7 million in long-overdue funding for street pavement.

Subsequent years have built on those investments, while securing wage contracts with our employees that boosted pay to improve employee morale, retention, and recruiting. In the last three years—and since the passage of Measure F and the City's new wage contract with our police—we've added more than 200 officers, net of retirements and departures, to our understaffed SJPD. Similarly, our recent agreement with the fire union will enable a raise for firefighters who had seen base pay rise by only 3% during a decade in which the cost of living increased by more than 25%. In addition to expanding staffing in public safety, we've managed to substantially reduce the roughly 900 vacancies that we faced only two years ago, to significantly improve all of our services to our residents.

For their ongoing commitment to providing the highest, most professional service to our residents, I have the deepest gratitude to our hardworking City workforce who have weathered many years of growing workloads without commensurate growth in staffing or support. I am also grateful to my City Council colleagues for their continued commitment to target our scarce resources to our residents' highest priorities.

Filling the Potholes: Restoring our Streets and Infrastructure

I'm especially proud of our important work together to secure ongoing funding that will finally enable us to provide the repaving and other basic maintenance required by our rapidly deteriorating streets and roads, and to rebuild much of our critical infrastructure.

Whether we're long-range commuters, devoted transit riders, or avid cyclists, every trip of ours begins—and depends upon—neighborhood streets. The condition of those streets and our main roads matters for our safety, for our fuel mileage, and for our pocketbooks. According to a recent study, roads in need of repair cost San José motorists more than $900 annually in the form of auto wear-and-tear, tire damage, and additional gas.

The current condition of our roads resulted from nearly two decades of underinvestment. In a typical year, City Hall spent only $20 or $25 million annually—but we would have needed to invest almost $93 million to keep our 2,400 miles of streets in a state of good repair. By 2015, San Joséans inherited more than a half-billion-dollar backlog of road maintenance and repair, with 400 miles of streets in "poor" condition, and plenty more posing less-than-safe conditions for motorists and pedestrians. Even worse, the costs escalated exponentially with neglect; a $1 investment today in preventative maintenance ("street sealing") saves more than $6 in more extensive repairs ("street resurfacing") a few years in the future.

In other words, there are no short-cuts here. There's no smartphone "app" to fix a road. It simply costs money to repair streets, and if we ignore the problem, it costs even more money.

Fortunately, the pieces have finally fallen into place for restoring our roads. This year, we'll pave more than 200 miles of streets for the first time since the turn of the century—and save our residents millions of dollars in tire and car repairs. We'll allocate $94 million for street repair this year, and more importantly, we have established a steady stream of dedicated funding for future years of sustained maintenance.

There are many people to thank for this turnaround. Our Department of Transportation has encouraged paving companies to use more cost-effective methods, such as cold-in-place-recycling of existing pavement, to help reduce costs by as much as 30%. Senator Jim Beall championed the passage of SB1, which has added another $19 million annually for local San José streets, and Silicon Valley Leadership Group CEO Carl Guardino led another countywide effort in 2016 for transportation funding.

But more than anyone, we need to thank our voting taxpayers, who have agreed to provide the federal and state funding that disappeared long ago:

- In the depths of the Great Recession in 2010, I worked with then-VTA official John Ristow—now San José's Acting Director of Transportation—to gather countywide support for the use of vehicle registration fees for street paving.
- VTA Measure B, which passed in November of 2016 with 70% of voter support countywide. I am grateful for Guardino's work in leading that initiative, and his partnership with me to raise the dollars needed for the campaign. Though it passed three years ago, we'll see the first dollars—some $42.8 million—from that measure only this year, with the dismissal of a frivolous lawsuit that stalled implementation.
- In November of 2018, voters defeated Proposition 6, and its proposed repeal of SB1.
- Finally, also last November, San Joseans passed the largest bond measure in our city's history, Measure T, with 71% support. In prior years, we lacked sufficient pavement funding to restore anything other than roads with high-frequency traffic, leaving neighborhood streets to continue deteriorating. Starting in 2020, however, Measure T funding will allow us to reach every neighborhood, with at least $300 million for the restoration of the 400 miles of residential streets in the worst condition. As we're paving, we'll also be improving roadway markings, installing bike lanes, and upgrading many curb ramps to enable full accessibility of our sidewalks.

Of course, in addition to all of the road work, the remainder of Measure T's $650 million in bonds will enable the City to acquire land and construct public improvements for public safety and disaster preparedness, as described more fully in Table 1.

Table 1. Proposed Measure T General Obligation Bond Project Categories

Bond Project List	Anticipated Dollar Amount	Description of Potential Projects[1] (final list will be pending environmental approval of individual projects)	Potential General Fund Impact[2]
Street Repair[3]	$300,000,000	Repair/replacement of neighborhood streets in worst condition	Positive
Police/Fire/Emergency Operations Center4	$175,000,000	Build new Fire Station 37	Negative
		Rebuild/relocate or build two Fire Stations, including property acquisition	Positive
		Rehabilitation of various stations	Positive
		Upgraded or new 911 and Emergency Operations Center (if new, assume built on existing City property)	Negative
		Public Safety Headquarters Infrastructure Needs	Positive
		New police training center (assume land acquisition and rehabilitation of an existing building)	Negative
		New police dept. Air Support Unit Hangar helicopter terminal on existing city property at Mineta SJIA	Positive
Environmental Protection Projects	$50,000,000	Water supply, flood control, open space and environmental protection of lands such as Coyote Valley	Neutral
Storm System Conveyance & Flood Prevention Projects	$35,000,000	Construction of a pump station at Charcot Avenue	Positive
Clean Water Projects	$25,000,000	Priority projects would be partnerships to simultaneously provide clean water to our Bays and beautify existing City-owned open space.	To be determined
Bridges	$20,000,000	Leverage up to or more than $80 million in outside funds for bridge overpasses to be seismically retrofitted or repaired.	Positive
LED Lighting	$20,000,000	Replacement of both streetlights and other outdoor lights in city facilities, such as the parks, libraries, community centers and corporation yards to reduce ongoing General Fund impacts.	Positive
Public safety parks/community center facility improvements	$12,950,000	Upgrading community centers/emergency shelters and parks facilities to support public safety	Positive
Other Priority-Critical Infrastructure	$5,000,000	Priority critical infrastructure repairs to reduce ongoing General Fund impacts	Positive
Total[5]	**$642,950,000**		

1. Although not listed above as a separate category, the inclusion of smart infrastructures, such as broadband and fiber connectivity to enhance emergency response, will be evaluated as appropriate as part of the scope of work for the above projects.

2. The potential General Fund impact column is a conceptual estimate of whether the project(s) would have a positive, neutral or negative direct impact on the City's General Fund after implementation. This typically relates to the change in operating and maintenance costs associated with the facilities/projects. At this time there is not enough information available to estimate the potential impact of the Clean Water Projects, so this is listed as "to be determined."

3. The street repair allocation is a minimum amount. All other allocations are anticipated dollar amounts and subject to change as projects are further defined and scoped out.

4. If any savings result from this category the intent would be to place them in the "Other Priority Critical Infrastructure" category

5. The total does not equal $650,000,000 as it takes into account approximately $7,050,000 in necessary funds for bond issuance

Source: https://www.sanjoseca.gov/DocumentCenter/View/80283

Our Fiscal Outlook

The recently revised General Fund Forecast (Table 2) illustrates an uncertain fiscal future over the next few years, with projections ranging from a $15 million deficit to an $11 million surplus. This demonstrates the need for continued and intentional financial prudence. Fortunately, we have multiple cost-saving strategies available that should allow us to close these gaps without significant service cuts in the year ahead.

Table 2 – 2020-2024 General Fund Forecast Incremental General Fund Surplus / (Shortfall) $ in Millions

2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
$3.5 M	($15.6 M)	($13.7 M)	$11.4 M	($1.7 M)

Source: 2020-2024 Five-Year Forecast and Revenue Projections for the General Fund

Some important facts compel concern, however. First, we've benefitted from a dramatic overperformance of several revenue streams, most notably sales taxes, with the help of legal changes in the tax treatment of internet transactions. Second, the standard projections do not account for what any economist would expect soon after 127 consecutive months of expansion: a recession. That is, five more consecutive years of steadily growing revenues would defy the laws of gravity. For this reason, the City Manager prepared a "Recession Scenario," so that we can better understand the dramatic impact of a typical recession on our budgetary forecast: over five years, the string of deficits would exceed $150 million in deficits. Most importantly, though, the forecast projections do not account for likely changes in the City's annual obligations for its long-term retirement debt, as discussed below.

Legacy Unfunded Liabilities, and Lagging Retirement Fund Returns

Long-standing battles over pension and retirement health costs have beleaguered San Jose over the past decade. In a little more than a decade between 2001 and 2012, the City's contribution to the retirement funds quadrupled, while the Great Recession pulled the bottom out of revenues. The pension and retiree healthcare accounts accrued billions in unfunded liabilities. General Fund deficits ranged between $84 and $119 million for three consecutive years. Budgetary austerity resulted in the layoffs of hundreds of employees, severe service reductions, hiring freezes, pay reductions, and pension reform, ultimately cutting the City's workforce by one-third.

After divisive political campaigns and lengthy court battles, we brought all of the parties back to the table when I came into office in 2015. Eleven unions and the City together agreed on a framework for resolving these challenging and complex issues, and negotiated a solution that saved City taxpayers at a level similar to the original 2012 Measure B, by closing the retiree healthcare plan, eliminating supplemental pension payments, and reducing pension benefits for new hires. We took that plan to the voters in 2016 and secured the support of our 61% electorate to win passage of Measure F in November.

The good news: we have succeeded in slowing the cost impacts of unsustainable benefit structures, and we have created a sustainable set of pension and healthcare benefits for new employees. Specifically:

- The City's actuary estimated that Measure F will save our taxpayers some $3 billion over the next three decades, including $42 million annually in the years after Measure F's enactment.
- We have dramatically reduced future retiree healthcare cost increases by closing the retiree health plan to employees hired after 2012.
- We have created a sustainable, stable "second-tier" of pension benefits for those employees hired after 2012, where unfunded liabilities are shared equally between the City and employees.
- The light appears visible at the end of the tunnel: five-year projections show the retirement plans' costs slowing their ascent by FY2020-21, and moderating to more sustainable increases on the order of 2% to 3% annually thereafter until 2027, when they begin dropping substantially.

We have accomplished this collaboratively, through negotiation at the bargaining table, and with the approval of our residents at the ballot box.

But there's plenty of worrisome news as well.

First, we're already paying a lot for retirement costs. Next year, retiree pension and health care will consume more than ¼ of the City's entire General Fund, or $334.7 million, a share far higher than any other large California city. Since 2013-14, the City's annual costs for pension and retiree healthcare have increased $125 million, an amount that exceeds the annual expenditures of all but two City departments. From all of the City's fund sources, including the airport, sewage treatment plant, the General Fund, and the like, the total bill will exceed $429.7 million. The historic growth of these costs to the City appears markedly faster than our revenue growth, as displayed below.

Second, the costs of financing the City's retirement obligations—or more precisely, its *past* retirement obligations— will continue rising for several more years. Even if the current (relatively rosy) assumptions hold, the General Fund impacts of retirement costs will increase another $50 million to $366 million by FY 2021-22, as displayed below.

Table 3 – 2020-2024 City Retirement Budgeted Contribution Amounts General Fund ($ in Millions)*

Retirement Plan	2018-2019**	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Federated Retirement Plan						
Tier 1 Pension (Normal Cost)	$19.6	$17.7	$15.9	$14.4	$13.1	$11.8
Tier 1 Pension (Normal Cost) Rate	*18.6%*	*19.3%*	*19.1%*	*19.0%*	*18.9%*	*18.7%*
Tier 2 Pension+	$8.8	$8.3	$9.3	$10.5	$11.5	$12.7
Tier 2 Pension Rate	8.3%	*8.3%*	*8.3%*	*8.3%*	*8.3%*	*8.3%*
Unfunded Actuarial Liability	$69.1	$78.8	$81.3	$85.4	$88.0	$90.9
Retiree Health Care	$13.5	$12.3	$12.2	$12.4	$12.6	$12.6
Total Federated Contributions	**$111.0**	**$117.1**	**$118.7**	**$122.7**	**$125.2**	**$128.0**
Police Retirement Plan						
Tier 1 Pension (Normal Cost)	$34.5	$31.3	$32.3	$29.8	$27.2	$24.7
Tier 1 Pension (Normal Cost) Rate	30.1%	*31.4%*	*31.7%*	*32.1%*	*32.7%*	*33.4%*
Tier 2 Pension+	$5.1	$9.6	$9.3	$11.3	$13.5	$15.7
Tier 2 Pension Rate	13.7%	*14.1%*	*14.1%*	*14.1%*	*14.1%*	*14.1%*
Unfunded Actuarial Liability	$61.2	$70.0	$75.8	$78.5	$68.3	$68.6
Retiree Health Care	$16.3	$14.5	$15.4	$16.4	$17.2	$17.9
Total Police Contributions	**$117.1**	**$125.4**	**$132.8**	**$136.0**	**$126.2**	**$126.9**
Fire Retirement Plan						
Tier 1 Pension (Normal Cost)	$25.1	$24.0	$23.7	$22.8	$21.7	$20.6
Tier 1 Pension (Normal Cost) Rate	31.2%	32.3%	32.4%	32.6%	32.8%	33.1%
Tier 2 Pension+	$1.5	$3.0	$3.5	$4.6	$5.7	$6.8
Tier 2 Pension Rate	*15.1%*	*15.4%*	*15.5%*	*15.4%*	*15.4%*	*15.4%*
Unfunded Actuarial Liability	$49.5	$55.0	$62.0	$67.0	$66.8	$70.9
Retiree Health Care	$9.6	$9.4	$10.0	$10.6	$11.1	$11.6
Total Fire Contributions	**$85.7**	**$91.4**	**$99.2**	**$105.0**	**$105.3**	**$109.9**
Other Retirement Contributions	**$1.0**	**$0.8**	**$0.8**	**$0.9**	**$0.9**	**$0.9**
Total General Fund	**$314.8**	**$334.7**	**$351.5**	**$364.6**	**$357.6**	**$365.7**
Total All Funds	**$405.6**	**$429.7**	**$448.0**	**$464.3**	**$459.4**	**$469.7**

+Though Tier 2 contributions are overwhelmingly comprised of normal costs, these figures do contain a very small component of UAL related to the Tier 2 program. For Tier 2, UAL is evenly split between the City and employees.

* City budgetary amounts differ from the Federated and Police and Fire Retirement Boards approved amounts due to the budgetary spread of retirement contributions across vacant, as well as filled positions. Cheiron, the Boards' actuary, applies retirement contributions to an assumed level of filled positions.

** Contributions in 2018-2019 associated with the UAL and retiree healthcare were paid at the beginning of the year, resulting in a slight discount in the contribution amount/rate. With the changing economic environment, all contributions in 2019-2020 will be spread throughout the year.

Source: Cheiron Letters dated January 9, 2019 (Federated) and January 30, 2019 (Police and Fire) and Cheiron presentation slides dated February 7, 2019 (Police and Fire).

It's critically important to look carefully at each of the components to understand why those costs are rising.

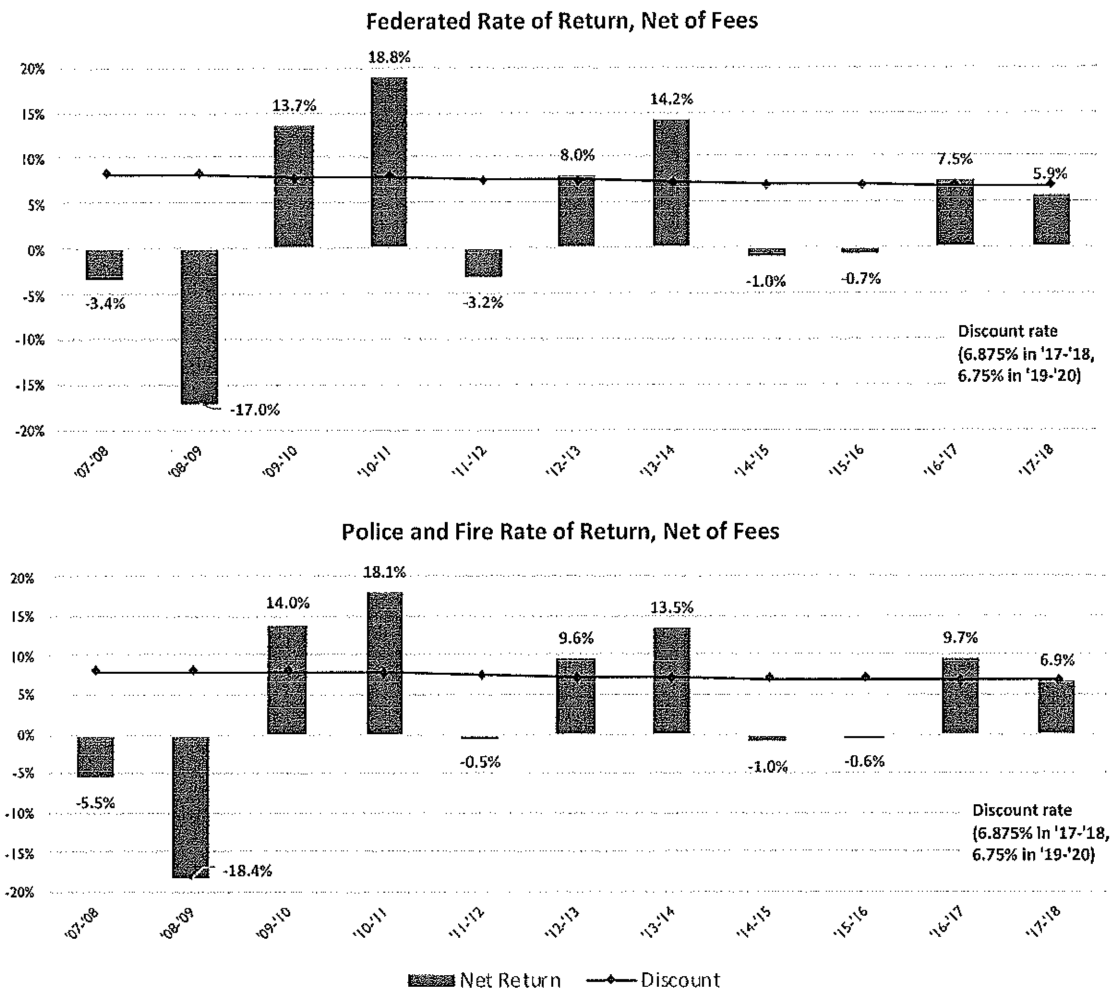
Specifically, with Measure F, we've successfully constrained what actuaries call the "normal" cost of pension and retiree healthcare obligations—the ongoing cost incurred today by current employees. As the figures for the Federated, Police, and Fire Plans show, current employees in Tier 1 and Tier 2 have very manageable pension and retiree healthcare costs projected over the next half-decade. The pension costs of Tier 1 employees decline in every plan as older employees retire from the workforce. Tier 2 employee pension costs remain relatively constant as a percentage of total employee compensation, increasing at a rate commensurate with headcount and salary gains. Retiree healthcare grows at a slow clip across the three plans, from an aggregate of $39.4 million to $42.1 million, or an increase of about 1% annually. In other words, Measure F is working.

The problem is that Measure F did not—and under California law, could not—retroactively constrain the cost of financing the "unfunded actuarial liability" —essentially the excess costs of the City's obligations to employees hired before 2012. That is, the "California Rule" generally precludes jurisdictions from reducing or limiting costs of benefits already promised and earned, even where those costs exceed the retirement plan's assets and projected earnings. The cost of financing unfunded liability rises in the aggregate by 28%, or more than $50 million over five years, and will continue rising until approximately 2027.

Third, projections understate the seriousness of the problem. Actuaries necessarily base their cost projections on relatively fixed assumptions, necessitating a static view of the universe. Given what we know today, "status quo" is unrealistically optimistic, for two interrelated reasons: inadequate investment returns, and changing assumptions.

As displayed below, our retirement plans have generally produced returns below the expected "discount rate" for their investments in recent years. In any year in which the investment returns fail to meet the discount rate, the unfunded liability of the funds—now reaching $4 billion—grows.

Figure 1. Retirement Plan Rates of Return, Net of Fees, Over the Past 10 Years



Source: Police and Fire Department Retirement Plan and Federated City Employees' Retirement System, Comprehensive Annual Financial Reports. Recreated from City Auditor Report 18-09.

There appear to be several factors causing these poor returns, independent of the larger market. They include some causes—such as the conservative (low-yield, low-risk) investment strategy embraced by the boards—that appear both deliberate and defensible. That is, given the highly vulnerable fiscal structure of a plan that has more retirees receiving benefits than workers paying in, a conservative approach that avoid large losses appears sensible.

Other factors appear more troubling, however. For example, until a few months ago, outsized portions of the plan assets sat in cash, seemingly a result of both board indecision and of lengthy delays in hiring a chief investment officer. Fortunately, a new CIO has now taken over, and those cash holdings appear to be getting reinvested. Also troubling has been the tendency for the boards and Retirement Services staff to favor investment in high-fee, management-intensive alternative investments such as private equity, real assets, private debt, and hedge funds. Monday-morning quarterbacking suggests that superior risk-adjusted returns, and greater transparency, could have been achieved from a combination of indexed, low-fee equity and bond funds. While the boards' approach appears by no means unusual, some experts have more successfully charted a different course toward more passive investments, such as the Nevada state pension system[1]. Academics have long speculated about the likelihood of a widespread bias in the industry to prefer higher fee, active investment approaches despite the evidence of inferior outcomes[2], perhaps because decision-makers tend to share the same education, career paths, and social circles as those directing actively managed funds. Time will tell whether decisions to allocate our fund assets to such high-cost investments appears justified. I've expressed concerns repeatedly in the past, however, that existing strategies maximize financial benefit to asset managers, at the cost to the City and our plan members.

The retirement boards' decisions to change the assumptions that actuaries use to calculate the assets, liabilities, and contribution rates of the funds also have profound impacts on the annual cost to the City, and have driven much of the aggregate cost increase since 2013. Those assumptions include demographic projections—such as retirees' life expectancy, health needs, and the like—as well as economic variables, regarding such variables as future inflation, wage increases, and most importantly, fund investment returns. I commend the boards for their courageous willingness to make adjustments as new data reveals the need to pivot toward reality. Indeed, it has been the historic failure of the Boards prior to 2008 (and of many other public pension fund boards nationally) that has irresponsibly created false optimism about the financial status of pension funds that obscured billions in unfunded liabilities.

The most important of those varying assumptions involves the "discount rate," which describes the expected investment returns of the funds. By choosing an optimistic discount rate, such as 10%, one can make unfunded liabilities disappear—on paper, at least. Eventually, of course, reality comes crashing in, as it did in 2008, when we saw steeply negative actual returns creating huge claims on the City treasury while our City's retirement funds kept discount rates of 8.25% (Federated) and 8.0% (Police & Fire). Since that time, we have learned our lesson, and the retirement boards have ratcheted return assumptions downward, to 6.75%. While we should commend them for demonstrating the fortitude and transparency to reduce the discount rate below that of nearly any public agency in the state, every reduction of the discount rate ratchets the required General Fund contribution upward. That is, this is tough medicine of fiscal discipline: we will be forced to pay more now for a more responsible and transparent estimate of the costs of paying for retirement costs over the long run.

Here's the challenge: this will get worse. Retirement board experts have—with good reason—continued to advise the boards to reduce their discount rates even further. Resulting board action will drive up annual retirement costs to the city by several tens of millions of dollars, cutting spending on everything from police to parks and potholes. Moreover, a historically long bull market run leaves many expecting a substantial correction, and other asset classes will get pulled down with declines in equities. Investment losses will require still higher General Fund contributions in the following half-decade.

---

[1] Martin, Timothy W., "What Does Nevada's $35 Billion Fund Manager Do All Day? Nothing", Wall Street Journal, 2016.
[2] Bird, Ron et al., "Why Do Investors Favor Active Management...To the Extent They Do?", Rotman International Journal of Pension Management, Volume 6-Issue2, Fall 2013.

All of this will happen despite the best of intentions: Unions and city management worked responsibly reduce Tier 2 benefits to sustainable levels, and the retirement boards have been honest brokers with discount rate assumptions. Nonetheless, absent corrective action, we will again see retirement costs undermine our collective efforts to serve our residents.

Discerning Our Residents' Priorities

Given these dark clouds on the horizon, any spending decisions should be made with only the very highest priorities of our residents in mind. Here's the problem: no one other than a Delphic oracle can claim to know our residents' spending priorities with precision. The best we can do is to ask our residents directly, which we've attempted through various surveys over the years. Although an imperfect means of identifying clear spending priorities, we do know that public safety comprises the highest priority of our residents—routinely ranking as the highest priority of our residents in nearly every poll. The City Auditor's Annual Report on City Services 2017-18 (Report 18-09), relates the results of the annual community survey in San Jose, and again, the "overall feeling of safety" ranked highest among resident priorities, as "essential" or "very important" by more than 90% of residents. When the same survey residents to rate their community characteristics, San Jose's Achilles' heel came into full view: more than 90% of residents rated as "poor" or "fair" our city's "cost of living" and "availability of affordable quality housing"—the two poorest-rated elements of our quality of life, and close behind was the "availability of affordable child care." Among the other areas of great concern involved our city's aesthetics: more than three-quarters of our residents ranked the cleanliness and overall appearance of the city as "fair" or "poor."

The Mayor's Office continues to explore new means to engage the community in prioritizing budgetary needs. This year, we have refined the online use of the "Balancing Act" software to allow us to see how residents would allocate dollars within a constrained fiscal outlook. We introduced this tool to our residents at our Community Budget Town Hall in mid-February, and in several meetings since, and we have translated it into three languages: English, Spanish, and Vietnamese. Residents can continue to provide budgetary feedback through the use of the online tool through the end of April. We'll report those results to the Council during the budget process, along with resident feedback from our low-tech communication tool known as "community meetings"— to inform our budget discussion.

RECOMMENDATIONS:

As we look to the future, the many issues highlighted above inform my recommendations for budgetary spending and savings. I make these recommendations mindful of the five principles of budgetary resilience that I described in the introductory section, above, namely the admonition to save, avoid unsustainable commitments, leverage external resources, prioritize investments that boost sustainability, and focus on residents' very highest priorities. Using those principles, my budgetary recommendations can be categorized in the following areas:

1. Saving
2. Public Safety
3. Confronting the High Cost of Housing and Living

4. Homelessness
5. Combatting Blight
6. Environment

1. SAVING

Surplus: Given the projected deficits ahead—which will likely grow in coming years— the entire ongoing surplus—with one exception—should be saved in reserve, to offset the shortfalls expected in future years. The exception: an ongoing allocation of $300,000 to bolster the rapid-response team's capacity to respond to illegal dumping and abate trash, as more fully described below. The City Manager is directed to allocate the ongoing $3.2 million surplus to a Future Deficit Reserve for 2020-2021, thereby delivering a "double benefit" of reducing the projected deficit in the following year by the same amount.

One-Time Funds: The City benefits uniquely this year from one-time sources of revenue, such as the City's portion of the sale proceeds of the SARA- owned land to Google, and the sale of various City-owned sites, such as the former FMC plant and Hayes Mansion. Even better, many of these transactions—such as on FMC and Hayes— have also reduced ongoing debt service obligations of the City. Since these one-time sources will not provide sustainable streams of revenue in future years, we should use them strategically to (a) pay down debt, such as on our City golf courses, that create ongoing drag on the General Fund, and (b) fund critical one-time needs, as more fully described in this memorandum, and (c) establish reserves sufficient to boost our fiscal resilience in tough times. The City Manager is directed to employ these strategies with one-time funding sources, and return to Council with an analysis of potential ongoing savings.

Paying Down Debts: City staff and the Council have diligently reduced debt citywide in recent years, by paying down outstanding general obligation bonds, refinancing redevelopment debt, and paying off obligations on City investments in real estate such as the Hayes Mansion and the FMC site. All of those efforts will reduce the drag of annual debt service on the General Fund, freeing dollars for services. The General Fund remains beholden to several smaller obligations yet, however, including legacy obligations on two golf courses, and an energy services company debt that financed LED light conversions. The City Manager is directed to pay down those debts, targeting an amount of up to $5 million, to free General Fund dollars for ongoing services.

Reserves: Insufficient reserves make existing City services vulnerable under fiscal strain, resulting in the too-familiar (but painful) whipsaw effects on our residents and employees, who reasonably expect stable service provision. A City audit in March 2015 (Report 15-03) revealed that the City does not sufficiently fund its reserves, as benchmarked against best practices by the Government Finance Officers Association (GFOA). The audit recommended a "safety net" reserve target in the range of 10 percent—the minimum among benchmarked California cities—to 16.6 percent of expenditures, which comprises the GFOA-recommended best practice. As of this fiscal year, those reserves appear to hover around 6%, or roughly three weeks of operating costs. Although we have made progress since the 2015 audit—boosting this percentage from the 4%, current levels remain insufficient against our future fiscal challenges. We need to prioritize funding to boost those reserves most critical to our City's resilience and core services, particularly the Budget Stabilization Reserve and Future Deficit Reserve. The City Manager is further directed to reassess reserve target levels in light of our own current operational needs to develop baseline, desired, and optimal reserve targets that protect recently-restored services, and to report those reserve targets to Council. Council and staff will then identify strategies for achieving more satisfactory reserve levels.

- **Budget Stabilization Reserve:** To protect residents and employees from the severe cuts that characterized the last two economic cycles, we must boost the Budget Stabilization Reserve. The City Manager is directed to contribute any one-time funds not otherwise prioritized to the Budget Stabilization Reserve, at a minimum amount of $10 million.

- **Future Deficit Reserve:** After this year's surplus, the City Manager's General Fund Forecast suggests we'll be grappling with deficits for several years. To preserve recently restored services, we must prepare prudently. The City Manager is directed to: 1) allocate $3.2 million of the current-year surplus to one-time needs to preserve the ongoing funding to address a portion of the FY 2019-20 projected shortfall, reducing that shortfall from $15.6 million to $12.4 million; and 2) carry over $12.4 million of the 2019-2020 Future Deficit Reserve to the 2020-2021 Future Deficit Reserve to address the remaining projected shortfall in that year. The City Manager is further directed to return to Council with proactive options for ongoing cost savings and efficiencies that will address the remaining ongoing gap of $12.4 million, that, if left unchecked will almost double the deficit projections for FY 2021-22.

- **Essential Services Reserve:** The City Manager is directed to set aside $4 million in one-time funds that may be used to support services that are of essential importance to our residents. Services deemed essential by the City Council may be funded with the use of these one-time funds.

- **IT Sinking Fund Reserve:** Investment in information technology can dramatically improve the productivity of our understaffed workforce, after years of underfunding our IT have forced much of our workforce to work harder with fewer results. IT Director Rob Lloyd came into office two years ago confronting tens of millions in "tech debt," with mismatched and poorly functioning software platforms, vulnerabilities in cybersecurity, and staff time wasted on patching holes in outdated, legacy software systems. Since that time, Lloyd has admirably improved IT, and the City has made critical investments, but the City has no "sinking fund" for critical replacement and repair of aging systems. The City Manager is directed to allocate at least $2 million in one-time funds for IT capital repair and replacement, independent of any allocations needed for 2019-2020 IT priorities.

Convening Stakeholders to Address Retirement Fund Resilience: As I've extensively described in the "Overview" portion of this memorandum, our retirement funds face serious challenges, with fast-growing contribution rates that will undermine the General Fund's capacity to pay and employ employees and deliver basic services to our residents. This is certainly not the fault of any employees or retirees who earned the benefits they were promised, nor of the unions nor Council who negotiated a sustainable solution for ongoing benefits, nor of the voters who approved Measure F that will save taxpayers $3 billion, nor of the retirement boards that have selected more realistic economic assumptions for investment. Every key stakeholder has acted in good faith, and has sought to make decisions in the long-term best interest of the community.

Nonetheless, we still collectively face a daunting challenge, and we need to explore options, such as around reducing "fee drag" on investment returns, altering amortization schedules to finance the $4 billion legacy pension debt that we inherited, and any other worthy ideas that stakeholders may bring forward.

In the past downturn, severe shortfalls created an intensely contentious atmosphere in City Hall that precluded constructive dialogue about solutions. Now is the time to convene key stakeholders—including our City unions, management, retirement board members and staff, with the help of experts—to calmly explore options that will both protect the benefits that our employees have earned, and protect the City's ability to provide basic services through the next recession. This convening should, at a minimum, ensure a full vetting and scrubbing of the numbers to enable a clear, shared understanding of the challenges of the fiscal landscape, and to educate the Council, our workforce, and the public. These public meetings will not constitute—nor substitute for—negotiations with our bargaining units. Rather, they will provide everyone with a clear view of the challenge ahead, and an opportunity to evaluate options. The City Manager is directed to provide staff support for such meetings in the coming months.

2. PUBLIC SAFETY

Police Hire-Ahead Program: As of late December, the Police Department had 1,098 filled sworn officers, and a budget to employ 1,110 officers. By July, our authorized sworn positions will increase to 1,151, enabling us to continue hiring. SJPD has consistently run full academies to bring new recruits into the fold, while several former SJPD officers continue to return home. Although police recruiting and hiring continues its successful run, the aging demographics of our force mean that we will face high rates of retirements that will prevent us from reaching our authorized sworn levels if we do not continue to hire aggressively. A Hire-Ahead Program enables SJPD to hire and train personnel in the Academy at a rate that anticipates future vacancies to provide street-ready officers available to fill them. The City Manager is directed to identify one-time funding required to maintain ongoing academies for the next two fiscal years, until FY 2020-21, in order to fill anticipated vacancies. In an acknowledgment of the need, the City Manager is further directed to develop a staffing plan that describes how an incremental increase in sworn officers would be prioritized, should any additional resources become available in the future.

South Police Substation Activation: Assuming that we can successfully maintain our current staffing projections, and with the passage of Measure T enabling construction of a new police training facility, we finally have an opportunity to utilize the South Substation for its intended purpose. The City Manager is directed to identify permanent sites for a police training facility, and make preparations to begin the transition of the South Substation from a training facility to fully activated substation.

Downtown Foot Patrol: Ongoing concern about the sense of safety of residents, workers, and visitors in our Downtown compels us to continue to fund the $600,000 Downtown Foot Patrol Program, using one-time funding to get more police officers into visible locations of our core.

Fire Department Call Volume: As we have invested in additional staffing and new technology, Chief Robert Sapien and the SJFD have done a tremendous job in restoring emergency response.

After years "browned-out" stations and post-recession struggles, we have now exceeded our emergency medical response standards for ten consecutive months, for example.

Yet our ability to sustain that response appears at risk. We've seen rapid increases in 911 call volume to our Fire Department, at rates far higher than population growth, from roughly 68,000 annual calls in 2012 to more than 93,000 today. There are many causes of this growth, including a fast-expanding elderly population that demands greater medical attention, and emergency medical calls now comprise 62% of all emergency calls for service to the Department. The explosion of homelessness over the last decade has generated more calls for everything from drug overdoses to encampment fires. While we are adding new fire stations and planning for additional line staff to fill those stations, fiscal constraints will not enable us to expand capacity at the same rate as demand growth. We must look critically at our capacity to determine whether the Fire Department should be responding in the same way to non-emergency calls, or whether we could achieve better efficiencies with alternative responses from other service providers.

Specifically, low-priority, non-emergency medical calls, jail transports, and interfacility transports comprise a substantial share of SJFD's call volume. According to the department's March 8, 2016 Fire Department Organizational Review memorandum, low-priority, non-emergency medical ("alpha") calls comprised 13% of total SJFD responses in 2014-15, for symptoms that included earaches, toothaches, hemorrhoids, diarrhea, sunburn, and sore throat. In many if not most cases, a Lyft or Uber ride to the County clinic will save both dollars and precious SJFD time. Similarly, the County contracts with a private ambulance provider to transport County patients under treatment for routine medical treatment, and ambulance delays often cause the County to call SJFD for transport from one County building to another—often literally across the street— even though the patient is rarely in critical condition. These and other calls represent an irrational expenditure of public resources that can distract and delay our SJFD firefighters from their life-saving mission.

The City Manager is directed to conduct an internal review of opportunities to triage rising call volumes and maximize our scarce SJFD resources on life-saving and fire mitigation. That report should be provided to the Council prior to our next budget cycle, and should inform the City in its upcoming negotiations with the County over the provision of medical transport services. The City Manager is further directed to engage in discussions with VTA and BART regarding financial responsibility for the increases in anticipated call volume resulting from the opening of the Berryessa-North San Jose BART Station, and whether 2008 Measure B should fund additional response.

3. CONFRONTING THE HIGH COST OF HOUSING AND LIVING

Child Care Workforce Development and Facilities: The lack of access to affordable childcare comprises a major barrier to securing and maintaining stable work for many families, and the second-greatest drain—after housing—on their budgets. Today, our families with infants, toddlers, and preschoolers need 17,000 more child care slots than currently exist. Families inhabiting fourteen San Jose zip codes dwell in child care "deserts," where at least 300 children lack the child care they need. The lack of quality child care also has huge impacts on the future prospects of our children. More than 70% of San José's 27,000 preschoolers enter kindergarten without the necessary skills and/or socio-emotional competencies. Students who are kinder-ready are 4 to 5 times more likely to pass 3rd grade standardized English literacy and mathematics tests—itself a powerful predictor of academic and life success.

Two of the main challenges driving the deficit in child care services are insufficient facilities and shortages in a trained workforce. Regarding facilities, leasing and upgrade costs inhibit many providers, yet San Jose has ample vacant retail spaces and several new developments that could potentially address this demand. Prior to the Great Recession, child care provider training once comprised a task of our own Library Department, enabling hundreds of parents—primarily immigrants of modest means— to generate additional income and start their own businesses.

The City Manager is directed to (1) allocate one-time funding to address the Council-approved priority of incentivizing construction of on-site child care facilities within new and existing developments, and identifying public facilities for child care; (2) request that the work2future board include childcare providers within its priority career pathway initiative, and include funding for certification training through our community colleges and other institutions; (3) allocate up to $250,000 to the Library Department to evaluate, design, and launch a child care provider training program, utilizing our prior experience and current best practices; and (4) should the Governor's $490 million budget proposal obtain legislative approval, apply for funding for childcare provider training, focusing on at-home, license-exempt providers.

Leveraging State Dollars for "Missing Middle" Affordable Housing: The Bay Area's housing crisis continues to afflict residents across the income spectrum, from homeless to housed. The Governor's January Proposed Budget calls for an investment of $500 million for the development of housing for "missing middle" workers, through the California Housing Finance Agency's expansion of its Mixed-Income Loan Program (MILP). The MILP finances housing for families earning between 60% and 80% of average median income, doing so with less subsidy than traditional programs.

The Housing Department has already been exploring innovative financing approaches to support housing development for the "missing middle," including the potential creation of a private-public investment fund for this purpose. A City commitment that aligns with the Governor's program could make our affordable housing projects more competitive in securing funding through the Governor's proposed mechanism, enabling San Jose to build more housing for workers of modest incomes. The City Manager is directed to identify $10 million in the Multi-Source Housing Fund for this purpose, should the legislature approve the Governor's direction. The City Manager is further directed to return during the budget process with a cost estimate for the creation of an affordable housing fund leveraging private investment, including costs associated with legal fees, structuring, planning, and execution.

San Jose College Promise: Due to the collaborative efforts of San Jose-Evergreen Community College District, West Valley College, the Library Department, the San Jose Library Foundation, and my office, this year we will enable more than 1,500 low-income students to attend community college without paying for books, fees, or tuition. The Governor recently announced his intention to make community college free for two years, essentially filling the need addressed by the College Promise. My office has communicated with several local companies about expanding our College Promise program to four-year institutions such as San Jose State University. If the legislature approves the Governor's proposal, the City Manager is directed to work with the Mayor's Office and local stakeholders to evaluate an expansion of the San Jose College Promise to four-year institutions, with philanthropic support.

Expedited Housing Development: Last year, the Council approved $144,000 for a dedicated staff person in the Department of Planning, Building, and Code Enforcement to provide service to expedite processing of housing projects. The City Manager is directed to adjust PBCE fees to fund this position, and to make this position permanent and ongoing. The City Manager is further directed, within his legal authority, to immediately enable off-hours fire inspection services to address the chokepoint of development processing with fire inspections.

Parcel-Mapping For Housing and City-wide Data Projects: In last year's Budget Message, I called for, and the Council approved, funding for a city-wide data strategy. Focusing on the most pressing issues for our residents, the strategy specifically mentioned: "adopting an early use case for a robustly layered, GIS-based map that will allow housing developers, real estate professionals, and housing advocates to have accurate, parcel-level, and spatial data about opportunity sites for housing development that could speed development of much needed-housing in the city." It appears that this direction has not yet been fully implemented, so the City Manager is directed to identify one-time funding sufficient to enable this specific priority to move forward as a demonstration project, and to report to the Smart City Committee about the program's progress and outcomes.

Additionally, as our City embraces the use of data to improve service delivery, we must improve data governance, open data, and data analytics policies and programs for our City. This takes on additional importance as we seek designation a "What Works" city—a Bloomberg Philanthropy designation for "best in class" cities that use data to inform policy decisions. In addition to improving the efficiency and efficacy of our own decisionmaking, sharpening our data saw will better position San Jose to attract substantial new external resources for evidence-based policy-making across our City. The City Manager is directed to allocate one-time funding to enable data analytics, visualization, and management across City departments, with an emphasis on Housing, PRNS, and SJPD, for a two-year period.

Alquist Building Redevelopment: Our State delegation, led by Senator Jim Beall and Assemblymember Ash Kalra, will seek funding to begin planning for the redevelopment of the Alquist Building on 2nd and San Carlos for housing—particularly for SJSU educators and staff—and other uses. The City Manager is directed to work collaboratively with State officials to enable the development of that site to maximize affordable housing potential, activate the ground-floor streetscape, and preserve public parking to support nearby arts venues and restaurants.

4. HOMELESSNESS

Transitional Jobs Program: Five months ago, we launched the Transitional Jobs Pilot Program to employ homeless residents to clean litter and trash in dozens of citywide "hot spots," with one-time funding that expires June 2019. This partnership with Downtown Streets Team and Goodwill helps homeless get back on their feet, and provides badly-needed cleaning of our streetscape. Most importantly, the program has begun to change the narrative around blight and homelessness in our City, from pointing fingers at homeless residents as "the problem," to including homeless individuals who want to be part of "the solution." Last week, a Goodwill manager informed me that of the dozen or so clients participating in his portion of the program, three have already secured jobs from other employers, and several more have moved on to recycling and other more steady work within Goodwill, plainly demonstrating the early success of this program. Yets dozens of their clients remain on a wait list—ready to work, but unable to do so. The City Manager is directed to use one-time dollars to double the capacity of the program, both to expand work opportunities for our homeless neighbors, and to improve the cleaning of our streets, creeks, and prominent public spaces. To make this more fiscally sustainable, staff is directed to review other potential sources of funding outside the General Fund. The City Manager is further directed to allocate no more than $100,000 for the purchase of trucks and other capital equipment needed to expand the program, to be coordinated with the Mayor's Office's corporate & philanthropic fundraising strategy.

"Cash-for-Trash": Continuing the theme of transforming "homeless as the problem" to "homeless with solutions," we have often heard from encampment residents that they would willingly clean their surrounding area if provided with trash bags and hauling service. In small pilots, we've seen experimentation with paying homeless individuals a few dollars for a bag of garbage, with positive effects. Of course, we should approach carefully: what economists refer to as "moral hazard" could undermine a poorly administered cash-for-trash program, and incentivize counterproductive behavior. The City Manager is directed to explore how to address this "moral hazard" risk, and to administer a modest pilot cash-for-trash program, with $50,000 in one-time funds.

Homeless Students: We're learning that statewide, college students are not immune to hunger and homelessness; locally, our university and community college partners work daily to address these problems. The City Manager is directed to explore partnerships with San Jose State University and our San Jose City and Evergreen Valley community colleges to address this challenge, with a particular focus on enhancing cash assistance funding for students needing emergency options. The City should provide a matching commitment for those schools that choose to increase their own contributions to help their students.

Navigation Center: The Governor has committed to supplement one-time Homeless Emergency Aid Program (HEAP) funding with another $500 million in this budget cycle. In our ongoing advocacy with the Big 13 city mayors, we have reason to believe that we could secure at least as large—if not a larger—allocation from this year's state surplus. We remain committed to a strategy that focuses on the ongoing, urgent, and critical need for permanent housing for the homeless. However, we also critically need to identify locations and structures that can address the acute needs of homeless willing to get off the street. The City Manager is directed to identify a location for a "navigation center," continue discussions with the County regarding sharing the burden, and return to Council in June with a proposal that will enable us to carve out specific one-time HEAP funding for land/building acquisition, or a long-term lease, that purpose.

Ballot Measure: I have been working with key stakeholders to assess whether we should return to the ballot in 2020 to seek voter approval for an affordable housing bond or other funding measure. Additionally, staff has continued to explore measures that might support other critical needs, such as rebuilding and restoring our parks, and expanding our public safety workforce. The City Manager is directed to allocate one-time funds to enable polling for these purposes.

5. BLIGHT

Beautify San Jose: Now in its second year, the Beautify SJ program has accelerated, leveraging the energy of more than 50,000 volunteers for community clean-ups, triple the number of volunteers two years ago. More than 48,000 residents now use our My San Jose reporting app, more than 70 neighborhood groups have collaborated in volunteer-led beautification projects with BeautifySJ grants, our illegal dumping abatement activity has doubled, and the volume of free unlimited junk pickup service has doubled to 496 tons collected per month. A cursory visual inspection of our city reveals, however, that all of these efforts have not lessened the blight problem; more than 80% of our residents in our 2018 community survey rated our city's cleanliness only "fair" or "poor." Through targeted one-time investments, we can leverage the growing community passion that supports our beautification efforts. Specifically:

- **Removing And Preventing Illegal Dumping (RAPID) Program:** The Environmental Services Department's Removing And Preventing Illegal Dumping (RAPID) team responds to illegal dumping service requests on public property and proactively sweeps dumping "hot spots." This hard-working crew removes 25 tons of dumped materials per week on average from City streets and public areas, and in a short time, this program has clearly demonstrated success. The rising demand for illegal dumping services—from 592 monthly requests to 1,226 monthly requests in two years—has strained RAPID's resources. The program now often exceeds its 4-5 day targeted response time, and response exceeds 10 days during busy summer months. The City Manager is directed to allocate $300,000 in ongoing funds for three maintenance worker positions to continue the progress we've seen. Further, the City Manager is directed to continue and expand their enterprise work—which should include ESD, DOT, SJPD, PRNS, and the CMO's data team—to study proactive, comprehensive strategies that better address dumping, and to improve enforcement. As a part of its study, the working group should consider opportunities for inter-departmental collaboration, multiple funding sources, and external partnerships with the San Jose Conservation Corps, Caltrans, VTA, and others.

- **Transitional Jobs, and Cash-for-Trash**: The City Manager is directed to ensure smooth cross-departmental collaboration on the expansion of models for cleaning our city by empowering homeless residents through work-first approaches to self-sufficiency, which was fully described in Section 4, above.

- **Proactive Legal Enforcement of Blighted and Nuisance Properties:** In struggling neighborhoods, blighted properties and empty parcels plant the seeds of decay, providing a sense of disorder to neighbors that invites crime and additional vandalism. Our understaffed code enforcement team assesses fines and other city sanctions, but some of the more neglectful landlords and property owners remain intransigent. The City has largely lacked any robust or consistent legal enforcement of those sanctions, due to staffing shortages in the City Attorney's Office. The City Manager is directed to allocate $400,000 in one-time funds to enable the City Attorney to hire a dedicated Deputy City Attorney for the purpose of litigating these matters for two years, and any fee recoveries, settlements, or money judgments shall fund the continued sustenance of this position.

- **Dumpster and Beautification Days:** In my prior Budget Messages, we directed the City Manager to allocate $18,000 to each Council Office for ongoing funding for Council Office- and neighborhood-led dumpster and beautification days. We neglected to include my own office. The Mayor's Office supports all of these cleanup efforts, with the help of three hard-working staff members and several interns. I direct the City Manager to allocate $36,000 in one-time funding for the Mayor's Office to support of dumpster and beautification days in each Council district.

- **BeautifySJ Capital Needs:** The Environmental Services Department currently has trash compactor equipment that appears inadequate in capacity and breaks down frequently. Moreover, the City needs more trucks to transport equipment to volunteer events. It seems reasonable to expect that the same truck could serve the Transitional Jobs Program during the week, and BeautifySJ volunteer events on the weekend. The City Manager is directed to allocate $300,000 in one-time resources from an appropriate funding source to purchase additional trash compactor equipment and trucks to meet the need, but to ensure that such purchases are not duplicative with equipment purchases for other programs.

- **BeautifySJ Grant Program:** More than 70 neighborhood organizations have received BeautifySJ grants in each year since the program's introduction, leveraging the power of volunteer energy and community pride. Neighborhoods have shown how they can multiply the force of small grants—never exceeding $5,000–to convene community members for neighborhood cleanups, tree plantings, mural-painting, and many other tasks to beautify their corner of San Jose. I direct the City Manager to allocate $200,000 in one-time funds to the BeautifySJ Grant program to continue this momentum.

- **Median Island Landscape Maintenance:** Previous funding of this program allowed us to increase weed abatement, trash cleanup, and other maintenance along major streets and at key gateway locations from once every 18 months to once every four months. The one-time funding for the program expires in June 2019, with initial funding in Fiscal Year 2017-2018 indicating a cost of $1 million. Staff is directed to return to Council to (1) identify the extent to which the Transitional Jobs Program or similar initiative could perform these tasks at a lower cost and with greater social impact, (2) assess alternative sources of funds, including SB1 revenues, to continue this program while limiting impact to the General Fund.

Freeway Trash and Debris: After several years of inaction in response to the poor freeway maintenance, we've seen significant improvement CalTrans response in recent months \under the leadership of their new District Director, Tony Tavares. City-brokered partnerships with the San Jose Conservation Corps and others are starting to gain traction. The City Manager is directed to report to Council on the status of ongoing efforts to encourage and support better CalTrans maintenance of our freeway.

Turning the Lights On in Empty Storefronts: High operating costs, combined with the "Amazon effect" on brick-and-mortar retail has left San Jose with too many empty storefronts. Empty, dark commercial spaces exacerbate blight, and undermines our efforts to activate streetscapes, and maintain an overall sense of safety. Of course, fiscal benefits accrue to the public as well: retail sales tax comprises the second-largest source of General Fund revenue, and retail provides our residents with a major source of employment and entrepreneurial opportunity. Brick-and-mortar retail also provides residents with better quality of life through access to convenient good and services, and provides public space for social convening and activation of our streetscape. The ongoing retail "leakage" in San Jose means that our residents continue to disproportionately send millions of our retail dollars to other communities.

- **Storefront Activation Grant Program:** We piloted the Storefront Activation Grant Program during my years as a Councilmember in District Three, and we've continued to see success in transforming empty spaces to vibrant retail by helping entrepreneurs reduce the burden of City fees for tenant improvements and permits, to get up and running. The City Manager is directed to allocate one-time funding to continue this program.

- **Retail Activation Program:** The Office of Economic Development (OED) recently completed work on Citywide, North San Jose, and Downtown retail strategies, and each point to the need to proactively facilitate retail growth across the City to achieve success. The existing efforts on retail attraction currently consume about 5% of OED time; however, this activity yields a 4:1 ratio of tax revenues (e.g., sales and business taxes, excluding property taxes) generated by companies assisted by the OED team. As such, the City Manager is directed to allocate $375,000 in one-time dollars, spread over two years, to create a Citywide Retail Attraction Program, that will research and market San Jose submarkets and prime opportunity sites, provide outreach to a broad range of retailers, assist small business owners seeking retail sites, and support property owners and developers in facilitating the leasing of available retail spaces. The City Manager is further directed to consider drawing some portion of these dollars from the General Purpose Parking Fund (for Downtown retail) or other sources to minimize burdens on unconstrained General Fund dollars.

6. ENVIRONMENT

Coyote Valley: With the voters' strong approval of Measure T, we have a once-and-only-once opportunity to preserve Coyote Valley from development, thereby protecting our drinking water from contamination risk, reducing downstream flooding, mitigating wildfire vulnerabilities, expanding recreational and trail opportunities, and securing key wildlife corridors. The City Manager is directed to dedicate staff resources to negotiate a favorable price for the purchase of parcels in Coyote Valley, so that the Council can vote in the months ahead to secure this gift for future generations.

Climate Smart San Jose: Environmental Services staff, working in collaboration with the Mayor's Office, have successfully secured grant funding to support the San Jose Climate Smart Program, including grants and other resources from PG &E, BAAQMD, and Microsoft. With our more recent success in the American Cities Climate Challenge, providing $2.5 million in assistance from Bloomberg Philanthropies, San Jose has the opportunity to pilot and demonstrate greenhouse gas-reducing strategies on a national stage. Our successful launch of San Jose Clean Energy will generate dollars to support our Climate Smart San Jose initiatives within 18-24 months, but several initiatives lack the data analysts and other staff needed for implementation and success, as defined by meeting our commitments to Bloomberg and other funders. The City Manager is directed to allocate $700,000 in one-time dollars from the General Fund and appropriate Environmental Services funding sources to enable implementation of Climate Smart San Jose. These dollars shall be spread over two years, to provide "bridge' funding until SJCE's operations provide stable net revenues needed to support the program, and to better position San Jose for similar grant funding opportunities in the future.

CONCLUSION

Prior One-Time Funded Items: The City Manager is directed to evaluate programs funded on a one-time basis in Fiscal Year 2018-2019 for continuation in Fiscal Year 2019-2020.

Budget Balancing Strategy Guidelines: In addition to the five principles I've articulated in this Budget Message, the City Manager is directed to use the familiar FY 2019-2020 Budget Balancing Strategy Guidelines as detailed in Appendix A to develop a balanced budget for the fiscal year ahead.

I respectfully request the support of my colleagues for this March Budget Message. This memorandum has been coordinated with the City Manager and City Attorney.

For more information on this memorandum, please contact Nicholas Almeida, Budget Director, at 408-535-4811.

ATTACHMENTS

Appendix A – FY 2019-2020 Budget Balancing Strategy Guidelines

APPENDIX A

2019-2020 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of the most essential services to the community with the resources available. Consider current needs in the context of long-term service delivery priorities.
2. Balance ongoing expenditures with ongoing revenues to maximize service delivery within existing resources, to ensure no negative impact on future budgets, and to maintain the City's high standards of fiscal integrity and financial management.
3. To the extent possible, establish a Future Deficit Reserve in the General Fund to cover any projected budgetary shortfall in the following year as a stopgap measure.
4. When bringing forward any position reductions, make every effort to eliminate vacant positions rather than filled positions, if operationally feasible, to minimize the number of employees displaced by reductions with the goal of no significant employee impacts.
5. Evaluate program-level budgets and determine if there are opportunities to shift resources or reconfigure operations to close service delivery gaps, generate new revenues, address truly significant community or organizational risks, fund programs added on a one-time basis in 2018-2019, and/or respond to City Council direction and organizational risks. Factor in performance measure data in the development of proposals.
6. Focus on business process redesign to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, simplifying, reorganizing functions, and reallocating resources).
7. Explore alternative service delivery models (e.g., partnerships with non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use City resources more efficiently and effectively.
8. Identify City policy changes that would enable/facilitate service delivery changes or other budget balancing strategies.
9. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
10. Explore expanding existing revenue sources and/or adding new revenue sources.
11. Establish a fees, charges and rates structure designed to fully recover operating costs, while considering the impacts on fee and rate payers, and explore opportunities to establish new fees and charges for services, where appropriate.
12. Focus any available one-time resources on investments that 1) address the City's unmet or deferred infrastructure needs; 2) leverage resources to or improve efficiency/effectiveness through technology and equipment or other one-time additions; 3) continue high-priority programs funded on a one-time basis in 2018-2019 for which ongoing funding is not available; and/or 4) increase budget stabilization reserves to address future budget uncertainty.
13. Engage employees in department budget proposal idea development.
14. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.
15. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.