Five-Year Economic Forecast and Revenue Projections

2020-2024

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 2019-2020 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast, however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment that affect the City's revenue collections.

- **Base Case** – The Base Case Forecast is built on the assumption of slowing, but still positive, economic growth. This region has significantly benefitted from a high level of venture capital investment in the technology industry, solid employment growth, and an extremely strong real estate market. Over the forecast period, activity in most of these areas is expected to moderate, which will result in a slowing rate of local expansion and ultimately lower growth in the City's revenues. In the Base Case Forecast, General Fund revenue collections are anticipated to experience slow growth over the forecast period, with lower growth in the out-years of the Forecast.

- **Optimistic Case** – The Optimistic Case assumes somewhat faster economic growth than anticipated in the Base Case, but still slower than that experienced in recent years. Venture capital investments, the key driver of the technology sector of the economy, are extremely high in each year of the forecast in the Optimistic Case. As a result the area's largest technology employers are doing much better than in the Base Case. Local employment continues to expand at a high rate and, because of this solid employment growth, housing prices remain at high levels and grow through the entire forecast period. Inflation is also expected to be higher than in the Base Case. This stronger growth results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.

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

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, both now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2019-2020 Proposed Operating Budget, scheduled to be published on May 1, 2019.

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

If the current economic expansion continues past July 2019, it will become the longest in U.S. history. The U.S. unemployment rate ranged from 3.7% to 4.1% in 2018, and stood at 4.0% in January 2019, according to the U.S. Department of Labor's Bureau of Labor Statistics. However, while employment rates are extremely strong, wages, which are the largest single source of income in the economy, have been growing only modestly (3.2% annual growth in 2018). The continued slow growth for wages will likely cause downward pressure on the overall economy. Changes in interest rates can also significantly impact economic growth. The Federal Reserve, the central bank of the United States which is tasked with maintaining the stability of the country's financial system, raised interest rates in September and December 2018, and it was anticipated that rates would raise again in January 2019. However, due to the overall health of the economy and inflation being at expected levels, the Federal Open Market Committee chose to maintain the federal funds rate at 2 ¼ to 2 ½ percent. "Job gains have been strong, on average, in recent months, and the unemployment rate has remained low. Household spending has continued to grow strongly, while growth of business fixed investment has moderated from its rapid pace earlier last year. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2 percent."[1] It is currently anticipated interest rates will only increase one to two times over the course of the next year, a significantly decreased from the previous assumption of interest rates increasing three to four times in 2019.

[1] Federal Reserve, Press Release, January 30, 2019

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Some of the key drivers to the U.S. economy include automotive manufacturing and sales, new housing construction, energy production, and a robust technology sector. While the new housing construction, energy, and technology sectors have all remained strong throughout 2018, auto sales are beginning to experience lower sales volumes. For the last several years, car sales have been above 17 million per year; however, in 2018 sales have begun to decrease and are now anticipated to remain close to 16 million per year over the next several years.

On a national level in 2018, the real estate market saw reduced home sales coupled with growing median home prices. Existing home sales (single-family and multi-family dwellings) totaled 5.3 million in 2018, which represents a 3% decline from the 2017 sales of 5.5 million. However, the median sale price for single-family homes increased by 5% from $247,200 in 2017 to $259,100 in 2018.[2] Looking forward, it is anticipated housing statistics will continue similarly to 2018 trends, unless the threat of a looming recession or an international trade war is realized. According to Lawrence Yun, National Association of Realtors Chief Economist, "Stock market volatility caused by talk over a trade war is not good. But economic fundamentals remain strong and should stay that way if normal trade patterns continue."[3] Housing starts (the number of new residential construction projects) have also experienced upward movement, with the 2017 level of 1.20 million increasing to 1.26 million in 2018. With population increases continuing to put pressure on the housing supply, it is anticipated the housing starts will continue to increase in 2019.

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. However, it is important to note that the housing and automobile sectors are highly sensitive to interest rates. Interest rates rose four times in 2018 and as mentioned above, are anticipated to rise again one to two times in 2019. As interest rates continue to rise, the economy will grow at a slower pace.

The energy sector is one of the backbones of the United States economy, with petroleum accounting for almost one-third of the nation's energy production. While oil production had been generally decreasing for many years, beginning in 2009, more cost-effective drilling and production technologies helped boost oil production.[4] United States crude oil and petroleum product net imports have continuously fallen over the last several years, and the United States Energy Information Administration (EIA) forecasts that by the fourth quarter of 2020, the United States will be a net exporter (instead of a net importer) of crude oil and petroleum products for the first time. The average crude oil price experienced sharp declines in 2015-2016, with the average Brent price per barrel dropping from $96 in 2014 to $41 in 2016. Beginning in 2017, production decreases and healthy economic growth resulted in oil prices increasing to an average Brent price per barrel of $54 in 2017 and $72 in 2018. When oil prices began to decline near the end of 2018, which was likely the result of fears over declining global trade and rising interest

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[2] National Association of Realtors, U.S. Economic Outlook, February 2019
[3] National Association of Realtors, Realtor Magazine, January-February 2019
[4] U.S. Energy Information Administration, U.S. Energy Facts Explained, Updated May 16, 2018

Base Case Forecast

rates, an agreement among members of the Organization of the Petroleum Exporting Countries (OPEC) and several non-OPEC countries was reached to reduce production. Based on production and demand currently anticipated, the EIA is forecasting the average Brent crude oil price will average $61 per barrel in 2019 and $62 per barrel in 2020.[5] The crude oil prices are consistently monitored and the forecasted price per barrel can change many times throughout the year.

Venture capital, the driving force of the technology sector, had a record-setting year in 2018 and finished the year with $130.9 billion invested, surpassing the $105.0 billion invested in the dot-com era in the early 2000's. Mega deals (deals over $100 million) experienced a significant 91.3% increase over the previously historic 2017 level. In 2015, the venture capital industry started evolving as venture capital-backed companies stayed private longer and required larger deal sizes. Therefore, fewer transactions are now occurring, but more capital is being deployed into higher valued companies. In 2018, deal counts continued to drop and were at the lowest figure since 2012, however, mega and medium size deals are at extremely high levels. Moving into 2019, the venture capital sector is anticipated to remain strong, however, changes in government regulations can potentially significantly impact foreign investment.[6]

National Economic Outlook

The United States economy has been steadily expanding over the last nine years. However, slow growth across most sectors of the economy appears likely for the next several years. The December 2018 UCLA Anderson Business School Forecast assumes fiscal stimulus that resulted from the large tax cuts passed last year are waning, interest rates will continue to rise, and trade policy changes will all negatively affect the economy, slowing down growth in 2019. Real U.S. Gross Domestic Product (GDP) increased at an annual rate of 2.6% in the fourth quarter of 2018[7], however, growth is anticipated to decline to 2.1% in 2019 and 1% in 2020. In addition, the unemployment rate is anticipated to decrease further in 2019, and wage growth will continue, but at a milder pace.

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) decreased 0.1% in December 2018 (seasonally adjusted), but increased 1.9% over the last 12 months (before seasonal adjustment).[8] However, higher wages, continued high housing costs, and increased tariffs are anticipated to result in the inflation rate rising slightly in 2019. The Federal Reserve will continue to monitor the inflation rate, as well as other economic factors, and increase interest rates accordingly to keep the economy in a mode of growth.

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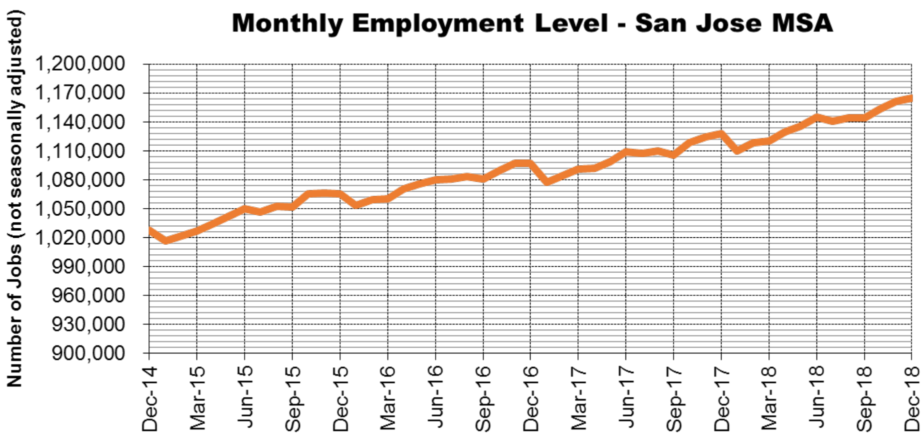
[5] U.S. Energy Information Administration, Short-Term Energy Outlook, February 2019
[6] National Venture Capital Association and PitchBook, Venture Monitor, 4th Quarter 2018
[7] U.S. Department of Commerce, Bureau of Economic Analysis, February 2019
[8] U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index Detailed Report, December 2018

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Current City of San José Economic Conditions

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



The December 2018 employment level in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (San José MSA) of 1.09 million was 3.7% higher than the December 2017 level of 1.05 million. Between December 2017 and December 2018, 37,000 jobs were added. This includes 11,800 jobs in professional and business services, (predominatly in professional, scientific and technical services), 8,100 private educational and health services (largely within health care and social assistance), 7,500 jobs in the information sector, and 5,700 manufacturing jobs.[9]

As noted in the January 2019 Beacon Employment Report, California ended 2018 with employment gains, after experiencing slow labor growth earlier in the year. Robert Kleinhenz, Executive Director of Research at Beacon Economics and the UC Riverside School of Business Center for Economic Forecasting, stated "As expected, Federal tax cuts and increased government spending boosted the economy last year, but we were concerned that a tight labor market would limit growth. However, the year ahead looks good with this surge in the labor force in recent months, precipitated in part by sharp increases in earnings at year end."[10]

Unemployment Rate (Unadjusted)

	Dec 2017	Nov 2018	Dec 2018**
San Jose Metropolitan Statistical Area*	2.7%	2.4%	2.5%
State of California	4.2%	3.9%	4.1%
United States	3.9%	3.5%	3.7%

* San Benito and Santa Clara Counties
Source: California Employment Development Department.
** December 2018 estimates are preliminary and may be updated.

The unemployment rates at the local, State, and national levels remain low. In December 2018, the unemployment rate for the San José Metropolitan Statistical Area (MSA) of 2.5% is slightly above the unemployment rate for

[9] State of California Employment Development Department Labor Market Information Division Press Release, January 18, 2019
[10] Beacon Economics, Employment Report, January 2019

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

November 2018 of 2.4%, but is below the December 2017 rate of 2.7%. In this region, the December 2018 unemployment rate continues to be lower than the unadjusted unemployment rate for the State (4.1%) and the nation (3.7%).

Local construction activity through December 2018 decreased 31.2% from 2017-2018 levels during the same time period. The 2018-2019 budget was developed with the expectation that private development activity would drop because activity in 2017-2018 was exceptionally high due to new construction and that level of activity was not expected to continue.

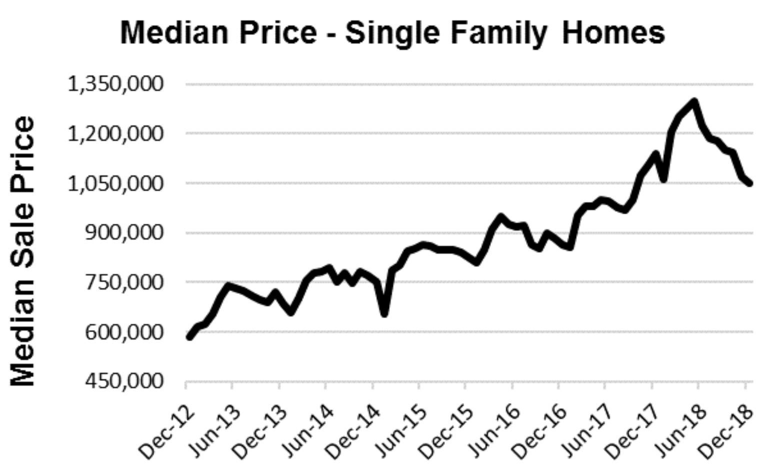
Residential permits for new dwelling units through December totaled 1,684 versus 1,809 in the prior year. Correspondingly, the valuation of new residential construction and alteration activity have also decreased compared to prior year levels ($299.4 million in 2018-2019 and $394.1 million in 2017-2018). Combined residential valuation of $299.4 million through December is 24.0% below the prior year level of $394.1 million.

Private Sector Construction Activity (Valuation in $ Millions)

	YTD December 2017	YTD December 2018	% Increase
Residential	$ 394.1	$ 299.4	(24.0%)
Commercial	$ 406.3	$ 243.9	(40.0%)
Industrial	$ 291.9	$ 208.4	(28.6%)
TOTAL	**$ 1,092.3**	**$ 751.7**	**(31.2%)**

Commercial valuation of $243.9 million through December 2018 is 40.0% lower than the 2018-2019 level of $406.3 million. The commercial activity in the month of December was very modest ($34.8 million) with alterations accounting for 43% of the commercial activity ($15.0 million). Industrial construction valuation of $208.4 million through December was also lower (28.6%) than the prior year level ($291.9 million in 2018-2019).

After seven years of year-over-year home price growth, the local real estate market is beginning to slow down. According to data from the Santa Clara County Association of Realtors, the single-family home price peaked at $1.3 million in May 2018, which represented a 30.0% increase from the May 2017 home price, but has steadily decreased each month since May. In December 2018, the median single-family home price totaled $1.05 million, which represents a 7.9% decrease from the December 2017 price of $1.14 million, but is 21.7% above the December 2016 price of $863,000. In addition to the median home



Base Case Forecast

price decreasing from the prior year level, the number of property transfers (sales) has also continued to steadily decline. The number of property transfers in December 2018 totaled 449, which represents a 3.9% drop from the 467 transfers that occurred in December 2017. In addition, the total number of property transfers that occurred through the first half of the 2018-2019 fiscal year has dropped 11% compared to the first half of 2017-2018. However, while homes are continuing continue to sell quickly, they are on the market significantly longer than the prior year. The average days-on-market for single-family and multi-family dwellings in December 2018 totaled 35 days, which is more than double the 16 days experienced in December 2017.

City of San José Economic Outlook

Over the five-year forecast, the local economy is expected to enter a period of slower economic growth similar to the national economy. Unemployment levels, which have consistently been well below national levels, are anticipated to remain low. While the employment growth level is slower than was previously experienced, it is still positive. Employment levels in Silicon Valley are determined largely by the flow of venture capital funding and the overall health of the U.S. economy.

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

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 Forecast

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

Elements of The General Fund Forecast

Assumptions Regarding the Economic Environment

Optimistic Case Forecast

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

Under the Optimistic Case Forecast, the economically sensitive revenues are expected to experience somewhat stronger performance as general increases in employment and wages offset the negative influences of higher interest rates and promotes increased spending, which generates Sales Tax for the City. Property Tax growth rates are lower than they have been over the past several years, but are much higher than the growth rate assumed in the Base Case Forecast. In addition, lower gasoline prices enable motorists to purchase more gasoline, which increases to the Gas Tax collections.

Pessimistic Case Forecast

The Pessimistic Case Forecast assumes that a combination of adverse factors results in lower economic growth rates than in the Base Case Forecast. The Pessimistic Case Forecast assumes home prices decline deeper than in the Base Case Forecast, and as a result of the lower home prices and property sales, Property Tax revenue decreases significantly. However, since current real estate prices and sales volumes are so strong, it will take a few years for the impact of the declining home prices to be realized with lower Property Tax collections. In the Pessimistic Case Forecast, employment levels are lower, which, coupled with the lower inflation rates assumed, result in lower Sales Tax revenue. In addition, as economic activity drops, occupancy rates and average room rates both fall as well, resulting in significantly lower Transient Occupancy Tax collections throughout the entire forecast.

Oil prices have been extremely volatile and unpredictable over the last several years as United States oil producers compete with powerful OPEC producers. The Pessimistic Case Forecast assumes higher oil prices than the Base Forecast, which results in consumers purchasing less gasoline. As gasoline consumption decreases, the Gas Taxes fall throughout the entire forecast.

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

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

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.

An in-depth analysis of the General Fund revenue categories was completed to develop 2019-2020 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2018-2019 and build upon those projections to develop the 2019-2020 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 2019-2020 Proposed Operating Budget scheduled to be released on May 1, 2019.

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 $1.14 billion in 2019-2020 to $1.28 billion in 2023-2024, for an average growth rate of 3% per year.

General Fund 2020-2024 Forecast
Revenue Summary

	Modified Budget	Forecast				
General Fund Revenue Category	**2018-2019**	**2019-2020**	**2020-2021**	**2021-2022**	**2022-2023**	**2023-2024**
General Revenues						
Property Tax	324,450,000	348,000,000	365,470,000	382,245,000	397,305,000	412,403,000
Sales Tax	250,500,000	258,300,000	264,422,000	269,684,000	276,695,000	284,166,000
Transient Occupancy Tax	19,700,000	22,500,000	23,352,000	24,213,000	25,124,000	26,066,000
Franchise Fees	50,474,798	49,554,000	50,719,000	51,200,000	51,707,000	52,648,000
Utility Tax	102,400,000	99,570,000	101,691,000	103,013,000	104,774,000	107,551,000
Telephone Line Tax	20,000,000	20,000,000	20,036,000	20,070,000	20,102,000	20,138,000
Business Tax	69,400,000	72,200,000	72,921,000	73,443,000	73,946,000	74,472,000
Licenses and Permits	60,893,631	60,450,000	62,030,000	64,305,000	66,449,000	68,709,000
Fees, Rates, and Charges	55,821,726	54,461,000	55,884,000	57,934,000	59,865,000	61,902,000
Fines, Forfeitures and Penalties	14,983,000	14,913,000	15,092,000	15,296,000	15,358,000	15,540,000
Money and Property	6,897,000	13,144,000	13,565,000	13,958,000	14,447,000	14,909,000
Revenue from Local Agencies	16,104,823	11,101,000	11,504,000	11,891,000	12,240,000	12,591,000
Revenue from the State	13,994,473	11,635,000	11,635,000	11,635,000	11,635,000	11,635,000
Federal Revenue	6,206,082	216,000	-	-	-	-
Other Revenue	186,092,775	9,186,000	9,010,000	9,027,000	9,045,000	9,079,000
Gas Tax	17,300,000	16,300,000	16,450,000	16,869,000	17,504,000	18,144,000
Total General Revenues	**1,215,218,308**	**1,061,530,000**	**1,093,781,000**	**1,124,783,000**	**1,156,196,000**	**1,189,953,000**
Transfers & Reimbursements						
Overhead Reimbursements	50,456,037	53,734,000	55,139,000	57,161,000	59,066,000	61,075,000
Transfers	25,968,684	26,594,000	27,670,000	28,422,000	28,564,000	29,183,000
Reimbursements for Services	925,395	654,000	671,000	695,000	718,000	743,000
Total Transfers & Reimbursements	**77,350,116**	**80,982,000**	**83,480,000**	**86,278,000**	**88,348,000**	**91,001,000**
Total General Fund Revenues	**1,292,568,424**	**1,142,512,000**	**1,177,261,000**	**1,211,061,000**	**1,244,544,000**	**1,280,954,000**
Beginning Fund Balance	249,953,260	65,226,000	67,572,000	68,686,000	69,709,000	70,522,000
Grand Total Sources	**1,542,521,684**	**1,207,738,000**	**1,244,833,000**	**1,279,747,000**	**1,314,253,000**	**1,351,476,000**
Growth %			**3.07%**	**2.80%**	**2.70%**	**2.83%**

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 2020-2024 General Fund Forecast.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

The Property Tax category consists of Secured Property Tax, Unsecured Property Tax, SB 813 Property Tax (retroactive collections back to the point of sale for reassessments of value due to property resale), Aircraft Property Tax, and Homeowner's Property Tax Relief. In 2018-2019 Property Tax receipts of $326.1 million are projected, which is slightly (0.5%) above the modified budget estimate of $324.5 million and $19.9 million (6.5%) above the 2017-2018 actual collection level of $306.2 million. A significant portion of the growth from the prior year is due to increased Secured Property Tax receipts, which includes general Secured Property Tax receipts (up $17.4 million) and Educational Revenue Augmentation Fund (ERAF) revenue (up $5.4 million), partially offset by lower Successor Agency to the Redevelopment Agency (SARA) Residual Property Tax receipts (down $3.7 million). In 2019-2020, Property Tax collections are expected to increase 6.7% to $348.0 million. This includes underlying growth of 5.5% in the general Secured Property Tax category (bringing the estimate to $293.6 million in 2019-2020) and increased SARA Residual Property Tax receipts of $7.8 million (bringing the 2019-2020 total to $16.0 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 2018-2019, Secured Property Tax receipts are expected to total $300.3 million, including $278.3 million in general Secured Property Taxes, $8.2 million from SARA Residual Property Tax receipts, and $13.8 million in ERAF revenue. This collection level is up 6.8% from the 2017-2018 receipts, primarily reflecting projected growth in general Secured Property Tax receipts of 6.7% and additional ERAF revenue of $5.4 million, partially offset by lower SARA Residual Property Tax receipts of $3.7 million. In 2019-2020, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2019, are expected to increase by 7.7% to $323.4 million. This primarily reflects the net impact of a 5.5% increase in general Secured Property Tax receipts and additional SARA Residual Property Tax receipts of $7.8 million.

The general Secured Property Tax receipts growth of 6.7% in 2018-2019 primarily reflects an increase in assessed value, due to the California Consumer Price Index (CCPI) increase of 2%, and increased valuation due to changes in ownership or new construction. 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. On a County-wide basis, the 2018-2019 roll growth was driven primarily by changes in ownership (51.4%), change in the CCPI (24.9%), and new construction (20.0%). In 2019-2020, the general Secured Property Tax receipts are estimated to grow by 5.5%. The CCPI adjustment for the 2019-2020 tax roll is 2%, which is consistent with the prior year level. In addition, the high property sale prices will continue to be a positive factor driving growth in this category in 2019-2020. In calendar year 2018, residential real estate experienced significant gains as the average median single-family sales price of $1.17 million was up 17.2% from the median price of $1.0 million in 2017. The number of sales, however, has declined which negatively impacts growth. The total number of property transfers for single-family and multi-dwelling homes declined approximately 9%, from 7,791 sales in calendar year 2017 to 7,083 sales in calendar year in 2018.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

In addition to the changes in assessed value, Secured Property Tax collections are impacted by excess ERAF revenue. 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 2017-2018, the City received $8.4 million primarily from excess 2016-2017 ERAF funds. In 2018-2019, based on information provided by Santa Clara County (that receives information from the State of California), excess ERAF receipts are estimated to total approximately $13.8 million, which has been incorporated into the 2018-2019 Secured Property Tax estimate. This funding level represents an approximately 65% increase from the 2017-2018 collection level of $8.4 million. It is anticipated in 2019-2020 the excess ERAF receipts will be consistent with the 2018-2019 estimated receipts.

The final component of the Secured Property Tax category is the SARA Residual Property Tax receipts. As a result of the SARA bond refunding that occurred in December 2017, the City received a residual property tax distribution of $11.8 million in 2017-2018. The Adopted 2018-2019 Budget assumed receipts would remain fairly flat at $12.0 million. However, due to outstanding Supplemental Education Revenue Augmentation Fund (SERAF) loans anticipated to be paid off within the next year, the SARA residual property tax revenue will be reduced on a one-time basis to an estimated $8.2 million in 2018-2019, but will increase again in 2019-2020 to an estimated $16.0 million. The City is also expected to receive the SERAF loan repayment revenue in 2019-2020 due to the timing of payments, which will be included in the 2019-2020 Proposed Budget.

It should be noted that final data on the actual tax levy for 2019-2020 is not yet available as adjustments are made through June 30, 2019. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Some of the adjustments, however, are not reflected until the latter months of a given fiscal year, such as the reassessments of commercial property. As this information becomes available, refinements to the Property Tax estimates may be brought forward during the 2019-2020 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 January and information provided by Santa Clara County, Unsecured Property Tax receipts are estimated at $15.8 million in 2018-2019, which is 12.4% above the prior year level of $14.0 million. Given the unusually high collection level anticipated in 2018-2019 and the potential impact of large 2018-2019 roll corrections on 2019-2020 revenues, receipts are anticipated to drop by 5% in 2019-2020 to $15.0 million.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

For the other Property Tax categories, 2018-2019 collections are estimated at $10.0 million and are estimated to decrease slightly to $9.6 million in 2019-2020. **SB 813 Property Tax** receipts are estimated at $6.6 million in 2018-2019, but are anticipated to decrease by 5% to $6.3 million in 2019-2020; **Aircraft Property Tax** receipts are estimated at $2.4 million in 2018-2019 and 2019-2020; and **Homeowners Property Tax Relief** revenue are anticipated to total $900,000 in 2018-2019 and 2019-2020.

In the out years of the Forecast, annual Property Tax receipts are projected to increase approximately 3.8% to 5.0% annually over the five-year period. A portion of this growth is due to an estimated 2% CCPI increase annually.

Sales Tax

The Sales Tax category includes General Sales Taxes, Local Sales Taxes, and Proposition 172 Sales Taxes. When the 2018-2019 Adopted Budget was developed, it was projected that Sales Tax receipts would end 2017-2018 at $230.8 million and grow 1.2% to $233.5 million in 2018-2019. In 2017-2018 Sales Tax receipts, however, ended the year at only $226.3 million. This lower collection level was due to the under-distribution of sales tax revenue throughout the State.

The California Department of Tax and Fee Administration (CDTFA), which is responsible for distributing Sales Tax revenue to jurisdictions in California, implemented a new automated system, which resulted in 3rd quarter and 4th quarter 2017-2018 receipts not being fully disbursed to jurisdictions during the quarter in which the tax revenue was received. The CDTFA processed the outstanding payments, which were estimated at approximately $10 million for San José, and included the additional revenue in the 1st quarter 2018-2019 disbursement that was received in November 2018. Based on 1st quarter receipts (including the $10 million that is attributed to the prior fiscal year), 2nd quarter receipts that were recently received, and estimated collections for the last two quarters, the 2018-2019 Sales Tax revenue is projected to reach $259.0 million. After adjusting 2017-2018 and 2018-2019 Sales Tax figures to account for the under-reporting in 2017-2018, the adjusted growth rate in 2018-2019 is 5.4%, which reflects strong performance in the first two quarters of the fiscal year and estimated receipts for the remaining quarters.

In June 2018, the United States Supreme Court made a historic ruling with the South Dakota vs. Wayfair, Inc., decision which provides states with the authority to require online retailers to collect sales tax even without a local presence in that state. Based on the most recent information provided by the CDTFA, which is implementing the changes in California as a result of the Supreme Court decision, out of state online retailers must comply with the new Sales Tax guidelines by April 2019. As a result, additional collections will not be reflected in local jurisdictions receipts until the 4th quarter 2018-2019 payment. Due to uncertainties of the timing and collection level in 2018-2019, the current year Sales Tax estimate does not include any additional revenue anticipated as a result of the internet sales. A final reconciliation of 2018-2019 Sales Tax, including any tax

Revenue Forecast

Sales Tax

revenue received from out-of-state internet sales, will be included in the 2018-2019 Annual Report, which is anticipated to be released on September 30, 2019.

In 2019-2020 Sales Tax receipts are estimated at $258.3 million, which factors in the following: a reduction of $10 million related to the one-time overpayment received in 2018-2019, estimated 2.5% underlying growth from the 2018-2019 estimate, and additional revenue of $5.0 million anticipated for out-of-state internet sales. Additional information about each of the Sales Tax sub-categories is provided below.

When the 2018-2019 Adopted Budget was developed, **General Sales Tax** was anticipated to total $181.2 million in 2017-2018 and after factoring out accrual and one-time adjustments would grow by approximately 2% to $184.3 million in 2018-2019. However, due to the under-distribution of 2017-2018 Sales Tax by the CDTFA, the General Sales Tax actual receipts in 2017-2018 of $176.8 was under-stated by approximately $9 million. The CDTFA has since processed the outstanding payments and included the additional revenue in the 1st quarter 2018-2019 disbursement that was received in November 2018. Based on the 1st and 2nd quarter actual receipts, including the one-time over-collection from the prior year of $9 million, and estimated receipts for the last two quarters, the 2018-2019 General Sales Tax receipts are anticipated to total $204.8 million. After adjusting 2017-2018 and 2018-2019 General Sales Tax figures to account for the under-reporting in 2017-2018, the adjusted growth rate in 2018-2019 is 5.3%, which reflects strong performance in the first two quarters of the fiscal year and estimated receipts for the remaining two quarters. In 2019-2020 General Sales Tax receipts are estimated at $204.6 million which includes a reduction of $9 million for the one-time overpayment received in 2018-2019, estimated 2.5% underlying growth from the 2018-2019 estimate, and additional revenue of $4.0 million anticipated for out-of-state internet sales.

In June 2016, San José voters approved a ¼ cent local sales tax, which was implemented in October 2016. As a result, beginning in 2016-2017, **Local Sales Tax** revenue started to be received in San José. The 2018-2019 Local Sales Tax budget was built on the assumption 2017-2018 receipts would total $42.6 million and after factoring out accrual adjustments would grow by approximately 2% to 43.0 million in 2018-2019. However, due to the CDTFA under-distributing payments, the Local Sales Tax actual receipts in 2017-2018 of $41.3 million were understated by an estimated $1 million - $2 million. The CDTFA has since processed the outstanding payments and included the additional revenue in the 1st quarter 2018-2019 disbursement that was received in November 2018. Based on the 1st and 2nd quarter actual receipts, including the one-time over-collection from the prior year and slight growth for the remainder of the fiscal year, the 2018-2019 Local Sales Tax receipts is anticipated to total $47.7 million. In 2019-2020 Local Sales Tax receipts are estimated at $47.0 million which includes a reduction for the estimated one-time overpayment received in 2018-2019, estimated 2.5% underlying growth from the 2018-2019 estimate, and additional revenue of $1.0 million anticipated for out of state internet sales.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Sales Tax

Proposition 172 Sales Tax collections (representing the ½ cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total $6.5 million in 2018-2019, which represents growth of 2.2% from the 2017-2018 collections. In 2019-2020, receipts are projected to increase by 2.5%, to $6.7 million.

In the out years of the Forecast, annual Sales Tax performance is expected to show growth of 2.0% to 2.7% annually.

Transient Occupancy Tax

In 2018-2019, Transient Occupancy Tax (TOT) receipts in the General Fund are projected to reach $21.0 million, reflecting an increase of 7.5% from the 2017-2018 collection level of $19.53 million. The anticipated increase represents the tenth year of consecutive growth, due to continued strong regional economic performance. Occupancy levels through December 2018 have increased slightly, from 77.44% to 78.48%, relative to December 2017 levels. This increase is coupled with higher average room rates, up 6.3% from December 2017 (from $183.48 to $195.08), and higher average revenue-per-available room, up 7.8% from December 2017 (from $142.08 to $153.10).

In 2019-2020, TOT receipts are projected at $22.5 million, reflecting growth of 7% from the 2018-2019 estimate. This figure incorporates information received from the City's consultants, factoring for the number of hotel rooms expected to come on-line, forecast economic and convention performance, and other correlated economic variables. As TOT can experience wide swings of positive and negative growth, and given the historically high average daily room rates and hotel occupancy, the out years of the Forecast assume growth ranging from 3.7% to 3.8%. However, the growth assumptions used in the development of this Forecast are more conservative than those assumed by the City's consultant, Conventions, Sports and Leisure (CSL), which projected potential annual growth ranging from 5% to 11%.

Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Commercial Solid Waste, Cable, City-Generated Tow, Water, and Nitrogen Gas Pipeline categories. Overall, collections are projected at $49.3 million in 2018-2019, reflecting a 3.6% drop from prior year receipts of $51.2 million. The projected decrease in 2018-2019 is primarily due to lower collections in Gas, Electricity, and Cable receipts. In 2019-2020, Franchise Fees are expected to grow slightly to $49.6 million, which primarily reflects growth in Electricity and Gas receipts (2%), partially offset by decreased revenue related to Cable Franchise Fees.

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 2018-2019 are based on

Franchise Fees

calendar year 2018 and revenues in 2019-2020 will be based on calendar year 2019). Year-end estimates are typically based upon an examination of electricity and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. The reconciliation of annual receipts from PG&E for 2018-2019 will be received in April 2019.

In the **Electricity Franchise Fee** category, collections in 2018-2019 are anticipated to reach $22.8 million, reflecting an almost 2% drop from the 2017-2018 receipts. This estimate takes into consideration the actual collection patterns for electricity utility tax receipts in calendar year 2018. In 2019-2020, Electricity Franchise Fee collections are projected to increase by approximately 2% to $23.3 million. Updated rate information is not available from PG&E, therefore, this growth factor is estimated based on historical patterns. In May 2016, San José City Council established the San José Clean Energy (SJCE), the City of San José's community Choice Energy (CCE) program, which allows governments to purchase electricity for their business and residents. SJCE will provide the same electricity service currently provided but with more renewable energy options at competitive rates. SJCE municipal launched in summer 2018 and the residential and large commercial accounts launch occurred in early 2019. As previously discussed, PG&E's new rates are not yet known, but are anticipated to be finalized and effective by April 1, 2019. SJCE will be able to determine their rates for the upcoming year once the new PG&E rates are finalized to reflect the 1% discount on PG&E's generation rates.

In the **Gas Franchise Fee** category, the 2018-2019 estimated collections of $5.2 million reflect a decrease of 8.8% from the $5.7 million received in the prior year. This estimate takes into consideration the actual collection patterns for gas utility tax receipts in calendar year 2018, which includes lower collections in October 2018 due to the California Climate Credit. In 2019-2020 collections are projected to grow 2% to $5.3 million, however, receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach budgeted levels of $11.8 million in 2018-2019, 2.1% above the prior year collections, which is due to the 2018-2019 CPI-based increase of 2.1%. Collections reflect the revised methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010, the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The fee structure is a base of $5 million per year for each of two geographic collection districts plus a supplemental fee of $1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the CPI rate during the prior two calendar years. It should be noted that this increase is not automatic, and is subject to City Council approval each year. Therefore, the 2019-2020 estimate of $11.8 million is consistent with the 2018-2019 estimate and does not automatically assume a CPI adjustment. This adjustment will be brought forward as a proposed change in the 2019-2020 Proposed Operating Budget.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Franchise Fees

In the **Cable** Franchise Fee category, the estimated 2018-2019 collections of $8.8 million is 9.7% below the prior year receipts of $9.8 million. In addition, revenue in 2019-2020 is anticipated to drop an additional 5% to $8.4 million. As people continue to move from cable to less expensive streaming options (that do not include a Franchise Fee), this revenue source is anticipated to continue to decline.

City Generated Tow Fees in 2018-2019 are projected at $400,000, reflecting a 35.2% decline from the 2017-2018 actual collection level. As detailed in the Amendments to City Generated Tow Agreements memorandum that was approved by the City Council on October 31, 2017, tow fees have significantly declined. To address the changing environment, contract amendments, such as allowing tow operators to deduct disposal expenses associated with certain tows of recreational vehicles and similar trailers, were approved as part of the memorandum that became effective January 1, 2018. Based on current collection trends, revenues are estimated to end 2018-2019 at $400,000 and remain flat in 2019-2020.

Remaining franchise fees include the **Great Oaks Water and Nitrogen Gas Pipeline** categories. Nitrogen Gas Pipeline receipts are estimated at $65,000 in 2018-2019 and 2019-2020. Great Oaks Water fees are anticipated to reach $320,000 in 2018-2019 and grow by 2% to $330,000 in 2019-2020.

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase by 0.95% to 2.35%. However, it is important to keep in mind that there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels.

Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2018-2019 are anticipated to total $99.0 million, representing a less than 1% drop from the 2017-2018 collection level of $99.8 million. In 2019-2020, Utility Tax collections are projected to increase approximately 0.6% to $99.6 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. As previously discussed, PG&E has not yet released their rate increases for 2019.

The **Electricity Utility Tax** is anticipated to generate $46.0 million in 2018-2019, a 1.6% drop from prior year levels. In 2019-2020, revenues are estimated to increase 2% to $46.9 million. PG&E has not yet released rate increases, therefore the 2019-2020 growth is based on historical patterns. As previously discussed, PG&E’s new rates are not yet known, but are anticipated to be finalized and effective by April 1, 2019. SJCE will be able to determine the City’s rates for the upcoming year once the new PG&E rates are finalized to reflect the 1% discount on PG&E’s generation rates.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Utility Tax

Gas Utility Taxes are projected at $9.8 million in 2018-2019, a 7.2% decrease from 2017-2018 levels. This estimate takes into consideration lower collections in October 2018 and April 2019 due to the California Climate Credit. Beginning in 2019-2020, this credit will only occur once per year in April, therefore the 2019-2020 collections are projected to increase to $10.4 million, which assumes 2% underlying growth as well as only one California Climate Credit. Receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

Water Utility Tax receipts of $16.3 million are anticipated to be received in 2018-2019, an increase of approximately 5% from 2017-2018 collection levels. In 2019-2020, receipts are projected to increase approximately 2.5% to $16.7 million based on the annualization of water rate increases that occurred effective January 2019.

In the **Telephone Utility Tax** category, revenues are collected on landlines, wireless, VoIP, and prepaid wireless services sold at retail locations. Receipts (excluding compliance revenue) in 2018-2019 and 2019-2020 are projected at $25.6 million, a 5% decrease from 2017-2018 collection levels. The decline in this revenue category is the result of wireless consumers shifting to less expensive prepaid wireless plans, competition with cellular companies that keep prices down, and the taxable base of wireless communications not including data plans.

In the out years of the Forecast, conservative growth ranging from 1.3% to 2.65% annually is projected overall in the Utility Tax category. There is significant volatility and uncertainty regarding the performance in this category based on potential changes in rates and consumption levels. In addition, the Water and Gas Utility Tax categories are significantly influenced by weather conditions.

Telephone Line Tax

Based on the current collection trend, receipts (excluding compliance revenue) in 2018-2019 and 2019-2020 are estimated to total $20.0 million, which is consistent with the 2017-2018 actuals. Given the steady nature of collections in this category, receipts are anticipated to remain relatively flat (growth of less than 0.5%) in the out years of the Forecast as well.

Business Taxes

This category includes General Business Tax, Cardroom Tax, Disposal Facility Tax, and Marijuana Business Tax. Business Taxes are estimated to reach $72.2 million in 2018-2019, a 2.2% increase from prior year levels, then remain flat in 2019-2020.

REVENUE FORECAST

Business Taxes

In 2018-2019, **General Business Tax** proceeds are anticipated to reach $26.5 million, which is consistent with the 2017-2018 collection level and slightly above the 2018-2019 Adopted Budget level of $25.7 million. The 2018-2019 Adopted Budget was built based on the assumption that the council-approved Business Tax Amnesty Program would begin in early 2018-2019. Although the Amnesty Program has not yet begun, revenue is anticipated to slightly exceed the Adopted Budget level. In 2019-2020, General Business Tax revenue is anticipated to grow by 2% from the 2018-2019 estimate, plus increase an additional $1.0 million due to the Amnesty Program beginning over the summer 2019, bringing the 2019-2020 General Business Tax estimate to $28.0 million.

Based on current performance, collections in the **Cardroom Tax** category are estimated at $18.7 million in 2018-2019, a slight decrease from the prior year collection level of $18.9 million. In 2019-2020, receipts are anticipated to remain flat at $18.7 million.

Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream can vary due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. Based on current collection trends, 2018-2019 DFT collections are estimated at $12.0 million, representing a 2.3% decline from 2017-2018 collection levels. In 2019-2020, receipts are anticipated to remain flat at $12.0 million. DFT revenues have slowly declined over time as a result of continued waste diversion efforts. For example, in 1997-1998, receipts totaled close to $20 million.

Marijuana Business Tax collections began after the November 2016 California Marijuana Legalization Initiative (Proposition 64) was approved by voters and recreational marijuana use was legalized in California. As a result, the sale of recreational cannabis at the 16 licensed dispensaries in San José began in January 2018. The 2018-2019 Adopted Budget for the Marijuana Business Tax totals $13.5 million, which represents almost 4% growth from the $13.0 million received in 2017-2018. While collections are tracking to exceed $13.5 million in 2018-2019, the 2019-2020 estimate remains at $13.5 million due to several possible changes that may affect future collections. Revenue may decrease in 2019-2020 as the result of neighboring cities passing Cannabis taxes in the November 2018 election, which will provide competition for San José when the dispensaries are open in other jurisdictions. In addition, dispensary remittance errors that have recently been discovered are currently being analyzed and may result in lower receipts. However, revenues may increase in 2019-2020 due to the City Council approving the expansion of the Marijuana Business Tax to include manufacturing, testing labs, and distribution in December 2018.

In the remaining years of the forecast, overall, the Business Tax category is expected to experience changes ranging from 0.7% to 1.0% per year.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Licenses and Permits and Fees, Rates, and Charges

The Licenses and Permits and Fees, Rates, and Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. In 2019-2020, the Licenses and Permits category is estimated at $60.45 million and the Fees, Rates, and Charges category is estimated at $54.5 million.

For the Development Fee Programs, the Forecast assumes no net impact on the General Fund based on the assumption that these programs will remain at 100% cost recovery. For 2019-2020, the Building Fee Program, Fire Fee Program, Public Works Fee Program, and City-Wide Planning Fee Program base expenditures are projected to exceed the base revenue estimates. For all of these fee programs there are sufficient earmarked reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact in 2019-2020. This Forecast assumes that 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 2019-2020 estimates are based on current collection trends.

In the out years of the Forecast, both the Licenses and Permits and Fees, Rates, and Charges categories are expected to experience annual growth ranging from 2.6% to 3.7%. The growth rates in the out years are tied to the expected increases in personnel costs, which the fees are designed to recover, including salary, retirement, and health costs.

Fines, Forfeitures and Penalties

In 2018-2019, the Fines, Forfeitures and Penalties category is expected to generate $15.0 million. The largest component of this revenue category is Parking Fines, which are expected to generate approximately $11.1 million in 2018-2019 and 2019-2020. These estimates reflect growth of 2.3% from 2017-2018 receipts of $10.9 million. Total revenue in 2019-2020 is estimated at $14.9 million in the Fines, Forfeitures, and Penalties category. In the out years of the Forecast, annual growth of approximately 0.4% to 1.4% 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 $9.0 million in 2018-2019. In 2019-2020, revenue is expected to grow to $13.1 million, which primarily reflects increased interest earnings due to increased interest rates as well as higher cash balances as the City will no longer pre-pay retirement contributions. In the out years of the Forecast, growth of 2.9% to 3.5% annually is assumed in the Money and Property category.

REVENUE FORECAST

Revenue from Local Agencies

In 2018-2019, revenue of $16.1 million is projected from other local agencies, such as the Central Fire District payment for fire services provided to County residents by the San José Fire Department, the County of Santa Clara payment for the Paramedic Program, and the Successor Agency to the Redevelopment Agency of San José (SARA). In 2019-2020, revenue in this category is projected at $11.1 million, which is $5.0 million below the 2018-2019 estimate. The decrease in 2019-2020 revenue is primarily due to reimbursements and grants that are not secured on an ongoing basis being eliminated. In addition, based on information provided by the County, SARA reimbursement costs for enforceable obligations is anticipated to decrease from $1.0 million in 2018-2019 to $339,000 in 2019-2020.

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, payments of $7.5 million are anticipated in 2018-2019. This reflects a 6.5% increase from the prior year level. In 2019-2020, collections are projected to increase 5.5% to $7.7 million. In 2019-2020, reimbursement totaling $970,000 is also expected from local agencies for services provided by the Animal Care and Services Program. This collection level is consistent with the 2018-2019 estimate.

The Forecast assumes reimbursement from the County of Santa Clara for the first responder advanced life support program (Paramedic Program), which totals $2.0 million in 2018-2019 and $1.3 million in 2019-2020. The reimbursement associated with the Paramedics Program was eliminated from the budget beginning in 2014-2015. Because the City's performance fell slightly below the performance standards set forth in the agreement with the County, no reimbursement was provided for either the equipment reimbursement component (Annex B, Category A funds) or the service-related component (Annex B, Category B funds). However, based on recent information received from the County, revenue is anticipated to be received in 2018-2019 totaling $2.0 million for Category A funds ($1.3 million) and Category B funds ($783,000). The category B funds are based on actual performance for the fourth quarter 2017-2018 and first quarter 2018-2019, however, additional reimbursement may be received based on performance for the remainder of the year. Due to uncertainty related to future reimbursements for Category B funds, the 2019-2020 estimate is decreased to $1.3 million and only incorporates Category A reimbursement. It should be noted that the direct incremental cost to the City to provide the paramedic program totals over $5 million annually. If the County were to assume responsibility for this program, its costs are estimated to far exceed this amount.

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 0.5%.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

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 $11.6 million in 2019-2020 and remain flat through the out years of the Forecast. Tobacco Settlement payments account for the majority of revenue in this category and are estimated at $9.4 million in 2019-2020, consistent with the amount projected for 2018-2019.

The State grants and reimbursements total $1.7 million in 2019-2020, with the largest reimbursement for the Abandoned Vehicles Abatement Program ($800,000), and Auto Theft Reimbursement ($800,000). Vehicle License Fees Collection in Excess are also estimated at $500,000 annually and account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures that are equally apportioned to counties and cities on a population basis.

Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues. In 2019-2020 revenue of $216,000 is anticipated for the second year of grant funding for the Northern California Regional Intelligence Center – Police 2018 ($111,000) Urban Areas Security Initiative Grant – Police 2018 ($105,000).

Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and proceeds from the Sale of Surplus Property. In 2018-2019, this category is expected to generate $186.2 million.

The 2018-2019 estimate includes a number of adjustments not included in the 2019-2020 Forecast, the largest of which is borrowing proceeds of $150.0 million from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension benefits that are brought forward for City Council approval in August of each year along with the associated expenditure. Beginning in 2019-2020 prefunding employee retirement contributions will no longer occur.

In 2019-2020, the revenue estimate of $7.5 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2019-2020 costs or agreements and the elimination of one-time funding sources. In 2019-2020 payments from Comcast and AT&T are estimated at $1.8 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

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Other Revenue

Program is estimated at $1.3 million based on the current allocation of staff to this function. In addition, the proceeds from the Sale of Surplus Property category is estimated at $1.0 million in 2019-2020 based on the anticipated assets that will be sold next fiscal year.

In the out years of the Forecast, annual collections are expected to experience growth and declines ranging from -1.9% (reduction is related to one-time grants) to 0.4% annually.

Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2018-2019 are projected to reach $16.3 million, which is approximately 2% lower than the prior year actuals. Several factors impact collections, including falling gas prices that would support increased consumption and, as an offsetting factor, the move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In 2019-2020, collections in this category are projected to remain at $16.3 million. In the out years of the Forecast, collections are expected to experience growth ranging from 0.9% to 3.8% annually.

Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2019-2020, a total of $53.7 million in reimbursements are projected based on 2019-2020 overhead rates for the majority of City funds prepared by the Finance Department applied against the projected 2019-2020 salaries for those positions for which an overhead rate is applied. In the remaining years of the Forecast, annual growth ranging from 2.6% to 3.7% is 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 $26.6 million in 2019-2020, which is slightly above the 2018-2019 modified budget estimate of $26.0 million. The largest component of this category ($17.1 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2019-2020, these reimbursements have been built to cover the direct base costs as well as indirect costs.

Additional large transfers programmed for 2019-2020 include the Construction and Conveyance Tax Fund transfer ($3.5 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer ($1.75 million) for general use and pavement maintenance activities; the General Purpose Parking Fund ($707,000); and the transfer from the Convention and Cultural Affairs Fund ($407,000) for reimbursement of City oversight of the fund.

REVENUE FORECAST

Transfers

In the remaining years of the Forecast, annual increases range from 0.5% to 4.0%. The reimbursement from the Airport Maintenance and Operation Fund for police and fire services is expected to increase in the out years based on the increased costs for those services.

Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program, Voluntary Employee Beneficiary Association (VEBA) Fund, and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2019-2020 of $654,000. In the remaining years of the Forecast, annual growth ranging from 2.6% to 3.7% is anticipated to recover the projected costs.

Beginning Fund Balance

The $65.2 million forecast estimate of available 2019-2020 Beginning Fund Balance is based on the following assumptions:

- The current Contingency Reserve of $37.0 million is carried forward at the current level based on the assumption that this amount will not be used in 2018-2019 and will be available for use in 2019-2020. The current funding level is approximately enough to cover General Fund payroll costs for approximately two weeks in an emergency. (On the expenditure side, the Contingency Reserve is set at $38.5 million in 2019-2020 and increases in the out years of the forecast to $41.5 million by 2023-2024 to comply with the City Council policy to set aside at least 3% of expenditures in this Reserve.)

- A total of $20.0 million in fund balance will be achieved in 2018-2019 for use in 2019-2020 from a combination of excess revenues and expenditure savings as well as the liquidation of prior-year carryover encumbrances. Consistent with past practice, the Administration will closely monitor actual General Fund performance through the remainder of the year and may bring forward adjustments to this estimate as appropriate later in the budget process.

- An additional $8.2 million reflects the anticipated liquidation of reserves. Of this amount, $7.8 million will be used to support the Development Fee Programs as follows: $5.9 million from the Building Development Fee Program Reserve; $1.1 million from the Public Works Development Fee Program Reserve; $704,000 from the Fire Development Fee Program Reserve; and $145,000 from the City-Wide Planning Fee Program Reserve. The use of Development Fee Program reserves is assumed to cover a portion of the 2019-2020 base costs associated with these programs that cannot be addressed with base fee revenue to keep the Development Fee Programs 100% cost recovery in the Forecast. Other current year reserves that will be used to support base costs programmed in 2019-2020 include the San Jose Environmental Sustainability Program Reserve ($269,000), and the Chief Data Officer Reserve ($200,000).

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Beginning Fund Balance

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue and expenditure savings, including liquidations of carryover encumbrances will increase slightly each year from $22.8 million in 2020-2021 to $24.9 million in 2023-2024. In addition, it is assumed that the Contingency Reserve of $37.0 million will be carried over each year; and the use of the Development Fee Program Reserves for Building, Planning, Public Works, and Fire continue in the out years to support projected development fee program costs in excess of revenues. For the Development Fee Programs, a combination of fee increases, cost reductions, and/or use of reserves may be used to close gaps between revenues and expenditures, as needed. In total, the Beginning Fund Balance ranges from $65.2 million in 2019-2020 to $70.5 million in 2023-2024.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2019-2020 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2019-2020 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from $1.2 billion in 2019-2020 to $1.4 billion in 2023-2024, for an average growth rate of 3.4% per year.

2020-2024 General Fund Forecast Expenditure Summary

	Modified Budget	Forecast				
Expenditure Category	**2018-2019**	**2019-2020**	**2020-2021**	**2021-2022**	**2022-2023**	**2023-2024**
Personal Services						
Salaries and Other Compensation	$ 509,535,364	$ 534,235,000	$ 557,790,000	$ 578,733,000	$ 598,989,000	$ 619,954,000
Retirement	319,052,538	334,656,000	351,528,000	364,631,000	357,608,000	365,660,000
Health and Other Fringe Benefits	61,309,534	64,824,000	68,625,000	72,789,000	77,341,000	82,307,000
Total Personal Services	**$ 889,897,436**	**$ 933,715,000**	**$ 977,943,000**	**$ 1,016,153,000**	**$ 1,033,938,000**	**$ 1,067,921,000**
Total Non-Personal/Equipment	**$ 134,288,315**	**$ 119,428,000**	**$ 122,965,000**	**$ 125,554,000**	**$ 127,039,000**	**$ 129,375,000**
City-Wide						
City-Wide Expenses	$ 267,923,914	$ 74,748,000	$ 75,694,000	$ 76,936,000	$ 77,730,000	$ 79,361,000
Capital Projects	38,883,500	5,680,000	5,680,000	5,680,000	5,680,000	5,680,000
Transfers	43,109,355	30,015,000	31,379,000	31,384,000	31,313,000	31,346,000
Earmarked Reserves	131,419,164	2,112,000	1,112,000	1,112,000	1,112,000	1,112,000
Contingency Reserve	37,000,000	38,500,000	39,000,000	40,500,000	41,000,000	41,500,000
Total City-Wide	**$ 518,335,933**	**$ 151,055,000**	**$ 152,865,000**	**$ 155,612,000**	**$ 156,835,000**	**$ 158,999,000**
Committed Additions						
Measure T (Public Safety - Fire Station 37) Maint. & Operations			-	2,010,000	4,130,000	4,254,000
Measure T (Public Safety - Police Training Center) Maint. & Operations			1,185,000	2,370,000	2,441,000	2,514,000
New Parks and Recreation Facilities Maint. & Operations		60,000	491,000	790,000	1,084,000	1,240,000
New Traffic Infrastructure Assets Maint. & Operations		26,000	75,000	117,000	148,000	170,000
Police Substation Activation			1,500,000	3,000,000	3,090,000	3,183,000
Total Committed Additions		**$ 86,000**	**$ 3,251,000**	**$ 8,287,000**	**$ 10,893,000**	**$ 11,361,000**
Total Base Exp. w/ Committed Additions	**$ 1,542,521,684**	**$ 1,204,284,000**	**$ 1,257,024,000**	**$ 1,305,606,000**	**$ 1,328,705,000**	**$ 1,367,656,000**
Growth %			**4.4%**	**3.9%**	**1.8%**	**2.9%**

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 2018-2019 Adopted Budget. Various one-time additions totaling over $16 million are scheduled to expire in June 2019. The major items funded on a one-time basis include the following: General Fund subsidy to the Self-Insured Medical Fund, Diridon Station Area Development Planning, Office of Civic Innovation Staffing/Technology, Police Recruiting and Backgrounding, Downtown Foot Patrol Program, Census 2020, Police Activities League, Public Life and Parks Activation, San José Sports Authority, City Portfolio-Product-Projects Office, Service Year, Master Addressing Database, Our City Forest, Vietnamese-American Community Center Staffing, Storefront Activation Grant Program, Summer Learning, Employment Services Temporary Staffing Continuation, Aquatics Program, BeautifySJ Grants, and Business Outreach and Support Services. Many of these programs and services will likely need to be re-evaluated for continued funding beyond 2018-2019. This analysis will be conducted during the 2019-2020 budget process and funding recommendations for these programs and services will be included in the 2019-2020 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

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

Personal Services

As is the usual practice, the first year (2019-2020) projection for personal services costs in this Forecast has been calculated at a detailed level, using a February 2019 extract from the City's payroll system as the starting point. This included the most recent retirement plan and health plan information for each position. The individual position-level information was then reviewed, corrected, and updated to ensure accurate salary step and bi-weekly salary, as well as any position reallocations. Further, 2018-2019 ongoing position additions (cost increases) and reductions (cost savings), as appropriate, were annualized and all categories of benefit costs in the coming year were projected.

For the 2019-2020 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 $933.7 million projected personal services total for 2019-2020, salaries and other compensation costs amount to $534.2 million (57.2% of projected personal services), retirement costs amount to $334.7 million (35.8% of projected personal services), and health and other fringe benefits costs amount to $64.8 million (6.9% of projected personal services).

Following is a discussion of the factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. The out-years are projected to inflate at an average annual rate of approximately 3.6%.

Salaries and Other Compensation:

Pay increases for all employees, salary step increases for current non-management employees, and pay for performance for management employees are assumed in each year of this Forecast. Most agreements with the City's bargaining units extend through June 30, 2021. The Association of Building, Mechanical and Electrical Inspectors (ABMEI) and the International Association of Fire Fighters, Local 230 (IAFF) have agreements that expire June 30, 2023. The agreement with the International Union of Operating Engineers, Local No. 3 (OE#3) expires September 30, 2019 and the San José Police Officers' Association (POA) agreement will expire June 30, 2020. With the exception of employees represented by SJPOA and IAFF, Local 230, non-management step increases have been calculated at a 2.5% step increase rate. For SJPOA and IAFF, a 5% step increase rate was applied in this Forecast.

EXPENDITURE FORECAST

A Salaries and Benefits Reserve funding is included in each year of this Forecast that sets aside funds to: 1) account for potential pay increases beyond the expiration date of the various bargaining unit agreements; 2) allocate funding for pay for performance for management employees; and 3) to reserve resources for anticipated increases to employee benefits such as health and dental. For 2019-2020, this reserve totals $7.1 million and would require City Council action before any form of distribution could be made. As contracts in the out-years of the forecast are determined, subsequent Forecast documents will be updated to reflect the latest information at that time. The out-years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

The Overtime budget in the General Fund totals $32.2 million for 2019-2020, with most of these funds allocated to Police Department ($20.3 million) and Fire Department ($10.0 million) operations. The out-years of the Forecast continue these costs, with small adjustments using salary step as the inflationary factor.

Retirement:

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

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

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

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

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 2019-2020, retirement costs total $334.7 million for the General Fund, an increase of $15.6 million from the 2018-2019 Modified Budget of $319.1 million. These costs represent 27.8% of the total General Fund base expenditure budget with committed additions and reflect the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. Beginning in 2019-2020, this Forecast no longer assumes a 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. While in the past this pre-payment yielded net budgetary savings to the City, a pre-payment is no longer recommended. City staff conducted an analysis of the benefit to the City to continue to prefund retirement contributions and concluded that given the continued reduced discount rate provided by the System for prefunding, increasing funds required to prefund, increased borrowing costs for Tax and Revenue Anticipation Notes, and the City's Investment Portfolio increased yield due to rising interest rates, there is no longer a meaningful budgetary benefit for the City to prefund retirement contributions to the Plans in fiscal year 2019-2020. The Administration will continue evaluate the benefits of prefunding retirement contributions on an annual basis to determine whether to exercise this option in future years.

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

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

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.

A portion of the City's retirement contributions ($36.1 million in the General Fund and $45.7 million in all funds) are associated with retiree healthcare. Prior to Measure F, these contributions were frozen at certain levels for Federated and Police and Fire systems. Subsequent to the passage of Measure F, each board adopted annual contribution amounts for retiree health care, subject to various actuarial assumptions that are evaluated each year.

For 2019-2020, both retirement boards lowered their discount rates for pension contributions from 6.875% to 6.75%. While this change continues a multi-year effort by the City's retirement systems to more closely align expected investment returns to achievable levels, this caused an increase to the City's annual contribution, resulting in a General Fund impact of approximately $11 million.

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 for the Federated Retirement System and the Police and Fire Department Retirement Plan. These amounts are broken out by Tier 1 contributions (normal cost), Tier 2 contributions, the UAL, and retiree healthcare. In previous years, retirement contributions were also expressed as a percentage rate of salary for Tier 1 and Tier 2 employees. However, as Tier 1 is now a closed system, spreading the UAL cost across a shrinking pool of Tier 1 employees distorted the apparent cost of a Tier 1 employee. For reference, Tier 1 normal cost contributions and Tier 2 contributions are also displayed in the tables below as a rate, illustrating the long-term cost savings the City will achieve with the transition of its workforce from Tier 1 to Tier 2. Over this Forecast, the General Fund retirement costs are expected to grow from $334.7 million ($429.7 million in all funds) in 2019-2020 to $365.7 million ($469.7 million in all funds) in 2023-2024. Though these amounts are increasing, it is important to note that retirements contributions as a percentage of ongoing General Fund expenditures slightly decreases across the forecast period, from 27.8% in 2019-2020 to 26.7% in 2023-2024. As shown in Table 1 below, this decrease is largely driven a reduction to the Police UAL contribution starting in 2022-2023.

For illustration purposes only, Table 2 depicts the Retirement Board approved contribution amounts for 2019-2020 and the Cheiron-projected amounts for the out-years of the Forecast. It should be noted that the City budgetary amounts differ from the Federated and Police and Fire Retirement Board approved amounts due to the budgetary spread across vacant, as well as filled, positions. Cheiron applies retirement contributions to an assumed level of filled positions.

EXPENDITURE FORECAST

TABLE 1 – 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).

EXPENDITURE FORECAST

TABLE 2 – 2020-2024 BOARD APPROVED CITY CONTRIBUTION AMOUNTS
ALL FUNDS
($ in Millions)

Retirement Plan	2018-2019*	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Federated Retirement Plan						
Tier 1 Pension (Normal Cost)	$29.0	$28.8	$26.1	$23.7	$21.4	$19.4
Tier 1 Pension (Normal Cost) Rate	*18.6%*	*19.3%*	*19.1%*	*19.0%*	*18.9%*	*18.7%*
Tier 2 Pension+	$11.2	$13.3	$15.2	$17.0	$18.8	$20.5
Tier 2 Pension Rate	8.3%	*8.3%*	*8.3%*	*8.3%*	*8.3%*	*8.3%*
Unfunded Actuarial Liability	$125.5	$137.4	$147.4	$154.7	$159.5	$164.7
Retiree Health Care	$22.0	$21.8	$22.1	$22.5	$22.8	$22.9
Total Federated Contributions	**$187.7**	**$201.3**	**$210.8**	**$217.9**	**$222.5**	**$227.5**
Police Retirement Plan						
Tier 1 Pension (Normal Cost)	$27.5	$29.0	$27.1	$25.0	$22.7	$20.6
Tier 1 Pension (Normal Cost) Rate	30.1%	*31.4%*	*31.7%*	*32.1%*	*32.7%*	*33.4%*
Tier 2 Pension+	$4.3	$6.2	$7.8	$9.5	$11.3	$13.1
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	$14.0	$14.6	$15.4	$16.4	$17.2	$17.9
Total Police Contributions	**$107.0**	**$119.8**	**$126.1**	**$129.4**	**$119.5**	**$120.2**
Fire Retirement Plan						
Tier 1 Pension (Normal Cost)	$22.9	$23.4	$22.8	$21.8	$20.7	$19.6
Tier 1 Pension (Normal Cost) Rate	31.2%	32.3%	32.4%	32.6%	32.8%	33.1%
Tier 2 Pension+	$1.7	$2.6	$3.4	$4.4	$5.4	$6.5
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	$9.1	$9.4	$10.0	$10.6	$11.1	$11.5
Total Fire Contributions	**$83.2**	**$90.4**	**$98.2**	**$103.8**	**$104.0**	**$108.5**
Total City Contributions	**$377.9**	**$411.5**	**$435.1**	**$451.1**	**$446.0**	**$456.2**

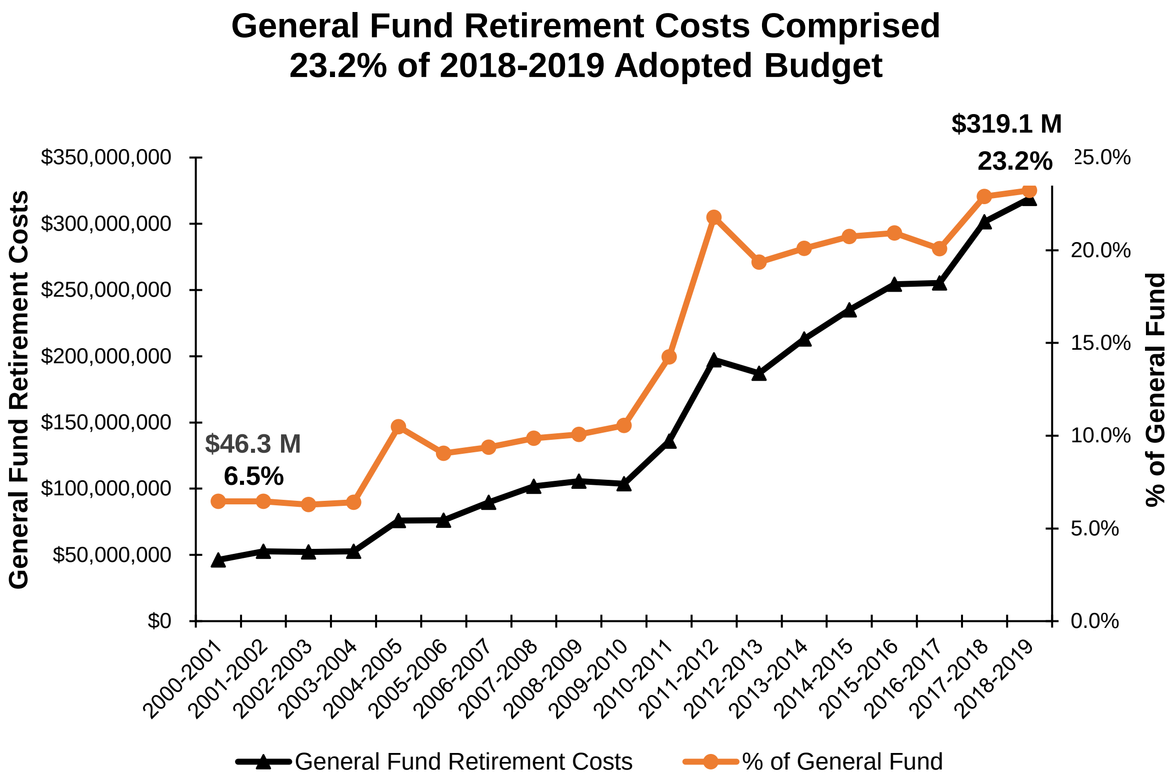
+Though Tier 2 contributions are overwhelmingly comprised of normal costs, these figures do contain a very small component of UAL related to the Tier 2 program. For Tier 2, UAL is evenly split between the City and employees.

* 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).

EXPENDITURE FORECAST

The chart below describes the history of retirement costs as a share of the total General Fund adopted budget. In 2001-2002, retirement costs of $46.3 million accounted for 6.5% of the General Fund, while in 2018-2019, those costs totaled 23.2% of the General Fund Adopted Budget. It is important to note that, because adopted budgets includes carryover costs from the previous year, fund balance, and other one-time elements, this percentage is lower than the ongoing average contribution of approximately 27% reflected in the Forecast.



Health and Other Fringe:

A projected health rate increase of 10.0% is included in the 2019-2020 Forecast effective January 2020 based on national and City trend information received from the City's Human Resources Department benefits consultant. The annual health increase assumptions are held constant at 5.0% annually for the out-years of the forecast.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, no dental rate increase is anticipated in 2019-2020. 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 2018-2019, current funding available in the Unemployment Insurance Fund, and projected future claims, an unemployment insurance rate of 0.025% is included in this Forecast.

EXPENDITURE FORECAST

Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total $119.4 million in 2019-2020. 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 2018-2019, 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 2019-2020 estimates represent a decrease of $14.9 million from the 2018-2019 Modified Budget level of $134.3 million, primarily due to the elimination of rebudgeted or carryover projects.

Departmental gas and electricity funding for 2019-2020 totaling $14.5 million has been adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes. Major non-personal/equipment increases are included, primarily in the Human Resources Department for Workers' Compensation Third Party Administrator contract costs ($1.7 million), City Attorney Office for increased litigation costs ($500,000), Parks, Recreation and Neighborhood Services Department for changes in water costs ($420,000), Library Department for the anticipated increased costs associated with the cost share agreement with San José State University ($337,000), Public Works Department for custodial services and facilities maintenance costs ($321,000), Police Department for crime lab fess ($292,000), and Public Works Department for Animal Care and Services cleaning costs ($210,000). Vehicle maintenance and operations costs in the General Fund, including fuel, inventory, and fleet staffing, total $19.7 million and reflect an increase of $1.6 million from the 2018-2019 Adopted Budget, primarily due to increased consumption and fuel costs and personal services costs. The 2019-2020 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 $4.9 million to $3.9 million based on the current replacement schedules and projected costs for these vehicles. Police vehicle replacement costs are expected to increase in the remaining years of the Forecast, based on the anticipated replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total $22.3 million.

For the out-years of the Forecast, growth rates ranging from 1.2% to 3.0% have been assumed from the 2019-2020 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. Excluding the police vehicle replacement cost adjustment, the average growth rate for the non-personal/equipment category is 2.0% annually.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

City-Wide

City-Wide Expenses in the first year of the Forecast (2019-2020) total $74.7 million, a decline from the 2018-2019 Modified Budget of $267.9 million. This large reduction primarily reflects the impact of deleting the $152.1 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; eliminating one-time allocations that were rebudgeted to 2018-2019 ($20.0 million); removing the one-time Federal Loan Assistance Program ($10.0 million) from 2018-2019 that was created to provide assistance to federal employees working at the airport during the federal government shutdown; and eliminating one-time budget actions ($9.4 million).

The line-items in this category are primarily made up of cross-departmental, large grant, and general city-wide expenditures. The 2019-2020 allocation includes anticipated cost adjustments based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2019-2020 allocations in the City-Wide Expenditures category include: Workers' Compensation Claims ($20.1 million); General Liability Claims ($6.0 million); San José BEST and Safe Summer Initiative Programs ($5.9 million); Sick Leave Payments Upon Retirement ($5.0 million); Homeless Rapid Rehousing ($4.0 million); ESCO Debt Service ($3.0 million); Digital Inclusion Program ($2.2 million); Banking Services ($2.2 million); Elections and Ballot Measures ($1.9 million); Property Tax Administration Fee ($1.9 million); Sidewalk Repairs ($1.8 million); Property Leases ($1.6 million); Homeless Response Team ($1.5 million); San José Works – Youth Jobs Initiative ($1.5 million); Public, Educational and Government Access Facilities – Capital ($1.3 million); Workers' Compensation State License ($1.2 million); San José Learns ($1.0 million); and Tech Museum of Innovation Subsidy ($1.0 million).

In 2020-2021, City-Wide Expenses increase by approximately $946,000 to $75.7 million, primarily due to the new Digital Inclusion Program increase in 2020-2021 of $725,000, with average annual allocations of $2.3 million, offset by corresponding revenue. While the majority of the individual line-items are expected to remain at 2019-2020 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from $20.1 million to $24.4 million), Banking Services (from $2.2 million to $2.3 million), Elections and Ballot Measures (from $1.9 million to $2.1 million), the Property Tax Administration Fee (from $1.9 million to $2.1 million), Property Leases (from $1.6 million to $1.8 million), the new History San José agreement (from $825,000 to $876,000), and Insurance Premiums (increase from $739,000 to $1.1 million). Two categories of funding are decreasing over this five-year period, which are ESCO Debt Service (from $3.0 million to $2.9 million) and the Public, Education, and Government (PEG) expenditure categories (from $2.0 million to $1.7 million) reflecting the reduced cable franchise fee revenue collection. Funding for many non-grant related City-Wide expenses has stabilized, including ongoing allocations for the San José BEST and Safe Summer Initiative Programs that includes a 3% COLA applied in each year ($5.9 million to $6.4 million).

EXPENDITURE FORECAST

The General Fund **Capital Projects** category totals $5.7 million in 2019-2020 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). It also assumes that the Fire Construction and Conveyance Tax Fund will contribute $400,000 annually for these costs over the five-year period. The Capital Projects category also includes the continuation of annual allocations for unanticipated maintenance of City facilities ($1.25 million, previously at $900,000), fuel tanks and methane monitoring control and replacement ($350,000), annual capital expenditures ($200,000) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building, and Arena repairs ($100,000).

The **Transfers** category totals $30.0 million in 2019-2020 and averages $31.4 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for the construction of City Hall is the largest line-item in this category at $21.1 million in 2019-2020 ($21.5 million in each of the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Rancho del Pueblo and Los Lagos Golf Courses ($2.7 million annually from 2019-2020 to 2021-2022 and $2.6 million annually in the remaining years of the Forecast); transfers for Arena capital rehabilitation and enhancements in accordance with the San José Arena Management agreement extension at $2.3 million annually; a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement ($1.5 million annually, previously at $1.2 million); and a transfer to the Construction and Conveyance Tax Fund – Communications to support the Silicon Valley Regional Interoperability Authority ($1.0 million in 2019-2020, rising to $1.3 million at the end of the Forecast).

One significant transfer that is no longer included in the Forecast is funding to the Community Facilities Revenue Fund to cover debt service payments and operating costs for the Hayes Mansion Conference Center. The 2019-2023 Forecast assumed a subsidy payment of $3.4 million in 2018-2019, and $3.4 million - $3.9 million in the remaining years of the Forecast based on projected debt service payments for the facility. The Hayes Mansion property was sold in February 2019, which eliminated the remaining long-term debt.

The debt service costs for the Rancho del Pueblo and Los Lagos golf courses are funded in the Municipal Golf Course Fund; however, revenues are not projected to be sufficient to completely cover the costs. The transfer from the General Fund for the golf course subsidy remains steady with 2018-2019 levels of $2.7 million annually through 2021-2022 and then decreases slightly to $2.6 million for the remaining two years of the Forecast.

Other transfers include the allocation of $2.3 million annually for capital improvements at the SAP Center in accordance with the agreement with Sharks Sports and Entertainment, transfers to the Service Yards Construction and Conveyance Tax (C&C) Fund to cover Central Service Yards Phase 1 debt service payments ($750,000 annually starting in 2020-2021) as there is not sufficient revenue in that fund to cover all required costs, and payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas ($976,000 to $1.0 million annually).

EXPENDITURE FORECAST

The **Earmarked Reserves** category totals $2.1 million in 2019-2020 and decreases to $1.1 million in 2020-2021 and throughout the Forecast. This category includes the Deferred Infrastructure and Maintenance Reserve of $1.0 million in 2019-2020 to fund critical capital maintenance or address urgent technology needs; these resources will be allocated as part of the 2019-2020 Proposed Budget. The annual allocation to the Cultural Facilities Maintenance Reserve increased from $450,000 to $750,000 throughout the Forecast to address the growing deferred infrastructure rehabilitation needs at these facilities. In addition, annual funding of $362,000 is allocated to the Artificial Turf Replacement to set aside funding for the cost of replacement of artificial turf fields in various neighborhood parks. These funds are available from the projected field reservation revenues collected above the estimated costs to reserve and maintain the fields.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2018-2019 and later recommended for rebudget or use in 2019-2020. Some of the larger current Earmarked Reserves include the Development Fee Program Reserves, Salaries and Benefits Reserve, Budget Stabilization Reserve, Workers' Compensation/General Liability Catastrophic Reserve, Sick Leave Payments Upon Retirement Reserve, Cultural Facilities Capital Maintenance Reserve, and City Health Plan Restructuring Reserve.

Per City Council policy, the **Contingency Reserve** ($38.5 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 2019-2020 budget. This amount would be sufficient to cover approximately one pay period of payroll costs (two weeks). This amount steadily increases each year of the Forecast, ending at $41.5 million in 2023-2024 to remain in compliance with the reserve policy.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

Committed Additions to the Base General Fund Forecast

In this Forecast, projected additions to the base expenditure level have been included as **Committed Additions**. Although all are subject to further review during the budget process, Committed Additions are additional expenditures to which the City is considered to be committed by prior City Council action, such as the costs related to maintaining and operating capital projects previously approved by the City Council. The Forecast Base Case, considered most likely to occur, includes ongoing program costs plus Committed Additions. Committed Additions total $86,000 in 2019-2020 and increase to approximately $11.4 million by 2023-2024, primarily due to the anticipated projects from the passage of Measure T – The Disaster Preparedness, Public Safety and Infrastructure Bond. 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 Measure T facilities anticipated to come online during the forecast include Fire Station 37 that will require additional maintenance and operations funding ($2.0 million in 2021-2022, increasing to approximately $4.3 million in 2023-2024) and the Police Training Facility that will require additional maintenance and operations funding ($1.2 million of a mid-year opening in 2020-2021, increasing to $2.5 million annually in 2023-2024). It should be noted that additional maintenance and operations funding ($1.5 million in 2020-2021, increasing to $3.2 million in 2023-2024) was factored in this Forecast for the activation of the South San José Police Substation once recruit academies and training functions are transferred to the new Police Training Facility.

Also included in the Committed Additions are maintenance and operations costs associated with non-bond projects such as new parks and recreation facilities and new traffic infrastructure assets. The non-bond projects committed additions costs in the Forecast range from $86,000 in 2019-2020 to $1.4 million by 2023-2024.

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 2019-2020, a small General Fund surplus of $3.5 million is projected for 2019-2020. This projection is derived by comparing estimated revenues with the cost of delivering City Council-approved existing services as well as the services for which the City has already committed, such as the operation of new facilities or other capital projects scheduled to come on-line next year. In the remaining years of the Forecast, General Fund shortfalls ranging from $1.7 million to $15.6 million are projected for three of four years with a surplus of $11.4 million projected in 2022-2023. These margins are relatively narrow when put into context of the size of the projected General Fund budget, ranging from -1.2% to 0.9% of the projected annual budget. Over the five-year period, total shortfalls of $16.2 million are anticipated, which equates to approximately $3.2 million annually. This average shortfall figure equates to -0.3% of the projected General Fund annual budget, which ranges from $1.2 billion to $1.4 billion.

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 2019 Forecast is compared to the corresponding year in the February 2018 Forecast.

2020-2024 General Fund Forecast
Changes in Operating Margin
($ in Millions)

	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
February 2018 Incremental Surplus/(Shortfall)	**($15.5)**	**($8.9)**	**($10.5)**	**$10.8**	**N/A**
June 2018 Incremental Surplus/(Shortfall)	$0.0	N/A	N/A	N/A	N/A
February 2019 Incremental Surplus/(Shortfall)	**$3.5**	**($15.6)**	**($13.7)**	**$11.4**	**($1.7)**

Note: Does not include 1) costs associated with services that were funded on a one-time basis in 2018-2019; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

For the February 2019 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2019-2020 and the remaining four years of the forecast period. There was no surplus or shortfall remaining from the 2018-2019 Adopted Budget that would carry-over into 2019-2020. Therefore, the 2019-2020 projected surplus of $3.5 million 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 has shortfalls ranging from a deficit of $15.6 million to a surplus of $11.4 million annually. Major factors contributing to this improvement are lower retirement costs and higher growth in several revenue categories, including Property Tax and Sales Tax. These margins are extremely narrow when put into context of the size of the projected General Fund budget of over $1 billion.