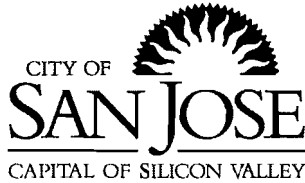


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by City Manager's Office



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: 2010-2014 PRELIMINARY
GENERAL FUND FORECAST

DATE: November 19, 2008

INFORMATION

EXECUTIVE SUMMARY

The City Manager's Budget Office has completed a 2010-2014 Preliminary General Fund Forecast that will be used as an initial planning tool in the development of the 2009-2010 Proposed Budget. The fiscal outlook for the City has worsened appreciably since the adoption of the 2008-2009 budget due to rapidly deteriorating economic conditions. Thus even with the successful passage of the Communications Taxes ballot measures earlier this month, this Forecast includes a projection for a significant increase in the General Fund deficit projected for 2009-2010. It must also be emphasized that this is a very preliminary forecast provided in a time of unprecedented turmoil in the world economy. This Forecast will need to be updated as additional information becomes available about the impact of the deteriorating economy on the revenue streams that fund the City's General Fund operations in San José.

Following are the major highlights of the preliminary Forecast:

- A deficit of \$59.1 million is projected for 2009-2010, which is well above the \$42.5 million estimated for 2009-2010 in the last five-year forecast. This updated deficit figure represents almost 7% of the projected expenditures for next year. The change in the projected shortfall reflects the net impact of several upward and downward adjustments. The most significant changes include: downward adjustments to the economically sensitive revenue estimates; the addition of costs associated with the phase-in of the City's share of the General Fund annual required contribution for retiree health care benefits and 25 new Police Officer positions per City Council direction; the addition of \$20 million in revenue as a result of the passage of the November 2008 ballot measures; and slightly lower than anticipated cost-of-living adjustments.
- The second year of the Forecast (2010-2011) also has a sizeable deficit of \$27.0 million. This figure is well above the \$5.5 million projected shortfall for that year in the last forecast. The majority of this shortfall reflects lower growth assumptions for some of our economically sensitive revenues, the addition of 25 Police Officers in the Forecast per City Council direction, and the continued phase-in of the costs associated with the City's annual required contribution for retiree health care benefits.

EXECUTIVE SUMMARY (CONT'D.)

- The variances in the last three years are minimal, ranging from a deficit of \$0.1 million to a surplus of \$5.8 million in the last year of the Forecast. The improvement in these years is the result of stronger revenue growth projected for that period coupled with lower expenditure growth. It is important to note that no cost-of-living adjustments (COLAs) for any of the City's employees have been assumed in the last three years. There are currently no negotiated agreements that cover this time period. This is a methodology change from prior forecasts that assumed COLAs in all years. With this change, the consideration of salary increases is being treated as a resource allocation policy decision. This decision will need to be made in the context of what is affordable in light of the many service delivery priorities. At current rates, each 1% increase in salary has a General Fund price tag of \$5.4 million.
- It is also important to note that this preliminary Forecast does not reflect: the impact of compensation increases resulting from outstanding negotiations that exceed Forecast projections; potential State budget actions; changes in City contributions to the two retirement plans due to the significant losses suffered by those funds in recent months; funding for unmet/deferred infrastructure and maintenance needs; financial impacts associated with planned County annexations, the expansion of North San José, the potential Convention Center expansion; and potential impacts if the San José Redevelopment Agency reaches its tax increment revenue cap and is unable to continue to fund various eligible City support services. It also does not factor in one-time revenue sources, such as the 2009-2010 Future Deficit Reserve, or one-time expenditure needs.
- The preliminary Forecast will be refined over the next few months as additional information becomes available. The formal 2010-2014 General Fund Five-Year Forecast will be issued in February 2009.

BACKGROUND

The City Manager's Budget Office has completed its early projections on the status of the General Fund for the next five years. This preliminary Forecast provides a starting point in the initial planning for the development of the 2009-2010 Proposed Budget and also provides updated shortfall information for use in the General Fund Structural Deficit Elimination Plan that will be released later this week.

The revenue and expenditure estimates update the figures that were last presented in the 2009-2013 General Fund Five-Year Forecast issued in February 2008. The projections reflect the following: actual 2007-2008 revenue and expenditure performance; year-end revenue and expenditure projections based on activity through the first quarter of 2008-2009 and revised expectations on economic performance; updated revenue growth assumptions over the forecast period; updated salary, benefit and other cost information; and the operating impact of capital projects that are scheduled to come on-line over the next five-years.

ANALYSIS

Overview

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative shortfall. In addition to the cumulative shortfall, the incremental shortfall (assuming each preceding deficit is solved completely with ongoing solutions in the year it appears) for each year of the forecast is included. Because it is the City's goal to solve each deficit with ongoing solutions, the incremental shortfall figure is useful in that it shows the additional shortfall and/or surplus attributed to a particular fiscal year.

2010-2014 PRELIMINARY GENERAL FUND FIVE-YEAR FORECAST
 (\$ in Millions)

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Projected Revenues	\$ 842.5	\$ 858.1	\$ 891.9	\$ 918.9	\$ 947.7
Projected Expenditures	\$ 901.6	\$ 944.2	\$ 978.1	\$ 1,001.5	\$ 1,024.5
Total Surplus/(Shortfall)	(\$ 59.1)	(\$ 86.1)	(\$ 86.2)	(\$ 82.6)	(\$ 76.8)
Incremental Surplus/(Shortfall)	(\$59.1)	(\$27.0)	(\$0.1)	\$3.6	\$5.8

The fiscal outlook for the City in years one and two of this Forecast is considerably worse when compared to the last forecast that was issued in February 2008. The remaining years, on the other hand, are relatively unchanged or improved. The major factors that have impacted the revised Forecast, some of which have increased the projected shortfall and others that have reduced it, are discussed below.

2009-2010 Forecast

The 2009-2010 General Fund shortfall of \$59.1 million is well above the \$42.5 million shortfall projected for 2009-2010 in the last forecast. Following is a summary of the major factors that have resulted in this change.

Negative Factors (Increasing the Shortfall):

- A net downward adjustment to the revenue estimates based on the more severe than previously anticipated downturn in the economy;
- A downward adjustment to the 2008-2009 Ending Fund Balance/2009-2010 Beginning Fund Balance estimate based on assumption that current year performance will yield expenditure savings but will not generate excess revenue to carry over to 2009-2010;
- The inclusion of the phase-in of the City's share of the General Fund annual required contribution for retiree health care benefits, which is projected at \$7.0 million in 2009-2010 and grows to \$22.2 million by the fifth year of the Forecast;
- The carryover of a portion of the shortfall from the 2008-2009 Adopted Budget that was solved with one-time solutions;
- An increase in costs to reflect the addition of 25 new Police Officers as directed in the Mayor's 2008-2009 June Budget Message and approved by the City Council; and
- An increase in Workers' Compensation Claims based on higher medical and disability payments.

Overview (Cont'd.)

Positive Factors (Reducing the Shortfall):

- A net upward adjustment of \$20 million in General Fund revenues as a result of the passage of the November 2008 ballot measures, making permanent the Communications Tax (replacement for the Emergency Communication System Support Fee which was scheduled to sunset at the end of 2008-2009) and reducing and modernizing the Telephone Utility Tax;
- A net decrease in expenditures to reflect lower cost-of-living adjustments based on recent negotiations with employee bargaining groups; and
- A decrease in expenditures as a result of the Council-approved pre-funding of the City's contribution for retirement costs.

Out Years of the Forecast

In the out years of the Forecast, the incremental variances between revenues and expenditures range from a deficit of \$27 million in 2010-2011 to a small surplus of \$5.8 million in 2013-2014. The projected shortfall in 2010-2011 is well above the \$5.5 million deficit projected for that year in the last forecast. The majority of this shortfall reflects the lower growth assumptions for some of the economically sensitive revenues, the addition of 25 Police Officers in the Forecast, and the addition of costs associated with the phase-in of the City's share of the General Fund annual required contribution for retiree health care benefits. In the last three years of the Forecast, the incremental shortfalls or surpluses are relatively small with annual differences ranging from a deficit of \$0.1 million to a surplus of \$5.8 million, which represent less than 1% of the annual projected expenditures of approximately \$1 billion. It is important to note, however, that the Preliminary 2010-2014 General Fund Forecast does not include cost-of-living salary increases for any employees in the last three years of the forecast period, which is a methodology change from prior forecasts. These salary increases have yet to be negotiated and it is expected that difficult decisions will have to be made in those years to keep the budgets in balance and achieve policy priorities in a way that is affordable.

Major Forecast Components

The three major components of the General Fund Forecast include the following: 1) revenue projections; 2) projections on the cost of delivering existing services; and 3) projections on the cost of delivering additional services to which the City is currently committed, primarily the operating costs of new facilities scheduled to come on-line in the next few years. Following is a discussion of each of those components.

General Fund Revenues

The General Fund revenue estimates for the first year of the Forecast have been prepared by analyzing over 500 individual revenue accounts. This includes reviewing actual collection trends, developing revenue growth assumptions based on current economic conditions, evaluating any available information on future rate increases/activity trends that would impact the City's revenues, and updating reimbursement-related revenues based on projected costs. Approximately one-half of the General Fund revenues are generated from categories that are tied

Major Forecast Components (Cont'd.)

directly to the performance of the economy, including the City's two largest revenue sources, Property Tax and Sales Tax. The remaining categories, while impacted by overall economic performance, are driven by other factors, such as rate changes and reimbursement-related costs.

The Preliminary Forecast is based on the expectation that the national and California economies will remain extremely weak through 2009. It is assumed that the continuing problems associated with sub-prime mortgages and the housing market slowdown and the more recent meltdown of the financial markets, the credit crunch, and the extreme stock market volatility will bring economic growth to a halt. This will result in a significant drop-off in the City's economically sensitive revenues. The difficulty in this Forecast is projecting the depth and length of the current slowdown given the unprecedented nature of the turmoil in the global economy, which has created economic conditions that have not been experienced in recent history. It is far from clear at this writing how or even if the various efforts underway to try to stabilize the situation globally will begin to show results. Until that time, the range of possible economic scenarios is staggering, ranging from a modest recession lasting a year or two, to a much more severe disruption with catastrophic and long lasting outcomes. Providing a forecast that one can count on with any kind of certainty will require more information than is now available.

In this Forecast, however, General Fund revenues in 2009-2010 are expected to be approximately 3% below the 2008-2009 Adopted Budget level. The City's Sales Tax revenue is expected to decline in both 2008-2009 and 2009-2010, with a projected drop of approximately 8% over this two-year period. Property Tax growth is expected to slow dramatically with an increase of approximately 2% in the current year and less than 2% in 2009-2010. These Property Tax growth levels are well below the 7.4% growth experienced in 2007-2008. Other categories that are expected to be negatively impacted by the economic environment include interest earnings, Transient Occupancy Tax, and Motor Vehicle In-Lieu collections. In addition, the 2009-2010 Beginning Fund Balance estimate is significantly lower than previously anticipated. Each year, it is expected that expenditure savings and excess revenue from the current year will be available in the following year. Given the current economic environment, however, only 2008-2009 expenditure savings are assumed to be available as a funding source for 2009-2010. Revenue collections are now expected to be only at or below budgeted levels.

In the out-years of the Forecast, economic growth is expected to improve somewhat from the dismal performance expected in the first year of the Forecast. It is expected that the economy as well as the housing market will begin to recover from the current slowdown in 2011-2012. Underlying General Fund revenue growth of approximately 2 - 4% is expected annually in those years.

General Fund Expenditures

To estimate the General Fund expenditures, growth assumptions are developed for each of the General Fund expenditure categories, including Personal Services, Non-Personal/Equipment, City-Wide Expenses, Capital, Reserves, and Transfers. The largest cost category is Personal Services, which represents over two-thirds of the City's base costs. Personal Services costs are broken down into three major components: Salaries and Other Compensation, Retirement, and

Major Forecast Components (Cont'd.)

Health and Other Fringe Benefits. The first year (2009-2010) projection for Personal Services costs has been calculated at a detailed level by analyzing each of these cost components. The projections for the remaining years of the Forecast are developed by applying growth assumptions to the Personal Services components. The Personal Services budget for each department is also adjusted to reflect anticipated vacancies during the year.

To develop the 2009-2010 Personal Services projections, an extract of payroll system information as of August 2008 was used as the starting point to identify the salaries, current salary steps, and benefits of existing staff. Salaries and Other Compensation and Retirement costs are adjusted for scheduled step increases, agreed upon or anticipated salary cost-of-living adjustments (COLAs) that are subject to negotiation, and any other salary-related adjustments. The Forecast also assumes annual step increases for employees that have not reached the top step in their classification. The projected average growth rate associated with step increases alone is estimated at approximately 1.5% annually in this Forecast. This accounts for approximately \$8.8 million of the Personal Services costs in 2009-2010.

Retirement costs are calculated as a percentage of salary costs. In this Forecast, retirement costs have only been adjusted for the impact of step increases and COLAs. In addition, one of the balancing strategies approved in 2008-2009 was the pre-funding of the City's annual contribution for the two retirement plans. Included in this Forecast, is the assumption that the City would continue to pre-fund its annual requirement which results in an annual savings of approximately \$4.1 million, partially offset by a loss of interest earnings revenue of approximately \$1.7 million. It should be noted that every two years, an actuarial study is completed on the City's two retirement systems, Federated and Police and Fire. The next actuarial studies are scheduled for 2010-2011, although the City Manager will be requesting that the two Retirement Boards consider performing actuarial valuations annually rather than biannually. Performing annual actuarial valuations, rather than biannual, would lead to a lower volatility in both the City's and the employee contribution rates. The extreme volatility and steep declines in the U.S. financial markets are negatively impacting performance in the two retirement systems. The extent of that impact upon the contribution rates is not known at this time although the likelihood is for upward movement in rates and City costs to offset the investment losses. Due to the volatility of retirement rates, however, no specific predictions for the retirement rate contribution adjustments that will be required have been assumed in this preliminary Forecast.

Health and Other Fringe Benefit cost increases have been projected in each year of the Forecast. Based on preliminary discussions with the Human Resources Department, a 12% increase to the City's contribution for employee health care has been assumed for 2009-2010 and each of the out years of the Forecast. The value of this increase in 2009-2010 is \$2.4 million. In the Other Fringe Benefits category (dental, unemployment insurance, employee assistance program), annual increases of 3.5% are assumed in all forecast years. The value of that increase is \$600,000 in 2009-2010.

Major Forecast Components (Cont'd.)

This preliminary Forecast incorporates Personal Services adjustments to reflect prior City Council direction. The Personal Services costs have been adjusted to ensure that the development fee programs (Fire, Public Works, Planning, and Building) have a neutral impact on the City's General Fund Forecast as these programs are designed to recover 100% of their costs. Because costs in these fee programs are currently anticipated to exceed revenues by \$8.3 million in 2009-2010, the costs have been reduced by that amount in this Forecast. Each of the fee programs will be required to develop strategies that will address this sizeable shortfall in the 2009-2010 Proposed Operating Budget process. These strategies will likely include a combination of fee increases, expenditure reductions, and the use of portions of the Development Fee Program Reserves.

On an overall basis, Personal Services costs in the 2010-2014 Five-Year Forecast are projected to increase approximately 2.7% annually. This average annual growth figure factors in known cost-of-living adjustments, step increases, and benefit changes. This growth level is well below the 4.3% growth projected in the February 2008 Forecast. It should be noted, however, that this lower growth is almost entirely the result of a change in forecast methodology. In this Forecast, no cost-of-living salary increases for any employees in the last three years of the Forecast has been assumed reflecting the fact that there are no negotiated agreements covering this period. In past years, projected increases were built into the Forecast. Approval of any negotiated salary or benefit increases in those years, without any offsetting increase in revenues or reduction in costs, will have the effect of driving up the City's shortfall. In this regard, consideration of salary increases is being treated as a resource allocation policy decision. This is not an indicator that competitive pay is not a priority. It means that decisions will need to be made in the context of what is affordable in light of the City's many service delivery priorities.

The remaining cost categories, Non-Personal/Equipment and Other Expenditures (City-Wide, Transfers, Capital, Contingency Reserve and Earmarked Reserves) have also been calculated at a detailed level for the first year of the Forecast. The process utilized by the Budget Office included eliminating one-time allocations that were approved in 2008-2009, annualizing all partial-year reductions or additions approved in 2008-2009, and incorporating adjustments for specific large Non-Personal/Equipment allocations (e.g., utilities, leases, contracted services and Police Department vehicle replacement). The Forecast also reflects adjustments to vehicle maintenance and operating costs, debt service payment obligations, and contractually required cost-of-living increases to major contracts. In all five years of the Forecast, the Contingency Reserve category has been adjusted in order to maintain the City Council policy of maintaining a Contingency Reserve equal to 3% of eligible expenditures.

Consistent with prior forecasts, an annual growth rate of 2.0% for the out years of the forecast has been assumed for the Non-Personal/Equipment costs. In the Other Expenditures category, every line item has been calculated for each of the out-years based on the specific drivers for that line item. For instance, debt service payments are based on the projected debt service schedules.

Major Forecast Components (Cont'd.)*General Fund Committed Additions*

As has been the City's practice with the General Fund forecasts, cost estimates for a number of specific Committed Additions that address previous City Council direction are included in this preliminary Forecast in the years that they are projected to be required. The "Committed Additions" category, summarized in the chart below, primarily reflects projected additional funding required for retiree healthcare benefits, additional Police Officers, and operating and maintenance costs for new capital projects now in the Adopted Capital Improvement Program, including bond-financed libraries, community centers, parks and public safety facilities.

2010-2014 General Fund Committed Additions

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Additional Police Officers (25 new positions annually)	1,817,000	5,035,000	8,595,000	10,580,000	11,392,000
Retiree Health Care Benefits	7,000,000	11,059,000	14,967,000	18,622,000	22,193,000
Defibrillator Replacement Program		1,631,000			
County Pocket Annexations (Transportation)	298,000	478,000	478,000	478,000	478,000
Diesel-Powered Vehicles Retrofit (State Mandated)	482,000	423,000	453,000	177,000	177,000
New Parks and Recreation Facilities Maintenance and Operations	209,000	1,095,000	1,722,000	2,073,000	2,131,000
New Traffic Infrastructure Assets Maintenance and Operations	203,000	396,000	548,000	647,000	747,000
Measure O (Library) Maintenance and Operations	733,000	4,149,000	5,291,000	5,753,000	5,882,000
Measure P (Parks) Maintenance and Operations	1,167,000	2,346,000	2,894,000	2,944,000	3,035,000
Measure O (Public Safety) Maintenance and Operations: Fire	11,000	598,000	2,718,000	2,846,000	2,995,000
Measure O (Public Safety) Maintenance and Operations: Police	1,229,000	1,835,000	1,921,000	1,978,000	2,043,000
Total	13,149,000	29,045,000	39,587,000	46,098,000	51,073,000

Several new Committed Additions have been added when compared to the forecast released in February 2008. As approved by the City Council in the 2008-2009 Adopted Operating Budget, the addition of 25 Police Officers annually through 2011-2012 is included in this category. The cost of these positions is projected at \$1.8 million in 2009-2010 and expected to increase to \$11.4 million by 2013-2014. Also included, the phase-in of the City's share of the General Fund

Major Forecast Components (Cont'd.)

annual required contribution for retiree health care benefits is projected at \$7 million in 2009-2010 and grows to \$22.2 million by the fifth year of the forecast period.

Operating and maintenance costs related to currently budgeted capital projects are expected to total \$2.4 million in 2009-2010 and increase to \$16.8 million by 2013-2014. Some of the larger facilities expected to come on-line during this forecast period include the South San José Police Substation; Bascom, Seven Trees, and Edenvale Community Centers; and the Bascom, Seven Trees, and Southeast Branch Libraries. A detailed listing of all capital project operating and maintenance costs included in this 2010-2014 Preliminary General Fund Forecast can be found in *Attachment A* of this document.

General Fund Capital Operating and Maintenance Costs Budget Principle

As part of the 2008-2009 budget process, the City Council adopted the Budget Principles recommended in the Mayor's March 2008 Budget Message. Budget Principle #8 pertains to Capital Improvement Projects and directs that capital improvement projects with annual operating and maintenance costs "shall not proceed for projects with annual operating and maintenance costs exceeding \$100,000 in the General Fund without City Council certification that funding will be made available in the applicable year of the cost impact. Certification shall demonstrate that funding for the entire project, including operations and maintenance costs, will not require a decrease in existing basic neighborhood services."

As detailed in the list of projects in *Attachment B*, numerous capital projects are underway or were previously approved by the City Council with annual operating and maintenance costs in the General Fund greater than \$100,000. Funding for these projects have been included as part of approved Capital Improvement Programs or Redevelopment Agency Budgets. The majority of these costs are associated with the voter-approved General Obligation bonds for Park, Library, and Public Safety facilities. The operating and maintenance costs for these facilities are included in the figures presented in this Preliminary General Fund Forecast. In total, by 2013-2014, the annualized costs to operate and maintain the City Council/Agency Board approved facilities with annual operating and maintenance costs in the General Fund greater than \$100,000 are projected at \$13.4 million annually.

It should be noted, however, that the operating and maintenance costs for these facilities will be evaluated on an annual basis for inclusion in subsequent Five-Year General Fund Forecasts. As part of this evaluation the costs and staffing necessary to operate and maintain these facilities may change as further analysis on the operational needs of each facility are conducted. Notably, further analysis may be required to determine the actual staffing of Fire Station 37. For purposes of this document, the operating and maintenance costs for Fire Station 37 – Willow Glen reflect the assumption that no staff would be relocated from Fire Station 6, and that a new Fire Engine (four additional duty positions) would staff the new facility. This is a change from what had been assumed in previous forecasts, including the forecast published last February. The revision is consistent with the "*City-Wide Policy for the Relocation/Closure and/or Selling Fire Stations and Removal of Fire Station 6 from the Budget*," approved by the City Council on September 9, 2008. The additional annual General Fund operating and maintenance costs projected for this

Major Forecast Components (Cont'd.)

facility alone if staffing is maintained at Station 6 represents \$2.6 million in 2011-2012, the first full year of operations. Ultimately, determination of staffing and deployment should be based on a quantifiable level of service analysis.

Additional operating and maintenance costs are identified for other (non-General Obligation Bond) City Council-approved projects. The General Fund costs to operate and maintain these facilities are projected at \$1.9 million annually. These facilities include projects such as the Edenvale Community Center approved by the City Council on September 23, 2008 and a planned Hoffman/Via Monte Neighborhood Center included as part of the approved Redevelopment Agency Capital Budget.

Lastly, projects where funding has not been approved through the City Capital Improvement Program or Redevelopment Agency Capital Budget have been identified. These projects are currently being evaluated for feasibility, and if developed, are anticipated to have an annualized operating and maintenance impact on the General Fund greater than \$100,000 in future years. For purposes of this Forecast, these figures are not included as part of the General Fund Five-Year Forecast. Consistent with the budget principle, certification for these projects and other identified projects that have not been approved by the City Council will be proposed as part of the 2010-2014 Proposed Capital Improvement Program. If certified by the City Council, the operating and maintenance costs associated with these facilities will be included in subsequent General Fund Five-Year Forecast documents.

The 2010-2014 Preliminary General Fund Forecast and the Structural Budget Deficit

In addition to addressing shortfalls identified in the 2010-2014 Preliminary General Fund Forecast, the City is grappling with a larger General Fund structural deficit. The budget shortfalls projected in the 2010-2014 Preliminary General Fund Forecast make up the majority of the General Fund structural deficit. In February 2007, the City Council established the elimination of the structural deficit as one of its five three-year goals. Since that time, extensive work efforts have been underway to define the problem, identify possible strategies to address the structural deficit, and to develop a plan incorporating those strategies.

The General Fund structural deficit, which is currently projected at \$106 million, is composed of the three components listed below.

1. A deficit due to the fact that operational costs (mainly personnel costs and the operation and maintenance costs for new facilities coming on line) are rising faster than operational revenues (included in preliminary 2010-2014 Forecast);
2. A deficit associated with the City's share of the General Fund annual required contribution for retiree health care benefits (included in preliminary 2010-2014 Forecast); and
3. An infrastructure and maintenance backlog (mostly street maintenance) keyed to the City's inability to completely fund replacement and renewal projects.

The 2010-2014 Preliminary General Fund Forecast and the Structural Budget Deficit
(Cont'd.)

While the first two components (operational costs and unfunded retiree health care benefits costs) are included in the 2010-2014 Preliminary General Fund Forecast, the costs associated with the unmet/deferred infrastructure and maintenance needs are not included. These costs are not incorporated into the preliminary Forecast because they are not part of the City's base level of funding, nor has the City Council committed to a specific funding plan to cover these costs.

The City's General Fund structural deficit has persisted since the recession of 2001. Since that time, the City has closed budget gaps by generating revenues and reducing costs in each annual budget process. The 2009-2010 budget will mark the eighth consecutive year that reductions will be required. The General Fund structural deficit was originally calculated at \$137 million based on the 2009-2013 Preliminary General Fund Forecast that was developed in November 2007. This figure was presented in the *City of San José – Development of Strategies to Address the City's General Fund Structural Budget Deficit* report released in January 2008. The projected structural deficit has now been revised to reflect budget actions included in the 2008-2009 Adopted Budget, updated costs for the City's share of the General Fund annual required contribution for retiree health care benefits and unmet/deferred infrastructure and maintenance needs, the current economic environment that has significantly impacted the City's projected revenues, and the results of the November 2008 election.

The following table displays the estimated structural deficit over the next five years.

General Fund Structural Deficit Projection (November 2008)
(\$ in Millions)

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014	Total
Projected Base Shortfall (Nov 2008 Forecast)*	(\$59.1)	(\$27.0)	(\$0.1)	\$3.6	\$5.8	(\$76.8)
Unmet/Deferred Infrastructure & Maintenance Needs**	(\$5.9)	(\$5.9)	(\$5.9)	(\$5.9)	(\$5.9)	(\$29.5)
Total Incremental Deficit	(\$65.0)	(\$32.9)	(\$6.0)	(\$2.3)	(\$0.1)	(\$106.3)
Total Cumulative Deficit	(\$65.0)	(\$97.9)	(\$103.9)	(\$106.2)	(\$106.3)	(\$106.3)

* Includes Retiree Healthcare (GASB 43/45) General Fund costs of \$7.0 million in 2009-2010, \$4.1 million in 2010-2011, \$3.9 million in 2011-2012, \$3.6 million in 2012-2013, \$3.6 million in 2013-2014 annualizing to \$22.2 million after five years

** Does not include \$14.7 million for sidewalk, curb/gutter and tree maintenance which are property owner responsibility or \$11.5 million for infrastructure needs where non-General Fund sources could provide funding, if available. Assumes backlog of one-time needs of \$456.9 million in the General Fund (\$825.1 million all funds) are addressed.

As directed by the City Council, a General Fund Structural Deficit Elimination Plan will be released later this week. This plan will serve as a policy guide and an operational blueprint for actions to achieve fiscal stability and organizational sustainability. A study session on this plan is scheduled for December 5, 2008.

Revenues/Expenditures Not Reflected in Forecast Model

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

- *Negotiated Labor Agreements:* The Forecast does not assume that the City will incur significant additional costs resulting from negotiations with some of the City's bargaining groups that exceed projections included in the Forecast.
- *State Budget Actions:* The Forecast does not assume any financial impact from State budget balancing actions that may negatively impact the City.
- *Retirement Rate Changes:* The retirement rates are updated based on biannual actuarial calculations and are expected to be adjusted in 2010-2011. Consistent with past practice, the new rates are not factored into the forecast until they are approved by the two retirement boards. Given the current market performance, it is assumed that the retirement rates will be increasing in the future to compensate for the lower earnings on investments. However, it should be noted that the retirement plans invest for long term benefits. The actuarial studies "smooth" or average market gains or losses over five years.
- *Unmet/Deferred Infrastructure and Maintenance Needs:* The annual ongoing General Fund costs are expected to reach \$29.5 million over the five-year period. This figure does not include the one-time backlog of approximately \$825 million, of which \$457 million is in the General Fund. In conjunction with the General Fund Structural Budget Deficit Elimination Plan, staff will bring forward various new funding proposals to begin to address this need.
- *County Annexations:* Both the potential costs and revenues associated with the County properties that are planned to be annexed into San José are not fully reflected in this Forecast model. The Forecast currently includes the transportation maintenance costs for the annexed areas.
- *North San José Expansion:* The overall impact on revenues and expenditures that may develop from the expansion of North San José are not reflected.
- *Convention Center Expansion:* The Forecast does not assume the expansion of the Convention Center, which would result in a temporary loss of Transient Occupancy Tax revenue during the construction period.
- *San Jose Redevelopment Agency Funding:* If the San Jose Redevelopment Agency reaches its funding cap and is no longer able to fund eligible City support services, the revenues and expenditures associated with these activities will be adjusted downward. Because it is unlikely that the City will be able to reduce all expenditures reimbursed by the Agency, such as funding for a portion of the Mayor and City Council and the Office of Economic Development, there could potentially be a net loss to the General Fund.
- *One-Time Revenues/Expenses:* Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding sources, such as the 2009-2010 Future Deficit Reserve or one-time expenditure needs.

NEXT STEPS

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

November/December 2008

- 2008-2009 Cost/Position Management Plans Development
- General Fund Structural Deficit Elimination Plan Released
- General Fund Structural Deficit Elimination Plan Study Session
- 2009-2010 Departmental General Fund Reduction Targets Released

January 2009

- Community Budget Survey
- Neighborhood Association/Youth Commission Priority Setting Session
- 2008-2009 Mid-Year Budget Review (including review of Cost/Position Management Plan impacts)

February 2009

- 2009-2010 City Manager's Budget Request and 2010-2014 Five Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program Released
- Updated General Fund Structural Deficit Elimination Plan Released

March 2009

- 2009-2010 Mayor's March Budget Message Released, Public Hearing, Amended/Approved by City Council

April 2009

- 2009-2010 Proposed Capital Budget and 2010-2014 Capital Improvement Program Released

May 2009

- 2009-2010 Proposed Operating Budget and 2009-2010 Proposed Fees and Charges Released
- City Council Study Sessions and Initial Public Hearing on 2009-2010 Proposed Operating Budget, 2010-2014 Proposed Capital Budget and Capital Improvement Program, and 2009-2010 Proposed Fees and Charges

June 2009

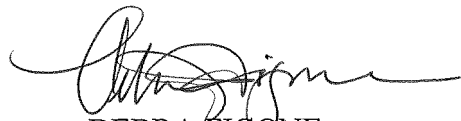
- 2009-2010 Mayor's June Budget Message Released, Final Public Hearing, Amended/Approved by City Council
- 2009-2010 Operating Budget, 2009-2010 Capital Budget and 2010-2014 Capital Improvement Program, and 2009-2010 Fees and Charges – City Council Adoption

CONCLUSION

The 2010-2014 Preliminary General Fund Forecast is intended to serve as a starting point in the development of the 2009-2010 Proposed Budget. This early data is provided to assist in planning efforts and will be refined over the next few months as additional information becomes available. It must be emphasized that the forecast figures presented in this document are particularly tenuous. Given the current unprecedented turmoil in the financial markets and the great uncertainty regarding the depth and length of the current economic downturn, changes to these estimates likely will be necessary and will be incorporated into the final 2010-2014 General Fund Forecast that is scheduled to be released in February 2009. This later and updated forecast will provide a more in-depth analysis of the revenue and expenditure trends and will present optimistic and pessimistic cases that will illustrate the impacts of lower or higher revenue and expenditure growth on the City's General Fund.

The 2010-2014 Preliminary General Fund Forecast will also provide updated information for the General Fund Structural Deficit Elimination Plan. This Plan will be released later this week and will also be revised after the release of the final 2010-2014 General Fund Forecast.

Given the deteriorating economic environment and its impact on the City's revenue streams, the Administration has taken proactive steps in the current fiscal year to reduce costs. These savings are expected to provide one-time funding to address any shortfalls experienced in the current year as well as provide funding for the 2009-2010 budget process. As we move through this challenging process, the City Council will be kept fully apprised of the status of our efforts.



DEBRA FIGONE
City Manager

Attachments:

Attachment A – 2010-2014 General Fund Forecast: Operating Impact of Capital Programs

Attachment B – 2010-2014 General Fund Forecast: Capital Projects – Operating and
Maintenance Costs Greater than \$100,000 Annually

ATTACHMENT A - 2010-2014 GENERAL FUND FORECAST
Operating Impact of Capital Programs

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
NEW PARK AND RECREATION FACILITIES MAINTENANCE AND OPERATIONS					
Aborn Park Playground Improvements	5,000	5,000	5,000	5,000	6,000
Almaden Apartments Area Park	-	10,000	20,000	21,000	22,000
Carolyn Norris Turnkey Park	19,000	19,000	20,000	20,000	21,000
Chelmers Park Development	-	18,000	36,000	37,000	38,000
Kirk Community Center Renovation	68,000	84,000	86,000	87,000	89,000
Martial-Cottle Community Garden	-	-	20,000	41,000	42,000
Martin Park Expansion	-	74,000	75,000	77,000	79,000
Newhall Neighborhood Park	21,000	22,000	22,000	23,000	24,000
Nisich Park Development	-	8,000	15,000	16,000	16,000
Tamien Specific Plan Area Park Improvements	-	-	18,000	37,000	38,000
TRAIL: Albertson Parkway	34,000	35,000	35,000	36,000	37,000
Vietnamese Cultural Heritage Garden	11,000	-	-	-	-
Edenvale Community Center (RDA)	-	487,000	751,000	766,000	782,000
Hoffman/Via Monte Neighborhood Center (RDA)	-	-	-	213,000	217,000
Mabury Park/Commodore Children's Park	-	-	114,000	117,000	119,000
Mayfair Park (RDA)	-	-	-	20,000	21,000
TRAIL: Lower Silver Creek	-	18,000	28,000	37,000	46,000
TRAIL: Penitencia Creek Reach I	-	21,000	21,000	21,000	22,000
TRAIL: Penitencia Creek Reach VI	-	5,000	5,000	5,000	5,000
TRAIL: Willow Glen Spur Acquisition	-	-	66,000	67,000	69,000
TRAIL: Willow Glen Spur Reach V (Developer)	6,000	6,000	6,000	6,000	7,000
Scottish Rite Parks (Venetian Terrace)	-	19,000	19,000	20,000	21,000
Spartan/Keyes Neighborhood Center (RDA)	14,000	14,000	14,000	15,000	15,000
Watson Park Remediation	8,000	32,000	33,000	34,000	34,000
Cadance Turnkey Park	5,000	5,000	6,000	6,000	6,000
Eden Court Housing	-	-	16,000	16,000	17,000
Goble Lane Turnkey Park and Tot Lot	-	27,000	28,000	28,000	29,000
Irvine Park	-	-	28,000	58,000	60,000
Japantown Turnkey Park and Tot Lot	-	16,000	16,000	17,000	17,000
King/Dobbin Site Turnkey Park and Tot Lot	-	16,000	16,000	17,000	17,000
Legacy Turnkey Park	2,000	2,000	2,000	2,000	2,000
North San Pedro Turnkey Park and Tot Lot	-	16,000	16,000	17,000	17,000
Piercy/Tennant Site Tot Lot	16,000	16,000	17,000	17,000	18,000
Vista Montana Turnkey Park and Tot Lot	-	86,000	88,000	91,000	93,000
Wyse Site Turnkey Park and Tot Lot	-	34,000	80,000	83,000	85,000
TOTAL NEW PARK AND RECREATION FACILITIES MAINTENANCE AND OPERATIONS	209,000	1,095,000	1,722,000	2,073,000	2,131,000
NEW TRAFFIC INFRASTRUCTURE ASSET MAINTENANCE AND OPERATIONS					
Traffic Projects - Forecast	62,000	65,000	88,000	91,000	95,000
Traffic Light Synchronization Project	33,000	67,000	100,000	100,000	100,000
Landscape Maint - New Infra Assets and Op Costs	108,000	264,000	360,000	456,000	552,000
TOTAL NEW TRAFFIC INFRASTRUCTURE ASSET MAINTENANCE AND OPERATIONS	203,000	396,000	548,000	647,000	747,000
MEASURE O (LIBRARY) MAINTENANCE AND OPERATIONS					
Bascom Branch	-	1,387,000	1,407,000	1,434,000	1,463,000
Calabazas Branch	(677,000)	(335,000)	190,000	194,000	200,000
East San José Carnegie Branch	563,000	619,000	634,000	647,000	662,000
Educational Park Branch	(647,000)	237,000	321,000	328,000	338,000
Santa Teresa Branch	1,048,000	1,064,000	1,087,000	1,111,000	1,136,000
Seven Trees Branch	446,000	1,177,000	1,203,000	1,227,000	1,254,000
Southeast Branch	-	-	449,000	812,000	829,000
TOTAL MEASURE O (LIBRARY) MAINTENANCE AND OPERATIONS	733,000	4,149,000	5,291,000	5,753,000	5,882,000
MEASURE P (PARKS) MAINTENANCE AND OPERATIONS					
Bascom Community Center	160,000	749,000	763,000	778,000	794,000
Happy Hollow Park & Zoo	663,000	-	-	-	-
Soccer Complex	-	295,000	521,000	529,000	550,000
Softball Complex	-	380,000	670,000	679,000	713,000
Seven Trees Community Center	344,000	922,000	940,000	958,000	978,000
TOTAL MEASURE P (PARKS) MAINTENANCE AND OPERATIONS	1,167,000	2,346,000	2,894,000	2,944,000	3,035,000

ATTACHMENT A - 2010-2014 GENERAL FUND FORECAST
Operating Impact of Capital Programs

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
MEASURE O (PUBLIC SAFETY) MAINTENANCE AND OPERATIONS: FIRE					
Fire Station 36 - Silver Creek/Yerba Buena - Maint/Util		49,000	72,000	74,000	76,000
Fire Station 19 - Maintenance and Utilities	9,000	21,000	22,000	23,000	24,000
Fire Station 21 - Maintenance and Utilities	-	2,000	20,000	21,000	22,000
Fire Station 37 - South Willow Glen - Staffing/NP	-	498,000	2,546,000	2,663,000	2,806,000
Fire Station 37 - South Willow Glen - Maint/Util	-	-	29,000	35,000	36,000
Fire Station 2 - Rebuild - Maintenance and Utilities	2,000	28,000	29,000	30,000	31,000
TOTAL MEASURE O (PUBLIC SAFETY) MAINTENANCE AND OPERATIONS: FIRE	11,000	598,000	2,718,000	2,846,000	2,995,000
MEASURE O (PUBLIC SAFETY) MAINTENANCE AND OPERATIONS: POLICE					
South San José Substation	1,107,000	1,591,000	1,637,000	1,684,000	1,734,000
ECOMM Maintenance	122,000	223,000	232,000	240,000	252,000
Driver Training Facility	-	21,000	52,000	54,000	57,000
TOTAL MEASURE O (PUBLIC SAFETY) MAINTENANCE AND OPERATIONS: POLICE	1,229,000	1,835,000	1,921,000	1,978,000	2,043,000

ATTACHMENT B - 2010-2014 GENERAL FUND FORECAST
Capital Projects - Operating and Maintenance Costs Greater than \$100,000 Annually

CITY COUNCIL-APPROVED GENERAL OBLIGATION BOND CAPITAL PROJECTS

PUBLIC SAFETY	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Fire Station 37 - Willow Glen	0	498,000	2,546,000	2,663,000	2,806,000
South San José Police Substation	1,107,000	1,591,000	1,637,000	1,684,000	1,734,000
LIBRARY					
Bascom Branch	0	1,387,000	1,407,000	1,434,000	1,463,000
Calabazas Branch	(677,000)	(335,000)	190,000	194,000	200,000
East San José Carnegie Branch	563,000	619,000	634,000	647,000	662,000
Educational Park Branch	(647,000)	237,000	321,000	328,000	338,000
Santa Teresa Branch	1,048,000	1,064,000	1,087,000	1,111,000	1,136,000
Seven Trees Branch	446,000	1,177,000	1,203,000	1,227,000	1,254,000
Southeast Branch	0	0	449,000	812,000	829,000
PARKS					
Bascom Community Center	160,000	749,000	763,000	778,000	794,000
Happy Hollow Park and Zoo	663,000	0	0	0	0
Soccer Complex	0	295,000	521,000	529,000	550,000
Softball Complex	0	380,000	670,000	679,000	713,000
Seven Trees Community Center	344,000	922,000	940,000	958,000	978,000
Total O&M - City-Council Approved GO Bond Capital Projects	3,007,000	8,584,000	12,368,000	13,044,000	13,457,000

OTHER CITY COUNCIL-APPROVED CAPITAL PROJECTS

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Edenvale Community Center	0	487,000	752,000	767,000	782,000
Mabury Park/Commodore Children's Park	0	0	114,000	117,000	119,000
Transporation Infrastructure - New Assets	108,000	264,000	360,000	456,000	552,000
E-COMM Public Safety System Maintenance	122,000	223,000	232,000	240,000	252,000
Hoffman/Via Monte Neighborhood Center (RDA)	0	0	0	213,000	217,000
Total O&M - Other City-Council Approved Capital Projects	230,000	974,000	1,458,000	1,793,000	1,922,000

TOTAL - CAPITAL PROJECTS WITH OPERATING AND MAINTENANCE COSTS GREATER THAN \$100,000 ANNUALLY	3,237,000	9,558,000	13,826,000	14,837,000	15,379,000
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OTHER POTENTIAL FUTURE CAPITAL PROJECTS WITH OPERATING AND MAINTENANCE COSTS GREATER THAN \$100,000 ANNUALLY (NOT INCLUDED IN FORECAST)

Convention Center Expansion (RDA)
Emma Prusch Park - Back Acreage Development
Festival Site (RDA)
Future Trail Projects
Meadowfair Community Center (RDA)