

2015-2016

ANNUAL

REPORT

TRANSMITTAL

MEMORANDUM



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Norberto Dueñas

SUBJECT: 2015-2016 ANNUAL REPORT

DATE: September 30, 2016

RECOMMENDATION

It is recommended that the City Council:

- (a) Accept the 2015-2016 City Manager's Annual Report of the Finances of the City of San José in compliance with City Charter Section 701 (F).
- (b) Adopt Appropriation Ordinance and Funding Sources Resolution amendments in various operating and capital funds to implement the 2015-2016 Annual Report recommendations, including appropriate technical adjustments, as detailed in Section IV (Recommended Budget Adjustments and Clean-Up/Rebudget Actions).
- (c) Approve the addition of 0.75 Senior Recreation Leader PT and the elimination of 0.50 Recreation Leader PT in the Parks, Recreation and Neighborhood Services Department and the elimination of 1.0 limit-dated Executive Analyst in the City Manager's Office, as detailed in Section IV (Recommended Budget Adjustments and Clean-Up/Rebudget Actions).

OUTCOME

In accordance with Section 701 (F) of the San José City Charter, the 2015-2016 Annual Report describes the financial status of the City at the end of the 2015-2016 fiscal year. As specified in the City Charter, the focus of the City Manager's Annual Report is a comparison of actual revenue collections and expenditures to projections and appropriations included in the City's budget. This will provide the City Council with the information necessary to review the financial performance of all City funds. In addition, this report provides a comparison of the actual 2015-2016 Ending Fund Balance for each fund to the estimate used in the development of the 2016-2017 Adopted Budget as well as information on the status of the year-end reserve levels for each of the City's budgeted funds.

Approval of the recommended budget actions will implement required fund balance reconciliations as well as necessary rebudget and clean-up adjustments based on the final 2015-2016 financial performance (unaudited). The document also includes actions that are necessary to revise the 2016-2017 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, recognize new or adjust existing grant, reimbursement or fee activity revenues and expenditures, fund a very limited number of urgent fiscal/program needs in the General Fund, and reflect changes in project and program allocations based on revised cost estimates as well as establish a limited number of new projects and programs in special and capital funds.

EXECUTIVE SUMMARY

The Administration proactively managed the City's 111 budgeted funds in 2015-2016. Budget actions were brought forward during the year to ensure that revenues and expenditures remained in alignment with actual performance. Through this careful management, the various City funds generally ended the year with revenues close to the budgeted estimates and expenditures below the budgeted allocations.

With the local economy's sustained growth over the past several years, and as expenditures were closely forecasted and monitored, the City's budget remained stable. Accordingly, the 2015-2016 Adopted Budget continued to hold the line, allowed for incremental increases in employee compensation in order to remain competitive as an employer in this challenging labor marketplace, and allocated a small General Fund surplus of \$9.4 million for targeted service restorations and infrastructure investments. As always, the City will maintain its focus on rebuilding services within available resources to meet the needs of the San José community.

In the General Fund, both the revenues and expenditures ended the year very close to budgeted expectations. At the end of 2015-2016, there was \$6.2 million (0.2% of the 2015-2016 Modified Budget total sources and uses) in additional General Fund 2015-2016 Ending Fund Balance above the level assumed in the development of the 2016-2017 Adopted Budget. These funds are recommended to be allocated in the 2015-2016 Annual Report as shown below.

PROPOSED 2016-2017 GENERAL FUND ADJUSTMENTS (\$000s)

Additional 2015-2016 Ending Fund Balance for Annual Report	\$ 6,248
Clean-Up Actions	
Development Fee Programs Reconciliation	(4,840)
Rebudgets/Clean-Up Adjustments (\$150,000 early rebudget on 8/16/16)	5,417
Sub-total Clean-Up Actions	\$ 577
Fund Balance Available After Clean-up Actions	\$ 6,825
Recommended Budget Adjustments	
Required Technical/Rebalancing Actions	(5,475)
Grants/Reimbursements/Fee Activities (\$2.1 million in net-zero adjustments)	0
Urgent Fiscal/Program Needs	(1,350)
Sub-total Recommended Budget Adjustments	\$ (6,825)
Remaining Balance After Clean-ups/Recommended Adjustments	\$ 0

EXECUTIVE SUMMARY

When bringing forward recommendations for the use of the additional 2015-2016 Ending Fund Balance, the Administration considers clean-up actions associated with the close-out of the 2015-2016 fiscal year to be essentially non-discretionary and the highest priority. These clean-up actions result in a net increase to the available fund balance of \$577,000 and are broken down into two categories: changes to the Development Fee Programs reserves to reconcile actual 2015-2016 performance (decrease to fund balance of \$4.84 million); and adjustments to rebudget amounts that were carried over to 2016-2017 to complete projects and technical adjustments to other revenue and expenditure line items (increase to fund balance of \$5.42 million). It should be noted that an early rebudget action of \$150,000 was previously approved by the City Council on August 16, 2016. After accounting for those clean-up actions, the additional General Fund 2015-2016 Ending Fund Balance was within \$6.83 million (0.25%) of the 2015-2016 Modified Budget (sources and uses). The \$6.83 million positive fund balance variance is comprised of net additional revenues of \$3.5 million (0.33%), additional 2015-2016 Beginning Fund Balance (\$335,000), net expenditure savings of \$2.1 million (0.18%), and higher than estimated liquidation of prior year encumbrances of \$869,000. The remaining General Fund balance of \$6.83 million is recommended to fund various required technical/rebalancing actions (\$5.48 million) and a small number of recommended actions to address urgent fiscal/program needs (\$1.35 million).

The largest actions in the General Fund include an increase to the Pavement Maintenance program (\$3.3 million) for street pavement and repairs, an increase to the Development Fee Program Technology Reserve (\$798,000) to account for the Multiple Housing Occupancy Program's share of costs for the implementation of the Integrated Permit System (AMANDA) upgrade, an increase of \$566,000 (partially offset by \$165,000 in contributions from other funds and the development fee programs) for the Human Resources/Payroll/Budget Systems Upgrades project to increase the project contingency and add funding for Managed Services, and an increase of \$540,000 for the Human Resources Department to support a third-party administrator (TPA) for a portion of the Workers' Compensation Program for the period of January 1, 2017 through June 30, 2017. In addition, \$2.1 million in net-zero adjustments to various grants, reimbursements and fee activities are included along with a series of technical adjustments.

This report also addresses immediate needs in various special and capital funds, including adding resources to support regional rail planning; increasing funding to address urgent needs at the Convention Center, Civic Auditorium, and Center for Performing Arts; increasing the Airport budget to provide funding for U.S. Customs and Border Protection (CBP) services to address the increasing level of international passengers; accelerating the replacement of the Fire Station 29 generator; and adding funding to complete the acquisition of property for conversion into a future affordable housing development.

As we move forward, the Administration will continue to monitor and report on the City's financial performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2015-2016 will also be factored into the development of the 2018-2022 General Fund Five-Year Forecast that will be released in February 2017.

BACKGROUND

Each year the City issues the Annual Report at the end of September, three months after the close of the fiscal year, as required by the City Charter. Following is a description of the various sections of the Annual Report document.

- **Transmittal Memorandum** – This section provides an overall summary of the 2015-2016 Annual Report.
- **Section I: Financial Performance Summary (All Funds)** – This section provides a comparison of the 2015-2016 budget to actual revenues received and expenditures incurred by fund as well as an explanation of revenue and/or expenditure variances of 10% or greater to the budget. This section also provides a comparison of the year-end actual 2015-2016 Ending Fund Balance by fund to the 2015-2016 Ending Fund Balance/2016-2017 Beginning Fund Balance estimate used in the development of the 2016-2017 Adopted Budget. In addition, a listing of the Earmarked and Contingency Reserves that were available at the end of 2015-2016 by fund is included.
- **Section II: General Fund Financial Performance** – This section provides a summary of the General Fund performance in 2015-2016, including the following: Results of Operations in the General Fund; Revenue Performance; and Expenditure Performance.
- **Section III: Selected Special/Capital Funds Financial Performance** – This section provides financial information on the 2015-2016 year-end performance for selected special and capital funds that represent major City operations. It includes a discussion of variances between actual and budgeted revenues and expenditures as well as a comparison between the actual ending fund balance and the fund balance estimated for 2015-2016 in the development of the 2016-2017 Adopted Budget.
- **Section IV: Recommended Budget Adjustments and Clean-Up/Rebudget Actions** – This section provides a description of the recommended budget adjustments and clean-up actions for City Council consideration. The proposed actions generally fall into three categories: (1) adjustments to the 2016-2017 Beginning Fund Balance amounts in various funds, including the General Fund, based on the final reconciliation of 2015-2016; (2) upward and downward adjustments to the rebudget figures to ensure the appropriate amount of unexpended funds are carried over to 2016-2017 to complete projects; and (3) actions based on more recent information that are necessary to revise the 2016-2017 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, recognize new or adjust grant, reimbursement or fee activity revenues and expenditures, fund a very limited number of urgent fiscal/program needs in the General Fund, and reflect changes in project and program allocations based on revised cost estimates as well as establish a limited number of new projects and programs in special and capital funds.

BACKGROUND

- **Section V: Financial Statements** – This section provides the financial results (unaudited), prepared by the Finance Department, for all budgeted fund groups for 2015-2016. It should be noted that audited financial results will be released later in the fall as part of the 2016 Comprehensive Annual Financial Report (CAFR) for Fiscal Year Ended June 30, 2016. Final fund balance reconciliations to the CAFR will be conducted for all funds and, while very few adjustments are typically necessary, any final adjustments will be brought forward for City Council consideration as part of the 2016-2017 Mid-Year Budget Review.

ANALYSIS

This Analysis section includes the following:

- an overview of the economic environment;
- a discussion of the 2015-2016 budget performance of all City funds;
- a discussion of the 2015-2016 budget performance for the General Fund;
- a discussion of the components of the 2015-2016 General Fund ending fund balance;
- an analysis of the impact of the General Fund performance on the 2016-2017 Adopted Budget; and
- a discussion of the 2015-2016 budget performance of selected special and capital funds.

Economic Environment

When the 2015-2016 Adopted Budget was developed, economic growth was expected to continue throughout the year. This assumption has proven true, with continued improvement in economic indicators and actual revenue performance during 2015-2016. Employment indicators, construction activity, median single-family home prices, number of home sales, and the number of days it took to sell these homes all performed well in 2015-2016.

The June 2016 employment level in the San José – Sunnyvale - Santa Clara Metropolitan Statistical Area (MSA) of 1.09 million was 2.2% above the June 2015 level of 1.06 million. This represents the sixth consecutive year of sustained growth



ANALYSIS

Economic Environment

from June to June. The growth is underscored by the current low unemployment that the San José – Sunnyvale – Santa Clara MSA is experiencing.

The unemployment rate in the San José metropolitan area continued to improve in 2015-2016, dropping from 4.2% in June 2015 to 4.1% in June 2016. The June 2016 unemployment rate in this region is less than the unadjusted rate for the State (5.7%) and the nation (5.1%).

Unemployment Rate (Unadjusted)

	June 2015	June 2016
SJ Metropolitan Statistical Area*	4.2%	4.1%
State of California	6.2%	5.7%
United States	5.5%	5.1%

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

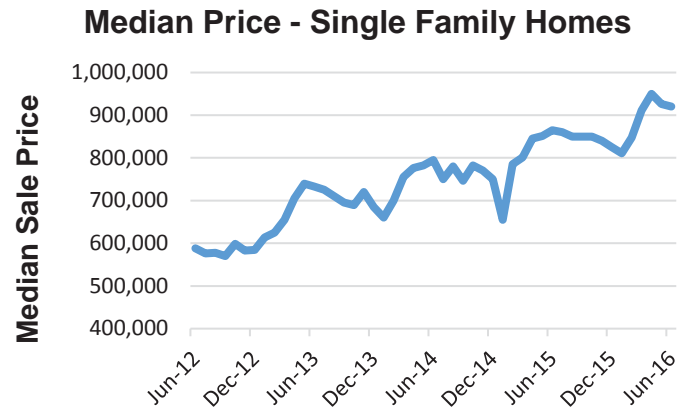
Construction activity remained strong in 2015-2016 at a valuation of \$1.5 billion, which was 14.3% above the \$1.3 billion valuation of projects that were received in 2014-2015. Commercial valuation of \$474.0 million tracked above the estimate of \$240.0 million and exceeded the prior year level of \$380.0 million. Industrial activity of \$594.7 million surpassed the forecasted level of \$250.0 million and was above last year’s level of \$359.9 million. While commercial and industrial activity was up compared to the prior year, residential activity was down. Residential valuation of \$440.9 million was lower than the prior year total of \$580.9 million and less than the estimate of \$615.0 million.

Major projects contributing to the tax receipts in 2015-2016 were the eBay campus on East Hamilton Avenue, the Samsung R&D building on North First Street, a 163,000 square foot warehouse on Piercy Road east of the Highway 101/85 split in South San José, a 144 room hotel located on North First Street just south of Highway 237, an office building in the Coleman Highline development, and a new 315 unit apartment building on West San Carlos Street. Overall, this construction activity drives the revenue collection in several construction tax categories such as the Building and Structure Construction Tax and Construction Excise Tax and is an indicator of future activity for other categories such as storm and sanitary sewer system fees.

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Economic Environment

The housing market also continued to improve in 2015-2016. The median price for single family homes increased in value, with a median home price in June 2016 of \$920,000, up 6.4% from the June 2015 price of \$865,000. The number of home sales (single-family and multi-family dwelling units), has increased over the past year (2.9%) from 7,992 in 2014-2015 to 8,223 sales in 2015-2016. The amount of time it takes to sell a home (single-family and multi-family dwelling units) has increased slightly in the past year from 17 days in June 2015 to 19 days in June 2016.



2015-2016 Budget Performance (All Funds)

As shown in Section I of this document, City revenues (excluding Beginning Fund Balances) totaled \$2.48 billion in 2015-2016, which was 1.9% (\$46.9 million) below the budgeted estimate of \$2.53 billion.

In 2015-2016, expenditures (excluding Reserves and Ending Fund Balances) totaled \$2.8 billion, which was \$497.6 million (15.2%) below the modified budget of \$3.3 billion. At the end of 2015-2016, the Contingency and Earmarked Reserves for all City funds totaled \$719.3 million, which represented 17.5% of the total 2015-2016 Modified Budget of \$4.1 billion (including interfund transfers, loans, and contributions). In the General Fund, Reserves totaled \$165.0 million.

The financial performance in 2015-2016 is used as the starting point for 2016-2017. The collective 2015-2016 Ending Fund Balances for all City funds totaled \$1.3 billion, which was \$107.3 million above the 2015-2016 Ending Fund Balance estimates of \$1.2 billion used in the development of the 2016-2017 Adopted Budget. After adjusting for additional rebudgets of \$12.1 million recommended in this report, the adjusted 2015-2016 Ending Fund Balance variance for all funds falls to \$95.2 million, or 2.3% of the 2015-2016 Modified Budget. The adjusted fund balance variance totaled \$6.8 million in the General Fund, \$30.5 million in the special funds, and \$58.0 million in the capital funds.

ANALYSIS

2015-2016 General Fund Budget Performance

The City's General Fund ended the 2015-2016 fiscal year within budgeted levels. As shown in the chart below, the General Fund Ending Fund Balance of \$255.2 million was \$6.2 million (0.2% of the 2015-2016 Modified Budget total sources and uses) above the fund balance estimate assumed when the 2016-2017 Adopted Budget was developed. The following table summarizes the General Fund performance in 2015-2016, comparing the actual results to the modified budget and the estimates used to develop the 2016-2017 Adopted Budget.

Table 1
General Fund Year-End Status
For the Year Ended June 30, 2016
 (\$000s)

Sources	2015-2016 Modified Budget	2015-2016 Year-end Estimate	2015-2016 Budgetary Basis Actual	Actual to Budget Variance	Actual to Estimate Variance
<i>Beginning Fund Balance</i>	265,520	265,520	265,855	335	335
<i>Carryover Encumbrances</i>	42,526	42,526	42,526	-	-
<i>Liquidation of Carry- over Encumbrances</i>	-	1,000	1,869	1,869	869
<i>Revenue</i>	<u>1,059,439</u>	<u>1,059,439</u>	<u>1,055,517</u>	<u>(3,922)</u>	<u>(3,922)</u>
<i>Total Sources</i>	<u><u>1,367,485</u></u>	<u><u>1,368,485</u></u>	<u><u>1,365,767</u></u>	<u><u>(1,718)</u></u>	<u><u>(2,718)</u></u>
Uses					
<i>Expenditures/Transfers</i>	1,202,426	1,118,802	1,110,561	(91,865)	(8,241)
<i>Reserves</i>	<u>165,059</u>	<u>725</u>	<u>-</u>	<u>(165,059)</u>	<u>(725)</u>
<i>Total Uses</i>	<u><u>1,367,485</u></u>	<u><u>1,119,527</u></u>	<u><u>1,110,561</u></u>	<u><u>(256,924)</u></u>	<u><u>(8,966)</u></u>
<i>Ending Fund Balance</i>	<u><u>-</u></u>	<u><u>248,958</u></u>	<u><u>255,206</u></u>	<u><u>255,206</u></u>	<u><u>6,248</u></u>

Note: In the chart above, the General Fund excludes the Emergency Reserve Fund and the Cash Reserve Fund, which are budgeted as separate funds and reflected separately in this document. In the 2015-2016 Comprehensive Financial Report (CAFR), the Emergency Reserve Fund and Cash Reserve Fund will be displayed as part of the General Fund to comply with GASB 54 reporting requirements.

In 2015-2016, General Fund revenues of \$1.1 billion ended the year \$3.9 million (0.4%) below both the modified budget and the estimate used to develop the 2016-2017 Adopted Budget. Other funding sources included additional 2015-2016 Beginning Fund Balance of \$335,000 and the liquidation of prior year carryover encumbrances totaling \$1.9 million, which was \$869,000 above the estimate used to develop the 2016-2017 Adopted Budget. General Fund expenditures/transfers of \$1.11 billion were \$91.9 million (7.6%) below the modified budget of \$1.2 billion and \$8.2 million (0.74%) below the estimate used to develop the 2016-2017 Adopted Budget. Budgeted reserves of \$165.1 million remain unexpended at year-end.

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2015-2016 General Fund Budget Performance

When comparing the actual revenue and expenditure performance to the estimates used to develop the 2016-2017 Adopted Budget, a portion of these variances is related to various grants and reimbursements that were not received in 2015-2016, but are expected to be received in 2016-2017. A total of \$4.3 million of grant and reimbursement revenues and expenditures were rebudgeted to 2016-2017 in the 2016-2017 Adopted Budget. This resulted in lower actual revenues and expenditures in 2015-2016, with no net impact to the General Fund. After factoring out the lower revenues and expenditures associated with these grants and reimbursements, revenues were above the estimate by \$407,000 (0.1%) and expenditures savings totaled \$4.6 million. In addition, the 2015-2016 Beginning Fund Balance was \$335,000 above the estimate, and the liquidation of carryover encumbrances exceeded the \$1.0 million estimate by \$869,000. Further adjustments to these figures are necessary to account for the recommended rebudget and clean-up actions in the Annual Report.

In this Annual Report document, budget actions are recommended to distribute fund balance. Of the \$6.248 million in additional fund balance, \$6.098 million is allocated in this report and the remaining \$150,000 was already distributed as an early rebudget approved by the City Council on August 16, 2016. Per City Council Policy 1-18, when determining the proposed distribution of these funds, the first priority is to complete clean-up actions associated with the final reconciliation of 2015-2016. Recommended clean-up actions result in net increase of \$577,000 to the amount of funding available to distribute, and reflect the allocation of \$4.84 million to reconcile the actual performance of the Development Fee Programs for 2015-2016 and a net negative adjustment of \$5.42 million in required expenditure rebudgets and other clean-up adjustments to close-out 2015-2016. The adjusted figure of \$6.83 million in additional funding available to distribute was generated from net additional revenues of \$3.5 million and net expenditure savings of \$2.1 million, a Beginning Fund Balance adjustment of \$335,000, and higher than estimated liquidation of prior year encumbrances (\$869,000).

The additional General Fund balance of \$6.83 million (0.25%) available for distribution is recommended to be allocated to address various required technical and rebalancing actions (\$5.48 million), and recommended urgent fiscal/program needs (\$1.35 million), which are described later in this transmittal memorandum.

To identify revenue and expenditure trends, the actual 2015-2016 revenues and expenditures are compared to the prior year. Table 2 below compares the City's financial performance in 2015-2016 with the financial performance of the prior year.

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2015-2016 General Fund Budget Performance

**Table 2
 General Fund
 Comparison of Year-End Actuals With Prior Year
 (\$000s)**

	2014-2015 Actuals	2015-2016 Actuals	Change	% Change
Source of Funds				
Beginning Fund Balance	311,414	265,855	(45,559)	-14.6%
Revenues	1,048,677	1,055,518	6,841	0.7%
Total Source of Funds	1,360,091	1,321,373	(38,718)	-2.8%
Use of Funds				
Personal Services	649,086	692,220	43,134	6.6%
Non-Personal/Equipment/Other	115,085	129,244	14,159	12.3%
City-Wide Expenses	264,174	223,639	(40,535)	-15.3%
Capital Contributions	29,470	38,308	8,838	30.0%
Transfers	36,756	27,150	(9,606)	-26.1%
Reserves	-	-	-	N/A
Total Use of Funds	1,094,571	1,110,561	15,990	1.5%

As shown in Table 2, 2015-2016 General Fund revenues of \$1.056 billion represent an increase of 0.7% from the 2014-2015 collection level of \$1.049 billion. The categories that experienced the largest increases included: Property Tax, Sales Tax, Business Taxes, Licenses and Permits, and Departmental Charges. The largest declines from the prior year were experienced in the Revenue from Local Agencies (primarily due to lower Successor Agency to the Redevelopment Agency reimbursement of \$22.5 million) and Other Revenue (lower Sale of Property proceeds of \$33.6 million due primarily to a portion of the Airport West property sold in 2014-2015) categories. These large declines are dampening overall revenue growth comparisons to the prior year.

General Fund expenditures of \$1.11 billion in 2015-2016 were 1.5% (\$16.0 million) above prior year expenditure levels of \$1.09 billion. This increase is due to higher Personal Services (\$43.1 million), Non-Personal/Equipment/Other (\$14.2 million), and Capital Contributions (\$8.8 million), partially offset by lower City-Wide Expenses (\$40.5 million), and Transfers (\$9.6 million).

A detailed discussion of the General Fund revenue and expenditure performance is provided in Section II of this document.

ANALYSIS

2015-2016 General Fund Ending Fund Balance

The current budgeting practice of the City is to use the projected level of fund balance expected to remain in the General Fund at the end of any fiscal year as a funding source for the following year. The Ending Fund Balance estimate always contains two components: the portion of the fund balance that needs to be rebudgeted for completing projects or retaining reserves; and the portion which is undesignated and available as a general funding source in the coming year. In the 2016-2017 Adopted Budget, a total fund balance estimate of \$249.0 million was included as a funding source. As discussed earlier, the 2015-2016 General Fund Ending Fund Balance of \$255.2 million was \$6.2 million above this estimate.

The components of the 2015-2016 General Fund Ending Fund Balance include additional funding sources, expenditure/transfer savings, and unexpended reserves as described below:

**2015-2016 General Fund
Ending Fund Balance Components**

Fund Balance Component	\$ Amount (\$ in 000s)
Additional Funding Sources	(1,718)
Expenditure/Transfer Savings	91,865
Unexpended Reserves	165,059
TOTAL	\$ 255,206

The total Sources of Funds ended the year \$1.7 million below the modified budget as a result of lower revenues (\$3.9 million) that were partially offset by a higher 2015-2016 Beginning Fund Balance (\$335,000) and liquidation of carryover encumbrances (\$1.9 million). After net-zero revenue rebudgets and additional rebudget and clean-up actions recommended in the Annual Report, there is an adjusted revenue surplus of \$3.5 million (0.33%) from the modified budget.

For the Uses of Funds, expenditure and transfer savings totaled \$91.9 million, while unexpended reserves totaled \$165.1 million, representing the largest component of the 2015-2016 Ending Fund Balance. Clean-up expenditure actions of \$2.5 million are recommended in this document to reconcile the Development Fee Programs for 2015-2016 (\$2.0 million) and to adjust various rebudget amounts and clean up appropriations (\$512,000). After accounting for these technical adjustments, the remaining General Fund expenditures and transfer savings totaled \$2.1 million, or 0.18% of the modified budget (excluding reserves).

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2015-2016 General Fund Ending Fund Balance

General Fund Reserves, totaling \$165.1 million at the end of 2015-2016, include two categories: Earmarked Reserves (\$130.6 million) established to address specific needs per City Council direction; and the Contingency Reserve (\$34.5 million) set at a minimum of 3% of expenditures per City Council policy.

Following is additional information regarding the two reserve categories.

- ***Earmarked Reserves (\$130.6 million)*** – At the end of 2015-2016, the most significant reserves included the following: Ending Fund Balance Reserve (\$25.5 million); Building Development Fee Program Reserve (\$24.4 million); Workers Compensation/General Liability Catastrophic Reserve (\$15.0 million); Budget Stabilization Reserve (\$10.0 million); Salaries and Benefits Reserve (\$6.9 million); Fire Development Fee Program (\$6.4 million); Retiree Healthcare Solutions Reserve (\$6.1 million); Sick Leave Payments Upon Retirement Reserve (\$6.0 million); Public Works Development Fee Program Reserve (\$5.5 million); Cultural Facilities Capital Maintenance Reserve (\$5.0 million); and the 2016-2017 Police Department Overtime Reserve (\$5.0 million). The majority of the Earmarked Reserves were either approved for rebudget or used as a funding source in the 2016-2017 Adopted Budget. A rebudget adjustment is recommended in the Annual Report to reconcile the Artificial Turf Capital Replacement Reserve.

The 2015-2016 Ending Fund Balance Reserve of \$25.5 million was proactively set aside to help ensure sufficient fund balance would be available at the end of 2015-2016 to meet the budgeted estimate used in the development of the 2016-2017 Adopted Budget. Annually, as part of the development of the General Fund Forecast and Adopted Budget for the following year, a certain amount of current year unrestricted ending fund balance is estimated to be available at the end of the year as a funding source for the following year's budget. This ending fund balance is expected to be generated from additional revenues above budgeted levels, expenditure savings, and the liquidation of carryover encumbrances during the year. In the 2016-2017 Adopted Budget, it was assumed that \$45.2 million would be generated from these sources. The establishment of the 2015-2016 Ending Fund Balance Reserve set aside a portion of this funding, with the assumption that the remaining amount would be realized by year-end primarily from expenditure savings and the liquidation of prior year carryover encumbrances.

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2015-2016 General Fund Ending Fund Balance

- **Contingency Reserve (\$34.5 million)** – The City Council has established a budget policy of maintaining a minimum 3% Contingency Reserve in the General Fund. At the end of 2015-2016, the Contingency Reserve Balance was \$34.5 million. As part of the 2016-2017 Adopted Budget, the full Contingency Reserve was rebudgeted in order to comply with the Council Policy of maintaining a 3.0% Contingency Reserve in the General Fund. It is important to note, however, that if this Contingency Reserve is ever needed, it is only sufficient enough to cover General Fund payroll expenditures for approximately two and a half weeks in the event of an emergency. This level of reserve is a very low amount for a city the size of San José.

As discussed above, it was assumed that \$249.0 million would remain in the General Fund at the end of 2015-2016 and would be carried over to 2016-2017 as Beginning Fund Balance as part of the adoption of the 2016-2017 Budget. These funds, which were expected to be generated from unexpended reserves, unexpended funds that were rebudgeted to 2016-2017, additional revenue, expenditure savings and the liquidation of carryover encumbrances, were programmed for use in the 2016-2017 Adopted Budget. The actual General Fund Ending Fund Balance was above the estimate used in the 2016-2017 Adopted Budget by \$6.2 million, due to excess revenues and additional expenditure savings.

The following chart details the recommended uses of the \$6.248 million additional fund balance as well as other budget adjustments that are recommended as part of this report. Recommended clean-up actions will result in an increase to the available fund balance by \$577,000, reflecting a downward adjustment of \$4.84 million to reconcile the actual performance of the Development Fee Programs in 2015-2016 and a net upward adjustment of \$5.42 million to account for additional rebudget and clean-up actions to close-out 2015-2016. Once these adjustments have been accounted for, the net available fund balance available for allocation totals \$6.83 million. This additional fund balance is proposed to be allocated to address required technical/rebalancing needs as well as a very limited number of urgent fiscal/program needs in the current year.

ANALYSIS

Impacts on the 2016-2017 General Fund Budget

PROPOSED 2016-2017 GENERAL FUND ADJUSTMENTS (\$000s)

Additional 2015-2016 Ending Fund Balance	\$ 6,248
Clean-Up Actions	
Development Fee Programs Reconciliation	(4,840)
Rebudgets/Clean-Up Adjustments (\$150,000 early rebudget on 8/16/16)	5,417
Sub-total Clean-Up Actions	577
Fund Balance Available After Clean-Up Actions	\$ 6,825
Recommended Budget Adjustments	
Required Technical/Rebalancing Actions	
- Pavement Maintenance Program	3,300
- Development Fee Program Technology Reserve	798
- Human Resources/Payroll Budget Systems Upgrade	401
- Urban Forestry Services Reserve	200
- Elections and Ballot Measures	200
- Banking Services	200
- Fire Non-Personal/Equipment (Electronic Patient Care Reporting Project)	186
- Finance Non-Personal/Equipment (State Board of Equalization Sales Tax Set-Up)	175
- Business Tax Outreach Reserve	150
- Animal Care and Services Fire Alarm and Security Upgrade	148
- SAP Center Renegotiation	20
- Sports Authority and Arena Authority	15
- Digital Arts Program (add 0.75 Senior Leader PT/delete 0.50 Recreation Leader PT)	0
- Vietnamese-American Community Center (eliminate 1.0 Executive Analyst)	0
- Police Department Overtime (\$17.0 million from Salaries and Benefits to overtime)	0
- Silicon Valley Regional Communications System - Infrastructure Payment	0
- Building Development Fee Program Reserve	(170)
- Air Service Incentive Program Reserve	(75)
- Transfers and Reimbursements (Water Utility Fund)	(66)
- Transfers and Reimbursements Convention and Cultural Affairs Fund)	(7)
Sub-total Required Technical/Rebalancing Actions	\$ 5,475
Grants/Reimbursements/Fee Activities (\$2.1 million in net-zero adjustments)	\$ 0
Urgent Fiscal/Program Needs	
- Human Resources Non-Personal/Equipment (Workers' Compensation Third Party Administrator)	540
- Housing (Legal Fees for Housing Authority Litigation)	360
- Hammer Theatre Center Upgrades	0
- City Manager's Office Talent Recruitment Initiative	250
- Economic Development Diridon Area Development Advisor	100
- City Attorney (E-Discovery and Public Records Act Software)	100
Sub-total Urgent Fiscal/Program Needs	\$ 1,350
Total Recommended Budget Adjustments	\$ 6,825
Remaining Balance After Recommended Adjustments	\$ 0

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Impacts on the 2016-2017 General Fund Budget

Following is a summary of the recommended actions. These adjustments are described in more detail in Section IV of this report.

Clean-Up Actions (\$577,000)

- **Development Fee Programs Reconciliation (-\$4.84 million)** – Consistent with the budget policy enacted many years ago, year-end reconciliations of the revenues and expenditures in the Development Fee Programs are conducted to determine if revenues exceeded or fell below costs. To meet the commitment to the development community that all development fees will be used solely to support development fee activities, any excess revenues and interest earnings above actual costs are placed in Development Fee Program Reserves. Based on 2015-2016 results, \$4.8 million is recommended to be added to the Development Program Fee Reserves (Building, Fire, Planning, and Public Works), preserving any net savings between revenues and expenditures in these programs.
- **Rebudgets/Clean-Up Adjustments (\$5.42 million)** – A series of adjustments are recommended to complete existing projects in 2016-2017 and to reflect any necessary technical budget adjustments or reconciliation actions. The Annual Report is the point in the budget process where action is required to rebudget unexpended funds from the prior year that were not anticipated when the Adopted Budget was approved, but are required to complete a project in the current year. Also recommended are actions that actually reduce previous rebudgets to reflect instances where expenditures, for which rebudgets were approved, actually occurred in 2015-2016, therefore, the funds are not available for rebudget to 2016-2017. Other technical adjustments include the reconciliation of restricted program funding (e.g. General Plan Update, 4th Street Garage Banquet Facility Maintenance and Operations, Public, Education, and Government Access activities) and the repayment of previous contributions for Leland Sports Fields to the Council District 10 Construction and Conveyance Tax Fund.

Recommended Budget Adjustments (-\$6.83 million)

A number of General Fund budget adjustments, with a total net cost of \$6.83 million are recommended and can be classified under three categories: 1) Required Technical/Rebalancing Actions (net cost of \$5.48 million) that align already approved expenditure budgets with the most current tracking information, comply with actions previously authorized by the City Council, or correct technical problems in the 2016-2017 Adopted Budget; 2) Grants/Reimbursement/Fee Activities that have a net-zero of \$2.1 million, recognizing new or adjusted grant, reimbursement, or fee activity revenue, and adjust the appropriations for these purposes; and 3) Urgent Fiscal/Program Needs (net cost of \$1.35 million) for needs the Administration has deemed cannot or should not wait until later in the year.

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Impacts on the 2016-2017 General Fund Budget

A summary of these adjustments include:

- **Required Technical/Rebalancing Actions (\$5.48 million)**
 - This action increases the *Pavement Maintenance Program* appropriation by \$3.3 million, from \$25.7 million to \$29.0 million, for street pavement and repairs. Per the Operating Budget and Capital Improvement Program Policy (Council Policy 1-18), any General Fund Ending Fund Balance identified in the City Manager's Annual Report, after accounting for actions to rebudget funds, correct errors, or reflected updated cost information, shall be allocated 50% towards unmet/deferred infrastructure and maintenance needs and 50% to offset any projected deficit. Because the projected deficit for 2017-2018 has already been addressed as part of the 2016-2017 Adopted Budget, this action will allocate the entire remaining General Fund Ending Fund Balance after rebudget and clean-up adjustments towards helping to address unmet/deferred pavement maintenance needs. (\$3.3 million)
 - This action increases the *Development Fee Program Technology Reserve* by \$798,000 (from \$295,000 to \$1.1 million) to include the Multiple Housing Occupancy Program's share of costs for the implementation of the Integrated Permit System (AMANDA) upgrade. The Development Fee Program Technology Reserve was established by contributions from the Development Services Partners (Building, Fire, Planning, and Public Works) and this action will payback those partners for the Multiple Housing Occupancy Program fair share portion of the system's costs that was funded by this reserve. This action is funded by 2015-2016 excess revenue and expenditure savings from the Multiple Housing Occupancy Program. (\$798,000)
 - This action increases the *Human Resources/Payroll/Budget Systems Upgrade* appropriation by \$566,000 consistent with recommendations included in the September 27, 2016 City Council memorandum on this project (Item 3.4). Of this amount, \$466,000 will be added to the project contingency, bringing the total contingency amount to \$1,883,740. The remaining \$100,000 of additional funding will cover an Agreement with CherryRoad Technology Inc. for Managed Services. This Agreement will provide the City with additional technical support once the systems have all been implemented. Transfers from various special and capital funds of \$136,000, and a reimbursement from the Development Fee Program of \$29,000, will provide partial funding for the additional project costs, resulting in a net General Fund impact of \$401,000. (\$566,000)
 - As previously directed by the City Council on June 21, 2016, this action establishes an *Urban Forestry Services Reserve* in the amount of \$200,000. This funding will potentially be used for additional work related to the cultivation of plants and young trees, planting and care for trees in neighborhoods, schools, and parks, and educating the community on urban forestry and environmental issues. A recommendation regarding the use of this reserve will be brought forward for City Council consideration in winter 2016 pending the

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Impacts on the 2016-2017 General Fund Budget

outcome of an audit regarding the expenditure of existing City funding and the compliance with terms of existing urban forestry grant agreements with the City. (\$200,000)

- This action increases the ***Elections and Ballot Measures*** appropriation by \$200,000 as a result of higher actual costs for the June 2016 General Election and increased cost estimates associated with the November 2016 General Election, including three ballot measures and run-off elections for Council Districts 2, 6, and 8. (\$200,000)
- This action increases the ***Banking Services*** appropriation by \$200,000 (from \$1,774,000 to \$1,974,000) to cover the rising merchant services fees paid by the City, as more customers have been paying City fees with credit cards. The increase in merchant fees is primarily a result of services newly covered by this appropriation, including utility payments. This is a result of the new Customer Information System (CIS) Infinity Utility system that was implemented in 2015-2016, enabling customers to pay online via credit card. Once this system became integrated with the City's cashiering system, the merchant fees from these payments began being charged directly to the Banking Services appropriation. (\$200,000)
- This action increases the ***Fire Department Non-Personal/Equipment*** appropriation by \$186,000 to purchase equipment and/or services to support the full implementation of the ***Electronic Patient Care Reporting (ePCR) Project***. The ePCR project will allow the Emergency Medical Services (EMS) providers in the County of Santa Clara to meet State-mandated EMS data reporting requirements, ensure quality assurance, and aggregate patient care reports. Each fire station will be equipped with various pieces of equipment and services (such as desktop computers, laptops, tablets, other remote data collection devices, required software, and connectivity). These pieces of equipment and services will be used by Firefighter/Paramedics and Fire Captains at the stations. Funding for this project was received at the end of 2015-2016 from the County of Santa Clara's allocation of the Emergency Medical Services (EMS) Trust Fund, but was not appropriated due to the late timing. The deadline for the City to complete the project is June 30, 2017. (\$186,000)
- This action increases the ***Finance Department Non-Personal/Equipment*** appropriation in the amount of \$175,000 to cover the costs of implementing the voter-approved increase to the City's sales tax rate. The State Board of Equalization (BOE) charges the City for its services in administering the local tax ordinance. With a newly approved sales tax rate, the BOE will charge the City a maximum amount of \$175,000 for the administrative costs associated with collecting the new sales tax, including the updating of returns and publications as well as the notification of taxpayers. (\$175,000)
- This action establishes a ***Business Tax Outreach Reserve*** in the amount of \$150,000 to fund a potential education outreach program regarding new Business Tax rates, if the voters approve a Business Tax Modernization Ballot Measure in November. On August 2, 2016,

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Impacts on the 2016-2017 General Fund Budget

the City Council directed the City Manager upon voter approval of the Business Tax Modernization Measure on the November 8 ballot, to develop an educational campaign for those affected by the Business Tax Modernization measure and to report to the Community and Economic Development (CED) Committee in December 2016 with education outreach implementation plan beginning in January 2017 for the July 1, 2017 effective date of the new tax rates. If the voters approve the Business Tax Modernization Measure, staff will present a report at the November 28 CED Committee that will include a recommended outreach plan with a report to the full Council on December 13. In order to commence a potential multi-lingual education outreach program in January 2017, it is necessary to set aside funds in a reserve for appropriation in December. (\$150,000)

- This action increases the *Animal Care and Services Fire and Security Upgrade* appropriation by \$148,000 (from \$100,000 to \$248,000) to address higher than anticipated project costs. The most recent quote for the construction phase of this project exceeded the engineering estimate, due primarily to material cost escalation and the current competitive nature of the construction industry. This project will upgrade the current fire alarm and security systems at the Animal Care and Services Shelter, which ensures that the fire alarm is heard throughout the facility. The project will also enhance the announcing devices so that the alarm is audible and visible throughout the entire facility, addressing health and safety needs. (\$148,000)
- This action establishes the *SAP Center Renegotiation* appropriation in the amount of \$20,000 to continue the renegotiation of the SAP Center operating agreement as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council. (\$20,000)
- This action increases the *Sports Authority* appropriation by \$10,400 (from \$698,200 to \$708,600) and the *Arena Authority* appropriation by \$4,300 (from \$189,900 to \$194,200) to provide funding for cost of living adjustments that were inadvertently omitted from the 2016-2017 Adopted Operating Budget. (\$14,700)
- This action adds 0.75 Senior Recreation Leader PT position and deletes 0.50 Recreation Leader PT position to provide appropriate staffing support for the expansion of the *Digital Arts* teen and youth program. The Digital Arts program was created to help at-risk youth discover non-violent forms of expression using music, film, photography, and art. This program is offered at Seven Trees, Mayfair, and Roosevelt Community Centers. There is sufficient funding in the San José Best and Safe Summer Initiative Programs appropriation to support this position change in 2016-2017. (\$0)

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Impacts on the 2016-2017 General Fund Budget

- This action eliminates 1.0 Executive Analyst (limit-dated through June 30, 2017) in the City Manager's Office focused on fundraising and community partnerships for the *Vietnamese-American Community Center*. The Executive Analyst position was added as part of the City Council's approval of the June 2016 Mayor's Budget Message for 2016-2017. The Administration has re-evaluated the program needs and determined that utilization of a City staff member to lead private fundraising efforts would not provide the most efficient and effective solution to achieve the program's fundraising goals. Donors often seek the tax benefits that can most readily be accessed through a 501c3 non-profit corporation, and as a result the Parks, Recreation and Neighborhood Services Department (PRNS) is working on the selection of an appropriate non-profit to successfully accomplish the private fundraising. (\$0)
- This action establishes the *Silicon Valley Regional Communications System - Infrastructure Payment* appropriation in the amount of \$1,961,440, offset by a corresponding decrease to the *Silicon Valley Regional Communications System (SVRCS) Reserve* to fully fund the second payment to the Silicon Valley Regional Interoperability Agency (SVRIA) for the City's share of the infrastructure costs related to the build out of the SVRCS. After this action, the remaining funds in the Reserve will fund the third payment and will fulfill the City's obligation. (\$0)
- This action increases *Police Department Overtime* funding in 2016-2017 by \$17.0 million (\$18.6 million to \$35.6 million). This funding will primarily be used to continue to backfill for vacant sworn and civilian positions and continue the expanded targeted enforcement efforts for high crime activity. This action reallocates \$17.0 million in anticipated 2016-2017 vacancy savings from the salary and benefits line items to the overtime line item in the Police Department Personal Services appropriation. (\$0)
- This action decreases the *Building Development Fee Program Reserve* by \$170,000 related to higher than budgeted personal services costs for the Building Inspector Combination classification. When the 2016-2017 Adopted Budget was developed, lower salary amounts were assumed for the flexibly staffed inspector positions, which understated costs for a number of these positions. This action correctly accounts for the actual salaries and associated overtime for Building Inspectors based on their classifications. (-\$170,000)
- This action eliminates the *Air Service Incentive Program Reserve* in the amount of \$500,000 and reduces the overhead reimbursement from the Airport Maintenance and Operation Fund to the General Fund by \$425,494. The municipally-funded Air Service Incentive Program, a provision in the Airline-Airport Lease and Operating Agreements that was approved by the City Council in March 2007, requires that, should the percentage growth in annual enplanements at the Airport exceed the growth in annual enplanements

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Impacts on the 2016-2017 General Fund Budget

nationwide, the City shall reduce the amount of its indirect overhead expenses in the following fiscal year by a corresponding percentage. In 2015-2016, the percentage growth in annual enplanements at the Airport was 6.8% which exceeded the FAA's projection of 4.2% for national enplanement growth. In order to comply with the provisions of the Agreements, the overhead reimbursement from the Airport Maintenance and Operation Fund will be reduced by 2.6% (from the Adopted Budget overhead rate of 17.57% to 15.00%), or \$425,494, in 2016-2017. In anticipation of this reduction, the 2016-2017 Adopted Budget included an Air Service Incentive Program Reserve of \$500,000 to offset the projected loss in revenue. Because the actual overhead reduction is slightly below the estimate incorporated into the 2016-2017 Adopted Budget, this action results in savings of \$74,506 to be returned to the General Fund. (-\$75,000)

- This action increases the *Transfers and Reimbursements* estimate by \$66,000 from the *Water Utility Fund* as a technical adjustment to bring the overhead costs into alignment with current year projected personal services costs. As approved by the City Council on June 14, 2016, the Amendments to the City Pay Plan for Various Classifications item included adjustments to various classifications that resulted in increased personal services costs for 2016-2017. (-\$66,000)
- This action increases the *Transfers and Reimbursements* estimate by \$7,209. Team San Jose collects \$1 for every ticket sold for a Broadway San José show and then remits these payments to the City for repayment of a past loan made to the American Musical Theater (AMT) in the amount of \$1 million. Receipts are collected in the *Convention and Cultural Affairs Fund* and then transferred to the General Fund, the originating funding source of the AMT loan. Ticket sale receipts in 2015-2016 exceeded the Modified Budget estimate of \$260,413 by \$7,209, for a total amount of receipts collected of \$267,622. (-\$7,209)
- **Grants/Reimbursements/Fees (\$0)**
 - A series of net-zero adjustments totaling \$2.1 million are recommended to reflect new or updated revenues and expenditures for *Grants, Reimbursements, and/or Fees* for the following Departments: Police (\$788,000), Parks, Recreation and Neighborhood Services (\$564,000), Office of Economic Development (\$250,000), Office of the City Clerk (\$245,000), Mayor and City Council (\$80,000), Fire (\$65,000), and Human Resources (\$7,000). These adjustments are described in *Section IV. Recommended Budget Adjustments and Clean-Up/Rebudget Actions*.

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Impacts on the 2016-2017 General Fund Budget

- **Urgent Fiscal/Program Needs (\$1.35 million)**

- This action increases the ***Human Resources Non-Personal/Equipment*** appropriation by \$540,000 to support a third-party administrator (TPA) for a portion of the ***Workers' Compensation Program*** for the period of January 1, 2017 through June 30, 2017. Currently, as part of an alternative service delivery pilot program, a TPA is handling approximately half of the City's workers' compensation claim administration cases as well as all City bill review, utilization review, and medical management, and provides for the use of a Medical Provider Network. As approved by the City Council on June 21, 2016, after three amendments, the current TPA agreement for these workers' compensation program services was extended for a fourth time, from July 1 through December 31, 2016, in order to provide sufficient time to prepare a new Request for Proposals (RFP) and to review and accept bids for these services through the standard procurement process. As planned, the RFP was initiated this fall and is in its final stages before award. Based on a preliminary estimate, additional funding will be needed to award a new contract for the second half of the year and additional ongoing funding for these services will also be required. The Human Resources Department will bring forward a recommendation to the City Council regarding the Workers' Compensation Program service delivery model, which will include a new TPA contract, by November 2016. This action ensures that funding for these workers' compensation services can be provided for the remainder of the year. (\$540,000)
- This action increases the ***Housing Department's Non-Personal/Equipment*** appropriation by \$360,000 to fund a reimbursement payment to the Housing Authority of the County of Santa Clara for ***Legal Fees*** associated with a ***Housing Authority Litigation*** for breach of contract claims against Housing and Urban Development (HUD), which resulted in a \$36 million judgment award to the City Housing Authority by the United States Court of Claims. Because of the various restrictions on the City's Housing funds, these litigation cost must be borne by the General Fund. Information on the authorized uses of the award to the City Housing Authority by the United States Court of Claims will be brought to the City Council by early winter 2017. (\$360,000)
- This action establishes the ***Hammer Theatre Center Upgrades*** appropriation in the amount of \$200,000 to fund repairs at this facility, offset by a corresponding reduction to the Cultural Facilities Capital Maintenance Reserve (from \$5,819,000 to \$5,619,000) for a net-zero impact on the General Fund. This funding will be used to modernize the elevator controls (\$125,000) and address repairs to the stage flooring (\$75,000). The single elevator, which services the facility, is at risk of failing and the control mechanisms are no longer available. In addition, the current stage floor has an uneven surface with protrusions and dips, creating possible trip hazards. (\$0)

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Impacts on the 2016-2017 General Fund Budget

- This action provides funding to support a *City Manager's Office Talent Recruitment Initiative* in the amount of \$250,000. Given the high level of position vacancies city-wide (as of September 14, 2016 there were 843 full time equivalent position vacancies, representing a vacancy level of 14%), this funding will be used to attract and rapidly onboard more people into City service. While recent improvements have been made to hiring cycle times, there has been an ongoing wave of retirements, continued attrition, and annual modest increases to the City's position count, which has caused the City to continue to experience a significant level of vacancies that necessitates a new recruitment approach. Professional services and contracts that directly support implementing an improved recruiting process, prototyping new recruiting methods, and analyzing the City's recruiting service delivery model are among the strategies that will be employed with this new funding. The outcome of this initiative is to 1) increase the number of people onboarded (volume); 2) reduce the time to recruit and fill positions (cycle time); and 3) increase the percentage of high performers entering City service (quality). (\$250,000)

- This action increases the *Economic Development Non-Personal/Equipment* appropriation in the amount of \$100,000 for consultant services to enable high-quality corporate development and financing associated with private development and intermodal transportation in the Diridon Area. The 2016-2017 Adopted Budget included one-time funding of \$140,000 for project management services to continue the coordination and development of the Diridon Station Area Plan (DSAP). Additionally, a grant award of \$600,000 was issued to the City from the California High Speed Rail Authority (CHSRA) for 2015-2016 and 2016-2017 to fund project management and consultant services to develop a financing strategy, governance structure, parking strategy, and process to select a master developer for the Diridon area. The work has begun and the process to select the master developer will begin in January 2017. The CHSRA, Valley Transportation Authority, and Caltrain are beginning rail planning and the consultant services are needed for the City to have an input in that planning to allow for future corporate development in the area. Given the time sensitive nature of this project, City funds of \$100,000 are recommended through this action to continue the DSAP work. (\$100,000)

This action increases the *City Attorney Non-Personal/Equipment* appropriation by \$100,000 for the acquisition of high-volume document processing, review, and production software that will enable the City Attorney's Office to respond to an increasing number of *E-Discovery and Public Records Act (PRA)* requests for litigation, in an accurate, timely, and legally defensible manner. Funding was provided in the 2015-2016 Adopted Budget for consultant services to ensure that the infrastructure development and legal framework for PRA requests were closely coordinated between the Information Technology Department and the Attorney's Office. As a result of the consultant's evaluation, it is recommended that the Attorney's Office procure software to aid in processing the high volume of documents to gain immediate improvements in the PRA process. (\$100,000)

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2015-2016 Selected Special/Capital Funds Budget Performance

Airport Operating Funds

The Airport served 10.21 million passengers in 2015-2016, which was an overall increase of 6.9% from 2014-2015. Moreover, the percentage growth in annual enplanements at the Airport in 2015-2016 was 6.8%, which exceeded the Federal Aviation Administration’s projection of 4.2% for national enplanement growth for 2015-2016. Additional airport activity categories that demonstrated growth as compared to last year include pounds of mail/freight/cargo, traffic operations, landed weights, parking exits, gallons of aviation fuel sold, and ground transportation. For 2016-2017, passenger growth is anticipated to increase by 2.25% over the 10.2 million passengers in 2015-2016.



Overall, revenue performance exceeded the budget by \$8.5 million (6.3%). Airline Rates and Charges (combined total of landing fees and terminal rents) and all other operating categories, excluding transfers, ended the year at \$143.5 million, which was \$8.5 million above the budget of \$135.0 million. The positive variance is mainly attributed to the Parking and Roadways revenue category, which was above the budgeted estimate by \$3.4 million (7.2%) due to higher revenues from parking and rental car concession fees associated with increased passenger activity.

The Airport Customer Facility and Transportation Fee Fund (Fund 519) and Airport Maintenance and Operating Fund (Fund 523) had a combined year-end expenditure savings of \$5.5 million (5.4%) compared to the budgeted levels of \$101.5 million. The \$2.3 million in personal services savings were the result of position vacancies experienced during the year. The non-personal/equipment expenditure savings of \$2.3 million resulted from adhering to strict cost controls, prioritizing needs, and deferring purchases. Savings were also realized from the

ANALYSIS

2015-2016 Selected Special/Capital Funds Budget Performance

transition to cashierless parking lot operations, from lower Letter of Credit fees for the Commercial Paper Program, and reduced costs from the new shuttle bus operator agreement.

These savings resulted in a lower than anticipated transfer from the Airport Revenue Fund to the Airport Maintenance and Operating Fund and higher year-end fund balance in the Airport Revenue Fund. The additional fund balance in the Airport Revenue Fund will contribute towards the development of the 2017-2018 budget.

Water Utility Operating Fund

Overall, revenues totaled \$36.9 million and were \$3.2 million (8.1%) below the modified budget, but \$23,000 (0.1%) above the prior year level of \$36.8 million. Notably, the revenue level was also \$1.7 million below the estimate used in the development of the 2016-2017 Adopted Budget. This negative variance to the estimate was due primarily to three factors: 1) an increase to the reserve for bad debt by approximately \$479,000 was necessary at fiscal year-end, due to an increase in levels of uncollected revenues; 2) an overall 5% decrease in potable water consumption for March through June compared to 2014-2015, with an uptick occurring in the last month, providing for some of the additional revenue from those water sales to be realized in 2016-2017; and 3) a multi-year potable water billing discrepancy, affecting a single customer and discovered as part of the billing system implementation, providing for an approximately \$300,000 higher than estimated reimbursement.

Expenditures totaled \$41.0 million and were \$4.7 million (10.2%) below the modified budget, but \$5.6 million (15.9%) above the prior year level of \$35.4 million. The negative variance to the budget was due primarily to lower non-personal/equipment expenditures in ESD (\$4.4 million), which was largely a result of lower than budgeted potable water purchases due to higher than anticipated water conservation; however, compared to the estimate used to develop the 2016-2017 Adopted Budget, the non-personal/equipment expenditure variance was only \$295,000. Expenditures were above the prior year due primarily to an increased transfer to the Water Utility Capital Fund and higher non-personal/equipment and personal services expenditures in ESD. The lower revenues in this fund resulted in an ending fund balance shortfall of \$1.4 million that is recommended to be addressed through adjustments that are described later in section IV of this report.

ANALYSIS

2015-2016 Selected Special/Capital Funds Budget Performance

Capital Fund Major Revenues

A number of taxes and fees levied on construction and property resale (conveyance) activity provide a large source of revenue to the City’s Capital program. The 2015-2016 actual collections in all major capital revenue categories, except Residential Construction Tax, ended the year above budgeted estimates. The chart below provides a comparison of estimated revenues to actual revenues for these types of revenues, and a discussion of the three largest revenue sources follows.

**Construction-Related Capital Program Revenues Comparison
 (\$ in Thousands)**

	2015-2016 Estimate*	2015-2016 Actuals	% Variance
Construction and Conveyance Tax	\$38,000	\$42,699	12.4%
Building and Structure Construction Tax	\$14,000	\$19,390	38.5%
Construction Excise Tax	\$18,500	\$22,466	21.4%
Municipal Water System Fees	\$100	\$103	3.0%
Residential Construction Tax	\$200	\$190	(5.0%)
Sanitary Sewer Connection Fee	\$700	\$989	41.3%
Storm Drainage Connection Fee	\$200	\$265	32.5%

* Revenue estimate used in the development of the 2016-2017 Adopted Capital Budget.

• **Construction and Conveyance Tax**

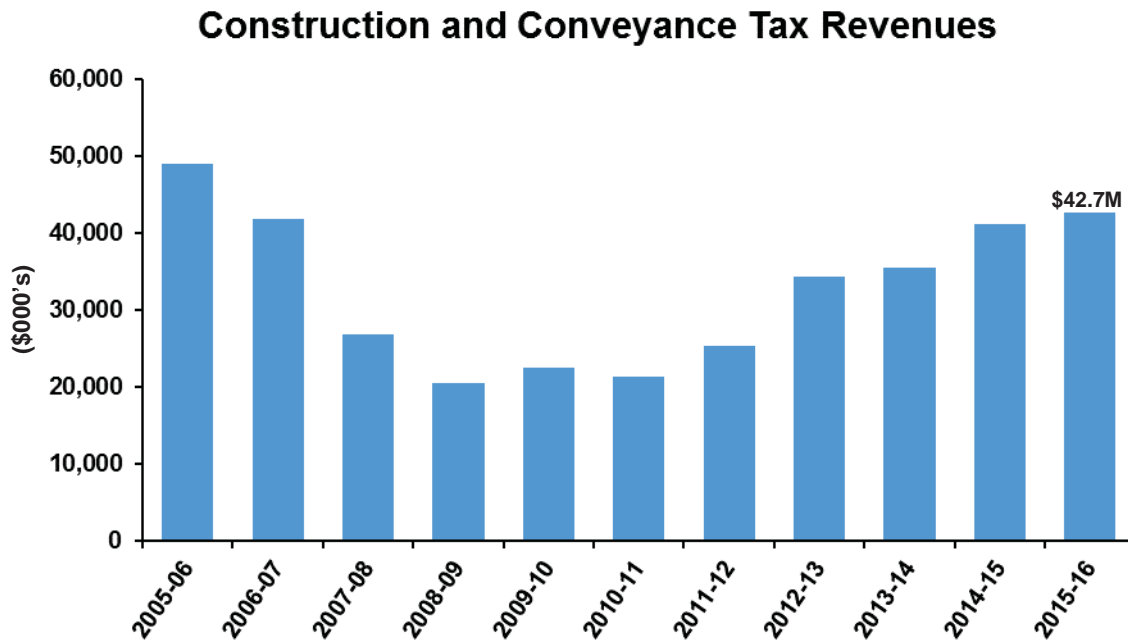
Real estate activity (primarily housing re-sales) determines the collection level of one of the major capital revenue sources, the Construction & Conveyance (C&C) Tax. Approximately 96% of C&C Tax is derived from a tax imposed upon each transfer of real property, with the remaining 4% generated from a construction tax levied on most types of construction. C&C Tax revenues, which are a significant source of funds for the Parks and Community Facilities Development, Library, Fire, Service Yards, and Communications capital programs, totaled \$42.7 million in 2015-2016. This collection level was \$1.5 million (3.6%) above 2014-2015 collections of \$41.2 million, \$7.7 million (22.0%) above the 2015-2016 Modified Budget estimate of \$35.0 million, and \$4.7 million (12.4%) above the estimate of \$38.0 million that was assumed in the development of the 2016-2017 Adopted Capital Budget.

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2015-2016 Selected Special/Capital Funds Budget Performance

Capital Fund Major Revenues

The following graph displays the collection history of Construction and Conveyance (C&C) Tax receipts.



The 2015-2016 tax receipts represent the highest collection level since the peak year 2005-2006 when annual collections peaked at \$49.0 million as a result of the recovering real estate market. Changes in home prices and the number of sales are major drivers of C&C Tax receipts. The median home price for single family homes within the City increased from \$865,000 in June 2015 to \$920,000 in June 2016, which represents a 6.4% increase. In addition, the number of home sales (single-family and multi-dwelling units) have increased over the past year, compared to 2014-2015 activity levels. The number of sales in 2015-2016 totaled 8,223, which represents a 2.9% increase from the 2014-2015 level of 7,992. Finally, the amount of time it takes to sell a home (single-family and multi-family dwelling units) has slightly decreased in the past year from an average 27 days in 2014-2015 to 24 days in 2015-2016, a 11.1% decrease.

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2015-2016 Selected Special/Capital Funds Budget Performance

Capital Fund Major Revenues

The 2015-2016 Adopted Capital Budget was developed with the assumption that C&C Tax receipts would total \$35.0 million in 2014-2015 and remain steady in 2015-2016. In the last quarter of 2014-2015, however, tax receipts had an extremely strong performance, which resulted in 2014-2015 receipts totaling \$41.2 million. Due to the unanticipated high collections in 2014-2015, the 2015-2016 C&C Tax Adopted Budget estimate of \$35.0 million, resulted in a 15.1% decline in tax revenue from the 2014-2015 actual tax collection. In development of the 2016-2017 Adopted Capital Budget, therefore, the 2015-2016 C&C Tax estimate was increased to \$38.0 million in response to the strong collection levels, however, actual collections did exceed the revised estimate. The 2015-2016 collection level of \$42.7 million exceeded the 2015-2016 Modified Budget by \$7.7 million and the 2015-2016 estimate by \$4.7 million. Due to the unanticipated high collections in 2015-2016, the 2016-2017 C&C Tax estimate of \$36.0 million, allows for a 15.7% decline in tax revenue from the 2015-2016 actual tax collection. Receipts in 2016-2017 will be closely monitored, and an upward adjustment to the estimated revenue may be recommended at a later date, with corresponding adjustments to fund balances as appropriate. It is important to note that tax receipts in this category have been volatile in the past with large surges in collections based on economic conditions.

- **Building and Structure Construction Tax and the Construction Excise Tax**

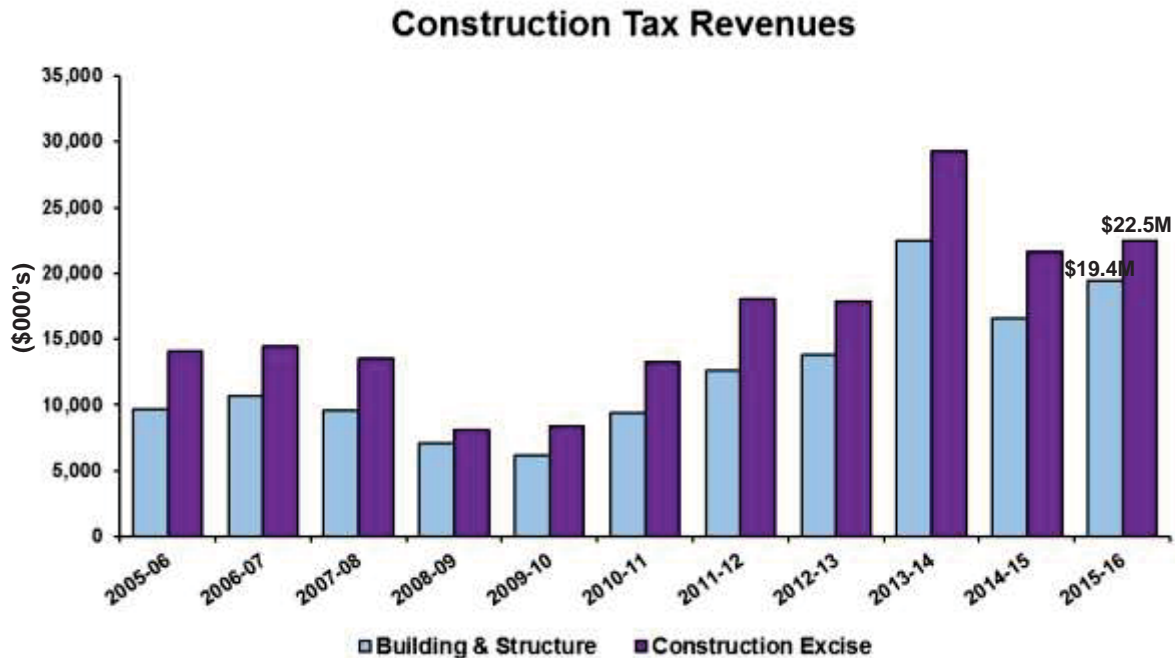
The Building and Structure Construction Tax and the Construction Excise Tax are major sources of funding for the Traffic Capital Program. Year-end collections in the Building and Structure Construction Tax category totaled \$19.4 million in 2015-2016. This collection level was 38.6% (\$5.4 million) above the revenue estimate of \$14.0 million used to develop the 2016-2017 Adopted Capital Budget, and represents a 16.9% (\$2.8 million) increase from 2014-2015 collections of \$16.6 million. Construction Excise Tax receipts for 2015-2016 totaled \$22.5 million, 21.6% (\$4.0 million) above the revenue estimate of \$18.5 million used to develop the 2016-2017 Adopted Capital Budget, and represents a 3.7% (\$795,000) increase from 2014-2015 collections of \$21.7 million.

The graph on the following page displays the collection history of both the Building and Structure and Construction Excise Tax receipts. While down from 2013-2014's historically high level, revenue growth has continued its upward trend from the low in 2009-2010.

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2015-2016 Selected Special/Capital Funds Budget Performance

Capital Fund Major Revenues



When the 2016-2017 Adopted Capital Budget was developed, it was assumed that Building and Structure Construction Tax receipts would total \$14.0 million in 2015-2016 and drop approximately 7% to \$13.0 million in 2016-2017 and Construction Excise Tax receipts would total \$18.5 million in 2015-2016 and drop 9% to \$17.0 million in 2016-2017 as projects are completed and activity levels slightly decrease. However, since actual collections were higher in 2015-2016, tax receipts for Building and Structure Construction Tax can now drop 33% and Construction Excise Tax can now drop 24% in 2016-2017. An upward adjustment to the 2016-2017 revenue estimate may likely be warranted later in the year after several months of current year actual experience is analyzed.

Special and Capital Funds Budget Adjustments

Several budget adjustments for both special and capital funds are included in this report, including recognition of grants, net-zero transfers/reallocations, new allocations for a small number of high priority projects and programs, and required fund rebalancing activity.

In the Water Utility Operating Fund, several budget actions are recommended in this report in order to address the ending fund balance shortfall which resulted from lower revenue collections, adjust for estimated 2016-2017 performance, and account for staff compensation adjustments and additional 1.0% rate increase (from 2.0% to 3.0%) approved in June 2016. Some notable actions include: an increase of \$300,000 to adjust the personal services allocation to include a reclassification of several water operator job specifications approved in June 2016, a net revenue

ANALYSIS

2015-2016 Selected Special/Capital Funds Budget Performance

Special and Capital Funds Budget Adjustments

decrease of \$1.1 million for potable water sales, a decrease to expenditures of \$1.1 million to reflect reduced amount of wholesale water purchases, and a decrease to the Transfer to the Water Utility Capital Fund (\$474,000). Additionally, a decrease to the Rate Stabilization Reserve (\$900,000) is recommended as a temporary funding source until staff returns to City Council with additional recommendations relating to water rates, including information regarding water conservation and its effects on changes in water usage, as well as wholesale water supply availability, which is currently anticipated for fall 2016.

In the Municipal Improvements Capital Program, year-end savings in the operating subsidy paid by the Convention and Cultural Affairs Fund to Team San Jose to operate the Convention Center and other cultural facilities allowed for additional resources to address urgent deferred maintenance needs or drive additional revenue-generating activity. Notable investments include: the replacement of several forklifts and floor scrubbers that have outlived their useful lives (\$275,000); the replacement of the Center for the Performing Arts marquee whose components are no longer available (\$255,000); funding to supplement an initial investment of \$400,000 of Theater Preservation for the activation of the Civic Auditorium courtyard into saleable space that will also generate additional food and beverage revenue (\$250,000); and abatement of asbestos encountered while replacing windows at the Civic Auditorium (\$200,000).

Included in this report are several recommended adjustments in the Parks and Community Facilities Development Capital Program. The recommended adjustments include, but are not limited to, funding to support the completion of the Happy Hollow Park and Zoo Alligator Exhibit (\$200,000), additional funding for the TRAIL: Coyote Creek Fish Passage Remediation and Pedestrian Bridge project (\$200,000) to complete design documents for a future bridge span and creek restoration work at the Singleton Crossing along Coyote Creek, and reallocation of funds to establish the Watson Park Taylor Street Access Study Reserve as a result of the study for the new entrance to Watson Park being on hold.

In the Traffic Capital Program, recommended adjustments include funding set aside in a Developer Permitting Fees Refund Reserve (\$3.0 million) to refund developers in the event that construction taxes collected are erroneously assessed an incorrect tax rate, funding to reimburse CalTrans (\$771,000) for grant reimbursements received by the City for ineligible expenditures on projects, additional funding for the Regional Rail Planning appropriation (\$725,000) to fund temporary staffing for transportation planning, engineering, and coordination with other departments and agencies related to regional rail systems, and recognition of new funding (\$270,000) from the High Speed Rail Authority to reimburse the City for staff costs associated with the development of high speed rail throughout the City.

Finally, the rebudget of unexpended funds for projects and programs extending into 2016-2017 is recommended in this report. Details of these adjustments can be found in Section IV of this report.

NEXT STEPS

The results of the 2015-2016 Annual Report will provide an updated starting point for monitoring 2016-2017 financial performance. The revenue and expenditure trends will be factored into the analysis of the General Fund and the numerous special and capital funds. Information on the City's budget for 2016-2017 will be provided in Bi-Monthly Financial Reports and the 2016-2017 Mid-Year Budget Review. These reports will also provide information on the current economic environment and its impact on the City's revenue collections.

The 2015-2016 Annual Report results will also be factored into the 2017-2018 budget development process. The General Fund Five-Year Forecast is scheduled to be released in late February 2017. The 2017-2018 Proposed Capital and Operating Budgets are scheduled to be released on April 24, 2017 and May 1, 2017, respectively.

PUBLIC OUTREACH/INTEREST

This document is posted on the City's website for the October 18, 2016, City Council agenda.

COORDINATION

The City Manager's Budget Office coordinated with the Finance Department on the reconciliation of the City's funds and coordinated with all City Departments and City Council appointees, as applicable, on recommended budget adjustments that are brought forward in this document.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

CONCLUSION

Through careful fiscal management, overall revenues for the various City funds ended the year close to estimated levels and expenditures were below budgeted allocations. When the 2015-2016 Adopted Budget was developed, it was assumed that economic growth would continue in 2015-2016. Economic indicators and actual revenue performance supported this general assumption, with a number of revenue categories, such as Property Tax, Sales Tax, Transient Occupancy Tax, and Construction and Conveyance Tax, experiencing strong growth. Those revenue categories associated with private development and construction projects, such as development-related fees and taxes, also continued to experience solid performance in 2015-2016.

In the General Fund, the additional fund balance at the end of 2015-2016 after considering clean-up adjustments totaled \$6.83 million. Recommendations are included in this report to allocate those funds to various required technical and rebalancing actions (\$5.48 million) and to address

CONCLUSION

urgent fiscal/program needs (\$1.35 million). The largest actions include the increase to the Pavement Maintenance Program by \$3.3 million for street pavement and repairs in accordance with the Operating Budget and Capital Improvement Program Policy (Council Policy 1-18) that directs the allocation of remaining fund balance – after accounting for all necessary appropriation adjustments – to unmet/deferred infrastructure, an increase of \$798,000 to the Development Fee Program Technology Reserve to include the Multiple Housing Occupancy Program’s share of costs for the implementation of the Integrated Permit System (AMANDA), an increase of \$566,000 (partially offset by \$165,000 in contributions from other funds and the development fee programs) to the Human Resources/Payroll/Budget Systems Upgrades appropriation to facilitate the project’s completion as approved by the City Council on September 27, 2016, and \$540,000 in the Human Resources Department to extend the support of a third party administrator for a portion of the Workers’ Compensation Program through the end of the fiscal year. In addition, \$2.1 million in net-zero adjustments to various grants, reimbursements, and fee activities are included.

The Administration will continue to monitor and report on the City’s budget performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2015-2016, as well as the actual performance in 2016-2017, will be factored into the development of the 2017-2018 budget. The 2018-2022 General Fund Five-Year Forecast will be released in February 2017 for budget planning purposes.



Norberto Dueñas
City Manager

CERTIFICATION OF FUNDS

I hereby certify that there will be available for appropriation in the designated funds and in the amounts as listed below in fiscal year 2016-2017 monies in excess of those heretofore appropriated therefrom:

General Fund	\$14,549,306
Airport Fiscal Agent Fund	\$362,149
Airport Passenger Facility Charge Fund	\$314,522
Airport Renewal and Replacement Fund	\$1,134,804
Airport Revenue Bond Improvement Fund	\$3,366,779
Airport Revenue Fund	\$13,601,008
Benefit Fund	\$2,316
Building and Structure Construction Tax Fund	\$8,820,859
Business Improvement District Fund	\$303,363
City Hall Debt Service Fund	\$116,190
Community Development Block Grant Fund	\$1,117,697
Community Facilities Revenue Fund	\$3,392,205
Community Facilities District Fund #1	\$38,993
Community Facilities District Fund #2 and #3	\$9,528
Community Facilities District Fund #11	\$16,381
Community Facilities District Fund #12	\$86,292
Community Facilities District Fund #13	\$12,341
Community Facilities District Fund #14	\$88,749
Community Facilities District Fund #15	\$92,864
Construction and Conveyance Tax – Central Fund	\$947,132
Construction and Conveyance Tax – Communications	\$306,927
Construction and Conveyance Tax – Fire	\$1,019,342
Construction and Conveyance Tax – Library	\$669,675
Construction and Conveyance Tax – Council District 1	\$485,204
Construction and Conveyance Tax – Council District 2	\$292,764
Construction and Conveyance Tax – Council District 3	\$314,385
Construction and Conveyance Tax – Council District 4	\$345,189
Construction and Conveyance Tax – Council District 5	\$605,348
Construction and Conveyance Tax – Council District 6	\$428,609
Construction and Conveyance Tax – Council District 8	\$400,788
Construction and Conveyance Tax – Council District 9	\$614,455
Construction and Conveyance Tax – Council District 10	\$486,265
Construction and Conveyance Tax – City-Wide	\$927,302
Construction and Conveyance Tax – Parks Yards	\$135,596
Construction and Conveyance Tax – Service Yards	\$609,435
Construction Excise Tax Fund	\$29,541,956

CERTIFICATION OF FUNDS

Contingent Lien District Fund	\$60,853
Convention and Cultural Affairs Fund	\$3,502,312
Convention Center Facilities District Project Fund	\$677,927
Dental Insurance Fund	\$4,568
Federal Drug Forfeiture Fund	\$72,384
General Purpose Parking Fund	\$3,948,492
Gift Trust Fund	\$276,112
Housing Trust Fund	\$500,979
Ice Centre Revenue Fund	\$1,075,142
Improvement District Fund	\$1,198,868
Integrated Waste Management Fund	\$1,967,800
Low and Moderate Income Housing Asset Fund	\$2,143,827
Maintenance District Fund #1	\$35,108
Maintenance District Fund #5	\$55,096
Maintenance District Fund #8	\$20,212
Maintenance District Fund #11	\$39,323
Maintenance District Fund #15	\$198,244
Maintenance District Fund #18	\$66,357
Maintenance District Fund #19	\$19,634
Maintenance District Fund #20	\$9,621
Maintenance District Fund #22	\$13,388
Major Collectors and Arterials Fund	\$349,534
Major Facilities Fund	\$489,746
Municipal Golf Course Fund	\$155,387
Neighborhood Security Bond	\$285,568
Parks and Recreation Bond Projects Fund	\$11,859,129
Residential Construction Tax Contribution Fund	\$221,618
San José Arena Capital Reserve Fund	\$1,073,115
Sanitary Sewer Connection Fee Fund	\$1,426,284
Sewer Service and Use Charge Fund	\$1,004,640
Sewer Service and Use Charge Capital Improvement Fund	\$9,393,242
San Jose-Santa Clara Treatment Plant Capital Fund	\$3,750,645
San Jose-Santa Clara Treatment Plant Operating Fund	\$3,314,993
San Jose-Santa Clara Treatment Plant Income Fund	\$89,049
Sewage Treatment Plant Connection Fee Fund	\$686,558
State Drug Forfeiture Fund	\$23,572
Storm Drainage Fee	\$163,016
Storm Sewer Capital Fund	\$3,052,685
Storm Sewer Operating Fund	\$486,913
Supplemental Law Enforcement Services Fund	\$1,161,751
Transient Occupancy Tax Fund	\$3,807,301
Underground Utility Fund	\$624,941

CERTIFICATION OF FUNDS

Unemployment Insurance Fund	\$102,643
Vehicle Maintenance and Operations Fund	\$186,950
Water Utility Capital Fund	\$529,413
Workforce Development Fund	\$4,207,052



Jennifer A. Maguire
Senior Deputy City Manager/
Budget Director