

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Norberto Dueñas

**SUBJECT: 2015-2016 CITY MANAGER'S
BUDGET REQUEST AND
2016-2020 FIVE-YEAR FORECAST**

DATE: February 27, 2015

INFORMATION

EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council's Adopted Budget process, this document provides both the recommended 2015-2016 City Manager's Budget Request (2015-2016 Budget Balancing Strategy Guidelines) and the 2016-2020 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. Major highlights of this report follow.

As shown in the chart below, a relatively small General Fund surplus of \$8.6 million is projected for 2015-2016. This projection is derived by comparing the estimated revenues with the cost of delivering City Council-approved existing services as well as the services for which the City has already committed, such as the operation of new facilities or other capital projects scheduled to come on-line next year. In the remaining years of the Forecast, a small General Fund shortfall and small surpluses are projected, ranging from -\$1.4 million to \$5.8 million annually. These margins are extremely narrow when put into context of the size of the projected General Fund budget, ranging from -0.1% to 0.5% of the projected annual budget (revenues and expenditures). Over the five-year period, a total surplus of \$18.5 million is anticipated, which equates to approximately \$3.7 million annually. This average surplus figure equates to only 0.2% of the projected General Fund annual budget.

**2016-2020 General Fund Forecast
Incremental General Fund Surplus/(Shortfall)**

2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
\$8.6 M	\$5.2 M	\$0.3 M	(\$1.4 M)	\$5.8 M

- This Forecast reflects the Administration's best estimates on the projected revenues and expenditures over the next five years based on the information currently available. It does not, however, incorporate several elements that would impact the General Fund over the Forecast period, including: 1) impacts associated with the implementation of the remaining elements of the Fiscal Reform Plan (e.g., cost savings and/or additional revenues); 2) costs associated with fully funding the annual required contributions for retiree healthcare; 3) costs associated with services that were funded on a one-time basis in 2014-2015; 4) costs associated with the restoration of key services (police, fire, libraries, community centers, and

street maintenance) to January 1, 2011 levels; 5) costs associated with a Police Staffing Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions); 6) costs associated with unmet/deferred infrastructure and maintenance needs; and 7) one-time revenue sources or expenditure needs. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

- Consistent with the last three forecasts, the City's budget is expected to remain in a fairly stable position over the forecast period. Revenues and expenditures are in close alignment in each year, reflecting the difficult budget actions implemented in prior years to address the General Fund structural budget deficit. While the City's budget has stabilized, we continue to run a "service deficit" and there is little room to address the major gaps in services that impact our community, from public safety to parks, libraries, and community services. There are also significant unmet deferred infrastructure and maintenance needs that will have a long-term impact on the City.
- The chart on page 3 compares the 2015-2016 Forecast to the 2014-2015 Adopted Budget. The carry-over from the 2014-2015 Adopted Budget of \$1.8 million is the first element and represents the ongoing funding made available as part of the 2014-2015 Adopted Budget that was allocated to one-time needs, resulting in the carryover of ongoing resource capacity to the following year. The next major comparison element is the change in revenue sources year-over-year. Ongoing revenues are projected to increase by \$37.5 million, driven primarily by increases in the Property Tax, Sales Tax, and Licenses and Permits (Medical Marijuana Regulatory Program) revenue estimates. When comparing expenditures (the third element), base costs are expected to increase by \$30.7 million from 2014-2015 ongoing budget levels, with the largest increase in employee compensation.

**2015-2016 General Fund Forecast
Reconciliation from 2014-2015 Adopted Budget**

2015-2016 General Fund Forecast Components (Ongoing)	\$ in Millions
Carry-Over from 2014-2015 Adopted Budget	\$ 1.80
Major Revenue Changes	
- Property Tax	19.24
- Sales Tax	9.17
- Licenses and Permits	2.65
- Transient Occupancy Tax	2.23
- 2015-2016 Beginning Fund Balance	1.87
- Reimbursement for Services (Gas Tax)	1.85
- Utility Taxes/Franchise Fees	1.09
- Overhead Reimbursements	(1.81)
- Other Revenue Net Changes	1.22
Total Revenue Changes (Increase)	\$ 37.51
Major Expenditure Changes	
- SJPOA Pay Increase/Employee Compensation Planning Reserve (includes associated retirement costs)	18.70
- Police Department Staffing Reserve (Tier 2 retirement savings)	3.53
- Non-Management Step/Management Pay-For-Performance (includes associated retirement costs)	2.91
- Transfers to Other Funds (Hayes Mansion, Muni Golf Course, City Hall Debt Service)	2.18
- Cultural Facilities Capital Maintenance Reserve (TOT Growth)	2.10
- Recycle Plus Environmental Services Late Fee Implementation Reserve	1.80
- Energy Services Company (ESCO) Debt Service Less Expenditure Savings	1.13
- Retirement Costs (Federated +\$3.6M, Police & Fire -\$3.0M)	0.88
- Committed Additions (e.g., Southeast Branch Library, Parks, Traffic Infrastructure)	0.53
- Healthcare/Dental Costs	(3.18)
- Other Expenditure Net Changes	0.13
Total Expenditure Changes (Increase)	\$ 30.71
2015-2016 Projected General Fund Surplus	\$ 8.60

- While retirement costs (pension and retiree healthcare) remain a major cost driver in this Forecast, growth of these costs have begun to level off. For 2015-2016, retirement costs are projected at \$243.9 million in the General Fund (\$318.8 million all funds), representing a total increase of \$9.3 million, or 4.0%, from the 2014-2015 Modified Budget level of \$234.6 million. This increase includes base budget net adjustments (\$0.9 million) and those increases associated with 1) a negotiated pay increase for employees represented by the San Jose Police Officers’ Association (SJPOA), 2) the establishment of an Employee Compensation Planning Reserve, 3) non-management step and management pay-for-performance increases, and 4) committed additions. During the forecast period, General Fund retirement contributions are projected to increase by approximately \$6 million, or 2.5%, from \$243.9 million in 2015-2016 (25.8% of the General Fund) to \$249.9 million in 2019-2020 (23.8% of the General Fund). During the same period, the City retirement contributions for all funds will increase by \$10 million, or 3.2%, from \$318.8 million in 2015-2016 to \$328.8 million in 2019-2020. The budgetary City retirement contribution rates to cover Tier 1 members in the Federated Retirement System and Police and Fire Department Retirement Plan are used to generate the majority of the required retirement payments. For Tier 1 members in the Federated

Retirement System, the budgetary City retirement contribution rate increases from 73.8% in 2015-2016 to 85.4% in 2019-2020; for Police Tier 1 members in the Police and Fire Department Retirement Plan, the budgetary City retirement contribution rate decreases from 81.2% in 2015-2016 to 80.2% in 2019-2020; and for Fire Tier 1 members in the Police and Fire Department Retirement Plan, the budgetary City retirement contribution rate decreases from 82.7% in 2015-2016 to 81.5% in 2019-2020.

- As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. Various cost elements can also vary from year to year. As seen in recent years, retirement costs have been fluctuating and will likely continue to experience upward or downward swings based on actual performance of the retirement funds and changes in actuarial economic and demographic assumptions as approved by the Federated and Police and Fire Department Retirement Boards. Consistent with past practice, as part of the preparation for the 2015-2016 Proposed and Adopted Budgets, the Administration will continue to update the City Council on both the revenue and expenditure estimates as new information becomes available.
- As is customary in the Forecast, two alternative forecasts have been developed to model the range of financial scenarios possible under varying economic conditions. "Optimistic" and "Pessimistic" Cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". In 2015-2016, the Optimistic Case results in a projected surplus of \$15.8 million, while the Pessimistic Case results in a shortfall of \$608,000.
- In approaching the 2015-2016 budget, the Administration proposes the use of the budget balancing strategy guidelines outlined in this memorandum (2015-2016 City Manager's Budget Request). The Service Restoration Decision Making Framework, the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City of San José Budget Principles combined with City Council priorities identified in prior policy sessions will also guide the City's budget development efforts. The Administration recommends City Council approval of the proposed 2015-2016 City Manager's Budget Request, with any desired revisions, as part of the Mayor's March Budget Message review and approval process.
- Looking forward, the Administration's goal is to build capacity to meet the City's basic service delivery needs, maintain competitiveness as an employer, and address the significant backlog of unmet/deferred infrastructure and maintenance needs.
- Projections for the selected Capital Improvement Program (CIP) revenues are also included in this document. These revenues total \$325.6 million over the five-year period and are down 8% from the \$354.2 million included in the 2015-2019 Adopted CIP. The projected collections for the Construction and Conveyance (C&C) Tax receipts over the five-year period are down 10% from the prior forecast as a result of the drop in the number of property transfers, reflecting the low level of inventory. Decreases to the Building and Structure Construction Tax (6% decrease) and the Construction Excise Tax (5% decrease) are included

in this Forecast to reflect the anticipated lower level of development activity as projects are completed over the next several years across residential, commercial and industrial sectors.

BACKGROUND

In compliance with City Charter Section 1204 and the City Council's Adopted Budget process, this document provides both the recommended 2015-2016 City Manager's Budget Request and the 2016-2020 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process and critical steps in developing the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP).

The City Manager's Budget Request includes budget balancing strategy guidelines that the Administration recommends be used in developing the 2015-2016 Proposed Budget. These guidelines are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's anticipated fiscal status for 2015-2016 is an integral part of the Administration's proposed approach to preparing the 2015-2016 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2015-2016, and the subsequent four years, is provided as part of this document.

ANALYSIS

This section includes the following: a discussion of the 2015-2016 City Manager's Budget Request; an overview of the 2016-2020 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program; and a description of the next steps in the 2015-2016 budget process.

2015-2016 CITY MANAGER'S BUDGET REQUEST

The City Manager's Budget Request includes a set of general budget balancing strategy guidelines recommended to be used in the development of the 2015-2016 Proposed Budget. These proposed guidelines have been formulated in the context of projections for small General Fund surpluses and a deficit over the Forecast period. The over-arching goals of these guidelines are to continue operational and fiscal stability, to deliver services to our community in a cost-effective manner, and to provide for modest pay increases for our employees. This includes keeping General Fund revenues and expenditures in balance while maintaining, and in some limited cases, expanding service levels in high priority areas that have been impacted by the budget balancing actions required in recent years. These guidelines will be used with the Service Restoration Decision Making Framework, the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City Council-approved City of San José Budget Principles that have been previously presented to the City Council and are attached as an appendix to this document.

In accordance with the City Charter, the City is required to adopt a balanced budget each year, allocating any projected surplus or addressing any projected shortfall. In 2015-2016, a General

Fund surplus of \$8.6 million is projected, representing only 0.5% of the General Fund annual budget (revenues and expenditures). In the out years of the Forecast, small General Fund surpluses and a shortfall range from -\$1.4 million to \$5.8 million annually. These surplus and shortfall amounts are very small when put into context of the size of the projected General Fund budget, ranging from -0.1% to 0.5% of the projected annual budget. With the small projected surplus, the Administration has the opportunity to bring forward a budget that makes some limited progress in addressing the significant service needs in our community. In order to create additional capacity to add resources in critical areas, the organization will continue to pursue additional revenues, more efficient and cost-effective ways to provide City services, potential restructuring opportunities, and reductions that do not impact direct service delivery.

Although overall service levels are clearly not at adequate levels for the San José community, the Administration continues to recommend aligning new ongoing service commitments with ongoing funds to support those additions, to the extent possible. Currently, there is a 2015-2016 Future Deficit Reserve that totals \$2.4 million. The Administration recommends that the one-time funding contained in the 2015-2016 Future Deficit Reserve, as well as any additional one-time funds that become available during the budget development process, be strategically invested to address one-time needs, such as addressing a portion of the City's unmet/deferred infrastructure and maintenance needs.

Because of the difficult decisions that have been made over the last few years and an improving economy, revenues and expenditures continue to be in close alignment in this Forecast, with annual variances of less than 0.5% of the budget (revenues and expenditures). Challenges remain, however, in addressing other funding needs that are not included in the Forecast. When evaluating the annual General Fund shortfalls or surplus projected in this Forecast, it is important to keep in mind that these figures do not include the following:

- Various cost reduction and revenue strategies identified in the City Council-approved Fiscal Reform Plan, which are not yet implemented. This Plan outlined cost reduction and revenue strategies to eliminate the General Fund structural deficit, restore selected services to January 1, 2011 levels, and open facilities that had been recently completed or were under construction.
- The costs associated with fully funding retiree healthcare. This Forecast reflects the limits included in negotiated Memoranda of Agreements (MOAs) with bargaining groups in the Police and Fire Department Retirement Plan. For Police and Fire members, the current percentage contribution limit of 11% is assumed in this forecast. For the Federated Retirement System, the extension of the phase-in to fully fund these costs is assumed. In 2009, the City and bargaining units contributing to the Federated Retirement System reached an agreement to begin a five-year phase-in to fully fund the annual required contribution for retiree healthcare benefits. The last year of the phase-in was originally scheduled for 2012-2013. Extensions of the phase-in for members in the Federated Retirement System were approved by the City Council and are currently set to expire in June 2015. Negotiations between the City and nine Federated Retirement System bargaining units are ongoing regarding potential changes to future retiree healthcare benefits. This Forecast assumes the continuation of the phase-in with previously approved cap increases (0.75% for Tier 1 and Tier 2A/1.5% for Tier 2B and Tier 2C) each year subject to negotiations with the Federated bargaining units, to allow time for ongoing negotiations until an outcome is known. Should

an outcome be determined that would require additional funds in 2015-2016 beyond the capped amount assumed in this Forecast, existing Retiree Healthcare Solutions reserves in most funds are available to offset potential costs.

- The costs to continue services funded on a one-time basis in 2014-2015 in the General Fund as well as those services funded on a two-year basis. The major items include funding for additional enhancements to the San José BEST and Safe Summer Initiative, Police Department Downtown Foot Patrol, Public Works Department Preventative Maintenance Program, Police Department Central ID Unit, Illegal Dumping Rapid Response Program, Anti-Human Trafficking Task Force, and Finance Purchasing Information Technology Manager, among others. There were also programs funded on a two-year basis totaling approximately \$5.1 million, including the Homeless Rapid Rehousing, the Homeless Response Team, an enhanced San José BEST and Safe Summer Initiative Program, and Community Action and Pride Grants. Many of these programs and services will likely need to be re-evaluated for continued funding in 2015-2016. This analysis will be conducted during the 2015-2016 budget process and funding recommendations for these programs and services will be included in the 2015-2016 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.
- The costs to restore service levels in critical service areas, including police, fire, libraries, and community centers to January 1, 2011 levels as previously directed by the City Council (see *Appendix A*). This cost is estimated at approximately \$37 million based on 2014-2015 costs.
- The costs associated with a Police Staffing Restoration Strategy (to increase budgeted sworn officers from 1,109 to 1,250 positions) that was approved with the adoption of the 2014-2015 budget. As part of this strategy, ongoing cost savings from new police officers who receive Tier 2 retirement benefits are to be dedicated to restoring sworn police staffing. Consistent with this strategy, the forecast sets aside estimated sworn police retirement savings ranging from \$3.5 million in 2015-2016 to \$8.5 million in 2019-2020 to fund a portion of this cost.
- The costs associated with ongoing unmet/deferred infrastructure and maintenance needs that were last calculated in April 2014 at \$15 million annually in the General Fund (\$178 million all funds). In addition, there is a one-time backlog of infrastructure needs totaling \$39 million in the General Fund (\$1.05 billion all funds). These figures will be updated and presented to the Transportation and Environment Committee in spring 2015.
- One-time revenues that may become available or one-time expenditure needs. This includes the 2015-2016 Future Deficit Reserve of \$2.4 million. Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding elements that may be available or required in any given year.
- It should be noted that the Development Fee Programs (Building, Fire, Planning, and Public Works) are designed to be 100% cost recovery and have been programmed to have a neutral impact on the Forecast by adjusting the revenue and costs to be equal. In the Fire Fee Program, revenues are sufficient to cover the Base Budget costs. In the Planning, Building, and Public Works Development Fee Programs, however, budget gaps are currently projected for 2015-2016. Sufficient fee program reserves are available in each of these programs to address these variances and have been programmed into the Forecast.

2015-2016 Budget Balancing Strategy Guidelines

The 2015-2016 Budget Balancing Strategy Guidelines provide recommended direction on the general approaches to use in the development of the 2015-2016 Proposed Budget. These guidelines are essentially the same as those approved by the City Council as part of the Mayor's March Budget Message for Fiscal Year 2014-2015 with minor clarifications and the addition of language associated with the Police Staffing Restoration Strategy that was approved in the 2014-2015 Adopted Budget.

2015-2016 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of the most essential services to the community with the resources available.
2. Balance ongoing expenditure needs with ongoing revenues to ensure no negative impact on future budgets and to maintain the City's high standards of fiscal integrity and financial management. Maintain adequate reserves to cover any budgetary shortfalls in the following year as a stopgap measure if necessary.
3. Focus on business process redesign in order to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, simplifying, reorganizing functions, and reallocating resources).
4. Explore alternative service delivery models (e.g., partnerships with the non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use our resources more efficiently and effectively. The City Council Policy on Service Delivery Evaluation provides a decision-making framework for evaluating a variety of alternative service delivery models.
5. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
6. Explore redirecting and/or expanding existing revenue sources and/or adding new revenue sources.
7. Establish a fee structure to assure that operating costs are fully covered by fee revenue and explore opportunities to establish new fees for services, where appropriate.
8. Identify City policy changes that would enable/facilitate service delivery changes or other budget balancing strategies.
9. If additional resources become available, spending on increasing compensation and restoring services should both be considered.
10. Focus service restorations the baseline January 1, 2011 service levels previously identified by the City Council in the areas of fire, police, library, community centers, and street maintenance, as well as the Police Staffing Restoration Strategy.
11. In addition to considering service restorations previously identified by the City Council, take a holistic approach regarding the restoration of services. As outlined in the Guiding Principles for Restoring City Service Levels as approved by the City Council on March 20, 2012, allocate additional resources with the following goals in mind: ensure the fiscal soundness of the City; choose investments that achieve significant outcomes; and improve efficiency and effectiveness of service delivery. Using a multi-pronged approach to restoring direct services, take into consideration the following factors: adequate strategic support resources; adequate infrastructure; service delivery method to ensure efficient and effective operations; service delivery goals and current performance status; service sustainability; and staffing resources.
12. Incorporate compensation adjustments in a fiscally responsible manner that does not result in a reduction or elimination of services in the General Fund.
13. Engage employees in department budget proposal idea development.
14. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.
15. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.

Framework and Guiding Principles for Restoring City Service Levels

As the City Council is aware, it is important that the City take a holistic approach regarding the restoration of services as additional resources become available. As mentioned previously, one of the goals of the City Council is to restore services to January 1, 2011 levels (see *Appendix A* for Service Restorations Previously Identified by City Council (January 1, 2011 Levels)). Another City Council goal is to implement the Police Sworn Staffing Restoration Strategy.

The Service Restoration Decision Making Framework and the City Council-approved Guiding Principles for Restoring City Service Levels (both included in *Appendix A*) provide the broader context that should be considered when analyzing potential service restorations. The Service Restoration Decision Making Framework provides a multi-pronged approach to restoring direct services to the community that takes into consideration various factors, including adequate strategic support resources, adequate infrastructure, service delivery method to ensure efficient and effective operations, service delivery goals and current performance status, service sustainability, and staffing resources. The Guiding Principles for Restoring City Service Levels, which were approved by the City Council as part of the Mayor's March Budget Message for Fiscal Year 2012-2013, provide a solid guide to help the City determine not only the appropriate service levels and most cost-effective method for service delivery, but also the critical areas for investment. The principles extend beyond the January 1, 2011 service restorations to include considerations such as infrastructure maintenance, technology improvements, and alternative service delivery models. These principles fall into three general categories: ensure the fiscal soundness of the City; choose investments that achieve significant outcomes; and improve the efficiency and effectiveness of service delivery.

When considering any additions to the budget, it is important to consider the overall City of San José Budget Principles (also included in *Appendix A*) that were initially developed as part of the General Fund Structural Deficit Elimination Plan work. These principles were approved as part of the City Council's approval of the Mayor's March Budget Message for Fiscal Year 2008-2009, and subsequently amended on September 9, 2008. These principles provide a meaningful framework for maintaining the financial discipline crucial to a large organization like the City of San José.

Incorporating Strategies into the 2015-2016 Budget Process

As noted above, the Administration proposes the use of the general budget balancing strategy guidelines outlined above in the 2015-2016 City Manager's Budget Request combined with the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City of San José Budget Principles to approach the 2015-2016 budget development process. In December 2014, the Administration directed the City departments to develop 2015-2016 budget proposals using a draft version of the 2015-2016 Budget Balancing Strategy Guidelines. For the first time in over a decade, reduction targets were not issued to departments as the budget was expected to remain stable. Instead of service reductions, departments were asked to analyze their core responsibilities and functions to drive the creation of proposals that improve service delivery methods and outcomes without increasing costs. These may include organizational reconfigurations to close service delivery gaps or reallocation of existing resources to adjust to shifting community needs. Budget proposals requesting a net addition of General Fund resources

were to be limited to those that address truly significant community or organizational risks. As a standard practice, opportunities to reduce costs without impacting direct services, generate new revenues, and/or implement new service delivery models were also to be pursued. The Administration will continue to consider cost reductions and service delivery efficiencies that make sense, but does not anticipate any direct service reductions in 2015-2016 consistent with the approach over the past three years.

As part of the 2015-2016 Mayor's March Budget Message, the Administration requests confirmation of the proposed 2015-2016 Budget Balancing Strategy Guidelines, with any desired revisions. These guidelines incorporate both short-term and long-term approaches to budget balancing efforts and service level restoration and reflect the City's sound fiscal principles. City Council priorities and goals identified in prior policy sessions will also guide the City's budget balancing efforts. Input from the community through community surveys, the Neighborhood Associations/Youth Commission 2015-2016 Priority Setting Session, and various City Councilmember and stakeholder outreach activities will also serve as an important tool in this process.

The Mayor is scheduled to issue a proposed March Budget Message on March 16, 2015, which will then be discussed, amended if necessary, and adopted by the City Council. The contents of that Message will provide specific guidance for the preparation of the City Manager's 2015-2016 Proposed Capital and Operating Budgets currently scheduled to be submitted on April 22, 2015 and May 1, 2015, respectively. As required by City Charter, those Proposed Budgets will contain comprehensive plans for how the City organization will address the highest priority needs of the community while maintaining the fiscal integrity of the City.

After the release of the Proposed Budgets, there will be a series of Proposed Budget Study Sessions and Public Hearings to discuss the budget proposals and the associated impacts on performance measures and service delivery. The Administration will also work with the City Council to provide informational meetings on the Proposed Budget in each City Council District in May 2015. Additional input by the City Council and community will be incorporated into the budget through these Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message during the months of May and June 2015.

2016-2020 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS

The 2016-2020 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with information regarding the projected General Fund operating margin for each of the five years included in the forecast period.

2. **Base General Fund Forecast** – The forecast model is presented in this section. It includes projections for each of the General Fund revenue and expenditure categories. The expenditure summary is divided into two sections:
 - *Base Case without Committed Additions* – This section describes projections associated with existing expenditures only.
 - *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed by previous City Council direction and has less discretion, such as maintenance and operating costs for capital projects scheduled to come on-line during the next five years.

The Five-Year Forecast discussion is based on the Base Case with Committed Additions scenario, which is considered the most likely scenario for the upcoming year.

3. **Committed Additions to the Base General Fund Forecast** – This section describes the committed additions per previous City Council direction considered in the Forecast, including the financial impact in each year of the Five-Year Forecast. This section also includes a discussion of Budget Principle #8, which pertains to capital projects with General Fund operating and maintenance costs in excess of \$100,000.
4. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an Optimistic Case and a Pessimistic Case that modify revenue assumptions. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.
5. **Capital Revenue Forecast** – This section describes the estimates for construction and real estate related revenues that are major sources of funding for the City's Five-Year Capital Improvement Program.
6. **Appendices** – Three appendices are also included in this document. *Appendix A* includes the following: Service Restorations Previously Identified by City Council (January 1, 2011 Levels); the Service Restoration Decision Making Framework; the City Council-approved Guiding Principles for Restoring City Service Levels; and the overall City Council-approved City of San José Budget Principles. *Appendix B* provides descriptions of the City's major General Fund revenue categories. *Appendix C*, prepared by the Planning, Building and Code Enforcement Department, documents the basis for that department's five-year projections for construction activity.

2016-2020 General Fund Forecast

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative surplus. In addition to the cumulative surplus, the incremental surplus or shortfall (assuming each preceding surplus or shortfall is addressed 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 remain in balance on an ongoing basis, the incremental figure is useful in that it shows the additional surplus and/or shortfall attributed to a particular fiscal year. To the extent

that a shortfall is not resolved or a surplus is not expended on an ongoing basis, it is important to understand that the remaining budget gap or surplus will carry over to the following year.

**2016-2020 General Fund Five-Year Forecast
(\$ in Millions)**

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Projected Revenues	\$952.4	\$984.2	\$1,016.2	\$1,040.9	\$1,068.7
Projected Expenditures	\$943.8	\$970.4	\$1,002.1	\$1,028.2	\$1,050.2
Total Cumulative Surplus/(Shortfall)	\$8.6	\$13.8	\$14.1	\$12.7	\$18.5
Total Incremental Surplus/(Shortfall)	\$8.6	\$5.2	\$0.3	(\$1.4)	\$5.8

Note: Does not incorporate impacts associated with elements of the Fiscal Reform Plan that are not yet implemented; costs associated with fully funding the annual required contributions for retiree healthcare; costs associated with services funded on a one-time basis in 2014-2015; costs associated with restoration of key services (police, fire, libraries, community centers, and street maintenance) to January 1, 2011 levels; costs associated with a Police Staffing Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions); costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

In the 2016-2020 Forecast, small incremental General Fund surpluses are anticipated for four of the five years. Similar to last year, overall revenue growth is close to the expenditure growth over the forecast period, with an annual variance of less than 0.5% of the budget (revenues and expenditures). However, as stated previously, there are significant expenditure components that are not incorporated into the Forecast. The Forecast also does not reflect Fiscal Reform Plan cost reduction and revenue generation strategies that have not yet been implemented.

Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the significance of the projections in the out years is not so much in terms of their absolute amounts, but rather in the relative size of the decrease or increase from the prior year. This information should be used to provide a multi-year perspective to budgetary decision-making, rather than as a precise prediction of what will occur.

When reconciling next year's Forecast to the 2014-2015 Adopted Budget, the projected surplus of \$8.6 million for 2015-2016 is the result of the following: a surplus carryover from the 2014-2015 Adopted Budget of \$1.8 million, improved revenues of \$37.5 million, offset by increased costs of \$30.7 million.

General Fund revenues are estimated to improve \$37.5 million when compared to the ongoing revenue performance assumed in the 2014-2015 Adopted Budget. Revenue performance in 2014-2015 continues to reflect moderate growth and is estimated to exceed current budgeted levels. In 2015-2016, revenue categories that are forecasted to grow year-over-year include: Property Tax based on the most recent information provided by the County of Santa Clara (\$19.2 million), Sales Tax to reflect improved current year growth rates (\$9.2 million); Licenses and Permits (\$2.7 million) primarily reflecting the addition of fee revenues associated with the implementation of the Medical Marijuana Regulatory Program approved by the City Council December 2014; Transient Occupancy Tax (\$2.2 million) based on current year activity levels which will be allocated to a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve per

previous City Council direction, and miscellaneous categories that have experienced a net increase based on actual collections experience (\$4.2 million).

On the expenditure side, several upward and downward adjustments have been incorporated into this Forecast resulting in a net increase of \$30.7 million in 2015-2016. The most significant expenditure changes are the following: the establishment of an Employee Compensation Planning Reserve (\$11.7 million); a negotiated pay increase for employees represented by the SJPOA (\$7.0 million); an increase to the Police Department Staffing Reserve (\$3.5 million) funded by Police sworn Tier 2 savings per previous City Council direction; an increase to the Cultural Facilities Capital Maintenance Reserve (\$2.1 million) funded by increased Transient Occupancy Tax receipts per City Council direction; and non-management step and management pay-for-performance increases (\$2.9 million). These cost increases are partially offset by lower health and dental costs (\$3.2 million).

City Retirement Contributions

Given the major impact of retirement costs on the City's budget in recent years, detailed information is provided on the retirement projections incorporated into this Forecast. Overall, the City Retirement contribution costs are determined by the two Retirement Boards as guided by actuarial recommendations and take into account overall benefit levels, the funding status of each retirement plan, and economic and demographic assumptions. The retirement costs in this Forecast assume the pre-payment of the annual required City contribution for Tier 1 participants in the Federated Retirement System, and Tier 1 members of the Police and Fire Department Retirement Plan. For 2015-2016, net budgetary savings are estimated at approximately \$7.5 million in the General Fund (includes borrowing costs) (\$10.2 million in all funds); however, based on a recent conversation with the Office of Retirement Services staff, the Retirement Boards' joint investment committee recommended that staff engage in discussions on the prefunding practice in context of the current investment environment. Analysis by the Office of Retirement Services is underway and a meeting will occur within the next few weeks.

As detailed in the table on the following page, General Fund retirement contributions are projected to increase by \$9.3 million, or 4%, from 2014-2015 to 2015-2016 (by \$14.3 million, or 4.7%, in all funds). Over the Forecast period, the General Fund retirement contributions are estimated to increase by \$6.0 million, or 2.5% from \$243.9 million in 2015-2016 (25.8% of the General Fund) to \$249.9 million in 2019-2020 (23.8% of the General Fund). During the same period, the City retirement contribution for all funds will increase by \$10.0 million, or 3.2%, from \$318.8 million in 2015-2016 to \$328.8 million in 2019-2020.

**2016-2020 City Retirement Contribution Costs
And Budgetary City Retirement Contribution Rates
(\$ in Millions and with Pre-Payment Discount)**

Retirement Plan	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Fed. Ret. System Tier 1 – Pension	\$64.7	\$68.8	\$68.5	\$69.5	\$68.7	\$66.4
Fed. Ret. Syst. Tier 1 – Ret. Healthcare*	\$10.1	\$10.6	\$10.9	\$10.7	\$9.9	\$9.1
Fed. Retirement Plan Tier 1 – Total	\$74.8	\$79.4	\$79.4	\$80.2	\$78.6	\$75.5
Budgetary Contribution Rates	67.3%	73.8%	76.9%	81.4%	83.6%	85.4%
Fed. Ret. System Tier 2A – Pension	\$0.6	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5
Fed. Ret. Syst. Tier 2A – Ret. Healthcare*	\$1.0	\$0.9	\$0.9	\$0.9	\$0.9	\$0.8
Fed. Retirement Plan Tier 2A – Total	\$1.6	\$1.4	\$1.4	\$1.4	\$1.4	\$1.3
Budgetary Contribution Rates	14.9%	15.9%	16.6%	16.9%	16.7%	16.4%
Fed. Ret. System Tier 2B – Pension	\$1.5	\$2.1	\$2.7	\$3.3	\$4.0	\$4.6
Fed. Ret. Syst. Tier 2B – Ret. Healthcare*	\$3.4	\$5.4	\$7.5	\$8.8	\$10.1	\$11.4
Fed. Retirement Plan Tier 2B – Total	\$4.9	\$7.5	\$10.2	\$12.1	\$14.1	\$16.0
Budgetary Contribution Rates	18.2%	19.9%	21.4%	20.9%	20.4%	19.9%
Fed. Ret. System Tier 2C – Pension	N/A	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Fed. Ret. Syst. Tier 2C – Ret. Healthcare*	N/A	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Fed. Retirement Plan Tier 2C – Total	N/A	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Budgetary Contribution Rates	N/A	20.1%	21.6%	21.1%	20.6%	20.1%
Police Ret. Plan Tier 1 – Pension	\$77.2	\$75.0	\$72.7	\$72.5	\$70.3	\$68.1
Police Ret. Plan Tier 1 – Ret. Healthcare**	\$11.8	\$11.3	\$11.2	\$11.0	\$10.8	\$10.4
Police Retirement Plan Tier 1 – Total	\$89.0	\$86.3	\$83.9	\$83.5	\$81.1	\$78.5
Budgetary Contribution Rates	80.3%	81.2%	79.7%	80.7%	80.2%	80.2%
Police Retirement Plan Tier 2 – Pension	\$1.3	\$2.1	\$2.8	\$3.5	\$4.3	\$5.2
Police Ret. Plan Tier 2 – Ret. Healthcare**	\$1.3	\$2.1	\$2.7	\$3.4	\$4.1	\$5.0
Police Retirement Plan Tier 2 – Total	\$2.6	\$4.2	\$5.5	\$6.9	\$8.4	\$10.2
Budgetary Contribution Rates	21.8%	22.3%	22.4%	22.4%	22.4%	22.3%
Fire Retirement Plan Tier 1 – Pension	\$54.2	\$56.2	\$56.0	\$57.3	\$57.1	\$56.9
Fire Ret. Plan Tier 1 – Retiree Healthcare**	\$6.8	\$8.0	\$8.4	\$8.5	\$8.5	\$8.6
Fire Retirement Plan Tier 1 – Total	\$61.0	\$64.2	\$64.4	\$65.8	\$65.6	\$65.5
Budgetary Contribution Rates	80.0%	82.7%	81.5%	82.4%	81.7%	81.5%
Fire Retirement Plan Tier 2 – Pension	N/A	\$0.0	\$0.2	\$0.4	\$0.7	\$1.0
Fire Ret. Plan Tier 2 – Retiree Healthcare**	N/A	\$0.0	\$0.2	\$0.4	\$0.6	\$1.0
Fire Retirement Plan Tier 2 – Total	N/A	\$0.1	\$0.4	\$0.8	\$1.3	\$2.0
Budgetary Contribution Rates	N/A	21.8%	22.2%	22.2%	22.2%	22.2%
Other Retirement Costs	\$0.7	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8
Total General Fund	\$234.6	\$243.9	\$246.0	\$251.6	\$251.4	\$249.9
Total All Funds	\$304.5	\$318.8	\$323.3	\$331.2	\$331.3	\$328.8

* Federated Retirement System rates in 2015-2016 and 2016-2017 differ from Board approved rates due to ongoing negotiations with nine Federated bargaining units on retiree healthcare costs. Federated Tier 2C rates were approved by the Retirement Board in 2014-2015 with a 0.20% premium on retiree healthcare compared to Tier 2B rates to cover dental coverage included in Tier 2C but not included in Tier 2. This premium is assumed throughout the Forecast period. Cheiron's Letter did not break out Tier 2C due to the timing of the requested information and approval of a Tier 2C plan.

** Police and Fire Retiree Healthcare is capped at the negotiated rate per MOA.

Source: 2014-2015 Modified Budget; Cheiron Letters dated January 30, 2015 and February 2, 2015 with applied pre-payment discount for Federated Retirement System Tier 1, the Police Retirement Plan Tier 1, and the Fire Retirement Plan Tier 1.

General Fund Committed Additions

Cost estimates for a number of specific “Committed Additions” that address previous City Council direction are included in this Forecast in the years that they are projected to be required. The Committed Additions category, summarized in the chart below, reflects projected additional operating and maintenance costs for new or renovated capital projects in the 2015-2019 Adopted Capital Improvement Program or for projects approved by the City Council during 2014-2015. The costs of the additions total \$526,000 in 2015-2016 and increase to approximately \$1.9 million by the end of the Forecast period.

**2016-2020 General Fund Committed Additions
Maintenance and Operations Costs**

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
New Municipal Improvements	\$48,000	\$61,000	\$63,000	\$64,000	\$66,000
New Parks and Recreation Facilities	186,000	380,000	580,000	682,000	787,000
New Traffic Infrastructure Assets	51,000	148,000	164,000	178,000	185,000
Measure O (Library)	228,000	701,000	722,000	743,000	763,000
Measure P (Parks)	0	0	87,000	88,000	84,000
Measure O (Public Safety) - Fire	13,000	26,000	27,000	28,000	28,000
Total	\$526,000	\$1,316,000	\$1,643,000	\$1,783,000	\$1,913,000

Some of the larger facilities expected to come on-line during this forecast period include: the Southeast Branch Library, the Lake Cunningham Bike Park, Fire Station 21, and the Softball Complex. The future operating and maintenance costs of approximately \$3.3 million for Fire Station 37 are not included in this forecast due to the lack of sufficient funding for project construction. Due primarily to the unexpectedly high cost of construction during much of the Measure O (Public Safety) program, the decision to rebuild instead of remodel Fire Station 2 (which resulted in a net cost increase of approximately \$4.1 million), and the higher bid prices received for the construction of Fire Station 21, the Administration anticipates that only \$2.8 million in public safety bond funding will remain after the completion of Fire Station 21. This amount leaves the Fire Station 37 project over \$4.8 million short of the funds needed to complete the project. Given the funding shortfall, the Mayor’s June Budget Message for Fiscal Year 2014-2015, as approved by the City Council, included Manager’s Budget Addendum #17 which, in part, directed staff to continue its analysis of response time performance through a comprehensive Fire Department organizational review. Pending completion of this analysis, the Fire Station 37 project has been deferred indefinitely. A detailed listing of all capital project operating and maintenance costs included in this 2016-2020 General Fund Forecast can be found in Section III - Committed Additions to the Base General Fund Forecast of this document.

General Fund Capital Operating and Maintenance Costs/Budget Principle #8

General Fund Capital Operating and Maintenance Costs/Budget Principle #8 requires City Council certification that funding will be made available in the General Fund for capital projects with an estimated operating budget impact greater than \$100,000 at the time of taking beneficial use of the facility or project, and that this operations and maintenance funding will not require a decrease in existing basic neighborhood services. Capital projects with operating and maintenance costs over \$100,000 that have been previously certified by the City Council, or are recommended for certification in the future, are identified in Chart A in Section III. Certification for potential new projects or modifications to existing projects identified after the release of this Forecast that have not been approved by the City Council may be recommended for certification as part of the 2016-2020 Proposed Capital Improvement Program. If certified by the City Council, the operating and maintenance costs associated with these facilities would then be included in subsequent General Fund Five-Year Forecast documents.

Alternative Forecast Scenarios

In order to model the range of budgetary scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the "Base Case." "Optimistic" and "Pessimistic" cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case." These alternatives are presented to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario and is being used for planning purposes for the 2015-2016 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios. In addition, as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve, therefore no change in Transient Occupancy Tax growth is modeled as part of these cases as there is no impact to the operating margin.

The Base Case Forecast is built on the assumption of continued moderate recovery from the deep global recession on a national level. At the local level, the technology industry continues to drive strong growth with many revenues exceeding pre-recession levels. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to continue to remain around historical normal levels. Home values continue to show steady growth and are anticipated to continue to improve over the five years. In the Base Case Forecast, General Fund revenue collections are anticipated to experience moderate growth over the forecast period.

The Optimistic Case assumes both a faster and more robust recovery than the Base Case anticipated. When compared to the Base Case scenario, the real estate market improves significantly with increases not only in the price of housing, but also the volume of home sales, outpacing the growth rates assumed in the Base Case. This housing market recovery with both an increase in new home construction and increased prices is driving growth in inflation higher than in the Base Case. Due to the currently high employment growth, the optimistic case presumes only slightly higher employment levels than the Base Case. This strong recovery results in increased collections in the economically sensitive revenue categories, such as Property Tax and

Sales Tax. In the Optimistic Case, the City would experience surpluses in all years of the Forecast ranging from \$6.5 million to \$15.8 million.

The Pessimistic Case assumes that a combination of adverse factors impede the moderate recovery underlying the Base Case and keep inflation low, causing a more sluggish recovery. Under this scenario, neither a crash at the international level nor the national level are anticipated. However, it does model lower than expected growth of the key factors and determinants of the City's revenue; local employment, local housing prices and number of sales, and local inflation are all lower than those of the Base Case. For example, a key assumption for this lower forecast is lower home prices, which are modeled to fall from their current double digit growth rates to 6% growth to 2% growth in this pessimistic case. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would be significantly impacted by an economic slowdown. In the Pessimistic Case, the City would experience one surplus and four shortfalls over the Forecast ranging from -\$8.0 million to \$0.8 million.

Capital Revenue Forecast

Section V of this report describes the Capital Revenue Forecast that will be used to develop several major elements of the 2015-2016 Capital Budget and the 2016-2020 Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement (PBCE) Department and an analysis of actual collection patterns. The projections and their basis are described in a report prepared by the PBCE Department, which is included as *Appendix C* of this document (Development Activity Highlights and Five-Year Forecast [2016-2020]). This activity forecast includes a review of specific projects that are in progress as well as a general prediction of expected levels of new construction.

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2015-2019 Adopted CIP. As shown below, revenues are anticipated to decrease as activity is tapering off as projects are completed. Based on the lower level of inventory in the real estate market, construction activity estimates, and a review of revenue collection patterns, a decrease in these taxes and fees of \$28.6 million, or 8%, is expected when comparing the 2016-2020 Forecast to the 2015-2019 Adopted CIP estimates.

Capital Revenue Forecast Comparison Summary
(\$ in Thousands)

	2015-2019 CIP	2016-2020 Forecast	Difference	% Change
Construction and Conveyance Tax	\$195,000	\$175,000	(\$20,000)	(10%)
Building and Structure Construction Tax	66,000	62,000	(4,000)	(6%)
Construction Excise Tax	87,000	83,000	(4,000)	(5%)
Municipal Water System Fees	750	500	(250)	(33%)
Residential Construction Tax	950	950	0	0%
Sanitary Sewer Connection Fee	3,750	3,400	(350)	(9%)
Storm Drainage Connection Fee	750	750	0	0%
TOTAL	\$354,200	\$325,600	(\$28,600)	(8%)

Real estate activity (primarily housing sales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance Tax. After reaching a record setting high of \$49 million in 2005-2006, tax collections continuously fell for several years following the real estate slowdown and financial market crisis, dropping to \$20.5 million in 2008-2009. Collections rose to \$35.5 million in 2013-2014, but are expected to remain at \$35.0 million in 2014-2015 and each year of the Forecast. Due to the lower level of inventory, the number of property transfers (sales) for all types of residences dropped from the prior year, which is holding down growth in this category. As a result, this category is projected to generate \$175 million in this Forecast, which represents a 10% decrease from the estimates assumed in the 2015-2019 Adopted CIP.

The remaining economically sensitive capital revenue categories are directly linked to private development activity. Based on projections provided by the Planning, Building and Code Enforcement (PBCE) Department, construction activity valuation is anticipated to continue at high levels but lower than the peak levels experienced in 2013-2014. In 2014-2015, construction valuation is estimated at \$1.3 billion for 2014-2015, a 26% decrease compared to \$1.7 billion in 2013-2014. This level of activity is expected to drop slightly to \$1.1 billion in 2015-2016, then down to \$910 million in 2016-2017 as projects are anticipated to be completed. PBCE expects a slight increase to \$965 million per year in 2017-2018 and 2018-2019 to reflect a slight surge of accelerated development activity prior to the implementation of the Housing Impact Fee, and then fall to \$790 million in 2019-2020 to reflect the anticipated lower level of development activity. For the largest categories, revenue decreases are projected, including a 6% (\$4 million) decrease to the Building and Structure Construction Tax and a 5% (\$4 million) decrease to the Construction Excise Tax, due to a decrease of development activity over the next several years across residential, commercial, and industrial sectors.

Next Steps in the 2015-2016 Budget Process

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

March 2015

- 2015-2016 Neighborhood Associations/Youth Commission Priority Setting Session
- 2015-2016 Mayor's March Budget Message Released with Public Hearing; Amended/Approved by City Council

April 2015

- 2015-2016 Proposed Capital Budget and 2016-2020 Capital Improvement Program Released

May 2015

- 2015-2016 Proposed Operating Budget and 2015-2016 Proposed Fees and Charges Released
- 2015-2016 Community Budget Meetings in Each City Council District
- City Council Study Sessions and Initial Public Hearing on 2015-2016 Proposed Operating Budget, 2016-2020 Proposed Capital Budget and Capital Improvement Program, and 2015-2016 Proposed Fees and Charges

June 2015

- 2015-2016 Mayor's June Budget Message Released with Final Public Hearing; Amended/Approved by City Council
- 2015-2016 Operating Budget, 2015-2016 Capital Budget and 2016-2020 Capital Improvement Program, and 2015-2016 Fees and Charges adopted by City Council

CONCLUSION

This document compares the projected revenues and expenditures for the General Fund over the next five years as well as provides estimates for some of the key revenues that support the City's Capital Improvement Program. In 2015-2016, a small General Fund surplus of \$8.6 million is projected, which the Administration seeks to allocate in a way that addresses the City's most urgent needs. In the remaining years of the Forecast, a small General Fund shortfall and surpluses ranging from -\$1.4 million to \$5.8 million annually are projected. These margins are very narrow when put into context of the size of the projected General Fund budget, ranging from -0.1% to 0.5% of the projected annual budget (revenues and expenditures).

As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document, and it is important to keep in mind that this Forecast does not reflect several elements that would impact the General Fund over the Forecast period, including: 1) impacts associated with the implementation of the remaining elements of the Fiscal Reform Plan (cost savings and additional revenues); 2) costs associated with fully funding the annual required contributions for retiree healthcare; 3) costs associated with services that were funded on a one-time basis in 2014-2015; 4) costs associated with the restoration of key services to January 1, 2011 levels; 5) costs associated with a Police Staffing Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions); 6) costs associated with

unmet/deferred infrastructure and maintenance needs; and 7) one-time revenue sources or expenditure needs. In addition, no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

The revenue and expenditure projections for 2015-2016 will continue to be refined over the next several months as additional information becomes available. This is particularly important in the areas of Sales Tax and Property Tax. Sales Tax data for the second quarter of 2014-2015, which covers the 2014 holiday period, will be received in March 2015. Based on this additional data, any necessary adjustments will be incorporated into the 2015-2016 Proposed Operating Budget. Similarly, as additional Property Tax data becomes available, it may be necessary to adjust the 2015-2016 revenue estimates.

This document also provides the recommended 2015-2016 City Manager's Budget Request (Budget Balancing Strategy Guidelines) for consideration by the City Council as part of its review of the Mayor's March Budget Message. With a projected surplus of less than 0.5% of the budget, the Administration does not anticipate major service enhancements this year. However, efforts will be taken to address the most urgent community needs and organizational risks, and identify modifications to improve service delivery methods and outcomes without significantly increasing costs.

Over the past several years, the City's budget has stabilized as a result of very difficult budget actions and continued improvement in the economy. The Mayor and City Council have remained committed to ensuring the fiscal health of the City while delivering essential services in the most cost-effective manner and providing for modest pay increases for our employees. This diligence has served the City well as it moves on from its most difficult financial crisis in recent history. While a very small budgetary surplus is available in 2015-2016, the City continues to experience a "service deficit". Continued focus and commitment to strategies that will enable the City to rebuild its core services and maintain organizational competitiveness remains a priority for 2015-2016 and beyond.



Norberto Dueñas
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