

*Five-Year Economic Forecast  
and  
Revenue Projections*

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*2015-2019*

Section 1

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Elements of the General Fund Forecast

# ELEMENTS OF THE GENERAL FUND FORECAST

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

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### Overview

This document provides three alternative Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2014-2015 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast; however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment.

- ❑ **Base Case** – The Base Case Forecast is built on the assumption of a continued moderate recovery from the deep global recession on a national level and the continued dampening of overall growth due to budgetary pressures at the federal level. At the local level, positive near term growth is estimated to continue in the Silicon Valley as a result of the continued strength in the technology industry. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to continue to decrease and ultimately remain around historical normal levels. Home values 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.
- ❑ **Optimistic Case** – The Optimistic Case assumes a much faster and more robust recovery than currently 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, out pacing the growth rates assumed in the Base Case. This housing market recovery drives growth in employment levels and inflation. This vigorous recovery results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.
- ❑ **Pessimistic Case** – The Pessimistic Case assumes that a combination of adverse factors interact to impede the moderate recovery underlying the Base Case and continue a sluggish recovery. Under this scenario, looming impacts in the world economy in areas such as Europe, Japan, and China are anticipated to ripple through to the U.S. economy at a national level as well as at the State and local levels. Housing prices are anticipated to fall both locally and nationally as the Federal Reserve monetary and fiscal policies result in higher interest rates, which in turn, results in higher mortgage rates. Higher mortgage rates would negatively impact both home sales and prices. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would be impacted by an economic slowdown.

### Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions

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and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2014-2015 Proposed Operating Budget, scheduled to be published on May 1, 2014.

The following is a discussion of both the national and local economic outlooks used to develop the revenue estimates for the Base Case Forecast. Various economic forecasts are reviewed in the development of the revenue estimates, including the national and State economic forecasts produced by the Anderson School of Management at University of California – Los Angeles (UCLA) and Beacon Economics. The City also uses an economic forecasting consultant to assist in the development of this Forecast, particularly the modeling of the growth in the out years of the Forecast. In addition, consultants that focus on particular revenue categories such as Sales Tax, Transient Occupancy Tax, Franchise Fees, and Utility Taxes were asked to weigh in on the current projections and future outlooks in these areas.

### Current National Economic Conditions

The U.S. economy continues to grow at a relatively subdued pace; the U.S. Gross Domestic Product (GDP) increased by 1.9% in 2013, compared with an increase of 2.8% in 2012. The slowing of GDP experienced in 2013 was due to a combination of factors, including slowed growth in nonresidential fixed investment, personal consumption expenditures (PCE), and imports, partly offset by a deceleration of imports and a smaller decrease in state and local government spending<sup>1</sup>. National employment has seen somewhat greater gains than GDP, but continues to reflect a very slow recovery from the "Great Recession" of 2009. The U.S. unemployment rate stood at 6.6% in January 2014, according to the U.S. Department of Labor's Bureau of Labor Statistics. While this is down from the 7.9% level at the end of January 2013, the current unemployment rate does not account for those workers too discouraged to search for work and remains above pre-recession levels of 4-5%.

Bright spots in the national economy include the auto industry and the energy sector. Selling at a pace close to 16 million units a year, the auto sector is providing solid support to the country's industrial production base. Car sales began recovering immediately after the 2008 housing crash and have been growing robustly since then. The energy sector has been stimulated by the adoption of advanced drilling techniques for natural gas and oil that are providing strong job growth in certain parts of the country and are anticipated to help moderate the growth in energy prices.

Though the real estate market continues to improve, existing home sales are being hampered by a lack of available inventory affecting most parts of the country. Prices for existing homes are rising but the rate of increase has recently tempered somewhat because of slightly rising interest rates. Existing home sales in December 2013 were 0.6% below the December 2012 level and the preliminary annual total for existing home sales in 2013 was up 9.1% from the prior year.<sup>2</sup> Sales

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<sup>1</sup> U.S. Department of Commerce Bureau of Economic Analysis, National Income and Product Accounts Gross Domestic Product, 4<sup>th</sup> Quarter and Annual 2013 (Advance Estimate), January 30, 2014

<sup>2</sup> National Association of Realtors, News Release, January 23, 2014.

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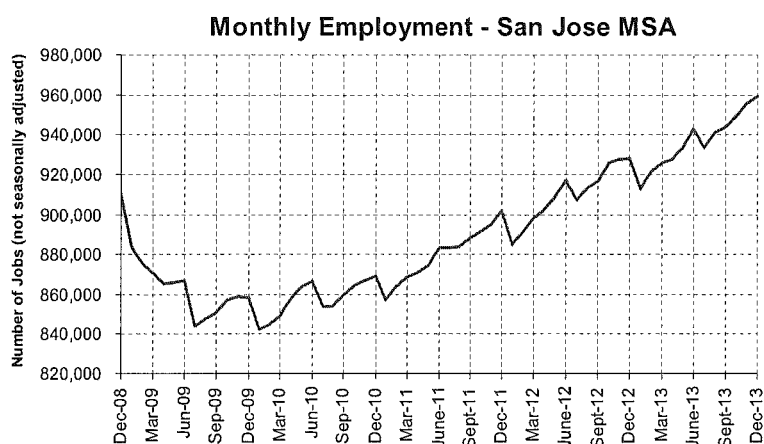
of new homes are still well below average sales levels for the last decade. Nation-wide, privately-owned housing starts in January 2014 reflected a 4.6% increase from the prior year level.<sup>3</sup> Yet, average new housing starts for all of 2013 were slightly less than one million. In a normal year, housing starts average around 1.5 million. Additionally, most of these new homes are multi-family residences. Multi-family residences will exert upward pressure on the economy in the coming quarters, but not quite as much as the equivalent amount of single-family homes. Because the Federal Reserve Board intends to lessen its monetary stimulus activities, mortgage rates are expected to rise slightly.

### National Economic Outlook

Moderate economic growth appears likely for the next several years, driven by the housing market, auto sales and energy production, combined with increased business spending and an end to the decline in federal, state and local government spending, according to the UCLA Anderson Business School Forecast. Weighing on the economy, however, is economic weakness abroad, including Europe's slow emergence from its very long recession, and lower than desired rate of inflation.

A modest rate of inflation is a key driver for business and consumer demand, and for future property and sales taxes. The Federal Reserve Board targets a core annual inflation rate of 2%. Currently, the Consumer Price Index (CPI) increased in 2013 by 1.6%<sup>4</sup>. This low rate is especially notable given the extraordinary efforts the Federal Reserve has undertaken to inject money into the economy. Factors holding inflation down include strong downward pressure on prices coming from the U.S. energy sector as discussed above, the second is wages, which have either remained flat or decreased across most income classifications.

Forces that would work to push prices up include the Federal Reserve itself, which is determined - and has the ability - not to let prices fall, increases in the minimum wage that may be undertaken nationally or across multiple states, and California's drought that will likely impact agricultural prices across the nation. The UCLA Anderson Business School Forecast anticipates that inflation will modestly increase in future years, and thereby contribute to economic growth; therefore, this key economic indicator will continue to be closely followed.



<sup>3</sup> U.S. Census Bureau and U.S. Department of Housing and Urban Development, News Release, January 27, 2014

<sup>4</sup> U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index News Release, February 20, 2014

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### Current City of San José Economic Conditions

Fortunately for the City, the economic performance in Silicon Valley and San José continues to show strength above that experienced nationally and state-wide. The Beacon Employment Report noted that nonfarm employment growth between August 2012 and August 2013 in the South Bay area was 3.0%, which was noticeably higher than the State of California average of 1.7%. Beacon anticipates future annual nonfarm employment growth of 2% through 2018 and is currently forecasting the unemployment rate in the region to reach 5% by the end of 2015<sup>5</sup>.

Data from the State of California Employment Development Department paints a similar picture. The employment levels in the San Jose Sunnyvale Santa Clara Metropolitan Statistical Area (MSA) continues to increase. Total employment grew by 31,000 jobs, or 3.3% from 928,300 in December 2012 to a preliminary estimate of 959,300 in December 2013. The entire increase is due to non farm jobs, the most significant of which are in the Professional and Business Services (6,800); Construction (5,500); Manufacturing (5,200); Trade, Transportation and Utilities (5,100); followed by Leisure and Hospitality (4,000) industries. Financial Activities was the only industry to experience a decline in growth when compared to December of the prior year.<sup>6</sup> The Administrative Support industry continues to be one of the fastest growing sectors in the State.<sup>7</sup> By August 2013, the South Bay labor market was one of the few in California whose levels had already exceeded its pre-recession employment peak.

Another positive indicator is the continuing decline in the unemployment rate. In December 2013, the unemployment rate in the San José Metropolitan Statistical Area (MSA) fell to 5.8%, down from the December 2012 rate of 7.8%. This compares favorably to the revised rate from November 2013 of 6.3%, to the unadjusted employment rate for California of 7.9%, and to the overall rate for the nation of 6.5%.

**Unemployment Rate (Unadjusted)**

	<b>Dec. 2012</b>	<b>Nov. 2013</b>	<b>Dec. 2013**</b>
San José Metropolitan Statistical Area*	7.8%	6.3%	5.8%
State of California	9.8%	8.3%	7.9%
United States	7.6%	6.6%	6.5%

\* San Benito and Santa Clara Counties

Source: California Employment Development Department

\*\* Preliminary Estimate

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<sup>5</sup> Beacon Economics, The Regional Outlook – South Bay

<sup>6</sup> State of California Employment Development Department Labor Market Information Division Press Release, January 24, 2014

<sup>7</sup> Beacon Economics, The Regional Outlook – South Bay

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Development activity has surged to levels not seen in over a decade. Through January, the table below shows substantial growth in all development categories when compared to last year. While this activity level is anticipated to decrease over the next several years, the increased supply of residential, commercial, and industrial buildings will provide future economic gains to San José.

### Private Sector Construction Activity (Valuation in \$ Millions)

	YTD Jan 2013	YTD Jan 2014	% Increase
Residential	\$ 278.2	\$ 496.3	78%
Commercial	\$ 128.2	\$ 261.1	104%
Industrial	\$ 137.5	\$ 382.2	178%

The local housing market continues to be a source of strength, though the pace of growth has moderated somewhat from the dramatic increases experienced in 2012-2013. The median single-family home price in January 2014 was \$660,000, which is an increase of 7.6% from the January 2013 price of

\$613,500. In addition, the average days on market for single-family and multi-family homes dropped slightly from 44 days in January 2013 to 42 days in January 2014. However, available inventory continues to be tight, as the number of property transfers (sales) for all types of residences in January 2014 totaled 398, which represents a decrease of approximately 12.7% from the 456 sales that occurred in the same month in the prior year.

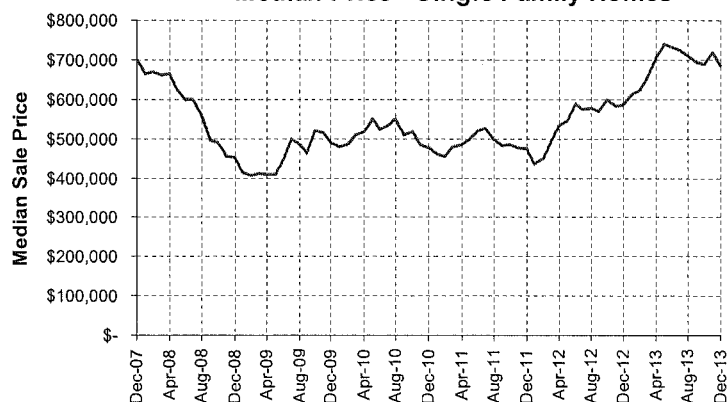
Economic conditions will continue to be closely monitored and factored into the development of the 2014-2015 Proposed Budget, scheduled to be released May 1, 2014.

### City of San José Economic Outlook

The outlook for Silicon Valley overall, and San José in particular, similar to the previous year's Forecast, is positive in the near term and in the out years of this Forecast.

Due to the concentration of technology firms in the Silicon Valley, this region is heavily influenced by the technology sector. The strength in the technology sector as well as continued improvement in the housing sector are expected to grow the local economy through 2015.

Median Price - Single Family Homes



In the near term, the strength in the technology industry will keep employment levels increasing. However, signs such as the high stock valuations of many technology companies indicate that the current technology product cycle may be over its peak. As this technology cycle recedes,

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which has been defined by the emergence of mobile-social networking, employment will continue to grow, but at a more sustainable long-term level. Mild rebounds in State and local government hiring, as well as the gains in construction are also expected to bolster the employment rate in the long term.

Continued improvement in the real estate sector is also expected over the Forecast period, though the growth rates will lessen compared to last year's surge. With a greater supply of land than in some other areas of the County, it is likely that both companies and workers will find San José an attractive place to build offices and homes. This will translate to growth in residents and jobs, and bring revenues to the City. However, on the negative side, the limited supply of housing may eventually limit the area's supply of high-tech workers, and thus dampen growth. These workers may decide to go elsewhere as the limited supply of housing becomes too expensive and commutes get too long.

Additionally, in the long term, political and policy constraints on Federal discretionary spending may have impacts on needed investments in the San José region. Potential impacts include transportation infrastructure spending, which stimulates a diverse array of economic demand, and defense spending, which now has a significant high tech component that reaches multiple companies in Santa Clara County.

Taken together, San José can expect a continued recovery from the steep declines experienced during the economic recession and is well positioned to experience moderate growth throughout the forecast period among economically sensitive revenues such as Sales Tax, Property Tax, and Transient Occupancy Tax receipts.

### **Optimistic Case**

In the Optimistic Case, the economy is assumed to grow at a much more rapid pace than assumed in the Base Case. This growth is primarily due to a more robust rebound in housing at both the national and local levels, higher local employment levels, and, most notably, higher inflation. Higher inflation would significantly increase many City revenues, particularly Sales and Property Taxes.

The higher economic growth rates envisioned by this scenario may come to pass. The economy is at a point in its business cycle where many of the lagging sectors could exhibit much stronger growth than expected, particularly in housing. The Optimistic Case is based partly on the assumption that the real estate sector nationally and locally greatly improves. With mortgage rates still low, employment increases and a well-performing stock market could spur a greater number of home purchases. As a partial result of more rapid new home construction, the country's overall employment and wage levels would improve.

Under the Optimistic Case, the economically sensitive revenues are expected to experience much stronger performance as general increases in employment and consumer attitudes promote increased spending, which generate Sales Tax for the City. Improvement in the real estate market will result in higher Property Tax revenues. Development activity is also expected to

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improve as well as business tax collections and Transient Occupancy Tax receipts. Conversely, Gas taxes are slightly lower as a result of higher oil prices and continued increases in mandated fuel economy, which is anticipated to cause the number of taxable gallons consumed to fall. By the end of the Forecast period, revenues are \$55.9 million above the Base Case.

### **Pessimistic Case**

The Pessimistic Case assumes lower than expected growth of the key national and local economic determinants of the City's revenues. Thus local employment, local housing, and local inflation are all lower than those of the Base Case. Like the Optimistic Case, the prospects for a lower scenario could still occur.

The world economy, already slow to recover, could still encounter setbacks from a variety of sources, including a slowing Chinese economy or problems within emerging markets. As the Federal Reserve begins to wind down its expansionary monetary policy, interest rates could rise faster than projected, thereby lowering national economic activity below that projected in the Base Case. The higher interest rates would also translate into higher mortgage rates. Should mortgage rates rise too high, home prices and home sales would fall both nationally and locally.

As the real estate market plays a primary role in the economic fortunes of San José, any lowering of real estate prices and related construction activity would apply a brake to job growth that would negatively impact all sectors of the economy. The result of which would be decreased revenue collections in categories such as Property Tax, Sales Tax, Transient Occupancy Tax, and development fee activity when compared to the Base Case. Conversely, Gas Taxes are slightly up due to projected reductions in oil prices which typically results in increased gas consumption. By the end of the Forecast period, total revenues are \$46.5 million below the Base Case.

### **Impact of Forecasted Economic Conditions on Revenue Collections**

The economic conditions discussed above are the primary drivers for the economically sensitive revenues, with the most significant impacts in the Sales Tax and Property Tax categories. Performance in other areas, however, is primarily driven by other factors. For example, the Franchise Fee and Utility Tax categories are more heavily impacted by utility rate changes and energy prices. Collections from local, State, and federal agencies are primarily driven by the grant and reimbursement funding available from these agencies. As a result, these General Fund revenues experience no significant net gain or loss in times of an economic expansion or slowdown, respectively. Because these revenue sources do not track directly with the performance of the economy, the growth in these areas, even in times of economic strength, can dampen the City's overall revenue growth. Conversely, in an economic slowdown, these categories can act as a buffer, easing the impact of declines in the economically sensitive revenue categories.

An in-depth analysis of the General Fund revenue categories was completed to develop 2014-2015 revenue estimates included in this Forecast. Over 450 revenue sources were examined to



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estimate the outcome in 2013-2014 and build upon those projections to develop the 2014-2015 revenue estimates. These estimates are based on the Base Case Forecast economic scenario described in this section. These revenue estimates will be closely examined and updated again during the preparation of the 2014-2015 Proposed Operating Budget that will be released on May 1, 2014.

## REVENUE FORECAST

As displayed in the General Fund Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from \$841.5 million in 2014-2015 to \$950.7 million in 2018-2019, for an average growth rate of 2.9% per year.

### February 2014 Forecast Revenue Summary

Revenue Category	Modified Budget	Forecast				
	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
<b>General Revenues</b>						
Property Tax	\$ 220,850,000	\$ 228,573,000	\$ 239,773,000	\$ 250,611,000	\$ 262,991,000	\$ 275,799,000
Sales Tax	172,110,000	177,724,000	184,371,000	191,783,000	198,514,000	204,867,000
Transient Occupancy Tax	10,600,000	11,750,000	12,496,000	13,028,000	13,449,000	13,923,000
Franchise Fees	43,923,000	45,186,000	46,089,000	46,914,000	47,768,000	48,676,000
Utility Tax	91,895,000	94,950,000	96,808,000	98,677,000	100,581,000	102,573,000
Telephone Line Tax	20,600,000	20,700,000	20,700,000	20,700,000	20,700,000	20,700,000
Business Tax	42,935,000	43,500,000	43,683,000	43,853,000	44,011,000	44,169,000
Other Licenses and Permits	49,268,246	45,055,000	46,902,000	48,309,000	50,000,000	51,450,000
Departmental Charges	38,179,213	37,443,000	38,978,000	40,148,000	41,553,000	42,758,000
Fines, Forfeitures & Penalties	14,862,200	14,175,000	14,447,000	14,700,000	14,938,000	15,301,000
Money and Property	2,673,000	2,799,000	2,883,000	2,969,000	3,059,000	3,150,000
Revenue From Local Agencies	37,131,820	22,145,000	22,745,000	23,344,000	23,986,000	24,644,000
Revenue from the State	11,877,725	10,734,000	10,510,000	10,510,000	10,510,000	10,510,000
Federal Revenue	13,111,532	1,473,000	-	-	-	-
Other Revenue	118,934,047	14,079,000	14,597,000	14,849,000	15,124,000	15,419,000
Gas Tax	15,000,000	14,850,000	14,554,000	14,247,000	14,015,000	13,778,000
<b>Total General Revenues</b>	<b>\$ 903,950,783</b>	<b>\$ 785,136,000</b>	<b>\$ 809,536,000</b>	<b>\$ 834,642,000</b>	<b>\$ 861,199,000</b>	<b>\$ 887,717,000</b>
<b>Transfers and Reimbursements</b>						
Overhead Reimbursements	\$ 36,576,248	\$ 37,107,000	\$ 38,629,000	\$ 39,788,000	\$ 41,180,000	\$ 42,374,000
Transfers	16,502,033	18,436,000	18,729,000	19,001,000	19,406,000	19,715,000
Reimbursements for Services	742,833	787,000	820,000	844,000	874,000	899,000
<b>Total Transfers and Reimbursements</b>	<b>\$ 53,821,114</b>	<b>\$ 56,330,000</b>	<b>\$ 58,178,000</b>	<b>\$ 59,633,000</b>	<b>\$ 61,460,000</b>	<b>\$ 62,988,000</b>
<b>Total General Fund Revenues</b>	<b>\$ 957,771,897</b>	<b>\$ 841,466,000</b>	<b>\$ 867,714,000</b>	<b>\$ 894,275,000</b>	<b>\$ 922,659,000</b>	<b>\$ 950,705,000</b>
<b>Beginning Fund Balance</b>	<b>\$ 215,180,741</b>	<b>\$ 57,752,000</b>	<b>\$ 57,014,000</b>	<b>\$ 57,865,000</b>	<b>\$ 58,666,000</b>	<b>\$ 57,317,000</b>
<b>Grand Total Sources</b>	<b>\$ 1,172,952,638</b>	<b>\$ 899,218,000</b>	<b>\$ 924,728,000</b>	<b>\$ 952,140,000</b>	<b>\$ 981,325,000</b>	<b>\$ 1,008,022,000</b>
Growth %			2.84%	2.96%	3.07%	2.72%

Understanding the basis for the revenue estimates included in this Forecast requires a discussion of the assumptions used for estimating each of the revenue categories. The following discussion focuses on estimates used for the 2014-2015 General Fund Forecast.

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## REVENUE FORECAST

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### Property Tax

Property Tax receipts of \$221.7 million are projected for 2013-2014, which represents 8.1% growth from the prior year and is slightly above the modified budget estimate of \$220.9 million. This projected increase is much stronger than the modest growth seen in 2011-2012 and 2012-2013 respectively, where actual Property Tax receipts were up 2.3% and 1.6% year-over-year for the first time since 2008-2009. Growth is reflected primarily in the Secured (8.8%) and SB 813 (10.0%), as well as Airplane Property Tax (3.2%) categories with a minor decline of 1.1% in Homeowners Property Tax Relief and 0.9% in Unsecured Property Tax. Overall, in 2014-2015, collections are expected to continue to increase but at a more moderate pace of 3.1% to \$228.6 million due in part to only a 0.45% California Consumer Price Index (CCPI) increase, which will be assessed in the Secured Property Tax category. Additional information about each of the Property Tax sub-categories is provided below.

Secured Property Taxes account for over 90% of the revenues in this category. In 2013-2014, Secured Property Tax receipts are expected to total \$202.7 million, reflecting an increase of 8.8% from the 2012-2013 collection level. This projected increase can be attributed to two primary factors: 1) the net increase in residential and commercial valuation resulting from the full or partial restoration of property values that were previously temporarily reassessed downwards under Proposition 8 due to the declining market values; and 2) the change in the California Consumer Price Index (CCPI) of 2.0% for the 2013-2014 tax roll. This is the first year that estimated receipts are anticipated to exceed the peak of \$192.3 million in 2008-2009. In 2014-2015, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2014, are expected to increase by 3.5% to \$209.8 million. This projected increase is related to two factors: the change in the CCPI and the net change in residential and commercial valuation. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. The CCPI adjustment for the 2014-2015 tax roll is an increase of 0.45%, significantly below the prior year level of 2.0%. A net increase in residential and commercial valuation is also anticipated from the combination of changes in ownership, new construction, and the continued partial or full restoration of property values that had previously been reassessed downward under Proposition 8 due to declining home values. All properties that have received a reduction under Proposition 8 do not automatically receive the CCPI adjustment as these properties are assessed annually and adjusted upward or downward depending on the changes to property values. With the continued recovery in the real estate market, it is anticipated that upward adjustments will continue to be realized in 2014-2015. In calendar year 2013, residential real estate experienced gains as the December 2013 median sales price of \$685,000 for single-family homes was 17% above the December 2012 level of \$584,500.

It should be noted that final data on the actual tax levy for 2014-2015 is not yet available as adjustments are made through June 30, 2014. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Many of the adjustments, however, are not reflected until the latter months of a given fiscal year (April-June). The impact of reassessments of commercial property will not be known until the end of 2013-2014. As this information becomes available, refinements to the Property Tax estimates may be

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brought forward in the 2014-2015 Proposed Budget or during the Proposed Budget review process in May and June.

Unsecured Property Taxes are the second largest revenue source in this category. Growth in this category is driven primarily by increases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections through December, Unsecured Property Tax receipts are estimated at \$12.5 million in 2013-2014, which is slightly below the prior year level and most recent peak of \$12.6 million. Collections are expected to increase 3.0% in 2014-2015 to \$12.9 million based on improving business conditions and increasing employment. In 2014-2015 estimates exceed the recent peak of \$12.6 million in 2012-2013, however, remain below the peak of \$14.1 million in 2002-2003.

SB 813 Property Taxes (supplemental taxes) represent payments for taxes owed on recent housing resales. In recent years, collections in this category had fallen significantly, due, in part, to a substantial number of refunds that were due to property owners as a result of declining home values. In 2013-2014, receipts are estimated at \$3.4 million, which is above the collection levels in both 2012-2013 (\$3.0 million) and 2011-2012 (\$3.3 million). However, collections are expected to remain well below the peak of \$10.1 million received in 2005-2006 and below levels seen just a few years ago (e.g., \$8.0 million in 2006-2007 and \$7.9 million in 2007-2008). In 2014-2015, collections in this category are projected to decrease approximately 17.6% to \$2.8 million due to an anticipated change in methodology for the SB 813 distribution. In 2004-2005, the State Motor Vehicle In-Lieu (VLF) Swap involved the permanent conversion of VLF backfill funds to Property Tax that was part of the approved State budget. Since SB 813 Property Tax receipts are pooled receipts that are allocated to each jurisdiction based on their share of secured property taxes, an increase in the City's Secured Property Taxes increased the City's share of SB 813 receipts. Per conversations with the County of Santa Clara, it is anticipated that beginning in 2014-2015, VLF receipts associated with the swap will not be considered Property Tax for the SB 813 calculation and, therefore, will reduce the City's relative share of this tax. This decrease is anticipated to be partially offset by the growth in property assessed value as discussed in the Secured Property Tax section.

Aircraft Property Tax payment is estimated at \$2.2 million in 2013-2014, a 3.2% increase from prior year levels. In 2014-2015, receipts are anticipated to remain at prior year levels.

The Homeowners Property Tax Relief category is projected at \$1.0 million for 2014-2015, which is consistent with the 2013-2014 revenue estimate and 2012-2013 actual collections.

In the out-years of the Forecast, annual Property Tax receipts are projected to increase approximately 4.5% to 4.9% annually over the five year period. A portion of this growth due to an estimated 2% CPI increase annually.

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### Sales Tax

The Sales Tax category includes General Sales Taxes and Proposition 172 Sales Taxes. Overall, 2013-2014 collections are expected to increase 5.4% over prior year levels to \$172.5 million. In 2014-2015, year-over-year growth of 3.0% is expected, bringing the projected revenue to \$177.7 million. It is important to note that the total revenue anticipated for 2013-2014 includes a number of one-time adjustments.

For the General Sales Tax revenue category, only one quarter of 2013-2014 data is available. Based on this limited information, year-over-year growth of 5.3% is projected in 2013-2014, resulting in collections of \$166.9 million. This increase from the \$158.6 million collected in 2012-2013 does factor in one-time accounting adjustments to reflect prior-year collections (\$300,000) and the "Triple Flip" true-up payment from the State for 2013-2014. The 2013-2014 estimate reflects actual growth of 8.5% in the first quarter and projected underlying growth of 3.5% in the remaining three quarters based on recent sales tax performance and current economic conditions. With continued improvement in the economy, sales tax growth is also expected to continue.

For 2014-2015, the General Sales Tax revenue projection of \$171.9 million assumes moderate growth of 3.0% in taxable sales from 2013-2014 levels. Because there are again one-time accounting adjustments to reflect prior-year collections and the "Triple Flip" true-up payment from the State in 2013-2014 that are not reflected in 2014-2015, the underlying economic growth in 2014-2015 is estimated to be approximately 4.0%. To put the 2014-2015 estimate into perspective, the projected revenue of \$171.9 million exceeds the historic peak collection of \$164.3 million in 2000-2001, bringing revenues above pre-recession levels and above levels seen during the dotcom boom (not adjusted for inflation). In the out-years of the Forecast, annual Sales Tax performance is expected to show moderate growth of 3.2% to 4.0% annually over the five-year period.

The Sales Tax revenue projections for 2013-2014 will continue to be refined over the next couple of months as additional information becomes available. Sales Tax data for the second quarter of 2013-2014, which covers the 2013 holiday period, will be received in March 2014. Based on this additional data, any necessary adjustments to the estimate will be incorporated into the 2014-2015 Proposed Operating Budget.

Proposition 172 Sales Tax collections (representing the one-half cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total \$5.6 million in 2013-2014, which represents an 8.7% increase from the prior year collections of \$5.2 million based on activity through the first seven months of 2013-2014. In 2014-2015, collections are projected to increase 4.0%, to \$5.8 million.

### Transient Occupancy Tax

Currently, Transient Occupancy Tax (TOT) receipts in 2013-2014 are projected to reach \$11.6 million, reflecting an increase of 14.8% from the 2012-2013 collection level. Current year

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receipts mark the fourth year of growth and the third year of double digit strong growth in this category which is in stark contrast to declines of 11.5% and 18.5% in 2009-2010 and 2008-2009, respectively. The completion of the Convention Center renovation and expansion project, which added 125,000 square feet of new flexible space, as well as improvements to the existing space, in September 2013, is expected to continue to support the room night activity in the market. Overall, the hotel industry continues to experience a period of growth with increases in occupancy levels (approximately 4% year-over-year growth) and average daily room rates (approximately 11% growth) with an average revenue-per-available room reflecting an increase of approximately 17% from prior year levels. Projected 2013-2014 receipts exceed the pre-recession level of \$9.6 million collected in 2007-2008 by approximately 21% and are approximately 6% above the historic peak of \$10.9 million in 2000-2001.

In 2014-2015, growth of 1.3% from the 2013-2014 estimate is anticipated which allows for the stabilization of the current high level of growth. Once adjusted for compliance revenue in 2013-2014, TOT receipts are estimated to grow 4.0% from 2013-2014 levels. Over the five-year forecast period, revenues are anticipated to grow steadily at 3.2% to 6.4% annually, with an assumed increase in room capacity inventory in 2015-2016 included in this forecast.

### Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Cable, Tow, Commercial Solid Waste, Water, and Nitrogen Gas Pipeline categories. Overall, collections are projected at \$44.7 million in 2013-2014, an increase of 2.1% from prior year receipts of \$43.7 million. The projected increase in 2013-2014 is primarily due to higher collections in the Gas and Electric services. In 2014-2015, Franchise Fees are expected to increase 1.2% to \$45.2 million due to growth in the Gas (5.1%), Water (5.0%), Cable (1.1%), and Electric (1.0%) categories.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2013-2014 are based on the calendar year 2013). Year-end estimates are typically based upon an examination of electricity and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. When comparing 2012 and 2013 calendar year Utility Tax receipts, Gas receipts showed a significant increase of 6.8% and Electric showed an increase of 4.5%. The reconciliation of annual receipts from PG&E for 2013-2014 will be received in April 2014.

In the Electric Franchise Fee category, collections in 2013-2014 are expected to reach \$19.0 million, reflecting growth of approximately 4% compared to actual receipts in 2012-2013 and slightly below the actual growth in Electric Utility Tax receipts in calendar year 2012 compared to 2013. In 2014-2015, growth of 1.0% from 2013-2014 estimates is anticipated reflecting a rate increase of 0.6% to 1.3% effective January 2014 per PG&E forecasts. It should be noted that due to the uncertainty regarding the outcome of rate cases, no rate increases associated with any pending rate cases have been assumed.

In the Gas Franchise Fee Category, the 2013-2014 estimated collections of \$4.4 million reflect a 5.0% increase from the \$4.2 million received in the prior year. This is compared to actual Gas

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Utility Tax receipts in calendar year 2012 compared to 2013 which reflected growth of 6.8%. In 2014-2015, Gas Franchise Fee collections are projected to increase further by 5% based on the assumption that costs will continue to rise. Based on PG&E forecasts, rate increases of 5.7% to 7.3% are estimated primarily due to the rising commodity and transportation costs. It should be noted that due to the uncertainty regarding the outcome of any rate cases, no rate increases associated with pending rate cases have been assumed in 2014-2015.

In City Generated Tow, projected revenues of \$875,000 in 2013-2014 are consistent with prior year levels. Collections are anticipated to remain flat at \$875,000 in 2014-2015 and continue to reflect the change in procedures by the Police Department, which reduced the number of tow and impounds for persons with violations that are not related to serious driving offenses in January 2011.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach budgeted levels of \$11.0 million in 2013-2014, consistent with the prior year collections reflecting the recently revised methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010 the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The new fee structure is \$5 million per year for each of two geographic collection districts plus a supplemental fee of \$1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the annual CPI rate during the prior two calendar years. It should be noted that this increase is not automatic and no increase was approved for 2013-2014; therefore, both the 2013-2014 and 2014-2015 estimates do not assume growth from 2012-2013 as City Council approval of a rate increase will be required.

Remaining categories, including Cable, Water, and Nitrogen Gas Pipeline, are estimated to end the year at \$9.4 million, which is slightly below (\$113,000) budgeted levels of \$9.5 million. Activity levels in 2014-2015 are expected to increase slightly compared to 2013-2014 levels, with 1.1% growth in Cable (to \$9.1 million), 5.0% growth in Water (to \$305,000), and no growth in the Nitrogen Gas Pipeline (\$66,000) categories. Increases are anticipated due to estimated changes in consumption levels as well as rates.

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase from 1.8% to 2.0% annually. Over the next five years, however, it should be noted that there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels. In addition, the City's current Cable Franchise Fee agreement is scheduled to sunset in 2016.

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### Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2013-2014 are anticipated to total \$94.8 million, representing an increase of 4.1% from the 2012-2013 collection level. The majority of this growth is projected in Electricity, Gas, and Water receipts as a result of rate increases, changes in consumption levels, and one-time adjustments.

In 2014-2015, Utility Tax collections are projected to increase 0.2% to \$95.0 million. Overall, a number of proposed rate cases have been filed that would affect electricity, gas, and water rates and consequently revenues. Due to the uncertainty regarding the outcome of rate cases, the Forecast generally does not assume revenue increases associated with pending rate cases. Rate cases will continue to be monitored and adjustments will be brought forward as appropriate based on the final outcomes.

The Electricity Utility Tax is anticipated to generate \$41.4 million in 2013-2014, a 5.3% increase from prior year levels. Estimated current year collections reflect a timing difference in payments, and estimated increase of 1% growth beginning January 2014, as well as actual collection trends. The significant growth from prior year levels is partially due to a refund that was processed by Pacific Gas and Electric (PG&E) for energy usage from April 2011 through June 2012. In 2014-2015, revenues are estimated to decrease 0.2% to \$41.3 million based on the annualization of the timing difference in payments reflected in 2013-2014, partially offset by the January 2014 estimated rate increase (0.7% to 1.3%) as outlined by PG&E, with minimal changes in anticipated consumption levels. Gas Utility Taxes are anticipated to increase to \$9.2 million in 2013-2014, a 9.4% increase from 2012-2013 levels, based on current collection trends. This increase reflects current collection levels as well as the anticipated increase in the commodity and transportation costs and is consistent with information from PG&E on the anticipated 5.7% to 7.3% increase in prices. In 2014-2015, revenues are anticipated to increase by approximately 1.6% to \$9.3 million. Actual collections continue to be subject to significant fluctuations from the impact of weather conditions and/or rate changes, as such no assumptions for changes due to rate cases are included and revenues will be monitored closely for projected performance.

Water Utility Tax receipts of \$11.1 million are anticipated to be received in 2013-2014, a 5.6% increase from 2012-2013 primarily reflecting the rising wholesale price of water and consistent with growth seen over the first half of this fiscal year. In 2014-2015, receipts are expected to increase 2.7% to \$11.4 million based on the continued rising wholesale price of water as well as some growth due to anticipated increases in rates. It should be noted that a significant rate case continues to be under review by the Public Utilities Commission and an increase in rates are anticipated, however a minimal increase of annualizing a 5% increase January 2014 is included in 2014-2015 projections. The current estimates do not factor in additional rate increases or a drop in consumption as a result of the current drought.

In the Telephone Utility category, revenues are collected on landlines, wireless, and VoIP. Based on current tracking, receipts in 2013-2014 are anticipated to reach \$33.1 million, an approximately 1% increase from 2012-2013 (\$32.9 million) due to one-time accounting

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adjustments that increased 2013-2014 receipts. In 2014-2015, revenues are estimated to decline slightly to \$32.9 million due to elimination of the one-time accounting adjustments in 2013-2014. Without that adjustment, slight growth of less than 1% is anticipated in 2014-2015.

In the out years of the Forecast, growth ranging from 1.9% to 2.0% annually is expected in the Utility Tax category. As discussed above, there is significant volatility and uncertainty regarding the performance in this category based on outstanding rate cases as well as consumption levels. The Water and Gas Utility Tax categories are significantly influenced by weather conditions.

### Telephone Line Tax

Based on the current collection trend, receipts in both 2013-2014 and 2014-2015 are anticipated to total \$20.7 million, which is very close to the collection levels seen since 2009-2010. Given the steady nature of collections in this category, receipts are anticipated to remain flat in the out years of the Forecast for this category.

### Business Taxes

This category includes General Business Tax, Disposal Facility Tax, Cardroom Tax, and Marijuana Business Tax. In 2013-2014, Business Taxes are estimated to reach \$43.8 million, a 3.0% decline from prior year levels. Collections were higher in 2012-2013 primarily as a result of the Business Tax Amnesty Program. In 2014-2015, revenues are estimated to decrease 0.7% to \$43.5 million due to a decrease in General Business Tax to normalize the one-time activities in 2013-2014 for the final two months of the Business Tax Amnesty Program which ended August 2013.

In 2013-2014, General Business Tax proceeds are expected to reach \$11.3 million, a decline of 18.6% from the prior year level of \$13.9 million as a result of the end of the Business Tax Amnesty Program. As part of the Amnesty Program, a business owner was allowed to file a request for amnesty between December 1, 2012 and August 31, 2013. In 2014-2015, a decline of 2.7% to \$11.0 million is projected and reflects the elimination of the one-time revenues generated by the final two months of the Amnesty Program. As a result of the Amnesty Program, a thorough review of business accounts was completed resulting in the closing of inactive accounts. Additional information on this program can be found in a February 4, 2014 information memo which can be found at <https://www.piersystem.com/external/content/document/1914/2086510/1/02-05-14Finance.PDF>.

Based on current performance, collections in the Cardroom Tax category are estimated at \$16.0 million in 2013-2014, a decrease of 1.9% from the prior year collection level (\$16.3 million). In 2012-2013, there was a slight spike in activity resulting from the opening of Casino M8trix in August 2012. In 2014-2015, receipts are anticipated to remain at 2013-2014 levels. When compared to 2011-2012 receipts that did not have these one-time impacts, estimated 2014-2015 collections of \$16.0 million reflect growth of 7.1%.

In the Disposal Facility Tax category, collections are estimated at \$10.5 million in 2013-2014



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based on current collection trends, which assumes a slight decline (2.0%) from prior year collection levels of \$10.7 million. Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream varies due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. In recent years, revenues in this category have declined due, in large part, to increased waste diversion and the overall slowdown in the economy. In 2014-2015, revenues are projected to remain consistent with the 2013-2014 collection level of \$10.5 million.

On November 2, 2010, San José voters approved Ballot Measure U, which allows the City to tax all marijuana businesses (medical and non-medical; legal and illegal) at a rate of up to 10% of gross receipts. The City Council approved an increase from 7% to 10% effective July 2013. In 2013-2014, collections are anticipated to reach up to \$6.0 million, reflecting growth of 41.7% from the prior year collection level primarily reflecting the change in the tax rate as well as increased activity. As a result of the continued uncertainty surrounding this tax and the Marijuana Regulatory Program, 2014-2015 estimates are anticipated to remain flat at \$6.0 million until more information is known.

In the remaining years of the Forecast, the Business Tax category is expected to experience very minimal growth of less than 1% per year.

### Licenses and Permits and Departmental Charges

The Licenses and Permits and Departmental Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. In 2014-2015, the Licenses and Permits category is estimated at \$45.1 million and the Departmental Charges category is estimated at \$37.4 million.

For 2014-2015, the development-related revenues are expected to continue the strong performance experienced in the past few years. In cases where the development-related costs are projected to exceed revenues, there are sufficient earmarked reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact. For 2014-2015, the Building Fee Program, Planning Fee Program, and Public Works Fee Program expenditures are projected to exceed the base revenue estimates. This Forecast assumes that Fee Program Reserves will be used to address these shortfalls as outlined in the Beginning Fund Balance section below. In the Fire Fee Program, revenues are projected to exceed the base program costs; and, for purposes of this Forecast, the revenues in these programs have been set at the base cost level. Budget actions will be brought forward in each of these fee programs to maintain cost-recovery and ensure resources are available to address service needs.

For the non-development-related fees and charges, the 2014-2015 estimates are based on current collection trends. In the out years of the forecast, both the Licenses and Permits and Departmental Charges categories are expected to experience growth ranging from 2.9% to 4.1%.

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The growth rates in the out years are tied to the expected increases in costs which the fees are designed to recover, including increased retirement and health costs.

### Fines, Forfeitures and Penalties

In 2013-2014, the Fines, Forfeitures and Penalties category is expected to generate \$14.4 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately \$9.8 million in 2013-2014, an increase of 3.8% from the 2012-2013 receipts of \$9.4 million. When the 2013-2014 Adopted Budget was developed, however, it was assumed that Parking Fines would increase to \$11.0 million in 2013-2014 after a decline in 2012-2013 resulting from the transition of parking compliance officers from the Airport Department to the Transportation Department. Actual parking fine revenues have remained below projections and well below the 2011-2012 level of \$11.8 million due to a higher level of staff absences as a result of injuries and non-work related injuries/illnesses. In 2014-2015, Parking Fines are expected to improve slightly with receipts estimated at \$10.0 million. Total revenue in 2014-2015 is estimated at \$14.2 million in the Fines, Forfeitures, and Penalties category. In the out years of the Forecast, annual growth of approximately 1.6% to 2.4% is projected.

### Money and Property

This category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, and interest income and is projected to generate \$2.8 million in 2014-2015. Of this amount, \$1.9 million is expected to be generated from the rental of City-owned facilities. An additional \$350,000 is projected from subrogation recovery efforts and \$550,000 is projected from various interest earnings. For the General Fund portion of pooled funds, the 2014-2015 estimate for interest earnings assumes an average interest rate of only 0.37% applied to an average cash balance of approximately \$115 million for a total collection level of \$425,000. In the out years of the Forecast, growth of approximately 3% annually is assumed.

### Revenue from Local Agencies

In 2014-2015, revenue of \$22.1 million is projected from other local agencies, such as the Successor Agency to the Redevelopment Agency of San Jose, and the Central Fire District. This is significantly lower than levels in the 2013-2014 Modified Budget primarily due to a number of one-time payments from various grants and a one-time reimbursement from the Successor Agency to the Redevelopment Agency of San Jose in 2013-2014 and the elimination of the reimbursement from the County of Santa Clara to support the paramedic program.

The largest revenue estimate in this category is a reimbursement from the Successor Agency to the Redevelopment Agency of San Jose for the payment of the Convention Center Debt Service of \$15.3 million. This obligation continues to be evaluated as part of the winding down of the Successor Agency and the method, timing, and ability to reimburse the payment continues to be under review. A corresponding expenditure is assumed in the City-Wide Expenses category for this debt service payment.

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The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. For 2013-2014, Central Fire District payments are expected to end the year at \$5.2 million based on information from the Central Fire District staff, reflecting a 6.6% increase from the prior year. In 2014-2015, collections are projected to increase approximately 3.5%, to \$5.4 million, consistent with the increase in Secured Property Tax assumed in this forecast.

Payment from the County of Santa Clara for the first responder advanced life support program (Paramedic Program) has been eliminated in 2014-2015. In 2013-2014, \$2.2 million in reimbursement from the County was budgeted to offset a portion of the City's paramedic program costs as the delivery of these services is a responsibility of the County. However, because the City has not met the response time performance standards set forth in the agreement with the County, the County has withheld payment for this service. While the City continues to work through this issue with the County, no payments are assumed over the forecast period. However, the direct incremental cost to the City to provide the advanced life support-level of service totaling over \$5 million annually remains in the Forecast.

In addition, other projected payments from local agencies total \$1.4 million in 2014-2015, the largest of which are reimbursements for services provided by the Animal Care and Services Program (\$1.1 million) and payments associated with the annexation in the Cambrian area to the City of Campbell (\$199,000).

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 2.6% to 2.8%.

### **Revenue from the State of California**

The Revenue from the State of California category includes Tobacco Settlement payments, State grant revenues, and other State reimbursements. Collections in this category are estimated to reach \$10.7 million in 2014-2015 and decline to \$10.5 million in 2015-2016 through 2018-2019. Tobacco Settlement payments, which are estimated at \$9.0 million in 2014-2015 and the remaining years of the Forecast, account for the majority of revenue in this category.

The following State grants and reimbursements are expected in 2014-2015: Abandoned Vehicles Abatement Program (\$600,000); Auto Theft reimbursement (\$370,000); California Gang Reduction, Intervention and Prevention (CalGRIP) Grant (\$224,000); and Highway Maintenance Charges reimbursement (\$105,000). Vehicle License Fees Collection In Excess are also estimated at \$435,000 annually and account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures that are equally apportioned to counties and cities on a population basis.

Adjustments to the grant amounts are reflected in the remaining years of the Forecast. A decrease of \$224,000 is expected in 2015-2016 to reflect the elimination of the CalGRIP Grant. No annual growth is projected in the remaining three out years of the Forecast.

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### Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues. The following grants are anticipated in 2014-2015: Staffing for Adequate Fire & Emergency Response Grant 2011 (SAFER) (\$1.0 million); Community Oriented Policing Services (COPS) Hiring Grants (\$68,000); Community-Based Violence Prevention Office of Juvenile Justice and Delinquency Prevention (OJJDP) Grant (\$264,000); and National Forum Capacity-Building Grant OJJDP 2012-2015 (\$142,000). The corresponding expenditures for these grants are included in this forecast.

In the out-years of the Forecast, no grant funding is included. All of these grants were originally scheduled to sunset in 2014-2015 and no revenue is included in the forecast for these programs. The Police Department has pursued a one-time grant extension for the COPS 2010 grant which was recently approved and the associated one-time revenue will be brought forward as part of the 2014-2015 Proposed Budget. Extensions to the SAFER 2011 and COPS 2011 grants will be sought. Should extensions to the term of these grants be approved, additional revenues may be brought forward as part of the 2014-2015 budget process.

### Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including Arena Rental, Suite, Parking, and Naming revenues, cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and proceeds from the Sale of Surplus Property. In 2013-2014, this category is expected to generate \$120.5 million. The 2013-2014 estimate includes \$100 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANS) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits. Factoring out the TRANS issuance, 2013-2014 collections for this category are estimated to total \$20.5 million.

In 2014-2015, the revenue estimate of \$14.1 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2014-2015 costs or agreements and the elimination of one-time funding sources. This figure excludes revenues associated with the issuance of the TRANS that will be brought forward in 2014-2015 with an offsetting expenditure based on estimated cash flow needs.

In 2014-2015, Arena Rental, Suite, Parking, and Naming revenues are projected at \$5.5 million. The cost reimbursement for the Investment Program is estimated at \$2.4 million based on the current allocation of staff to this function. Payments from Comcast and AT&T are estimated at \$1.8 million. As defined in the Franchise Agreement, these funds will be used to support the Public, Education, and Government (PEG) Access facilities. There is an associated City-Wide Expenses allocation for this purpose. In addition, the proceeds from the Sale of Surplus Property category has been set at \$1.2 million based on the anticipated assets that will be sold next fiscal year and is slightly down from the \$1.3 million assumed in the 2013-2014 Adopted Budget. In the out years of the Forecast, annual increases range from 1.7% to 3.7%.

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### Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2013-2014 are projected to reach \$15.0 million, a slight decline of 0.7% from the prior year level of \$15.1 million. Collections are expected to continue to decline slightly by 1.0% to \$14.85 million in 2014-2015. In recent years, revenues in this category have declined. Several factors can impact collections, including volatile gas prices, the lingering impacts of the economic downturn, and a move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In the out years of the Forecast, collections are expected to decline by between 1.6% and 2.1% annually.

### Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2014-2015, a total of \$37.1 million in reimbursements are projected based on 2014-2015 overhead rates for the majority of City funds prepared by the Finance Department applied against the projected 2014-2015 salaries for those positions for which an overhead rate is applied.

In the remaining years of the Forecast, annual increases ranging from 2.9% to 4.1% are assumed, reflecting increases in costs which the overhead rate is designed to recover, including increased personal services costs.

### Transfers

The Transfers category is projected at \$18.4 million in 2014-2015, which reflects an increase of 7.8% from the \$17.1 million anticipated in 2013-2014, primarily due to the elimination of one-time reductions to transfer amounts in 2013-2014. The largest component of this category (\$9.6 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2014-2015, these reimbursements have been set to cover the base 2014-2015 costs. As discussed in the 2013-2014 Adopted Operating Budget, Fire SAFER 2010 grant revenues of \$2.3 million were anticipated to be received in 2013-2014 as a result of the approved extension of the time period to expend the grant funds from the Federal Emergency Management Agency/Department of Homeland Security. This additional revenue was used to lower the Transfer from the Airport Maintenance and Operation Fund to the General Fund for aircraft rescue and firefighting services provided by the Fire Department in order to help with airport cost competitiveness in 2013-2014. This one-time reduction was eliminated as part of the 2014-2015 forecasted transfer levels. However, a reserve of \$508,000 remains and it is anticipated that the Administration will incorporate this strategy into the 2014-2015 budget development process as appropriate.

Additional large transfers programmed for 2014-2015 include the Construction and Conveyance Tax Fund transfer (\$3.8 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer (\$1.8 million) for pavement maintenance activities; and the Workforce

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Investment Act Fund transfer (\$528,000) for use of various community centers and Workforce Investment Act program services.

Annual increases in the out years range from 1.5% to 2.1%. The reimbursement from the Airport Maintenance and Operation Fund for police and fire services is expected to increase in the out years based on the increased costs for those services.

### Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2014-2015 of \$787,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases from 2.9% to 4.1%.

### Beginning Fund Balance

The \$57.8 million forecast estimate of available 2014-2015 Beginning Fund Balance is based on the following assumptions:

- The 2014-2015 Contingency Reserve, \$31.0 million, is projected at the current level based on the assumption that this amount will not be used in 2013-2014 and will be carried over to 2014-2015. This reserve level complies with the City Council policy to maintain a minimum 3% Contingency Reserve. The Contingency Reserve is approximately enough to cover General Fund payroll costs for less than two and one-half weeks in an emergency.
- A total of \$24.0 million in fund balance will be achieved from a combination of excess revenues and expenditure savings (\$22.0 million) as well as the liquidation of prior-year carryover encumbrances (\$2.0 million). The estimated revenue and expenditure savings of \$22.0 million is anticipated to be generated by approximately 1% excess revenue and expenditure savings of 1.5%.
- An additional \$2.8 million reflects the liquidation of reserves: \$1.98 million from the Building Development Fee Program Reserve, \$417,000 from the Planning Development Fee Program Reserve, and \$339,000 from the Public Works Development Fee Program Reserve have been included in the fund balance estimate to cover 2014-2015 costs associated with these programs; and \$17,000 from the Wellness Program Reserve is included to support Wellness Program costs programmed in 2014-2015.

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue of 1.0% and expenditure savings, including liquidations of carryover encumbrances, of 1.75% would be generated annually; that the Contingency Reserve of \$31.0 million would be carried over each year; and the use of the Development Fee Program Reserves would continue in the out years to support development fee projected program costs in excess of revenues. This Contingency Reserve level in the out years of the Forecast complies with the City Council approved policy to maintain a minimum 3% Contingency Reserve level. In total, the Beginning Fund Balance ranges from \$57.8 million in 2014-2015 to \$57.3 million in 2018-2019.

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## EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2014-2015 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2014-2015 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from \$900.8 million in 2014-2015 to \$1.0 billion in 2018-2019, for an average growth rate of 3.2% per year.

### February 2014 Forecast Expenditure Summary

Expenditure Category	Modified Budget	Forecast				
	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
Personal Services						
Salaries and Other Compensation	\$ 378,477,361	\$ 384,846,000	\$ 398,387,000	\$ 407,847,000	\$ 417,533,000	\$ 427,449,000
Retirement	212,191,405	236,135,000	241,882,000	247,446,000	258,948,000	264,615,000
Health and Other Fringe Benefits	51,610,549	54,991,000	59,752,000	64,926,000	71,298,000	77,471,000
<b>Total Personal Services</b>	<b>\$ 642,279,315</b>	<b>\$ 675,972,000</b>	<b>\$ 700,021,000</b>	<b>\$ 720,219,000</b>	<b>\$ 747,779,000</b>	<b>\$ 769,535,000</b>
<b>Total Non-Personal/Equipment</b>	<b>\$ 95,400,806</b>	<b>\$ 86,995,000</b>	<b>\$ 90,173,000</b>	<b>\$ 91,939,000</b>	<b>\$ 94,925,000</b>	<b>\$ 97,305,000</b>
City-Wide						
City-Wide Expenses	\$ 223,771,488	\$ 73,803,000	\$ 75,265,000	\$ 77,979,000	\$ 81,929,000	\$ 84,410,000
Capital Projects	31,270,000	5,250,000	5,250,000	5,250,000	5,250,000	5,250,000
Transfers	24,913,473	26,092,000	26,660,000	28,246,000	29,177,000	30,872,000
Earmarked Reserves	124,317,556	1,450,000	1,450,000	1,450,000	1,450,000	1,450,000
Contingency Reserve	31,000,000	31,000,000	31,000,000	31,000,000	31,000,000	31,000,000
<b>Total City-Wide</b>	<b>\$ 435,272,517</b>	<b>\$ 137,595,000</b>	<b>\$ 139,625,000</b>	<b>\$ 143,925,000</b>	<b>\$ 148,806,000</b>	<b>\$ 152,982,000</b>
Committed Additions						
New Parks and Recreation Facilities Maint. & Operations		\$ 193,000	\$ 331,000	\$ 484,000	\$ 605,000	\$ 692,000
New Traffic Infrastructure Assets Maint. & Operations		11,000	57,000	121,000	131,000	145,000
Measure O (Library) Maint. & Operations			237,000	735,000	757,000	779,000
Measure P (Parks) Maint. & Operations					87,000	81,000
Measure O (Public Safety) Maint. and Operations - Fire			11,000	23,000	23,000	23,000
<b>Total Committed Additions</b>		<b>\$ 204,000</b>	<b>\$ 636,000</b>	<b>\$ 1,363,000</b>	<b>\$ 1,603,000</b>	<b>\$ 1,720,000</b>
<b>Total Base Exp. w/ Committed Additions</b>	<b>\$ 1,172,952,638</b>	<b>\$ 900,766,000</b>	<b>\$ 930,455,000</b>	<b>\$ 957,446,000</b>	<b>\$ 993,113,000</b>	<b>\$ 1,021,542,000</b>
<b>Growth %</b>			<b>3.3%</b>	<b>2.9%</b>	<b>3.7%</b>	<b>2.9%</b>

It is important to note that adjustments are made to the Forecast to eliminate one-time additions/deletions and annualize partial year allocations that were included in the 2013-2014 Adopted Budget. Various one-time additions totaling approximately \$2.5 million that are scheduled to expire in June 2014, include funding for the Public Works Department Preventative Maintenance Program, Evergreen Branch Saturday Hours, San Jose Parks Foundation, CommUniverCity Program, Overfelt Swimming, Franklin McKinley Children's Initiative Summer Programming, Domestic Violence Coordination, 2-1-1 Santa Clara County Information and Referral Services, Neighborhoods of Distinction Program, Filling Empty Storefronts Pilot, Senior Nutrition Gas Cards, La Raza Roundtable/Harvard Study Consensus Building Project, Center for Employment Training, and the Energy Efficiency Program. There were also programs funded on a two-year basis totaling approximately \$7.3 million, including the Homeless Rapid Rehousing, the Homeless Response Team, an enhanced San José BEST and

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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 2014-2015 and 2015-2016. This analysis will be conducted during the 2014-2015 budget process and funding recommendations for these programs and services will be included in the 2014-2015 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.

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

### Personal Services

As is the usual practice, the first year (2014-2015) projection for personal services costs in this Forecast has been calculated at a detailed level. An extract of payroll system information as of September 2013 was used as the starting point. This individual position-level information was then reviewed, corrected, and updated by each department to include current vacancies and filled positions, accurate salary step status, as well as any position reallocations. Also, 2013-2014 ongoing position reductions (cost savings) and additions (cost increases) were annualized and all categories of benefit costs in the coming year were projected. In January 2014, the most recent retirement plan and health plan information for each position was also updated from the payroll system.

For the 2014-2015 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the General Fund's total costs. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the \$676.0 million projected personal services total for 2014-2015, salaries and other compensation costs amount to \$384.8 million (56.9% of projected personal services), retirement costs amount to \$236.1 million (34.9% of projected personal services), and health and other fringe benefits costs amount to \$55.0 million (8.2% of projected personal services). Growth in retirement costs and other personnel cost components (e.g., scheduled non-management step increases, management pay for performance, health and other fringe benefits) continue to impact personal services costs and are the primary factor for the expenditure growth in this category. In addition, as was the case in the February 2013 Forecast, a modest employee compensation planning reserve has been assumed to set aside funds for future salary adjustments for all employees with the exception of those represented by the San José Police Officers' Association (SJPOA). The City and the SJPOA have agreed upon pay increases through December 31, 2015 which are reflected in this Forecast. Also, an employee market competitiveness reserve has been included to potentially provide salary adjustments to specific job classifications where recruitment and retention issues are being experienced.

Below is a discussion of the specific factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this



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Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. For this Forecast, the out years are projected to inflate at a composite rate of approximately 3.5%.

### Salaries and Other Compensation:

An Employee Compensation Planning Reserve for all employees but SJPOA is included in each year of this Forecast in order to set aside funds for potential employee pay increases. This reserve allocation totaling \$13.5 million for 2014-2015 represents a modest amount of funding, and would require City Council labor negotiations direction and discussions with the City's bargaining groups before any form of distribution could be made. For employees represented by the SJPOA, the Forecast includes 3.33% increases in 2014-2015 (\$7.0 million) and 3.33% increases through December 2015. Total ongoing funding of \$1.2 million is also included in an Employee Market Competitiveness Reserve in 2014-2015 to provide funding for potential salary increases for specific job classifications where recruitment and retention issues are being experienced. Further analysis is underway to determine which classifications may be considered for a special employee compensation pay increase.

Salary step increases for current non-management employees and pay for performance for management employees for 2014-2015 are projected at \$3.0 million, or an increase of 0.44%. With the exception of employees represented by the San José Police Officers' Association (SJPOA) and San José Fire Fighters, International Association of Fire Fighters (IAFF) Local 230, non-management step increases have been calculated at a 2.5% step increase rate. For SJPOA and IAFF, a 5% step increase rate was applied in this forecast. The out years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

Overtime expenditures in the General Fund total \$21.2 million for 2014-2015, with the majority of the expenditures for Police Department (\$12.0 million) and Fire Department (\$5.6 million) operations. The out years of the Forecast continue these costs, with small adjustments using salary step growth as the inflationary factor.

### Retirement:

The City's two retirement systems, the Federated Retirement System and the Police and Fire Department Retirement Plan, provide defined retirement benefits to eligible employees. Both retirement plans use investment income and employer and employee contributions to provide eligible retirees with pensions and retiree healthcare benefits. Employees represented by SJPOA and IAFF, Local 230 are members of the Police and Fire Department Retirement Plan and have different retirement benefits with the corresponding different City contributions and rates. Within the Federated Retirement System, effective September 30, 2012, as approved by the City Council, the City provides for a lower defined benefit plan (Tier 2) for new employees who are members of the Federated Retirement System. Employees who joined the City prior to

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September 30, 2012, who are members of the Federated Retirement System are members of Tier 1. Employees who are members of the Federated Retirement System who joined the City between September 30, 2012 and September 27, 2013 are eligible for retiree healthcare coverage (Tier 2a). Effective September 27, 2013, as approved by the City Council, new employees, who are members of the Federated Retirement System, no longer receive retiree healthcare coverage (Tier 2b). Within the Police and Fire Department Retirement Plan, effective August 4, 2013, the City provides for a lower defined benefit plan (Tier 2) for new police members. A lower defined benefit plan has not yet been implemented for new fire members in the Police and Fire Department Retirement Plan and is pending binding interest arbitration.

For 2014-2015, retirement costs total \$236.1 million for the General Fund based on the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. To generate budgetary savings, this cost assumes the pre-payment of the City's annual required contribution (ARC) for Federated Retirement System Tier 1 members and contributions for the Police and Fire Department Retirement Plan for police Tier 1 and fire members. This amount, which is an increase of \$23.9 million from the 2013-2014 Modified Budget of \$212.2 million, represents 26.2% of the total General Fund base expenditure budget. Of the \$236.1 million General Fund retirement cost, \$235.5 million is associated with the ARC for pension and retiree healthcare as follows: \$82.9 million is projected to be paid to the Federated Retirement System (\$76.2 million for Tier 1, \$1.8 million for Tier 2a and \$4.9 million for Tier 2b); and \$152.6 million to the Police and Fire Department Retirement Plan (\$89.0 million for police Tier 1, \$2.6 million for police Tier 2, and \$61.0 million for fire).

The remaining \$0.6 million in retirement costs are associated with part-time benefited employees, the Mayor and City Council, and new employees in Unit 99, who opted to participate in a defined contribution plan versus a defined benefit plan. At the December 4, 2012 City Council Meeting, the City Council approved a defined contribution plan (Tier 3) for new employees in Unit 99. Unit 99 consists of Senior Staff, Executive Staff, and senior managers under the City Manager's Appointing Authority; City Council Office staff; professional and management employees under the appointing authority of the City Attorney, City Auditor, and Independent Police Auditor; and some employees in the City Clerk's Office. Effective February 4, 2013, new employees to the City hired directly into Unit 99 will have the ability to make the one-time election to participate in the defined benefit Tier 2 plan or the Tier 3 plan. The Tier 3 plan provides for a City contribution of 3.75%.

In comparison to the February 2013 Forecast for the 2014-2015 retirement cost projections, the 2014-2015 retirement costs experienced an increase of \$7.4 million, from \$228.7 million to \$236.1 million, due to economic and demographic assumption changes between the Federated Retirement System and the Police and Fire Department Retirement Plan. The overall increase was partially offset by savings from the implementation of the lower cost defined benefit plan for police Tier 2 members.

In 2010-2011, the Retirement Boards adopted an annual required contribution methodology, which requires the City to pay a minimum ARC or a percentage of payroll, whichever is greater.

# ELEMENTS OF THE GENERAL FUND FORECAST

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With this ARC funding methodology, if the City's pensionable payroll amount changes due to staffing reductions or vacancies, the City's retirement cost will not change unless the City's ARC is based on a percentage of payroll. Due to the independently estimated payroll projections by the Retirement Boards' actuary and the City Manager's Budget Office, the City calculations for the City retirement contributions for Federated Retirement System Tier 1, police Tier 1 and fire members of the Police and Fire Department Retirement Plan, are based on the minimum ARC as required by the Boards or the ARC based on Board approved percentage of budgeted payroll as calculated by the City Manager's Budget Office, whichever is greater. For fire members of the Police and Fire Department Retirement Plan, the payment of the minimum ARC is assumed in the 2014-2015, 2017-2018, and 2018-2019 fiscal years. The City's payment of retirement costs based on a percentage of payroll is assumed for the fire members of the Police and Fire Department Retirement Plan in 2015-2016 and 2016-2017 fiscal years, in all five years for police Tier 1 members of the Police and Fire Department Retirement Plan and the Federated Retirement System Tier 1 contributions. Please note that in November 2012, the Federated Retirement System Board approved that for Federated Retirement System Tier 2 members, the City's contribution shall only be based on a percentage of payroll. This Forecast continues the assumption that the City's contributions for the Federated Retirement System Tier 2a and Tier 2b members and for police Tier 2 participants of the Police and Fire Retirement Plan shall be paid based on a percentage of payroll.

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 2012-2013. In June 2013, an 18-month extension of the phase-in for members in the Federated Retirement System was approved by the City Council. This is set to expire in December 2014. This Forecast assumes the full funding of the ARC upon expiration in December 2014 (with a contribution rate of 12.96% for the City for the Federated Retirement System Tier 1 and Tier 2a members and a contribution rate of 18.6% for Tier 2b employees in the Federated Retirement System). It is important to note that a retiree healthcare working group is currently underway with the nine Federated Retirement System bargaining units, with the possibility of entering into negotiations, where changes to retiree healthcare could be made.

Per the respective Memoranda of Agreements with SJPOA and IAFF, the annual retiree healthcare contribution rate is capped at 11.0% for the City and 10.0% for employees. The City's retiree healthcare contribution rate for police members assumes the 11% cap through the Five-Year Forecast. The City's retiree healthcare contribution rate for fire members is increasing by 1.3% percentage points from 8.0% in 2013-2014 to 9.3% in 2014-2015, and is projected to increase to 10.6% for 2015-2016 and remain steady at 10.7% for the remaining Forecast period falling slightly below the cap of 11%.

Based on projections received from the Retirement Boards' actuary (Cheiron) and the Budget Office's independent analysis, the table on the following page details the General Fund's retirement costs and budgetary retirement contribution rates for the Federated Retirement System and the Police and Fire Department Retirement Plan and the respective pension and retiree healthcare costs for the forecast period.

# ELEMENTS OF THE GENERAL FUND FORECAST

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### 2015-2019 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES ( \$ in Millions and with Pre-Payment Discount)

Retirement Plan	2013- 2014	2014- 2015	2015- 2016	2016- 2017	2017- 2018	2018- 2019
Fed. Ret. System Tier 1 – Pension	\$58.2	\$64.4	\$64.3	\$65.0	\$67.2	\$67.5
Fed. Ret. Syst. Tier 1 – Ret. Healthcare*	\$10.1	\$11.8	\$13.8	\$13.4	\$12.7	\$12.0
<b>Fed. Retirement Plan Tier 1 - Total</b>	<b>\$68.3</b>	<b>\$76.2</b>	<b>\$78.1</b>	<b>\$78.4</b>	<b>\$79.9</b>	<b>\$79.5</b>
<b>Budgetary Contribution Rates</b>	<b>57.4%</b>	<b>68.8%</b>	<b>73.6%</b>	<b>77.7%</b>	<b>83.7%</b>	<b>88.3%</b>
Fed. Ret. System Tier 2a – Pension	\$2.0	\$0.6	\$0.6	\$0.6	\$0.6	\$0.7
Fed. Ret. Syst. Tier 2a – Ret. Healthcare*	\$2.5	\$1.2	\$1.5	\$1.6	\$1.6	\$1.7
<b>Fed. Retirement Plan Tier 2a - Total</b>	<b>\$4.5</b>	<b>\$1.8</b>	<b>\$2.1</b>	<b>\$2.2</b>	<b>\$2.2</b>	<b>\$2.4</b>
<b>Budgetary Contribution Rates</b>	<b>15.3%</b>	<b>16.6%</b>	<b>19.0%</b>	<b>19.3%</b>	<b>19.3%</b>	<b>19.4%</b>
Fed. Ret. System Tier 2b – Pension	N/A	\$1.3	\$1.8	\$2.3	\$2.8	\$3.4
Fed. Ret. Syst. Tier 2b – Ret. Healthcare*	N/A	\$3.6	\$4.4	\$5.7	\$7.1	\$8.4
<b>Fed. Retirement Plan Tier 2b - Total</b>	<b>N/A</b>	<b>\$4.9</b>	<b>\$6.2</b>	<b>\$8.0</b>	<b>\$9.9</b>	<b>\$11.8</b>
<b>Budgetary Contribution Rates</b>	<b>N/A</b>	<b>16.6%</b>	<b>19.0%</b>	<b>19.3%</b>	<b>19.3%</b>	<b>19.4%</b>
Police Ret. Plan Tier 1 – Pension	\$75.4	\$77.2	\$77.1	\$77.7	\$79.9	\$79.7
Police Ret. Plan Tier 1 – Ret. Healthcare	\$11.9	\$11.8	\$12.0	\$11.9	\$11.8	\$11.5
<b>Police Retirement Plan Tier 1 – Total</b>	<b>\$87.3</b>	<b>\$89.0</b>	<b>\$89.1</b>	<b>\$89.6</b>	<b>\$91.7</b>	<b>\$91.2</b>
<b>Budgetary Contribution Rates</b>	<b>73.3%</b>	<b>80.3%</b>	<b>79.1%</b>	<b>79.8%</b>	<b>82.7%</b>	<b>84.0%</b>
Police Retirement Plan Tier 2 – Pension	N/A	\$1.3	\$1.6	\$2.0	\$2.5	\$3.1
Police Ret. Plan Tier 2 – Ret. Healthcare	N/A	\$1.3	\$1.6	\$2.0	\$2.6	\$3.2
<b>Police Retirement Plan Tier 2– Total</b>	<b>N/A</b>	<b>\$2.6</b>	<b>\$3.2</b>	<b>\$4.0</b>	<b>\$5.1</b>	<b>\$6.3</b>
<b>Budgetary Contribution Rates</b>	<b>N/A</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>
Fire Retirement Plan – Pension	\$46.1	\$54.2	\$54.5	\$56.2	\$60.8	\$63.8
Fire Ret. Plan – Retiree Healthcare	\$5.4	\$6.8	\$8.0	\$8.3	\$8.6	\$8.9
<b>Fire Retirement Plan - Total</b>	<b>\$51.5</b>	<b>\$61.0</b>	<b>\$62.5</b>	<b>\$64.5</b>	<b>\$69.4</b>	<b>\$72.7</b>
<b>Budgetary Contribution Rates</b>	<b>73.0%</b>	<b>81.1%</b>	<b>80.0%</b>	<b>80.7%</b>	<b>83.4%</b>	<b>84.4%</b>
<b>Other Retirement Costs</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>\$0.7</b>	<b>\$0.7</b>	<b>\$0.7</b>	<b>\$0.7</b>
<b>Total General Fund</b>	<b>\$212.2</b>	<b>\$236.1</b>	<b>\$241.9</b>	<b>\$247.4</b>	<b>\$258.9</b>	<b>\$264.6</b>
<b>Total All Funds</b>	<b>\$272.1</b>	<b>\$308.6</b>	<b>\$317.3</b>	<b>\$324.6</b>	<b>\$339.0</b>	<b>\$345.8</b>

\* Federated Retirement System Board approved a blended Retiree Healthcare rate for 2015-2016 through 2018-2019 projections. Actual rates in those years will differ depending on Plan.

Source: 2013-2014 Modified Budget; Cheiron Letters dated January 15, 2014, January 29, 2014, February 18, 2014, and February 26, 2014 with applied pre-payment discount for Federated Retirement System Tier 1, the Police Retirement Plan Tier 1, and the Fire Retirement Plan; Automated Budget System adjusted payroll for Fire Retirement Plan and Other Retirement Costs

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During the forecast period, General Fund retirement contributions will increase by approximately \$28.5 million, or 12.1%, from \$236.1 million in 2014-2015 to \$264.6 million in 2018-2019. For 2018-2019, projected retirement costs are estimated to be 25.9% of the General Fund. During the same period, the City retirement contribution for all funds will increase by \$37.2 million from \$308.6 million in 2014-2015 to \$345.8 million in 2018-2019.

Similarly, the City's budgetary retirement contribution rates show significant increases for the Federated Retirement System Tier 1 participants and for police Tier 1 and fire members of the Police and Fire Department Retirement Plan. To cover the necessary City payment for Federated Retirement System Tier 1 members, the budgetary retirement contribution rate increases from 68.8% in 2014-2015 to 88.3% in 2018-2019; for Federated Retirement System Tier 2a, the budgetary contribution rate increases from 16.6% in 2014-2015 to 19.4% in 2018-2019; for Federated Retirement System Tier 2b members, the budgetary City contribution rate decreases from 21.3% in 2014-2015 to 19.4% in 2018-2019; for police Tier 1 members, the budgetary City contribution rate increases from 69.7% in 2014-2015 to 73.3% in 2018-2019; for the police Tier 2, the budgetary retirement contribution rate stays at 21.8% through the five-year Forecast; and for fire members, the budgetary retirement contribution rate increases from 81.1% in 2014-2015 to 87.3% in 2018-2019.

For illustration purposes, the table on the following page depicts the Retirement Board approved contribution rates for 2014-2015 and the Cheiron projected rates for the out years of the Forecast. To cover Federated Retirement System Tier 1 contributions, the Board approved City pension rate increased from 50.8% for 2013-2014 to 60.3% for 2014-2015 and is projected to increase to 77.7% for 2018-2019. The City pension rate to cover Tier 2a and Tier 2b participants is 5.5% throughout the Five-Year Forecast. The retiree healthcare contribution rate (for employees with retiree healthcare coverage – Tier 1 and Tier 2a) increased from 8.7% for 2013-2014 to 11.0% for 2014-2015 (blending of the capped rate of 9.4% for the first half of 2014-2015 and the full ARC of 12.56% for the second half of 2014-2015) and is projected to increase to 13.8% for 2018-2019. It should be noted that the Federated Retirement Board approved a blended retiree healthcare contribution rate between 2015-2016 (13.5%) and 2018-2019 (13.8%) for contributions covering all Federated Retirement System members. The actual rate will differ between Tier 1, Tier 2a and Tier 2b.

To cover contributions for police Tier 1 members, the Retirement Board approved pension rate increased from 65.3% for 2013-2014 to 72.1% for 2014-2015 and is projected to increase to 75.9% for 2018-2019. The City pension rate to cover police Tier 2 participants decrease from 11.0% in 2013-2014 to 10.8% in each year of the Five-Year Forecast. Per the MOA between the City and SJPOA, the retiree healthcare contribution rate increased from 10.3% for 2013-2014 to 11.0% for 2014-2015 and will be held at 11.0% for the out-years even if the ARC for retiree healthcare is not fully funded. Per the MOA with SJPOA, once the 10% and 11% caps are reached, the parties will meet and confer. Through that process, changes could be made to retiree healthcare. Over the Forecast period, the total City contribution rate for police Tier 1 members increases from 83.1% to 86.9%. To cover contributions for police Tier 2 members, City rates increase from 21.3% in 2013-2014 to 21.8% in 2014-2015 and remain at this rate through the five-year Forecast.

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To cover contributions for fire members, the Board approved pension rate increased from 66.8% for 2013-2014 to 73.5% for 2014-2015 and is projected to increase to 76.6% for 2018-2019. The retiree healthcare contribution rate increased from 8.0% for 2013-2014 to 9.3% for 2014-2015 and is projected to increase to 10.6% for 2015-2016 and remain steady at 10.7% for the remaining Forecast period which is slightly below the cap of 11.0%. Over the Forecast period, the total contribution rate to cover fire members increases from 82.8% to 87.3%.

#### 2015-2019 BOARD APPROVED CITY CONTRIBUTION RATES

Retirement Plan	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
Fed. Ret. System Tier 1 – Pension	50.8%	60.3%	62.7%	66.7%	72.9%	77.7%
Fed. Ret. Syst. Tier 1 – Ret. Healthcare*	8.7%	11.0%	13.5%	13.8%	13.8%	13.8%
<b>Fed. Retirement Plan Tier 1 – Total</b>	<b>59.5%</b>	<b>71.3%</b>	<b>76.2%</b>	<b>80.5%</b>	<b>86.7%</b>	<b>91.5%</b>
Fed. Ret. System Tier 2a – Pension	6.7%	5.5%	5.5%	5.5%	5.5%	5.5%
Fed. Ret. Syst. Tier 2a – Ret. Healthcare*	8.6%	11.0%	13.5%	13.8%	13.8%	13.8%
<b>Fed. Retirement Plan Tier 2a - Total</b>	<b>15.3%</b>	<b>16.5%</b>	<b>19.0%</b>	<b>19.3%</b>	<b>19.3%</b>	<b>19.3%</b>
Fed. Ret. System Tier 2b – Pension	6.7%	5.5%	5.5%	5.5%	5.5%	5.5%
Fed. Ret. Syst. Tier 2b – Ret. Healthcare*	10.6%	15.7%	13.5%	13.8%	13.8%	13.8%
<b>Fed. Retirement Plan Tier 2b - Total</b>	<b>17.3%</b>	<b>21.2%</b>	<b>19.0%</b>	<b>19.3%</b>	<b>19.3%</b>	<b>19.3%</b>
Police Ret. Plan Tier 1 – Pension **	65.3%	72.1%	70.9%	71.6%	74.6%	75.9%
Police Ret. Plan Tier 1 – Ret. Healthcare***	10.3%	11.0%	11.0%	11.0%	11.0%	11.0%
<b>Police Retirement Plan Tier 1 – Total</b>	<b>75.6%</b>	<b>83.1%</b>	<b>81.9%</b>	<b>82.6%</b>	<b>85.6%</b>	<b>86.9%</b>
Police Retirement Plan Tier 2 – Pension **	11.0%	10.8%	10.8%	10.8%	10.8%	10.8%
Police Ret. Plan Tier 2 – Ret. Healthcare	10.3%	11.0%	11.0%	11.0%	11.0%	11.0%
<b>Police Retirement Plan Tier 2– Total</b>	<b>21.3%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>21.8%</b>
Fire Retirement Plan – Pension	66.8%	73.5%	72.3%	72.8%	75.6%	76.6%
Fire Retirement Plan – Retiree Healthcare	8.0%	9.3%	10.6%	10.7%	10.7%	10.7%
<b>Fire Retirement Plan – Total</b>	<b>74.8%</b>	<b>82.8%</b>	<b>82.9%</b>	<b>83.5%</b>	<b>86.3%</b>	<b>87.3%</b>

\* Federated Retirement System Board approved a blended Retiree Healthcare rate for 2015-2016 through 2018-2019 projections. Actual rates in those years will differ depending on Plan.

\*\* At the City's request, Cheiron provided a letter dated February 18, 2014 to the City Manager's Budget Office detailing Tier 1 and Tier 2 pension rates.

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

Source: Cheiron Letters dated January 15, 2014, January 29, 2014, February 18, 2014 (informational letter to City Manager's Budget Office providing further detail of the breakdown of rates between Tier 1 and Tier 2), and February 26, 2014

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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### Health and Other Fringe:

A forecasted health rate increase of 10% is included in the 2014-2015 Forecast based on national and City trend information received from the City's Human Resources Department benefits consultant. For the out years of the Forecast, the annual rate increase assumptions are held constant to the 2014-2015 rate increase.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, a 2.5% increase is anticipated in 2014-2015. For the out years, the Forecast assumes annual rate increases of 5.0% based on City trends and actuarial analysis.

There are no changes to the life insurance rates in this Forecast based on projected provider charges. For the payment of Unemployment Benefit Claims, the City is self-insured. Based on actual claims experienced in 2013-2014, current funding available in the Unemployment Insurance Fund, and projected future claims, the unemployment insurance rate continues to be suspended through 2016-2017. Starting in 2017-2018 and through the remaining out years, \$750,000 is included to cover projected future claims.

### Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total \$87.0 million in 2014-2015. In general, the process utilized by the Budget Office includes adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2013-2014, and including projected increases or decreases for specific large non-personal/equipment allocations (e.g., utilities, contractual services, vehicle maintenance and operations costs, and Police Department vehicle replacement). The resulting 2014-2015 estimates represent a decrease of \$8.4 million from the 2013-2014 Modified Budget level of \$95.4 million, primarily due to the elimination of rebudgeted or carryover projects.

Departmental gas and electricity funding for 2014-2015 totaling \$12.6 million has been slightly adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes. Minimal increases for negotiated contracts are included, primarily in the Police Department (\$315,000) for academy and County lab costs. Vehicle maintenance and operations costs in the General Fund including fuel, inventory, and fleet staffing reflect a \$300,000 increase (total of \$15.4 million) from the 2013-2014 Adopted Budget, primarily due to increased fuel and personnel costs. The 2014-2015 non-personal/equipment base includes an adjustment for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of \$3.9 million to \$2.9 million based on the current replacement schedules and projected costs for these vehicles. In the out years of the Forecast, the police vehicle replacement costs are expected to decline in the first three Forecast years and increase in the last two years of the Forecast, based on the anticipated

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total \$16.8 million.

For the out years of the Forecast, a growth rate of 2.0% has been assumed from the 2014-2015 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. With this adjustment, the average growth rate for the non-personal/equipment category is 3.0% annually.

### City-Wide

**City-Wide Expenses** in the first year of the Forecast (2014-2015) total \$73.8 million, a decline from the 2013-2014 Modified Budget of \$223.8 million. This large reduction primarily reflects the impact of deleting the \$100.6 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; deleting allocations that were rebudgeted to 2013-2014 (\$29.0 million); and the elimination of one-time proposals (\$9.4 million).

As part of determining the current financial state of the Successor Agency to the Redevelopment Agency (Successor Agency), in the context of the continuing efforts to wind down and dissolve the former Redevelopment Agency of San Jose, the Administration recently reviewed property tax increment revenues and the current level of enforceable obligations for the forecast period. For the purpose of this Forecast, assumptions regarding Property Tax Increment receipts over the five year period (2% growth annually), as well as sale of property timing, have been made. Based on these assumptions, it is projected that there will not be sufficient property tax increment revenues to pay all enforceable obligations during the forecast period and that the City will assume a portion of certain contractually obligated payments of the Successor Agency (4<sup>th</sup> Street Garage Debt Service, Convention Center Debt Service, HUD 108 Loan payments, and ERAF Loan Payments) as necessary. In addition, it is assumed that the City will also fund Successor Agency administrative support costs over the forecast period. The City's legal challenge of the County's actions of withholding a percentage of former agency tax increment to fund the County employees' retirement plan (the PERS levy) remains unknown, therefore, this forecast does not include these revenues.

Total General Fund support of \$2.0 million is assumed in 2014-2015. This figure drops to \$1.0 million annually in the out years of this forecast to reflect anticipated improvements in the financial outlook of the Successor Agency. In addition to the General Fund support, the General Purpose Parking Fund and Community Development Block Grant Fund are projected to provide financial support for the 4<sup>th</sup> Street Garage Debt Service and HUD 108 Loan payments, respectively, as necessary.

Although no assumption for City repayment of \$10.0 million in interfund loans associated with the former Redevelopment Agency Supplemental Educational Revenue Augmentation Fund (SERAF) loan is included at this time, the 2013-2014 budget includes an \$8.0 million reserve to assist in making the principle plus interest payments due by June 30, 2015. With the approval of



## ELEMENTS OF THE GENERAL FUND FORECAST

### EXPENDITURE FORECAST

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AB 1484 in June 2012, loans such as the interfund loans made in connection with the SERAF loan may be deemed an enforceable obligation contingent upon 1) a finding by the State Department of Finance that all required audits of the Successor Agency have been completed, and 2) a finding by the Oversight Board that these loans were for legitimate redevelopment purposes. The Administration continues to work through these requirements.

The remaining line-items in this category are adjusted to reflect anticipated costs for 2014-2015 based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2014-2015 allocations in this category include: Workers' Compensation Claims (\$19.5 million); Convention Center Lease Payments (\$15.3 million); Sick Leave Payments Upon Retirement (\$5.0 million); City-owned Facility Operating Agreements (\$3.4 million); FMC Debt Service Payments (\$3.3 million); San José BEST and Safe Summer Initiative Program (\$3.1 million); Parking Citations/Jail Courthouse Fees (\$2.5 million); General Liability Claims (\$3.0 million); Successor Agency Legal Obligations Subsidy (\$2.0 million); and Property Leases (\$1.9 million).

In the out years of the Forecast, City-Wide Expenses are projected to increase at an average growth rate of 3.6%. While several of the individual line items are expected to remain at 2014-2015 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from \$19.5 million to \$24.4 million). The FMC debt service payment is expected to increase significantly in the out years (from \$3.3 million to \$6.9 million) based on higher variable interest rate assumptions.

The anticipated administrative costs to issue TRANs Debt Service are also expected to climb (from \$800,000 to \$3.1 million over the forecast period) based on a conservative estimate of the size of the issuance required and anticipated increases in variable interest rates and higher bank fees. Prefunding the City's portion of retirement contributions over the past several years was successful in generating budgetary savings. Over the five-year period, however, prefunding amounts are projected to increase to levels where the City's short-term borrowing capacity may be reached. Additionally, to fulfill the larger cash requirements, the maturity horizon of the City's investment portfolio may need to shorten, reducing investment returns. Should this scenario materialize during the five-year projected period, switching back to a pay-as-you-go method of funding retirement contributions may be considered.

The General Fund Capital Projects category totals \$5.3 million in 2014-2015 and remains at this level in each of the out years of the Forecast. The largest item in this category is fire apparatus replacement (\$4.0 million annually). The investment in fire apparatus replacement in this Forecast is based on an analysis of projected replacement schedules, replacement costs, and apparatus changes to meet safety needs and has been lowered by \$1.0 million annually based on this analysis. It also assumes that the Fire C&C Fund will pay \$400,000 annually for these costs. In the Service Yards C&C Fund, this forecast assumes revenue collections in that fund would fully cover Central Service Yards debt service payments. The Capital Projects category also includes the continuation of annual allocations for Arena repairs (\$100,000 in the out years), unanticipated maintenance of City facilities (\$600,000), fuel tanks and methane monitoring

## ELEMENTS OF THE GENERAL FUND FORECAST

### EXPENDITURE FORECAST

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control and replacement (\$350,000), and annual capital expenditures (\$150,000) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building.

The **Transfers** category totals \$26.1 million in 2014-2015 and increases to \$30.9 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for City Hall is the largest line-item in this category and totals \$17.2 million in 2014-2015 (\$17.6 million to \$20.5 million in the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Hayes Mansion Conference Center (\$4.0 million in 2014-2015 to \$5.4 million in the out years) and Rancho del Pueblo and Los Lagos Golf Courses (\$1.6 million in 2014-2015 and up to \$1.89 million in the out years); payments in accordance with the San José Arena Management agreement extension (\$1.3 million in 2014-2015 and \$750,000 in the out years of the Forecast) for Arena repairs and capital enhancements; and a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement (\$1.0 million annually).

All of the debt service and maintenance and operations costs for the Hayes Mansion Conference Center and golf courses are funded in the Community Facilities Revenue and Municipal Golf Course Funds; however, revenues in those funds are not projected to be sufficient to completely cover these costs. The transfer for the Hayes Mansion Conference Center decreased from a \$5.9 million subsidy level in the out years of the last forecast to \$4.0 million required in 2014-2015 and then increases to \$5.4 million in the last year of this forecast based on projected debt service payments for that facility. These debt service payments are lower than the last Forecast due to a recent debt refunding and principal pay down. The transfer for the golf course subsidy also decreases from the \$2.0 million annual level assumed in the February 2013 Forecast to \$1.6 million in 2014-2015 based on current operational activity.

The payments for Arena repairs and capital enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. Payment for the City's share of the \$16.5 million of improvements at the Arena, as approved by the City Council in May 2007, total \$1.0 million in this Forecast. An additional \$250,000 is allocated to the Arena Reserve Fund to pay for repairs.

The transfer to the Vehicle Maintenance and Operations Fund (\$1.0 million annually) is included to fund a vehicle replacement schedule for the General Fleet as well as transfers to the Communications C&C Fund (\$237,500 in 2014-2015 to \$450,000 in the out years) to fund the City's share of capital costs for the Silicon Valley Regional Interoperability Authority and reimburse that fund for Civic Center video equipment.

The Transfers category also includes payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas (\$829,000 to \$870,000 annually).

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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The **Earmarked Reserves** category includes a Deferred Infrastructure and Maintenance Reserve of \$800,000 to fund critical capital maintenance or address urgent technology needs. These resources would be allocated as part of the 2014-2015 Proposed Budget. In addition, funding of \$150,000 is allocated to the General Plan Update Reserve to set aside fees collected by developers toward the future update or revision of the General Plan.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2013-2014, and would be recommended for rebudget or use in 2014-2015. Some of the larger current Earmarked Reserves include the 2014-2015 Future Deficit Reserve, Workers' Compensation/General Liability Catastrophic Reserve, Development Fee Program Reserves, and Salaries and Benefits Reserve.

Per City Council policy, the **Contingency Reserve** is projected at the level necessary to comply with the City Council policy to maintain a minimum 3% Contingency Reserve (\$31.0 million). This amount would be sufficient to cover approximately one pay period of payroll costs (two and one-half weeks). Amounts necessary to remain in compliance with that policy are also included in each of the remaining four years of the Forecast.

### Committed Additions to the Base General Fund Forecast

In this Forecast, projected additions to the base expenditure level have been included as **Committed Additions**. Although all are subject to further review during the budget process, Committed Additions are additional expenditures to which the City is considered to be committed by prior City Council action, such as the costs related to maintaining and operating capital projects previously approved by the City Council. The Forecast Base Case, considered most likely to occur, includes ongoing program costs plus Committed Additions.

Committed Additions total \$204,000 in 2014-2015 and increase to approximately \$1.7 million by 2018-2019. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

The approved bond measures from the elections of November 2000 and March 2002 will result in new and expanded library (Measure O), park (Measure P), and police and fire (Measure O) facilities and will require additional maintenance and operations funding (\$248,000 in 2015-2016 and increasing to approximately \$883,000 in 2018-2019). Some of the new facilities anticipated to be open during this forecast period include the Southeast Branch Library and the Softball Complex.

Also included in the Committed Additions are maintenance and operations costs associated with non-bond projects such as new parks and recreation facilities and new traffic infrastructure. The non-bond projects committed additions costs in the Forecast range from \$204,000 in 2014-2015 and increases to \$837,000 by 2018-2019.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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

Budget Principle #8 states that Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding \$100,000 without City Council certification that funding will be made available in the applicable year of the cost impact. Consistent with that direction, this Forecast includes a detailed list and discussion of capital projects that were previously certified by the City Council with annual operating and maintenance costs in the General Fund greater than \$100,000. Capital funding for these projects have been included as part of approved Capital Improvement Programs or approved by City Council in 2013-2014. The majority of these costs are associated with the voter-approved General Obligation bonds for Park, Library, and Public Safety facilities. The operating and maintenance costs for these facilities are included in the figures presented in this Forecast. There are no new projects identified in the Forecast that would need certification.

## ELEMENTS OF THE GENERAL FUND FORECAST

### OPERATING MARGIN

The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the Forecast, assuming the Base Case with Committed Additions. In 2014-2015, a shortfall of \$1.5 million is projected, followed by a shortfall of \$4.2 million in 2015-2016. A modest surplus of \$421,000 is projected in 2016-2017, followed by shortfalls of \$6.5 million in 2017-2018 and \$1.7 million in 2018-2019. Base Case expenditures, including committed additions, increase from \$900.8 million in 2014-2015 to \$1.02 billion in 2018-2019, for an average annual growth rate of approximately 3.2%. The sources of revenue total \$899.2 million in 2014-2015 and grow to \$1.01 billion in 2018-2019, increasing at a slightly lower average annual growth rate of 2.9%.

The following table shows how the projected surpluses and shortfalls have changed in the most recent forecasts. It is assumed that each preceding surplus or shortfall is addressed completely with ongoing solutions in the year it appears. Each year of the February 2014 Forecast is compared to the comparable year in the February 2013 Forecast.

<b>2015-2019 General Fund Forecast Changes in Operating Margin (\$ in Millions)</b>					
	<u>2014-2015</u>	<u>2015-2016</u>	<u>2016-2017</u>	<u>2017-2018</u>	<u>2018-2019</u>
<b>February 2013</b> Incremental Surplus/(Shortfall)	(\$13.7)	\$2.0	(\$4.7)	(\$6.0)	N/A
<b>June 2013</b> Incremental Surplus/(Shortfall)	(\$0.1)	N/A	N/A	N/A	N/A
<b>Revised Forecast</b>	(\$13.8)	\$2.0	(\$4.7)	(\$6.0)	N/A
<b>February 2014</b> Incremental Surplus/(Shortfall)	(\$1.5)	(\$4.2)	\$0.4	(\$6.5)	(\$1.7)

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 police retiree healthcare; costs associated with services funded on a one-time basis in 2013-2014; 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) that will be brought forward by City Council consideration as a Manager's Budget Addendum later in the 2014-2015 budget process; costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses. This forecast also does not factor in the potential impacts associated with the sunset of the Library Parcel Tax I 2015, which is budgeted in a special fund. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost recovery nature of those programs.

# ELEMENTS OF THE GENERAL FUND FORECAST

## OPERATING MARGIN

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For the February 2014 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2014-2015 and the remaining four years of the forecast period. The 2014-2015 projected shortfall of \$1.5 million reflects an improvement from the \$13.8 million budget shortfall projected in June 2013. A major factor contributing to this improvement includes the liquidation of the ongoing portion of the 2014-2015 Future Deficit Reserve (\$5.8 million) that was set aside as part of the \$20 million General Fund Contingency Plan to address uncertainties related to the Supplemental Retiree Benefit Reserve (SRBR) elimination and the lowest cost healthcare plan changes that is no longer needed. The remaining improvement is the net result of numerous revenue and expenditure changes that are explained earlier in this section.

In the remaining years of the Forecast, small General Fund shortfalls and a surplus are projected, ranging from -\$6.5 million to \$421,000 annually. These margins are extremely narrow when put into context of the size of the projected General Fund budget, ranging from -0.3% to 0.02% of the projected annual budget (revenues and expenditures). Over the five-year period, a total shortfall of \$13.5 million is anticipated, or approximately \$2.7 million annually. This average shortfall figure equates to only 0.1% of the projected General Fund annual budget.

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