



**2014-2015**  
**City Manager's Budget Request**  
  
**&**  
  
**2015-2019**  
**Five-Year Forecast**  
**and**  
**Revenue Projections**

**For the**  
**General Fund and Capital Improvement Program**

**Office of the City Manager**

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February 2014

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CITY MANAGER'S BUDGET REQUEST  
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FIVE-YEAR ECONOMIC FORECAST  
AND  
REVENUE PROJECTIONS**

**For the  
General Fund and Capital Improvement Program**

**TABLE OF CONTENTS**

	Page
TRANSMITTAL MEMORANDUM .....	I
I. Elements of the General Fund Forecast .....	I - 1
II. Base General Fund Forecast .....	II - 1
III. Committed Additions to the Base General Fund Forecast .....	III - 1
IV. Alternate Forecast Scenarios .....	IV - 1
V. Capital Revenue Forecast .....	V - 1
APPENDIX A: Service Restorations Previously Identified by City Council (January 1, 2011 Levels) Service Restoration Decision Making Framework Guiding Principles for Restoring City Service Levels City of San José Budget Principles .....	A - 1
APPENDIX B: General Fund Revenue Descriptions .....	B - 1
APPENDIX C: Development Activity Highlights .....	C - 1

Prepared by  
Office of the City Manager  
February 2014

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**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Ed Shikada

**SUBJECT:** 2014-2015 CITY MANAGER'S  
BUDGET REQUEST AND  
2015-2019 FIVE-YEAR FORECAST

**DATE:** February 28, 2014

## INFORMATION

### EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council's Adopted Budget process, this document provides both the recommended 2014-2015 City Manager's Budget Request (2014-2015 Budget Balancing Strategy Guidelines) and the 2015-2019 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. Following are the major highlights of this report.

As shown in the chart below, a small General Fund shortfall of \$1.5 million is projected for 2014-2015. This projection is derived by comparing the estimated revenues with the cost of delivering City Council-approved existing services as well as the services for which the City has already committed, such as the operation of new facilities or other capital projects scheduled to come on-line next year. In the remaining years of the Forecast, small General Fund shortfalls and a surplus are projected, ranging from -\$6.5 million to \$0.4 million 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.

### **2015-2019 General Fund Forecast Incremental General Fund Surplus/(Shortfall)**

2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
(\$1.5 M)	(\$4.2 M)	\$0.4 M	(\$6.5 M)	(\$1.7 M)

- This Forecast reflects the Administration's best estimates on the projected revenues and expenditures over the next five years based on the information currently available. It does not, however, incorporate several elements that would impact the General Fund over the Forecast period, including: 1) impacts associated with the implementation of the remaining elements of the Fiscal Reform Plan (e.g., cost savings and/or additional revenues); 2) costs associated with fully funding the annual required contributions for police retiree healthcare; 3) costs associated with services that were funded on a one-time basis in 2013-2014; 4) costs associated with the restoration of key services (police, fire, libraries, community centers, and street maintenance) to January 1, 2011 levels; 5) costs associated with a Police Staffing

Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions) that will be brought forward for City Council consideration as a Manager's Budget Addendum later in the 2014-2015 budget process; 6) costs associated with unmet/deferred infrastructure and maintenance needs; and 7) one-time revenue sources or expenditure needs, including the \$18.1 million in one-time funding that is currently in the 2014-2015 Future Deficit Reserve. The Forecast also does not factor in the potential impact associated with the sunset of the Library Parcel Tax in 2015, which is budgeted in a special fund. If this Tax is not renewed, there would be significant service delivery impacts for the Library, which relies on this tax revenue to support both operations and the capital program, including the purchase of library materials. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

- The City's budget is in a fairly stable position over the forecast period. The difficult budget balancing actions implemented in recent years played a critical role in bringing revenues and expenditures into close alignment in this Forecast. These actions included a combination of significant service and position reductions, employee total compensation reductions, increased employee benefit cost sharing, changes to service delivery models across the organization, and increasing revenues, including four voter-approved tax measures, to address a decade of cumulative General Fund budget shortfalls totaling almost \$700 million that required the elimination of approximately 2,000 positions. In-depth planning efforts were undertaken to strategically address these unprecedented budget challenges. The City first developed a General Fund Structural Deficit Elimination Plan in 2008 that outlined cost reduction and revenue strategies to bring the General Fund into structural balance. This document was later updated by the Fiscal Reform Plan that was approved by the City Council in May, 2011. The Fiscal Reform Plan presented a strategy to achieve long-term financial stability, restore key City services to January 1, 2011 levels (police, fire, libraries, community centers, and street maintenance), and open facilities that had been recently completed or were under construction. This plan identified cost reduction strategies, primarily retirement-related, and revenue strategies, primarily Sales Tax and Business Tax measures, that would generate additional resources to meet these goals.
- While the City's budget has stabilized, there continues to be a significant deficit in the service levels provided to the residents and businesses in San José. There are major gaps in services across the board that impact our community, from public safety to parks, libraries, and community services. There are also significant unmet deferred infrastructure and maintenance needs that will have a long-term impact on the City.
- The chart on page 3 compares the 2014-2015 Forecast to the 2013-2014 Adopted Budget. The carry-over from the 2013-2014 Adopted Budget of -\$0.1 million is the first element and represents the amount of the 2013-2014 General Fund shortfall addressed with one-time solutions, resulting in the carryover of that portion to the following year. The next major comparison element is the change in revenue sources year-over-year. Ongoing revenues are projected to increase by \$27.8 million, driven primarily by increases in the Sales Tax, Property Tax, Utility Tax, Franchise Fee, and Licenses and Permits revenue estimates. When comparing expenditures (the third element), base costs are expected to increase by \$29.2 million from 2013-2014 ongoing budget levels, with the largest increase in retirement contribution expenditures and employee compensation.

**2014-2015 General Fund Forecast  
Reconciliation from 2013-2014 Adopted Budget**

<b>2014-2015 General Fund Forecast Components (Ongoing)</b>	<b>\$ in Millions</b>
<b>Carry-Over from 2013-2014 Adopted Budget</b>	<b>-\$ 0.1</b>
<b>Major Revenue Changes</b>	
- Sales Tax Increase	10.0
- Property Tax Increase	7.7
- Licenses and Permits Increase	4.8
- 2014-2015 Beginning Fund Balance Increase	4.7
- Utility Taxes/Franchise Fees Increase	4.3
- Departmental Charges Increase	2.0
- Revenue from the Federal Government Decrease	(5.5)
- County of Santa Clara Paramedic Program Reimbursement Elimination	(2.2)
- Other Revenue Net Increases	2.0
<b>Total Revenue Changes (Increase)</b>	<b>\$ 27.8</b>
<b>Major Expenditure Changes</b>	
- Retirement Contributions Increases	14.6
- Employee Compensation Planning Reserve Increase	10.9
- SJPOA Negotiated Employee Pay/Associated Fringe Increase	7.0
- Non-Management Step/Management Pay-For-Performance Increases	3.0
- Employee Market Competitiveness Reserve Establishment	1.2
- Successor Agency to the Redevelopment Agency Subsidy Increase	1.1
- General Liability Claims Cost Increases	1.0
- Healthcare/Dental Cost Increases	0.6
- 2014-2015 Future Deficit Reserve Liquidation (ongoing portion)	(5.9)
- Fire Apparatus/Police Vehicle Replacements Cost Decreases	(2.0)
- Sick Leave Payments Upon Retirement Cost Decrease	(1.0)
- Other Expenditure Net Decreases	(1.3)
<b>Total Expenditure Changes (Increase)</b>	<b>\$ 29.2</b>
<b>2014-2015 Projected General Fund Shortfall</b>	<b>-\$ 1.5</b>

- Retirement costs (pension and retiree healthcare) remain a major cost driver in this Forecast. For 2014-2015, retirement costs are projected at \$236.1 million in the General Fund (\$308.6 million all funds), representing a total increase of \$23.9 million (11.3%) from the 2013-2014 Modified Budget level of \$212.2 million. This increase includes base budget increases (\$14.6 million) and those associated with committed additions, non-management step increases, management pay-for-performance, negotiated salary adjustments, and the Employee Compensation Planning Reserve. During the forecast period, General Fund retirement contributions will increase by approximately \$28.5 million (12.0%) from \$236.1 million in 2014-2015 to \$264.6 million in 2018-2019. During the same period, the City retirement contributions for all funds will increase by \$37.2 million (12.0%) from \$308.6 million in 2014-2015 to \$345.8 million in 2018-2019. Similarly, the budgetary City retirement contribution rates show significant increases to cover Tier 1 members in the Federated Retirement System, police Tier 1, and fire members of the Police and Fire Department Retirement Plan. For Tier 1 members in the Federated Retirement System, the budgetary City retirement contribution rate increases from 68.8% in 2014-2015 to 88.3% in 2018-2019; for police Tier 1 members in the Police and Fire Department Retirement Plan the

budgetary City retirement contribution rate increases from 80.3% in 2014-2015 to 84.0% in 2018-2019; and for fire members in the Police and Fire Department Retirement Plan, the budgetary City retirement contribution rate increases from 81.1% in 2014-2015 to 84.4% in 2018-2019.

- As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. Various cost elements can also vary from year to year. As seen in recent years, retirement costs have been fluctuating and will likely continue to experience upward or downward swings based on actual performance of the retirement funds and changes in actuarial economic and demographic assumptions as approved by the Federated and Police and Fire Department Retirement Boards. Consistent with past practice, as part of the preparation for the 2014-2015 Proposed and Adopted Budgets, the Administration will continue to update the City Council on both the revenue and expenditure estimates as new information becomes available.
- As is customary in the Forecast, two alternative forecasts have been developed to model the range of financial scenarios possible under varying economic conditions. "Optimistic" and "Pessimistic" Cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". In 2014-2015, the Optimistic Case results in a projected surplus of \$6.7 million, while the Pessimistic Case results in a shortfall of \$10.5 million.
- In approaching the 2014-2015 budget, the Administration proposes the use of the budget balancing strategy guidelines outlined in this memorandum (2014-2015 City Manager's Budget Request). The Service Restoration Decision Making Framework, the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City of San José Budget Principles combined with City Council priorities identified in prior policy sessions will also guide the City's budget development efforts. The Administration recommends City Council approval of the proposed 2014-2015 City Manager's Budget Request, with any desired revisions, as part of the Mayor's March Budget Message review and approval process.
- Looking forward, the Administration's goal is to build capacity to meet the City's basic service delivery needs, maintain competitiveness as an employer, and address the significant backlog of unmet/deferred infrastructure and maintenance needs. This will require continued diligence on controlling the City's costs and pursuing increased revenues to support City services.
- Projections for the selected Capital Improvement Program (CIP) revenues are also included in this document. These revenues total \$352 million over the five-year period and are up 25% from the \$281 million included in the 2014-2018 Adopted CIP. Significant growth is anticipated for the Construction and Conveyance (C&C) Tax receipts (30% increase) due to the recovering real estate market, and strong growth is also anticipated for the Building and Structure Construction Tax (18% increase) and the Construction Excise Tax (23% increase)



due to an increase of development activity over the next several years across residential, commercial and industrial sectors.

## **BACKGROUND**

In compliance with City Charter Section 1204 and the City Council's Adopted Budget process, this document provides both the recommended 2014-2015 City Manager's Budget Request and the 2015-2019 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process and critical steps in developing the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP).

The City Manager's Budget Request includes budget balancing strategy guidelines that the Administration recommends be used in developing the 2014-2015 Proposed Budget. These guidelines are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's anticipated fiscal status for 2014-2015 is an integral part of the Administration's proposed approach to preparing the 2014-2015 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2014-2015, and the subsequent four years, is provided as part of this document.

## **ANALYSIS**

This section includes the following: a discussion of the 2014-2015 City Manager's Budget Request; an overview of the 2015-2019 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program; the Fiscal Reform Scorecard; and a description of the next steps in the 2014-2015 budget process.

### **2014-2015 CITY MANAGER'S BUDGET REQUEST**

The City Manager's Budget Request includes a set of general budget balancing strategy guidelines recommended to be used in the development of the 2014-2015 Proposed Budget. These proposed guidelines have been formulated in the context of projections for small General Fund deficits and a surplus over the Forecast period. The over-arching goals of these guidelines are to continue operational and fiscal stability and to deliver services to our community in a cost-effective manner. This includes bringing General Fund revenues and expenditures into balance while maintaining, and in some limited cases, expanding service levels in high priority areas that have been impacted by the budget balancing actions required in recent years. These guidelines will be used with the Service Restoration Decision Making Framework, the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City Council-approved City of San José Budget Principles that have been previously presented to the City Council and are attached as an appendix to this document.

In accordance with the City Charter, the City is required to adopt a balanced budget each year, addressing any projected shortfall or allocating any projected surplus. In 2014-2015, a General Fund shortfall of \$1.5 million is projected, representing only 0.1% of the General Fund annual

budget (revenues and expenditures). In the out years of the Forecast, General Fund shortfalls and a surplus range from -\$6.5 million to \$0.4 million annually. These surplus and shortfall amounts are very small when put into context of the size of the projected General Fund budget, ranging from -0.3% to 0.02% of the projected annual budget. With a projected shortfall of less than 0.5% of the budget, the Administration does not anticipate major service changes in 2014-2015. However, in order to balance the budget and create capacity to add resources in critical areas, the organization will continue to pursue additional revenues, more efficient and cost-effective ways to provide City services, potential restructuring opportunities, and reductions that do not impact direct service delivery.

Although overall service levels are clearly not at adequate levels for our community, the Administration continues to recommend aligning new ongoing service commitments with ongoing funds to support those additions, to the extent possible. Given the projected shortfall in the second year (2015-2016) of the Forecast of \$4.2 million, it would also be prudent to consider a two-year strategy when developing the budget for 2014-2015. This multi-year strategy, which was implemented in both 2012-2013 and 2013-2014, has helped provide both organizational and fiscal stability and has served as an effective budget balancing tool. Currently, there is a 2014-2015 Future Deficit Reserve that totals \$18.1 million. The Administration recommends that the one-time funding contained in the 2014-2015 Future Deficit Reserve, as well as any additional one-time funds that become available during the budget development process, be strategically invested, with a portion reserved to address the projected shortfall in 2015-2016.

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

- Various cost reduction and revenue strategies identified in the City-Council-approved Fiscal Reform Plan, which are not yet implemented. This Plan outlined cost reduction and revenue strategies to eliminate the General Fund structural deficit, restore selected services to January 1, 2011 levels, and open facilities that had been recently completed or were under construction.
- The costs associated with fully funding retiree healthcare in the first half of 2014-2015 for members of the Federated Retirement System and in all years for police Tier 1 and Tier 2 members of the Police and Fire Department Retirement Plan. This Forecast reflects limits included in negotiated Memoranda of Agreements (MOAs) with bargaining groups in the Federated Retirement System and the Police and Fire Department Retirement Plan. The MOAs with bargaining units in the Federated Retirement System include an 18-month extension of the phase-in to fully fund these costs, which expires in December 2014. For police and fire members, the current limit of the percentage contribution is 11%. This limit has not been reached for fire members, however, it has been reached for police members of the Police and Fire Department Retirement Plan in this Forecast, resulting in the meet and confer process.

- The costs to continue services funded on a one-time basis in 2013-2014 totaling approximately \$2.5 million in the General Fund as well as those services funded on a two-year basis totaling approximately \$7.3 million. Some of the major one-time items include the Public Works Department Preventative Maintenance Program (\$1.3 million), the Filling Empty Storefronts Pilot Program (\$250,000), the Evergreen Branch Library Sunday Hours (\$150,000), and the CommUniverCity Program (\$100,000). The programs funded on a two-year basis include Homeless Rapid Rehousing (\$2.0 million), Homeless Response Team (\$1.5 million), enhanced San Jose BEST and Safe Summer Initiative Program (\$1.5 million), and Community Action and Pride Grants (\$100,000). Many of these programs and services will likely need to be re-evaluated for continued funding in 2014-2015. 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.
- The costs to restore service levels in critical service areas, including police, fire, libraries, and community centers to January 1, 2011 levels as previously directed by the City Council. This cost is estimated at approximately \$36 million based on 2013-2014 costs.
- The costs associated with a Police Staffing Restoration Strategy (to increase budgeted sworn officers from 1,109 to 1,250 positions) that will be brought forward for City Council consideration as a Manager's Budget Addendum later in the 2014-2015 budget process.
- The costs associated with ongoing unmet/deferred infrastructure and maintenance needs that were last calculated in April 2013 at \$13 million annually in the General Fund (\$148 million all funds). In addition, there is a one-time backlog of infrastructure needs totaling \$135 million in the General Fund (\$909 million all funds). These figures will be updated and presented to the Transportation and Environment Committee in spring 2014.
- One-time revenues that may become available or one-time expenditure needs. This includes the 2014-2015 Future Deficit Reserve of \$18.1 million. Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding elements that may be available or required in any given year.
- Impacts associated with the potential elimination of the Library Parcel Tax. The Library Parcel Tax is scheduled to sunset in 2015. These tax revenues, which are budgeted in a special fund, generate \$7.9 million annually and are used to support both library operations and the library capital program, including the purchase of library materials. Without these funds, there would be significant service delivery impacts for the Library; therefore, on March 4, 2014, the City Council will be considering placing a San Jose Libraries Local Funding Continuation Measure on the June 3, 2014 ballot for voter consideration.
- It should be noted that the Development Fee Programs (Building, Fire, Planning, and Public Works) are designed to be 100% cost recovery and have been programmed to have a neutral impact on the Forecast by adjusting the revenue and costs to be equal. In the Fire Fee Program, revenues are sufficient to cover the Base Budget costs. In the Planning, Building, and Public Works Development Fee Programs, however, small budget gaps are currently projected for 2014-2015. Sufficient fee program reserves are available in each of these programs to address these small variances and have been programmed into the Forecast.

### ***2014-2015 Budget Balancing Strategy Guidelines***

The 2014-2015 Budget Balancing Strategy Guidelines provide recommended direction on the general approaches to use in the development of the 2014-2015 Proposed Budget. These guidelines are consistent with those adopted by the Mayor and City Council last year as part of the 2013-2014 Mayor's March Budget Message.

#### **2014-2015 Budget Balancing Strategy Guidelines**

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

### ***Framework and Guiding Principles for Restoring City Service Levels***

As the City brings the General Fund revenues and expenditures into balance and continues to implement the cost reduction and revenue strategies identified in the Fiscal Reform Plan, there is expected to be some capacity to restore City service levels in the future. As mentioned previously, one of the goals of the City Council is to restore services to January 1, 2011 levels (see *Appendix A* for Service Restorations Previously Identified by City Council (January 1, 2011 Levels)). As the City Council is aware, it is important that the City take a holistic approach regarding the restoration of services as additional resources become available.

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

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

### ***Incorporating Strategies into the 2014-2015 Budget Process***

As noted above, the Administration proposes the use of the general budget balancing strategy guidelines outlined above in the 2014-2015 City Manager's Budget Request combined with the Service Restoration Decision Making Framework, the City Council-approved Guiding Principles for Restoring City Service Levels, and the overall City of San José Budget Principles to approach the 2014-2015 budget development process. In December 2013, the Administration directed the City departments to develop 2014-2015 budget proposals using a draft version of the 2014-2015 Budget Balancing Strategy Guidelines. For prudent contingency planning, General Fund budget reduction targets were set at levels to generate approximately \$10 million in General Fund proposals from non-public safety departments to address a potential General Fund shortfall. While a much smaller shortfall is projected for 2014-2015 than originally anticipated, the budget

balancing strategy guidelines and budget proposals generated from departments will still provide a good starting point for developing the 2014-2015 budget. The Administration will continue to pursue cost reductions and service delivery efficiencies that make sense, but does not anticipate any further direct service reductions in 2014-2015 consistent with the approach in 2013-2014 and 2012-2013.

As part of the 2014-2015 Mayor's March Budget Message, the Administration requests confirmation of the proposed 2014-2015 Budget Balancing Strategy Guidelines, with any desired revisions. These guidelines incorporate both short-term and long-term approaches to budget balancing efforts and service level restoration and reflect the City's sound fiscal principles. City Council priorities and goals identified in prior policy sessions will also guide the City's budget balancing efforts. Input from the community through community surveys, various City Councilmember and stakeholder outreach activities, and the January 2014 San José Neighborhood Association/Youth Commission Priority Setting Session will also serve as an important tool in this process.

The Mayor is scheduled to issue a proposed March Budget Message on March 7, 2014, which will then be discussed, amended if necessary, and adopted by the City Council. The contents of that Message will provide specific guidance for the preparation of the City Manager's 2014-2015 Proposed Capital and Operating Budgets currently scheduled to be submitted on April 21, 2014 and May 1, 2014, respectively. As required by City Charter, those Proposed Budgets will contain comprehensive plans for how the City organization will address the highest priority needs of the community while maintaining the fiscal integrity of the City.

After the release of the Proposed Budgets, there will be a series of Proposed Budget Study Sessions and Public Hearings to discuss the budget proposals and the associated impacts on performance measures and service delivery. The Administration will also work with the City Council to provide informational meetings on the Proposed Budget in each City Council District in April and May 2014. Additional input by the City Council and community will be incorporated into the budget through these Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message during the months of May and June 2014.

## **2015-2019 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS**

The 2015-2019 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with information regarding the projected General Fund operating margin for each of the five years included in the forecast period.
2. **Base General Fund Forecast** – The forecast model is presented in this section. It includes projections for each of the General Fund revenue and expenditure categories. The expenditure summary is divided into two sections:

- *Base Case without Committed Additions* – This section describes projections associated with existing expenditures only.
- *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed by previous City Council direction and has less discretion, such as maintenance and operating costs for capital projects scheduled to come on-line during the next five years.

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

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

### ***2015-2019 General Fund Forecast***

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative shortfall. In addition to the cumulative shortfall, the incremental shortfall or surplus (assuming each preceding shortfall or surplus is addressed completely with ongoing solutions in the year it appears) for each year of the forecast is included. Because it is the City's goal to remain in balance on an ongoing basis, the incremental figure is useful in that it shows the additional shortfall and/or surplus attributed to a particular fiscal year. To the extent that a shortfall is not resolved or a surplus is not expended on an ongoing basis, it is important to understand that the remaining budget gap or surplus will carry over to the following year.

**2015-2019 General Fund Five-Year Forecast**  
(\$ in Millions)

	2014- 2015	2015- 2016	2016- 2017	2017- 2018	2018- 2019
<b>Projected Revenues</b>	\$899.2	\$924.7	\$952.1	\$981.3	\$1,008.0
<b>Projected Expenditures</b>	\$900.7	\$930.4	\$957.4	\$993.1	\$1,021.5
<b>Total Cumulative Surplus/(Shortfall)</b>	(\$1.5)	(\$5.7)	(\$5.3)	(\$11.8)	(\$13.5)
<b>Total Incremental Surplus/(Shortfall)</b>	(\$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. The Forecast also does not factor in the potential impact associated with the sunset of the Library Parcel Tax in 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 these programs.

In the 2015-2019 Forecast, small incremental General Fund shortfalls are anticipated for four of the five years. Similar to last year, overall revenue growth is close to the expenditure growth over the forecast period, with an annual variance of less than 0.5% of the budget (revenues and expenditures). However, as stated previously, there are significant expenditure components that are not incorporated into the Forecast. The Forecast also does not reflect Fiscal Reform Plan cost reduction and revenue generation strategies that have not yet been implemented.

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

When reconciling next year's Forecast to the 2013-2014 Adopted Budget, the projected shortfall of \$1.5 million for 2014-2015 is the result of the following: a shortfall carryover from the 2013-2014 Adopted Budget of \$0.1 million, improved revenues of \$27.8 million, offset by increased costs of \$29.2 million.

General Fund revenues are estimated to improve \$27.8 million when compared to the ongoing revenue performance assumed in the 2013-2014 Adopted Budget. Revenue performance in 2013-2014 continues to reflect moderate growth and is estimated to slightly exceed current budgeted levels. Revenue categories that are forecasted to grow year-over-year include: Sales Tax to reflect improved current year growth rates (\$10.0 million); Property Tax based on the most recent information provided by the County of Santa Clara (\$7.7 million); Licenses and Permits (\$4.8 million) primarily reflecting strong Development Fee Program Revenues; Franchise and Utility Taxes (\$4.3 million) based on current year activity levels and forecasted rate increases, and miscellaneous categories that have experienced a net increase based on actual collections experience (\$1.0 million).



On the expenditure side, several upward and downward adjustments have been incorporated into this Forecast resulting in a net increase of \$29.2 million in 2014-2015. The most significant expenditure changes are the following: increase in retirement contributions based on rates provided by the Retirement Boards (\$14.6 million); an increase to the Employee Compensation Planning Reserve (\$10.9 million); SJPOA negotiated pay increases and associated fringe (\$7.0 million), and non-management step increases/management pay-for-performance (\$3.0 million). These cost increases are partially offset by the liquidation of the ongoing portion of the 2014-2015 Future Deficit Reserve (\$5.9 million) and lower than projected replacement costs for fire apparatus and police vehicles (\$2.0 million).

### City Retirement Contributions

Given the major impact of retirement costs on the City's budget in recent years, detailed information is provided on the retirement projections incorporated into this Forecast. Overall, the City Retirement contribution costs are determined by the two Retirement Boards as guided by actuarial recommendations and take into account overall benefit levels, the funding status of each retirement plan, and economic and demographic assumptions. The retirement costs in this Forecast assume the pre-payment of the annual required City contribution for Tier 1 participants in the Federated Retirement System, police Tier 1 and fire members of the Police and Fire Department Retirement Plan. As detailed in the table on the following page, General Fund retirement contributions are projected to increase by \$23.9 million, or 11.3%, from 2013-2014 to 2014-2015 (by \$36.5 million, or 13.4%, in all funds). Over the Forecast period, the General Fund retirement contributions are estimated to increase by \$28.5 million, or 12.1% from \$236.1 million in 2014-2015 to \$264.6 million in 2018-2019. During the same period, the City retirement contribution for all funds will increase by \$37.2 million, or 12.1%, from \$308.6 million in 2014-2015 to \$345.8 million in 2018-2019.

**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

In 2009, the City and Federated bargaining units 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 Tier 1 and Tier 2a members of the Federated Retirement System and a contribution rate of 18.6% for Tier 2b employees). It is important to note that retiree healthcare negotiations are ongoing between the Administration and the Federated Retirement System bargaining groups. For the Police and Fire Department Retirement Plans, in the out years of the Forecast period, the retiree healthcare contribution percentage has a limit of 11%, which, if reached, results in the meet and confer process per the MOAs with SJPOA and IAFF, Local 230. The cost for retiree healthcare is shared approximately 50/50 between the City and employees. Per the Board's actuary, in order to fully fund the ARC for retiree healthcare benefits, preliminary results indicate that the City's annual contributions would be in excess of the current limit of the percentage contribution of 11% for police members of the Police and Fire Department Retirement Plan.

In the Five-Year General Fund Forecast, retirement costs (pension and retiree healthcare) remain a major cost driver. Throughout the forecast period, retirement costs account for a significant percentage of overall expenditures, representing approximately 26% of General Fund.

#### ***General Fund Committed Additions***

Cost estimates for a number of specific "Committed Additions" that address previous City Council direction are included in this Forecast in the years that they are projected to be required. The Committed Additions category, summarized in the chart below, reflects projected additional operating and maintenance costs for new or renovated capital projects in the 2014-2018 Adopted Capital Improvement Program or for projects approved by the City Council during 2013-2014. The costs of the additions total \$204,000 in 2014-2015 and increase to approximately \$1.7 million by the end of the Forecast period.

**2015-2019 General Fund Committed Additions**

	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019
New Parks and Recreation Facilities Maintenance & Operations	\$193,000	\$331,000	\$484,000	\$605,000	\$692,000
New Traffic Infrastructure Assets Maintenance & Operations	11,000	57,000	121,000	131,000	145,000
Measure O (Library) Maintenance & Operations	0	237,000	735,000	757,000	779,000
Measure P (Parks) Maintenance & Operations	0	0	0	87,000	81,000
Measure O (Public Safety) Maintenance & Operations: Fire	0	11,000	23,000	23,000	23,000
<b>Total</b>	<b>\$204,000</b>	<b>\$636,000</b>	<b>\$1,363,000</b>	<b>\$1,603,000</b>	<b>\$1,720,000</b>

Some of the larger facilities expected to come on-line during this forecast period include: the Fire Station 21, the Southeast Branch Library, and the Softball Complex. While the future operating and maintenance costs of approximately \$3.1 million for Fire Station 37 (South Willow Glen) were included in previous forecasts, Fire Station 37 has been removed from this forecast due to a lack of sufficient funding for project construction. Due primarily to the unexpectedly high cost of construction during much of the Measure O program, the decision to rebuild instead of remodel Fire Station 2 (which resulted in a net cost increase of approximately \$4.1 million), and the recent uptick in bid prices expected for Fire Station 21, the Administration anticipates that only \$2.0 million in public safety bond funds will remain after the completion of Fire Station 21. This amount leaves the Fire Station 37 project over \$5.0 million short of the funds needed to complete the project. A Manager's Budget Addendum outlining options related to Fire Station 37 and Fire Station 6 will be released for City Council consideration later in the 2014-2015 budget process. A detailed listing of all capital project operating and maintenance costs included in this 2015-2019 General Fund Forecast can be found in the Committed Additions Section of this document.

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

General Fund Capital Operating and Maintenance/Budget Principle #8 requires City Council certification that funding will be made available in the General Fund for capital projects with an estimated operating budget impact greater than \$100,000 at the time of taking beneficial use of the facility or project. Capital projects with operating and maintenance costs over \$100,000 and previously certified are included in the Capital Improvement Program and displayed in Chart A in Section III. Certification for potential new projects or modifications to existing projects identified after the release of this Forecast that have not been approved by the City Council may be recommended for certification as part of the 2015-2019 Proposed Capital Improvement Program. If certified by the City Council, the operating and maintenance costs associated with these facilities would then be included in subsequent General Fund Five-Year Forecast documents.

### *Alternative Forecast Scenarios*

In order to model the range of budgetary scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the "Base Case." "Optimistic" and "Pessimistic" cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case." These alternatives are presented to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario and is being used for planning purposes for the 2014-2015 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios.

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.

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. In the Optimistic Case, the City would experience surpluses in all years of the Forecast ranging from \$3.6 million to \$14.1 million.

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. In the Pessimistic Case, the City would experience shortfalls in all years of the Forecast ranging from \$7.0 million to \$17.9 million.

***Capital Revenue Forecast***

Section V of this report describes the Capital Revenue Forecast that will be used to develop several major elements of the 2014-2015 Capital Budget and the 2015-2019 Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement (PBCE) Department and an analysis of actual collection patterns. The projections and their basis are described in a report prepared by the PBCE Department, which is included as *Appendix C* of this document (Development Activity Highlights and Five-Year Forecast [2015-2019]). This activity forecast includes a review of specific projects that are in progress as well as a general prediction of expected levels of new construction.

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2014-2018 Adopted CIP. As shown below, higher collections are projected in all revenue categories. Based on improved real estate activity, construction activity estimates, and a review of revenue collection patterns, a significant increase in these taxes and fees of \$71.5 million, or 25%, is expected when comparing the 2015-2019 Forecast to the 2014-2018 Adopted CIP estimates.

**Capital Revenue Forecast Comparison Summary**  
(\$ in Thousands)

	2014-2018 CIP	2015-2019 Forecast	Difference	% Change
<b>Construction and Conveyance Tax</b>	\$150,000	\$195,000	\$45,000	30%
<b>Building and Structure Construction Tax</b>	55,000	65,000	10,000	18%
<b>Construction Excise Tax</b>	70,000	86,000	16,000	23%
<b>Municipal Water System Fees</b>	750	750	0	0%
<b>Residential Construction Tax</b>	925	950	25	3%
<b>Sanitary Sewer Connection Fee</b>	3,250	3,750	500	15%
<b>Storm Drainage Connection Fee</b>	750	750	0	0%
<b>TOTAL</b>	<b>\$280,675</b>	<b>\$352,200</b>	<b>\$71,525</b>	<b>25%</b>

Real estate activity (primarily housing sales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance Tax. As the housing market shows continued improvement from the sharp declines experienced after the collapse of the financial market, this category is projected to generate \$195 million over the next five years, which is 30% higher than the estimates assumed in the 2014-2018 Adopted Capital Improvement Program. However, the growth rate in real estate activity has slowed compared to last year, and the average annual collection level of \$39 million is still below the actual collection levels in the mid-2000's that reached a peak of \$49 million in 2005-2006.

The remaining economically sensitive capital revenue categories are directly linked to private development activity. Based on projections provided by the Planning, Building and Code

Enforcement Department, the robust construction activity experienced in 2013-2014—estimated at \$1.45 billion—will taper off over the next several years: \$1.0 billion for 2014-2015, \$825 million in 2015-2016, and then drop slightly again to \$775 million for 2016-2017 through 2018-2019. These assumptions show a slight improvement of 9% or \$350 million from the levels presented in the 2014-2018 Forecast (\$775 million in 2014-2015 and \$750 million from 2015-2016 through 2017-2018). For the largest categories, significant revenue increases are projected, including an 18% (\$10 million) increase to the Building and Structure Construction Tax and a 23% (\$16 million) increase to the Construction Excise Tax, due to an increase of development activity over the next several years across residential, commercial and industrial sectors.

### ***Fiscal Reform Plan Scorecard***

In May 2011, the City Council approved the Fiscal Reform Plan, which contained various cost savings/avoidance and revenue strategies to achieve \$216 million in General Fund savings by 2016-2017. The table below provides an update, or scorecard, for these strategies by identifying the amount of General Fund savings for the fiscal year it was implemented or specific notes regarding the implementation status. For strategies that are not yet implemented, the potential cost savings/avoidance amount or the anticipated revenue amount for the respective fiscal year are depicted below.

**Fiscal Reform Plan - General Fund Scorecard**  
(\$ in Millions)

	Implement. Status	Not Yet Implemented				Total
		2014-2015	2015-2016	2016-2017	2017-2018	
<b>Cost Reduction Strategies</b>						
10% Total Compensation Reduction	Net \$39.6M (2011-2012)					
Workers' Compensation Reform	(1)					TBD
Additional Retirement Contribution/ Employee Pay Reductions (or Opt-In)		TBD	TBD	TBD	TBD	TBD
Supplemental Retiree Benefit Reserve Elimination	\$13.4M (2014-2015)					
Retiree Healthcare Modifications (2)	\$6.5M (2014-2015)					
Tier 2 – Federated Retirement System and Police Retirement Plan	(3)					
Tier 3 for Unit 99	(4)					
Sick Leave Payments Upon Retirement (\$5.0M)	(5)					
Overtime (est. \$1.2M)	(6)					TBD
Organizational Changes/Efficiencies	(7)					
<b>Subtotal Cost Red. Strategies</b>	<b>\$59.5M</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>
<b>Revenue Strategies</b>						
Sales Tax (1/4% - 1/2%)		\$8.5M - \$17.0M	\$25.5M - \$51.0M			\$34.0M - \$68.0M
Business Tax (est. \$10.0M)						TBD
Disposal Facility Tax/Muni. Water System Tax (est. \$7.5M)						TBD
<b>Subtotal Revenue Strategies</b>		<b>\$8.5M - \$17.0M</b>	<b>\$25.5M - \$51.0M</b>			<b>\$34.0M - \$68.0M</b>
<b>TOTAL</b>	<b>\$59.5M</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>	<b>TBD</b>

- (1) Workers' Compensation Reform includes implementation of the workers' compensation offset as part of Measure B (not yet implemented) and the Workers' Compensation Pilot Program (in progress).
- (2) These savings due to the retiree healthcare modifications only include savings for non-sworn employees. Per the Memoranda of Agreements with SJPOA and IAFF, Local 230, the City and employees' retiree healthcare contributions are capped at 11.0% and 10.0%, respectively.
- (3) The Tier 2 plan for non-sworn employee groups became effective on September 30, 2012. A Tier 2 Plan for Police sworn employees became effective August 4, 2013. A Tier 2 Plan for Fire sworn employees has not yet been agreed to by that bargaining unit and is pending binding interest arbitration.
- (4) The Tier 3 Defined Contribution Plan for new employees in Unit 99 was effective on February 4, 2013.
- (5) Sick Leave Payments Upon Retirement were eliminated for non-sworn employees hired after September 30, 2012 and for police sworn employees hired on or after July 7, 2013. Sick Leave Payments Upon Retirement were frozen effective June 22, 2013 for non-sworn employees hired on or before September 30, 2012, and were frozen effective July 6, 2013 for police sworn employees hired before July 7, 2013. Sick Leave Payments Upon Retirement remain eliminated for employees represented by OE#3.
- (6) Elimination of overtime pay for management employees (Police Captain, Battalion Chief, and maintenance supervisory positions) requires negotiation with affected Bargaining Groups (SJPOA; IAFF, Local 230; AMSP).
- (7) As part of the annual budget process, during the last several years, departments and services were consolidated (e.g., Public Works and General Services), lower cost service models were put in place (e.g., Police sworn civilianization and Parks Maintenance), services were outsourced (e.g., custodial, graffiti eradication, and in-state prisoner transport services), and technologies were implemented in order to gain efficiencies and reduce costs.



### *Next Steps in the 2014-2015 Budget Process*

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

#### *March 2014*

- 2014-2015 Mayor's March Budget Message Released with Public Hearing; Amended/Approved by City Council

#### *April 2014*

- 2014-2015 Proposed Capital Budget and 2015-2019 Capital Improvement Program Released

#### *April-May 2014*

- Community Budget Meetings in Each City Council District

#### *May 2014*

- 2014-2015 Proposed Operating Budget and 2014-2015 Proposed Fees and Charges Released
- City Council Study Sessions and Initial Public Hearing on 2014-2015 Proposed Operating Budget, 2015-2019 Proposed Capital Budget and Capital Improvement Program, and 2014-2015 Proposed Fees and Charges

#### *June 2014*

- 2014-2015 Mayor's June Budget Message Released with Final Public Hearing; Amended/Approved by City Council
- 2014-2015 Operating Budget, 2014-2015 Capital Budget and 2015-2019 Capital Improvement Program, and 2014-2015 Fees and Charges adopted by City Council

### **CONCLUSION**

This document compares the projected revenues and expenditures for the General Fund over the next five years as well as provides estimates for some of the key revenues that support the City's Capital Improvement Program. In 2014-2015, a small General Fund shortfall of \$1.5 million is projected, which the Administration seeks to balance without service reductions or eliminations. In the remaining years of the Forecast, small General Fund shortfalls and a surplus ranging from -\$6.5 million to \$0.4 million annually are projected. These margins are very narrow when put into context of the size of the projected General Fund budget, ranging from -0.3% to 0.02% of the projected annual budget (revenues and expenditures).

As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document and it is important to keep in mind that this Forecast does not reflect several elements that would impact the General Fund over the Forecast period, including: 1) impacts associated with the implementation of the remaining elements of the Fiscal Reform Plan (cost savings and additional revenues); 2) costs associated with fully funding the annual required contributions for police retiree healthcare; 3) costs associated with services that were funded on a one-time basis in 2013-2014; 4) costs associated with the restoration of key services to January 1, 2011 levels; 5) costs associated with unmet/deferred infrastructure and maintenance

needs; and 6) one-time revenue sources or expenditure needs. This Forecast also does not factor in the impacts associated with the sunseting of the Library Parcel Tax in 2015, which is budgeted in a special fund. In addition, no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

The revenue and expenditure projections for 2014-2015 will continue to be refined over the next several months as additional information becomes available. This is particularly important in the areas of Sales Tax and Property Tax. Sales Tax data for the second quarter of 2013-2014, which covers the 2013 holiday period, will be received in March 2014. Based on this additional data, any necessary adjustments will be incorporated into the 2014-2015 Proposed Operating Budget. Similarly, as additional Property Tax data becomes available, it may be necessary to adjust the 2014-2015 revenue estimates.

This document also provides the recommended 2014-2015 City Manager's Budget Request (Budget Balancing Strategy Guidelines) for consideration by the City Council as part of its review of the Mayor's March Budget Message. With a projected shortfall of less than 0.5% of the budget, the Administration does not anticipate major service changes this year. However, in order to balance the budget and create capacity to add resources in critical areas, the organization will continue to pursue additional revenues, more efficient and cost-effective ways to provide City services, potential restructuring opportunities, and reductions that do not impact direct service delivery. Given the projected shortfall in the second year (2015-2016) of the Forecast of \$4.2 million, it would also be prudent to consider a two-year strategy when developing the budget for 2014-2015. The 2014-2015 Future Deficit Reserve of \$18.1 million, along with any additional one-time funds identified in the budget development process, provides the resources necessary to implement this two-year strategy and to address critical service delivery and infrastructure needs.

Over the last three years, the City's budget has stabilized as a result of the very difficult budget actions taken in recent years and the improving economy. The Mayor and City Council have remained committed to ensuring the fiscal health of the City while delivering essential services in the most cost effective manner. This diligence has served the City well during its most difficult financial crisis in recent history. Bringing the budget into balance, however, has come at a great cost to the community and City employees and the City continues to remain in a "service deficit" position. Continued focus and commitment to strategies that will enable the City to rebuild its core services remains a priority for 2014-2015 and beyond.



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