

2014-2015 MID-YEAR BUDGET REVIEW

STATUS OF GENERAL FUND EXPENDITURES

OVERVIEW

General Fund expenditures through December totaled \$482.8 million, or 36.1% of the total 2014-2015 Modified Budget. This represents an increase of \$37.3 million, or 8.4%, from the December 2013 level of \$445.5 million. Encumbrances totaling \$67.4 million were nearly double the December 2013 level of \$34.1 million. Expenditures and encumbrances through December of \$550.2 million constituted 41.1% of the total Modified Budget (including reserves) of \$1.3 billion; without reserves of \$165.5 million, expenditures and encumbrances constituted 46.9% of the total Modified Budget. The following chart displays the year-to-date expenditures (excluding encumbrances) compared to the prior year, by category.

2014-2015 General Fund Expenditures through December (\$ in Thousands)

Category	Current Budget*	YTD Actual	% of Budget	Prior Year % of Budget
Departmental Expenditures				
Personal Services	\$ 670,804	\$ 308,355	46.0%	45.2%
Non-Personal/Equipment	102,908	36,187	35.2%	36.0%
Other Departmental	17,901	7,885	44.0%	40.0%
<i>Subtotal Departmental Expenditures</i>	<u>791,613</u>	<u>352,427</u>	<u>44.5%</u>	<u>43.8%</u>
Non-Departmental Expenditures				
City-Wide Expenses	\$ 297,082	\$ 92,561	31.2%	40.2%
Capital Contributions	47,793	1,473	3.1%	4.2%
Transfers	36,342	36,342	100.0%	100.0%
Reserves	165,470	-	0.0%	0.0%
<i>Subtotal Non-Departmental</i>	<u>546,687</u>	<u>130,376</u>	<u>23.8%</u>	<u>27.5%</u>
Total	\$ 1,338,300	\$ 482,803	36.1%	37.8%

* Figures include carryover encumbrances which will be adjusted to reflect final 2013-2014 audited financials after the printing of this document.

Overall, General Fund expenditures are tracking within anticipated levels and are expected to end the year with savings to assist in meeting the 2015-2016 ending fund balance estimate used as a funding source in the Five-Year General Fund Forecast.

Recommended Adjustments

Various budget adjustments are recommended in this document to accomplish the following major urgent and required items:

- Address a limited number of urgent fiscal/program needs, including: the establishment of a \$5.0 million Police Department Overtime Reserve for 2015-2016, funded by Police Department salary and benefit savings; provide funding for a Downtown Environmental Impact Review (\$500,000); provide funding for a Limited Detention Policing Study (\$125,000) offset by Police Department salary and benefit savings; and Government Accounting Standards Board (GASB) 68 training (\$50,000), offset by Finance Department personal services savings.

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- Implement required technical and rebalancing actions including:
 - Increasing the United States Patent and Trademark Office – City Staff Relocation project (\$850,000); and
 - Establish an Energy Services Company (ESCO) Debt Service appropriation in the amount of \$1.1 million to pay for the Energy and Utility Conservation Measures program, partially offset by an increase in revenue (\$955,000).
 - Addressing updated cost estimates, funding needs, and technical adjustments, including additional funding for Public Works Department retirement costs (\$800,000), for the Municipal Golf Course Fund (\$300,000), and others discussed in further detail below.
- Appropriate additional grant, reimbursement, and/or fee related funds (\$3.4 million).
- Implement clean up actions that reduce Personal Services appropriations to reflect a 4.5% reduction in the City’s lowest cost health plan rate (\$849,000).

In total, adjustments recommended in this document result in a net increase of \$5.6 million to General Fund expenditures. Additional information on these adjustments can be found in *Section III. Recommended Budget Adjustments and Clean-Up Actions* of this document. The following discussion highlights major General Fund expenditure activities through December.

DEPARTMENTAL EXPENDITURES

Departmental expenditures include personal services (salaries, overtime, retirement, health, and other fringe benefit costs), non-personal/equipment, and other departmental expenses. Personal services’ costs represent the largest single General Fund expense category for the City. These costs accounted for 63.9% of the General Fund expenditures to date.

Through December, personal services expenditures for all City departments totaled 46.0% of the current Modified Budget, which is slightly below expectations (48.1%) at this point of the year. This expenditure level was slightly above the 45.2% expended through December last year. Overall, Personal Services expenditures are tracking to end the year with savings. As of January 5, 2015, the City had 593 vacancies city-wide (all funds) compared to 543 vacancies in the prior year, representing a vacancy factor of over 10%. Of the vacant positions, 367 are budgeted in the General Fund compared to 331 in the prior year. Although some of these vacancies are backfilled with temporary staffing resources, vacancy savings have been accumulating throughout the organization. As described in Section III of this document, a number of reallocations of personal services savings to non-personal/equipment are recommended to reflect the use of temporary staffing or contractual services until vacancies are filled. In addition, budget actions are recommended to reallocate salary and benefit savings to overtime for the Fire Department and to establish a 2015-2016 Police Department Overtime Reserve.

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Non-Personal/Equipment expenditures of \$36.2 million are also tracking within anticipated levels with 35.2% expended through December, slightly below prior year levels of 36.0% in December 2013. In addition to expenditures, \$18.6 million was encumbered, bringing the total amount of funding committed to \$54.8 million, or 53.2% of the \$102.9 million budget. Overall, these expenditures are expected to remain within budget for all departments with some savings generated by year-end. As a result of the high vacancy levels, as discussed above, many departments have needed to backfill with temporary staffing or contractual services to continue service delivery. As described in Section III of this document, the reallocation of personal services savings to Non-Personal/Equipment appropriations is recommended for the Finance, Human Resources, Information Technology, and Planning, Building and Code Enforcement Departments, as well as the City Attorney’s Office, to ensure sufficient funding for the backfilling of vacant positions with temporary staffing or contractual services to maintain service delivery levels.

The Other Departmental category includes the budget for the Mayor and City Council, Library Grants, and Parks, Recreation and Neighborhood Services Fee Activities. Other Departmental Expenditures totaled \$7.9 million (44.0%) of the \$17.9 million budget through December, above prior year levels of \$6.9 million (40.0%) in December 2013. In addition to expenditures, \$100,000 was encumbered, bringing the total amount of funding committed to \$8.0 million, or 44.6% of the Modified Budget.

DISCUSSION OF SELECTED GENERAL FUND DEPARTMENTS

Expenditure Status (\$ in thousands)			
<u>Department</u>	<u>2014-2015 Budget</u>	<u>YTD Actual</u>	<u>Prior YTD Actual</u>
Fire	\$178,167	\$83,197	\$76,703

On an overall basis, Fire Department expenditures are tracking within estimated levels. Personal Services expenditures of \$79.9 million are on par with anticipated levels (47.4% compared to the par of 48.1%). The Fire Department’s Non-Personal/Equipment budget of \$9.6 million was 51.3% expended or encumbered through December. Overall, expenditures are expected to end the year within their respective budgeted allocations. Once development fee program expenditures are excluded, personal services expenditures of \$77.7 million continue to be on par with anticipated levels and non-personal/equipment expenditures and encumbrances of \$4.8 million were 51.4% of the budget through December.

Through December, overtime expenditures of \$4.3 million tracked above anticipated levels with 80.8% expended. To provide sufficient resources for overtime expenditures necessary to backfill positions due to vacancies, this report includes a recommendation to shift \$2.0 million in salary and benefit savings to overtime. There are 22 recruits in the September 2014 Firefighter Recruit Academy who are expected to

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graduate at the end of January. A second Firefighter Recruit Academy in May/June 2015 will fill the remaining nine current sworn vacancies and the additional 15 vacancies anticipated in early 2015. Overall, the average vacancy rate of 3.9% has exceeded the budgeted rate of 2.8%. A portion of the higher than estimated overtime expenditures was also attributed to vacation usage and strike team and mutual aid deployments; personnel were sent to respond to fires in Mendocino, Humboldt, King, and Kern counties. The Department continues to seek reimbursements from the federal government for costs associated with strike team deployments and actions are being brought forward in this report to recognize and allocate those funds during 2014-2015 (\$308,000). Disability usage through December was 18% lower than the same period in 2013-2014, while modified duty was 10% higher. Combined disability and modified duty hours through December were 7% lower than 2013-2014.

Personal services expenditures in the Development Fee Program of \$2.2 million tracked slightly below estimated levels with 47.0% expended. Any savings realized in the Development Fee Program are returned to the Program's Earmarked Reserve. The Fire Department and the Budget Office will continue to monitor activity to ensure the department remains within its Personal Services appropriation.

In accordance with the City Council's approval of a March 2010 report on annual vacancy and absence rates, the Fire Department has committed to limiting administrative assignments for sworn administrative personnel for overtime control purposes. As of the end of December, the Fire Department has 35 sworn personnel on administrative assignments, one more than the current authorized level, reflecting one employee on a temporary administrative assignment. It is anticipated that staffing levels will be within approved levels by the first quarter of 2015.

Expenditure Status (\$ in thousands)

<u>Department</u>	<u>2014-2015 Budget</u>	<u>YTD Actual</u>	<u>Prior YTD Actual</u>
Police	\$329,286	\$147,508	\$139,101

On an overall basis, the Police Department's expenditures are tracking below estimated levels through December. Personal services expenditures of \$138.4 million tracked below anticipated levels (45.7% compared to the par of 48.1%) due to lower salaries and benefits costs. However, overtime expenditures of \$13.1 million tracked above anticipated levels (52.8% compared to the par of 48.1%). To address higher overtime costs, the 2013-2014 Annual Report included budget actions to increase the overtime budget by \$7.8 million (from \$17.1 million to \$24.8 million), which is approximately equivalent to the overtime expenditures for 2013-2014, with an adjustment for the recent sworn and non-sworn salary increases. Overtime expenditures may exceed this revised budget by year end, but there are sufficient salary and benefit savings to offset this cost.

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Based on current trends, personal services expenditures are tracking to end the year with savings between approximately \$11.0 million and \$12.0 million, which represents approximately 4% of the personal services budget. Of this amount, \$5.0 million is recommended to be set aside in a Police Department Overtime Reserve for use in 2015-2016 as has been the practice in recent years. Although the Police Department is conducting regular police officer recruit academies to hire for the sworn vacancies and continues to review strategies to improve the rate of sworn hiring and training, the Department is anticipated to begin 2015-2016 with approximately 140 sworn vacancies based on current attrition rates. The recommended overtime reserve will supplement 2015-2016 vacancy savings to continue backfilling for vacant patrol positions and maintain targeted enforcement of high crime activity through suppression cars as well as cover for civilian vacancies. Budget actions are also recommended in this report to reallocate salary and benefit savings of \$241,000 to non-personal/equipment to address urgent departmental needs, including a study on limited detentions (\$125,000) and an increase to address higher police recruit academy costs (\$116,000). Approximately \$4.0 million of the personal services savings is attributed to lower retirement costs, which will be evaluated on a city-wide level to ensure all of the retirement contribution obligations are met by year-end. After factoring out the recommended funding reallocations and the retirement savings, the remaining personal services savings in the Department are estimated between \$2.0 million to \$3.0 million.

Overtime consists of overtime expenditures and compensatory time. The Memorandum of Agreement with the Police Officer’s Association (POA) limits how much overtime can be earned for pay versus compensatory time. The compensatory time balance at the end of December 2014 was 178,576 hours for sworn personnel. This represents an increase of 8,167 or 4.8% compared to the December 2013 balance of 170,409.

As of January 2015, the Department had 1,109 authorized sworn staff, of which 118 were vacant (10.6%) and 42 were in training (3.8%), leaving 949 street ready sworn positions (this includes sworn employees on disability/modified duty/other leaves) as shown in the chart below. When sworn employees on Disability/Modified Duty/Other Leaves are excluded, a total of 882 sworn positions were actually available. This compares to 895 positions one year ago.

	2013-2014 (as of 1/16/2014)	2014-2015 (as of 1/08/2015)
Authorized Sworn Staffing	1,109	1,109
Vacancies	(63)	(118)
Filled Sworn Staffing	1,046	991
Field Training Officer/Recruits	(76)	(42)
Street-Ready Sworn Positions	970	949
Disability/Modified Duty/Other Leaves	(75)	(67)
Street-Ready Sworn Positions Available	895	882

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In order to fill the vacant sworn positions and put more Police Officers back on patrol, the Department will conduct three Police Recruit Academies in 2014-2015 with the next one beginning in February 2015. Currently, 25 recruits are scheduled to begin the February 2015 Academy.

A total of \$12.6 million (47.6%) of the Department’s Non-Personal/Equipment budget was expended or encumbered through December. Excluding the remaining balances for centrally determined details, including electricity, gas, and vehicle operation and replacement, the Department has approximately \$6.4 million, or 44.6% of the non-centrally-determined appropriation available for the remainder of the fiscal year. The Police Department and Budget Office will continue to monitor expenditures closely, although expenditures are anticipated to remain within budgeted levels by year-end.

Expenditure Status (\$ in thousands)			
<u>Department</u>	2014-2015 <u>Budget</u>	YTD <u>Actual</u>	Prior YTD <u>Actual</u>
Office of Economic Development	\$4,280	\$1,946	\$1,820

Through December 2014, non-fee activity expenditures for the Office of Economic Development (OED) were tracking above estimated levels with 49.1% expended or committed. Personal Services expenditures totaled \$1.7 million (53.9% of the \$3.2 million budget), exceeding the par level of 48.1%. The Office of Economic Development Non-Personal/Equipment budget of \$854,000 was 31.1% expended or encumbered through December and is anticipated to end the year within budgeted levels.

Personal Services expenditures are currently tracking above estimated levels by approximately \$260,000; however, after factoring in the salary program budget adjustments recommended in this report and adjustments for anticipated activity in the latter half of the year, the Department is projected to exceed budgeted levels by approximately \$100,000 to \$150,000. Higher than estimated expenditures primarily result from a greater proportion of Real Estate staff charged to the General Fund for unanticipated projects than authorized in the budget. The Department is in the process of realigning charges with appropriate funding sources to prevent any personal services overage. The Department and Budget Office will continue to closely monitor expenditures to ensure expenditures remain within authorized levels by year-end.

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NON-DEPARTMENTAL EXPENDITURES

With a Modified Budget of \$546.7 million, Non-Departmental Expenditures include City-Wide Expenses, Capital Contributions, Transfers, and Reserves.

Through December, City-Wide Expenses totaled \$92.6 million, or 31.2% of the Modified Budget of \$297.1 million. Adjusting for differences in timing variances that occurred in 2013-2014, as a result of the transition to a third party administrator for some of the Workers' Compensation payments, City-Wide Expenses totaled \$96.7 million or 41.8% of the Modified Budget in December 2013. When expenditures and encumbrances of \$43.6 million are combined, the total amount of funding committed (\$136.2 million) was 45.8% of the budget. Overall, expenditures are anticipated to generate savings by year-end, primarily due to savings in overall workers' compensation claims costs and sick leave payments upon retirement.

2014-2015 City-Wide Expenses
Expenditures by City Service Area
(\$ in Thousands)

City Service Area	Current Budget	YTD Actual	% of Budget	Prior Year Actual	Prior Year % of Budget
Community & Economic Development	\$ 34,373	\$ 17,247	50.2%	\$ 16,672	57.3%
Environmental & Utility Services	2,367	970	41.0%	825	31.6%
Neighborhood Services	9,858	2,950	29.9%	2,922	29.0%
Public Safety	20,320	9,118	44.9%	5,724	25.6%
Transportation & Aviation Services	6,252	2,616	41.8%	2,515	32.3%
Strategic Support	223,912	59,660	26.6%	64,291	40.4%
TOTAL	297,082	92,561	31.2%	92,949	40.2%

The expenditure tracking for City-Wide Expenses can vary significantly depending on payment schedules and the timing of projects. In 2014-2015, as in 2013-2014, expenditures through December reflect the partial payment of the \$100 million Tax and Revenue Anticipation Notes (TRANS) of \$50.0 million. In some instances, the appropriations will not be fully expended by year-end because of the multi-year nature of some larger projects. As needed, recommendations will likely be brought forward at the end of the year to rebudget any savings to 2015-2016 to complete projects in progress.

Adjustments to City-Wide Expenses appropriations are recommended in this report to align the budget with the year-end expenditure projections, additional details on these actions can be found in *Section III. Recommended Budget Adjustments and Clean-Up Actions* of this 2014-2015 Mid-Year Budget Review. Key actions recommended in this report include:

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- Establish an Energy Services Company (ESCO) Debt Service appropriation in the amount of \$1.1 million to pay for the Energy and Utility Conservation Measures program, partially offset by an increase in revenue (\$955,000) to recognize rebates for the conversion to LED streetlights.
- Increases totaling \$84,000 reflecting increased contractual costs for various services including the Bi-Annual Customer Satisfaction Survey (\$25,000), the SAP Center Renegotiations (\$40,000), and Audits (\$4,000).
- Recognizing various net zero grants, reimbursements, and fees of \$1.2 million. These expenditure increases are offset by corresponding increases in grant revenue or fee revenue.

In total, adjustments recommended in this report result in a net increase of \$2.4 million to City-Wide Expenses. Additional information on these adjustments can be found in Section III of this report.

The following highlights key appropriations in City-Wide Expenses across the five different City Service Areas (CSAs):

- The \$100.4 million **Tax and Revenue Anticipation Notes (TRANS)** appropriation for the issuance, principal, and interest costs associated with the repayment of TRANS for cash flow purposes was issued in July 2014 and is tracking within budgeted levels; minor savings between \$75,000 and \$125,000 from the ancillary costs are anticipated. This appropriation constitutes the largest allocation in the Strategic Support CSA.
- **Worker's Compensation Claims** appropriations totaling \$19.6 million are budgeted in four of the six CSAs with total expenditures of \$8.9 million through December 2014, or approximately 45% of the Modified Budget. This is slightly higher than last year's expenses through December, after correcting for timing differences, of \$8.1 million, or 40.0% of budgeted levels. If current expenditure trends continue, savings of approximately \$500,000 are anticipated by year-end across all appropriations.

Although overall savings are anticipated, both the Public Works and Police Departments are currently tracking to exceed budgeted levels. Therefore, net zero adjustments to increase these allocations by \$100,000 and \$175,000, respectively, are recommended in this report. Public Works' projected overage reflects increased claims during the first half of the year. The projected overage in the Police Department is due to the close-out of older claims resulting in more settlement awards, and due to an increase in complex medical issues. These increases are offset by reductions in the Workers' Compensation Other Departments appropriation and the PRNS Workers' Compensation appropriation, which are both anticipated to have savings by year-end.

- In the Strategic Support CSA, the **General Liability Claims** appropriation totals \$13.5 million, of which approximately 36% is expended or encumbered through December compared to 55.1% or

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expended encumbered through December 2013. Higher year-to-date expenditures occurred in 2013-2014 as a result of two significant settlements paid in the first six months which skewed payments above historical levels. It should be noted that the litigation exposure far exceeds the amount in this appropriation and the corresponding reserve (\$15.0 million) combined.

- The appropriation for **FMC Debt Service Payments** in the Strategic Support CSA totals \$36.6 million as a result of an adjustment of \$33.6 million to reflect the sale of 22.8 acres comprising a portion of the Coleman Highline mixed use development. The net sale proceeds of \$33.6 million are to be used to pay down debt associated with the property.
- In the Strategic Support CSA, **Sick Leave Payment Upon Retirement** expenditures of \$960,000 through December reflect 19.2% of the total 2014-2015 budget of \$5.0 million. The majority of the expenses in this appropriation typically occur in the second half of the year. Historically, only 15%-30% of the total year end expenditures occur through December.
- In the Community and Economic Development CSA, the **Homeless Rapid Rehousing** and **Homeless Response Team** appropriations have expended or encumbered 54% and 77% of their respective budgets. These two appropriations provide critical resources to address the City's ongoing efforts related to homelessness.
- In the Neighborhood Services CSA, the **San José BEST and Safe Summer Initiative Programs** appropriation has year-to-date expenditures of \$1.8 million with an additional \$1.8 million encumbered, reflecting 57% of the total budget of \$6.3 million. This appropriation supports gang prevention and intervention efforts across the City.

Through December, **General Fund Capital** expenditures totaled \$1.5 million and encumbrances totaled \$5.2 million, bringing the amount committed to \$6.6 million, or 13.9% of the \$47.8 million budget. Overall, once adjusted to include the recommended \$850,000 increase in this report for the United States Patent and Trademark Office Tenant improvements appropriation, General Fund Capital expenditures are expected to end the year without savings, as a substantial portion of the projects in process will be recommended for rebudget into 2015-2016.

Transfers of \$36.3 million are 100.0% expended through December as anticipated. All of the transfers to the General Fund are processed at the beginning of the year and have been completed. A recommended increase to the transfer to the Municipal Golf Course Fund of \$300,000 is included in this report to ensure sufficient fund balance remains in this fund in 2014-2015.

There are no expenditures against the **Reserves** budget of \$165.5 million because expenditures cannot be charged directly to a reserve. Several budget actions are recommended in this report that impact General Fund Reserves. The major actions are described below.

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- Establish a **2015-2016 Police Department Overtime Reserve** (\$5.0 million) that would be funded from Police Department salary and benefits savings. As discussed in this report, the Police Department is expected to begin 2015-2016 with approximately 140 sworn vacancies based on current attrition rates. It is anticipated that additional overtime funding will be needed in 2015-2016 to continue backfilling for vacant patrol positions and maintain targeted enforcement of high crime activity through suppression cars. The funding will also be available to cover for civilian staffing vacancies as needed. The establishment of this reserve will provide the necessary overtime funding to continue to address these and other Police needs in 2015-2016.
- Establish the **Cultural Facilities Capital Maintenance Reserve** (\$1.25 million). In accordance with City Council direction approved as part of the Mayor's March Budget Message for Fiscal Year 2014-2015, the growth in General Fund Transient Occupancy Tax (TOT) revenues above the established 2013-2014 base level is to be allocated for capital maintenance of the City's cultural facilities. Based on collections through December, TOT receipts are expected to exceed the budgeted estimates by at least \$1.25 million and these funds are recommended to be set aside in reserve for allocation during the 2015-2016 Proposed Budget process.
- A total decrease of \$3.4 million to the **Salaries and Benefits Earmarked Reserve** is recommended to reflect:
 - Liquidation of the health and dental program savings in the Salaries and Benefits Reserve (\$2.1 million). Funding was programmed into the reserve during the development of the 2014-2015 Adopted Budget in anticipation of an increase in the lowest cost health plan rates, which were forecast at 10% based on national and City trend information. A 2.5% increase to dental rates were forecast based on actuarial information and an evaluation of funding levels in the Dental Insurance Fund. Actual costs declined year-over-year, resulting in a 4.54% reduction in health and no increase to dental rates; and
 - Liquidation of funding associated with the management pay for performance program (\$1.3 million) set aside as part of the 2014-2015 Adopted Budget. This is partially offset by the distribution of \$726,000 to those departments with insufficient vacancy savings to cover these increased costs.

No budget action is recommended for the Contingency Reserve, which currently totals \$32.7 million and complies with the City Council policy to set aside 3% of expenditures.