Five-Year Economic Forecast and Revenue Projections

2014-2018

Section 1

Elements of the General Fund Forecast

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Overview

This document provides three alternative Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2013-2014 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast; however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment.

- **Base Case** – The Base Case Forecast is built on the assumption of a continued slow recovery from the deep global recession on a national level and the continued dampening of overall growth due to budgetary pressures at the federal level. At the local level, positive near term growth is estimated to continue in the Silicon Valley as a result of the continued strength in the technology industry. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to continue to decrease and ultimately remain around historical normal levels. Home values are anticipated to continue to improve over the five years. In the Base Case Forecast, General Fund revenue collections are anticipated to experience moderate growth over the forecast period.

- **Optimistic Case** – The Optimistic Case assumes a much faster and more robust recovery than currently anticipated. When compared to the Base Case scenario, the real estate market improves significantly with increases not only in the price of housing, but also the volume of home sales, out pacing the growth rates assumed in the Base Case. This housing market recovery drives growth in employment levels and inflation. This vigorous recovery results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.

- **Pessimistic Case** – The Pessimistic Case assumes that a combination of adverse factors interact to impede the moderate recovery underlying the Base Case and continue a sluggish recovery. Under this scenario, looming impacts in the world economy in areas such as Europe, Japan, and China are anticipated to ripple through to the U.S. economy at a national level as well as at the State and local levels. Housing prices are anticipated to fall both locally and nationally as the Federal Reserve monetary and fiscal policies result in higher inflation, which in turn, results in higher mortgage rates. Higher mortgage rates would negatively impact both home sales and prices. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would be impacted by an economic slowdown.

Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2013-2014 Proposed Operating Budget, scheduled to be published on May 1, 2013.

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

Current National Conditions

Currently, the U.S. economy is growing at a relatively subdued pace. US Gross Domestic Product (GDP) increased 2.2% in 2012, which is 0.4 percentage points higher than the 1.8% increase experienced in 2011, according to the "advance" released by the Bureau of Economic Analysis. In the fourth quarter of 2012, GDP decreased by an annual rate of 0.1%, according to the "advance" estimate, after increasing 3.1% in the third quarter. The Bureau emphasized that the fourth quarter advance estimate is based on source data that is incomplete or subject to further revision. The "second" estimate for the fourth quarter 2011, based on more complete data, will be released on February 28, 2013. The fourth quarter decrease primarily reflected negative contributions from private inventory investment, federal government spending, and exports, partly offset by positive contributions from personal consumption expenditures (PCE), non-residential fixed investment, and residential fixed investment.

Consumer confidence, as reflected by The Conference Board Consumer Confidence Index, has declined in the last two months. In January, the Index declined 8.1 points, to 58.6. This follows a decline of 6.4 points in December. According to Lynn Franco of The Conference Board, "Consumer Confidence posted another sharp decline in January, erasing all of the gains made through 2012. Consumers are more pessimistic about the economic outlook and, in particular, their financial situation. The increase in the payroll tax has undoubtedly dampened consumers' spirits and it may take a while for confidence to rebound and consumers to recover from their initial paycheck shock."[1]

Employment continues to reflect a very slow recovery from the "Great Recession" of 2009. The U.S. unemployment rate stood at 7.9% in January 2013, according to the Bureau of Labor Statistics. It has been at or near this level since September 2012. The 7.9% level shows improvement from a high of 9.6% in 2010; however, unemployment remains well above pre-recession levels of 4-5%. In order to keep up with population growth, the economy needs to generate 150,000 new jobs each month. Employment has been growing at approximately that

[1] The Conference Board, Press Release/News, January 29, 2013.

rate for the last year; however, growth of around 250,000 new jobs per month should be occurring at this point in the recovery period.

Despite the suluggish performance in these areas, there are a few bright spots in the economy including: the housing market, the auto industry, and the energy sector. The housing sector is a strong point in the recovery with both existing sales and new starts growing at strong rates. Nationwide, privately-owned housing starts in January 2013 reflected a 23.6% increase from the prior year level.[2] Existing home sales in December 2012 were also 12.8% above the December 2011 level and the preliminary annual total for existing home sales in 2012 was up 9.2% from the prior year.[3] While housing starts remain below the 1990-2007 average of 1.5 million units per year[4], the sector is showing a strong recovery and is expected to continue growing.

The National Economic Outlook

Moderate economic growth appears likely for the next two to three years, driven by growing strength in the housing market and, in the longer term, the expansion of domestic energy production, according to the UCLA Anderson Business School Forecast. Weighing on the economy, however, are economic weakness abroad, anticipated tax increases and spending cuts at the Federal level, and, in the near-term, decreases in economic output that are the result of Hurricane Sandy.

As described above, the housing sector, which had been slow to recover after the 2009 recession, is growing. The UCLA Anderson Business School Forecast anticipates that the expansion in this sector will continue into 2014. Expansive domestic fiscal and monetary policy is forcing interest rates down to historic lows, enticing millions of Americans to buy homes. This rebound in housing brings a boost to other sectors of the economy. New housing starts are particularly important to economic growth because they create construction jobs and demand for materials and components, such as appliances, many of which are domestically produced. Additionally, rising prices for existing homes also translate to economic growth, as the equity they create for homeowners provides them with greater spending power, and may make them more confident in making larger purchases.

Over the longer term, domestic energy development is expected to be a significant economic engine. According to the International Energy Agency, the U.S. will become the world's largest oil producer by 2020. Domestic natural gas production is also soaring. The new technology of hydraulic fracturing, a process by which highly pressurized water, sand, and chemicals are injected into rock, has made it possible to release hydrocarbon reserves from previously inaccessible shale formations. This has led to an energy boom in Pennsylvania and Ohio, and turned North Dakota into a leading energy producing state.[5] Industries that support oil and gas, for example the manufacture of steel pipe and drilling equipment, are also being revived. It should be noted, however, that concerns over the potential impacts of the chemicals used in the

---

[2] U.S. Census Bureau and U.S. Department of Housing and Urban Development, News Release, February 20, 2013.
[3] National Association of Realtors, News Release, January 22, 2013.
[4] UCLA Andersen Forecast, December 2012.
[5] UCLA Andersen Forecast, December 2012.

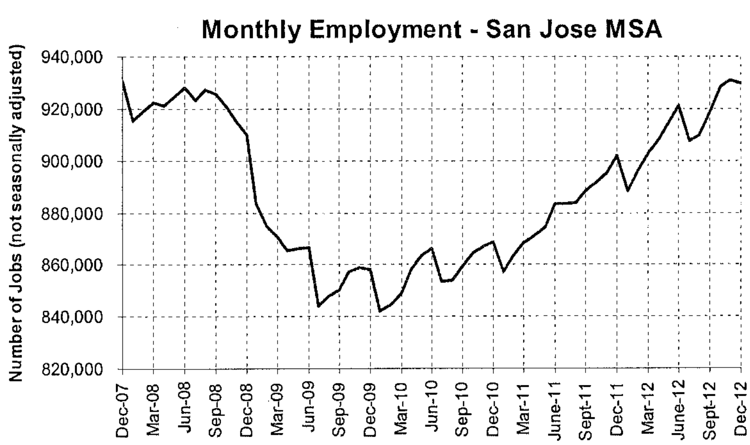
hydraulic fracturing process on groundwater and the environment may lead to regulation in the future that would limit the growth in this type of production.

The growth led by the housing and energy sectors is dampened by economic weakness abroad, anticipated tax increases and spending cuts at the Federal level, and, in the near-term, decreases in economic output that are the result of Hurricane Sandy. According to the UCLA Andersen Forecast, Europe and Japan are in recession, and growth is slowing in Brazil, China, and India, causing a slowdown in demand for U.S. exports, which up to this point have been a driver in the economic recovery. At the federal level, austerity looms, as Congress grapples with ways to reduce the federal deficit. In early January, Congress passed a bill that forestalled the impacts of the "fiscal cliff", "the expiration of previously enacted tax cuts combined with some automatic spending cuts totaling about $600 billion (about 4% of the economy) that (were) scheduled to take effect in January 2013"[6]. The bill kept the majority of tax cuts in place for the time being, and pushed the automatic spending cuts out until March. With automatic spending cuts looming again on March 2nd, and the continuing resolution on the federal budget, which has kept the federal government in operation ending on March 27th, the same questions regarding the balance between our Nation's spending, taxation levels, and deficit level will be revisited soon. It is likely that some measure of austerity will arise from the upcoming negotiations in Congress, causing a drag on the economy. ,

Current City of San José Economic Conditions

The economic performance in Silicon Valley and San José continues to show strength. In its most recent update, Beacon Economics noted that nonfarm employment growth between October 2011 and October 2012 in the South Bay area was 3.5%, which was noticeably higher than the State of California average of 2.1%. Private sector growth of 4% year over year came in even higher, than non-farm growth[7].

Data from the State of California Employment Development Department paints a similar picture. The employment levels in the San Jose Sunnyvale Santa Clara Metropolitan Statistical Area (MSA) continues to increase. The preliminary estimate of the December 2012 employment level in the MSA was 929,700, a 3.1% increase from the December 2011 level of 901,800. The employment level is now equivalent to the most the recent peak of 930,500 experienced in December 2007.



6 The UCLA Anderson Forecast for the Nation and California, "Beyond the Cliff", December 2012.
7 Beacon Economics, The Regional Outlook – South Bay, Quarterly Update – as posted January 16, 2012.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

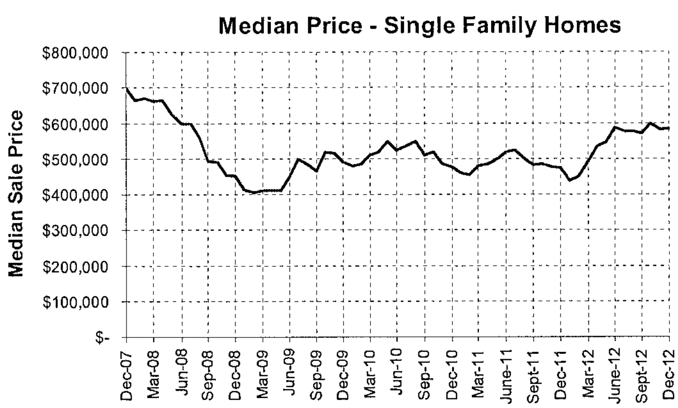
Unemployment Rate (Unadjusted)

	Dec. 2011	Nov. 2012	Dec. 2012**
San José Metropolitan Statistical Area*	8.8%	7.8%	7.6%
State of California	10.9%	9.6%	9.7%
United States	8.3%	7.4%	7.6%

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

The unemployment rate in the MSA continues to decline, reaching its lowest point since November 2008. The preliminary December 2012 unemployment rate of 7.6% decreased from the November 2012 rate of 7.8% and is lower than the 8.8% rate experienced a year ago. The preliminary December 2012 unemployment rate in this region is less than the unadjusted 9.7% unemployment rate for the State, and is equal to that of the nation, which currently has an unadjusted unemployment rate of 7.6% as well.

Overall, construction activity remains strong in the City. Permits for 1,592 residential dwelling units have been issued since the beginning of 2012-2013, which is well above the 1,186 units issued during the same period in 2011-2012. At $128.2 million, permit valuation for commercial construction activity through January is tracking 2.5% below last year, but January 2013 was the strongest month in two and a half years ($35.3 million). Industrial permit activity is up significantly, with valuation at $137.5 million through January, compared to valuation of $75.1 million through the same period last year.



Housing prices have improved significantly since the same period in 2011. The December 2012 median single-family home price of $584,500 showed a slight decline from a recent peak of $599,000 in October 2012, but was far above the December 2011 median home price of $474,500. Cumulatively, property transfers from July through December totaled 4,171, which was up 3.4% from 4,032 transfers during the first six months of 2011-2012. The average days-on-market for single family and multi-family dwellings totaled 36 days in December 2012, reaching the lowest point since June 2006. Average days-on-market in December 2011 was 84.

Economic conditions will continue to be closely monitored and factored into the development of the 2013-2014 Proposed Budget, due to be released May 1, 2013.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

City of San José Economic Outlook

The outlook for Silicon Valley overall, and San José in particular, is positive in the near term, with growth likely to level off in the out years of this Forecast. Due to the concentration of technology firms in the Silicon Valley, this region is heavily influenced by the technology sector.

The strength in the technology sector as well as continued improvement in the housing sector are expected to grow the local economy through 2014.

In the near term, the strength in the technology industry will keep employment levels increasing. However, signs such as the exorbitant stock valuations of many startups indicate that the current technology product cycle may be over its peak. As this technology cycle, which has been defined by the emergence of mobile-social networking, recedes, employment will continue to grow, but at a more sustainable long term level. Mild rebounds in State and local government hiring, as well as construction are also expected to bolster the employment rate in the long term.

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

Additionally, in the long term, as politics and policies are developed around the Federal Budget and the U.S. debt, the residual effects are anticipated to be felt as they ripple through state and local economies. In particular, cuts in defense, which may result from the upcoming Federal Budget debates, would likely impact the local technology industry. In the out years of this Forecast, the strong growth associated with technology is anticipated to level off and growth will begin to temper.

In summary, the recovery from the economic recession is expected to continue to impact the City's economic performance in 2013-2014 and beyond. The economically sensitive revenues, such as Sales Tax and Property Tax receipts, are expected to experience moderate growth over the forecast period. The deep decline in the City's revenue collections over the past few years have continued to recover through 2012-2013 and are anticipated to grow through 2013-2014 and the out years of this Forecast.

Optimistic Case

In the Optimistic Case, the economy is assumed to rebound at a much more rapid pace than assumed in the Base Case. This growth is primarily due to a more robust rebound in housing at both the national and local levels primarily due to the continued assistance from the Federal Reserve through monetary and fiscal policy. This case reflects the continuation of historically low mortgage rates and an increase in housing construction and all ancillary economic activities associated with this activity as a result. Consistent with the growing housing market, this Optimistic Case forecasts that development activity, employment, and inflation are all well above levels assumed in the Base Case. With these higher levels, the economy will react more quickly and result in considerably higher rates of growth in revenues.

Under the Optimistic Case, the economically sensitive revenues are expected to experience much stronger performance as general increases in employment and consumer attitudes promote increased spending, which generate Sales Tax for the City. Improvement in the real estate market will result in higher Property Tax revenues. Development activity is also expected to improve as well as business tax collections and Transient Occupancy Tax receipts. Conversely, Gas taxes are slightly lower as a result of higher oil prices and continued increases in mandated fuel economy, which is anticipated to cause the number of taxable gallons consumed to fall. By the end of the Forecast period, revenues are $46.4 million above the Base Case.

Pessimistic Case

The Pessimistic Case assumes that a combination of adverse factors interact to impede the recovery underlying the Base Case. These factors include the impact of the world economy, including the current financial troubles in the European and Asian markets, and increasing weakness in housing markets as home prices both locally and nationally fall as a result of rising mortgage rates.

In the Pessimistic Case, one of the most significant changes is the anticipated impact of the world economy. This case assumes that the European economy, Japan and China all continue to face economic challenges and the potential to sink into a much deeper recession. The Japanese economy is struggling with large debt, declining prices, and falling exports with controversial fiscal and monetary policies in place which could result in a currency war. The Chinese economy continues to recover from a weak point, however, its focus on investment rather than consumption has the potential to fail and once again bring the Chinese economy to a weak point. Given the current fragile state of the U.S. economy, the effects of the status of these world markets could reverberate through the U.S. and significantly dampen growth during the forecast period.

As such, home prices are expected to fall and resale activity is forecasted to drop significantly compared to those assumed in the Base Case. The contracting national economy triggers state and local governments to lapse back into deficits, once again contracting the labor market. With the declining economy, unemployment rates are projected to increase and employment growth rates are expected to fall.

The housing market is a critical assumption in the Base Case, and this Pessimistic Case reflects lower home prices than the Base Case. It is estimated that on both a local and national level, housing prices may fall as mortgage rates rise. Aggressive monetary and fiscal policies of the Federal Reserve run a risk of producing higher inflation rates. Because mortgage rates are very sensitive to inflation rates, this case assumes an adverse affect on the housing market. With increasing mortgage rates, home sales and prices will fall. Conversely, the Base Case assumes

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

that despite this potential for a dampened market, that housing prices will see strong growth locally.

As a result of these negative impacts to the economy, revenue collections in categories such as Property Tax and Sales Tax collections are lower in this scenario than in the Base Case, driven by the lack of job creation, which slows demand for residential and commercial property and business and consumer goods. Franchise Fee and Utility Tax revenue are slightly lower and economically sensitive revenues and activities such as Transient Occupancy Tax and development activity are expected to be suppressed in this Pessimistic Case as well. Conversely, Gas Taxes are slightly up due to projected reductions in oil prices which typically results in increases in gas consumption. By the end of the Forecast period, total revenues are $59.0million below the Base Case.

Impact of Forecasted Economic Conditions on Revenue Collections

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

An in-depth analysis of the General Fund revenue categories was completed to develop 2013-2014 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2012-2013 and build upon those projections to develop the 2013-2014 revenue estimates. These estimates are based on the Base Case Forecast economic scenario described in this section. These revenue estimates will be closely examined and updated again during the preparation of the 2013-2014 Proposed Operating Budget that will be released on May 1, 2013.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

As displayed in the General Fund Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from $801.9 million in 2013-2014 to $908.6 million in 2017-2018, for an average growth rate of 3.1% per year.

February 2013 Forecast Revenue Summary

	Modified Budget	Forecast				
Revenue Category	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
General Revenues						
Property Tax	$ 202,925,000	$ 209,050,000	$ 217,809,000	$ 228,547,000	$ 240,866,000	$ 254,017,000
Sales Tax	161,270,000	166,660,000	173,843,000	180,884,000	188,770,000	196,680,000
Transient Occupancy Tax	10,100,000	10,600,000	11,024,000	11,354,000	11,694,000	12,104,000
Franchise Fees	43,625,000	43,923,000	44,885,000	45,998,000	47,341,000	48,752,000
Utiltiy Tax	90,973,000	91,895,000	93,705,000	95,776,000	98,295,000	100,861,000
Telephone Line Tax	20,525,000	20,600,000	20,600,000	20,600,000	20,600,000	20,600,000
Business Tax	42,400,000	40,700,000	40,875,000	41,047,000	41,207,000	41,355,000
Other Licenses and Permits	39,085,517	39,804,000	41,117,000	42,474,000	43,918,000	45,631,000
Departmental Charges	32,934,892	33,739,000	35,547,000	36,720,000	37,968,000	39,449,000
Fines, Forfeitures & Penalties	15,458,500	15,862,000	16,184,000	16,579,000	17,005,000	17,277,000
Money and Property	2,910,500	2,625,000	2,678,000	2,731,000	2,786,000	2,841,000
Revenue From Local Agencies	37,823,606	26,140,000	26,839,000	27,499,000	28,226,000	29,009,000
Revenue from the State	12,539,765	10,606,000	10,450,000	10,450,000	10,450,000	10,450,000
Federal Revenue	22,785,970	6,934,000	1,577,000	-	-	-
Other Revenue	121,762,920	14,955,000	15,141,000	15,380,000	15,631,000	15,905,000
Gas Tax	14,500,000	14,000,000	13,628,000	13,228,000	12,936,000	12,589,000
Total General Revenues	$ 871,619,670	$ 748,093,000	$ 765,902,000	$ 789,267,000	$ 817,693,000	$ 847,520,000
Transfers and Reimbursements						
Overhead Reimbursements	$ 32,348,979	$ 36,385,000	$ 37,586,000	$ 38,826,000	$ 40,146,000	$ 41,712,000
Transfers	20,126,726	16,734,000	17,336,000	17,647,000	18,016,000	18,489,000
Reimbursements for Services	684,579	737,000	762,000	787,000	814,000	845,000
Total Transfers and Reimbursements	$ 53,160,284	$ 53,856,000	$ 55,684,000	$ 57,260,000	$ 58,976,000	$ 61,046,000
Total General Fund Revenues	$ 924,779,954	$ 801,949,000	$ 821,586,000	$ 846,527,000	$ 876,669,000	$ 908,566,000
Beginning Fund Balance	$ 168,299,570	$ 50,800,000	$ 52,341,000	$ 53,137,000	$ 53,823,000	$ 54,707,000
Grand Total Sources	$ 1,093,079,524	$ 852,749,000	$ 873,927,000	$ 899,664,000	$ 930,492,000	$ 963,273,000
Growth %			2.48%	2.94%	3.43%	3.52%

Understanding the basis for the revenue estimates included in this Forecast requires a discussion of the assumptions used for estimating each of the revenue categories. The following discussion focuses on estimates used for the 2013-2014 General Fund Forecast.

Property Tax

Property Tax receipts of $204.0 million are projected for 2012-2013, which represents 1.1% growth from the prior year and is slightly above the modified budget estimate of $202.9 million. This projected increase continues the modest growth seen in 2011-2012, where actual Property Tax receipts were up 2.3% year-over-year for the first time since 2008-2009. Growth is reflected in the Secured, Unsecured, and Airplane Property Tax categories. Overall, in 2013-2014, collections are expected to continue to increase 2.5% to $209.1 million primarily due to a 2% California Consumer Price Index (CCPI) increase, which will be assessed in the Secured Property Tax category. Additional information about each of the Property Tax sub-categories is provided below.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Secured Property Taxes account for over 90% of the revenues in this category. In 2012-2013, Secured Property Tax receipts are expected to total $186.0 million, reflecting growth of only 1.1% from the prior year. Although this slight increase marks the second year of positive performance after two years of declines in this category, estimated receipts remain below the most recent peak of $192.3 million in 2008-2009. In 2013-2014, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2013, are expected to increase by 2.5% to $190.7 million. This projected increase is related to two factors: the change in the CCPI and the net change in residential and commercial valuation. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. The CCPI adjustment for the 2013-2014 tax roll is an increase of 2.0%, consistent with the prior year. A net increase in residential and commercial valuation is also anticipated from the combination of changes in ownership, new construction, and the partial restoration of property values that had previously been reassessed downward under Proposition 8 due to declining home values. All properties that have received a reduction under Proposition 8 do not automatically receive the 2% CCPI adjustment as these properties are assessed annually and adjusted upward or downward depending on the changes to property values. As property values increase, the property taxes can be restored up to the factored base year value. With the improvement in the real estate market, it is anticipated that some upward adjustments will be realized in 2013-2014. In calendar year 2012, residential real estate experienced gains as the December 2012 median sales price of $584,500 for single-family homes was 23% above of the December 2011 level.

It should be noted that final data on the actual tax levy for 2013-2014 is not yet available as adjustments are made through June 30, 2013. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Many of the adjustments, however, are not reflected until the latter months of a given fiscal year (April-June). The impact of reassessments of commercial property will not be known until the end of 2012-2013. As this information becomes available, refinements to the Property Tax estimates may be brought forward in the 2013-2014 Proposed Budget or during the Proposed Budget review process in May and June.

Unsecured Property Taxes are the second largest revenue source in this category. Growth in this category is driven primarily by increases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections, receipts in this category are expected to grow to $11.5 million in 2012-2013, which is 2.7% above the prior year collection level of $11.2 million. Collections are expected to increase another 2.6% in 2013-2014 to $11.8 million based on improving business conditions and increasing employment.

SB 813 Property Taxes (supplemental taxes) represent payments for taxes owed on recent housing resales. In recent years, collections in this category had fallen significantly, due, in part, to a substantial number of refunds that were due to property owners as a result of declining home values. In 2011-2012, collections of $3.3 million experienced strong growth, but remained well below the peak of $10.1 million received in 2005-2006 and below levels seen just a few years ago (e.g., $8.0 million in 206-2007 and $7.9 million in 2007-2008). Based on the most recent estimate from the County of Santa Clara Controller's Office, receipts in this category are expected to total $3.3 million in 2012-2013, consistent with the prior year collection level. In 2013-2014, collections in this category are projected to increase 2.6% to $3.4 million.

The Homeowners Property Tax Relief category is projected at $1.1 million for 2013-2014, which is consistent with the 2012-2013 revenue estimate and 2011-2012 actual collections.

In the out-years of the Forecast, annual Property Tax performance is expected to range from growth of 4.2% in 2014-2015 to an increase of 5.5% in 2017-2018. Moderate annual growth is expected throughout the Forecast period, with a portion of this growth due to an estimated 2% CPI increase annually.

Sales Tax

The Sales Tax category includes General Sales Taxes and Proposition 172 Sales Taxes. Overall, 2012-2013 collections are expected to increase 4.9% over prior year levels to $161.5 million. In 2013-2014, year-over-year growth of 3.2% is expected, bringing the projected revenue to $166.7 million. It is important to note that the total revenue anticipated for 2012-2013 includes a number of one-time adjustments. After adjusting for those one-time payments, year-over-year growth of 2.9% is expected in 2012-2013 and additional underlying growth of 4.0% is expected in 2013-2014.

For the General Sales Tax revenue category, only one quarter of 2012-2013 data is available. Based on this limited information, year-over-year growth of 4.6% is projected in 2012-2013, resulting in collections of $156.2 million. This increase from the $149.4 million collected in 2011-2012 does factor in one-time accounting adjustments to reflect prior-year collections ($1.7 million) and the "Triple Flip" true-up payment from the State for 2012-2013 ($1.4 million). Excluding those adjustments, the 2012-2013 estimate reflects actual growth of 6.4% in the first quarter and projected underlying growth of 3% in the remaining three quarters based on recent sales tax performance and current economic conditions. With continued improvement in the economy, sales tax growth is expected to continue.

For 2013-2014, the General Sales Tax revenue projection of $161.2 million assumes moderate growth of 4.0% in taxable sales from 2012-2013 levels. Because there are again one-time accounting adjustments to reflect prior-year collections and the "Triple Flip" true-up payment from the State in 2012-2013 that are not reflected in 2013-2014, as discussed above, the year-over-year growth in 2013-2014 is estimated to be approximately 3.2%. To put the 2013-2014 estimate into perspective, the projected revenue of $161.2 million is only $3.1 million (1.9%) below the peak collections of $164.3 million collected in 2000-2001, bringing revenues above pre-recession levels and close to levels seen during the dotcom boom.

The Sales Tax revenue projections for 2012-2013 will continue to be refined over the next couple of months as additional information becomes available. Sales Tax data for the second quarter of 2012-2013, which covers the 2012 holiday period, will be received in March 2013. Based on this additional data, any necessary adjustments to the estimate will be incorporated into the 2013-2014 Proposed Operating Budget.

Proposition 172 Sales Tax collections (representing the one-half cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total $5.3 million in 2012-2013, which represents a 13.5% increase from the prior year collections of $4.7 million based on activity through the first seven months of 2012-2013. In 2013-2014, collections are projected to increase 4.0%, to $5.5 million.

Transient Occupancy Tax

Currently Transient Occupancy Tax (TOT) receipts in 2012-2013 are projected to reach $10.1 million, reflecting an increase of 12.4% from the 2011-2012 collection level. Current year receipts mark the third year of growth in this category which is in stark contrast to prior year declines of 11.5% and 18.5% in 2009-2010 and 2008-2009, respectively. Despite the renovation and expansion construction activity at the Convention Center and the expected adverse impact on those hotels most reliant on convention-related business, the hotel industry continues to experience a period of strong growth with increases in occupancy levels and average daily room rates. Projected 2012-2013 receipts exceed the pre-recession level of $9.6 million collected in 2007-2008 by approximately 5.2%.

In 2013-2014, growth of 5.0% from the 2012-2013 estimate is anticipated which allows for the stabilization of the current high level of growth and allow for potential disruption associated with the ongoing Convention Center renovation and expansion project. Over the five year forecast period, revenues are anticipated to grow steadily at 3% to 4%, however, it is important to note that no assumption for additional room capacity is included in this forecast. If additional hotel rooms are added to the City's inventory, additional TOT revenues should be generated. By 2017-2018, collections are projected to reach $12.1 million, which is above pre-recessionary levels as well as above the level seen in 2000-2001 ($10.9 million) during the dotcom boom. The completion of the Convention Center renovation and expansion project, which will add 125,000 square feet of new flexible space, as well as improvements to the existing space, in late 2013, is expected to drive additional room night activity in the market.

Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Cable, Tow, Commercial Solid Waste, Water, and Nitrogen Gas Pipeline categories. Overall, collections are projected at $43.7 million in 2012-2013, an increase of 4.7% from prior year receipts of $41.7 million. The projected increase in 2012-2013 is due to higher collections in the Commercial Solid Waste category, reflecting the new methodology for assessing this fee effective July 1, 2012. In 2013-2014, Franchise Fees are expected to increase 0.6% to $43.9 million due to growth in the Water (5.1%) and Electric (2.0%) categories, partially offset by declines in Gas (-4.9%).

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2012-2013 are based on the calendar year 2012). Year-end estimates are typically based upon an examination of electricity and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. When comparing 2011 and 2012 calendar year Utility Tax Receipts, Gas receipts showed a decline of approximately 5% and Electric receipts remained flat. The reconciliation of annual receipts from PG&E for 2012-2013 will be received in April 2013.

In the Electric Franchise Fee category, collections in 2012-2013 are expected to reach $18.2 million, which is flat compared to actual receipts in 2011-2012 and consistent with the actual Electric Utility Tax receipts in calendar year 2011 compared to 2012. In 2013-2014, growth of 2.0% from 2012-2013 estimates is anticipated reflecting a California Public Utilities Commission approved rate increase of 2.6% effective January 2013. It should be noted that due to the uncertainty regarding the outcome of rate cases, no rate increases associated with any pending rate cases have been assumed.

In the Gas Franchise Fee Category, the 2012-2013 estimated collections of $4.2 million reflect a 4.0% decline from the $4.4 million received in the prior year. This decline primarily reflects a decline in gas prices, consistent with information from PG&E and with calendar receipts of Utility Users Gas Tax in 2011 compared to 2012. In 2013-2014, Gas Franchise Fee collections are projected to decline further by 5% based on the assumption that costs and consumption will continue to decline. It should be noted that due to the uncertainty regarding the outcome of any rate cases, no rate increases associated with pending rate cases have been assumed in 2013-2014.

In City Generated Tow, revenues are growing compared to prior year levels and are estimated to reach $875,000 in 2012-2013, an increase of 13.7% from the $770,000 received in 2011-2012. Collections are anticipated to dampen slightly in 2013-2014 with a decline of 2.9% to reflect the continued change in procedures by the Police Department, which reduced the number of tow and impounds for persons with violations that are not related to serious driving offenses.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach budgeted levels of $11.0 million in 2012-2013, a 14.7% increase from the prior year collections ($9.6 million) reflecting the new methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010 the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The new fee structure is $5 million per year for each of two geographic collection districts plus a supplemental fee of $1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the annual CPI rate during the prior two calendar years. It should be noted that this increase is not automatic; therefore, the 2013-2014 estimate currently assumes no growth from 2012-2013 as City Council approval of a rate increase will be required.

Remaining categories, including Cable, Water, and Nitrogen Gas Pipeline, are estimated to end the year at $9.3 million, which is slightly above ($505,000) budgeted levels of $8.8 million. Activity levels in 2013-2014 are expected to increase slightly compared to 2012-2013 levels, with 1.4% growth in Cable (to $9.1 million), 5.1% growth in Water (to $289,000), and no growth in the Nitrogen Gas Pipeline ($55,000) categories. Increases are anticipated due to estimated changes in consumption levels as well as rates.

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase from 2.2% to 3.0% annually. Over the next five years, however, it should be noted that there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels. In addition, the City's current Cable Franchise Fee agreement is scheduled to sunset in 2016.

Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2012-2013 are anticipated to total $90.2 million, representing a slight decrease of 0.3% from the 2011-2012 collection level. A portion of this decrease from the prior year is the result of a one-time settlement of $1.6 million from PG&E received in 2011-2012. This settlement corrected for underpayments and related penalties and interest of Gas and Electric franchise fees, surcharges and utility users taxes from January 1, 2007 through December 21, 2010 that were not coded as San José properties in PG&E's billing system. After adjusting for this one-time settlement, 2012-2013 revenues are estimated to increase 1.5% from prior year levels. This 1.5% growth reflects approved rate increases for Water (5% increase in July 2012) and Electric (2.6% effective January 2013), declines in the Gas Utility Tax category, and changes in consumption levels.

In 2013-2014, Utility Tax collections are projected to increase 1.9% to $91.9 million. Overall, a number of proposed rate cases have been filed that would affect electricity, gas, and water rates and consequently revenues. Due to the uncertainty regarding the outcome of rate cases, the Forecast generally does not assume revenue increases associated with pending rate cases. Rate cases will continue to be monitored and adjustments will be bought forward as appropriate based on the final outcomes.

The Electricity Utility Tax is anticipated to generate $39.4 million in 2012-2013, a 0.8% increase from prior year levels. Estimated current year collections reflect the average 2.6% rate increase effective January 2013 as well actual collection trends. In 2013-2014, revenues are estimated to increase 2.0% to $40.2 million based on the annualization of the January 2013 rate increase with minimal changes in anticipated consumption levels. Gas Utility Taxes are anticipated decline to $8.0 million in 2012-2013, a 9.0% decrease from 2011-2012 levels, based on current collection trends. This decline is consistent with information from PG&E on the drop in gas prices. In 2013-2014, revenues are anticipated to increase by approximately 1% to $8.1 million. The PG&E gas rate projections for 2013 do show some expected growth in the average bills in the latter part of 2013. Actual collections continue to be subject to significant fluctuations from the impact of weather conditions and/or rate changes, as such no assumptions for changes due to rate cases are included and revenues will be monitored closely for projected performance.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Water Utility Tax receipts of $10.9 million are anticipated to be received in 2012-2013, a 13.9% increase from 2011-2012. This growth reflects approved rate increases, including a 5% rate increase in January 2012 and a 5% increase July 2012. In 2013-2014, receipts are expected to increase 5.0% to $11.4 million based on the rising wholesale price of water. No change in consumption levels is assumed. It should be noted that a significant rate case is under review by the Public Utilities Commission and no assumption for these proposed increases are assumed for 2013-2014.

In the Telephone Utility category, revenues are collected on landlines, wireless, and VoIP. Based on current tracking, receipts in 2012-2013 are anticipated to reach $31.9 million, a 1.6% increase from 2011-2012. In 2013-2014, revenues are estimated to increase an additional 1.0% to $32.2 million based on collection trends in recent years.

In the out years of the Forecast, growth ranging from 2.0% to 2.6% annually is expected in the Utility Tax category. As discussed above, there is significant volatility and uncertainty regarding the performance in this category based on outstanding rate cases as well as consumption levels. The Water and Gas Utility Tax categories are significantly influenced by weather conditions.

Telephone Line Tax

Based on the current collection trend, receipts in both 2012-2013 and 2013-2014 are anticipated to total $20.6 million, which is very close to the collection levels seen since 2009-2010. Given the steady nature of collections in this category, receipts are anticipated to remain flat in the out years of the Forecast for this category.

Business Taxes

This category includes General Business Tax, Disposal Facility Tax, Cardroom Tax, and Marijuana Business Tax. In 2012-2013, Business Taxes are estimated to reach $42.6 million, a 3.6% increase from prior year levels. This increase is primarily due to higher than anticipated Cardroom Tax receipts (7.1% increase) as well as Marijuana Business Tax (4.4%) and General Business Tax (1.9%). In 2013-2014, revenues are estimated to decrease 4.5% to $40.7 million due to a decrease in Disposal Facility Tax as well as the normalization of one-time activities in the current year for both General Business Tax and Cardroom Tax.

In 2012-2013, General Business Tax proceeds are expected to reach $11.5 million, a 1.9% increase from the prior year level of $11.3 million. This positive collection trend reflects the gradual economic recovery, efforts by the Finance Department to maximize the receipt of this tax, and the early results of the City Council approved Business Tax Amnesty Program. As part of the Amnesty Program, a business owner may file a request for amnesty between December 1, 2012 and March 29, 2013. An extension to this program is recommended for City Council consideration on March 5, 2013 and, if approved, would extend the program to May 31, 2013. In 2013-2014, a decline of 1.7% to $11.3 million is projected and reflects the elimination of the one-time revenues generated by the Amnesty Program and remains consistent with the historical trend. Once the ongoing results of the Amnesty Program are known, any necessary revenue estimate adjustment will be brought forward as part of the 2013-2014 budget process.

Based on current performance, collections in the Cardroom Tax category are estimated at $16.0 million in 2012-2013, an increase of 7.1% from the prior year collection level ($14.9 million). This increase primarily reflects a spike in activity resulting from the opening of Casino M8trix in August 2012. Though this accounts for the majority of the upward growth in the current year, the continued economic recovery is also a contributing factor in the additional activity. In 2013-2014, a decline of 3.1% from 2012-2013 is anticipated, normalizing the spike in activity for the opening of M8trix. When compared to 2011-2012 receipts that did not have these one-time impacts, estimated 2013-2014 collections of $15.5 million reflect growth of 3.7%.

In the Disposal Facility Tax category, collections are estimated at $11.2 million in 2012-2013 based on current collection trends, which assumes no growth from prior year collection levels. Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream varies due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. In recent years, revenues in this category have declined due, in large part, to increased waste diversion and the overall slowdown in the economy. In 2012-2013, receipts have been tracking to meet or slightly exceed the prior year collection level. However, improvements in the processing of waste for the commercial program are expected to reduce DFT collections beginning in the second half of 2012-2013. The commercial program represents approximately 10-15% of total DFT associated waste. To account for the potential impact of this change as well as the historical downward trend in this category, the 2013-2014 revenue estimate of $10.0 million allows for a decline of 10.7% from the projected 2012-2013 collection level.

On November 2, 2010, San José voters approved Ballot Measure U, which allows the City to tax all marijuana businesses (medical and non-medical; legal and illegal) at a rate of up to 10% of gross receipts. The City Council approved a 7% rate and the tax became effective on March 1, 2011. In 2012-2013, collections are anticipated to reach $3.9 million, reflecting growth of 4.4% from the prior year collection level. As a result of the continued uncertainty surrounding this tax and the Marijuana Regulatory Program, 2013-2014 estimates are anticipated to remain flat at the prior year level until more information is known.

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

Licenses and Permits and Departmental Charges

The Licenses and Permits and Departmental Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. In 2013-2014, the Licenses and

Permits category is estimated at $39.8 million and the Departmental Charges category is estimated at $33.7 million.

For 2013-2014, the development-related revenues are expected to continue the strong performance experienced in the past two years. In cases where the development-related costs are projected to exceed revenues, there are sufficient earmarked program reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact. For 2013-2014, the Building Fee Program and Planning Fee program expenditures are projected to exceed the base revenue estimates. This Forecast assumes that Fee Program Reserves will be used to address these shortfalls as outlined in the Ending Fund Balance section of this document. In the Fire and Public Works Development Fee Programs, revenues are projected to exceed the base program costs; and, for purposes of this Forecast, the revenues in these programs have been set at the base cost level. Budget actions will be brought forward in each of these fee programs to maintain cost-recovery and ensure resources are available to address service needs.

For the non-development-related fees and charges, the 2013-2014 estimates are based on current collection trends. In the out years of the forecast, both the Licenses and Permits and Departmental Charges categories are expected to experience growth ranging from 3.3% to 5.4%. The growth rates in the out years are tied to the expected increases in costs which the fees are designed to recover, including increased retirement and health costs.

Fines, Forfeitures and Penalties

In 2012-2013, the Fines, Forfeitures and Penalties category is expected to generate $15.0 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately $9.8 million in 2012-2013, a decrease of 17.2% from the 2011-2012 receipts of $11.8 million. In the 2012-2013 Adopted Budget, it was assumed that Parking Fine revenues would decline to $11.0 million as a result of the transition of parking compliance officers that were transferred from the Airport Department to the Transportation Department. The actual reduction has been much larger than anticipated due to more significant impacts of training and transition, a reduction in activity in neighborhoods around the HP Arena due to the delayed hockey season, and a higher level of staff absences. Given the temporary nature of some of these impacts, Parking Fines revenues are expected to improve in 2013-2014 with collections estimated again at $11.0 million, which is below recent actual levels. Total revenue in 2013-2014 is estimated at $15.9 million in the Fines, Forfeitures, and Penalties category. In the out years of the Forecast, annual growth of approximately 1.6% to 2.6% is projected.

Money and Property

This category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, and interest income and is projected to generate $2.6 million in 2013-2014. Of this amount, $2.1 million is expected to be generated from the rental of City-owned facilities. An additional $250,000 is projected from subrogation recovery efforts and $299,000 is projected from various interest earnings. For the General Fund portion of pooled funds, the 2013-2014 estimate for interest earnings assumes an average interest rate of only 0.33% applied to an average cash balance of approximately $50 million for a total collection level of $175,000. In the out years of the Forecast, approximately 2.0% growth annually is assumed.

Revenue from Local Agencies

In 2013-2014, revenue of $26.1 million is projected from other local agencies, such as the Successor Agency to the Redevelopment Agency, the Central Fire District, and the County of Santa Clara to reimburse the City for services provided. This is significantly lower than levels in the 2012-2013 Modified Budget due to a number of one time payments from various grants.

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

The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. For 2012-2013, Central Fire District payments are expected to end the year at $4.9 million based on information from the Central Fire District staff, reflecting a 6.1% increase from the prior year. In 2013-2014, collections are projected to increase 2.5%, to $5.0 million, consistent with the increase in Secured Property Tax assumed in this forecast.

In 2013-2014, payments from the County of Santa Clara for the first responder advanced life support program (Paramedic Program) are assumed to total $2.2 million. In addition, payments of $2.5 million from other local agencies are expected to reimburse the City for the Police Department CAL-ID and SB 720 program.

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 2.5% to 2.8%.

Revenue from the State of California

The Revenue from the State of California category includes Tobacco Settlement payments, State grant revenues, and other State reimbursements. Collections in this category are estimated to reach $10.6 million in 2013-2014 and decline to $10.5 million in 2014-2015 through 2017-2018. Tobacco Settlement payments, which are estimated at $9.0 million in 2013-2014 and the remaining years of the Forecast, account for the majority of revenue in this category.

The following State grants and reimbursements are expected in 2013-2014: Abandoned Vehicles Abatement Program ($500,000); Auto Theft reimbursement ($370,000); Highway Maintenance Charges reimbursement ($105,000); Planning Grants Planner ($82,000); and California Gang Reduction, Intervention and Prevention (CALGRIP) Grant ($74,000). Vehicle License Fees

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Collection In Excess are also estimated at $475,000 annually and account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures are equally apportioned to counties and cities on a population basis.

Adjustments to the grant amounts are reflected in the remaining years of the Forecast. A net decrease of $156,000 is expected in 2014-2015 to reflect the elimination the following grants which are set to expire in 2013-2014: the Planning Grants Planner and CALGRIP Grants. No annual growth is projected in the remaining three out years of the Forecast.

Revenue from the Federal Government

The Revenue from the Federal Government category, including the American Recovery and Reinvestment Act (ARRA) revenue, consists of grant revenues. The following grants are anticipated in 2013-2014: Staffing For Adequate Fire & Emergency Response Grant 2011 (SAFER) ($4.1 million); Community Oriented Policing Services (COPS) Hiring Grants ($2.6 million); Community Based Violence Prevention OJJDP Grant ($100,000); Clean Creeks and Healthy Community Grant ($93,000); and National Forum Capacity-Building Grant OJJDP 2012-2015 ($63,000).

Adjustments to these grant amounts are reflected in the remaining years of the Forecast. In the out years of the Forecast, only the SAFER 2011 grant ($1.1 million), the COPS 2011 Hiring Grant ($406,000), and the Clean Creeks and Healthy Community Grant ($93,000) are assumed in 2014-2015. All other grants are anticipated to sunset in 2013-2014.

Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including proceeds from the Sale of Surplus Property, cost reimbursements for the Investment Program, and Arena Rental, Suite, Parking, and Naming revenues. In 2012-2013, this category is expected to generate $122.8 million. The 2012-2013 estimate includes $100.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits. Factoring out the TRANs issuance, 2012-2013 collections for this category are estimated to total $22.8 million.

In 2013-2014, the revenue estimate of $15.0 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2013-2014 costs or agreements and the elimination of one-time funding sources. This figure excludes revenues associated with the issuance of the TRANs that will be brought forward in 2013-2014 with an offsetting expenditure based on estimated cash flow needs. It also excludes a one-time sale of property of $5.0 million for the sale of 14.5 acres to the Earthquakes, LLC.

In 2013-2014, the proceeds from the Sale of Surplus Property category has been set at $1.3 million based on the anticipated assets that will be sold next fiscal year and is slightly down from the $1.4 million assumed in the 2012-2013 Adopted Budget. The cost reimbursement for the Investment Program is estimated at $2.4 million based on the current allocation of staff to this function. In addition, $5.3 million is projected from Arena Rental, Suite, Parking, and Naming revenues.

In the out years of the Forecast, annual increases range from 1.2% to 1.8%. According to the contract with the San Jose Arena Management, the Arena Parking revenue is scheduled to end in 2012-2013 and the Arena Naming revenue is schedule to end in 2014-2015. In this Forecast, it is assumed that the contract for these items will be extended and these revenues will continue through the full five years of this forecast.

Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2012-2013 are projected to reach $14.0 million, a drop of 4.7% from the prior year level of $14.7 million. Collections are expected to remain flat at $14.0 million in 2013-2014. In recent years, revenues in this category have declined. Several factors may have impacted collections, including volatile gas prices, the lingering impacts of the economic downturn, and a move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In the out years of the Forecast, collections are expected to decline by between 2.2% and 2.9% annually.

Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2013-2014, a total of $36.4 million in reimbursements are projected based on 2013-2014 overhead rates prepared by the Finance Department applied against the projected 2013-2014 salaries for those positions for which an overhead rate is applied.

In the remaining years of the Forecast, annual increases ranging from 3.3% to 3.9% are assumed, reflecting increases in costs which the overhead rate is designed to recover, including increased personal services costs.

Transfers

The Transfers category is projected at $16.7 million in 2013-2014, which reflects a drop from the $20.2 million anticipated in 2012-2013, primarily due to the elimination of one-time transfers in 2012-2013. The largest component of this category ($9.0 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2013-2014, these reimbursements have been set to cover the base 2013-2014 costs. As discussed in an information memorandum to the City Council dated September 24, 2012, it should be noted that contingent on an extension of the SAFER 2010 period of performance, the Administration has developed a strategy that would allocate the $2.4 million of SAFER 2010 grant reimbursement that is expected to be received in 2013-2014 towards the estimated $2.6 million cost differential between providing the Fire services in-house and contracting out those services ($2.3 million) during the 16-month period in which the Fire Department would continue to provide services. This use of the $2.4 million grant reimbursement for this purpose will not impact the General Fund Forecast as these grant funds were not assumed to be received in 2013-2014. It is anticipated that the Administration will incorporate this strategy into the 2013-2014 budget development process as appropriate.

Additional large transfers programmed for 2013-2014 include the Construction and Conveyance Tax Fund transfer ($2.9 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer ($1.8 million) for pavement maintenance activities; and the Workforce Investment Act Fund transfer ($528,000) for use of various community centers and Workforce Investment Act program services.

Annual increases in the out years range from 1.8% to 3.6%. The reimbursement from the Airport Maintenance and Operations Fund for police and fire services is expected to increase in the out years based on the increased costs for those services.

Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2013-2014 of $737,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases.

Beginning Fund Balance

The $50.8 million forecast estimate of available 2013-2014 Beginning Fund Balance is based on the following assumptions:

- The 2013-2014 Contingency Reserve, $29.3 million, is projected at the current level based on the assumption that this amount will not be used in 2012-2013 and will be carried over to 2013-2014. This reserve level complies with the City Council policy to maintain a minimum 3% Contingency Reserve. The Contingency Reserve is approximately enough to cover General Fund payroll costs for one pay period or two and one-half weeks.

- A total of $18.5 million in fund balance will be achieved from a combination of excess revenues and expenditure savings ($16.0 million) as well as the liquidation of prior-year carryover encumbrances ($2.5 million). As part of the 2012-2013 Mid-Year Budget Review actions, $12.0 million of the excess revenues ($7.6 million) and expenditure savings were ($4.4 million) were identified and set aside in a 2012-2013 Ending Fund Balance Reserve to meet a portion of this fund balance estimate. Based on General Fund performance through January, it is anticipated that the remaining $4.0 million needed for the ending fund balance will be determined and recommended as part of the year-end clean-up memorandum. The liquidation of prior-year carryover encumbrances in 2012-2013 are tracking to meet the $2.5 million estimate.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

- An additional $2.5 million from the Building Development Fee Program Reserve and $436,000 from the Planning Development Fee Program Reserve has been identified in the fund balance estimate to cover 2013-2014 costs associated with these programs, and $53,000 from the Wellness Program Reserve is included to support Wellness Program costs programmed in 2013-2014.

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue of 1.0% and expenditure savings of 1.5% would be generated annually; that the Contingency Reserve of $29.3 million would be carried over each year; and the use of the Building and Planning Fee Program Reserve would continue in the out years to support development fee projected program costs in excess of revenues. This Contingency Reserve level in the out years of the Forecast complies with the City Council approved policy to maintain a minimum 3% Contingency Reserve level. In total, the Beginning Fund Balance ranges from $52.3 million in 2014-2015 to $54.7 million in 2017-2018.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2013-2014 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2013-2014 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from $858.2 million in 2013-2014 to $991.3 million in 2017-2018, for an average growth rate of 3.7% per year.

February 2013 Forecast Expenditure Summary

Expenditure Category	Modified Budget 2012-2013	Forecast 2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Personal Services						
Salaries and Other Compensation	$ 365,995,898	$ 365,707,000	$ 375,250,000	$ 384,671,000	$ 394,180,000	$ 403,924,000
Retirement	187,128,582	211,496,000	228,740,000	233,980,000	242,911,000	256,648,000
Health and Other Fringe Benefits	49,908,532	53,821,000	59,842,000	66,764,000	73,147,000	80,141,000
Total Personal Services	$ 603,033,012	$ 631,024,000	$ 663,832,000	$ 685,415,000	$ 710,238,000	$ 740,713,000
Total Non-Personal/Equipment	$ 89,923,935	$ 81,970,000	$ 83,348,000	$ 84,194,000	$ 86,226,000	$ 88,225,000
City-Wide						
City-Wide Expenses	$ 232,157,363	$ 81,130,000	$ 79,618,000	$ 79,251,000	$ 82,908,000	$ 87,552,000
Capital Projects	16,559,000	6,050,000	6,718,000	6,713,000	6,716,000	6,716,000
Transfers	29,008,552	26,085,000	26,596,000	27,253,000	28,971,000	30,226,000
Earmarked Reserves	93,088,662	600,000	600,000	600,000	600,000	750,000
Contingency Reserve	29,309,000	29,309,000	29,309,000	29,309,000	29,309,000	29,309,000
Total City-Wide	$ 400,122,577	$ 143,174,000	$ 142,841,000	$ 143,126,000	$ 148,504,000	$ 154,553,000
Committed Additions						
New Parks and Recreation Facilities Maint. & Operations		$ 51,000	$ 331,000	$ 560,000	$ 795,000	$ 862,000
New Police Maintenance & Operations		336,000	399,000	413,000	326,000	340,000
New Traffic Infrastructure Assets Maint. & Operations		31,000	56,000	83,000	108,000	136,000
Measure O (Library) Maint. & Operations				648,000	725,000	742,000
Measure P (Parks) Maint. & Operations				50,000	87,000	81,000
Measure O (Public Safety) Maint. and Operations - Fire			8,000	24,000	3,026,000	3,146,000
Measure O (Public Safety) Maint. & Operations - Police		1,616,000	2,253,000	2,303,000	2,355,000	2,405,000
Total Committed Additions		$ 2,034,000	$ 3,047,000	$ 4,081,000	$ 7,422,000	$ 7,712,000
Total Base Exp. w/ Committed Additions	$ 1,093,079,524	$ 858,202,000	$ 893,068,000	$ 916,816,000	$ 952,390,000	$ 991,203,000
Growth %			4.1%	2.7%	3.9%	4.1%

It is important to note that adjustments are made to the Forecast to eliminate one-time additions/deletions and annualize partial year allocations that were included in the 2012-2013 Adopted Budget. Various one-time additions totaling $5.2 million that are scheduled to expire in June 2013 include funding for San José BEST Program; Medical Marijuana Program; Economic Development Incentive Fund; City Attorney legal support staffing, Senior Transportation Services; Fiscal Reform Plan staffing; Senior Services and Wellness Program support; City Clerk staffing; Safe Summer Initiative; Independent Police Auditor staffing; Volunteer Engagement; Neighborhood Business Districts; Fair Swim Center Program; and Silver Creek Aquatics Program. Many of these programs and services will likely need to be re-evaluated for continued funding in 2013-2014. This analysis will be conducted during the 2013-2014 budget process and funding recommendations for these programs and services, will be included in the 2013-2014 Proposed Operating Budget, as appropriate, and in context of other budgetary needs. A listing of the one-time funded services is included in *Appendix A.*

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

This Forecast assumes that the General Fund will assume the full costs for expenditures related to the Staffing for Adequate Fire and Emergency Response (SAFER) Grants and Community Oriented Policing Services (COPS) Grants after the expiration of grant funding. This includes expenditures related to the SAFER 2010 Grant totaling $8.0 million for 49 Fire Fighter positions starting in 2013-2014 and the SAFER 2011 Grant totaling $3.1 million for 27 Fire Fighter positions starting in 2014-2015 ($4.2 million annually). General Fund expenditures for the 2010 COPS Grant total $2.9 million for 16 Police Officers starting in 2014-2015 and 2011 COPS Grant expenditures total $568,000 for three Police Officers starting in 2015-2016. Without the continuation of these positions, significant service level reductions would occur.

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

Personal Services

As is the usual practice, the first year (2013-2014) projection for personal services costs in this Forecast has been calculated at a detailed level. An extract of payroll system information as of August 2012 was used as the starting point. This individual position-level information was then reviewed, corrected, and updated by each department to include current vacancies and filled positions, accurate salary step status, as well as any position reallocations. Also, 2012-2013 ongoing position reductions (cost savings) and additions (cost increases) were annualized and all categories of benefit costs in the coming year were projected. In January 2013, the most recent retirement plan and health plan information for each position was also updated from the payroll system.

For the 2013-2014 General Fund Forecast, personal services costs continues to account for approximately three-quarters of the General Fund's total costs. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the $631.0 million projected personal services total for 2013-2014, salaries and other compensation costs amount to $365.7 million (58.0% of projected personal services), retirement costs amount to $211.5 million (33.5% of projected personal services), and health and other fringe benefits costs amount to $53.8 million (8.5% of projected personal services). Growth in retirement costs and other personnel cost components (e.g., scheduled non-management step increases, management pay for performance, health and other fringe benefits) continue to impact personal services costs and are the primary factor for the expenditure growth in this category. In addition, a small employee compensation planning reserve has been assumed in this Forecast to set aside funds for potential limited salary adjustments.

Below is a discussion of the specific factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. For this Forecast, the out years are projected to inflate at a composite rate of approximately 4.1%.

Salaries and Other Compensation:

Salary step increases for current non-management employees and pay for performance for management employees for 2013-2014 is projected at $3.2 million, or an increase of 0.51%. With the exception of employees represented by the POA and IAFF, non-management step increases have been calculated at a 2.5% step increase rate. For POA and IAFF, a 5% step increase rate was applied in this forecast. The out years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

Overtime expenditures in the General Fund total $19.1 million for 2013-2014, with the majority of the expenditures for Police Department ($12.1 million) and Fire Department ($5.2 million) operations. The out years of the Forecast continue these costs, with small adjustments for salary step growth.

An employee compensation planning reserve is included in this Forecast ($11.1 million) in order to set aside funds for potential limited salary adjustments. This reserve allocation, representing only a modest amount of funding, would require City Council labor negotiations direction and discussions with the City's bargaining groups before any form of distribution could be made. How this allocation would be applied, if it remains funded, has not been determined.

Retirement:

For 2013-2014, retirement costs total $211.5 million for the General Fund assuming the pre-payment of the City's Annual Required Contribution (ARC) for the Federated Retirement System Tier 1 plan as well as the Police and Fire Department Retirement Plan. This amount, which is an increase of $24.4 million from the 2012-2013 Modified Budget of $187.1 million, represents 24.6% of the total General Fund base expenditure budget. Based on the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions, of the $211.5 million of the General Fund's annual required contribution (ARC) for pension and retiree healthcare, $72.8 million is projected to be paid to the Federated Retirement System ($68.7 for Tier 1 and $4.1 million for Tier 2) and $138.1 million to the Police and Fire Department Retirement Plan ($86.1 million for the Police Retirement Plan and $52.0 million for the Fire Retirement Plan). Effective September 30, 2012, as approved by the City Council, the City provides for a lower defined benefit plan (Tier 2) for new employees, who are members of the Federated Retirement System, than for existing employees (Tier 1).

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

In 2010-2011, the Retirement Boards adopted an annual required contribution methodology, which requires the City to pay a minimum ARC or a percentage of payroll, whichever is greater. With this ARC funding methodology, if the City's pensionable payroll amount changes due to staffing reductions or vacancies, the City's retirement cost will not change unless the City's ARC is based on a percentage of payroll. Due to the independently estimated payroll projections by the Retirement Boards' actuary and the City Manager's Budget Office, the City calculations for the City retirement contributions for the Federated Retirement System Tier 1 plan and the Police and Fire Department Retirement Plan are based on the minimum ARC as required by the Boards or the ARC based on Board approved percentage of budgeted payroll as calculated by the City Manager's Budget Office, whichever is greater. Please note that in November 2012, the Federated Retirement System Board approved that for the Federated Retirement System Tier 2 plan, the City's contribution shall only be based on a percentage of payroll.

In comparison to the February 2012 Forecast for the 2013-2014 retirement cost projections, the 2013-2014 retirement costs experienced a slight decrease of $3.6 million from $215.1 million to $211.5 million primarily due to retirement cost decrease for the Federated Retirement System offset with an increase to the Police and Fire Department Retirement Plan. The overall decrease is primarily due to structural retirement cost changes for both plans through the elimination of the Supplemental Retiree Benefit Reserve (SRBR) and the approval of a Low Cost/High Deductible Health Care Plan for retirees, partially offset with a higher budgeted payroll than assumed by the Boards' actuary. For the Police and Fire Department Retirement Plan, the retirement cost reductions due to these structural changes were also offset by the lowering of the interest earnings assumption for this plan from 7.5% to 7.25% as approved by the Police of Fire Department Retirement Plan Board in December 2012.

In June 2012, the voters approved Measure B, which included the elimination of the SRBR. The City Council approved an ordinance change to eliminate the SRBR for both the Federated Retirement System and the Police and Fire Department Retirement Plan on December 4, 2012 and January 29, 2013, respectively. The SRBR in the respective retirement plans provided for supplemental benefits to retirees which were derived from plan "excess" earnings. When the plans actual investment returns exceeded the expected returns, a portion of these "excess" returns was transferred into the SRBR for later distribution as a supplemental benefit. This transfer also took place even when the plans were underfunded. Through the elimination of the SRBRs, the City's contribution amount and rate were reduced. Specifically, for the Federated Retirement System Tier 1 plan, the City's ARC for the General Fund was reduced by $4.4 million ($9.2 million all funds) from $59.0 million to $54.2 million based on the 2013-2014 Forecast budgeted payroll; and for the Police and Fire Retirement Plan, the City's ARC for the General Fund was reduced by $8.6 million from $129.4 million to $120.8 million based on the 2013-2014 Forecast budgeted payroll. It should be noted, though, that the reduction of the City's ARC for 2013-2014 due to the City Council's elimination of the SRBR for the Police and Fire Department Retirement Plan is pending final approval of the Police and Fire Department Retirement Board. This Forecast assumes that the Board will approve the reduction in the coming months.

In June 2012, the City Council approved a low cost/high deductible healthcare plan for employees and retirees effective December 23, 2012. Additionally, effective July 1, 2012, Federated Retirement System members are required to enroll in Medicare A and B supplemental plans at the age of 65. With these healthcare plan modifications, the projected City and employees combined Federated Retirement System retiree healthcare rate previously forecasted for 2012-2014 as of February 2012 was reduced by 7.55 percentage points from 30.22% to 22.67%. For the City, the 2013-2014 projected contribution rate decreased by 4.9 percentage points from 16.8% to 11.9%. In comparison to the February 2012 Forecast for 2013-2014 retiree healthcare cost projections, the 2013-2014 retiree healthcare costs experienced a decrease of $6.5 million in the General Fund ($12.5 million all funds). The Federated Retirement System Board's actuary, Cheiron, noted that the changes to healthcare plans reduced the retiree healthcare unfunded liability by approximately $200 million. Similarly, due to City Council approval of a low cost/high deductible healthcare plan for employees and retirees and required enrollment in Medicare A and B at age 65, the Police and Fire Retirement Plan's unfunded liability was reduced by $196 million but was offset significantly by an $187 million increase in the liability due to the reduction in the interest earnings assumption for this plan from 7.5% to 7.25%.

Although the low cost/high deductible plan reduced the overall cost for Retiree Healthcare in the Police and Fire Department Retirement Plan, per the respective Memoranda of Agreements with the San Jose Police Officers' Association (SJPOA) and the International Association of Firefighters (IAFF), Local 230, the annual Retiree Healthcare contribution rate is capped at 11.0% for the City and 10.0% for employees. The City's Retiree Healthcare contribution rate for the Police Retirement Plan is increasing by 0.7 percentage points from 10.3% in 2012-2013 to 11.0% in 2013-2014. The City's Retiree Healthcare contribution rate for the Fire Retirement Plan is increasing by 1.3% percentage points from 8.0% in 2012-2013 to 9.3% in 2013-2014.

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 (with a contribution rate of 7.69% for employees and 7.9% for the City) with the full funding of the ARC starting with 2013-2014 (with a contribution rate of 10.74% for employees and 11.93% for the City). It is important to note that in December, as part of ongoing retiree healthcare negotiations, the Administration made a proposal to the Federated Retirement System bargaining groups that included a continuation of the phase-in of the Retiree Healthcare contribution rates because of the significant increase in the contribution rates from 2012-2013 to 2013-2014. If an agreement is reached on that proposal, a further reduction to both the employees' and City retiree healthcare contribution rates for 2013-2014 is anticipated.

EXPENDITURE FORECAST

Based on projections received from the Retirement Boards' actuary (Cheiron) and the Budget Office's independent analysis, the table on the following page details the General Fund's retirement costs and budgetary retirement contribution rates for the Federated Retirement System and the Police and Fire Retirement Plan and the respective pension and retiree healthcare costs for the forecast period. These figures assume the pre-payment of the ARC for the Federated Retirement System Tier 1 plan and the Police and Fire Department Retirement Plan over the five-year period. The budgetary retirement contribution rates set aside sufficient funds to either pay the City's retirement costs based on the minimum ARC or a percentage of payroll, whichever is greater. For this Forecast, only the City's 2013-2014 ARC for all three retirement plans as well as the 2014-2015 ARC for the Police Retirement Plan are based on a percentage of payroll. Additionally, the retirement costs associated with part-time employees, the Mayor and City Council, and Tier 3 are identified in the table below.

During the forecast period, General Fund retirement contributions will increase by approximately $45.1 million, or 21.3%, from $211.5 million in 2013-2014 to $256.6 million in 2017-2018. For

2014-2018 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES
($ in Millions)

Retirement Plan	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Fed. Ret. System Tier 1 – Pension	$56.5	$55.6	$58.5	$59.1	$60.4	$62.9
Fed. Ret. Syst. Tier 1 – Ret. Healthcare	10.0	13.1	12.7	12.4	11.9	11.3
Fed. Retirement Plan Tier 1 - Total	**$66.5**	**$68.7**	**$71.2**	**$71.5**	**$72.3**	**$74.2**
Budgetary Contribution Rates	*50.5%*	*60.6%*	*65.9%*	*68.1%*	*71.6%*	*77.1%*
Fed. Ret. System Tier 2 – Pension	N/A	$1.5	$1.5	$2.0	$2.5	$3.1
Fed. Ret. Syst. Tier 2 – Ret. Healthcare	N/A	2.6	2.7	3.6	4.6	5.7
Fed. Retirement Plan Tier 2 - Total	N/A	**$4.1**	**$4.2**	**$5.6**	**$7.1**	**$8.8**
Budgetary Contribution Rates	N/A	*18.6%*	*18.9%*	*18.9%*	*18.9%*	*18.9%*
Police Retirement Plan – Pension	$66.3	$74.3	$82.0	$83.1	$86.5	$92.2
Police Ret. Plan – Retiree Healthcare	10.5	11.8	12.9	13.2	13.7	14.2
Police Retirement Plan – Total	**$76.8**	**$86.1**	**$94.9**	**$96.3**	**$100.2**	**$106.4**
Budgetary Contribution Rates	*65.7%*	*73.0%*	*78.3%*	*77.3%*	*77.6%*	*79.7%*
Fire Retirement Plan – Pension	$38.9	$46.5	$51.1	$52.1	$54.3	$57.9
Fire Ret. Plan – Retiree Healthcare	4.4	5.5	6.7	7.9	8.4	8.7
Fire Retirement Plan - Total	**$43.3**	**$52.0**	**$57.8**	**$60.0**	**$62.7**	**$66.6**
Budgetary Contribution Rates	*64.0%*	*72.2%*	*78.0%*	*78.4%*	*79.1%*	*81.1%*
Other Retirement Costs	$0.5	$0.6	$0.6	$0.6	$0.6	$0.6
Total General Fund	**$187.1**	**$211.5**	**$228.7**	**$234.0**	**$242.9**	**$256.6**
Total All Funds	**$245.9**	**$275.8**	**$295.1**	**$301.6**	**$312.6**	**$329.6**

Source: 2012-2013 Modified Budget; Cheiron Letters dated January 9, 2013, January 30, 2013, and January 31, 2013 with applied pre-payment discount for Federated Retirement System Tier 1, the Police Retirement Plan, and the Fire Retirement Plan.

2017-2018, projected Retirement costs are estimated to be 26.3% of the General Fund. During the same period, as indicated in the table below, the City retirement contribution for all funds will increase by $53.8 million from $275.8 million in 2013-2014 to $329.6 million in 2017-2018.

Similarly, the budgetary retirement contribution rates show significant increases for the Federated Retirement System Tier 1 plan and the Police and Fire Department Retirement Plan. For the Federated Retirement System Tier 1 plan, the budgetary retirement contribution rate increases from 60.6% in 2013-2014 to 77.1% in 2017-2018; for the Federated Retirement System Tier 2 plan, the budgetary contribution rate increases only slightly from 18.6% in 2013-2014 to 18.9% in 2017-2018; for the Police Retirement Plan the budgetary retirement contribution rate increases from 73.0% in 2013-2014 to 79.7% in 2017-2018; and for the Fire Retirement Plan, the budgetary retirement contribution rate increases from 72.2% in 2013-2014 to 81.1% in 2017-2018.

For illustration purposes, the table on the following page depicts the Board approved contribution rates for 2013-2014 and the Cheiron projected rates for the out years of the Forecast. For the Federated Retirement System Tier 1 plan, the Board approved pension contribution rate increased from 44.4% for 2012-2013 to 50.9% for 2012-2013 and is projected to increase to 67.3% for 2017-2018. The retiree healthcare contribution rate increased from 7.9% for 2012-2013 to 11.9% for 2013-2014 and is projected to increase to 12.2% for 2017-2018. Over the Forecast period, the Federated Retirement System Tier 1 contribution rates increase by nearly 17 percentage points from 50.9% to 67.3%. For the Federated Retirement System Tier 2 plan, the Board approved pension contribution rate stays flat at 6.68% for the Forecast period and the retiree healthcare contribution rates are the same than for Tier 1.

For the Police Retirement Plan, the Board approved pension contribution rate increased from 56.6% for 2012-2013 to 65.3% for 2013-2014 and is projected to increase to 71.5% for 2017-2018; and per the Memorandum of Agreement (MOA) between the City and the San Jose Police Officers' Association (SJPOA), the retiree healthcare contribution rate increased from 9.0% for 2012-2013 to 10.3% for 2013-2014 and will be held at 11.0% for the out-years even if the ARC for Retiree Healthcare is not fully funded. Over the Forecast period, the total Police Retirement Plan City contribution rates increase from 75.6% to 82.5%. Similarly, for the Fire Retirement Plan, the Board approved pension contribution rate increased from 58.4% for 2012-2013 to 66.8% for 2013-2014 and is projected to increase to 73.0% for 2016-2017; and per the MOA between the City and the International Association of Firefighters (IAFF), Local 230, the retiree healthcare contribution rate increased from 6.6% for 2012-2013 to 8.0% for 2013-2014 and is projected to increase to 11.0% for 2016-2017 and will be held at 11.0% for the remaining Forecast period even if the ARC for Retiree Healthcare is not fully funded. Over the Forecast period, the total Fire Retirement Plan contribution rates increase from 74.8% to 84.0%. 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 and these MOAs expire June 30, 2013. 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%.

EXPENDITURE FORECAST

It should be noted that this Forecast does not assume potential savings due to additional active employees' retirement contributions or the Voluntary Election Program (Opt-In program) of approximately $12 million for 2013-2014 to 2016-2017 as included in the voter approved Measure B due to the unknown outcome of current litigation of Measure B and the pending approval from the IRS for the Voluntary Election Program.

2014-2018 BOARD APPROVED AND PROJECTED CITY CONTRIBUTION RATES

Retirement Plan	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Fed. Ret. System Tier 1 – Pension	44.4%	50.9%	56.1%	58.4%	62.1%	67.3%
Fed. Ret. System Tier 1 – Ret. Healthcare	7.9%	11.9%	12.2%	12.2%	12.2%	12.2%
Federated Retirement System – Total	**52.3%**	**62.8%**	**68.3%**	**70.6%**	**74.3%**	**79.5%**
Fed. Ret. System Tier 2 – Pension*	6.7%	6.7%	6.7%	6.7%	6.7%	6.7%
Fed. Ret. System Tier 2 – Ret. Healthcare*	7.9%	11.9%	12.2%	12.2%	12.2%	12.2%
Federated Retirement System – Total	**14.6%**	**18.6%**	**18.9%**	**18.9%**	**18.9%**	**18.9%**
Police Retirement Plan – Pension	56.6%	65.3%	70.1%	69.0%	69.4%	71.5%
Police Ret. Plan – Retiree Healthcare	9.0%	10.3%	11.0%	11.0%	11.0%	11.0%
Police Retirement Plan – Total	**65.6%**	**75.6%**	**81.1%**	**80.0%**	**80.4%**	**82.5%**
Fire Retirement Plan – Pension	58.4%	66.8%	71.5%	70.5%	70.9%	73.0%
Fire Retirement Plan – Retiree Healthcare	6.6%	8.0%	9.3%	10.7%	11.0%	11.0%
Fire Retirement Plan – Total	**65.0%**	**74.8%**	**80.8%**	**81.2%**	**81.9%**	**84.0%**

* The Federated Retirement System Tier 2 rates were approved by the Federated Retirement System Board on September 20, 2012.

Source: Cheiron Letters dated January 9, 2013, January 30, 2013, and January 31, 2013 with a pre-payment discount applied for the Federated Retirement System Tier 1 plan, the Police Retirement Plan, and the Fire Retirement Plan.

Health and Other Fringe:

A forecasted health rate increase of 11% is included in the 2013-2014 Forecast based on national and City trend information received from the City's Human Resources Department benefits consultant. For the out years of the Forecast, the annual rate increase assumptions are held constant to the 2013-2014 rate increases.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, a 2% increase is anticipated in 2013-2014. For the out years, the Forecast assumes annual rate increase assumptions of up to 6% based on City trends and actuarial analysis.

There are no changes to the life insurance rates in this Forecast based on projected provider charges. For the payment of Unemployment Benefit Claims, the City is self-insured. Based on actual claims experienced in 2012-2013, current funding available in the Unemployment Insurance Fund, and projected future claims, the unemployment insurance rate continues to be suspended through 2014-2015. Starting in 2015-2016 and through the remaining out years, $1.2 million is included to cover projected future claims.

Suspension of the Benefit Administrative Fee is assumed in 2013-2014, generating one-time savings of $875,000 in the General Fund ($1.2 million all funds). A one-time reserve in the Benefit Fund is available to cover operating costs for one year. This fee is assumed to resume in 2014-2015 in this forecast model.

Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total $81.9 million in 2013-2014. In general, the process utilized by the Budget Office includes adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2012-2013, and including projected increases or decreases for specific large non-personal/equipment allocations (e.g., utilities, contractual services, vehicle maintenance and operations costs, and Police Department vehicle replacement). The resulting 2013-2014 estimates represent a decrease of $8.0 million from the 2012-2013 Modified Budget level of $89.9 million, primarily due to the elimination of rebudgets or carryover projects.

Departmental gas and electricity funding for 2013-2014 totaling $12.3 million has been slightly adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes. Minimal increases for negotiated contractual contracts are included, primarily in the Police Department ($336,000) academy and County lab costs. Vehicle maintenance and operations costs in the General Fund including fuel, inventory, and fleet staffing reflect a $1.3 million increase (total of $14.7 million) from the 2012-2013 Adopted Budget, primarily due to increased fuel and personnel costs. The 2013-2014 non-personal/equipment base includes an adjustment for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of $3.9 million to $3.7 million based on the current replacement schedules and projected costs for these vehicles. In the out years of the Forecast, the police vehicle replacement costs are expected to decline in the first three Forecast years and increase in the last year of the Forecast, based on the anticipated replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total $14.1 million.

For the out years of the Forecast, a growth rate of 2.0% has been assumed from the 2013-2014 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. With this adjustment, the average growth rate for the non-personal/equipment category is 1.86% annually.

City-Wide

City-Wide Expenses in the first year of the Forecast (2013-2014) total $81.1 million, a decline from the 2012-2013 Modified Budget of $232.2 million. This large reduction primarily reflects the impact of deleting the $100.8 million of borrowing proceeds from the Tax and Revenue

Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; deleting allocations that were rebudgeted to 2012-2013 ($29.1 million); and the elimination of one-time grants ($7.3 million).

Effective February 1, 2012, all redevelopment agencies in the State of California were dissolved pursuant to AB 1X 26 and AB 1484. As part of the legislation, Successor Agencies are charged with winding down operations and overseeing the dissolution process in an orderly manner. On January 24, 2012, the City Council adopted Resolution No. 76128 documenting its decision to serve as the Successor Agency to the former Redevelopment Agency ("Successor Agency").

As part of determining the current financial state of the Successor Agency, the Administration recently projected future property tax increment revenues and analyzed the current level of enforceable obligations for the forecast period. For the purpose of this Forecast, assumptions regarding Property Tax Increment receipts over the five year period as well as sale of property timing have been made. As more detailed information becomes available regarding the amount and or timing of these items, the Forecast will be refined as appropriate. There is currently no resolution of the City's legal challenge of the County's actions of withholding a percentage of former agency tax increment (approximately $7.5 million annually) to fund the County employees' retirement plan (the PERS levy), therefore this forecast does not include these revenues. Based on these assumptions, it is projected that there will not be sufficient property tax increment revenue to pay all enforceable obligations during the forecast period. It should be noted that if the Successor Agency cannot pay all of its obligations, the City is contractually obligated to assume certain payments of the Successor Agency as follows: 4th Street Garage Debt Service, Convention Center Debt Service, HUD 108 Loan payments, and ERAF Loan Payments.

Based on the current budget projections as detailed below, in addition to City contractually required enforceable obligations, it is assumed that the City will also fund Successor Agency administrative support costs over the forecast period. No assumption for City repayment of $10.0 million in interfund loans associated with the former Redevelopment Agency Supplemental Educational Revenue Augmentation Fund (SERAF) loan is included at this time. With the approval of AB 1484 in June 2012, loans such as the interfund loans made in connection with SERAF loan may be deemed an enforceable obligation contingent upon 1) a finding by the State Department of Finance that all required audits of the Successor Agency have been completed, and 2) finding by the Oversight Board that these loans were for legitimate redevelopment purposes. Currently, principal plus interest is due by June 30, 2015 for the Ice Centre Revenue Fund ($2.0 million), Sewage Treatment Plant Connection Fee Fund ($5.0 million), and Subdivision Park Trust Fund ($3.0 million). The Administration continues to work through these requirements.

It is currently projected that City funds may need to be advanced to provide for payment of Successor Agency enforceable obligations in all funds amounts of $14.1 million in 2013-2014, $9.8 million in 2014-2015, $1.9 million in 2015-2016, and $1.3 million in both 2016-2017 and 2017-2018. Per the bond covenants for the 4th and San Fernando Street Parking Garage, revenues of both the Successor Agency and the General Purpose Parking Fund are pledged to make the loan repayment for the annual debt service of $3.4 million related to this facility (through 2014-2015). In the event the Successor Agency has insufficient revenues to make the payment, the General Purpose Parking Fund is expected to cover the payment. Per the agreement between the Federal Department of Housing and Urban Development, if the Successor Agency is not able to make the loan repayment for the HUD Section 108 loan program, Community Development Block Grant (CDBG) funds are pledged to cover this obligation (approximately $2 million annually through 2014-2015). Since these other City Funds are pledged to make these payments, the potential General Fund impact for contractually obligated Successor Agency payments and administrative costs is currently estimated at $8.7 million in 2013-2014, $4.3 million in 2014-2015, and $1.3 million annually in 2015-2016 through 2017-2018. Although a cash flow mismatch occurs between the payment obligation dates and the receipt of tax increment revenues from the County of Santa Clara, these projected additional costs to the General Fund only reflect projected structural deficits and assume that any necessary Successor Agency short-term borrowing to align anticipated revenues with anticipated expenditures will occur with a net-zero impact on the General Fund.

It should be noted that the City Attorney's Office and the Administration continue to review all of the Successor Agency obligations to minimize the impact on the General Fund, the Community Development Block Grant Fund, and the General Purpose Parking Fund. Similarly, as part of the 2013-2014 Proposed Budget process, the Administration will carefully review the administration for the Successor Agency and the City to adequately support the winding down of operations and overseeing the dissolution process in an orderly manner. Any related cost savings from these efforts will be presented as part of the 2013-2014 Proposed Operating Budget.

The remaining line-items in this category are adjusted to reflect anticipated costs for 2013-2014 based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2013-2014 allocations in this category include: Workers' Compensation Claims ($19.5 million); Convention Center Lease Payments ($15.3 million); Successor Agency Legal Obligations Subsidy ($8.7 million); Sick Leave Payments Upon Retirement ($6.0 million); City-owned Facility Operating Agreements ($3.4 million); FMC Debt Service Payments ($3.3 million); San José BEST Program ($2.6 million); Parking Citations/Jail Courthouse Fees ($2.5 million); Children's Health Initiative ($2.1 million); General Liability Claims ($2.0 million); and Property Leases ($1.9 million).

In the out years of the Forecast, City-Wide Expenses are projected to increase at an average growth rate of 2.0%. While several of the individual line items are expected to remain at 2013-2014 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from $19.5 million to $25.4 million). Increases to workers' compensation claims have been driven by higher medical costs and changes in State legislation. The FMC debt service payment is expected to increase significantly in the out years (from $3.6 million to $7.0 million) based on higher variable rate assumptions.

The anticipated administrative costs to issue TRANs Debt Service is also expected to climb (from $1.0 million to $4.3 million over the forecast period) based on a conservative estimate of the size of the issuance required and anticipated increases in variable interest rates and higher bank fees. Prefunding the City's portion of retirement contributions over the past several years was successful in generating budgetary savings. Over the five-year period, however, prefunding amounts are projected to increase to levels where the City's short-term borrowing capacity may be reached. Additionally, to fulfill the larger cash requirements, the maturity horizon of the City's investment portfolio may need to shorten, reducing investment returns. Should this scenario materialize during the five-year projected period, switching back to a pay-as-you-go method of funding retirement contributions may be considered.

The General Fund **Capital Projects** category totals $6.1 million in 2013-2014 and increases to $6.7 million in each of the out years of the Forecast. The largest items in this category include fire apparatus replacement ($5.0 million annually) and debt service payments for Central Service Yard – Phase I ($668,000 in 2014-2015 and relatively flat payments in the remaining out years). The investment in fire apparatus replacement in this Forecast is based on an analysis of projected replacement schedules, replacement costs, and apparatus changes to meet safety needs. It also assumes that the Fire C&C Fund will pay $300,000 annually for these costs. In the Service Yards C&C Fund, this forecast assumes $1.6 million in 2013-2014 and $1.0 million in the out years would pay for Central Service Yards debt service payments. The Capital Projects category also includes the continuation of annual allocations for Arena repairs ($100,000 in the out years), unanticipated maintenance of City facilities ($400,000), fuel tanks and methane monitoring control and replacement ($350,000), and annual capital expenditures ($150,000) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building.

The **Transfers** category totals $26.1 million in 2013-2014 and ranges from $26.6 million to $30.2 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for City Hall is the largest line-item in this category and totals $15.1 million in 2013-2014 ($16.2 million to $19.3 million in the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Hayes Mansion Conference Center ($4.7 million in 2013-2014 to $5.9 million in the out years) and Rancho del Pueblo and Los Lagos Golf Courses ($2.0 million in 2013-2014 and $1.8 million in the out years); payments in accordance with the San José Arena Management agreement extension ($2.3 million in 2013-2014 and $1.3 million to $1.0 million in the out years of the Forecast) for Arena repairs and capital enhancements; and a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement ($800,000 annually).

All of the debt service and maintenance and operations costs for the Hayes Mansion Conference Center and golf courses are funded in the Community Facilities Revenue and Municipal Golf Course Funds; however, revenues in those funds are not projected to be sufficient to completely cover these costs. The transfer for the Hayes Mansion Conference Center decreased from a $6.8 million subsidy level in the out years of the last forecast to $4.8 million required in 2012-2013 and then increases to $5.9 million in the last year of this forecast based on projected debt service payments for that facility. The transfer for the golf course subsidy, however, has increased from the $1.8 million annual level assumed in the February 2012 Forecast to $2.0 million in 2013-2014 based on current operational activity.

EXPENDITURE FORECAST

The payments for Arena repairs and capital enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. In 2013-2014, an additional $1.25 million is necessary to pay for the City's share of the $16.5 million of improvements at the Arena, as approved by the City Council in May 2007. Savings from the interest paid on the commercial paper issued for these improvements are realized in out years of this forecast.

The transfer to the Vehicle Maintenance and Operations Fund ($800,000 annually) is included to fund a vehicle replacement schedule for the General Fleet as well as transfers to the Communications C&C Fund ($412,500 in 2013-2014 to $575,000 in the out years) to fund the City's share of capital costs for the Silicon Valley Regional Interoperability Authority and reimburse that fund for Civic Center video equipment.

The Transfers category also includes payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas ($828,000 to $870,000 annually).

The **Earmarked Reserves** category includes a Deferred Infrastructure and Maintenance Reserve of $600,000 to fund critical capital maintenance or address technology needs. These resources would be allocated as part of the 2013-2014 Proposed Budget.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2012-2013, and would be recommended for rebudget or use in 2013-2014. Some of the larger current Earmarked Reserves include the Workers' Compensation/General Liability Catastrophic Reserve, Development Fee Program Reserves, Salaries and Benefits Reserve, and Retirement Pre-Payment Reserve.

Per City Council policy, the **2013-2014 Contingency Reserve** is projected at the level necessary to comply with the City Council policy to maintain a minimum 3% Contingency Reserve ($29.3 million). This amount would be sufficient to cover approximately one pay period of payroll costs (two and one-half weeks). Amounts necessary to remain in compliance with that policy are also included in each of the remaining four years of the Forecast.

Committed Additions to the Base General Fund Forecast

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

Committed Additions total $2.0 million in 2013-2014 and increase to approximately $7.7 million by 2017-2018. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

The approved bond measures from the elections of November 2000 and March 2002 will result in new and expanded library (Measure O), park (Measure P), and police and fire (Measure O) facilities and will require additional Maintenance and Operations funding ($1.6 million in 2013-2014 and increasing to approximately $6.4 million in 2017-2018). Some of the new facilities anticipated to be open during this forecast period include: Southeast Branch Library, Softball Complex, Fire Station 37 (South Willow Glen), and the South San José Police Substation.

Also included in the **Committed Additions** are maintenance and the operations costs associated with non-bond projects such as new parks and recreation facilities and new traffic infrastructure. The Police Department's new Automated Field Reporting/Records Management System maintenance costs are also included in this Forecast. The non-bond projects committed additions costs in the Forecast range from $418,000 in 2013-2014 and increases to $1,338,000 by 2017-2018.

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

Budget Principle #8 states that Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding $100,000 without City Council certification that funding will be made available in the applicable year of the cost impact. Consistent with that direction, this Forecast includes a detailed list and discussion of capital projects that were previously certified by the City Council with annual operating and maintenance costs in the General Fund greater than $100,000. Capital funding for these projects have been included as part of approved Capital Improvement Programs or approved by City Council in 2012-2013. The majority of these costs are associated with the voter-approved General Obligation bonds for Park, Library, and Public Safety facilities. The operating and maintenance costs for these facilities are included in the figures presented in this Forecast. There are no new projects identified in the Forecast that would need certification.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the Forecast, assuming the Base Case with Committed Additions. In 2013-2014, a shortfall of $5.5 million is projected, followed by a shortfall of $13.7 million in 2014-2015. A modest surplus of $2.0 million is projected in 2015-2016, followed by shortfalls of $4.7 million in 2016-2017 and $6.0 million in 2017-2018. Base Case expenditures, including committed additions, increase from $858.2 million in 2013-2014 to $991.2 million in 2017-2018, for an average annual growth rate approximately 3.7%. The sources of revenue total $852.7 million in 2013-2014 and grow to $963.3 million in 2017-2018, increasing at a slightly lower average annual growth rate of 3.1%.

The following table shows how the projected surpluses and deficits have changed in the most recent forecasts. It is assumed that each preceding surplus or deficit is addressed completely with ongoing solutions in the year it appears. Each year of the February 2013 Forecast is compared to the comparable year in the February 2012 Forecast.

2014-2018 General Fund Forecast
Changes in Operating Margin
($ in Millions)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
February 2012 Incremental Surplus/(Shortfall)	**($22.5)**	**($1.3)**	**$19.0**	**$10.7**	**N/A**
June 2012 Incremental Surplus/(Shortfall)	$9.0	N/A	N/A	N/A	N/A
Revised Forecast	**($13.5)**	**($1.3)**	**$19.0**	**$10.7**	**N/A**
February 2013 Incremental Surplus/(Shortfall)	**($5.5)**	**($13.7)**	**$2.0**	**($4.7)**	**($6.0)**

Note: Does not incorporate impacts associated with elements of the Fiscal Reform Plan that are not yet implemented; Tax Increment funding for the Successor Agency to the Redevelopment Agency, a public entity, regarding the outcome of litigation with the County of Santa Clara related to the PERS Levy; costs associated with fully funding the annual required contributions for police and fire retiree healthcare; costs associated with services funded on a one-time basis in 2012-2013; costs associated with restoration of key services to January 1, 2011 levels; costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses.

Assumes that the Police and Fire Retirement Plan Board will approve the elimination of the Supplemental Retiree Benefit Reserve (SRBR) for the 2013-2014 City retirement contribution amount and rates; and includes an Employee Compensation Planning Reserve, which totals $11.1 million in 2013-2014. Without that Reserve, a surplus of $5.6 million is projected for 2013-2014, and surpluses would be generated in all years but 2014-2015.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

In the February 2012 Forecast, an incremental shortfall of $22.5 million for 2013-2014 was projected. This figure was based on the assumption that the entire 2012-2013 surplus would be allocated on an ongoing basis. In the 2012-2013 Adopted Budget, the ongoing budget surplus was reserved and carried over to 2013-2014 as part of a two-year budget balancing strategy. The carryover impact of this action ($9.0 million) is reflected in the June 2012 incremental shortfall line item, resulting in a revised forecast of $13.5 million.

For the February 2013 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2013-2014 and the remaining four years of the forecast period. The 2013-2014 projected shortfall of $5.5 million reflects an improvement from the $13.5 million budget shortfall projected in June 2012. This reduction in the shortfall is the net result of numerous revenue and expenditure changes. A major factor contributing to this shortfall improvement is the decrease to retirement costs associated with the elimination of the SRBR (approved for the Federated Retirement System and pending final approval by the Police and Fire Department Retirement Plan Board) and the implementation of a low cost health plan reduced costs for 2013-2014. Partially offsetting these factors is the inclusion of the Employee Compensation Planning Reserve of $11.1 million, which is a change in practice from recent forecasts. This reserve allocation, representing only a modest amount of funding, would require City Council labor negotiations direction and discussions with the City's bargaining groups before any form of distribution could be made. How this allocation would be applied, if it remains funded, has not been determined.

In the remaining years of the Forecast, small General Fund shortfalls and a surplus are projected, ranging from -$13.7 million to $2.0 million annually. These margins are extremely narrow when put into context of the size of the projected General Fund budget, ranging from -0.8% to 0.1% of the projected annual budget (revenues and expenditures). Over the five-year period, a total shortfall of $27.9 million is anticipated, or approximately $5.6 million annually. This average shortfall figure equates to only 0.3% of the projected General Fund annual budget. Excluding the Employee Compensation Planning Reserve, General Fund surpluses would be generated in four of the five years of the Forecast, including a $5.5 million surplus in 2013-2014.

The second year of the Forecast (2014-2015) projects a General Fund shortfall of $13.7 million. This shortfall is primarily driven by an increase in personal services expenditures and the expiration of one-time grants. While revenues are anticipated to grow by an additional $21.2 million; this revenue growth is outpaced by expenditure growth ($34.9 million). Expenditure increases are primarily attributable to an increase in retirement contributions ($17.2 million), salaries and other compensation ($9.5 million), and health and other fringe benefits ($6.0 million). This Forecast assumes that the General Fund will assume the full costs for expenditures related to the Staffing for Adequate Fire and Emergency Response (SAFER) Grants and Community Oriented Policing Services (COPS) Grants after the expiration of grant funding. Specifically for the second year of the Forecast, this includes a net impact related to the SAFER 2011 Grant totaling $3.1 million for 27 Fire Fighter positions ($4.2 million annually thereafter). Expenditures related to the 2010 COPS Grant total $2.9 million for 16 Police Officers starting in 2014-2015. Without the continuation of these positions, significant service level reductions would occur.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

The variances in the three out years vary modestly compared to the size of the projected General Fund budgets in those years. In the third year of the Forecast (2015-2016), where growth rates of revenue are expected to exceed expenditures by 0.28%, a surplus of $2.0 million is projected. In the last two years of the Forecast, small deficits of $4.7 million in 2016-2017 and $6.0 million in 2017-2018 are expected. Expenditure growth is expected to exceed revenue growth in those two years by 0.45% and 0.56%, respectively.