Five-Year Economic Forecast and Revenue Projections

2013-2017

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 2012-2013 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. At the local level, positive near term growth is estimated in the Silicon Valley as a result of the strength in the technology industry. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to decrease, but ultimately remain above the historical normal levels. Home values are anticipated to improve at a slow pace 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, Gross Domestic Product (GDP) increases substantially and much greater job creation is anticipated. In turn, the real estate market improves significantly with increases not only in the price of housing but also the volume of homes sales, out pacing the growth rates assumed in the Base Case. 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 potentially lead the economy into another recession. Under this scenario, looming impacts in the world economy in areas such as Europe 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. A contraction in State and local government spending is anticipated that will impede job growth and increase unemployment levels. Housing prices are also anticipated to remain stagnant as the inventory of bank-owned properties enters the for-sale housing market. In this scenario, the City's revenues, particularly Property Tax and Sales Tax, would be severely impacted by an economic slowdown.

Base Case Forecast

As with all forecasts, this one 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

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projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2012-2013 Proposed Operating Budget, scheduled to be published on May 1, 2012.

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), California's Legislative Analysts Office, 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 were consulted in areas such as Utility Taxes, Franchise Fees, Sales Tax, and Transient Occupancy Tax to weigh in on the current projections and future outlooks in these areas.

Current National Conditions

U.S. Gross Domestic Product (GDP) picked up in the fourth quarter of 2011, growing at an annual rate of 3.0%. This is up from the annual growth rate of 1.8% experienced in the third quarter. The Bureau of Economic Analysis attributes the fourth quarter increase in GDP to positive contributions from personal consumption expenditures, private inventory investment, exports, and residential and non-residential fixed investment, that was partially offset by negative contributions in government spending (federal, State, and local). Imports also increased, which are a subtraction in the calculation of GDP. Overall, GDP increased 1.7% in 2011, which is down from the 3.0% increase experienced in 2010.¹

Consumer confidence has also shown improvement in recent months as reflected by The Conference Board Consumer Confidence Index, 70.8 in February 2012, which experienced increases in three of the last four months. According to Lynn Franco of The Conference Board, "Consumer Confidence, which had declined last month, posted a sizeable improvement in February. The index is now close to levels last seen a year ago (Feb, 2011, 72.0). Consumers are considerably less pessimistic about current business and labor market conditions than they were in January. And despite further increases in gas prices, they are more optimistic about the short-term outlook for the economy, job prospects and their financial situation."

Housing remains weak and the U.S. economy is not anticipated to truly begin to recover until the housing market begins to show substantial increases as housing continues to be a major contributing factor to the economy. Though housing has begun to show these signs of improvement, the housing sector is still at a level approximately one third of what would normally be considered healthy. Much of the struggle in the housing market stems from the residual effects of the significant decline and high foreclosure rates, and much of the market continues to be saturated with existing housing rather than new housing developments. One

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¹ Bureau of Economic Analysis, U.S. Department of Commerce, News Release: Gross Domestic Product, February 29, 2012

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positive note is that mortgage rates continue to hit all time lows and are expected to remain relatively low into the future.

The National Economic Outlook

A moderate economic recovery appears likely for the next three to four years, with momentum in the early years of the forecast driven by pent-up demand. According to the UCLA Anderson Business School Forecast, the near and mid-term outlook for the U.S. economy is good but not great. Looming over the national economy are near term risks, namely the debt crisis in Europe as well as a slowdown in China and potential impacts of Iran. In addition, after the November 2012 election, the pace of growth may be dampened somewhat by attempts to address the increasingly large federal deficit.

Events in Europe have the potential for dramatically altering the U.S. economic outlook. The Europeans, like the Americans, are facing the prospect of having to cut their domestic budget deficits. A big difference between the U.S. deficits and European deficits is that the European debts are mostly held by their own banks. The holding of this debt by European banks means that the Europeans are facing a banking crisis along with the government deficit crisis. Despite this situation, the UCLA Forecast anticipates that Europe will drop into a mild recession beginning in 2012 and extending through 2013 but will avoid a collapse of equal magnitude as the recession felt in the United States in 2008-2009.

Per the UCLA Forecast, the Chinese economy is anticipated to slow in the coming year though the rate of this reduction in pace is unknown given the difficulty in interpreting data regarding the Chinese economy. Given the size of the Chinese economy, even a dampening of the growth rate is likely to ripple through the national and State economy.

Lastly, the U.S. has its own Federal budget deficit to address which is anticipated to begin after the November 2012 election. The process to confront this deficit and the growing debt will be difficult and arduous process, which will put constant pressure on the U.S. economy throughout the term of this Forecast.

Current Santa Clara County Economic Conditions

The 2011-2012 revenue estimates were built on the assumption that the economy would continue its slow recovery from the recent recession. Economic indicators and actual revenue performance support this general assumption, with some improvement in recent months. Beacon Economics described Silicon Valley as a bright spot in a grey economy. "The South Bay/Silicon Valley continues to be one of the regions leading California's economic recovery. This is not surprising due to the strong demand for the area's technology products at the state, national and international levels." This region continues to experience solid job growth and improvement in the unemployment rate which still remains high. Construction activity is increasing at a good pace and the housing market appears to be stabilizing.

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² Beacon Economics, The Regional Outlook – South Bay, Quarterly Update – December 2011

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Although still well below the recent peak of 930,500 jobs experienced in December 2007, employment in the San José Metropolitan Statistical Area (MSA) continues to experience solid growth. The December 2011 employment level of 894,500 was (2.9%) above the December 2010 employment level of 868,900.

Unemployment Rate (Unadjusted)

	Dec. 2010	Nov. 2011	Dec. 2011
San José Metropolitan Statistical Area*	10.6%	9.2%	8.9%
State of California	12.3%	10.9%	10.9%
United States	9.1%	8.2%	8.3%

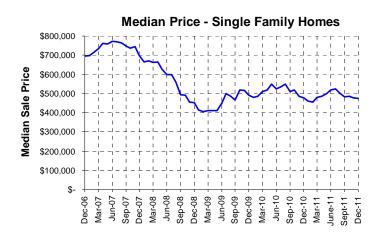
^{*} San Benito and Santa Clara Counties

Source: California Employment Development Department

The unemployment rate in the San José metropolitan area continues to remain high, but has dipped below the double digit levels that had been experienced in recent years. The December 2011 unemployment rate of 8.9% decreased from the November rate of 9.2% and is lower than the 10.6% rate experienced a year ago. The December 2011

unemployment rate in this region is less than the unadjusted rate for the State (10.9%), but continues to track above the nation, which has an unadjusted unemployment rate of 8.3%.

Through January, the level of construction permit activity compared with the prior year at this time varies significantly across the three types of construction. Industrial construction remained significantly above prior year levels, with the valuation of industrial permits issued this year totaling \$75.1 million, up 64.4% from the prior year valuation of \$28.4, and is only 1.2% below the \$76.0 million in 2009-2010. The total valuation of commercial permits issued is \$131.5 million, which is only 1.4% below the prior year valuation of \$133.4 million. The 1,186 residential permits issued through January, however, fell below the prior year level of 2,186 by almost 50.0%. In 2010-2011, there was a dramatic spike in residential activity due almost entirely to two very large development projects in late 2010 in North San José. In 2011-2012, there has been relatively steady growth in activity. This permit activity drives the revenue collection in several construction tax categories and is an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.



The housing market appears to be somewhat stable. The December 2011 median single-family home price of \$474,500 was within 1% of the December 2010 price of \$478,000. The number of property transfers (sales) for all types of residences totaled 713 in December 2011, which was also within 1% of the December 2010 figure of 718. The average days-on-market for single-family and multi-family dwellings totaled 84 days in December 2011, which is a slight drop from the 87 days experienced in December 2010.

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Economic conditions will continue to be closely monitored and factored into the development of the 2012-2013 Proposed Budget, due to be released May 1, 2012.

Santa Clara County Economic Outlook

The outlook for Silicon Valley is positive in the near term with growth levels likely to slow in the out years of this Forecast. Due to the unique nature of the Silicon Valley, this region is heavily influenced by the technology sector. The strength in this sector in particular as well as improvement in other areas is anticipated to drive the growth of the economy through 2013.

In the near term, the strength in the technology industry will keep employment levels increasing. Currently, a number of record breaking Initial Public Offerings (IPO's) of large technology and social networking companies are anticipated to occur over the next year or so. These IPO's are estimated to create a significant and rapid influx of wealth in this region. Following that, capital investments in social media and networking sites in addition to software for the rapidly expanding mobile computing trend will continue. Continued improvement in the real estate market is also expected over the Forecast period.

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 2013-2014 and beyond. As the future of the nation remains uncertain both on a political front and monetary front, it is anticipated the growth rates will be dampened. 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.

The economically sensitive revenues, such as Sales Tax and Property Tax receipts, are expected to experience moderate growth over the forecast period. Utility Tax and Franchise Fee revenues will also benefit from the economic growth projected through the forecast period.

In summary, the recovery from the economic recession is expected to continue to impact the City's economic performance in 2012-2013 and beyond. The deep decline in the City's revenue collections over the past few years have shown signs of recovery in 2011-2012 and are anticipated to continue to grow through 2012-2013 and the out years of this Forecast.

Optimistic and Pessimistic Scenarios

As discussed above, all forecasts are burdened with a large degree of uncertainty, which increases going further into the future. As a result, in addition to the Base Case, two alternate, but plausible, revenue forecast scenarios are also presented in this document: an Optimistic Case and a Pessimistic Case. These alternatives were developed to display the range of possible outcomes over the next five years under varying economic conditions. The Base Case is, however, still considered the most likely outcome. Following is a discussion of these scenarios.

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Optimistic Case

In the Optimistic Case, the economy is assumed to rebound at a much faster and more robust recovery than assumed in the Base Case. In this scenario, the real estate market rebounds much more quickly than in the Base Case, with increases in property values as well as in the volume of home sales. The major economic drivers in sectors other than the housing market react more vigorously to the monetary and fiscal policy than assumed in the Base Case.

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 quickly gain significant forward momentum propelling the growth through the five years of the Forecast. Growth in real gross national product and employment levels are much stronger in this Optimistic Case. Mortgage rates remain low over the forecast period and both the quantity of home sales and housing prices out pace the growth rates assumed in the Base Case.

Under the Optimistic Case, the economically sensitive revenues are expected to experience much stronger performance as general increases in inflation, 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 \$50.3 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 realization of the current debt and potential banking problem Europe is facing; a prolonged contraction in state and local government; and continuing weakness in housing markets as foreclosed properties serve to dampen any price recovery.

In the Pessimistic Case, one of the most significant changes is the anticipated impact of the European debt crisis. The Pessimistic Case assumes that the European economy will sink into a much deeper recession, and given the current fragile state of the U.S. economy, the effects would reverberate through the U.S. and potentially result in another recession. 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.

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The housing market continues to show volatility as the persistent addition of bank-owned properties to the for-sale housing inventory holds housing values at their current suppressed levels. With a struggling economy, housing prices start to fall and decreases in re-sale levels are experienced once again. Conversely, the Base Case assumes that despite this dampened market, other economic drivers will push home prices to improve by late 2012 or early 2013.

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. Utility Tax and Franchise Fee 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 \$58.9 million below the Base Case.

<u>Impact of Forecasted Economic Conditions on Revenue Collections</u>

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 Utility Tax and Franchise Fee 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 2012-2013 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2011-2012 and, building upon those projections, to develop the 2012-2013 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 2012-2013 Proposed Operating Budget that will be released on May 1, 2012.

REVENUE FORECAST

As displayed in the Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from \$760.0 million in 2012-2013 to \$855.3 million in 2016-2017, for an average growth rate of 3% per year.

February 2012 Forecast	Modified Budget			Forecast		
Revenue Summary	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017
General Revenues						
Property Tax	\$ 200,095,000	\$ 204,720,000	\$ 214,424,000	\$ 224,930,000	\$, ,	\$ 245,111,000
Sales Tax	150,450,000	151,705,000	159,214,000	165,551,000	172,223,000	178,630,000
Transient Occupancy Tax	8,300,000	8,715,000	9,151,000	9,517,000	9,802,000	10,096,000
Franchise Fees	42,625,000	44,740,000	45,760,000	47,160,000	48,797,000	50,651,000
Utiltiy Tax	90,245,000	91,855,000	94,363,000	97,646,000	101,357,000	105,381,000
Telephone Line Tax	20,525,000	20,525,000	20,628,000	20,731,000	20,834,000	20,939,000
Business Tax	40,174,000	40,450,000	40,612,000	40,762,000	40,909,000	41,052,000
Other Licenses and Permits	35,287,770	36,622,000	39,112,000	40,247,000	40,810,000	41,545,000
Departmental Charges	29,970,872	29,290,000	31,282,000	32,189,000	32,639,000	33,227,000
Fines, Forfeitures & Penalties	16,971,000	16,709,000	16,962,000	17,175,000	17,389,000	17,607,000
Money and Property	2,474,000	2,733,000	2,713,000	2,827,000	2,940,000	3,058,000
Revenue From Local Agencies	17,479,415	11,360,000	11,768,000	12,154,000	12,438,000	12,734,000
Revenue from the State	14,514,319	9,751,000	9,716,000	9,716,000	9,716,000	9,716,000
Federal Revenue	24,378,072	10,266,000	2,930,000	36,000	37,000	37,000
Other Revenue	116,147,022	14,609,000	14,877,000	15,107,000	15,311,000	15,531,000
Gas Tax	15,667,000	15,300,000	15,147,000	14,996,000	14,982,000	14,967,000
Total General Revenues	825,303,470	709,350,000	728,659,000	750,744,000	775,596,000	800,282,000
Transfers and Reimbursements						
Overhead Reimbursements	31,823,543	32,908,000	35,146,000	36,165,000	36,672,000	37,332,000
Transfers	23,555,867	17,049,000	16,405,000	16,739,000	16,814,000	16,955,000
Reimbursements for Services	846,452	662,000	707,000	727,000	737,000	751,000
Total Transfers and Reimbursements	56,225,862	50,619,000	52,258,000	53,631,000	54,223,000	55,038,000
Total General Fund Revenues	881,529,332	759,969,000	780,917,000	804,375,000	829,819,000	855,320,000
Beginning Fund Balance	137,536,794	47,362,000	47,829,000	48,609,000	49,225,000	49,670,000
Grand Total Sources	\$ 1,019,066,126	\$ 807,331,000	\$ 828,746,000	\$ 852,984,000	\$ 879,044,000	\$ 904,990,000

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 2012-2013 General Fund Forecast.

Property Tax

Property Tax receipts of \$199.7 million (adjusted for the recategorization of Airplane Property Tax in 2011-2012) are projected for 2011-2012, which represents 1.2% growth from the prior year and is only slightly below the modified budget estimate. This projected increase is the first growth seen since 2008-2009 and reflects increases in the Secured, SB 813 (property resales), Unsecured, and Airplane Property Tax categories. In 2012-2013, collections are expected to continue to increase 2.5% to \$204.7 million primarily due to a 2% CPI increase, which will be assessed. Additional information about each of the Property Tax sub-categories is provided below.

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Secured Property Taxes account for over 90% of the revenues in this category. In 2011-2012, Secured Property Tax receipts are expected to increase slightly to \$182.9 million, an increase of 0.7% from the prior year. This slight increase marks the first positive performance after two years of declines in this category. In 2012-2013, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2012, are expected to increase by 2.5%. This projected increase is related to two factors: the change in the California Consumer Price Index (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 or new construction. The CCPI adjustment for the 2012-2013 tax roll is an increase of 2.0% compared to 0.75% last year. In addition to the CCPI adjustment, it is anticipated that the 2012-2013 valuation will increase slightly. In calendar year 2011, residential real estate experienced gains through the first seven months of the year, but then declined during the last five months. Overall, little change occurred during the year as the December 2011 median sales price of \$474,500 for single family homes was within 1% of the December 2010 level of \$478,000. The impact of reassessments of commercial property will not be known until the end of the fiscal year.

It should be noted that final data on the actual tax levy for 2012-2013 is not available as adjustments are made through June 30, 2012. 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). As this information becomes available, refinements to the Property Tax estimates may be brought forward in the 2012-2013 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 reach \$11.5 million in 2011-2012, which is 5.2% above the 2010-2011 collection level of \$10.9 million. Collections are expected to increase 3.0% in 2012-2013 to \$11.9 million based on improving business conditions and increasing employment.

SB 813 Property Taxes (supplemental taxes) represent payments for taxes owed on recent housing resales. Over the past few years, collections in this category have fallen significantly, due, in part, to a substantial number of returns that were due to property owners as a result of declining home values. Based on the most recent estimate from the County of Santa Clara Controller's Office, the backlog of refunds has been resolved and receipts in this category are expected to total \$1.8 million in 2011-2012, an increase of 58.8% from the 2010-2011 level. In 2012-2013, collections in this category are projected to normalize at \$2.0 million, a 13.8% increase from 2011-2012, though still below the collection level of \$3.0 million experienced during 2009-2010.

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The Homeowners Property Tax Relief category is projected at \$1.1 million for 2012-2013, which is consistent with the 2011-2012 revenue estimate. Through the remaining years of the Forecast, annual Sales Tax growth ranging from 3.7% to 5.0% is projected.

In the out-years of the Forecast, annual Property Tax performance is expected to range from growth of 4.7% in 2013-2014 to an increase of 4.1% in 2016-2017. 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, collections are expected to increase 9.4% in 2011-2012 to \$150.9 million from prior year levels. In 2012-2013, year over year growth of 0.5% is expected, bringing the projected revenue to \$151.7 million. It is important to note that the total revenue anticipated for 2011-2012 includes a number of one-time adjustments. After adjusting for those one time payments, year-over-year growth of 4.7% is expected in 2011-2012 and additional growth of 3.0% is expected in 2012-2013.

For the General Sales Tax revenue category, only one quarter of current fiscal year data is available. Based on this limited information, year-over-year growth of 9.4% is projected in 2011-2012, resulting in collections of \$146.5 million. This increase from the \$133.9 million collected in 2010-2011, however, factors in a substantial value of one-time accounting adjustments to reflect prior-year collections and the "Triple Flip" true-up payment from the State for 2011-2012. Excluding those adjustments, year-over-year growth is estimated to be approximately 4.7% from the 2010-2011 collection level. This reflects actual growth of 8.4% in the first quarter and estimated growth of 3.5% in the remaining three quarters. This gain marks the second year of growth after two years of declines. With continued improvement in the economy, sales tax growth is expected to continue.

For 2012-2013, the General Sales Tax revenue projection of \$147.2 million assumes modest growth of 3.0% in taxable sales from 2011-2012 levels. Because there are a number of one-time accounting adjustments to reflect prior-year collections and the "Triple Flip" true-up payment from the State in 2011-2012 that are not reflected in 2012-2013, the year-over-year growth in 2012-2013 is estimated to be approximately 0.4%. To put the 2012-2013 estimate into perspective, the projected revenue of \$147.2 million is only \$2.3 million (1.5%) below the \$149.5 million collected in 2007-2008, bringing revenues close to pre-recession levels.

The Sales Tax revenue projections for the 2011-2012 fiscal year will continue to be refined over the next couple of months as additional information becomes available. Sales Tax data for the second quarter of 2011-2012, which covers the 2011 holiday period, will be received in March 2012. Based on this additional data, any necessary adjustments to the estimate will be incorporated into the 2012-2013 Proposed Operating Budget.

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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 \$4.4 million in 2011-2012, which represents a 7.7% increase from the actual 2010-2011 collections of \$4.1 million based on activity through the first seven months of 2011-2012. In 2012-2013, collections are projected to increase 3.0% to \$4.5 million.

Transient Occupancy Tax

It is currently estimated that Transient Occupancy Tax (TOT) receipts for 2011-2012 will total \$8.3 million, reflecting an increase of 14.9% from the 2010-2011 collection level. Although the estimated current year receipts mark the second year of growth in this category, this growth is in stark contrast to the prior year declines of 11.5% and 18.5% in 2009-2010 and 2008-2009 respectively. Projected 2011-2012 receipts fall short of the \$9.6 million collected in 2007-2008 by approximately 13.2%.

In 2012-2013, growth of 5.0% from the 2011-2012 estimate is anticipated. 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 appears to be experiencing a period of stabilization and emerging growth with increases in occupancy levels and average daily room rates. The 2012-2013 assumed growth of 5.0% in TOT receipts is slightly lower than the 6.0% to 8.0% growth range cited in the consultant study by Conventions Sports and Leisure (CSL) for 2012-2013 to allow for potential disruption associated with the Convention Center renovation and expansion project.

Based on the CSL consultant estimates, growth ranging from 3% to 5% is estimated for the out years of the Forecast. By 2016-2017, collections are projected to reach \$10.1 million, which is above pre-recessionary levels. The completion of the 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 \$42.4 million in 2011-2012, an increase of 2.6% from the 2010-2011 actual receipts of \$41.3 million. The projected increase in 2011-2012 is due to higher collections anticipated in the Electric and Gas Franchise Fee category, partially offset by declines in the Tow and Commercial Solid Waste categories. In 2012-2013, Franchise Fees are expected to increase 5.6% to \$44.7 million due primarily to growth in the Commercial Solid Waste (CSW) (19.6%) and the Electricity (2.6%) Franchise Fee categories.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2011-2012 are based on the calendar year 2011). 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

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categories. The reconciliation of annual receipts from PG&E for 2011-2012 will be received in April 2012.

In the Electric Franchise Fee category, collections in 2011-2012 are expected to reach \$19.0 million, up from \$17.7 million received in 2010-2011, due primarily to the full year implementation of the 0.3% surcharge, which was implemented during the last four months of 2010. In 2012-2013, growth of 2.6% from 2011-2012 estimates is anticipated reflecting the rate increase of 2.9% approved in January 2011. It should be noted that there are a number of proposed rate cases for electric rates, though due to the uncertainty regarding the outcome of these cases, no rate increases associated with these outstanding rate cases have been assumed in 2012-2013.

In the Gas Franchise Fee Category, the 2011-2012 estimated collections of \$4.8 million reflect growth of 7.2% from the \$4.5 million received in the prior year. This growth is also primarily due to the full year implementation of the 0.3% surcharge which was implemented during the last four months of 2010. In 2012-2013, Gas Franchise Fee collections are projected to remain flat based on the assumption that rates will remain relatively constant in 2012. It should be noted that there are also rate cases for gas rates, though due to the uncertainty regarding the outcome of these cases, no rate increases associated with these outstanding rate cases have been assumed in 2012-2013.

In City Generated Tow, revenues are significantly below prior year levels and are estimated to reach \$700,000 in 2011-2012, a drop of 28.5% from the \$979,000 received in 2010-2011. This significant reduction reflects the change in Police Department procedure, which reduced the number of tows and impounds for persons with violations that are not related to serious driving offenses. In 2012-2013, revenues are anticipated to remain flat at 2011-2012 levels as no changes in this new procedure or fee levels are anticipated.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach budgeted levels of \$9.2 million in 2011-2012, a 3.2% decline from the \$9.5 million received in 2010-2011 reflecting current tracking of this revenue. In 2012-2013, collections in this category are expected to increase 19.6% to \$11.0 million based on a new methodology for assessing this fee that becomes 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.

Remaining categories, including Cable, Water, and Nitrogen Gas Pipeline, are estimated to end the year slightly below (\$190,000) budgeted levels of \$8.8 million. Activity levels in 2012-2013 are expected to increase slightly compared to 2011-2012 levels, with 1.0% growth in Cable, 2.4% growth in Water, no growth in the Nitrogen Gas Pipeline categories.

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase from 2.3% to 3.8% annually. Over the next five years, there is a potential for fluctuations in growth rates

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depending the outcomes rate cases for both gas and electric rates. 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 2011-2012 are anticipated to total \$91.8 million, representing an increase of 4.5% from the 2010-2011 collection level. A portion of this increase from the prior year is the result of a one-time settlement of \$1.6 million from PG&E. This settlement corrected for underpayments and related penalties and interest of Gas an 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, revenues are estimated to increase 2.7% from 2010-2011 levels. This 2.7% growth reflects approved rate increases beginning in January 2012 for Water (5% rate increase) and Electric (2.9% rate increase) and changes in consumption levels.

In 2012-2013, Utility Tax collections are projected to increase 0.1% to \$91.9 million. After adjusting for the one-time settlement funding received in 2011-2012, growth of 1.8% is estimated for 2012-2013. 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 these rate cases, the Forecast generally does not assume revenue increases associated with these outstanding 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 \$39.8 million in 2011-2012, a 1.8% increase from 2010-2011 levels. The estimated 2011-2012 collections reflect the approved 2.9% rate increase beginning January 2012. In 2012-2013, revenues are estimated to increase 1.5% based on the annualization of the January 2012 rate with minimal to no change in consumption levels. Gas Utility Taxes are anticipated to reach \$8.8 million in 2011-2012, a 1.7% increase from the prior year levels based on current collection trends. In 2012-2013, revenues are anticipated to remain flat at 2011-2012 levels. No changes in rates or consumption levels are assumed.

Water Utility Tax receipts of \$9.2 million are anticipated to be received in 2011-2012, a 7.1% increase from 2010-2011. This growth reflects approved rate increases, including a 5% rate increase in January 2012. In 2012-2013, receipts are expected to increase 7.6% based on the annualization of the January 2012 rate increase, a 5% increase projected in July 2012, and an additional 5% in January 2013. No change in consumption levels is assumed.

In the Telephone Utility category, revenues are collected on landlines, wireless, and VoIP. Based on current tracking, receipts in 2011-2012 are anticipated to reach \$32.4 million, a 2.9% increase from 2010-2011. In 2012-2013, revenues are estimated to increase an additional 1.0%.

In the out years of the Forecast, growth ranging from 2.7% to 4.0% annually is expected in the Utility Tax category. Due to the number of rate cases currently proposed, consistent with recommendations from the City's Utility Tax Consultant, larger growth is anticipated in the latter

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years of the Forecast. As discussed above, there is uncertainty regarding the performance in this category based on the number of outstanding rate cases. In addition, 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 2011-2012 and 2012-2013 are anticipated to total \$20.5 million, unchanged from the 2009-2010 and 2010-2011 collection levels. Minimal growth of 0.5% annually is anticipated in the out years of the Forecast for this category.

Business Tax

This category includes General Business Tax, Disposal Facility Tax, Cardroom Tax, and Marijuana Business Tax. In 2011-2012, Business Taxes are estimated to reach \$40.5 million, a 6.7% increase from 2010-2011 levels. This increase is primarily due to the full year receipt of the Marijuana Business Tax, which began in March 2011. In 2012-2013, revenues are estimated to decrease 0.1% to \$40.45 million due to a decrease in Disposal Facility Tax, partially offset by an increase in Cardroom Tax.

In 2011-2012 General Business Tax proceeds are expected to reach \$11.0 million, a 0.5% increase from the 2010-2011 level. In 2012-2013, consistent with the historical trend, no growth is anticipated in this category.

In the Disposal Facility Tax category, collections are estimated at \$10.9 million in 2011-2012 based on current collection trends, which reflect a decline of 1.8% from the 2010-2011 collection level. Receipts are expected to continue to decline at the 1.8% annual rate to \$10.7 million in 2012-2013 as waste diversion is expected to continue to negatively impact this revenue source.

Based on current performance, collections in the Cardroom Tax category are estimated at \$15.1 million in 2011-2012, an increase of 2.3% from the 2010-2011 collection level. This increase from the prior year reflects, in part, the impact of the Cardroom Tax ballot measure that was approved by the voters in June 2010. The ballot measure increased the tax rate from 13% to 15% and increased the maximum number of card tables from 80 to 98. The new rates went into effect on August 13, 2010, therefore the increase was not reflected in the first two months of the prior fiscal year. Though this accounts for some of the upward growth, the continued economic recovery is also a contributing factor in the additional activity. In 2012-2013, 1.0% growth is anticipated, bringing collections to \$15.3 million.

On November 2, 2010, San Jose 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 2011-2012, collections are anticipated to reach \$3.5 million, or 203.7% of the prior year collection level, to reflect the full year implementation of the tax. As a result of the continued uncertainty surrounding this tax and the Marijuana Regulatory Program, 2012-2013 estimates are anticipated to remain flat at the 2011-2012 level until more information is known.

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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.

For 2012-2013, the development-related revenues are expected to continue to build on the growth experienced in 2011-2012. In cases where the development-related costs are projected to exceed revenues, the impacted departments will be submitting proposals to reduce costs and/or increase fees to bring projected revenues and expenditures back in line for a net-zero General Fund impact. For 2012-2013, the Building Fee Program and Planning Fee program expenditures are projected to exceed the base revenue estimates. It is important to note that Fee Program Reserves are available to address shortfalls in these programs. In the Fire Fee Program and Public Works Fee Program, revenues are projected to be above the base program costs. 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 2012-2013 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 1.4% to 6.8%. 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. It should be noted that cost-of-living salary adjustments have not been factored into the out years of the Forecast. There are currently no negotiated agreements for that period.

Fines, Forfeitures and Penalties

In 2011-2012, the Fines, Forfeitures and Penalties category is expected to generate \$16.5 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately \$11.0 million in 2011-2012, a decrease of 3.0% from the 2010-2011 receipts of \$11.4 million as a result of vacancies in the unit. In 2012-2013, total revenue collections of \$16.7 million are projected in the Fines, Forfeitures, and Penalties category. This includes \$11.0 million from Parking Fines, which assumes no growth from 2011-2012. In the out years of the Forecast, annual growth of approximately 1.3% to 1.5% is projected.

Money and Property

This category consists of interest income and revenue associated with the rental of City-owned property. The 2012-2013 estimate for interest earnings in the General Fund assumes an average interest rate of only 0.35% applied to an average cash balance of approximately \$50 million for a total collection level of \$175,000. This anticipated collection level is close to the 2011-2012

REVENUE FORECAST

projected interest earnings of \$161,000. An additional \$2.6 million is expected to be generated from the remaining sources in this category, primarily rental of City-owned facilities. In the out years of the Forecast, growth rates range from a decrease of 0.7% to growth of 4.2% annually.

Revenue from Local Agencies

In 2012-2013, revenue of \$11.4 million is projected from other local agencies, such as the Central Fire District and the County of Santa Clara to reimburse the City for services provided. This is significantly lower than levels of approximately \$36.6 million estimated in the February 2011 Forecast and Adopted 2011-2012 Budget levels of \$19.3 million. This reduction is due to the loss of reimbursement from the San Jose Redevelopment (SJRA) for certain City services that supported the Agency as well as the reimbursement for the Convention Center 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 2011-2012, Central Fire District payments are expected to end the year at \$4.6 million, reflecting a significant drop of 10.2% from 2010-2011. In 2012-2013, collections are expected to increase 2.5%, to \$4.7 million, consistent with the increase in Secured Property Tax assumed in this forecast.

In 2012-2013, payments from the County of Santa Clara for the first responder advanced life support program (Paramedic Program) are assumed to total \$2.3 million. In addition, payments of \$2.9 million from other local agencies are expected to reimburse the City for the Police Department CAL-ID program.

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately 2.3% to 3.6%.

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 \$14.0 million in 2012-2013 and drop to \$9.8 million in 2012-2013. This drop reflects the loss of Motor Vehicle In-Lieu revenue, the elimination of on-time grants, and lower estimated Tobacco Settlement revenues. Tobacco Settlement payments are anticipated to total \$9.0 million in 2011-2012 and \$8.5 million in 2012-2013, reflecting the downward trend in collection in this category. In June 2011, Motor Vehicle In-Lieu collections were eliminated by the State legislature's approval of SB 89, which shifted over \$130 million in annual General Fund Motor Vehicle In-Lieu revenue from cities to support State law enforcement grants effective July 1, 2011. In 2011-2012, revenues of \$2.1 million were received to reflect a true-up payment for four prior fiscal years. No Motor Vehicle In-Lieu revenue estimate is included for 2012-2013 or beyond.

The following State grants and reimbursements are expected in 2012-2013: Abandoned Vehicles Abatement Program (\$600,000); Auto Theft reimbursement (\$370,000); Highway Maintenance

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Charges reimbursement (\$105,000); Waste Tire Enforcement Grant (\$141,000); and Pesticide Management Grant (\$35,000). No annual growth is projected in the 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 2012-2013: Staffing For Adequate Fire & Emergency Response Grant (SAFER) (\$7.5 million); Community Oriented Policing Services (COPS) Hiring Grants (\$2.4 million); Clean Creeks and Healthy Community Grant (\$33,000); and American Recovery and Reinvestment Act (ARRA) Retrofit California Program grant (\$26,000). In the out years of the Forecast, the SAFER grant and the ARRA Retrofit California Program Grant are set to sunset at the end of 2012-2013, while the COPS grants extend to 2013-2014 and the Clean Creeks and Healthy Community Grant is assumed throughout the five years of the forecast.

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 2011-2012, this category is expected to generate \$116.5 million. The 2011-2012 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, 2011-2012 collections for this category are estimated to total \$16.5 million.

In 2012-2013, the revenue estimate of \$14.6 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2012-2013 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 2012-2013 with an offsetting expenditure based on estimated cash flow needs. In 2012-2013, the proceeds from the Sale of Surplus Property category has been set at \$1.4 million based on the anticipated assets that will be sold next fiscal year and is down from the \$1.8 million assumed in the 2011-2012 Adopted Budget. The cost reimbursement for the Investment Program is estimated at \$2.1 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 1.4% 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.

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Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2011-2012 are projected to reach \$15.3 million, a drop of 2.4% from the 2010-2011 level of \$15.7 million. Collections are expected to remain flat at \$15.3 million in 2012-2013. These collection levels remain below historical tracking patterns for this category. Several factors may be impacting collections in this category, including volatile gas prices, the lingering impacts of the economic downturn, and a move to more energy efficient automobiles. In the out years of the Forecast, collections are expected to decline by between 0.1% and 1.0% annually.

Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2012-2013, a total of \$32.9 million in reimbursements are projected based on 2012-2013 overhead rates prepared by the Finance Department applied against the projected 2012-2013 salaries for those positions for which an overhead rate is applied.

In the remaining years of the Forecast, annual increases ranging from 1.4% to 6.8% are assumed, reflecting increases in costs which the overhead rate is designed to recover, including increased retirement and health contribution costs. It should be noted that cost-of-living salary adjustments have not been factored into the out years of the Forecast as there are currently no negotiated agreements for that period.

Transfers

The Transfers category is projected at \$23.9 million for 2011-2012 and \$17.0 million in 2012-2013. The largest component of this category (\$7.0 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 2012-2013, these reimbursements have been set to cover the base 2012-2013 costs, with the fire SAFER Grant covering a portion of the costs for firefighting services at the Airport as reflected in the Revenue from the Federal Government category. Additional large transfers programmed for 2012-2013 include the Construction and Conveyance Tax Fund transfer (\$2.1 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer (\$2.8 million); the FMC Bond close-out fund transfer (\$1.7 million); and the Workforce Investment Act Fund transfer (\$615,000) for use of various community centers and Workforce Investment Act program services.

Adjustments to these transfer amounts are reflected in the remaining years of the Forecast. A net decrease of \$638,000 is expected in 2013-2014 to reflect the elimination or reduction of transfers budgeted in 2012-2013, including: FMC Bond Close-Out (\$1.7 million); Construction Excise Tax Fund (\$1.0 million); Camden Debt Service (\$202,000); and an inter-fund loan from the Public Works Support Services Fund (\$63,000). These downward adjustments are partially offset by a \$1.7 million increase to the transfer from the Airport Operations and Maintenance Fund to reflect the full reimbursement of costs associated with delivering firefighting services at the Airport that were temporarily supported by the SAFER Grant. After these one-time adjustments

REVENUE FORECAST

are accounted for in 2012-2013 and 2013-2014, annual increases in the last three years range from 0.4% to 2.0%. 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, including increased retirement and health contribution costs. As discussed above, cost-of-living salary adjustments have not been factored into the out years of the Forecast as there are currently no negotiated agreements for that period.

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 2012-2013 of \$662,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases, including increased retirement and health contribution costs. As discussed above, cost-of-living salary adjustments have not been factored into the out years of the Forecast as there are currently no negotiated agreements for that period.

Beginning Fund Balance

The \$47.4 million forecast estimate of available 2012-2013 Beginning Fund Balance is based on the following assumptions:

- The 2012-2013 Contingency Reserve, \$29.3 million, is projected at the current level based on the assumption that this amount will not be used in 2011-2012 and will be carried over to 2012-2013. 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 two and one-half weeks.
- A total of \$18.0 million will be achieved from a combination of excess revenues (\$3.7 million, expenditure savings (\$12.3 million) and the liquidation of prior-year carryover encumbrances (\$2.0 million). This figure is based on the 2011-2012 Ending Fund Balance Reserve established as part of the 2011-2012 Mid-Year Budget Review actions, a review of actual revenues and expenditures through January, and a review of liquidation of prior-year carryover encumbrance performance in 2011-2012.
- An additional \$53,000 from the Wellness Program Reserve to support Wellness Program costs programmed in 2012-2013.

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 and that the Contingency Reserve of \$29.3 million would be carried over each year. 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. The combination of expenditure savings and Contingency Reserve would generate beginning fund balance ranging from \$47.8 million in 2013-2014 to \$49.7 million in 2016-2017.

EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2012-2013 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2012-2013 Proposed Operating Budget.

As displayed in the Forecast and the chart below, expenditures are shown to increase from \$797.4 million in 2012-2013 to \$889.1 million in 2016-2017, for an average growth rate of 2.8% per year.

February 2012 Forecast	Modified Budget			Forecast		
Expenditure Summary	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017
Personal Services						
Salaries and Other Compensation	\$ 349,630,761	\$ 349,950,000	\$ 351,187,000	\$ 352,430,000	\$ 353,678,000	\$ 354,931,000
Retirement	192,789,713	185,609,000	215,081,000	230,279,000	230,593,000	233,920,000
Health and Other Fringe Benefits	56,916,636	48,664,000	53,107,000	57,956,000	63,248,000	69,023,000
Total Personal Services	599,337,110	584,223,000	619,375,000	640,665,000	647,519,000	657,874,000
Total Non-Personal/Equipment	83,727,100	79,055,000	80,047,000	81,286,000	82,044,000	84,039,000
0:- 140.1						
City-Wide						
City-Wide Expenses	201,493,789	57,252,000	58,667,000	61,580,000	66,638,000	68,224,000
Capital Projects	11,295,937	7,500,000	7,970,000	7,968,000	7,963,000	7,966,000
Transfers	30,210,250	35,089,000	38,424,000	35,677,000	29,176,000	29,904,000
Earmarked Reserves	63,692,940	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	336,001,916	129,750,000	134,970,000	135,134,000	133,686,000	136,153,000
Committed Additions	l					
New Parks and Recreation Facilities Mai	int. & Operations	49,000	131,000	234,000	294,000	521,000
New Traffic Infrastructure Assets Maint.	& Operations	49,000	82,000	107,000	124,000	127,000
Police Automated Field Reporting/Recor	ds Mgmt. System	,	335,000	438,000	461,000	376,000
Measure O (Library) Maint. & Operations	,	1,185,000	3,106,000	3,160,000	3,851,000	3,962,000
Measure P (Parks) Maint. & Operations		653,000	712,000	720,000	774,000	810,000
Measure O (Public Safety) Maint. and O	perations - Fire			2,503,000	2,474,000	2,618,000
Measure O (Public Safety) Maint. & Ope	rations - Police	2,393,000	2,465,000	2,504,000	2,545,000	2,585,000
Total Committed Additions		4,329,000	6,831,000	9,666,000	10,523,000	10,999,000
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Total Base Exp. w/ Committed Additions	\$ 1,019,066,126	\$ 797,357,000	\$ 841,223,000	\$ 866,751,000	\$ 873,772,000	\$ 889,065,000

It is important to note that adjustments are made to each department's budget to eliminate one-time additions/deletions and annualize partial year allocations included in the 2011-2012 Adopted Budget. This Forecast does not assume various one-time additions included in the 2011-2012 Mayor's June Budget Message as approved by the City Council that are scheduled to expire in June 2012. These include positions that impact police field patrol and crossing guards, Lake Cunningham Skate Park and marina, code enforcement, Safe School Campus Initiative staff, City Attorney's Office support, and senior wellness activities.

This Forecast assumes the continuation of 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 SAFER expenditures in 2012-2013 of \$7.5 million for 49 Fire Fighter positions and COPS expenditures of \$2.4 million for 19 Police Officers after the grant funding period ends. Without the continuation of these positions, significant service level reductions would occur.

EXPENDITURE FORECAST

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 (2012-2013) projection for personal services costs in this Forecast has been calculated at a detailed level. An extract of payroll system information as of August 2011 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, 2011-2012 ongoing position reductions (cost savings) and additions (cost increases) were annualized and all categories of benefit costs in the coming year were projected.

For the 2012-2013 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the General Fund's total costs. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the \$584.2 million projected personal services total for 2012-2013, salaries and other compensation costs amount to \$350.0 million (59.9% of projected personal services), retirement costs amount to \$185.6 million (31.8% of projected personal services), and health and other fringe benefits costs amount to \$48.7 million (8.3% of projected personal services). Despite no negotiated salary increases for any employee group, 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) impact personal services costs and continue to be responsible for a growing element of the major increases in this category.

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 adjustments. For this Forecast, the out years are projected to inflate at a composite rate of approximately 3.0%. This projected rate of growth is well below the 5.2% presumed in February 2011 due primarily to revisions by the Retirement Boards' actuary for contribution amounts for the City's two retirement plans and caps on the City's contribution rate for Police and Fire Retiree Healthcare as discussed further in this section.

Salaries and Other Compensation:

Salary step increases for current non-management employees and pay for performance for management employees for 2012-2013 is projected at \$2.0 million, or an increase of 0.35%. 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

EXPENDITURE FORECAST

step increases for eligible non-management employees and pay for performance for management employees.

- No salary increases for any employees are included in this Forecast reflecting the fact that there are no negotiated agreements covering the five-year period. Agreements for the Association of Building, Mechanical and Electrical Inspectors (ABMEI), Association of Engineers and Architects (AEA), Association of Maintenance Supervisory Personnel (AMSP), International Association of Firefighters (IAFF), and the San Jose Police Officers Association (SJPOA) were approved in 2011 and reflect no approved wage increase in 2012-2013. The imposition of terms by the City Council in June 2011 for the International Union of Operating Engineers, Local No. 3 (OE#3), Municipal Employees' Federation (MEF), International Brotherhood of Electrical Workers (IBEW), and Confidential Employees' Organization (CEO) expire June 30, 2012. The Agreement with the Association of Legal Professionals (ALP) also expires June 30, 2012. The approval of any negotiated salary or benefit increases in those years, without any offsetting increase in revenues or reduction in costs, will obviously have the effect of increasing the City's shortfall or reducing any projected surplus. Each 1% of total compensation increase granted to all employees would increase the General Fund cost in 2012-2013 dollars by approximately \$5.8 million. In this regard, consideration of salary increases is being treated as a resource allocation policy decision and any decision will be made in the context of what is affordable in light of the City's many service delivery priorities after a decade of service and position reductions.
- Overtime expenditures in the General Fund total \$18.6 million for 2012-2013, with the majority of the expenditures for Police Department (\$11.9 million) and Fire Department (\$5.2 million) operations. The out years of the Forecast continue these costs, with small adjustments for salary step growth.

Retirement:

For 2012-2013, retirement costs total \$185.6 million for the General Fund assuming the prepayment of the annual required contribution, or 23.3% of the total base expenditure budget. This represents a decrease of \$7.2 million from the 2011-2012 Modified Budget of \$192.8 million. Based on the Federated and Police and Fire Retirement Boards' actions regarding interest earnings assumptions and/or demographic assumption changes, of the \$185.6 million of the General Fund's annual required contribution (ARC), \$64.2 million is projected to be paid to the Federated Retirement System and \$120.9 million to the Police and Fire Retirement Plan (\$77.3 million for the Police Retirement Plan and \$43.6 million for the Fire Retirement Plan). Please note that the Police and Fire Retirement Board's actuary indicated that for the June 30, 2012 Valuation it may recommend to the Board to consider reducing the investment return assumption from the current 7.50% to 7.25%. All things being equal, reducing the investment return assumption will increase the City's annual required contribution starting with 2013-2014. The remaining \$0.5 million in retirement costs are associated with part-time benefited employees and the Mayor and City Council who do not participate in the City's retirement plans.

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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. Therefore, for this forecast period, the minimum ARC and the percentage of payroll are discussed in detail below. Please note that due to the independent estimated payroll projections by the Retirement Boards' actuary and the City Manager's Budget Office, the City calculations for the City retirement contributions are based on the minimum ARC or the ARC based on the budgeted payroll, whichever is greater. Due to this funding methodology for the ARC, if the City's pensionable payroll amount changes due to staffing reductions, the retirement cost will not change unless the ARC is above the minimum.

As stated previously and detailed in the table on the next page, for 2012-2013, the General Fund's retirement costs decreased by \$7.2 million from the 2011-2012 Modified Budget. This net reduction of \$7.2 million is due to retirement cost increases in the Federated Retirement System that are more than offset by retirement cost reductions in the Police and Fire Retirement Plan. Further, based on projections received from Cheiron, the Retirement Boards' actuary, the table below details the General Fund's retirement costs by the Federated 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 over the five-year period. Additionally, the retirement costs associated with part-time employees and the Mayor and City Council are in the table below. During the forecast period, General Fund retirement contributions will increase by approximately \$48.3 million or 26% from \$185.6 million in 2012-2013 to \$233.9 million in 2016-2017. For 2016-2017, projected Retirement costs are estimated to be 26.0% of the General Fund. During the same period, as indicated in the table below, the City retirement contribution for all funds will increase by \$68.2 million in \$245.8 million in 2012-2013 to \$314.0 million in 2016-2017.

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2013-2017 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES (\$ in Millions and with Pre-Payment Discount)

2011-2012-2013-2014-2015-2016-**Retirement Plan** 2012 2013 2014 2015 2016 2017 Federated Ret. System - Pension \$61.2 \$44.3 \$54.5 \$58.1 \$61.1 \$61.7 Fed. Ret. System - Retiree Healthcare \$23.8 \$10.9 \$9.7 \$20.8 \$22.3 \$23.1 Federated Retirement Plan - Total \$55.2 \$64.2 \$78.9 \$83.5 \$84.2 \$85.5 **Budgetary Contribution Rates** 43.7% 50.5% 65.2% 61.8% 65.4% 66.2% \$74.8 \$74.6 \$79.9 \$79.2 Police Retirement Plan - Pension \$66.8 \$78.6 Police Ret. Plan - Retiree Healthcare \$11.5 \$10.5 \$12.2 \$13.4 \$13.8 \$14.3 Police Retirement Plan - Total \$86.3 \$77.3 \$86.8 \$93.3 \$92.4 \$93.5 **Budgetary Contribution Rates** 75.1% 65.7% 73.5% 78.9% 78.1% 78.8% Fire Retirement Plan – Pension \$46.0 \$39.2 \$43.6 \$46.6 \$45.9 \$46.3 Fire Ret. Plan - Retiree Healthcare \$4.7 \$4.4 \$5.3 \$6.4 \$7.6 \$8.1 Fire Retirement Plan - Total \$48.9 \$53.0 \$53.5 \$50.7 \$43.6 \$54.4 **Budgetary Contribution Rates** 64.0% 71.3% 74.0% 76.9% 77.2% 78.1% \$0.6 \$0.5 \$0.5 \$0.5 \$0.5 \$0.5 **Other Retirement Costs Total General Fund** \$192.8 \$185.6 \$215.1 \$230.3 \$230.6 \$233.9 **Total All Funds** \$245.5 \$245.8 \$288.9 \$308.4 \$309.3 \$314.0

Source: 2011-2012 Modified Budget; Cheiron Letters dated February 8, 2012 and February 21, 2012 with applied pre-payment discount

The table above also indicates the budgetary retirement contribution rates which are discounted for the pre-payment of the ARC in order to set aside sufficient funds in the General Fund's budget 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 2012-2013 Federated System pension payment is based on a percentage of payroll. Over the forecast period, the budgetary rates show significant increases. In order to fund the ARC for the Federated System, the budgetary retirement contribution rate increases from 50.5% in 2012-2013 to 66.2% in 2016-2017; for the Police Retirement Plan the budgetary retirement contribution rate increases from 65.7% in 2012-2013 to 78.8% in 2016-2017; and for the Fire Retirement Plan, the budgetary contribution rate increases from 64.0% in 2012-2013 to 78.1% in 2016-2017.

For illustration purposes and discussion of the ARC for Retiree Healthcare, the table on the following page depicts the Board approved contribution rates for 2012-2013 and the Cheiron projected rates for the out years of the Forecast.

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2013-2017 BOARD APPROVED CITY CONTRIBUTION RATES

Retirement Plan	2011- 2012	2012- 2013	2013- 2014	2014- 2015	2015- 2016	2016- 2017
Fed. Ret. System – Pension	28.3%	44.4%	46.9%	48.0%	46.3%	45.4%
Fed. Ret. System – Ret. Healthcare	7.2%	7.9%	16.8%	17.4%	17.5%	17.5%
Federated Retirement System - Total	35.5%	52.3%	63.7%	65.4%	63.8%	62.9%
Police Retirement Plan – Pension	49.3%	57.0%	63.6%	65.7%	62.5%	60.8%
Police Ret. Plan – Retiree Healthcare	7.6%	9.0%	10.3%	11.0%	11.0%	11.0%
Police Retirement Plan – Total	56.9%	66.0%	73.9%	76.7%	73.5%	71.8%
Fire Retirement Plan – Pension	51.0%	58.9%	65.5%	67.6%	64.4%	62.8%
Fire Retirement Plan – Retiree Healthcare	5.3%	6.6%	8.0%	9.3%	10.7%	11.0%
Fire Retirement Plan - Total	56.3%	65.5%	73.5%	76.9%	75.1%	73.8%

Source: Cheiron Letters dated February 8, 2012 and February 21, 2012

For the Federated Retirement System, the Board approved pension contribution rate increased from 28.3% for 2011-2012 to 44.4% for 2012-2013 and is projected to increase to 45.4% for 2016-2017. The retiree healthcare or Other Post-Employment Benefit (OPEB) contribution rate increased from 7.2% for 2011-2012 to 7.9% for 2012-2013 and is projected to increase to 17.5% for 2016-2017. Over the Forecast period, the Federated System contribution rates increase by over 10 percentage points from 52.3% to 62.9% primarily due to the more than doubling of the Retiree Healthcare contribution rate. The substantive increase of the Retiree Healthcare contribution rate from 7.9% in 2012-2013 to 17.5% in 2016-2017 is primarily due to the full funding of the ARC starting with 2013-2014. In order to begin to addressing the significant unfunded actuarial liability for retiree healthcare costs, at the direction of the City Council, the Administration worked will all employee bargaining groups to begin a five-year phase-in to fully fund the annual required contribution (ARC). 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 is 2012-2013 with the full funding of the ARC starting with 2013-2014. Based on Cheiron's projections, in order to fully fund the ARC for retiree healthcare benefits in 2013-2014, the City's contribution will more than double and increase to 16.8%. The employees' contribution rate is projected to more than double as well from 7.3% in 2012-2013 to 15.5% in 2013-2014.

For the Police Retirement Plan, the Board approved pension contribution rate increased from 49.3% for 2011-2012 to 57.0% for 2012-2013 and is projected to increase to 60.8% for 2016-2017; and per the MOA between the City and the San Jose Police Officers' Association, the retiree healthcare contribution rate increased from 7.6% for 2011-2012 to 9.0% for 2012-2013 and is projected to increase to 11.0% for 2016-2017. Over the Forecast period, the Police Pension Plan contribution rates increase from 66.0% to 71.8%. Similarly, for the Fire Retirement Plan, the Board approved pension contribution rate increased from 51.1% for 2011-2012 to 58.9% for 2012-2013 and is projected to increase to 62.8% for 2016-2017; and per the MOA between the City and the International Association of Firefighters, Local 230, the retiree healthcare contribution rate increased from 5.3% for 2011-2012 to 6.6% for 2012-

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2013 and is projected to increase to 11.0% for 2016-2017. Over the Forecast period, the Fire Pension Plan contribution rates increase from 65.5% to 73.8%. 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 the San Jose Police Officers' Association and the San Jose Fire Fighters, IAFF, Local 230. The cost for retiree healthcare is shared 50/50 between the City and employees and these MOAs expire June 30, 2013. Per Cheiron, 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%. In order to fully understand the out year projections, the Administration recently requested that the Board's actuary prepare the annual required contribution for retiree healthcare so that the full amount can be analyzed.

Health and Other Fringe:

- Forecasted health rate increase of 11% is included in 2012-2013 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 2012-2013 rate increases.
- Based On actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, no increase is anticipated 2012-2013. For the out years, the Forecast assumes an annual rate increase assumptions of 3% based on City trends and actuarial analysis.
- For the payment of Unemployment Benefit Claims, the City is self-insured. Based on actual claims experienced in 2011-2012, current funding available in the Unemployment Insurance Fund, and projected future claims, the unemployment insurance rate has been suspended, resulting in \$2.2 million savings when compared to the 2012-2013 Preliminary Forecast.

Other Cost Factors:

It is important to note that this Forecast does not assume the implementation of any elements of the Fiscal Reform Plan approved by the City Council. Furthermore, not included in the Personal Services category are two large General Fund cost categories that are personnel-related and discussed further in the "Other Expense" portion of this section: Workers' Compensation Claims Payments and Sick Leave Payments Upon Retirement. These costs are included in the City-Wide Expenses category. In 2012-2013, estimates of \$16.6 million for Workers' Compensation Claims Payments and \$6.2 million for Sick Leave Payments Upon Retirement have been included in this General Fund Forecast.

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Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total \$79.1 million in 2012-2013. 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 2011-2012, and including projected adjustments for specific large non-personal/equipment allocations (e.g., utilities, leases, contracted services, debt service payments, fuel, and Police Department vehicle replacement). The resulting 2012-2013 estimates represent a decrease of \$4.7 million from the 2011-2012 Modified Budget level of \$83.7 million. Departmental gas and electricity funding for 2012-2013 has been slightly adjusted in this Forecast to reflect projected rate increases and consumption changes.

The 2012-2013 non-personal/equipment base includes an increase for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of \$4.2 million to \$3.9 million based on the current replacement schedules and projected costs for these vehicles. In the out years of the Forecast, the police vehicle replacement costs are expected to decline in the first three Forecast years and increase in the last 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 \$14.8 million.

For the out years of the Forecast, a growth rate of 2.0% has been assumed from the 2012-2013 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 1.54% annually.

City-Wide

City-Wide Expenses in the first year of the Forecast (2012-2013) total \$57.3 million, a decline from the 2011-2012 Modified Budget of \$201.5 million. This large reduction primarily reflects the impact of deleting the \$100.4 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 2011-2012 (\$28.8 million); and the elimination of one-time grants (\$6.1 million). In addition, the elimination of the Convention Center lease payment (\$15.4 million) in this Forecast reflects the assumption that funding from the Successor Agency to the San Jose Redevelopment Agency will directly pay for this debt service payment. It should be noted, however, this Forecast assumes City funding would be necessary to meet the obligations required by the Successor Agency to the Redevelopment Agency, as discussed later in this section.

The line-items in this category are adjusted to reflect anticipated costs for 2012-2013 based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2012-2013 allocations in this category include: Workers' Compensation Claims (\$16.6 million); Sick Leave Payments Upon Retirement (\$6.2 million); FMC debt service

EXPENDITURE FORECAST

payments (\$4.5 million); City-owned Facility Operating Agreements (\$3.5 million); Property Tax Administration Fee (\$3.3 million); San Jose BEST Program (\$2.6 million); Parking Citations/Jail Courthouse Fees (\$2.5 million); Children's Health Initiative (\$2.1 million); and General Liability Claims (\$2.0 million).

In the out years of the Forecast, City-Wide Expenses are projected to increase at an average growth rate of 1.3%. While several of the individual line items are expected to remain at 2012-2013 levels over this period, there are some categories that are expected to experience growth, including Workers' Compensation Claims (from \$16.6 million to \$20.8 million). The FMC debt service payment is expected to increase significantly in the out years (from \$5.0 million to \$6.8 million) based on higher variable rate assumptions. The anticipated administrative costs to issue TRANs Debt Service is also expected to climb (from \$800,000 to \$6.3 million) based on a conservative estimate of the size of the issuance required and anticipated increases in variable interest rates and higher bank fees. It should be noted that these costs are still projected to achieve savings to the City for the annual prepayment of employer retirement contributions for pension and retiree health benefits through the forecast period. However, the budgetary benefit for prepayment of retirement costs will be closely evaluated as part of the annual budget process.

The General Fund **Capital Projects** category totals \$7.5 million in 2012-2013 and increases to \$8.0 million in each of the out years of the Forecast. The largest items in this category include fire apparatus replacement (\$5.3 million annually) and debt service payments for Central Service Yard – Phase I (\$1.3 million in 2012-2013 and relatively flat payments of \$1.7 million in the out years). The investment in fire apparatus replacement in this Forecast is based on an analysis of projected replacement costs, replacement schedules, and apparatus changes to meet safety needs. 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 (\$300,000), fuel tanks and methane monitoring control and replacement (\$450,000), 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 \$35.1 million in 2012-2013 and ranges from \$38.4 million to \$29.9 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for City Hall is the largest line-item in this category and totals \$15.3 million in 2012-2013 (\$16.3 million to \$18.4 million in the remaining years of the Forecast) followed by transfers to the Successor Agency to the Redevelopment Agency of \$8.6 million in 2012-2013, \$10.6 million in 2013-2014, and \$6.8 million in 2014-2015. 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 (\$4.8 million in 2012-2013 to \$6.8 million the out years) and Rancho del Pueblo and Los Lagos Golf Courses (\$1.8 million annually); payments in accordance with the San José Arena Management agreement extension (\$2.8 million in 2012-2013 and \$2.0 million to \$750,000 in the out years of the Forecast) for Arena repairs and capital enhancements; and a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement (\$800,000 annually).

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Effective February 1, 2012, all redevelopment agencies in the State of California were dissolved pursuant to AB 1X 26. 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, the Property Tax Increment is projected to grow by 1.7 % in 2012-2013, 0.8% in 2013-2014, 2.4% in 2014-2015, 1.3% in 2015-2016, and 2.8% in 2016-2017. Based on that analysis, it is projected that there will not be sufficient property tax increment revenue to pay all of the enforceable obligations for the first four years of the forecast period. It should be noted that the City is only contractually obligated to assume certain payment requirements of the Successor Agency as follows: 4th Street Garage Debt Service, Convention Center Debt Service, HUD 108 Loan payments, ERAF Loan Payments, and Interfund Loans made in connection with the SERAF Loan. However, while the City is not legally obligated to assume all of the Successor Agency obligations, there may be policy reasons why the City Council would want to see certain redevelopment obligations continue. Therefore, based on the current conservative budget projections as detailed below, it is assumed that City funds would pay the remaining amounts owed by the former Redevelopment Agency during the next four years.

It is currently projected that City funds may need to be advanced to provide for payment of Successor Agency enforceable obligations in the amounts of \$13.5 million in 2012-2013, \$15.6 million in 2013-2014, \$11.9 million in 2014-2015, and \$2.1 million in 2015-2016. Thereafter, sufficient tax increment revenue is projected to cover the current cost level of enforceable obligations and no further negative impact to City funds is expected.

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 (between \$1.6 and \$1.7 million in each year for the next three fiscal years). In the event the Successor Agency has insufficient revenues to make the payment, the CDBG fund is expected to cover the payment. 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. In the event the Successor Agency has insufficient revenues to make the payment, the General Purpose Parking Fund is expected to cover the payment. Since these other City Funds are pledged to make these payments, the potential General Fund impact for the purpose of this forecast is \$8.6 million for 2012-2013, \$10.6 million for 2013-2014, and \$6.8 million for 2014-2015. Given that 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 assume that the County will provide short-term borrowing to the Successor Agency to align anticipated revenues with anticipated expenditures.

EXPENDITURE FORECAST

It should be noted that the City Attorney's Office and the Administration are in the process of reviewing all of the Successor Agency obligations to reduce the impact on the General Fund, the Community Development Block Grant Fund, and the General Purpose Parking Fund during the next four years. Similarly, as part of the 2012-2013 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 2012-2013 Proposed Operating budget.

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 the \$5.5 million annual subsidy level in the last forecast to \$4.8 million required in 2012-2013 and then increases to \$6.8 million in the out years based on forecasted debt service payments for that facility. The transfer for the golf course subsidy, however, has increased from the \$1.6 million annual level assumed in the February 2011 Forecast to \$1.8 million in 2012-2013 based on current operational activity.

The payments for Arena repairs and capital enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. In 2012-2013, 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.

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 (\$37,500 in 2012-2013 to \$375,000 in the out years) to fund projected expenditures in that fund that is above the anticipated C&C revenue available to support capital maintenance of the City's communications and radio infrastructure.

The Transfers category also includes the final payments of the Camden Lifetime Activities Center debt service (\$202,000 in 2012-2013), Fiber Optics loan repayment (\$50,000 annually), and transfers to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas (\$780,000 to \$910,000 annually). An extension of the Fiber Optics loan beyond June 30, 2013 until one-time funds become available to pay off the loan is assumed in this Forecast.

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 2012-2013 Proposed Budget.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2011-2012, and would be recommended for rebudget or use in 2012-2013. Some of the larger current Earmarked Reserves include the Workers' Compensation/General Liability Catastrophic

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Reserve, Development Fee Program Reserves, Salary and Benefits Reserve, and Retirement Pre-Payment Reserve.

Per City Council policy, the **2012-2013 Contingency Reserve** is projected at the level necessary to comply with the City Council policy to maintain a 3% Contingency Reserve (\$29.3 million). This amount would be sufficient to cover approximately one pay period of payroll costs (two ½ 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 \$4.3 million in 2012-2013 and increase to approximately \$11.0 million by 2016-2017. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

The approved bond measures from the elections of November 2000 and March 2002 will result in new and expanded library (Measure O), park (Measure P), and police and fire (Measure O) facilities and will require significant additional Maintenance and Operations funding (\$4.2 million in 2012-2013 and increasing to approximately \$10.0 million in 2016-2017). Some of the new facilities anticipated to be open during this forecast period include: Bascom Branch Library, Calabazas Branch Library, Educational Park Branch Library, Seven Trees Branch Library, Southeast Branch Library, Softball Complex, Soccer Complex, Bascom Community Center, Fire Station 37 (South Willow Glen), and the South San José Police Substation.

Also included in the **Committed Additions** are maintenance and operations costs associated with non-bond projects such as new parks and recreation facilities, new traffic infrastructure, and the Police Department's new Automated Field Reporting/Records Management System. Costs included in the Forecast range from \$98,000 in 2012-2013 and increases to \$1,024,000 by 2016-2017.

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

EXPENDITURE FORECAST

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 2011-2012. 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.

OPERATING MARGIN

The Base Case with Committed Additions General Fund Forecast projects a surplus in the first year (2012-2013) of \$10.0 million. However, budget shortfalls are projected in the following two years of the Forecast totaling \$23.7 million. Over the five-year period, a surplus of \$15.9 million is anticipated, with a \$10.7 million surplus in the final year. Base Case expenditures, including committed additions, increase from \$797.4 million in 2012-2013 to \$889.1 million in 2016-2017, for an average growth rate each year of approximately 2.8%. This rate of expenditure growth falls slightly below the average increase in General Fund sources (including Beginning Fund Balance) of 2.9%. The sources of revenue total \$807.3 million in 2012-2013, and grow to \$905.0 million in 2016-2017.

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 2012 Forecast is compared to the comparable year in the February 2011 Forecast. This chart also includes the one year projections for 2012-2013 provided after the adoption of the 2011-2012 Budget, in the 2012-2013 Preliminary Forecast issued in November 2011, as well as in the Forecast update provided in December 2011.

2013-2017 General Fund Forecast Changes in Operating Margin (\$ in Millions)

	<u>2012-2013</u>	<u>2013-2014</u>	<u>2014-2015</u>	<u>2015-2016</u>	<u>2016-2017</u>
February 2011 Incremental Surplus/(Shortfall)	(\$43.08)	(\$25.12)	(\$10.03)	(\$0.11)	N/A
June 2011 Incremental Surplus/(Shortfall)	(\$34.88)	N/A	N/A	N/A	N/A
Revised Forecast	(\$77.96)	(\$25.12)	(\$10.03)	(\$0.11)	N/A
_					_
November 2011 Incremental Surplus/(Shortfall)	(\$80.48)	N/A	N/A	N/A	N/A
Incremental	(\$80.48) (\$25.00)	N/A N/A	N/A N/A	N/A N/A	N/A N/A

Note: Does not assume cost-of-living salary increases; additional impacts from changes in actuarial assumptions and methodologies that may be approved by the Retirement Boards in future years that could change the City's required contributions or, conversely, that reduce the City's required contributions as a result of pension reform efforts that are currently underway; unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses.

OPERATING MARGIN

In the February 2011 Forecast, an incremental shortfall of \$43.1 million for 2012-2013 was projected. This figure was based on the assumption that the entire 2011-2012 shortfall would be solved with ongoing actions. Although the 2011-2012 Adopted Budget was balanced with 70% in ongoing solutions, 30% of the shortfall was solved with one-time solutions and carried forward to the next year. The carryover impact of those one-time measures (-\$34.9 million) is reflected in the June 2011 incremental shortfall line item resulting in a revised forecast of \$78.0 million.

In November 2011, staff prepared a 2012-2013 Preliminary General Fund Forecast incorporating the final 2010-2011 actual performance and the first three months of activity in 2011-2012. In that Preliminary Forecast, the General Fund deficit for 2012-2013 increased slightly to \$80.5 million. This increase in the projected deficit was the net result of a number of upward and downward adjustments to the City's many General Fund revenue and expenditure categories. For complete details of the 2012-2013 Preliminary General Fund Forecast, please refer to the memorandum issued on November 4, 2011 (available on-line http://www.sanjoseca.gov/budget/FY1213/2012-2013PrelimGFForecast.pdf). In December 2011, the 2012-2013 projected shortfall figure was revised downwards to \$25.0 million to reflect lower projected Police and Fire pension contributions based on updated information provided by Cheiron, the actuary for the Police and Fire Retirement Board.

For the February 2012 General Fund Forecast, staff completed an in-depth review of anticipated revenues and expenditures for 2012-2013 and the remaining four years of the forecast period. The 2012-2013 projected surplus of \$10.0 million reflects an improvement from the \$25 million budget shortfall projected in December 2011. The improvement in this Forecast in 2012-2013 reflects the following: 1) a reduced impact from the dissolution of the San Jose Redevelopment Agency (\$10.6 million); 2) improved revenue projections (\$7.5 million); 3) a reduction in estimated retirement costs, primarily retiree healthcare-related (\$7.0 million); 4) a reduction in estimated sick leave payments upon retirement, health care, and workers' compensation costs (7.0 million); and 5) and other miscellaneous changes (\$2.9 million). The improved revenue projections and the lower costs for sick leave payments upon retirement, health care, and workers' compensation costs were discussed as part of the 2011-2012 Mid-Year Budget Review.

In the out-years of the Forecast, General Fund shortfalls and surpluses range from -\$22.5 million to \$19.0 million annually. These surplus and shortfall amounts are very small when put into context of the size of the projected General Fund budget, ranging from -1.3% of the budget to 1.1% of the projected annual budget (revenues and expenditures). For the first time in recent history, over the five-year period, an overall General Fund surplus of \$15.9 million is projected, with an average surplus of approximately \$3.2 million annually (0.2% of the annual budget).

The second year of the Forecast (2013-2014) projects a General Fund deficit of \$22.5 million. Revenues are anticipated to grow by an additional \$21.4 million though this growth rate is dampened as a result of the loss of a few one-time revenue sources in 2012-2013 including the sunset of the SAFER Grant (-\$7.5 million), the elimination of the transfer from the FMC Bond Fund related to the close-out of this project (-\$1.7 million) and a reduction in the Construction

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Excise Tax Fund transfer (-\$1.0 million). Ultimately, by the final year of this forecast, revenues are projected to increase to levels seen prior to the recent recession.

The expenditure growth of \$43.9 million in 2013-2014 outpaces the anticipated revenue growth of \$21.4 million. This overall expenditure growth is primarily driven by higher retirement costs (\$29.5 million) as well as higher health and other fringe benefit costs (\$4.4 million), and salaries and other compensation costs (\$1.2 million). City-wide expenditure categories (City-Wide Expenses, Capital Projects, Transfers, and Reserves) are expected to increase by \$5.2 million and additional costs for facilities scheduled to come on-line in 2012-2013 are also expected to total \$2.5 million. The variances in the three out years vary with a deficit of \$1.3 million in 2014-2015, surplus of \$19.0 million in 2015-2016 and a surplus of \$10.7 million in 2016-2017.

