



2012-2013

MID-YEAR
BUDGET
REVIEW



TRANSMITTAL
MEMORANDUM



TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: 2012-2013 MID-YEAR
BUDGET REVIEW REPORT

DATE: January 31, 2013

RECOMMENDATIONS

- A. Approval of the 2012-2013 Mid-Year Budget Review Report.
- B. Adoption of related Appropriation Ordinance and Funding Sources Resolution amendments in various funds as detailed in Section III (Recommended Budget Adjustments and Clean-Up Actions) of the 2012-2013 Mid-Year Budget Review Report.

OUTCOME

The Mid-Year Budget Review Report provides an assessment of the City's budget condition in the current fiscal year as compared to the 2012-2013 Modified Budget based on actual performance during the first six months of 2012-2013. Based on this analysis, budget revisions are recommended to address projected revenue and expenditure variances, account for new grants and reimbursements, and better position the City for the 2013-2014 budget process.

EXECUTIVE SUMMARY

Over the last decade, the City has addressed severe budget shortfalls by implementing significant service reductions and changes to service delivery models across the organization. The City continues to manage through those difficult changes but did experience some relief in 2012-2013. After a decade of General Fund shortfalls, the 2012-2013 Adopted Budget allocated a small \$9.0 million General Fund surplus. Major budget actions in the 2012-2013 Adopted Budget enabled the City to:

- Continue services funded on a one-time basis in 2011-2012;
- Open four libraries and one community center constructed with General Obligation Bonds;
- Address some of the most immediate and critical of the City's unmet/deferred infrastructure needs;
- Address some essential operational needs to strengthen the organization, meet community expectations, or mitigate potential risk of higher long-term costs;
- Fund a limited number of programs/initiatives identified in the Mayor's March and June Budget Messages; and

- Implement more effective service delivery models to improve efficiency, reduce costs, and/or enhance service levels.

With some improvement in the City's fiscal condition, the City has started to stabilize service delivery, although at levels that are far below what we believe is satisfactory for the community. The Administration is closely monitoring the City's budget to ensure that current year revenues and expenditures are meeting expectations, which is necessary to maintain stability in the budget and avoid disruptions in service during the year. I am pleased to report that through the first half of the year, almost all City funds are performing within expected 2012-2013 budgeted levels and, in some cases, revenues are outperforming expectations. There are isolated instances where current year performance is not meeting budgeted estimates. Budget actions are recommended in this document to address those problems without any service impacts.

Mid-Year Budget Review Highlights

General Fund

- If current collection trends continue, General Fund revenues are expected to slightly exceed the budgeted estimate by year-end. This is the result of stronger performance in several categories, such as Sales Tax, Transient Occupancy Tax, and Business Taxes, partially offset by lower collections in other revenue categories, such as Utility Taxes and Fines, Forfeitures, and Penalties. Overall, General Fund expenditures are also tracking within estimated levels and are projected to generate savings by year-end.
- A series of Mid-Year Budget Review actions are recommended based on actual performance through December and projected activity through the remainder of the year. Major actions include the following:
 - Address a limited number of urgent fiscal/program needs, including:
 - An increase of \$6.9 million to the 2013-2014 Future Deficit Reserve (from \$22.5 million to \$29.4 million) funded by a one-time payment from the County to reflect the recalculation of prior year Property Tax Administration Fees; and
 - The establishment of a \$4.0 million Police Department Overtime Reserve funded from Police personal services savings to ensure that sufficient overtime resources are available in 2013-2014 to help offset the impact of vacancies next year.
 - Establish a \$12.0 million 2012-2013 Ending Fund Balance Reserve. In the development of the annual budget each year, it is assumed that a combination of excess revenue, expenditure savings, and the liquidation of prior year carryover encumbrances will be available in the current year to be carried forward into the following year. This action would set aside 75% of the funds expected to be generated in 2012-2013 from excess revenues and expenditure savings that were identified in the February 2012 Forecast as a source of funds for 2013-2014. Proactively establishing this Reserve helps ensure the necessary funds are available by year-end to meet those expectations.
 - Implement required technical and rebalancing actions, as well as net-zero grants/reimbursements/fee adjustments. These transactions are balanced within the

General Fund. The largest adjustment includes a \$25 million reduction to the Tax Revenue Anticipation Notes (TRANs) Debt Service appropriation and associated revenue estimate based on the lower actual TRANs issuance required for City cash flow purposes in 2012-2013. Other larger recommended budget actions bring various revenue estimates and expenditure appropriations into alignment with current projections, including: an \$880,000 increase to the Transfer from the Construction and Conveyance (C&C) Tax Fund to reflect higher tax C&C Tax receipts of which a portion is transferred to the General Fund to cover parks operating and maintenance expenses; a \$1.25 million reduction to the Parking Fine revenue, partially offset by a \$400,000 reduction to the City-Wide Parking Citations/Jailhouse Fees appropriation, to reflect a lower than anticipated issuance of parking citations in the current year; and a \$1.0 million increase to the Workers' Compensation Claims – Fire Department appropriation to address higher than budgeted expenditures.

Special/Capital Funds

- The revenues and expenditures in the City's special and capital funds are generally performing within expected levels through December. Budget adjustments are recommended in several special and capital funds to adjust for revised revenue and cost estimates, to address critical current year funding needs, and to recognize various grants and reimbursements. Some of the major recommended adjustments include:
 - In the Construction and Conveyance Tax Funds, the Convention and Cultural Affairs Fund, and the Transient Occupancy Tax Fund, an increase to revenue estimates and an allocation of those additional funds are recommended based on current collection trends and estimated activity through the remainder of 2012-2013.
 - In the Municipal Golf Course Fund, an increase to the Los Lagos Golf Course expenditure appropriation is recommended to reflect the higher net costs at this course, offset by a decrease to the Ending Fund Balance.
 - In the Construction Excise Tax Fund, funding is recommended to turn on approximately 900 streetlights previously turned off as a budget reduction strategy. Generally located along arterial streets, these streetlights will improve street and public safety as well as street appearance. Lights will be turned on beginning in March at the rate of approximately 225 per month.

Looking forward, the Administration is scheduled to release the 2014-2018 General Fund Forecast on February 28, 2013, and the 2013-2014 Proposed Capital and Operating Budgets on April 22, 2013 and May 1, 2013, respectively. Analysis from this Mid-Year Budget Review will be factored into both the Forecast and Proposed Budgets, as appropriate.

BACKGROUND

The annual Adopted Budget is a financial plan predicated on the best information available at the time it is prepared. As with any budget, however, changing conditions create the need to modify the original plan. Through its budget policies, the City Council has designated mid-year as the appropriate time to perform a comprehensive review of the current year's budget, and the Mid-

Year Budget Review as the appropriate vehicle for consideration of any revisions to the budget. This Mid-Year Budget Review Report complies with that policy. It contains a comprehensive review of the status of the City's 2012-2013 Operating and Capital Budgets.

The Mid-Year Budget Review Report includes the following sections:

- **Transmittal Memorandum** – An overall summary of the contents of the Mid-Year Budget Review Report.
- **Section I: General Fund Status Report** – A review of the General Fund revenues and expenditures through Mid-Year.
- **Section II: Selected Special/Capital Funds Status Report** – A review of selected special and capital funds that have revenue and/or expenditure variances from the modified budget or other issues of interest.
- **Section III: Recommended Budget Adjustments and Clean-up Actions** – The Recommended Budget Adjustments detail the proposed budget augmentations/reductions in the General Fund and special/capital funds. The Clean-up Actions detail the technical appropriation and revenue estimate adjustments for the General Fund and special/capital funds.
- **Section IV: Appendix** – This section includes the financial results, prepared by the Finance Department, for all budgeted fund groups for the first six months of the year.

ANALYSIS

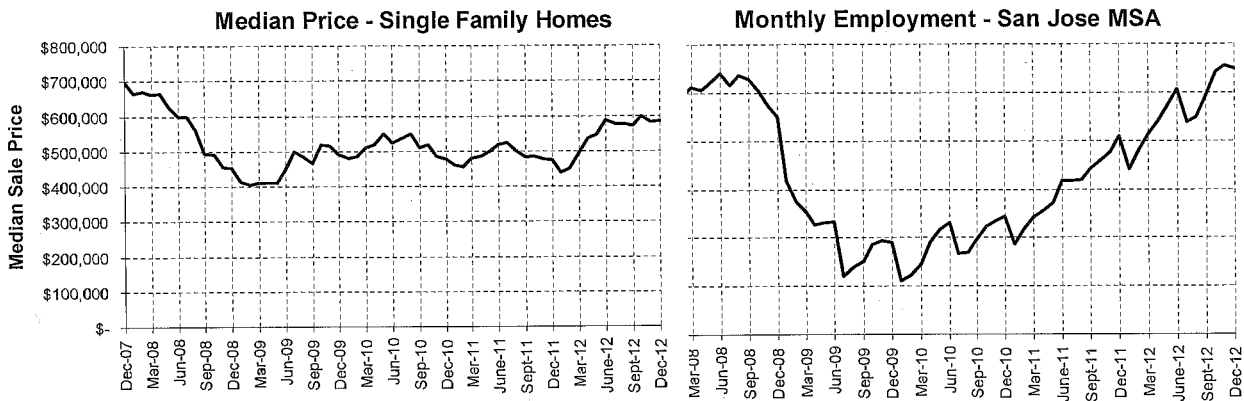
The Analysis section includes the following: an overview of the current economic environment; a discussion of General Fund performance through December; a summary of recommended General Fund budget adjustments included in the Mid-Year Budget Review Report; and a status report on selected special and capital funds.

ECONOMIC ENVIRONMENT

The 2012-2013 Adopted Budget was built on the assumption that the economic recovery would continue with modest growth. Actual revenue performance through the first six months of the year support the continuance of the economic recovery. Local economic indicators, including employment indicators, and local construction and real estate activity measures all show continuing growth. However, national economic indicators, such as the Gross Domestic Product (GDP) and consumer confidence, show mixed results.

The economic performance in Silicon Valley continues to show strength. In its most recent update, Beacon Economics noted that non-farm employment growth between October 2011 and October 2012 in the South Bay area was 3.5%, which was noticeably higher than the State average of 2.1%. Private sector growth of 4% year-over-year came in even higher than non-farm growth¹.

¹ Beacon Economics, The Regional Outlook – South Bay, Quarterly Update – as posted January 16, 2013.



Data from the State of California Employment Development Department paints a similar picture. The San Jose Sunnyvale Santa Clara Metropolitan Statistical Area (MSA) continues to

experience employment gains. The preliminary estimate of the December 2012 employment level in the MSA was 929,700, a 3.1% increase from the December 2011 level of 901,800. The employment level is now equivalent to the most recent peak of 930,500 experienced in December 2007.

Unemployment Rate (Unadjusted)

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

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

The unemployment rate in the MSA continues to decline, reaching its lowest point since November 2008.

The preliminary December 2012 unemployment rate of 7.6% decreased from the November 2012 rate of 7.8% and is lower than the 8.8% rate experienced a year ago. This regional unemployment rate is less than the unadjusted unemployment rate for the State (9.7%), and is equal to that of the nation, which currently has an unadjusted unemployment rate of 7.6% as well.

Through December, residential activity remained strong, with 1,519 new dwelling units authorized compared to the prior year level of 996 dwelling units. Construction valuation for commercial construction activity is tracking below last year, but valuation for industrial construction activity is tracking higher. The valuation for commercial activity of \$93.0 million through December is below the \$117.3 million through the same period last year. Industrial activity is up significantly, with valuation at \$126.1 million through December, compared to \$69.8 million through the same period last year. On a calendar year basis, total construction valuation in 2012 surged to \$984 million, a 58% increase from the prior year and a five-year high.

Housing prices have improved significantly since the same period in 2011. The December 2012 median single-family home price of \$584,500 showed a slight decline from a recent peak of \$599,000 in October 2012, but was far above the December 2011 median home price of \$474,500. The number of property transfers (sales) for all types of residences totaled 675 in

December 2012, which is below the December 2011 figure of 713. Cumulatively, property transfers from July through December totaled 4,171, which was up 3.4% from the 4,032 transfers during the first six months of 2011-2012. The average days-on-market for single-family and multi-family dwellings totaled 36 days in December 2012, reaching the lowest point since June 2006. Average days-on-market in December 2011 was 84.

On a national level, GDP increased at an annual rate of 3.1% in the third quarter of 2012. This represents growth from the 1.3%² increase seen in the second quarter of 2012-2013, and is 1.8 percentage points higher than the 1.3% rate of growth in the third quarter of 2011. However, according to the “advance” estimate released by the Bureau of Economic Analysis³, GDP decreased by an annual rate of 0.1% in the fourth quarter of 2012. The Bureau emphasized that the fourth quarter advance estimate is based on source data that is incomplete or subject to further revision. The “second” estimate for the fourth quarter 2012, based on more complete data, will be released on February 28, 2013. The decrease, which was the first drop since the second quarter of 2009, primarily reflected negative contributions from private inventory investment, federal government spending, and exports, partly offset by positive contributions from personal consumption expenditures (PCE), nonresidential fixed investment, and residential fixed investment.

The leading Consumer Confidence indicator reflects uncertainty about the country’s economic future, in light of the congressional battles surrounding the “fiscal cliff” that would have resulted in the expiration of previously enacted tax cuts and still looming mandatory spending cuts of approximately \$600 billion split between defense and non-defense discretionary spending (about 4% of the economy). The Conference Board Consumer Confidence Index declined 6.4 points, from 71.5 in November to 65.1 in December⁴. According to Lynn Franco, Director of Economic Indicators at The Conference Board, “Consumers’ expectations retreated sharply in December resulting in a decline in the overall Index. The sudden turnaround of expectations was most likely caused by uncertainty surrounding the oncoming fiscal cliff. A similar decline in expectations was experienced in August of 2011 during the debt ceiling discussions. While consumers are negative about the short-term outlook, they are more upbeat than last month about current business and labor market conditions.” According to the Conference Board, consumers remain in austerity mode in early January, remaining “cautious about spending on big ticket items, especially if that entails borrowing”.⁵

While Congress has enacted a bill that kept the majority of tax cuts in place for the time being and pushed the automatic spending cuts out until March, Congress will have to negotiate a more permanent agreement on spending levels and taxation to address the Federal deficit. It is likely that some measure of austerity will arise from the upcoming negotiations in Congress, and would likely slow the economy. However, as the December 2012 UCLA Anderson Forecast suggests, a deal that reduces spending and increases taxes in a phased manner over the next few years would allow the economy to continue to grow at a modest pace.

² Bureau of Economic Analysis, U.S. Department of Commerce, News Release: Gross Domestic Product, December 20, 2012.

³ Bureau of Economic Analysis, U.S. Department of Commerce, News Release: Gross Domestic Product, January 30, 2013.

⁴ The Conference Board, News Release, December 27, 2012.

⁵ The Conference Board, Press Release/News, January 14, 2013.

Economic conditions will continue to be closely monitored and factored into the 2014-2018 General Fund Forecast, scheduled to be released February 28, 2013, and the upcoming releases of both the Proposed Capital and Operating Budgets, scheduled to be released on April 22, 2013 and May 1, 2013, respectively.

GENERAL FUND PERFORMANCE

General Fund revenues and transfers through December totaled \$397 million, or 42.6% of the budgeted estimate. Overall, existing revenues are generally performing within budgeted expectations and are projected to end the year with approximately \$7.5 million to \$10 million in additional revenues. This positive variance represents approximately 1% of the budget. Additional revenue is also expected to be generated from the one-time payment from the County associated with the recalculation of Property Tax Administration Fees (\$6.9 million) as well as various net-zero grants and reimbursements. Higher than budgeted collections are expected in a number of categories, including: Sales Tax, Transient Occupancy Tax, Business Taxes, and Revenue from the State. The higher collections in these categories are expected to be partially offset by lower collections in a few categories, including Utility Taxes and Fines, Forfeitures and Penalties.

In this document, an overall net downward adjustment of \$8.8 million to the total General Fund revenue estimate is recommended. This decrease primarily reflects a \$25.0 million reduction in the anticipated revenue from the TRANs (and associated expenditures) based on the actual debt issuance required for City cash flow purposes this year. Excluding this action, net upward adjustments total \$16.2 million and reflect higher projected collections (\$14.3 million) as well as various net-zero grants, reimbursements, and fee adjustments (\$1.9 million). Major revenue-related items include the establishment of the 2012-2013 Ending Fund Balance Reserve (\$7.6 million of excess revenue applied towards a \$12 million reserve) and an increase to the 2013-2014 Future Deficit Reserve (\$6.9 million) funded by a one-time payment from the County based on the recalculation of prior year Property Tax Administration Fees. The revenue estimates for this year will continue to be updated and refined as part of the upcoming forecast and proposed budget process and will be reported through the release of the Bi-Monthly Financial Reports. General Fund expenditures through December totaled \$383.1 million, or 34.2% of the budget, and were 2.3% above the December 2011 level of \$374.6 million. Encumbrances totaling \$36.2 million were \$556,000 (1.6%) above the December 2011 level of \$35.6 million. Expenditures and encumbrances through December of \$419.3 million constituted 41.4% of the total 2012-2013 modified budget amount (excluding reserves) of \$1 billion. Overall, expenditures are tracking within anticipated levels and are expected to generate savings by year-end. Budget actions are recommended in this document to set aside \$4.4 million of those savings into a 2012-2013 Ending Fund Balance Reserve.

There are a limited number of budget adjustments recommended to address potential overages that may occur by year-end and address urgent fiscal or program needs. Other technical/rebalancing actions, clean-up actions, and net-zero grants, reimbursements, and fee adjustments are also recommended in this document. A summary of these transactions is provided below and a more detailed discussion of both the General Fund revenue and expenditure performance is provided in Section I of this document.

RECOMMENDED GENERAL FUND BUDGET ADJUSTMENTS

The budget actions recommended in the Mid-Year Budget Review result in a net reduction of \$8.8 million to General Fund revenues and expenditures. The recommended Mid-Year Budget Review actions accomplish the following: 1) funds some urgent fiscal or program needs 2) implements required technical/rebalancing adjustments; 3) recognizes various revenue-supported grants, reimbursements, and fee adjustments; and 4) implements clean-up actions.

The following chart summarizes these recommended adjustments.

**2012-2013 MID-YEAR BUDGET REVIEW
 RECOMMENDED GENERAL FUND BUDGET ACTIONS**

BUDGET CATEGORY	(\$ in Millions)
Urgent Fiscal/Program Needs	
2013-2014 Future Deficit Reserve/Revenue from Local Agencies	\$ 6.900
Net-Zero Funding Shifts in Police Department	0.000
Total Urgent Fiscal/Program Needs	\$ 6.900
Required Technical/Rebalancing Actions	
TRANS Debt Service/TRANS Proceeds	(\$25.000)
2012-2013 Ending Fund Balance Reserve/Partially Funded by Additional Revenue (\$7.643 M)	12.000
- Expenditure Savings to Support Ending Fund Balance Reserve	(4.357)
Other Net Adjustments	(0.105)
Total Required Technical/Rebalancing Actions	(\$17.462)
Grants/Reimbursements/Fees	
Various Net-Zero Grants/Reimbursements/Fee Adjustments	\$1.918
Clean-Up Adjustments	
Voluntary Furlough/Reduced Work Week Program	(\$0.122)
Net-Zero Adjustments	0.000
Total Clean-Up Adjustments	(\$0.122)
TOTAL GENERAL FUND ADJUSTMENTS	(\$8.766)

Following is a brief description of the General Fund revenue and expenditure adjustments recommended in this report. Additional information on these adjustments is provided in Section III, Recommended Budget Adjustments and Clean-Up Actions, of this document.

URGENT FISCAL/PROGRAM NEEDS

- **2013-2014 Future Deficit Reserve/Revenue from Local Agencies (\$6.9 million):** An increase to the Revenue from Local Agencies estimate is recommended to recognize a one-time payment from the County of Santa Clara for the recalculation of prior year Property Tax Administration Fees (PTAF). The City of Alhambra et al. had successfully sued the County of Los Angeles regarding the calculation of these fees. The cities argued that the SB 1096

Triple Flip and Motor Vehicle License Fee revenues, which are now incorporated into Property Tax, should be excluded from the calculation of SB 2557 PTAF. The Supreme Court of California denied a rehearing of the City of Alhambra et al. v. County of Los Angeles, therefore upholding the prior ruling on the recalculation of these fees. On January 25, 2013, the County notified the City that it was prepared to remit the disputed PTAF. The City's additional PTAF for the affected years from 2004-2005 through 2011-2012 totaled \$6.9 million, \$6.7 million in PTAF adjustments and earned interest of \$223,000. This revenue is recommended to be allocated to the 2013-2014 Future Deficit Reserve, increasing the Reserve from \$22.5 million to \$29.4 million. This funding will be available for allocation as needed as part of the upcoming 2013-2014 budget process.

- **Net-Zero Funding Shifts in Police Department (\$0):** The following net-zero shifts in Police Department funding are recommended:
 - *Police Department Overtime Reserve (\$4.0 million)/Police Department Personal Services (-\$4.0 million)* – Establishes a \$4.0 million Police Department Overtime Reserve for 2013-2014 that would be funded by Police Department Personal Services savings of \$4.0 million generated from Police Department vacancies in 2012-2013. The Department is anticipated to begin 2013-2014 with at least 80 sworn vacancies based on current hiring and attrition rates. It is anticipated that additional overtime funding will be needed in 2013-2014 to continue backfilling for vacant patrol positions and maintain targeted enforcement of high crime activity through suppression cars. The funding will also be available for additional civilian staffing as needed.
 - *Police Department Funding Reallocations* – Reallocates additional personal services savings of \$500,000 to overtime to allow the Department to perform additional enforcement and targeted investigations as needed during the second half of 2012-2013. In addition, several actions in this report reallocate \$487,000 in vehicle maintenance and operations savings within the Police Department's Non-Personal/Equipment appropriation. Due to the number of sworn vacancies in the Department, fewer patrol cars are being driven, resulting in lower vehicle maintenance and operations costs. These savings are recommended to be reallocated to the following needs: contract with the South Bay Public Safety Consortium for the April 2013 academy (\$212,000); recruitment efforts (\$200,000); and scheduled 12-year major maintenance inspection for the Police helicopter (\$75,000).

REQUIRED TECHNICAL/REBALANCING ACTIONS

- **TRANS Debt Service/Other Revenue (-\$25.0 million)** – This transaction lowers the TRANS Debt Service appropriation and the associated TRANS proceeds revenue estimate due to a lower than estimated issuance of TRANS for 2012-2013. These notes are used to pre-fund City contributions to the Retirement System, as described in a memorandum to the City Council on June 1, 2012, because sufficient cash is not available on the pre-payment date. Due to the prudent management of the City's cash flows, it was possible to issue only \$100.0 million in TRANS, rather than the full \$125.0 available through the City's agreement with the notes purchaser.

- **2012-2013 Ending Fund Balance Reserve (\$12.0 million):** This Reserve would be funded from excess revenues (\$7.6 million) and expenditure savings (\$4.4 million). In the 2013-2017 Five-Year Forecast issued in February 2012, it was assumed that \$18.5 million of fund balance generated from a combination of excess revenues, expenditure savings, and the liquidation of prior year carryover encumbrances would be available at the end of 2012-2013 as a funding source in 2013-2014. Assuming \$2.5 million will be generated from the liquidation of prior year carryover encumbrances, a total of \$16.0 million from excess revenues and expenditure savings is necessary to meet the prior Forecast estimate. The recommended actions in this document would set aside \$12.0 million of the \$16.0 million, or 75% of the required amount based on information through December. The remaining \$4.0 million needed for the ending fund balance will be determined and recommended as part of the year-end clean-ups memorandum that will be brought forward for consideration in June 2013. Following is a description of the excess revenues and expenditure savings that would generate this additional fund balance:

Increase in Revenues to Support Ending Fund Balance Reserve (\$7.643 million):

- *Sales Tax* (\$5.45 million) based on higher first quarter performance and assumption of 3% growth over actual 2011-2012 collections for the remaining three quarters.
- *Transient Occupancy Tax* (\$1.0 million) based on current collection trends.
- *Business Taxes* (\$668,000) to reflect higher collections in the Disposal Facility Tax; an additional increase to this category is recommended elsewhere for rebalancing needs described elsewhere in this document.
- *Revenue from the State* (\$525,000) to recognize a payment from the State for the Vehicle License Fees Collection in Excess.

Reduction in Expenditures to Support Ending Fund Balance Reserve (\$4.357 million):

- *Departmental Savings* (-\$2.25 million) – Based on recent information regarding vacancy savings, decreases to the Parks, Recreation and Neighborhood Services Department Personal Services (\$900,000), Information Technology Department Personal Services (\$550,000), City Manager’s Office Personal Services (\$500,000), and Planning, Building and Code Enforcement Department Personal Services (\$300,000) allocations are recommended.
- *City-Wide Expenses Savings* (-\$1.70 million) – A decrease to the Property Tax Administration Fee appropriation to reflect a revised calculation methodology for SB 2557 Property Tax Administration Fees (\$1.5 million) is recommended. In addition, a reduction to the TRANs (Tax Revenue Anticipation Notes) Debt Service appropriation (\$200,000) is recommended to account for savings in the interest charges associated with the debt issuance required for City cash flow purposes.
- *Reserve Savings* (-\$407,000) – A decrease to the Salary and Benefits Reserve to reflect the savings associated with a lower than budgeted health rate increase (9.2% actual increase compared to 11% budgeted increase in the Benefits Program).

- **Other Net Adjustments (-\$105,000)** – A number of adjustments to various revenue and expenditure line items are recommended to bring the budget in line with current projections. Major recommendations include the following:
 - *Decrease Fines and Forfeitures* revenue estimate (-\$1.25 million) due to lower than expected Parking Fine revenue as a result of a decline in the number of parking citations issued in the current year. This downward adjustment to the revenue estimate would be partially offset by a reduction to the *Parking Citations/Jail Courthouse Fees City-Wide Expenses* appropriation (-\$400,000) to reflect the lower activity level.
 - *Decrease Utility Tax* revenue estimate (-\$882,000) to reflect lower collections levels in Gas (-\$1.0 million), Electricity (-\$500,000), and Telephone (-\$382,000) Utility Taxes, partially offset by higher collection in Water (\$1.0 million) Utility Tax.
 - *Increase Transfers and Reimbursements* revenue estimate (up \$914,000) to reflect a higher transfer from the Parks Construction and Conveyance Tax Funds for Parks Operating and Maintenance Costs (\$880,000); an additional transfer from the Community Facilities Revenue Fund (\$26,000); and a transfer from the Public Works Program Support Fund for a portion of the final payment for the City's Standard Plans and Specifications long-term loan (\$8,000).
 - *Increase Business Taxes* revenue estimate (\$882,000) to reflect higher collections in the Cardroom Tax (\$750,000), the Marijuana Business Tax (\$100,000), and the Disposal Facility Tax (\$32,000).
 - *Increase Licenses and Permits* (\$63,000) and *Departmental Charges* (\$46,000) revenue estimates to reflect the overhead reimbursement from the addition of Building Development Fee Program positions (\$51,000), Fire Fee Program positions (\$12,000); and Public Works Fee Program positions (\$46,000) as approved by the City Council on January 29, 2013.
 - *Decrease the Salary and Benefits Reserve* (-\$1.1 million) to reflect the elimination of the Benefits Program funding that had been set aside to cover projected health rate increases effective January 2013. This represents the funding that is not necessary to be distributed to departments due to sufficient vacancy savings within the departments. The portion of the Benefits Program that is needed to cover increased health costs in departments is shown below under the Clean-Up Actions.
 - *Increase the Workers' Compensation Claims Payments – Fire Department* (\$1.0 million) based on current expenditure trends. An increase in the number of claims and a spike in the severity of injuries requiring surgery, hospital stays, and prescription drugs have resulted in higher than budgeted expenditures through December.
 - *Increase the Wellness Program Reserve* (\$220,000) to reconcile revenues and expenditures in the Wellness Program for 2011-2012 that were inadvertently not included in the 2011-2012 Annual Report.
 - *Increase the Workers' Compensation State License* (\$142,000) due to implementation of SB863 that increased the permanent disability rates effective January 1, 2013 and requires a greater claims oversight by the State. A 7% increase in costs was assumed for 2012-2013, but the actual increase for this license was 34%.

- *Net-Zero Technical Adjustments* (\$0) are recommended to align the budget with actual expenditure patterns and would fund the following: Finance Department temporary staffing (shift \$400,000 from Personal Services to Non-Personal/Equipment); Human Resources Department senior staff recruitments (shift \$50,000 from Personal Services to Non-Personal/Equipment), Workers' Compensation Claims Payments for the Department of Transportation (shift \$50,000 from Workers' Compensation Claims Payments for the Public Works Department), and City Clerk recruitment (shift \$20,000 from Personal Services to Non-Personal/Equipment).

GRANTS/REIMBURSEMENTS/FEES

- A series of revenue-supported adjustments totaling \$1.9 million are recommended to reflect new or updated revenues and expenditures for grants, reimbursements and/or fee activities. The largest grants and reimbursements support the following: California Gang Reduction, Intervention and Prevention (\$426,000); Parks, Recreation, and Neighborhood Services Fee Activity (\$424,000); the Maddie Lifesaving Program (\$370,000); the Fire Department State Homeland Security Program (\$149,000); the Anti-Drug Abuse Program for 2012-2013 (\$102,000); and the Police Department Urban Area Security Initiative for 2010 (\$100,000). A complete listing of these actions can be found in Section III of this document.

CLEAN-UP ACTIONS

- *Voluntary Furlough/Reduced Work Week Program (-\$122,000)* – Actions are recommended to reduce departmental budgets by a total of \$222,000 to reflect the actual results of the implementation of the Voluntary Furlough/Reduced Work Week Program. A portion of this funding (\$100,000) is recommended to be allocated to the Salary and Benefits Reserve, which was originally used to capture the estimated savings from this program in 2012-2013. The remaining savings is recommended to offset other rebalancing needs as described elsewhere in this document.
- *Net-Zero Adjustments (\$0):* To implement a variety of clean-up actions, a number of net-zero adjustments are recommended, including the following:
 - *Benefits Program* – Increases to various departmental budgets totaling \$499,000 are recommended to fund the 9.2% health rate increase effective January 1, 2013. These increases are recommended to be offset by a reduction to the Salary and Benefits Reserve.
 - *Reallocation of City-Wide Expenses and Revenues* – The shift of two grants to the appropriate appropriation is recommended as well as the shift of two revenue estimates between revenue categories to more appropriately account for those revenues is recommended.

STATUS OF SELECTED SPECIAL AND CAPITAL FUNDS

A comprehensive review of the special and capital funds as well as all of the capital projects is conducted as part of the Mid-Year Budget Review. On an overall basis, revenues and expenditures in the special and capital funds are tracking within estimated levels through

December. Section II of this report contains the status of selected special and capital funds with issues of interest or variances.

Special Funds

Following is a summary of activity in selected special funds through December.

- ***Airport Funds*** – Through December, the Norman Y. Mineta San José International Airport has enplaned and deplaned 4.3 million passengers, an increase of 0.9% from the figures reported through December of the prior year. When the 2012-2013 budget was developed, flat passenger activity was forecasted. Overall, operating revenues through December 2012 totaled \$55.7 million, or 48.2% of the budget, compared to a benchmark of 48.1%. While passenger activity and operating revenues are on target with estimated levels, expenditures (excluding encumbrances) are tracking below budgeted estimates at 36.0%, or \$22.9 million. While the Airport continues to face a challenging environment, strategies to improve operating efficiencies, contain costs, and achieve sustainability continue. Air service development, retention of existing capacity, and growth in destinations, carriers, flights, and passenger levels remain high priorities and the key to long-term success. Through a separate memo that was approved by City Council on January 29, 2013, limited staffing additions to the Operations Division and the creation of a Business Development Division were approved as part of ongoing efforts to remain cost-competitive while enhancing revenue-generating, safety and security, and customer service activities.
- ***Transient Occupancy Tax Fund*** – Revenues in the Transient Occupancy Tax (TOT) Fund are tracking above estimated levels and are anticipated to end the year above the budgeted level. The 2012-2013 Modified Budget assumed a 5.0% increase from 2011-2012 revenues. Through December 2012, year-to-date Transient Occupancy Tax receipts of \$5.4 million are 16.7% above December 2011 receipts. As a result of the higher than anticipated revenue collections, an increase to the budgeted revenue estimate of \$1.5 million (from \$13.7 million to \$15.2 million) is recommended as part of this report, representing an increase of 12.8% from 2011-2012 collection levels. This \$1.5 million of additional revenue is further recommended to be placed into a reserve for future distribution in 2013-2014 as follows: \$750,000 to the Convention and Cultural Affairs Fund for operation of convention facilities, \$375,000 for the Convention and Visitors Bureau, and \$375,000 for Cultural Development. Placing the additional funding in reserve, rather than increasing the 2012-2013 recipient appropriations, will allow for further monitoring of the tax collections to ensure all funding is received as projected by year-end.

The increase in TOT receipts is due to increased hotel usage and room rates at major hotels. Through December, the average hotel occupancy rate at the City's 14 major hotels was 64.4%, up from 57.9% for the same period last year, while room rates have increased from \$121.99 to \$134.34 (10.1%). As of December, the trailing 12-month average revenue-per-available-room (RevPAR) increased to \$87.56, a 23.7% increase from the \$70.76 level experienced in December 2011.

- ***Convention and Cultural Facilities Fund*** – Operating revenues in this fund are tracking well above anticipated levels and are projected to end the year higher than the budgeted

revenue estimate. The increase is primarily due to increased activity that is driving contract labor and food and beverage revenues, which also have corresponding expenditures. As a result, a revenue increase of \$6.3 million is recommended along with a corresponding operating expenditure increase of \$5.1 million.

Other modifications to this fund include recognizing \$1.2 million in revenue from the City National Bank for naming rights to the Civic Auditorium and Center for the Performing Arts, of which \$870,000 will be directed to capital improvements at the auditorium and \$330,000 will be paid to Front Row and Nederlander as an incentive fee for brokering the naming rights agreement; an increase of \$500,000 for needed miscellaneous capital improvements; establishing a \$150,000 appropriation for Public Works staff to manage a Request for Proposal (RFP) process to select vendors for build-out of a coffee concessions location on the outside and a business center on the inside of the Convention Center; and eliminating the \$200,000 Team San Jose incentive fee for not meeting all performance targets.

- ***Municipal Golf Course Fund*** – Through December, revenues in the Municipal Golf Course Fund are tracking close to budgeted estimates. Year-to-date revenues of \$260,000 from the San José Municipal Golf Course, which are based on a fixed percentage of gross sales, are expected to meet the budgeted estimate of \$444,000. For the Rancho del Pueblo and Los Lagos Golf Courses, only the net profits received on a monthly basis from the operation of the courses are paid into the Municipal Golf Course Fund. Based on estimated activity levels, no net profits are assumed in the 2012-2013 Adopted Budget from Rancho del Pueblo. For the Los Lagos Golf Course, revenues are projected to end the year slightly below the budgeted estimate of \$110,000 due to a drop in activity experienced in the second quarter of 2012-2013.

During the first three months of 2012-2013, activity levels at Rancho del Pueblo and Los Lagos were slightly above the same period a year ago. However, from October through December, activity levels at these courses decreased significantly primarily due to inclement weather and a colder fall. Specifically, rounds of golf played through December 2012 decreased by 11.1% at Los Lagos and by 8.7% at Rancho del Pueblo. As a result, the year-end revenue projection for Los Lagos is estimated to end the year \$25,000, or 22.7%, below the budgeted estimate of \$110,000. Additionally, the Los Lagos Golf Course expenditure appropriation of \$115,000, established to cover months when costs outpace revenues, is tracking to end the year at \$230,000, or \$115,000 above the budgeted estimate. Therefore, an adjustment to increase the Los Lagos Golf Course appropriation is recommended in this report. Staff continues to work with the operators to identify and implement expenditure reduction strategies at the courses.

Capital Funds

Following is a discussion of the major construction-related revenues that support the capital program and the major capital program expenditure revisions recommended in this document.

Construction Related Revenues

Through December, construction activity has continued to experience strong growth. Compared to last year, overall construction activity valuation increased by 23%. Growth has been experienced in the residential and industrial sectors, which saw respective increases of 29% and 81%, but is partially offset by a commercial sector decline of 21%. The total number of new residential units through December 2012 was 1,519 compared to 996 units through December 2011. Much of the residential growth stems from construction of new multi-family residential housing in North San José, while industrial activity has been helped by both increased alterations (e.g. remodeling or retrofitting) and new construction, including two new parking garages for Cisco Systems. As a result of this private sector development, this report recommends recognizing North San José and Evergreen Traffic Impact fees in the amount of \$3.0 million and \$1.2 million, respectively. Further, construction activities drive capital program revenue collections in several other categories, including the Building and Structure Construction Tax, the Construction Excise Tax, and the Residential Construction Tax, and are an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.

A discussion of the performance for Building and Structure Construction Tax and Construction Excise Tax, the two largest construction-related revenue sources is included below.

- ***Building and Structures Construction Tax*** – Compared to last year, tax receipts of \$6.3 million are up 16%; however, the Adopted Budget allowed for a decline of 21%, as prior year collections saw unusually strong gains later in the year related to new multi-family residential construction and higher commercial and industrial alteration activity. Strong residential and industrial activity in 2012-2013 has thus far sustained the previous year's surge, offset by relatively weaker commercial activity. Though revenues are on pace to slightly exceed the budget estimate of \$10.0 million (by \$1.0 to \$2.0 million), no budget action is recommended at this time. Staff will continue to monitor revenue performance, and year-end revenue estimates will be revised as appropriate with the release of the 2014-2018 Five-Year Forecast and Revenue Projections.
- ***Construction Excise Tax*** – Compared to last year, tax receipts of \$7.8 million are up 2%; however, the budgeted estimate for this tax allowed for a 28% decline from 2011-2012, as prior year collections saw unusually strong gains later in the year related to new multi-family residential construction. Residential construction activity in 2012-2013 has sustained the previous year's surge, but growth is tempered by a decline in commercial-related construction. Though revenues are on pace to slightly exceed budget estimate of \$13.0 million (by \$1.0 to 2.0 million), no budget action is recommended at this time. As with the Building and Structures Construction Tax, staff will continue to monitor collections and revise year-end estimates as appropriate with the release of the 2014-2018 Five-Year Forecast and Revenue Projections.

Construction and Conveyance Taxes

Following a slightly improved year in 2011-2012, Construction and Conveyance (C&C) Tax receipts have experienced very strong growth in 2012-2013. Receipts through December 2012 totaled \$12.4 million, an increase of 41% from the \$8.8 million collected during the same period last year. In addition, the City has received notification from the County of Santa Clara stating January receipts of \$6.7 million, an unprecedented amount for a single month. This high collection level is likely due to the timing of tax receipt processing, and not an indicator that revenues will continue at this significantly higher collection level. Nevertheless, the real estate market is showing clear signs of improvement.

Nearly 99% of the total C&C Taxes are comprised of conveyance receipts, a tax based on the value of property transfers. The December 2012 median single-family home price of \$584,500 reflects an increase of 23.2% from the December 2011 price of \$474,500. In addition, it is taking less time to sell these homes, as the average days-on-market for single-family and multi-family dwellings totaled 36 days in December 2012, which is a significant drop (57.1%) from the 84 days experienced in December 2011. The new single-family and multi-family dwellings listed on the market has dropped approximately 33.3% from the 583 listings in December 2011 to 389 in December 2012. Likely as a result of the lower level of inventory, the property transfers (sales) for all types of residences dropped approximately 5.3% from 713 in December 2011 to 675 in December 2012. Cumulatively, property transfers from July through December totaled 4,171, which was up 3.4% from the 4,032 transfers during the first six months of 2011-2012.

As a result of the improved collection levels, a recommendation is included in this report to increase the 2012-2013 C&C Tax estimate by \$9.0 million, from \$21.0 million to \$30.0 million. Per the C&C Tax distribution formula, corresponding increases to the various capital funds that receive an allocation of C&C revenue are also recommended, including Parks C&C Tax (\$5.8 million), Library C&C Tax (\$1.3 million), Service Yards C&C Tax (\$790,000), Fire C&C Tax (\$756,000), Communications C&C Tax (\$306,000), and Park Yards C&C Tax (\$108,000). A portion of the increase to the Parks and Park Yards C&C Tax Funds will be transferred to the General Fund (\$880,000) to reflect the transfer of 15% of these revenues to the General Fund for parks maintenance and operations. Further detail regarding these transactions can be found in Section III of this report. With the exception of the Service Yards and Public Safety Capital Programs, the remaining revenue increase is recommended to be added to the ending fund balances within each program for future allocation.

Major Capital Program Expenditure Revisions

A series of recommended Appropriation Ordinance and Funding Sources Resolution amendments to the Adopted Capital Budget are included in Section III of this report. Following is a summary of the most significant adjustments.

- **Traffic Capital Program** - a recommendation is included for turning on approximately 900 streetlights previously turned off as a budget reduction strategy. Generally located along arterial streets, these streetlights will improve street and public safety as well as street appearance, and will be turned on beginning in March at the rate of approximately 225 per month. One-time funds totaling \$44,000 are needed for equipment, materials and overtime to

replace various lamps and fuses. If the recommendation is approved, ongoing electricity costs of \$92,000 will be included in the Department of Transportation's 2013-2014 General Fund Base Budget.

Other Traffic Capital Program budget modifications are recommended to keep projects moving forward that have encountered challenges in project implementation, including increasing funding by \$644,000 for The Alameda: A Plan for the Beautiful Way, which required a partial redesign due to initial bids coming in \$1.5 million higher than the grant amount. This report also includes a recommendation to reduce the budgeted Montague Expressway NSJ County Settlement payment from \$6.0 million to \$4.0 million, and establish a \$2.0 million reserve for next year's payment, and recognition of an additional \$1.8 million in State Gas Tax revenue to establish a State Gas Tax Pavement Maintenance Reserve in the same amount for use in 2013-2014.

- **Service Yard Capital Program** – a recommendation is included to dedicate the increased 2012-2013 C&C revenues of \$790,000 to a new a debt service reserve to offset 2013-2014 General Fund contributions to the debt service payments related to the Central Service Yard Phase I project. In 2012-2013, the General Fund is contributing \$1.3 million of the total \$1.7 million debt service payment. In the 2013-2017 Capital Improvement Program, it is assumed that the General Fund will fund the entire \$1.7 million debt service payment in 2013-2014.
- **Public Safety Capital Program** – a recommendation is included to dedicate the increased 2012-2013 Fire C&C revenues of \$756,000 to establish a fire facilities improvements reserve to fund urgent facility maintenance and repairs. There are many fire stations that are more than 50 years old and are recently showing signs of significant maintenance and repair needs. This reserve will help to ensure that money is available for any critical fire station need that may arise in the near future.

LOOKING FORWARD

The 2014-2018 General Fund Forecast is scheduled to be released on February 28, 2013 and will contain a comprehensive analysis of all revenue and expenditure projections, including the latest information on the City retirement contributions for 2013-2014 and forecasted for the next four years.

In February, a 2013-2014 Budget Planning Study Session will be held and results from the Community Budget Survey will be available. In March, the Mayor's 2013-2014 Budget Message will be released and approved by the City Council in order to provide policy direction for the development of the Proposed Capital and Operating Budgets, which are scheduled to be released on April 22nd and May 1st, respectively.

PUBLIC OUTREACH/INTEREST

- ✓ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.

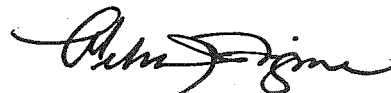
This document is posted on the City's website for the February 12, 2013 Council agenda.

CONCLUSION

Through December, the City's over 100 operating and capital funds are generally performing within expected levels. The 2012-2013 Adopted Budget was built on the assumption that the economic recovery would continue in 2012-2013 with modest growth. Actual collection trends support this assumption with some categories exceeding expectations. The development-related fees and taxes as well as the property-related Construction and Conveyance Taxes are continuing the strong performance that was experienced in 2011-2012.

As part of the Mid-Year Budget Review, budget adjustments are recommended in the General Fund and many special and capital funds to bring projected revenues and expenditures into alignment based on performance through the first half of the fiscal year, to account for updated cost projections, to implement technical adjustments, and to recognize various grants and reimbursements. Major actions in the General Fund include a \$6.9 million increase to the 2013-2014 Future Deficit Reserve (bringing the Reserve total to \$29.4 million) funded by a one-time payment from the County to reflect the recalculation of prior year Property Tax Administration Fees, the establishment of the 2012-2013 Ending Fund Balance Reserve of \$12.0 million funded by excess revenue and expenditure savings, and the establishment of a \$4.0 million Police Overtime Reserve funded from Police personal services savings to ensure that sufficient overtime resources are available to help mitigate the impact of vacancies next year. These recommendations will better position the City for the 2013-2014 budget process.

The adjustments brought forward in this report reflect our best estimate of the financial performance for the City's funds through the end of the fiscal year. The Administration will continue to closely monitor performance and provide status reports on the City's finances through the Bi-Monthly Financial Reports. These reports will highlight any significant developments as well as identify any potential budget actions necessary to ensure the City's funds remain in balance by year-end. Diligent monitoring, continued budgetary discipline, and timely actions will be critical to maintain the City's fiscal health.

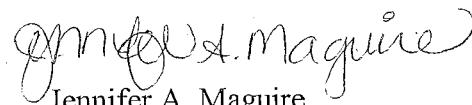


Debra Figone
City Manager

Certification of Funds

I hereby certify that there will be available for appropriation in the designated funds and in the amounts as listed below in fiscal year 2012-2013 monies in excess of those heretofore appropriated therefrom:

Affordable Housing Investment Fund	\$ 300,081
Airport Revenue Fund	2,722,009
Benefit Fund	10,000
Building & Structures Construction Tax Fund	210,000
Community Facilities Revenue Fund	26,000
Construction & Conveyance Tax Fund – Parks Central	5,760,000
Construction & Conveyance Tax Fund – Communications	306,000
Construction & Conveyance Tax Fund – Fire	756,000
Construction & Conveyance Tax Fund – Library	1,280,000
Construction & Conveyance Tax Fund – District 1	386,000
Construction & Conveyance Tax Fund – District 2	258,000
Construction & Conveyance Tax Fund – District 3	224,000
Construction & Conveyance Tax Fund – District 4	322,000
Construction & Conveyance Tax Fund – District 5	391,000
Construction & Conveyance Tax Fund – District 6	488,000
Construction & Conveyance Tax Fund – District 7	372,000
Construction & Conveyance Tax Fund – District 8	318,000
Construction & Conveyance Tax Fund – District 9	334,000
Construction & Conveyance Tax Fund – District 10	171,000
Construction & Conveyance Tax Fund – Park Yards	108,000
Construction & Conveyance Tax Fund – Parks City-Wide	90,000
Construction & Conveyance Tax Fund – Service Yards	790,000
Construction Excise Tax Fund	6,663,892
Convention and Cultural Affairs Fund	7,500,000
Federal Drug Forfeiture Fund	287,434
Gift Trust Fund	97,360
Integrated Waste Management Fund	880,530
Multi-Source Housing Fund	5
Sewer Service & Use Charge Capital Fund	73,577
Storm Sewer Capital Fund	444,872
Subdivision Park Trust Fund	938,000
Transient Occupancy Tax Fund	1,500,000
Water Utility Fund	304,255


Jennifer A. Maguire
Budget Director