

2010-2011

**ANNUAL
REPORT**

LETTER OF TRANSMITTAL

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: 2010-2011 ANNUAL REPORT

DATE: September 30, 2011

RECOMMENDATIONS

It is recommended that the City Council:

1. Accept the 2010-2011 City Manager's Annual Report of the Finances of the City of San José in compliance with City Charter Section 701 (F);
2. Adopt Appropriation Ordinance and Funding Sources Resolution amendments in various operating and capital funds to implement the 2010-2011 Annual Report recommendations, including appropriate technical adjustments, as detailed in Section IV (Recommended Budget Adjustments and Clean-Up Actions);
3. Adopt a resolution accepting the 2011 COPS Hiring Program Grant in the amount of \$1,703,664, adding 3.0 Police Officer positions in the Police Department, and authorizing the City Manager and Chief of Police to execute the Grant Agreement and all related documents; and
4. Authorize the City Manager and Chief of Police to negotiate and execute additional amendments to the grant without further City Council action.

OUTCOME

In accordance with Section 701(F) of the San José City Charter, the 2010-2011 Annual Report describes the financial status of the City at the end of the 2010-2011 fiscal year. As specified in the City Charter, the focus of the City Manager's Annual Report is a comparison of actual revenue collections and expenditures to projections included in the City's budget. This will provide the City Council with the information necessary to review the financial performance of all City funds. In addition, this report provides a comparison of the actual 2010-2011 Ending Fund Balance for each fund to the estimate used in the development of the 2011-2012 Adopted Budget as well as information on the status of the City's year-end reserves by fund.

Approval of the recommended budget actions will implement fund balance reconciliations as well as rebudget and clean-up adjustments necessary based on final 2010-2011 performance. In addition, revisions to the 2011-2012 budget are recommended to align budgeted revenue and expenditures with the most current information, correct technical problems and implement reconciliation adjustments, recognize new or adjust existing grant, reimbursement or fee activity revenues and expenditures, reflect changes in project and program allocations based on revised cost estimates, and establish a limited number of new projects. Actions are also recommended to accept the 2011 COPS Hiring Program grant and authorize the addition of three Police Officer positions.

EXECUTIVE SUMMARY

The Administration proactively managed the City’s many funds in 2010-2011. Through this careful management, the various City funds generally ended the year with revenues close to the budgeted estimates and expenditures below the budgeted allocations. A moderate level of budget adjustments was required during the year to maintain this balance.

While the 2010-2011 budget performance was generally within estimated levels, the starting point for 2010-2011 was extremely challenging. Representing the ninth consecutive year of shortfalls, the 2010-2011 Adopted Budget addressed a General Fund deficit of \$118.5 million, resulting in significant service reductions across the organization. The slow pace of the economic recovery was not expected to result in revenue growth that would keep pace with the City’s increasing costs. Actual performance was consistent with this assumption.

In the General Fund, revenues ended the year close to budgeted expectations and expenditures ended the year with slight savings. As displayed in the chart below, there was \$16.3 million in additional General Fund 2010-2011 Ending Fund Balance/2011-2012 Beginning Fund Balance above the level assumed in the development of the 2011-2012 Budget. These funds, as well as additional funds generated from the reconciliation of 2011-2012 retirement and unemployment costs are recommended to be allocated in the Annual Report as shown below.

Proposed 2011-2012 General Fund Adjustments (\$000s)

Additional 2010-2011 Ending Fund Balance	\$ 16,263
Clean-Up Actions	
Changes to Development Fee Program Reserves	(3,764)
Rebudgets/Clean-Up Adjustments	(4,378)
Sub-total Clean-Up Actions	\$ (8,142)
Fund Balance Available After Clean-up Actions	\$ 8,121
Recommended Budget Adjustments	
Required Technical/Rebalancing Actions	4,561
Urgent Fiscal/Program Needs	(1,065)
Sub-total Recommended Budget Adjustments	\$ 3,496
Remaining Balance After Clean-ups/Recommended Adjustments	\$ 11,617
2012-2013 Future Deficit Reserve	\$ (11,617)

Approximately half of the additional fund balance (\$8.1 million) is recommended to be allocated back to the development fee programs, reconcile other reimbursement-related expenditures, or to adjust rebudget amounts that were carried over to 2011-2012 to complete projects. After adjusting for those clean-up actions, the additional General Fund 2010-2011 Ending Fund Balance/2011-2012 Beginning Fund Balance was within \$8.1 million, or 0.4%, of the 2010-2011 Modified Budget (sources and uses). The remaining General Fund balance of \$8.1 million, combined with additional net funding from various technical and rebalancing actions (\$4.6 million), offset by a small number of urgent fiscal and program needs (\$1.1 million) will allow for a 2012-2013 Future Deficit Reserve of \$11.6 million to be established as directed in the Mayor’s June Budget Message for 2011-2012 and approved by the City Council. This 2012-

2013 Future Deficit Reserve will partially address the large General Fund shortfall projected for 2012-2013 (currently estimated between \$78 and \$115 million).

While the City ended the year as expected and a small additional fund balance accumulated in the General Fund and most City funds, the fiscal challenges faced over the last decade are expected to continue over the next several years. The City will have to remain diligent to ensure the revenues and expenditures within all funds remain in alignment.

As we move forward in 2011-2012, the Administration will continue to monitor and report on the City's financial performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2010-2011 will also be factored into the development of the 2013-2017 General Fund Forecast that will be released in February 2012. The preliminary 2012-2013 General Fund Forecast is expected to be released in early November 2011.

BACKGROUND

Each year the City issues the Annual Report at the end of September, three months after the close of the fiscal year, as required by the City Charter. The Annual Report document has been revised this year to provide additional context on the combined performance of all funds and to streamline the discussion of significant expenditure and revenue variances by fund.

Following is a description of the various sections of the Annual Report document.

- **Transmittal Memorandum** – This section provides an overall summary of the 2010-2011 Annual Report.
- **Section I: Financial Performance Summary (All Funds)** – This section of the Annual Report provides a comparison of 2010-2011 budget to actual revenues and expenditures by fund as well as a discussion of expenditure and/or revenue variances of 5% or greater to the budget. In addition, this section provides a comparison of the year-end actual 2010-2011 Ending Fund Balance by fund to the 2010-2011 Ending Fund Balance/2011-2012 Beginning Fund Balance estimate used in the development of the 2011-2012 Adopted Budget. This section also includes a listing of the Earmarked and Contingency Reserves that were available at the end of 2010-2011 by fund.
- **Section II: General Fund Budget Performance** – This section provides a summary of the General Fund performance in 2010-2011, including the following: General Fund Year-End Performance; Revenue Performance; and Expenditure Performance.
- **Section III: Selected Special/Capital Funds Financial Performance** – This section provides financial information on the 2010-2011 year-end performance for selected special and capital funds that represent major City operations. It includes a discussion of variances between actual and budgeted revenues and expenditures as well as a comparison between the actual ending fund balance and the fund balance estimated for 2010-2011 in the development of the 2011-2012 Adopted Budget.

- **Section IV: Recommended Budget Adjustments and Clean-Up Actions** – This section provides a description of the recommended budget adjustments and clean-up actions. The proposed actions generally fall into three categories: (1) adjustments to the 2011-2012 Beginning Fund Balance amounts in various funds, including the General Fund, based on the final reconciliation of 2010-2011; (2) upward and downward adjustments to the rebudget figures to ensure the appropriate amount of unexpended funds are carried over to 2011-2012 to complete projects; and (3) actions based on more recent information that are necessary to revise the 2011-2012 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, implement reconciliation adjustments, recognize new or adjust grant, reimbursement or fee activity revenues and expenditures, reflect changes in project and program allocations based on revised cost estimates, and establish a limited number of new projects in special and capital funds.
- **Section V: Financial Statements** – This section provides the financial results (unaudited), prepared by the Finance Department, for all budgeted fund groups for 2010-2011.

ANALYSIS

This Analysis section includes the following:

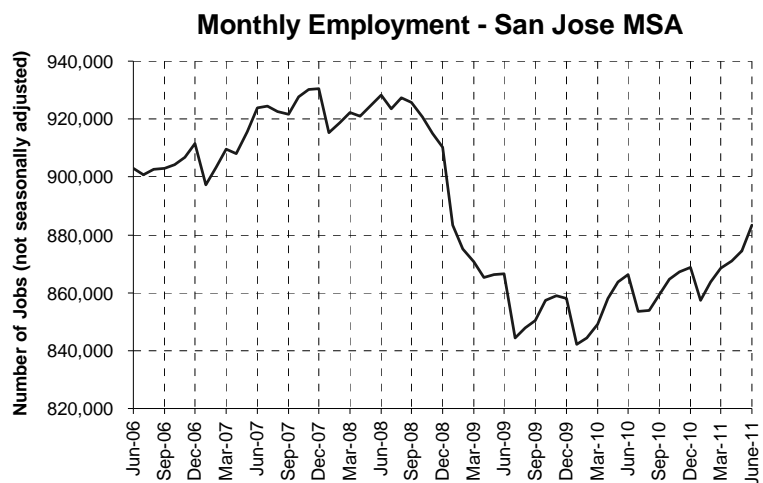
- an overview of the economic environment;
- a discussion of the 2010-2011 budget performance of all City funds;
- a discussion of the 2010-2011 General Fund budget performance;
- a discussion of the components of the 2010-2011 General Fund ending fund balance;
- an analysis of the impact of the 2010-2011 General Fund budget performance on the 2011-2012 Adopted Budget; and
- a discussion of the budget performance of selected special and capital funds.

Economic Environment

When the 2010-2011 budget was developed, it was assumed the economy would continue its slow recovery and not dip back into a recession. Actual performance in 2010-2011 is consistent with this general assumption. In fiscal year 2010-2011, the Gross Domestic Product (GDP) increased in each of the four quarters, with stronger increases in the first two quarters (2.5% and 2.3%, seasonally adjusted) followed by increases of 0.4% in the third quarter and 1.3% in the fourth quarter.

The June 2011 employment level in the San José Metropolitan Statistical Area (MSA) of 883,400 was 2.0% above the June 2010 employment level of 866,300. While this employment level was still well below the recent peak of 930,500 jobs experienced in December 2007, it reflects modest improvement from the prior year and the January 2010 low of 839,300.

The San José metropolitan area continued to experienced double-digit unemployment, with the June 2011 unemployment rate of 10.4%. The June 2011 figure has, however, has



Unemployment Rate (Unadjusted)

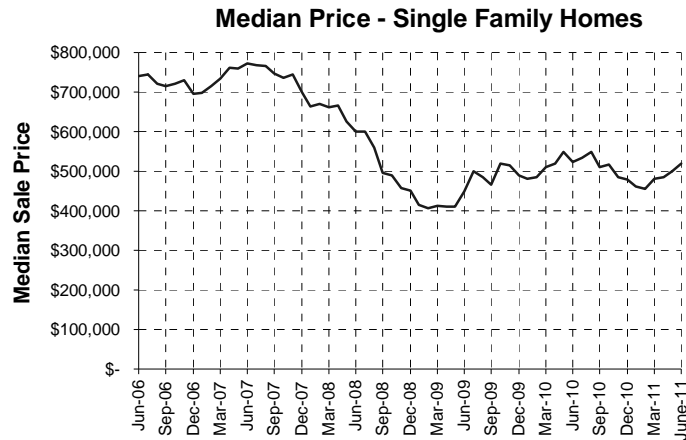
	June 2009	June 2010	June 2011
San José Metropolitan Statistical Area	11.9%	11.4%	10.4%
State of California	11.6%	12.2%	11.4%
United States	9.7%	9.6%	9.3%

Source: California Employment Development Department

shown improvement from the 11.4% experienced in June 2010. The unemployment rate in this region remains less than the unadjusted unemployment rate for the State, but above the nation, which has a current unadjusted unemployment rate of 9.3%.

In 2010-2011, the level of construction permit activity compared with the prior year varied significantly across the three types of construction. Industrial construction valuation dropped 21%, with new industrial construction reaching an eight-year low. Commercial valuation also dropped 17%, reflecting a 50% decline in new commercial valuation, partially offset by 25% increase in alterations. Residential valuation experienced strong growth, with a 159% increase in valuation and a 285% increase in the number of new housing units, reaching a four-year high. A one-month surge in December, however, accounted for nearly three quarters of the new units. 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 June 2011 median home price of \$520,000 for single family homes within the City was slightly (0.7%) below the June 2010 median of \$523,500. The number of sales for all residences, however, fell 10% as the credit market tightened and tax incentive programs expired.



Looking forward, the City continues to face uncertain economic times with serious concerns regarding global financial markets, the lack of employment growth, and the relatively high unemployment rates. There is potential risk that the economy will stall and slip into a double dip recession. The Administration will closely monitor economic conditions and any associated potential impacts on the City's revenues.

2010-2011 Budget Performance (All Funds)

As shown in Section I of this document, City revenues (excluding Beginning Fund Balance) totaled \$2.2 billion in 2010-2011, which was 2.4% (\$54.4 million) below the budgeted estimate of \$2.3 billion. In several funds, grants and expenditure-related reimbursements were not received in 2010-2011 and are now expected to be received in 2011-2012.

In 2010-2011, expenditures (excluding Reserves and Ending Fund Balance) totaled \$2.3 billion, which was \$599.9 million (20.3%) below the modified budget of \$2.9 billion. Almost 60% of the expenditure variance (\$348.1 million) was in the capital funds, which expended \$396.7 million of the \$744.8 million modified budget. The majority of the unexpended capital funds were rebudgeted to 2011-2012 in the 2011-2012 Adopted Budget and additional funds are recommended to be rebudgeted in this document.

At the end of 2010-2011, the Earmarked and Contingency Reserves for all City funds totaled \$415.8 million, which represented 11.1% of the total modified budget for the City of \$3.7 billion (includes Contributions, Loans and Transfers). In the General Fund, Reserves totaled \$88.1 million. Almost all of these General Fund Reserves were rebudgeted to 2011-2012 or assumed as savings in the development of the 2011-2012 Adopted Budget.

The financial performance in 2010-2011 is used as the starting point for 2011-2012. The collective 2010-2011 Ending Fund Balances for all City funds totaled \$1.36 billion, which was \$115.5 million above the 2010-2011 Ending Fund Balance estimates of \$1.24 billion used in the development of the 2011-2012 Adopted Budget. After adjusting for additional rebudgets of \$41.6 million recommended in this document, the adjusted 2010-2011 Ending Fund Balance variance for all funds drops to \$74.0 million. The General Fund had an adjusted fund balance variance of \$8.1 million. The additional fund balance in the special funds totaled \$50.4 million. The capital funds had the largest adjusted fund balance variance of \$15.5 million.

2010-2011 General Fund Budget Performance

The City's General Fund ended the 2010-2011 fiscal year within budget. As shown in the chart below, the General Fund Ending Fund Balance of \$137.3 million was \$16.3 million above the fund balance estimate assumed when the 2011-2012 Adopted Budget was developed, primarily as a result of expenditure savings. The following table summarizes the General Fund performance in 2010-2011, comparing the actual results to the modified budget and the estimates used to develop the 2011-2012 Adopted Budget.

Table 1
General Fund Year-End Status
For the Year Ended June 30, 2011
 (\$000s)

Sources	2010-2011 Revised Budget	2010-2011 Year-end Estimate	2010-2011 Budgetary Basis Actual	Actual to Budget Variance	Actual to Estimate Variance
<i>Beginning Fund Balance*</i>	141,398	141,398	141,484	86	86
<i>Carryover Encumbrances</i>	15,717	15,717	15,717	-	-
<i>Liquidation of Carry-over Encumbrances</i>	-	4,688	4,918	4,918	230
<i>Revenue*</i>	888,154	888,154	876,170	(11,984)	(11,984)
Totals	1,045,269	1,049,957	1,038,289	(6,980)	(11,668)
Uses					
<i>Expenditures*</i>	928,613	900,053	872,431	56,182	27,622
<i>Transfers</i>	28,539	28,539	28,534	5	5
<i>Reserves</i>	88,117	304	-	88,117	304
Totals	1,045,269	928,896	900,965	144,304	27,931
<i>Ending Fund Balance</i>	-	121,061	137,324	137,324	16,263

* The General Fund incorporates the Special Services Assessment Revolving Fund, which was previously an unbudgeted fund. After adjusting for a net-zero \$12.9 million of grant and reimbursement related revenues and expenditures not received or expended in 2010-2011, but rebudgeted to 2011-2012, the revenue variance resulted in a surplus of \$873,000 and the expenditures variance actually totaled \$14.8 million.

The negative variance of \$12.0 million in revenues was 1.3% of the budget and the \$27.6 million positive variance generated from expenditures and transfers was 2.9% of the budget. The majority of these variances are related to various grants and reimbursements that were not received in 2010-2011 but are expected to be received in 2011-2012. After adjusting for a net-zero \$12.9 million of grant and reimbursement-related revenues and expenditures not received or expended in 2010-2011, but rebudgeted to 2011-2012 in the 2011-2012 Adopted Budget, the revenue variance resulted in surplus of \$0.9 million (0.1%) and the expenditures and transfers variance totaled \$14.8 million (1.5%).

In this Annual Report document, budget actions are recommended to distribute the additional fund balance of \$16.3 million. Per City Council Policy 1-18, when determining the proposed distribution of these funds, the first priority is to complete clean-up actions associated with the

final reconciliation of 2010-2011. Net clean-up adjustments of \$8.1 million are recommended in this document to reconcile the development fee programs for 2010-2011 (\$3.8 million) and to adjust various rebudget amounts (\$4.3 million). After accounting for these clean-up adjustments, the remaining unallocated fund balance in the General Fund is \$8.1 million, representing only 0.4% of the total 2010-2011 Modified Budget (sources and uses). This additional fund balance was generated from net expenditure savings (\$9.1 million) and the liquidation of prior year encumbrances above the estimated level (\$0.2 million), partially offset by net lower funding sources (-\$1.2 million).

Combining the additional fund balance of \$8.1 million with the additional net resources generated from recommended 2011-2012 budget adjustments (\$3.5 million) will generate \$11.6 million that is proposed to establish a 2012-2013 Future Deficit Reserve. Typically, per Council Policy I-18, the remaining fund balance would be distributed equally to the Future Deficit Reserve for the upcoming year (if a shortfall is projected) and to unmet/deferred infrastructure and maintenance needs. However, per the Mayor's June Budget Message for Fiscal Year 2011-2012 as approved by the City Council, any remaining fund balance from 2010-2011 along with savings generated from the final reconciliation of 2011-2012 retirement and unemployment costs is to be allocated entirely to a 2012-2013 Future Deficit Reserve in recognition of the large General Fund projected shortfall estimated to be at least \$78 - \$115 million projected for next year.

To identify revenue and expenditure trends, the actual 2010-2011 revenues and expenditures are compared to the prior year. Table 2 below compares the City's financial performance in 2010-2011 with the financial performance of the prior year.

Table 2
General Fund
Comparison of Year-End Actuals With Prior Year
(\$000s)

	2009-2010	2010-2011	Change	% Change
	Actuals	Actuals		
Source of Funds				
Beginning Fund Balance	199,037	162,119	(36,918)	-18.5%
Revenues	782,623	876,170	93,547	12.0%
Total Source of Funds	981,660	1,038,289	56,629	5.8%
Use of Funds				
Personal Services	601,211	591,413	(9,798)	-1.6%
Non-Personal/Equipment/Other	95,951	90,939	(5,012)	-5.2%
City-Wide Expenses	98,239	181,240	83,001	84.5%
Capital Projects	19,436	8,839	(10,597)	-54.5%
Transfers	25,425	28,534	3,109	12.2%
Reserves	-	-	-	N/A
Total Use of Funds	\$ 840,262	900,965	60,703	7.2%

As shown in Table 2, 2010-2011 General Fund revenues of \$876.2 million represented an increase of 12.0% from the 2009-2010 collection level. The majority of this increase was due to the issuance of Tax Revenue Anticipation Notes (TRANS) of \$75 million in 2010-2011. Excluding this transaction, revenues were only above the 2009-2010 levels by \$18.5 million (2.4%). In 2010-2011, the categories that experienced the largest increases included: Sales Tax, Licenses and Permits, Revenue from the State of California, and Departmental Charges. Increases in those categories were partially offset by lower collections in the Property Tax and Revenue from Local Agencies categories. A detailed discussion of the revenue performance by category is provided in Section I of this document.

General Fund expenditures of \$901.0 million in 2010-2011 increased 7.2% (\$60.7 million) when compared to the prior year expenditure level of \$840.3 million. This increase was due entirely to the repayment of TRANS of \$75.4 million in the City-Wide Expenses category. Excluding this transaction, expenditures ended the year \$14.7 million (1.7%) below the 2009-2010 levels. This decline from the prior year reflects lower expenditure levels in the Personal Services, Non-Personal/Equipment/Other, and Capital Projects categories, partially offset by increases in the City-Wide Expenses and Transfers categories.

2010-2011 General Fund Ending Fund Balance

The current budgeting practice of the City is to use the projected level of fund balance expected to remain in the General Fund at the end of any fiscal year as a funding source for the following year. The Ending Fund Balance estimate always contains two components: the portion of the fund balance that needs to be rebudgeted for completing projects or retaining reserves; and that portion which is undesignated and available as a general funding source in the coming year. In the 2011-2012 Adopted Budget, a total fund balance estimate of \$121.1 million was included as a funding source. The 2010-2011 General Fund Ending Fund Balance of \$137.3 million was \$16.3 million above this estimate.

The components of the 2010-2011 General Fund Ending Fund Balance include unexpended reserves, expenditure/transfer savings, and funding sources as described below:

**2010-2011 General Fund
Ending Fund Balance Components**

Fund Balance Component	\$ Amount (\$ in 000s)
Funding Sources	(\$ 6,980)
Expenditure/Transfer Savings	56,187
Unexpended Reserves	88,117
TOTAL	\$ 137,324

The total Sources of Funds ended the year \$7.0 million below the revised budget as a result of lower revenues (-\$11.9 million) that were partially offset by the liquidation of carryover encumbrances (\$4.9 million). As discussed above, the negative revenue variance can be attributed to various grants and reimbursements totaling \$12.9 million that were not expected to

be received in 2010-2011 and the revenues and associated expenditures were rebudgeted to 2011-2012 as part of the Adopted Budget. Additional rebudget and clean-up actions are also recommended in the Annual Report, resulting in a revenue shortfall of \$1.2 million, or 0.1% of the revised budget.

For the Uses of Funds, expenditure and transfer savings totaled \$56.2 million while unexpended reserves totaled \$88.1 million; this represented the largest component of the 2010-2011 Ending Fund Balance. Of the \$56.2 million in expenditure/transfer savings, almost 75% of these savings (\$41.4 million) was assumed as savings in the development of the 2011-2012 budget or rebudgeted to 2011-2012 to complete projects. Based on actual 2010-2011 expenditures, additional rebudget and clean-up adjustments totaling \$4.5 million are recommended in this document. In addition, the fee-related expenditure savings of \$1.3 million are recommended to be used to reconcile the development fee programs. After accounting for these adjustments, net expenditure/transfer savings totaled \$9.0 million at year-end, or 0.9% of the revised budget.

General Fund Reserve categories include: Earmarked Reserves (\$45.9 million) established to address specific needs per City Council direction; the Contingency Reserve (\$29.3 million) set at a minimum of 3% of expenditures per City Council policy; and the Ending Fund Balance Reserve (\$12.9 million) established at the end of each year from excess revenues and expenditure savings that are programmed for use in the 2011-2012 Adopted Budget. Of the \$88.1 million in Reserves, \$87.8 million was approved for rebudget or assumed as a source of funding in the development of the 2011-2012 Adopted Budget. Following is additional information regarding the three reserve categories.

- ***Earmarked Reserves (\$45.9 million)*** – At the end of 2010-2011, the most significant reserves included the following: Workers’ Compensation/General Liability Reserve (\$10.0 million); Fee Supported – Building Reserve (\$7.7 million); Economic Uncertainty Reserve (\$5.0 million); Unemployment Insurance Reserve (\$5.0 million); Salaries and Benefits Reserve (\$4.3 million); Retiree Healthcare Reserve (\$2.6 million); and Fee Supported – Fire Reserve (\$2.4 million). In the 2011-2012 Adopted Budget, all but \$304,000 of these reserves were approved for rebudget to 2011-2012 (\$28.5 million) as part of the Adopted Budget and appropriated as reserves, or were used as solutions to the 2011-2012 General Fund shortfall (\$17.1 million).
- ***Ending Fund Balance Reserve (\$12.9 million)*** – Funding was set aside as part of the 2010-2011 Mid-Year Budget Review (\$8.5 million) and as part of the 2010-2011 year-end clean-up actions (\$4.4 million) to account for additional revenues and expenditure savings expected to be generated in 2010-2011 for use in 2011-2012. The use of these funds was assumed in the development of the 2011-2012 Adopted Budget.
- ***Contingency Reserve (\$29.3 million)*** – The City Council has established a Budget Policy of maintaining a minimum 3% Contingency Reserve in the General Fund. This Reserve is in place as a last resort for unexpected critical needs. At the end of 2010-2011, the General Fund Contingency Reserve balance was \$29.3 million. As part of the 2011-2012 Adopted Budget, the entire Contingency Reserve was rebudgeted to 2011-2012. No additional

funding is necessary to be added to the Contingency Reserve as part of the 2011-2012 Annual Report in order to meet the minimum 3% Contingency Reserve level.

Impacts on the 2011-2012 General Fund Budget

As discussed above, it was assumed that \$121.1 million would remain at the end of 2010-2011 and carried over to 2011-2012 as Beginning Fund Balance as part of the adoption of the 2011-2012 Operating Budget. These funds, which were expected to be generated from unexpended reserves, unexpended funds that were rebudgeted to 2011-2012, expenditure savings and the liquidation of carryover encumbrances, were programmed for use in the 2011-2012 Adopted Budget. The actual General Fund Ending Fund Balance was above the estimate used in the 2011-2012 Adopted Budget by \$16.3 million, primarily due to additional expenditure savings.

The following chart details the recommended uses of the \$16.3 million additional fund balance as well as other budget adjustments that are recommended as part of this report. Approximately half of the available fund balance (\$8.1 million) is proposed to be allocated to address rebudgets and clean-up adjustments to close out the 2010-2011 fiscal year. After factoring out these adjustments, a total of \$8.1 million in available fund balance remains. This additional fund balance, when combined with required technical and rebalancing actions (\$4.6 million) offset by a small number of urgent fiscal and program needs (\$1.1 million), will allow for a 2012-2013 Future Deficit Reserve of \$11.6 million to be established consistent with City Council's approval of the Mayor's June Budget Message for Fiscal Year 2011-2012.

Proposed 2011-2012 General Fund Adjustments (\$000s)

Additional 2010-2011 Ending Fund Balance	\$ 16,263
Clean-Up Actions	
Changes to Fee Reserves	(3,764)
Rebudgets/Clean-Up Adjustments	(4,378)
Total Clean-Up Actions	(8,142)
Fund Balance Available After Clean-up Actions	\$ 8,121
Recommended Budget Adjustments	
Required Technical/Rebalancing Actions	
- Sales Tax Revenue Estimate	6,223
- 2011-2012 Retirement Contributions Reconciliation	4,310
- 2011-2012 Unemployment Insurance Reconciliation	1,645
- 2010-2011 Federated Retirement System Annual Req'd. Contribution - Potential Addtl. Pymt.	(4,387)
- Property Tax Revenue Estimate	(1,359)
- Motor Vehicle In-Lieu Revenue Estimate (Eliminate per State Budget Action)	(2,800)
- Motor Vehicle In-Lieu Revenue Estimate (Prior Year True-Up Payment)	2,100
- Commercial Solid Waste Franchise Fee Revenue Estimate	(400)
- Transfer to the Police and Fire Retirement Fund (SB 90)	(276)
- Disposal Facility Tax Revenue Estimate	(200)
- Transfer to the District 10 C&C Fund (Leland High School Sports Field Repayment)	(120)
- Parks, Recreation & Neighborhood Services Personal Services (Living Wage Adjustment)	(90)
- Code Enforcement Clean-Ups and Landscape Accident Repair Program	(85)
- 2009 UASI Grant/Fire Apparatus Replacement	0
- Grants/Reimbursements/Fee Activities (\$3.2 million in net-zero adjustments)	0
Sub-Total Required Technical/Rebalancing Actions	4,561
Urgent Fiscal/Program Needs	
- Fire Minimum Staffing Overtime	(760)
- Third SAFER Grant Firefighter Academy	(103)
- Police Horse Mounted Unit	(102)
- Habitat Conservation Plan Earmarked Reserve	(100)
- Comprehensive General Plan Update/General Plan Update Reserve	0
Sub-Total Urgent Fiscal/Program needs	(1,065)
Total Recommended Budget Adjustments	3,496
Funding Available After Recommended Adjustments	\$ 11,617
2012-2013 Future Deficit Reserve	\$ (11,617)

Following is a summary of the recommended actions. These adjustments are described in more detail in Section III of this report.

Clean-Up Actions (-\$8.14 Million)

- **Changes to Fee Reserves (-\$3.76 million)** – Consistent with budget practices enacted several years ago, year-end reconciliations of the revenues and expenditures in the development fee programs are conducted to determine if revenues exceeded or fell below costs. To meet the commitment to the development community that all development fees will be used solely to support the development fee activities, any excess revenues and

interest earnings over costs are placed in Development Fee Program Reserves. Based on the 2010-2011 results, \$3.8 million is recommended to be added to the Development Program Fee Reserves (Building, Fire, Planning, and Public Works), preserving any net savings between revenues and expenditures in these programs. With the approval of these changes, a total balance of over \$15 million would be available for the development fee programs, a sizable amount considering the balances in the development fee program reserves in recent years.

- **Rebudgets/Clean-Up Adjustments (-\$4.38 million)** – A series of adjustments are recommended to complete existing projects in 2011-2012 and to reflect any necessary technical budget adjustments. The Annual Report is the point in the budget process where action is required to rebudget unexpended funds from the prior year that were not anticipated when the Adopted Budget was approved, but are required to complete a project in the current year. Also recommended are actions that actually reduce previous rebudgets to reflect instances where expenditures for which the rebudgets were approved actually occurred in 2010-2011, therefore, the funds are not available for rebudget to 2011-2012. Other actions include budget corrections, net-zero expenditure reallocations to correct or realign funding, various reconciliations of revenue-supported services, and reallocation of funds between revenue categories in 2011-2012. Lastly, adjustments are included in the Energy Efficiency Fund from departments Non-Personal/Equipment appropriations as new energy saving projects became online, which by Council Policy savings are to be deposited in this revolving fund for two years.

Recommended Budget Adjustments (+\$3.5 million)

A number of General Fund budget changes are recommended in this report to adjust 2011-2012 revenue estimates and expenditure appropriations, as well as to address current year funding needs that have emerged since the 2011-2012 budget was approved. These adjustments generate net additional funding of \$3.5 million and are classified under two categories: 1) Required Technical/Rebalancing Actions that generate an additional \$4.6 million in savings; and 2) Urgent Fiscal/Program Needs with a net cost of \$1.1 million. In addition, grant/reimbursement/fee-related adjustments are recommended totaling \$3.2 million, with a net-zero impact on the General Fund.

Following is a summary of the recommended adjustments:

- **Required Technical/Rebalancing Actions (+\$4.56 million)**
 - Increase the *Sales Tax Revenue Estimate* for 2011-2012 by \$6.2 million (from \$136.8 million to \$143 million) to recognize additional Sales Tax revenue generated in the fourth quarter 2010-2011 (\$2.6 million) and higher estimated collections based on an adjusted starting point for 2011-2012 (\$3.6 million). This adjustment will allow for 2% economic growth in 2011-2012 sales tax collections over the actual level received in 2010-2011. (\$6,223,000)

- Per direction from the City Council-approved Mayor’s June Budget Message for Fiscal Year 2011-2012, any additional funding resulting from a complete **2011-2012 Retirement Contributions Reconciliation** based on final actions approved as part of the 2011-2012 Adopted Budget were to be used to establish a 2012-2013 Future Deficit Reserve in the General Fund. Due to the fact that the City is now providing funding to the Federated City Employees’ Retirement System and the Police and Fire Department Retirement System for 2011-2012 with a methodology that provides for a minimum annual required contribution amount that is paid for by all City funds with personal services allocations, a reconciliation and rebalancing was necessary in all affected funds. Based on this reconciliation, adjustments to decrease personal services or project appropriations will properly fund required retirement contributions, producing savings in all funds of \$5.5 million. As a result of these savings, \$4.31 million is available and recommended be allocated to the 2012-2013 Future Deficit Reserve in the General Fund. In all other funds, a total of \$1.19 million in savings is available and recommended to increase those funds’ ending fund balances or reserves accordingly. (\$4,310,000)
- Per direction from the City Council-approved Mayor’s June Budget Message for Fiscal Year 2011-2012, any additional funding resulting from a complete **2011-2012 Unemployment Insurance Reconciliation** based on final actions approved as part of the 2011-2012 Adopted Budget were to be used to establish a 2012-2013 Future Deficit Reserve in the General Fund. Based on this reconciliation, technical adjustments to decrease appropriations across all City funds to appropriately align funding sources with projected unemployment insurance payments was required. Recommendations included in this document decrease personal services and project appropriations across all City funds, restore funding to the Salary and Benefits Reserve in the General Fund (\$1.67 million) as that reserve was temporarily used as a source of funds to restore General Fund services until this reconciliation could be completed, contribute \$1.65 million to a new 2012-2013 Future Deficit Reserve in the General Fund, and increase the ending fund balances or reserves in all other funds accordingly. (\$1,645,000)
- Establish a **2010-2011 Federated Retirement System Annual Required Contribution – Potential Additional Payment** transfer appropriation for potential payments to the Federated Retirement System. In 2010-2011, the City fully paid the annual required contribution (ARC) to the Federated Retirement System using a 23.18% City Contribution Rate of pensionable payroll as requested by the Federated Retirement Board based on the Board’s approved phased reduction of the interest earning assumption from 8.25% to 7.75% over 5 years. In September 2011, however, the Department of Retirement Services informed the Administration that the City did not in fact fully fund the ARC for 2010-2011, since the ARC should have been paid using a previously calculated 25.75% City Contribution Rate which was based on an earning assumption of 7.75%. Since the City fully paid the ARC as requested by the Board, the Administration is analyzing this new information and will seek clarification from the Federated Retirement Board whether the City should have paid the ARC using a 23.18% or 25.75% City Contribution Rate. Using the higher City Contribution Rate, the additional ARC amount based on actual pensionable payroll for 2010-2011 is estimated at \$8.1 million for all funds and \$4.4 million for the General Fund. This report includes recommendations to set aside the additional potential ARC payment of \$8.1 million from

all impacted funds to be transferred to the Federated Retirement Fund in the event that the Federated Retirement Board determines that the City should pay the higher amount as is now being indicated. If, however, it is determined that it is not necessary for the City to pay the additional ARC, it will be the Administration's intention to return to the City Council as part of the 2011-2012 Mid-Year Budget Review with a recommendation to allocate the set aside funds of \$4.4 million in the General Fund to the 2012-2013 Future Deficit Reserve and the remaining funds of \$3.7 million to each affected fund's ending fund balance as appropriate. (-\$4,387,000)

- Decrease the ***Property Tax Revenue Estimate*** by \$1.4 million (from \$201.5 million to \$200.1 million) to bring the revenue estimate in line with the 2011-2012 Property Tax information provided by the county of Santa Clara Controller-Treasurer Department in August 2011. This includes downward adjustments to the following Property Tax sub-categories: Secured Property Tax (down \$327,000); SB 813 Property Tax (down \$656,000); Unsecured Property Tax (down \$346,000); and Homeowner's Exemption Subvention (down \$30,000). (-\$1,359,000)
- Decrease ***Motor Vehicle In-Lieu Revenue Estimate*** by \$2.8 million to reflect loss of this revenue based on the recent State approved bill (SB 89) that eliminated these payments beginning in 2011-2012. On September 28, 2011, the League of California Cities filed a petition in the Sacramento County Superior Court challenging the legality of the State's diversion of this revenue. (-\$2,800,000)
- Increase the ***Motor Vehicle In-Lieu Revenue Estimate*** by \$2.1 million to reflect the receipt in July 2011 of a Motor Vehicle In-Lieu true-up payment that accounted for underpayments in prior years (2006-2007 through 2009-2010). (\$2,100,000)
- Decrease the ***Commercial Solid Waste Franchise Fees Revenue Estimate*** by \$400,000 (from \$9.6 million to \$9.2 million) to reflect lower anticipated collections based on actual 2010-2011 performance and the downward collection trend in this category. This adjustment will allow for a 3.2% decline from the 2010-2011 actual collection level of \$9.5 million. (-\$400,000)
- Establish a ***Transfer to the Police and Fire Retirement Fund*** for reimbursements from the State of California for the City's Police and Fire Retirement Plan following State SB 90 mandates. The Police and Fire Retirement Plan (Plan) is required to offer medical benefits to the surviving spouse and family of sworn officers that died in the line of duty. Annually, the Retirement Department provides information regarding the amounts paid by the Plan and requests reimbursement. The reimbursements have been posted to the General Fund in error since 2006-2007 for reimbursements that cover claims since 1996-1997; as has been recently discovered that the reimbursement should have been instead posted to the Police and Fire Retirement Fund. (-\$275,368)
- Decrease the ***Disposal Facility Tax Revenue Estimate*** by \$200,000 (from \$10.9 to \$10.7 million) to reflect lower estimated Disposal Facility Tax revenues based on actual 2010-2011 performance and the downward collection trend in this category. This adjustment will allow for a 3% decline from the actual 2010-2011 collection level. (-\$200,000)
- Per direction from the City Council, establish a ***Transfer to the Council District 10 Construction and Conveyance Tax Fund*** in the amount of \$120,000 to reflect a partial

repayment of the total investment of \$350,000 from the Council District 10 Construction and Conveyance Tax Fund that originally supported the addition of an enhanced concession/storage/bathroom facility at the Leland High School Sports Field. This allocation of \$120,000 reflects the balance of fees collected once the cost of operations and maintenance were paid in 2008-2009, 2009-2010 and 2010-2011. (-\$120,000)

- Consistent with City Council Policy, increase the ***Parks, Recreation and Neighborhood Services Department Personal Services*** appropriation by \$90,000 to provide for a living wage increase for part-time unbenefitted (Assistant Swimming Pool Manager, Instructor Lifeguard, Open Water Lifeguard, and Regional Park Aide) position costs where the hourly living wage (\$14.84) exceeds the budgeted hourly wage in 2011-2012. (-\$90,000)
- Provide funding for a ***Code Enforcement Clean-Ups and Landscape Accident Repair Program*** in the Planning, Building and Code Enforcement Department's Non-Personal/Equipment appropriation (\$50,000) and the Department of Transportation's Non-Personal/Equipment appropriation (\$35,000) to fund contractual services for the clean-ups on properties that are found to be unsafe, dangerous, hazardous, or a nuisance and to fund emergency repairs to median islands, median island landscaping, and the irrigation system as a result of traffic accident damages. In previous fiscal years, these costs and the associated reimbursements from individuals and insurance companies were accounted for in the Special Services Assessment Revolving Fund, an unbudgeted fund. It has been determined that a more appropriate process is to budget this activity in the General Fund. As part of the 2010-2011 General Fund reconciliation, this fund has been merged into the General Fund and the associated fund balance from that fund is sufficient to support these activities in 2011-2012. Since the activity level is minimal and volatile, no revenues are being recommended to be recognized at this time. (-\$85,000)
- Reallocate funding from the ***2009 Urban Areas Security Initiative (UASI) Grant - Fire*** city-wide appropriation to the ***Fire Apparatus Replacement*** capital improvement appropriation. In 2010-2011, the 2009 UASI Grant- Fire appropriation did not have enough funding to charge the purchase of thermal imaging cameras for the emergency fire apparatus; however, the UASI grant had funding appropriated in 2011-2012. The UASI eligible cameras were temporarily charged to the Fire Apparatus Replacement appropriation in 2010-2011; therefore, this action is recommended to reimburse the Fire Apparatus Replacement appropriation for 2010-2011 expenditures. (\$0)
- A series of net-zero adjustments are recommended to reflect new or updated revenues and expenditures for ***Grants, Reimbursements and/or Fee Activities*** for Public Safety, Neighborhood Services, Development Services and other miscellaneous programs. Net-zero new Public Safety grants total \$1.9 million and are designated for equipment and selective special public safety activities. Adjustments in the Neighborhood Services area include After School Education and Safety (\$608,000), Senior Nutrition (\$414,000), Summer Youth Nutrition (\$61,000) and Sheppard Middle School Operations and Maintenance (\$33,000). Other miscellaneous adjustments include reallocating funds for the Public Works Fee Program from reserves (\$312,000), providing for the Silicon Valley Interoperability Project (\$75,000), and recognizing funds received for State Waste Tire activities (\$67,000). (\$0)

- **Urgent Fiscal/Program Needs (-\$1.1 million)**

- Increase the Fire Department's Personal Services appropriation to provide additional ***Fire Minimum Staffing Overtime*** funding to augment daily staffing. In order to generate savings for the 2011-2012 Adopted Operating Budget, the Fire Department's overtime budget was reduced by \$3.8 million, leaving \$2.8 million for minimum staffing needs. This reduction was part of the Flexible Brown-Out Plan that is described in the 2011-2012 Adopted Operating Budget. Due to higher than anticipated absence rates through the first two months of this year and Department-wide understaffing at the Fire Engineer rank, overtime expenditures through August were higher than budgeted, but necessary in order to maintain acceptable fire service response times. The Department is reviewing staffing configurations and the completion of a Fire Engineer Academy in mid-September should mitigate future additional overtime needs; however, additional funding is recommended in this report to ensure the Department stays within its Personal Services appropriation by year-end. (-\$760,000)
- Increase the Fire Department's Personal Services appropriation to provide funding for a ***Third Staffing for Adequate Fire and Emergency Response (SAFER) Grant Firefighter Academy***. When the training needs for reinstating the 49 Firefighter positions associated with the SAFER Grant were estimated, it was assumed that two academies of 22 and 27 Firefighters would be needed. However, the first two academies had 22 and 14 Firefighters respectively, and a third academy is needed in February 2012 in order for the remaining 13 positions to start in April 2012. (-\$103,000)
- Increases the Police Department's Personal Services (\$56,000) and Non-Personal/Equipment (\$46,000) appropriations to continue the ***Police Horse Mounted Unit*** (HMU) through mid-February 2012 as a collateral assignment as described in the 2011-2012 Adopted Operating Budget. The Friends of the Horse Mounted Unit (Friends) were fundraising for the collateral HMU assignment and provided \$35,500 towards operations in 2011-2012. As the Friends are no longer engaged in these fundraising efforts, the Administration is now exploring having the San José Police Foundation fundraise matching funds of \$102,000 to continue the HMU through the end of 2011-2012. The Police Department will report on the fundraising efforts to the City Council with an information memorandum in late November to determine if the HMU will continue through June 2012. If the fundraising efforts are not successful, this will leave the Department enough time to disband the HMU by mid-February. (-\$102,000)
- Establishes a ***Habitat Conservation Plan Earmarked Reserve*** in the amount of \$100,000. The City Council is currently discussing refinements to the draft Habitat Conservation Plan (City Council Agenda, 9/20/11 – Item 4.3, 9/27/11 – Item 4.1) as directed as part of the City Council-approved Mayor's June Budget Message for Fiscal Year 2011-2012. If the City Council approves to proceed with the plan, funding will be required to prepare the Final Habitat Conservation Plan for formal review by the U.S. Fish and Wildlife Service and California Department of Fish and Game. In addition, consultant costs will be necessary to prepare the supporting documents to allow the Army Corps of Engineers to issue a Regional General Permit for wetlands. The estimated costs are \$100,000 to prepare the final habitat plan and funding is recommended to be set aside in a reserve, pending final City Council decision to proceed with or terminate the plan. If the City

Council chooses to proceed with the plan, the reallocation of funding from the reserve to fund these activities will be recommended as part of the 2011-2012 Mid-Year Budget Review in February 2012. However, should the City Council decide not to proceed with the plan, funding will be recommended to be allocated to the 2012-2013 Future Deficit Reserve as part of the 2011-2012 Mid-Year Budget Review. (-\$100,000)

- Reallocates funding from the *General Plan Update Reserve* to the City-Wide Expenses *Comprehensive General Plan Update* appropriation to provide personal services funding (\$15,000) for staff to attend community meetings and public hearings, and associated non-personal/equipment funding (\$85,000) for marketing and public outreach (e.g. printing of publications, postage for mass mailing, and translation services). In addition, this action will provide funding for the Department of Transportation (\$20,000) to develop and analyze land use scenarios; develop, compile, and validate dynamic traffic assignments; and review, coordinate, and respond to Environmental Impact Reports (EIR). These costs related to the General Plan Update were inadvertently left out during the development of the 2011-2012 Adopted Operating Budget. (\$0)

2012-2013 Future Deficit Reserve (\$11.6 Million)

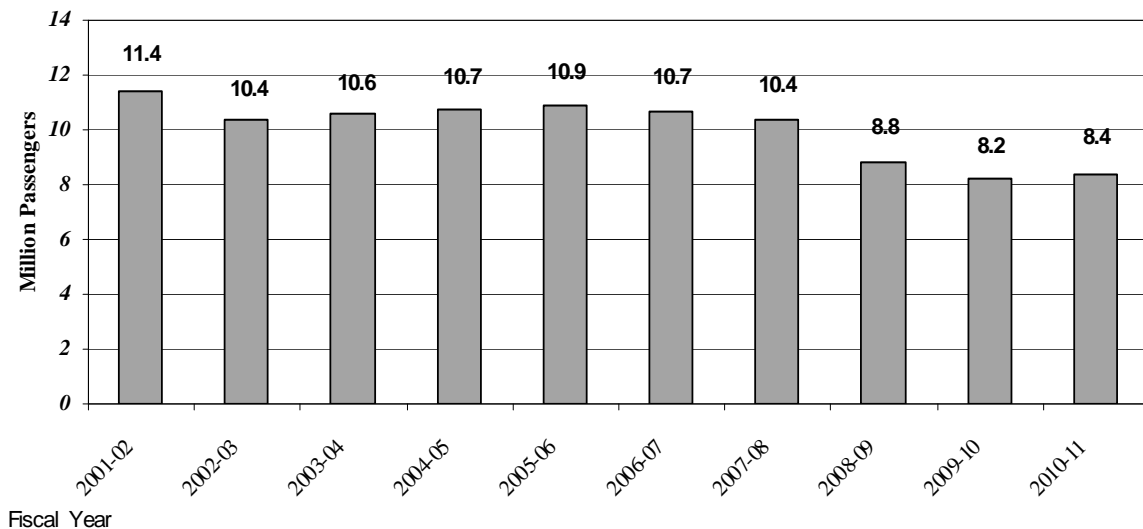
The establishment of a 2012-2013 Future Deficit Reserve totaling \$11.6 million is recommended to set aside all available net funding in the General Fund to address the large General Fund shortfall currently estimated between \$78 - \$115 million for 2012-2013. Per direction from the City Council-approved Mayor's June Budget Message for Fiscal Year 2011-2012, any additional funding resulting from the a retirement contributions and unemployment insurance reconciliation as well as any ending fund balance that may be available after the close of the 2010-2011 fiscal year is to be allocated entirely to establish a 2012-2013 Future Deficit Reserve. A total of \$5.96 million is available for this Reserve, as previously described, from the savings associated with the retirement contributions (\$4.31 million) and unemployment insurance (\$1.65 million) reconciliations. In addition, if the Administration budget recommendations are approved as part of this report, a total of \$5.66 million is available for this Reserve to reflect the net remaining funds from the close out of the 2010-2011 fiscal year.

2010-2011 Selected Special/Capital Funds Budget Performance

Airport Operating Funds

The Airport served 8.4 million passengers in 2010-2011, which was an overall increase of 1.9% in fiscal year passenger activity. Airport activity categories had mixed results. Parking exits, gallons of aviation fuel sold, and taxicab operations exceeded last year's activity, while pounds of mail/freight/cargo, traffic operations, and landed weights experienced declines in comparison to last fiscal year.

**Norman Y. Mineta San José International Airport
10 Year History Passenger Activity**



Overall revenue performance exceeded budget by 3.6% with the primary driver in Parking and Roadway revenue. Airline Rates and Charges (combined total of landing fees and terminal rents) and all other categories were at or slightly above the budgeted estimate. Parking revenue and Rental Car Privilege Fees increased most likely due to an end to construction activity and opening of new conveniently located Rental Car garage and parking lots. Customer Facility Charges reflecting rental car activity, have demonstrated a steady increase since January 2011, as have passengers, peaking in June as expected for the summer travel season. Other increases are in revenue associated with rented space in the Terminals and non-terminal locations.

The Airport's two operating funds, Airport Customer Facility and Transportation Fee Fund and the Airport Maintenance and Operation Fund, had year-end expenditure savings in excess of \$18 million. Of these savings, approximately \$8.8 million were contingency funds that were not used during the year. Personal Services savings of approximately \$1.8 million were the result of an increase in the number of vacancies and, most significantly, reduced compensated absence liabilities associated with decreased Airport staffing levels. Non-personal/equipment savings of \$8.5 million resulted from adhering to strict cost controls, prioritizing needs, deferring purchases as well as conservative budgeting for operation of new terminal facilities and utilities for the rental car garage. Reduced activity in the shuttle bus program and lower than anticipated costs

on new lines of credit also account for notable one-time savings. The improved revenue performance and the lower expenditure levels were factored in part into the 2011-2012 Adopted Budget. The additional fund balance will also better position the Airport Funds in 2011-2012 and in the development of the 2012-2013 budget. While Airport activity for the first two months of 2011-2012 has shown passenger growth, this growth is not at the anticipated level (2.0%) projected in this budget. Airport staff will continue to monitor and report on activity, expenditures and revenues.

Convention and Cultural Affairs Fund

This fund accounts for Team San José's (TSJ) operation of the City's Convention Facilities. In 2010-2011, Convention Facilities activities generated revenues (\$860,000) above the modified estimate due primarily to building rental, food and beverage, and contract labor revenue. Expenditures were below budgeted levels by approximately \$1.5 million due primarily to savings in the Center for Performing Arts Improvements, Personal Services, and Non-Personal/Equipment appropriations. This combination of higher revenues and lower expenditures resulted in an ending fund balance that was approximately \$2.6 million higher than the level assumed in the 2011-2012 Adopted Budget. The City is currently in the process of reviewing 2010-2011 performance against the City Council-approved performance targets.

Due to higher than anticipated Transient Occupancy Tax receipts, the Annual Report includes a recommended increase of \$436,000 to the Transfer from the Transient Occupancy Tax Fund, and an off-setting increase to the Ending Fund Balance. The Annual Report also includes a recommendation to rebudget \$696,000 in the Center for Performing Arts Improvements appropriation to complete an overhaul of the fire monitoring system at that facility. Also recommended is the allocation of \$600,000 to support sales efforts associated with the Convention Center expansion/renovation, and \$450,000 to address any sudden and unanticipated building repairs at the Convention Center or cultural facilities.

Low and Moderate Income Housing Fund

After a reconciliation of the fund's actual revenue collections and expenditures, the fund ended 2010-2011 with an ending fund balance that was \$1.4 million below the estimate used to develop the 2011-2012 Adopted Budget. This lower ending fund balance was primarily the result of not issuing \$14.0 million in commercial paper proceeds, which was partially offset by a reduction in encumbrances (\$10.6 million). To offset the negative ending fund balance, there is a recommendation to reduce the budget for the Kings Crossing Housing project by \$1.8 million and shift these costs to the Home Investment Partnership Program Fund. With this adjustment, the ending fund balance will be \$1.6 million. On June 28, 2011, as part of the approval of the State budget, the Governor signed Assembly Bill XI 26 which would dissolve redevelopment agencies throughout the State. The majority of funding for the Low and Moderate Income Fund is derived from the 20% tax increment revenues from the San Jose Redevelopment Agency. If the redevelopment agencies do dissolve, the Low and Moderate Income Housing Fund will need to be rebalanced by eliminating positions, funding shifts to other Housing funds, and/or reducing non-personal/equipment funding for projects. No budget adjustments are recommended at this time because the California Supreme Court granted a Stay pending the Court's ruling on the

dissolution of redevelopment agencies throughout the State. With the Stay issued, the Housing Department has suspended all new activities. The Court is expected to make a decision on the dissolution of redevelopment agencies by January 15, 2012.

Transient Occupancy Tax Fund

Transient Occupancy Tax (TOT) Fund revenues of \$10.9 million exceeded the 2010-2011 Modified Budget by \$885,000, or 8.8%. Actual revenues ended the year 5.1% above the 2009-2010 actual level, and 2.5% above the 2010-2011 estimate used in the development of the 2011-2012 Adopted Budget. For the fourteen largest hotels, the average room rate increased from \$117 to \$121, while the occupancy rate increased from 55.9% to 59.8%. With actual collections coming in above the modified estimate, additional allocations to the recipient organizations (above the levels programmed in the 2011-2012 Adopted Budget) are recommended in this Annual Report. A total of \$872,000 will be distributed to the following organizations: the Convention and Cultural Affairs Fund (\$436,000); the Conventions and Visitors' Bureau (\$218,000); and Cultural Development (\$218,000).

The 2011-2012 budget assumed a 1.8% increase from the 2010-2011 estimate used to develop the 2011-2012 Adopted Budget. With the final revenue performance coming in at higher than anticipated levels, revenues can decline by approximately 1% and still meet the budgeted level. Revenues in this economically sensitive category will continue to be actively monitored, and adjustments to the estimate and corresponding recipient organizations will be brought forward if necessary.

Construction-Related Capital Program Revenues

A number of taxes and fees levied on construction and property resale (conveyance) activity provide a large source of revenue to the City's Capital program. As reported in Monthly Financial Reports, 2010-2011 collections in all of the major capital revenue categories exceeded budgeted estimates. The chart below provides a comparison of estimated revenues to actual revenues for these types of revenues.

Construction-Related Capital Program Revenues Comparison
 (\$ in Thousands)

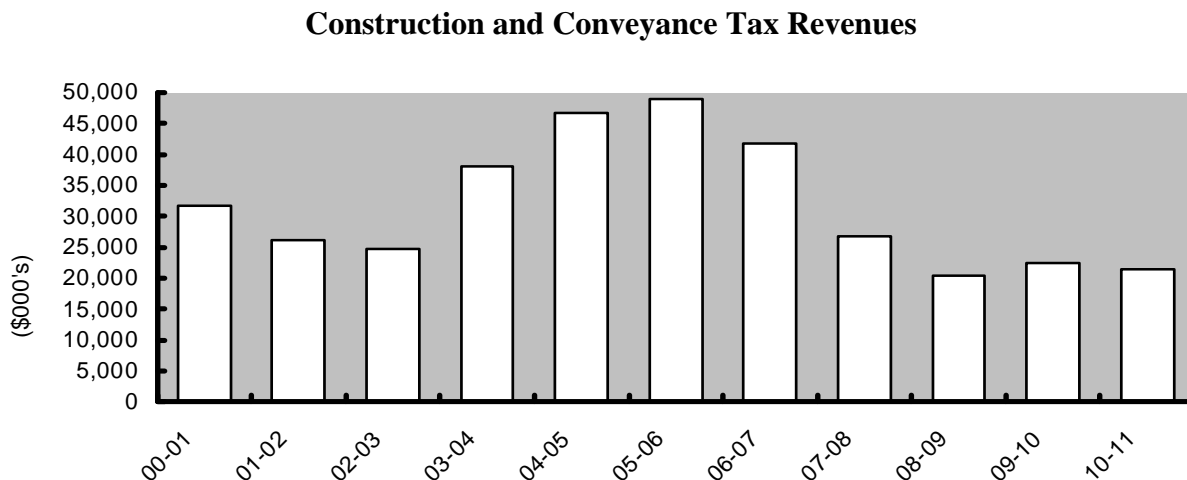
	2010-2011 Estimate*	2010- 2011 Actual	% Variance
Construction and Conveyance Tax	\$20,000	\$21,384	6.9%
Building and Structure Construction Tax	\$8,500	\$9,397	10.6%
Construction Excise Tax	\$12,500	\$13,261	6.1%
Municipal Water System Fees	\$120	\$171	42.5%
Residential Construction Tax	\$200	\$286	43.0%
Sanitary Sewer Connection Fee	\$500	\$546	9.2%
Storm Drainage Connection Fee	\$100	\$137	37.0%

* Revenue estimate used in the development of the 2011-2012 Adopted Capital Budget

Construction and Conveyance Tax

Real estate activity (primarily housing resales) determines the collection level of one of the major capital revenue sources, the Construction and Conveyance (C&C) Tax. Construction and Conveyance Tax revenues, which are a significant source of funds for the Parks and Community Facilities Development, Library, Fire, Service Yards, and Communications capital programs, totaled \$21.4 million in 2010-2011. This collection level was 7% (\$1.4 million) above the modified budget estimate of \$20 million, but 5% (\$1.1 million) below the 2009-2010 receipts of \$22.5 million. The drop in tax receipts from the prior year is consistent with the 11% decrease in property transfers for all types of residences between 2009-2010 and 2010-2011. Numerous tax incentive programs, foreclosures, and short sales occurred in 2009-2010, which was reflected in the higher Construction and Conveyance Tax receipts. However, as the credit market tightened and tax incentive programs expired, less home sales occurred in 2010-2011, which resulted in lower Construction and Conveyance Tax revenue compared to 2009-2010 collection levels. Additionally, the median home price for single family homes within the City decreased slightly in value, with a median home price in June 2011 of \$520,000, down less than 1% from the June 2010 price of \$523,500. Also, the amount of time it takes to sell a home (single-family and multi-family dwelling units) has slightly risen in the past year from 71 days in June 2010 to 76 days in June 2011. Collections in 2010-2011, however, are still slightly above the \$20.3 million received in 2008-2009, which was the lowest level of collections received since 1996-1997. The revenue in 2010-2011 represents a 56% drop from the record peak of \$49.0 million collected in 2005-2006.

The following graph displays the collection history of Construction and Conveyance Tax receipts.



After reaching a collection peak of \$31.6 million in 2000-2001, receipts dropped following the dot-com bust in both 2001-2002 and 2002-2003. This downward trend ended with the unprecedented and unsustainable growth of 54% in 2003-2004 followed by additional 22% growth in 2004-2005 and 5% growth in 2005-2006. The declines experienced in 2006-2007 through 2008-2009 are indicative of a real estate market correction after the financial market collapse. Collections bottomed in 2008-2009 at levels not seen in twelve years (since 1996-

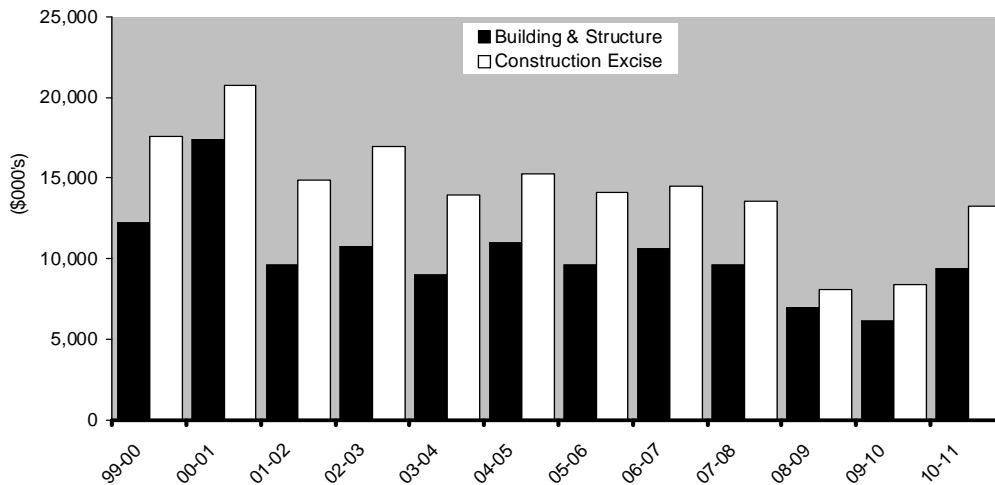
1997). After the severe drop, receipts rebounded modestly to \$22.5 million in 2009-2010. In 2010-2011, receipts declined slightly to \$21.4 million, but it is currently assumed that the housing market has reached bottom, with receipts in this category expected to remain relatively flat in the upcoming year. The 2011-2012 Adopted Budget assumes receipts in 2011-2012 will total \$21.0 million and grow slightly in 2012-2013 to \$22.0 million. Staff will closely monitor receipts in this area to determine if adjustments to this revenue category are necessary during the year.

Building and Structure Construction Tax and the Construction Excise Tax

The Building and Structure Construction Tax and the Construction Excise Tax are the primary sources of funding for the Traffic Capital Program. Year-end collections in the Building and Structure Construction Tax category totaled \$9.4 million, which was \$0.9 million above the estimate of \$8.5 million, but significantly below peak collections in 2000-2001 of \$17.5 million. With a similar trend, Construction Excise Tax receipts of \$13.3 million exceeded the estimate of \$12.5 million; however, results were well below peak collections in 2000-2001 levels of \$20.7 million. While a strong 2nd quarter 2010-2011 performance for construction valuation activity caused this short term spike in the collection levels for Building and Structure Construction Tax and the Construction Excise Tax, the level of activity is expected to be unsustainable and activity is expected to return back to moderate levels. Therefore, the 2011-2012 Adopted Budget assumes receipts in 2011-2012 will total \$6 million for the Building and Structure Construction Tax and \$8 million for the Construction Excise Tax. Staff will closely monitor receipts in this area to determine if adjustments to these revenue categories are necessary during the year.

The following graph displays the collection history of both the Building and Structure and Construction Excise Tax receipts over the past decade. Collections have dropped sharply with collections in 2010-2011 totaling only a fraction of peak receipts received in 2000-2001.

Construction Tax Revenues



Capital Budget Adjustments

Several capital budget adjustments are recommended in this document including recognition of grants, net-zero transfers/reallocations, and new allocations for a small number of high priority projects. Excess revenues received or expenditure savings in 2010-2011 beyond the budgeted levels will be available for programming for future use. In addition, the rebudget of unexpended funds for capital projects extending into 2011-2012 is recommended in this report. Details of these adjustments can be found in Section III of this document.

Airport Capital Funds

In 2010-2011, major projects were completed at the Airport including construction of the South loop parking lots, the Terminal B parking lots and the Taxiway W Improvement project (Phase I and Phase II) which was awarded a significant amount of grant funding. The Airport also received the National Steel Industry Award for the new Terminal B. Major projects with expenditures and encumbrances in 2010-2011 include the Terminal Area Improvement, Phase I (\$47.9 million), Taxiway W Improvements (\$9.3 million) and Public Parking Improvements (\$11.0 million) projects.

Library, Parks and Community Facilities, and Public Safety General Obligation Bond Funds

Major improvements continue in the City's libraries, parks, community centers, and public safety facilities as a result of voter-approved bond measures that will generate a total of \$599 million for these purposes. Several new bond-funded facilities completed construction in 2010-2011, including the Bascom Community Center and Library, Seven Trees Community Center and Library, Educational Park Branch Library, Fire Station 2, Fire Station 19, and South San José Police Substation. However, due to the significant operating and maintenance impacts these facilities will have on the General Fund, only the Seven Trees Community Center, Fire Station 19, and Fire Station 2 opened. A total of \$32.7 million was expended or encumbered in the Library (\$16.0 million), Public Safety (\$10.1 million), and Parks and Community Facilities (\$6.6 million) General Obligation Bond Funds.

In the Library Program, the projects with the largest expenditures and encumbrances in 2010-2011 included the following: Educational Park Branch Library (\$5.6 million); Calabazas Branch Library (\$5.5 million); and Bascom Branch Library (\$2.1 million). Only one branch library facility remains to enter into a construction contract - the Southeast Branch Library.

In the Parks and Community Facilities Program, the projects with the largest expenditures and encumbrances included the following: Happy Hollow Park and Zoo Renovations and Improvements (\$2.6 million); Bascom Community Center (\$1.3 million); and Seven Trees Community Center (\$844,000). The last two facilities to enter into a construction contract are the Soccer Complex and the Softball Complex.

In the Public Safety Program, the projects with the largest expenditures and encumbrances included the following: Fire Station 24 (\$5.0 million); South San José Police Substation (\$3.3

million); and Fire Station 37 (\$656,000). The two remaining Fire Stations to enter into construction contracts are Fire Station 21 – White Road and Fire Station 37 – Willow Glen.

Traffic Capital Funds

In 2010-2011, a total of \$65.5 million was spent or encumbered for traffic capital projects. The projects with the largest expenditures and encumbrances included Prop 42– Pavement Maintenance (\$8.2 million); Prop 1B – Pavement Maintenance (\$7.6 million); Recovery Act – Street Resurfacing and Rehabilitation (\$7.1 million); Traffic Signal Communications and Synchronization (\$6.4 million); Pavement Maintenance (\$4.9 million); and the Julian and St. James Street Couplet Conversion (\$3.1 million). Significant projects completed in 2010-2011 include the Jackson Street Pedestrian Corridor, Seven Trees Sidewalk Improvements, Julia/St. James Couplet Conversion, and Hensley Historic District – SJSU to Japantown Pedestrian Corridor.

San José/Santa Clara Treatment Plant Capital Fund

In 2010-2011, a total of \$70.4 million was spent or encumbered for Water Pollution Control capital projects. The projects with the largest expenditures and encumbrances included Plant Electrical Reliability (\$14.9 million), the Revised South Bay Action Plan – South Bay Water Recycling Extension (\$18.1 million), Plant Infrastructure Improvements (\$5.2 million), SBWR Reservoir Facility (\$5.1 million), Recovery Act – South Bay Water (\$4.3 million), and Plant Master Plan (\$3.2 million). This expenditure level was \$31.6 million (31.0%) below budget. Of the \$31.6 million in savings, \$17.1 million was rebudgeted as part of the 2011-2012 Adopted Capital Budget, and an additional \$3.0 million is recommended for rebudget as part of this report. The remaining funding of \$11.5 million would be returned to the Ending Fund Balance for use in future projects. The sizable savings are due largely to challenges in staffing the growing capital program, as well as some refinement in scope and cost estimates of projects arising out of the Plant Master Plan. The Administration is developing a strategy to further advance the capital program and ensure that the projects are completed as planned.

NEXT STEPS

The results of the 2010-2011 Annual Report will provide an updated starting point for monitoring 2011-2012 budget performance. The revenue and expenditure trends will be factored into the analysis of the General Fund and the numerous special and capital funds. Information on the City's budget for 2011-2012 will be provided in Bi-Monthly Financial Reports and the 2011-2012 Mid-Year Budget Review. These reports will also provide information on the current economic environment and its impact on the City's revenue collections.

The 2010-2011 Annual Report results will also be factored into the development of the 2012-2013 Proposed Budget. As discussed at the September 20, 2011 City Council meeting, a substantial General Fund shortfall of \$78 million to \$115 million is anticipated in 2012-2013, based on the 2012-2016 General Fund Forecast issued in February 2011, updated for the 2011-2012 Adopted Budget actions and adding in likely impacts from several significant risk factors.

This initial estimate will be revised based on the actual 2010-2011 performance, data for the first quarter of 2011-2012, and projections for future performance based on current economic trends. A preliminary 2012-2013 General Fund Forecast is anticipated to be released in early November 2011, with a final Five-Year General Fund Forecast released in late February 2012. The 2011-2012 Proposed Capital and Operating Budgets are scheduled to be released in late April 2012 and May 1, 2012, 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 October 18, 2011 Council agenda.

COORDINATION

The Budget Office coordinated with the Finance Department on the reconciliation of the City's funds and coordinated with all City Departments on recommended budget adjustments that are brought forward in this document.

CONCLUSION

Through careful fiscal management, the revenues for the various City funds generally ended the year close to estimated levels and expenditures were below the budgeted allocations. The continued slow economic recovery was consistent with the assumptions incorporated into the development of the 2010-2011 budget.

In the General Fund, the additional fund balance at the end of 2010-2011 after considering clean-up adjustments totaled \$8.1 million, or 0.4% of the Modified Budget (total sources and uses). This funding, when combined with additional net funding from various technical and rebalancing actions (\$4.6 million), offset by a small number of urgent fiscal and program needs (-\$1.1 million), will allow for the establishment of a 2012-2013 Future Deficit Reserve in the amount of \$11.6 million which is recommended as part of this Report consistent with the City Council's approval of the Mayor's June Budget Message for 2011-2012. If approved, this 2012-2013 Future Deficit Reserve will be used to partially address the large General Fund shortfall (currently estimated between \$78 and \$115 million) projected for 2012-2013.

HONORABLE MAYOR AND COUNCIL

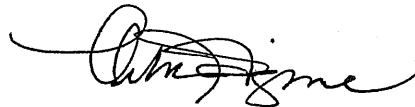
September 30, 2011

Subject: 2010-2011 Annual Report

Page xxvii

In developing the upcoming preliminary 2012-2013 General Fund Forecast, the Administration will closely analyze economic trends and the projected impacts of those trends on the City's revenues. The Administration will also continue to closely monitor the current year financial status and report to the City Council any significant developments through the regular Bi-Monthly Financial Reports.

While the City addressed another significant General Fund shortfall of \$115.1 million in 2011-2012 on the heels of balancing a shortfall of \$118.5 million in 2010-2011 and \$84.2 million in 2009-2010, the budgetary challenges facing the organization in 2012-2013 are expected to be even more severe and will be unacceptable to the San Jose community given the budget balancing actions that have already been implemented for the past ten consecutive years. As discussed at the September 20, 2011 City Council meeting, it is the Administration's professional opinion that the City is in a fiscal and service level emergency. Fundamental changes to the City's revenue and cost structures are needed to create a sustainable organization that can meet the most critical needs of our community. The fiscal reform efforts currently underway are extremely important to both the short-term and long-term viability of this City. It will take the fortitude of all involved to accept and make the difficult changes that are needed.



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 2011-2012 monies in excess of those heretofore appropriated therefrom:

General Fund	\$ 22,944,365
Airport Customer Facility and Transportation Fee	1,908,394
Airport Fiscal Agent	3,123,295
Airport Passenger Facility Charge	593,783
Airport Renewal & Replacement	3,244,273
Airport Revenue	10,666,272
Anti-Tobacco Settlement Master Settlement Agreement Benefit	147,683
Building & Structures Construction Tax	133,932
Branch Library Bond Projects	5,301,394
Business Improvement District	451,144
City Hall Debt Service	346,356
Civic Center Construction	653,246
Community Development Block Grant	12,697
Community Facilities Revenue	1,025,954
Community Facilities District Fund #2 and #3	503,478
Community Facilities District Fund #8	175,136
Community Facilities District Fund #11	170,150
Community Facilities District Fund #12	28,736
Construction & Conveyance Tax – Central Fund	88,141
Construction & Conveyance Tax – Communications	1,031,337
Construction & Conveyance Tax – Fire	680,816
Construction & Conveyance Tax – Library	918,969
Construction & Conveyance Tax – Council District 1	1,078,455
Construction & Conveyance Tax – Council District 2	1,673,337
Construction & Conveyance Tax – Council District 3	687,590
Construction & Conveyance Tax – Council District 4	273,354
Construction & Conveyance Tax – Council District 5	970,310
Construction & Conveyance Tax – Council District 6	1,447,805
Construction & Conveyance Tax – Council District 7	1,774,678
Construction & Conveyance Tax – Council District 8	1,834,713
Construction & Conveyance Tax – Council District 9	620,955
Construction & Conveyance Tax – Council District 10	1,117,411
Construction & Conveyance Tax – City-Wide	1,366,401
Construction & Conveyance Tax – Parks Yards	419,928
Construction & Conveyance Tax – Service Yards	219,117
Construction Excise Tax	398,732
Convention and Cultural Affairs	10,372,204
Convention Center Facilities District Project	3,065,815
	16,119,154

CERTIFICATION OF FUNDS (CONT'D.)

Convention Center Facilities District Revenue	9,804,926
Dental Insurance	402,809
Downtown Property & Business Improvement District	2,782
Economic Development Administration Loan	2,308
Economic Development Enhancement	343
Emergency Reserve	11,000
Emma Prusch Memorial Park	97,733
Federal Drug Forfeiture	50,524
Federal Local Law Enforcement Block Grant	93
Fiber Optics Development	32
General Purpose Parking	803,018
Gift Trust	843,187
Home Investment Partnership Program Trust	
1,584,332	
Housing Trust	404,225
Ice Centre Revenue	2,605,314
Integrated Waste Management	3,662,167
Lake Cunningham	12,726
Library Parcel Tax	1,556,697
Life Insurance	37,090
Maintenance Assessment District Fund #1	205,383
Maintenance Assessment District Fund #5	18,488
Maintenance Assessment District Fund #8	35,526
Maintenance Assessment District Fund #11	35,657
Maintenance Assessment District Fund #13	2,808
Maintenance Assessment District Fund #15	203,929
Maintenance Assessment District Fund #18	6,193
Maintenance Assessment District Fund #19	4,269
Maintenance Assessment District Fund #20	28,767
Maintenance Assessment District Fund #21	13,538
Maintenance Assessment District Fund #22	9,375
Major Collectors and Arterials	182,379
Major Facilities Fee	436,847
Parking Capital Development	36,001
Parks & Recreation Bond Projects	296,538
Public Works Program Support	733,100
San Jose Arena Enhancement	429
Sanitary Sewer Connection Fee	1,307,815
Services for Redevelopment Capital Projects	830,270
Sewer Service & Use Charge	1,000,495
Sewer Service & Use Charge Capital	5,415,478
SJ-SC Treatment Plant Capital	11,359,802
SJ-SC Treatment Plant Operating	6,618,129
State Drug Forfeiture	195,802
Stores	160,776

CERTIFICATION OF FUNDS (CONT'D.)

Storm Drainage Fee	31,883
Storm Sewer Capital	1,255,133
Storm Sewer Operating	1,360,590
Subdivision Park Trust	11,759,557
Supplemental Law Enforcement Services	748,521
Transient Occupancy Tax	464,559
Underground Utility	454,981
Vehicle Maintenance & Operation	262,752
Water Utility Capital	773,409
Water Utility	1,038,852
Workforce Investment Act	2,351,657

Jennifer A. Maguire
Budget Director