Five-Year Economic Forecast and Revenue Projections

2022-2026

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Overview

This document provides three Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2021-2022 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast, however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment that affect the City's revenue collections.

- **Base Case** – The Base Case Forecast is built on the assumption of the economy rebounding from the declines experienced from the COVID-19 pandemic. As this region continues to emerge from public health order restrictions, it is anticipated to continue benefitting from a high level of venture capital investment in the technology industry, employment growth, and a strong real estate market. Over the forecast period, activity in most of these areas is expected to rebound from the declines experienced in 2020, resulting in City's revenues exceeding pre-pandemic levels. Economically sensitive General Fund revenues such as Property Tax, Sales Tax, and Transient Occupancy Tax receipts will remain strong throughout the forecast period.

- **Optimistic Case** – The Optimistic Case Forecast assumes somewhat faster economic growth than anticipated in the Base Case, but still slower than that experienced in recent years. Venture capital investments, the key driver of the technology sector of the economy, are extremely high in each year of the forecast in the Optimistic Case. As a result, the area's largest technology employers are doing much better than in the Base Case. Local employment continues to expand at a high rate and, because of this solid employment growth, housing prices remain at high levels and grow through the entire forecast period. Inflation is also expected to be higher than in the Base Case. This stronger growth results in increased collections in the economically sensitive revenue categories, such as Property Tax, Sales Tax, and Transient Occupancy Tax.

- **Pessimistic Case** – The Pessimistic Case Forecast assumes that a combination of adverse factors results in lower economic growth rates than in the Base Case, and is strongly influenced by the pandemic's persistence as new variant transmission rates allows for a resurgence of the virus in the summer and fall of 2021-2022. Significantly lower growth is assumed for several of the key determinants of the City's revenue; local employment, local housing prices and number of property sales, and local inflation are all lower than those of the Base Case. However, this scenario does not assume an economic crash at the local, national, or international levels. In this scenario, the City's revenues, particularly Property Tax, Sales Tax, and Transient Occupancy Tax, are significantly impacted by an economic slowdown.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

As with all forecasts, this General Fund Forecast is based on a series of assumptions regarding the overall economic environment, both now and in the future. These assumptions were reached after reviewing the projections included in a number of economic forecasts. The economic conditions and the projected impacts on City revenues will continue to be closely monitored and any new developments will be factored into the City Manager's 2021-2022 Proposed Operating Budget, scheduled for release on May 3, 2021.

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

Current National Economic Conditions

Prior to the pandemic, the United States was experiencing the longest economic expansion in United States history. However, in spring 2020, as a result of the pandemic, the United States economy suddenly plunged into a recession, which lasted until summer 2020. After a very difficult 2020, the economy is anticipated to continue rebounding in 2021, even with the continued public health restrictions. Additionally, several crucial United States economic sectors are performing well, which is bolstering the United States economy, including the housing construction and technology sectors.

Housing, one of the most critical sectors in the United States economy is thriving. New home sales are continuing to rise, home prices are experiencing significant growth, and new home construction is strong. One of the primary drivers of the robust housing sector are low mortgage rates. In addition, the housing sector is performing well due to home purchasers leaving large urban centers to relocate in outlying areas, which is spurring new construction demand in those areas. These relocations are driven in part by the rising number of employees working from home due to shelter-in-place mandates, plus homeowner's desire to relocate to areas perceived as less vulnerable to problems facing big cities.

The technology sector is another very rapidly growing area of the economy. Both existing technology businesses and newly minted IPOs are driving the technology sector's rapid expansion. E-commerce and associated web experiences and related businesses are thriving, with their stocks outperforming all other sectors. In addition, the emergence of the electric cars industry will further elevate this sector in the near-term future, as electric cars are heavily technology dependent mostly in the form of software. While not yet in full production mode, electric vehicles are continuing to increase production, therefore the much-needed software for these cars will continue to be in great demand. Other areas of technology that are also becoming increasingly important include artificial intelligence, biotech, and environmental technologies, which are all growing rapidly.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Venture capital, the driving force of the technology sector, remained resilient in 2020, despite the COVID-19 pandemic. 2020 set new records in total deal values, exit value, and capital raised for venture capital funds; finishing the year with $156.2 billion invested. There was a total of 321 mega deals (deals over $100 million) in 2020, which represented an astonishing 35% increase over the previously historic 2019 level. However, first-time financing activity fell sharply, providing a more challenging fundraising environment for newer entrepreneurs. Female founders and entrepreneurs in the middle of the country, who have traditionally been under-represented in venture capital funding, also felt the impact of investors largely allocating capital to existing portfolio companies or known relationships. In addition, 2020 seemed to mark a turning point in the search for more feasible alternatives for going public. Bobby Franklin, President and Chief Executive Officer of the National Venture Capital Association stated "Despite facing macro headwinds from the COVID-19 pandemic for most of 2020, the US VC industry remained resilient on a broad level. Overall, 2020 posted record investment into high-growth startups, record capital raised by VC funds, and the second-highest year for VC-backed exit value. However, underneath the surface of those topline stats exists an increasingly concentrated industry with divergent outcomes for established players and newcomers."[1] Looking forward, the venture capital market will continue to be heavily influenced by outcomes related to the pandemic and the new presidential administration.

Another key driver to the U.S. economy is energy production. The energy sector is one of the backbones of the United States economy, with petroleum accounting for approximately one-third of the nation's energy production. While oil production had been generally decreasing for many years, beginning in 2009, more cost-effective drilling and production technologies helped boost oil production.[2] United States crude oil and petroleum product net imports fell for many years, and beginning in September 2019 the United States became a net exporter (instead of a net importer) of crude oil and petroleum products for the first time since the 1940's.

The average crude oil price experienced sharp declines in 2015-2016, with the average Brent price per barrel dropping from $96 in 2014 to $41 in 2016. Beginning in 2017, production decreases and healthy economic growth resulted in oil prices increasing to an average Brent price per barrel of $54 in 2017 and $72 in 2018. In 2019, the Brent crude oil prices totaled an average $64 per barrel and based on production and demand at that time, it was anticipated that the average Brent crude oil price would average $65 per barrel in 2020 and $68 per barrel in 2021. However, due to the weakened demand as a result of the pandemic, the average Brent crude oil price in 2020 was less than $42. In early 2021, the Brent crude oil price was forecasted to remain between $52-$56 per barrel in 2021[3]; however, due to the colder than normal weather experienced in the many states in February 2021, crude oil prices may rise over $60 per barrel. It is important to note that crude oil prices are consistently monitored and the forecasted price per barrel can change many times throughout the year.

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[1] National Venture Capital Association and PitchBook, Venture Monitor, 4th Quarter 2020
[2] U.S. Energy Information Administration, U.S. Energy Facts Explained, Updated May 7, 2020
[3] U.S. Energy Information Administration, Short-Term Energy Outlook, February 2021

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

National Economic Outlook

Prior to the pandemic that began in late February/early March 2020, the United States economy had been steadily expanding for almost a decade. The pandemic created not only a public health crisis, but an economic crisis as well. As a result of the pandemic, employment levels fell, the Gross Domestic Product (GDP) experienced its steepest quarterly drop on record, and several economic sectors such as entertainment, leisure, hospitality, travel, and recreation were decimated. However, after a difficult 2020, the outlook is cautiously optimistic for 2021, which is based on assumptions regarding several key economic indicators, including GDP, unemployment, inflation, and consumer confidence.

Following extremely high annualized GDP growth in the 3rd quarter of 2020, weak growth is anticipated in the 4th quarter of 2020 and the 1st quarter of 2021. However, as the vaccinations become more widely available for the general public in 2021, robust GDP growth is anticipated in the 2nd quarter of 2021, followed by consistent positive growth into 2023.

Unemployment levels hit record highs in 2020 as the COVID-19 pandemic shut down the national economy. However, in 2021 the unemployment rate is anticipated to decline as the economy continues to improve and more people are able to re-enter the labor market. Additionally, as many schools transitioned to distant learning due to the pandemic, many women were forced to leave the labor market in order to homeschool or provide childcare for their children. As schools continue to re-open, these women will once again enter the labor market, which will drive unemployment figures down as well.

Inflation is anticipated to average 1.8% for 2020 and remain at levels near 2.1-2.2% through 2023. Low inflation is anticipated due to excess capacity in the economy absorbing the surge in consumer demand, without leading to an increase in prices.[4] This low inflation level means the Federal Reserve will likely leave the fed funds rate (which determines the course of all other interest rates) at very low levels through the end of 2023.

On a national level, consumer confidence improved in January and February, but continues to remain below pre-pandemic levels. According to Lynn Franco, Senior Director of Economic Indicators at The Conference Board, "After three months of consecutive declines in the Present Situation Index (consumers' assessment of current business and labor market conditions), consumers' assessment of current conditions improved in February. This course reversal suggests economic growth has not slowed further. While the Expectations Index (consumers' short-term outlook for income, business, and labor market conditions) fell marginally in February, consumers remain cautiously optimistic, on the whole, about the outlook for the coming months. Notably, vacation intentions – particularly plans to travel outside the U.S. and via air – saw an uptick this month, and are posted to improve further as vaccination efforts expand."[5]

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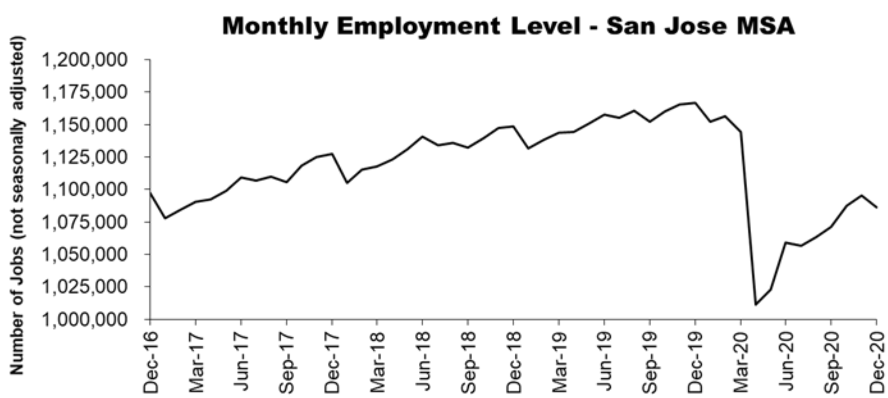
[4] UCLA Anderson Economic Forecast, December 2020
[5] The Conference Board, Consumer Confidence Survey, February 2021

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Current City of San José Economic Conditions

Economic conditions in the Silicon Valley significantly changed in Spring 2020 as a result of the pandemic. Due to uncertainty regarding the timing of when a vaccine will be widely distributed, a steep rise in COVID-19 cases during the fall and winter months, and ongoing social distancing requirements, economic conditions are anticipated to continue to be suppressed during the remainder of 2020-2021.



The December 2020 employment level of 1.09 million in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (San José MSA) dropped by 80,300 jobs, or 6.9%, from the December 2019 level of 1.17 million. This decrease includes leisure and hospitality jobs dropping by 33,400 jobs; manufacturing declining 10,900 jobs, and the information industry declining by 10,300 jobs.[6] However, as shown in the chart above, since the initial sharp employment decline at the beginning of the shelter-in-place, employment levels have increased by 75,100 jobs, or 7.4%, from April 2020 through December 2020.

After topping at 12.0% in April, the local unemployment rate has significantly dropped. In December 2020, the local unemployment rate was 6.0%, which is significantly lower than April 2020 (12.0%) and July 2020 (9.5%). Additionally, while local unemployment figures have risen since the shelter-in-place mandate began, the unadjusted rates continue to be lower than the State and the national levels.

Unemployment Rate (Unadjusted)

	Dec. 2019	April 2020	July 2020	Dec. 2020**
San Jose Metropolitan Statistical Area*	2.3%	12.0%	9.5%	6.0%
State of California	3.7%	16.2%	13.9%	8.8%
United States	3.4%	14.4%	10.5%	6.5%

* San Benito and Santa Clara Counties Source: California Employment Development Department.
** December 2020 estimates are preliminary and may be updated.

[6] State of California Employment Development: Labor Market Information Division Press Release, January 22, 2021

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Overall construction activity through December 2020 increased 17.2% from prior year levels. The increase is primarily due to extremely strong commercial activity occurring in the first quarter of the fiscal year. The 2020-2021 Adopted Budget was developed with the expectation that private development activity would remain strong, but would be significantly weaker than previous years.

Through December 2020, residential permit valuation has decreased 12.5% from prior year levels ($203.6 million through December 2020; $232.8 million through December 2019). Residential activity through December included 585 multi-family units and 271 units for single-family construction for a total of 856 units.

Commercial valuation through December experienced growth of 108.1% from the prior year level ($921.7 million through December 2020; $442.9 million through December 2019). Extremely strong commercial activity in the first quarter of the fiscal year ($741.8 million) was followed by more typical valuation in the second quarter ($179.8 million). The permit for one large new commercial office building in downtown San José accounted for more than half the valuation in the first quarter ($415.0 million). The months of November and December were a modest $39.6 million, with additions/alterations ($24.7 million) accounting for most of the commercial activity.

Private Sector Construction Activity (Valuation in $ Millions)

	YTD December 2019	YTD December 2020	% Increase
Residential	$ 232.8	$ 203.6	(12.5%)
Commercial	$ 442.9	$ 921.7	108.1%
Industrial	$ 552.0	$ 278.6	(46.6%)
TOTAL	**$ 1,197.7**	**$ 1,403.9**	**17.2%**

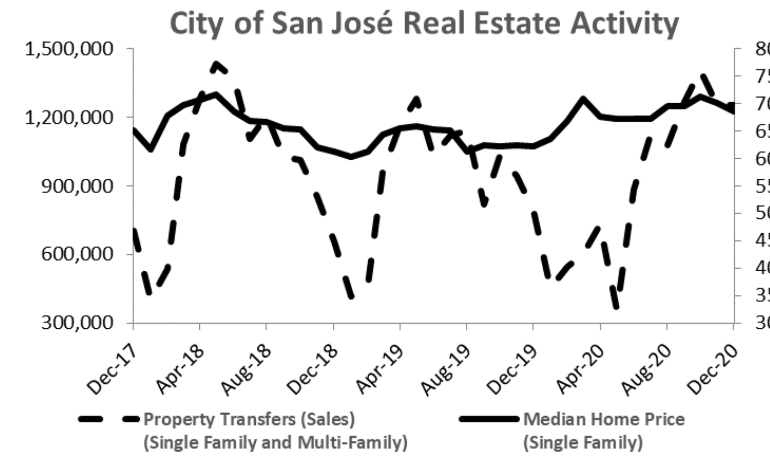
Industrial construction valuation through December was 46.6% lower than prior year levels, with receipts totaling $278.6 million through December 2020 and $552.0 million through December 2019, which was an historically high figure. The current fiscal year, however, is 33.7% higher than the 2018-2019 valuation level through December ($208.4 million). Similar to the same period for last year, a spike in permit valuations in July drove the strong valuation level thru December of this fiscal year. Industrial activity for November and December was similar for both new construction and additions/alterations (new construction of $14.6 million; alterations of $15.3 million).

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Base Case Forecast

Real estate activity was anticipated to be sluggish in 2020-2021 due to to higher unemployment rates coupled with lower consumer confidence. According to data from the Santa Clara County Association of Realtors, the number of property transfers (sales) experienced year-over-year decreases (from the same time period in the prior year) ranged from 10%-54% between the beginning of the shelter-in-place through June. However, beginning in September, the local real estate market once again began to experience year-over-year gains. Through December, there were a total of 4,099 property transfers for all residences, which represents growth of approximately 18% from December 2019 levels. In addition, median single family home prices remain strong. As of December 2020, the median single family home price totaled $1.23 million, which represents a 14.4% increase from the December 2019 price of $1.07 million.



City of San José Economic Outlook

Similar to the cautiously optimistic outlook regarding the national economy, the local economy is anticipated to experience growth in 2021, which will continue over the five-year forecast. While unemployment levels rose sharply in spring 2020, they have remained consistently well below national levels. However, while venture capital investment, a key determinant of employment levels in Silicon Valley, is still strong, the pace of investment may slightly slow over the next five-year period, which would negatively impact employment growth. The local real estate market is also anticipated to remain strong over the course of the forecast, including home prices and property sales.

Many policies and decisions made at the national level significantly influence the local economy. Near-term economic conditions are anticipated to improve if the stimulus package currently being considered in Washington D.C. passes. Additionally, foreign investment, primarily in technology and real estate, are vital to the local economy, which is anticipated to remain strong during the forecast period.

Taken together, after experiencing sharp declines in 2020, the City of San José is anticipated to rebound over the first few years of the forecast period among economically sensitive revenues such as Sales Tax, Business Tax, and Transient Occupancy Tax receipts.

ELEMENTS OF THE GENERAL FUND FORECAST

ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

Optimistic Case Forecast

The Optimistic Case Forecast assumes somewhat faster economic growth than anticipated in the Base Case. There is, however, one key economic variable for this scenario which increases at a faster rate than what would occur even in a higher economic growth scenario – the inflation rate. Higher inflation is a tonic for the City's revenue streams since higher inflation rates will tend to increase almost all of its tax revenues except for the Gas Tax.

Both the higher inflation and the higher economic activity of the Optimistic Case are distributed across the forecast period. A higher near-term inflation is assumed in the case as the result of large stimulus measures passed by Congress this calendar year. This higher inflation begins in the 2021-2022 summer and extends through most of next year and then declines but still remain above the inflation rates of the entire base case.

Sales Tax revenues benefit greatly from higher inflation, with higher prices at the retail level which translates directly into higher tax collections. Revenue from the Transient Occupancy Tax rise the fastest in the Optimistic Case compared to any other City revenues. The higher inflation assumption promotes increases in room rates while the increased levels of economic activity in this case increases occupancy rates. Rising room prices and occupancies lead directly to higher revenues for hotels and so higher tax collections. The number of hotel rooms coming online during the forecast period also causes this revenue to rise even faster. Utility Tax and Franchise Fees rise only moderately above the Base Case. These increases arise from the higher of rate inflation which increase utility rates and the increasing levels of economic activity which increase usage. Most affected are the electricity related revenues which rise faster than the other utilities such as natural gas and water and usage. The Gas Tax revenue is actually lower in the high case because the rising inflation increases gasoline prices which lowers gasoline consumption. The Gas Tax is a per gallon tax so lower consumption results in lower tax revenues. The Gas Tax is the only City revenue to decline in the Optimistic Case.

Pessimistic Case Forecast

The Pessimistic Case Forecast assumes that a combination of adverse factors results in lower economic growth rates than in the Base Case Forecast, and these lower growth rates persist through the duration of the five-year projection. In this case, the COVID-19 resurges even with the vaccination of much of the population. The new virus variant transmission rates are so much higher than current COVID-19 that these new variants transmissions overcome the progress from vaccinations. This resurgence of the virus occurs in the summer and fall of 2021-2022 for this case.

Revenue from Sales Tax are much lower than the Base Case with the next two years having negative growth rates, with 2021-2022 in particular is hard hit. This sharp decline in 2021-2022 is in contrast to the very strong positive growth rate for sales taxes in the Base Case. Property Tax revenue is lower in this case, though this revenue is not as impacted by COVID-19 related

Pessimistic Case Forecast

restrictions as other revenues. Median home prices and number of home resales are lower in the Pessimistic Case. One aspect of the Property Tax, which sets it apart from other revenues, is that it is much slower to recover from declines than other revenues – there is a long lead time from when real estate conditions actually improve to when these improvements are translated to higher assessments and then actually show up as property tax collections in the City's revenues. Another cause for the slow recovery is Proposition 8 appeals, which tend to drag down growth even after conditions have improved in the real estate markets as homeowners appeal previous assessments.

In the Pessimistic Case, the Transient Occupancy Tax revenues only grow by a miniscule 3% in 2021-2022 and recovers much more slowly than it does in the Base Case. This relatively slow recovery is because of overall lower economic activity, lower inflation which lowers room rates, and a slightly lower number of new hotel rooms coming online than for the Base Case. Utility Tax and Franchise Fees are much lower compared to Base Case for the next several years as well. These taxes, particularly for electricity, decline with the lower levels of economic activity expected in this scenario. Like many of the City's revenues, these utility related taxes begin a long climb back to normal levels after 2021-2022 but in this scenario, they never recover to the levels of the Base Case. Gas Tax revenues are actually higher in this scenario than in the base case due to the decline of oil prices. Lower oil prices reduce gas prices, which leads people to consume greater quantities of gasoline in this scenario. The Gas Tax is collected on a per gallon basis, so more gallons sold means higher tax collections.

Impact of Forecasted Economic Conditions on Revenue Collections

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

An in-depth analysis of the General Fund revenue categories was completed to develop 2021-2022 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2020-2021 and build upon those projections to develop the 2021-2022 revenue estimates. These estimates are based on the Base Case Forecast economic scenario described in this section. These revenue estimates will be closely examined and updated again during the preparation of the 2021-2022 Proposed Operating Budget scheduled to be released on May 3, 2021.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

As displayed in the General Fund Forecast below, revenues (exclusive of Beginning Fund Balance) are shown to increase from $1.31 billion in 2020-2021 to $1.34 billion in 2025-2026, for an average growth rate of 4% per year.

General Fund 2022-2026 Forecast
Revenue Summary

	Modified Budget	Forecast				
General Fund Revenue Category	**2020-2021**	**2021-2022**	**2022-2023**	**2023-2024**	**2024-2025**	**2025-2026**
General Revenues						
Property Tax	361,500,000	386,100,000	405,984,000	428,273,000	450,329,000	471,945,000
Sales Tax	262,500,000	280,200,000	294,490,000	307,065,000	322,142,000	335,253,000
Transient Occupancy Tax	5,500,000	10,000,000	15,000,000	17,130,000	18,483,000	19,444,000
Real Property Transfer Tax	40,000,000	40,000,000	40,000,000	40,000,000	40,000,000	40,000,000
Franchise Fees	45,921,096	44,501,000	45,173,000	45,954,000	46,979,000	48,168,000
Utility Tax	95,800,000	97,060,000	98,312,000	99,905,000	102,143,000	104,819,000
Telephone Line Tax	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Business Tax	63,900,000	74,500,000	75,945,000	76,553,000	77,165,000	77,783,000
Licenses and Permits	19,894,447	19,542,643	20,331,000	21,079,000	21,823,000	22,565,000
Fees, Rates, and Charges	8,575,702	14,590,339	15,179,000	15,738,000	16,293,000	16,846,000
Fines, Forfeitures and Penalties	9,730,100	8,676,000	8,863,000	9,073,000	9,235,000	9,345,000
Revenue from Money and Property	11,769,800	9,304,000	9,341,000	9,453,000	9,652,000	9,845,000
Revenue from Local Agencies	23,291,739	15,490,023	15,943,000	16,446,000	16,945,000	17,435,000
Revenue from the State	15,137,455	12,130,000	12,130,000	12,130,000	12,130,000	12,130,000
Revenue from Federal	7,859,131	-	-	-	-	-
Other Revenue	200,910,694	8,420,324	8,444,000	8,472,000	8,509,000	8,552,000
Gas Tax	15,000,000	16,000,000	14,965,000	14,275,000	13,852,000	13,736,000
Total General Revenues	**1,207,290,164**	**1,056,514,329**	**1,100,100,000**	**1,141,546,000**	**1,185,680,000**	**1,227,866,000**
Transfers & Reimbursements						
Overhead Reimbursements	69,197,893	66,185,738	68,857,000	71,390,000	73,909,000	76,420,000
Transfers	36,578,485	28,360,478	28,972,000	29,416,000	30,073,000	30,843,000
Reimbursements for Services	745,997	788,507	820,000	851,000	881,000	910,000
Total Transfers & Reimbursements	**106,522,375**	**95,334,723**	**98,649,000**	**101,657,000**	**104,863,000**	**108,173,000**
Total General Fund Revenues	**1,313,812,539**	**1,151,849,052**	**1,198,749,000**	**1,243,203,000**	**1,290,543,000**	**1,336,039,000**
Beginning Fund Balance	400,283,991	68,785,000	63,899,000	64,473,000	66,296,000	68,151,000
Grand Total Sources	**1,714,096,530**	**1,220,634,052**	**1,262,648,000**	**1,307,676,000**	**1,356,839,000**	**1,404,190,000**

Understanding the basis for the revenue estimates included in this Forecast requires a discussion of the assumptions used for estimating each of the revenue categories. The following discussion focuses on estimates used for the 2022-2026 General Fund Forecast.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

The Property Tax category consists of Secured Property Tax, Unsecured Property Tax, SB 813 Property Tax (retroactive collections back to the point of sale for reassessments of value due to property resale), Aircraft Property Tax, and Homeowner's Property Tax Relief. In 2020-2021 Property Tax receipts of $370.2 million are projected, which is slightly above the modified budget estimate ($361.5 million; 2.4%) and the 2019-2020 actual collection level ($369.5 million; 0.2%). In 2021-2022, Property Tax receipts are anticipated to grow overall by approximately 4% from estimated 2020-2021 levels to $386.1 million. Additional information about each of the Property Tax sub-categories is provided below.

Secured Property Taxes account for over 90% of the revenues in this category. The Secured Property Tax category includes general Secured Property Tax, Educational Revenue Augmentation Fund (ERAF) revenues, and Successor Agency to the Redevelopment Agency (SARA) Residual Property Tax. In 2020-2021, Secured Property Tax receipts are anticipated to total $344.4 million, including $315.1 million in general Secured Property Taxes, $18.0 million in ERAF revenue, and $11.3 million from SARA Residual Property Tax receipts. In 2021-2022, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2021, are expected to increase by approximately 5.5% to $363.5 million. This increase reflects underlying growth of 3.5% for secured receipts, plus an additional $7.0 million in SARA Residual Property Tax receipts, which is further described below.

The general Secured Property Tax receipts are estimated at $315.1 million in 2020-2021, which is 5.1% above the 2019-2020 collection level. This growth primarily reflects an increase in assessed value due to the California Consumer Price Index (CCPI) increase of 2%, and increased valuation due to changes in ownership or new construction. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. On a County-wide basis, the 2020-2021 roll growth was driven primarily by changes in ownership (48.3%), change in the CCPI (27.3%), and new construction (24.0%).

In 2021-2022, the general Secured Property Tax receipts are estimated to grow by 3.5%, reflecting a 1% CCPI and 2.5% increased valuation. Due to impacts related to the COVID-19 pandemic, the CCPI adjustment for the 2021-2022 tax roll is 1%, which is below the prior year level (which is typical of most years) of 2%. In addition, while high residential property sale prices are anticipated to continue being a positive factor driving growth in this category, the COVID-19 pandemic is estimated to continue negatively impacting commercial real estate activity. Therefore, while general Secured Property growth has ranged from 5% to 8% since 2014-2015, growth of only 3.5% is anticipated in 2021-2022.

In addition to the changes in assessed value, Secured Property Tax collections are impacted by excess ERAF revenue. Beginning in 1992, agencies have been required to reallocate a portion of property tax receipts to the ERAF, which offsets the State's General Fund contributions to school districts under Proposition 98. However, once there are sufficient funds in ERAF to fulfill

REVENUE FORECAST

Property Tax

obligations, the remainder is to be returned to the taxing entities that contributed to it, which generally occurs in March of each fiscal year. Due to a State-required change regarding the calculations of ERAF, 2020-2021 revenues are estimated at $18.0 million, which reflects a 22% decline from 2019-2020 actual receipts and a 40% decline from collections that would have been received in 2020-2021 if the calculations were not revised. In 2021-2022, ERAF receipts are anticipated to grow by 3.5% to $18.6 million. After the City receives an official ERAF estimate from the County later in March, these figures may be revised with the release of the 2021-2022 Proposed Operating Budget.

The final component of the Secured Property Tax category is the SARA Residual Property Tax receipts. As a result of the SARA bond refunding that occurred in December 2017, the City receives a residual property tax distribution. In 2019-2020, SARA Residual Property Tax receipts totaled $21.1 million, but are anticipated to drop to $11.3 million in 2020-2021. This decrease is the result of a State of California Appellate Court decision, which revised the distribution formula related to all California residual property tax revenue from former Redevelopment Agencies, resulting in a loss of approximately $10 million in 2020-2021 to the City of San José. Of this amount, approximately $7 million reflected a one-time reduction for the payback of prior years, and $3 million reflected an ongoing decrease. In 2021-2022, SARA Residual Property Tax receipts are estimated at $18.9 million, which reflects the reinstatement of the one-time payback of $7 million and underlying growth of 3.5%.

It should be noted that final data on the actual tax levy for 2021-2022 is not yet available as adjustments are made through June 30, 2020. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Some of the adjustments, however, are not reflected until the latter months of a given fiscal year, such as the reassessments of commercial property. Due to the COVID-19 pandemic, larger adjustments to commercial property than normally occur is anticipated. As updated information becomes available, refinements to the Property Tax estimates may be brought forward during the 2021-2022 budget process.

Unsecured Property Taxes are the second largest revenue source in this category. Growth in this category is driven primarily by increases or decreases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections through January and information provided by Santa Clara County, Unsecured Property Tax receipts are estimated at $15.8 million in 2020-2021, which is slightly above the prior year collection level of $15.5 million. In 2021-2022, due to COVID-19 pandemic’s impact on local businesses, Unsecured Property Taxes are estimated to drop 15% and total $13.5 million.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Property Tax

For the other Property Tax categories, 2020-2021 collections are estimated at $10.0 million in 2020-2021 and $9.1 million in 2021-2022. **SB 813 Property Tax** receipts are estimated at $6.0 million in 2020-2021 and $5.1 million in 2021-2022; **Aircraft Property Tax** receipts are estimated at $3.1 million in 2020-2021 and 2021-2022; and **Homeowners Property Tax Relief** revenue are anticipated to total approximately $900,000 in 2020-2021 and 2021-2022.

In the out-years of the Forecast, annual Property Tax receipts are projected to increase approximately 4.8% to 5.5% annually over the five-year period. A portion of this growth is due to an estimated 2% CCPI increase annually.

Sales Tax

As shown in the following table, the City receives 1.25% of the 9.25% Sales Tax collected for items sold in San José. The distribution percentage includes a 0.25% local transaction and use tax enacted by the City of San José effective October 1, 2016 (limited to 15 years). The City also receives a portion of the Public Safety Fund (Proposition 172) Sales Tax collected State-wide.

Agency	Distribution Percentage
State of California	5.500%
City of San José	1.000%
City of San José (Local Tax)	0.250%
Public Safety Fund (Proposition 172)	0.500%
Santa Clara County (Including VTA)	2.000%
Total	**9.250%**

In March 2020, as the COVID-19 pandemic rapidly accelerated, the County of Santa Clara instituted a shelter-in-place order, which severely restricted economic activity. The shelter-in-place and subsequent public health orders have impacted almost all sectors of Sales Tax revenue, including retail sales, transportation, and business-to-business. Information related to Sales Tax payments are distributed from the California Department of Tax and Fee Administration (CDTFA) four times throughout the year: November (representing July-September activity), February (representing October-December activity), May (representing January-March activity), and August (representing April-June activity). Based on information received through February 2021 (which reflects two quarters of Sales Tax activity; from July 2020 through December 2020), it is anticipated that 2020-2021 Sales Tax revenue will total $269.0 million. In 2021-2022, receipts are estimated at $280.2 million, which reflects overall growth of approximately 4%. Additional information about each of the Sales Tax sub-categories is provided below.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Sales Tax

General Sales Tax is the largest driver of the Sales Tax category and accounts for approximately 80% of all Sales Tax receipts. General Sales Tax receipts for the first quarter (sales tax activity for July-September) and second quarter (sales tax activity for October-December) were received in November 2020 and February 2021, respectively. When excluding revenue associated with the Revenue Capture agreement with eBay, Inc. (which was not received in the first quarter of 2019-2020), receipts in 2020-2021 have declined approximately 9% from the 2019-2020 collection level. However, 3rd and 4th quarter receipts (January through June activity) are anticipated to experience growth of 5%-6% compared to 2019-2020 levels, which had significant declines due to the strict shelter-in-place mandates that began in March 2020. Based on these assumptions, General Sales Tax collections are anticipated to total $219 million in 2020-2021, which reflects a decrease of 3% from the 2019-2020 collection level (excluding the Revenue Capture Agreement, which was only received in three quarters of 2019-2020).

Most General Sales Tax categories have experienced significant declines from the prior year, with the exception of Construction and the County Pool. The first quarter General Sales Tax payment reflected growth of 3.7% in Construction and 42.0% growth for the County Pool, while reflecting negative growth within the transportation, general retail, business-to-business, and food products sectors ranging of -17.5% to -26.2%. The County Pool's significant growth is attributable to the surge in online purchases during the pandemic, and facilitated by the South Dakota vs. Wayfair, Inc. Supreme Court decision in 2018, which provided states with the authority to require online retailers to collect sales tax even without a local presence in that State. The County Pool revenue is distributed to all cities within Santa Clara County based on a distribution formula administered by the CDTFA. This formula is based each quarter on each jurisdiction's total General Sales Tax receipts divided by the Total General Sales Tax receipts for the entire County. The City typically receives between 40% - 50% of the total County Pool.

In 2021-2022, as the COVID-19's vaccine rollout continues and shelter-in-place mandates are continued to be eased, General Sales Tax activity is anticipated to improve. The 2021-2022 General Sales Tax revenue is anticipated to experience underlying growth of 7%; however, it is also estimated that collections associated with the Revenue Capture Agreement may decrease slightly as people shift some online spending to general retail (brick and mortar) shopping. Therefore, the 2021-2022 General Retail Sales Tax estimate of $228 million reflects underlying growth of 7%, but overall growth of only 4% from the prior year collection level.

In June 2016, San José voters approved a ¼ cent **Local Sales Tax**, which was implemented in October 2016. Local Sales Tax is generated based on the destination of the purchased product; therefore, all out-of-state online retailers (including marketplace facilitators) sales tax collections are directly distributed to the City of San José, versus the General Sales Tax revenue that is deposited in the County Pool, where the City only receives approximately 40% - 50% of the proceeds. Due to this distinction, Local Sales Tax revenue may not always experience the same growth and decline rates as General Sales Tax receipts.

REVENUE FORECAST

Sales Tax

Similar to General Sales Tax, Local Sales Tax receipts for the first quarter (sales tax activity for July-September) and for the second quarter (sales tax activity from October-December) were received in November 2020 and February 2021, respectively. Receipts through the first two quarters reflect a decline of approximately 5% from the prior year. However, 3rd and 4th quarter receipts (January through June activity) are anticipated to have growth of 10% compared to 2019-2020 levels, which had significant declines due to the strict shelter-in-place mandates that began in March 2020. Based on these assumptions, Local Sales Tax collections are anticipated to total $44 million in 2020-2021, which is fairly consistent with the prior year level. In 2021-2022, Local Sales Tax revenue is anticipated to grow approximately 5% to $46.0 million. This increase reflects improvements due to the anticipation of shelter-in-place mandates easing and the economy continuing to improve.

Proposition 172 Sales Tax collections (representing the ½ cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total $6.0 million in 2020-2021 and grow approximately 4% to $6.2 million in 2021-2022.

In the out-years of the Forecast, annual Sales Tax performance is expected to show growth of 4.1% to 5.1% annually.

Transient Occupancy Tax

In 2020-2021, Transient Occupancy Tax (TOT) receipts in the General Fund (which represent 40% of the total tax) are estimated to reach $5.5 million, reflecting a 61% drop from the 2019-2020 collection level of $14.1 million, and a 73% decline from the 2018-2019 collection level of $20.5 million. The drastic decline in TOT receipts beginning in spring 2020 illustrate the contraction in hotel activity in response to the COVID-19 pandemic. Through December 2020, the average hotel occupancy rate reported for the San José market was 36.7%, a steep drop from the same period in 2019-2020 (74.1%). Average room rates also decreased by 46.9%, from $191.50 to $101.70, and the year-to-date average revenue-per-available room (RevPAR) decreased 73.7%, from $141.96 to $37.33, relative to the same period in 2019-2020.

Beginning in 2021-2022, as vaccines become more widely available and travel restrictions are lifted, hotel activity is anticipated to steadily rebound. The 2022-2026 General Fund Forecast projects TOT receipts will increase by approximately 82%, to $10.0 million in 2021-2022, and increase an additional 50% to $15.0 million in 2022-2023. In the remaining out-years of the Forecast, growth ranging from 5.2% to 14.2% are anticipated. These figures incorporate the City's internal review of available data along with information received from the City's consultants, forecasted economic and convention performance, and other correlated economic variables. However, the growth assumptions used in the development of this Forecast are more conservative than those assumed by the City's consultant, Tourism Economics, which projected potential annual growth ranging from 127% to 5% over the forecast period.

Elements of The General Fund Forecast

Revenue Forecast

Franchise Fees

Franchise Fees are collected in the Electricity, Gas, Commercial Solid Waste, Cable, City-Generated Tow, Water, and Nitrogen Gas Pipeline categories. Overall, collections are projected at $45.8 million in 2020-2021, which is approximately 3% above the prior year receipts of $44.4 million. In 2021-2022, Franchise Fees are expected to decrease approximately 3% to $44.5 million, which primarily reflects drops in the Electric, Gas, and Cable Franchise Fees.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2020-2021 are based on calendar year 2020 and revenues in 2021-2022 will be based on calendar year 2021). Year-end estimates are typically based upon an examination of electricity and gas rate changes, industry actions, and actual collection patterns in the utility tax categories. The reconciliation of annual receipts from PG&E for 2020-2021 will be received in April 2021.

In the **Electricity Franchise Fee** category, collections in 2020-2021 are anticipated to reach $18.8 million, reflecting growth of approximately 9% from the 2019-2020 receipts. This estimate takes into consideration the actual collection patterns for electricity utility tax receipts in calendar year 2020. Due to the COVID-19 pandemic and the resulting stay-at-home orders, electricity usage increased in late 2019-2020 through 2020-2021, which will result in higher Electricity Franchise Fee receipts. However, as stay-at-home orders are lifted and the COVID-19 vaccine becomes more widely available, people will return to work and school, which may negatively impact fee receipts in 2021-2022. Therefore, in 2021-2022, Electricity Franchise Fee collections are projected to decrease by approximately 5% to $17.9 million

In the **Gas Franchise Fee** category, the 2020-2021 estimated collections of $6.2 million reflects a 5% increase from prior year receipts of $5.9 million. This estimate takes into consideration the actual collection patterns for gas utility tax receipts in calendar year 2019. Similar to the Electric Franchise Fee, gas usage increased in late 2019-2020 through 2020-2021 due to more people staying at home. However, in 2021-2022 Gas Franchise Fee collections are projected to decrease by approximately 5% to $5.9 million as more people return to work and school. It is important to note, however, that receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

Commercial Solid Waste (CSW) Franchise Fee collections are estimated to reach $12.3 million in 2020-2021, 1.8% above the prior year collections, which is due to the 2020-2021 CPI-based increase. Collections reflect the revised methodology for assessing this fee that became effective July 1, 2012. On October 19, 2010, the City Council amended the CSW fee to charge franchises based on geographic collection districts rather than volume. The fee structure is a base of $5 million per year for each of two geographic collection districts plus a supplemental fee of $1.0 million for the right to conduct CSW services in both the North District and the South District. This revised structure is subject to an annual increase based on the percentage change in the CPI rate during the prior two calendar years. It should be noted that this increase is not automatic, and is subject to City Council approval each year. Therefore, the 2021-2022 estimate of $12.3 million

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Franchise Fees

is consistent with the 2020-2021 estimate and does not automatically assume a CPI adjustment. This adjustment will be brought forward as a proposed change in the 2021-2022 Proposed Operating Budget.

In the **Cable** Franchise Fee category, the estimated 2020-2021 collections of $8.3 million is 5% below the prior year receipts of $8.7 million. In addition, revenue in 2021-2022 is anticipated to drop an additional 2% to $8.1 million. As people continue to move from cable to less expensive streaming options (that do not include a Franchise Fee), this revenue source is anticipated to continue to decline.

Remaining franchise fees include the **City Generated Tow, Great Oaks Water, and Nitrogen Gas Pipeline** categories. City Generated Tow receipts are estimated at $0 in 2020-2021 and $50,000 in 2021-2022 (these low levels are associated with the pandemic's impact on the Tow program), Great Oaks Water receipts are estimated at $210,000 in 2020-2021 and $216,000 in 2021-2022, and Nitrogen Gas Pipeline receipts are estimated at $65,000 in 2020-2021 and 2021-2022.

In the out-years of the Forecast, Franchise Fee revenues are anticipated to increase by 1.5% to 2.5%. However, it is important to keep in mind that there is a significant potential for fluctuations in growth rates depending on the outcome of rate cases as well as changes in consumption levels.

Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2020-2021 are anticipated to total $100.2 million, which is slightly above the 2019-2020 collection level of $99.5 million. In 2021-2022, Utility Tax collections are projected to decrease approximately 3% to $97.1 million. Due to the uncertainty regarding the outcome of rate cases, the Forecast generally does not assume revenue increases associated with pending rate cases; however, it does take into account changes already approved. Rate cases will continue to be monitored and adjustments will be brought forward as appropriate based on the final outcomes.

The **Electricity Utility Tax** is anticipated to generate $51.1 million in 2020-2021, a 5% increase from prior year levels. Due to the COVID-19 pandemic and the resulting stay-at-home orders, electricity usage increased in late 2019-2020 through 2020-2021, which is driving up the Electricity Utility Tax receipts. However, as stay-at-home orders are lifted and the COVID-19 vaccine becomes more widely available, people will return to work and school, which may result in less Electricity Utility Tax receipts in 2021-2022. Therefore, the 2021-2022, Electricity Utility Tax revenues are estimated to decrease 5% to $48.5 million.

The **Gas Utility Tax** is anticipated to generate $12.3 million in 2020-2021, a 9.6% increase from the 2019-2020 collection level. Similar to the Electricity Utility Tax, gas usage increased in late 2019-2020 through 2020-2021, due to the stay-at-home orders. Additionally, gas rates have risen,

REVENUE FORECAST

Utility Tax

which increases collection levels. In 2021-2022, as more people return to work and school, Gas Utility Tax receipts are anticipated to decrease by approximately 5% to $11.7 million It is important to note, however, that receipts can fluctuate significantly due to consumption changes associated with the weather and future rate changes.

Based on current year collection levels, **Water Utility Tax** receipts of $16.5 million are anticipated to be received in 2020-2021; a decrease of approximately 2% from the 2019-2020 collection levels. In 2021-2022, water rates are anticipated to rise, therefore Water Utility Tax receipts are estimated at $17.6 million, which reflects a 6.5% increase from the 2020-2021 anticipated collection level.

In the **Telephone Utility Tax** category, revenues are collected on landlines, wireless, VoIP, and prepaid wireless services sold at retail locations. Receipts (excluding compliance revenue) in 2020-2021 are projected at $20.3 million, an 11% drop from the 2019-2020 collection level. In 2021-2022, receipts are projected to decrease an additional 5% to $19.3 million. The decline in this revenue category is the result of wireless consumers shifting to less expensive prepaid wireless plans, competition with cellular companies that keep prices down, and that the data component of wireless plans is not taxable.

In the out-years of the Forecast, conservative growth ranging from 1.3% to 2.6% annually is projected overall in the Utility Tax category. There is significant volatility and uncertainty regarding the performance in this category based on potential changes in rates and consumption levels. In addition, the Water and Gas Utility Tax categories are significantly influenced by weather conditions.

Telephone Line Tax

Based on the current collection trend, receipts (excluding compliance revenue) in 2020-2021 and 2021-2022 are estimated to total $20.0 million, which is consistent with the 2019-2020 actuals. Given the steady nature of collections in this category, receipts are anticipated to remain flat in the out-years of the Forecast as well.

Business Taxes

This category includes General Business Tax, Cardroom Business Tax, Cannabis Business Tax, and Disposal Facility Tax. Business Taxes are estimated to reach $63.4 million in 2020-2021, a 10.5% drop from prior year levels, which is primarily due to decreased Cardroom and General Business Tax revenues. In 2021-2022, Business Taxes revenues are anticipated to increase 17.5% to $74.5 million.

REVENUE FORECAST

Business Taxes

Beginning in 2017-2018, **General Business Tax** collections reflect the modernization of the San José business tax, which was approved by San José voters on November 8, 2016 and took effect on July 1, 2017. The adjustments to the business tax included increasing the base tax, increasing the incremental tax and making it more progressive, increasing the cap (the maximum amount of the tax affecting large businesses), updating the application of the tax to more classes of business, and adding inflation-based adjustments for future tax rates. In 2020-2021, **General Business Tax** proceeds are anticipated to reach $25.7 million, which is approximately 11% below the 2019-2020 collection level. This decrease reflects the COVID-19 pandemic's impact on local businesses. In 2021-2022, General Business Tax revenue is anticipated to remain flat as a result of a moderate annual inflation rate change, offset by reduced activity levels.

Cardroom Business Tax receipts are estimated at $9.4 million, a 30% drop from the 2019-2020 collection level, and a 50% drop from the 2018-2019 collection level. As a result of the shelter-in-place mandate, cardrooms suspended operations in March 2020 and remained closed through August 2020. In September, public health orders were modified to allow cardrooms to begin outdoor operations with social distance requirements. However, cardrooms were only open for a limited period of time, before further health orders by Santa Clara County and then subsequently the State of California resulted in the closure of cardrooms from November 30 through January 27. As of the writing of this report, Cardrooms are once again operational, under modified restrictions. In 2021-2022, as health orders restrictions continue to ease, Cardroom Tax receipts are anticipated to increase to $20.0 million. The estimates for Cardroom Tax receipts are inclusive of the ballot measure approved by voters in November 2020 that increased taxes on cardroom operators beginning in January 2021.

Cannabis Business Tax collections began after the November 2016 California Marijuana Legalization Initiative (Proposition 64) was approved by voters and recreational marijuana use was legalized in California. As a result, the sale of recreational cannabis at the 16 licensed dispensaries in San José began in January 2018. Based on current collection trends, it is anticipated Cannabis Business Tax receipts will total $17.0 million in 2020-2021, which is 6.8% above the prior year collections. In 2021-2022 receipts are projected to grow by approximately 3% to $17.5 million.

Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream can vary due to factors that affect the amount of waste generated and how it is disposed including: economic activity, weather, diversion programs, and price sensitivity to disposal rates. Based on current collection trends, 2020-2021 DFT collections are estimated at $11.3 million, representing a 10% drop from 2019-2020 collection levels. In 2021-2022, receipts are anticipated to remain flat at $11.3 million.

In the remaining years of the forecast, overall, the Business Tax category is expected to experience changes ranging from 0.8% to 1.9% per year.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Licenses and Permits and Fees, Rates, and Charges

The Licenses and Permits and Fees, Rates, and Charges categories contain fees and charges collected by various departments. Historically, a significant portion of the revenue captured in these categories were associated with development-related fees. However, beginning in 2020-2021, all revenue and expenditures related to the Development Fee Programs are no longer captured in the General Fund, and are instead allocated to specific Development Fee Program Funds.

Remaining non-development fees are projected based on City Council-approved cost-recovery policies with the goal of a net-zero impact on the General Fund. The Licenses and Permits category is estimated to total $19.2 million in 2020-2021 and grow slightly to $19.5 million in 2021-2022.

Fees, Rates, and Charges revenue has been significantly impacted by the shelter-in-place mandate, especially Parks, Recreation and Neighborhood Services (PRNS) Departmental Charges. PRNS program delivery and revenue generation has been impacted in all fee categories, including: Happy Hollow Park and Zoo; Fee Activity (classes, camps, and after-school activities); Facility Rentals; Sports Facilities Reservations; Lake Cunningham Action Sports Park; Gym and Fitness; Parking; Park Permits; Arcadia Ball Park; Family Camp; and Aquatics Program. In 2020-2021, PRNS Fee Revenue is estimated at $1.1 million, which is vastly below the 2019-2020 actual collection level of $14.2 million and the 2018-2019 actual collection level of $21.7 million. In 2021-2022, PRNS Fee revenue is anticipated to grow to $9.0 million as health orders restrictions are eased. Overall, the Fees, Rates and Charges revenue category is estimated at $6.3 million 2020-2021 and $14.6 million in 2021-2022.

In the out-years of the Forecast, both the Licenses and Permits and Fees, Rates, and Charges categories are expected to experience annual growth ranging from 3.4% to 4.0%. The growth rates in the out-years are tied to the expected increases in personnel costs, which the fees are designed to recover, including salary, retirement, and health costs.

Fines, Forfeitures and Penalties

The Fines, Forfeitures and Penalties category is expected to generate $5.8 million in 2020-2021 and $8.7 million in 2021-2022. The largest component of this revenue category is Parking Fines, which are expected to generate approximately $3.5 million in 2020-2021 and $6.0 million in 2021-2022. These levels are far below historical Parking Fine collections of approximately $11 million - $12 million annually. Parking Fines activity has been significantly impacted by the COVID-19 pandemic as the Transportation Department have only been performing limited citations related to meter violations. Beginning in January 2021 enforcement of posted street sweeping restrictions restarted, which is anticipated to increase revenue generation. However, at this time there is no set timeline to begin to fully activate citations for meter violations or to resume enforcement of other types of violations. In the out-years of the Forecast, annual growth of approximately 1.2% to 2.4% is projected in this revenue category.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Revenue from the Use of Money and Property

The Revenue from the Use of Money and Property category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, interest income, and small cell lease revenue. Overall revenue in this category is anticipated to generate $9.6 million in 2020-2021 and reduce slightly to $9.3 million in 2021-2022.

In the out-years of the Forecast, growth of 0.4% to 2.1% annually is assumed in the Money and Property category.

Revenue from Local Agencies

In 2020-2021, revenue of $23.3 million is projected from other local agencies, such as the Central Fire District payment for fire services provided to County residents by the San José Fire Department, the County of Santa Clara payments for the Paramedic Program and Senior Nutrition, and the Valley Transportation Authority reimbursement for police services at the Berryessa BART station. In 2021-2022, revenue in this category is projected at $15.5 million, which is $7.8 million below the 2020-2021 estimate. The decrease in 2021-2022 revenue is primarily due to reimbursements and grants that are not secured on an ongoing basis being eliminated.

The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. Based on information provided by the Central Fire District, payments of $8.1 million are anticipated in 2020-2021 and 2021-2022.

The Forecast assumes reimbursement from the County of Santa Clara for the first responder advanced life support program (Paramedic Program), which totals $3.0 million in 2020-2021 and 2021-2022. Funding for the Paramedic Program includes the equipment reimbursement component (Annex B, Category A funds; $1.45 million) and service-related component (Annex B, Category B funds; $1.55 million). In addition, the Forecast assumes reimbursement from the Valley Transportation Authority for police services at the Berryessa BART station, which totals $2.2 million in 2020-2021 (which includes one-time costs associated with vehicle purchases) and $2.1 million in 2021-2022.

In the out-years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by 2.9% to 3.2%.

Revenue from the State of California

The Revenue from the State of California category includes Tobacco Settlement payments, State grant revenues, and other State reimbursements. Collections in this category are estimated to reach $12.1 million in 2021-2022 and remain flat through the out-years of the Forecast. Tobacco

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Revenue from the State of California

Settlement payments account for the majority of revenue in this category and are estimated at $10.2 million in 2021-2022, which is consistent with the amount projected for 2020-2021.

The remaining State grants and reimbursements total $1.9 million in 2021-2022, with the largest reimbursements for the Auto Theft program ($800,000), Vehicle License Fees Collection in Excess ($500,000), and Abandoned Vehicles Abatement program ($500,000). Vehicle License Fees Collection in Excess account for the Vehicle License Fee revenues that are collected by the Department of Motor Vehicles as a result of certain compliance procedures that are equally apportioned to counties and cities on a population basis.

Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues. In 2021-2022 and the out-years of the Forecast, there is no funding assumed for this revenue category.

Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and payments for Sidewalk Repairs. In 2020-2021, this category is expected to generate $198.2 million, which includes one-time revenue of $130.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension benefits that are brought forward for City Council approval in June of each year along with the associated expenditure. Additionally, one-time funding of $26.0 million is anticipated for the refunding of City Hall lease-revenue, and $23.4 million is anticipated from commercial paper proceeds related to the construction of the Fire Training Center and Emergency Operations Center.

In 2021-2022, the Other Revenue estimate of $8.4 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2021-2022 costs or agreements and the elimination of one-time funding sources. In 2021-2022, payments from Comcast and AT&T are estimated at $1.6 million. As defined in the Franchise Agreement, these funds will be used to support the Public, Education, and Government (PEG) Access facilities; associated City-Wide Expenses appropriations are also allocated for this purpose. Sidewalk repair services are estimated at $2.0 million (which has an expenditure offset in City-Wide Expenses). In addition, the cost reimbursement for the Investment Program as administered by the Finance Department is estimated at $1.1 million based on the current allocation of staff to this function.

In the out-years of the Forecast, annual collections are expected to experience growth ranging from 0.3% to 0.5% annually.

ELEMENTS OF THE GENERAL FUND FORECAST

REVENUE FORECAST

Gas Tax

Based on year-to-date performance, the Gas Tax receipts in 2020-2021 are projected to reach $15.5 million, which is consistent with the prior year actuals. Several factors impact collections, including falling gas prices that would support increased consumption and, as an offsetting factor, the move to more energy efficient automobiles. In addition, a portion of the Gas Tax revenue is allocated to cover various State-wide expenses, which affects net receipts as well. In 2021-2022, as the shelter-in-place mandate is lifted, it is anticipated driving will increase, which will result in higher gas tax collections. Therefore, 2021-2022 collections are estimated at $16.0 million, a 3% increase from current year levels. In the out-years of the Forecast, due to a combination of rising fuel prices, increased use of fuel-efficient or hybrid vehicles, and the increased use of electric vehicles, annual collections are expected to experience declines ranging from -0.8% to -6.5% annually.

Overhead Reimbursements

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2021-2022, a total of $66.2 million in overhead reimbursements are projected based on 2021-2022 overhead rates for the majority of City funds prepared by the Finance Department applied against the projected 2021-2022 salaries for those positions for which an overhead rate is applied. In the remaining years of the Forecast, annual growth ranging from 3.4% to 4.0% is assumed, reflecting increases in costs, which the overhead rate is designed to recover, including increased personal services costs.

Transfers

The Transfers category is projected at $28.4 million in 2021-2022. The largest component of the Transfers category is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs ($18.6 million). Additional large transfers programmed for 2021-2022 include the Construction and Conveyance Tax Fund transfer ($3.7 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer ($1.75 million) for general use and pavement maintenance activities; the General Purpose Parking Fund ($707,000); and the transfer from the Convention and Cultural Affairs Fund ($348,000) for reimbursement of City oversight of the fund.

In the remaining years of the Forecast, annual increases range from 1.5% to 2.6%. The reimbursement from the Airport Maintenance and Operation Fund for police and fire services is expected to increase in the out-years based on the increased costs for those services.

Elements of The General Fund Forecast

Revenue Forecast

Reimbursements for Services

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program, Voluntary Employee Beneficiary Association (VEBA) Fund, and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2021-2022 of $789,000. In the remaining years of the Forecast, annual growth ranging from 3.4% to 4.0% is anticipated to recover the projected costs.

Beginning Fund Balance

The $68.8 million forecast estimate of available 2021-2022 Beginning Fund Balance is based on the following assumptions:

- The current Contingency Reserve of $40.0 million is carried forward at the current level based on the assumption that this amount will not be used in 2020-2021 and will be available for use in 2021-2022. The current funding level is enough to cover General Fund payroll costs for approximately two weeks in an emergency. (On the expenditure side, the Contingency Reserve is set at $40.0 million in 2021-2022 and increases in the out-years of the forecast to $42.5 million by 2025-2026 to comply with the City Council policy to set aside at least 3% of General Fund operating expenditures in this Reserve.
- A total of $20.0 million in fund balance will be achieved in 2020-2021 for use in 2021-2022 from a combination of excess revenues and expenditure savings, as well as the liquidation of prior-year carryover encumbrances. Consistent with past practice, the Administration will closely monitor actual General Fund performance through the remainder of the year and may bring forward adjustments to this estimate as appropriate later in the budget process.
- An additional $8.8 million reflects the anticipated liquidation of reserves. The current year reserves that will be used to support base costs programmed in 2021-2022 include the Police Sworn Hire Ahead Program Reserve ($7.0 million), Community Service Officer Program Reserve ($700,000), Solid Waste Code Enforcement Program Reserve ($600,000), and SAFER Grant Reserve ($485,000).

In the out-years of the Forecast, the Beginning Fund Balance estimates assume that excess revenue and expenditure savings, including liquidations of carryover encumbrances will increase slightly each year from $23.0 million in 2022-2023 to $26.5 million in 2025-2026. In addition, it is assumed that the Contingency Reserve will be carried over each year and will grow slightly from $40.0 million in 2021-2022 to $42.5 million in 2025-2026. In total, the Beginning Fund Balance totals $68.8 million in 2021-2022 (of which $8.8 million reflects the liquidation of reserves discussed above) and $68.2 million in 2025-2026.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

General Fund expenditure categories were analyzed in depth to develop the 2021-2022 expenditure estimates in this Forecast. These estimates will be re-examined and updated during the preparation of the 2021-2022 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from $1.3 billion in 2021-2022 to $1.4 billion in 2025-2026, representing an average annual growth rate of 3.3%.

2022-2026 General Fund Forecast Expenditure Summary

Expenditure Category	Modified Budget 2020-2021	2021-2022	2022-2023	Forecast 2023-2024	2024-2025	2025-2026
Personal Services						
Salaries and Other Compensation	511,530,578	537,329,767	548,436,309	567,631,580	587,498,685	608,061,139
Retirement	314,958,406	356,168,241	375,696,891	387,705,507	400,191,020	414,966,394
Health and Other Fringe Benefits	61,135,910	68,152,595	70,689,274	73,320,370	76,049,397	78,880,000
	887,624,894	**961,650,603**	**994,822,474**	**1,028,657,457**	**1,063,739,102**	**1,101,907,533**
Non-Personal/Equipment	**131,876,514**	**122,804,000**	**123,649,000**	**126,900,000**	**129,295,000**	**130,885,000**
City-Wide						
City-Wide Expenses	315,047,917	73,169,140	74,836,528	75,590,759	76,338,999	77,390,816
Capital Projects	110,023,656	5,270,000	5,250,000	5,200,000	5,200,000	5,200,000
Transfers	88,049,604	22,968,524	23,762,750	23,918,245	23,976,339	24,042,593
Earmarked Reserves	141,473,945	40,314,000	39,064,000	39,064,000	39,064,000	39,064,000
Contingency Reserve	40,000,000	40,000,000	40,500,000	41,500,000	42,500,000	42,500,000
	694,595,122	**181,721,664**	**183,413,278**	**185,273,004**	**187,079,338**	**188,197,409**
Committed Additions						
New Parks and Recreation Facilities Maintenance and Operations		384,000	901,000	1,362,000	1,848,000	1,947,000
New Public Safety Facilities Maintenance and Operations		19,000	249,000	407,000	423,000	440,000
New Traffic Infrastructure Assets Maintenance and Operations		175,000	287,000	367,000	404,000	428,000
Measure T (Emergency Operations Center Relocation)		-	31,000	56,000	59,000	61,000
Measure T (Fire Station 8 Relocation)		-	-	9,000	36,000	37,000
Measure T (Fire Station 32)		-	-	1,053,000	4,338,000	4,468,000
Measure T (Fire Station 36)		-	-	-	-	3,953,000
Measure T (Fire Station 37)		1,977,000	4,071,000	4,193,000	4,319,000	4,449,000
Measure T (Police Air Support Hangar)		-	-	71,000	75,000	77,000
Measure T (Police Substation Activation)		-	-	2,359,000	3,239,000	3,336,000
Measure T (Police Training Center Relocation)		-	-	1,547,000	2,136,000	2,212,000
		2,555,000	**5,539,000**	**11,424,000**	**16,877,000**	**21,408,000**
Total Base Expenditures (w/Committed Additions)	**1,714,096,530**	**1,268,731,267**	**1,307,423,752**	**1,352,254,461**	**1,396,990,441**	**1,442,397,942**
% Growth			*3.0%*	*3.4%*	*3.3%*	*3.3%*

Adjustments are made to this Forecast to account for one-time additions/deletions included in the 2020-2021 Adopted Budget, and to annualize partial-year allocations. Various one-time additions totaling over $15 million – excluding funding committed for capital projects, equipment purchases, and pay down of debt obligations that are truly one-time in nature – are scheduled to expire in June 2021 and may need to be re-evaluated for inclusion in 2021-2022. Notable one-time allocations include the following: Digital Divide, Office of Racial Equity, Foot Patrol in High Needs Neighborhoods and Downtown, Police Department Public Records Requests Staffing, Beautify San José Street Landscape Maintenance Program, Diridon Station Area Development Planning, Transitional Jobs Program (San José Bridge), Climate Smart San José Plan Implementation, Project Hope Expansion, Neighborhood Center Partner Program, Police Activities League (PAL) Facility Support, Police Redistricting, and Outdoor Park Activation.

EXPENDITURE FORECAST

Many of these programs and services will be re-evaluated for continued funding beyond the 2020-2021 fiscal year, with recommendations included in the 2021-2022 Proposed Operating Budget as appropriate, and in the context of other budgetary needs.

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

Personal Services

As is the usual practice, the first year (2021-2022) projection for personal services costs in this Forecast has been calculated at a detailed level, using a January 2021 extract from the City's payroll system as the starting point. This included the most recent salary, retirement plan, and health plan information for each position. The individual position-level information was then reviewed, corrected, and updated to ensure accurate salary step and bi-weekly salary, as well as any position reallocations. Further, 2020-2021 ongoing position additions (cost increases) and reductions (cost savings), as appropriate, were annualized and all categories of benefit costs in the coming year were projected.

For the 2021-2022 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the total cost in the General Fund. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the $961.7 million projected personal services total for 2021-2022, salaries and other compensation costs amount to $537.3 million (55.9% of projected personal services), retirement costs amount to $356.2 million (37.0% of projected personal services), and health and other fringe benefits costs amount to $68.2 million (7.1% of projected personal services).

Following is a discussion of the factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. The out-years are projected to inflate at an average annual rate of approximately 3.5%.

Salaries and Other Compensation:

Pay increases for all employees, salary step increases for current non-management employees, and pay for performance for management employees are assumed in each year of this Forecast. Most agreements with the City's bargaining units will expire June 30, 2021. The Association of Building, Mechanical and Electrical Inspectors (ABMEI), International Association of Fire Fighters, Local 230 (IAFF), and Peace Officer Park Rangers Association (POPRA) have agreements that expire June 30, 2023. The San José Police Officers' Association (POA) agreement expired June 30, 2020.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

Personal Services

Salaries and Other Compensation:

Except for employees represented by SJPOA and IAFF, Local 230, non-management step increases have been calculated at a 2.5% step increase rate. For SJPOA and IAFF, a 5% step increase rate was applied in this Forecast.

A Salaries and Benefits Reserve funding is included in each year of this Forecast that sets aside funds to: 1) account for potential pay increases and other compensation beyond the expiration date of the various bargaining unit agreements; 2) allocate funding for pay for performance for management employees; and 3) to reserve resources for anticipated increases to employee benefits such as health and dental. For 2021-2022, this reserve totals $32.9 million and would require City Council action before any form of distribution could be made. As contracts in the out-years of the forecast are determined, subsequent Forecast documents will be updated to reflect the latest information at that time. The out-years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

The Overtime budget in the General Fund totals $41.1 million for 2021-2022, with most of these funds allocated to Police Department ($28.4 million) and Fire Department ($11.1 million) operations. The Police Department overtime budget includes the second year of the $7.0 million Hire Ahead program approved by the City Council in the 2020-2021Adopted Operating Budget. The out-years of the Forecast removes this one-time funding allocation beginning in 2022-2023 and continues the ongoing base level costs, with small adjustments using salary and step growth as the inflationary factor.

Retirement:

The City's two retirement systems, the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan, provide defined retirement benefits to eligible employees. Both retirement plans use investment income and employer and employee contributions to provide eligible retirees with pensions and retiree healthcare benefits. Each system also maintains two benefit levels: Tier 1 and Tier 2.

Employees represented by SJPOA and IAFF, Local 230 are members of the Police and Fire Department Retirement Plan and have different retirement benefits with the corresponding different City contributions and rates. Within the Police and Fire Department Retirement Plan, effective August 4, 2013, the City provides for a lower defined benefit plan (Tier 2) for new and rehired Police members. Effective January 2, 2015, a lower defined benefit plan (Tier 2) was implemented for new and rehired Fire members. With the passage of Measure F in 2016, former Tier 1 members previously or newly rehired to the City are placed within the Tier 1 defined benefit plan.

EXPENDITURE FORECAST

Personal Services

Within the Federated Retirement System, effective September 30, 2012, the City provides for a lower defined benefit plan (Tier 2) for new employees in that system. Federated employees who joined the City between September 30, 2012 and September 27, 2013 are eligible for retiree healthcare coverage (Tier 2A). Effective September 27, 2013, however, new employees no longer receive retiree healthcare coverage (Tier 2B). With the passage of Measure F, former Tier 1 members previously or newly rehired to City are placed within the Tier 1 defined benefit plan.

Effective March 31, 2017 for members of the Police and Fire Department Retirement Plan and June 18, 2017 for members of the Federated City Employees' Retirement System, employees with previous CalPERS or reciprocal retirement system experience are eligible to join the Tier 1 defined benefit pension plan for their respective retirement systems. These employees need to have been employed at their previous agency before January 1, 2013, have less than a six month break in service before joining the City, and not have concurrent service.

On December 4, 2012, a defined contribution plan (Tier 3) for new employees in Unit 99 (Senior Staff, Executive Staff, and senior managers under the City Manager's Appointing Authority; City Council Office staff; professional and management employees under the appointing authority of the City Attorney, City Auditor, and Independent Police Auditor; and some employees in the City Clerk's Office) was approved. Effective February 4, 2013, new employees to the City hired directly into Unit 99 have the ability to make the one-time election to participate in the defined benefit Tier 2B plan or the Tier 3 plan. The Tier 3 plan provides for a City contribution of 3.75%.

For 2021-2022, retirement costs total $356.2 million for the General Fund, an increase of $41.2 million from the 2020-2021 Modified Budget of $315.0 million. It is important to note that, in addition to the increased actuarial contribution levels and assumption changes authorized by the Retirement Boards, the relatively large increase between 2020-2021 to 2021-2022 is also attributable to a portion of anticipated retirement costs that still remain within the 2020-2021 Salaries and Benefits Reserve that were previously set aside for potential salary increases that have not yet been approved or have otherwise been absorbed within existing department budgets, and position costs that were reallocated to the Coronavirus Relief Fund to support the City's emergency response efforts. After accounting for these factors, the increment of change in retirement costs between 2020-2021 and 2021-2022 is similar to the out-years of the Forecast.

Retirement costs in 2021-2022 represent 28.1%, a similar level to previous years, of the total General Fund base expenditure budget with committed additions and reflect the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. These assumptions included a reduction in the discount rate for both pension system from 6.75% to 6.625%, which is held flat throughout the Forecast period.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

Personal Services

To generate budgetary savings, retirement contributions assume the pre-payment of Tier 1 pension costs related to the Federated Retirement System and the Police and Fire Department Retirement Plan. For 2020-2021, net budgetary savings from the pre-payment, including short-term borrowing costs, and foregone interest earnings, are estimated at approximately $12.6 million in the General Fund ($20.2 million in all funds). While pre-payment is assumed to continue in the out-years of the Forecast, the Administration will continue to evaluate the cost effectiveness of pre-payment as part of the annual budget development process.

A portion of the City's retirement contributions ($38.3 million in the General Fund and $49.9 million in all funds) are associated with retiree healthcare. Prior to Measure F, these contributions were frozen at certain levels for Federated and Police and Fire systems. Subsequent to the passage of Measure F, each board adopted annual contribution amounts for retiree health care, subject to various actuarial assumptions that are evaluated each year.

Based on projections received from the Retirement Boards' actuary (Cheiron) and the City Manager's Budget Office's independent analysis, Table 1 details the General Fund's retirement costs and for the Federated Retirement System and the Police and Fire Department Retirement Plan. These amounts are broken out by Tier 1 contributions (normal cost), Tier 2 contributions, the UAL, and retiree healthcare.

Prior to 2019-2020, retirement contributions were also expressed as a percentage rate of salary for Tier 1 and Tier 2 employees. However, as Tier 1 is now a closed system, spreading the UAL cost across a shrinking pool of Tier 1 employees distorted the apparent cost of a Tier 1 employee. For reference, Tier 1 normal cost contributions and Tier 2 contributions are also displayed in the tables below as a rate, illustrating the long-term cost savings the City will achieve with the transition of its workforce from Tier 1 to Tier 2. Over this Forecast, the General Fund retirement costs are expected to grow from $356.2 million ($468.8 million in all funds) in 2021-2022 to $415.0 million ($540.1 million in all funds) in 2025-2026.

Though these amounts are increasing, it is important to note that retirements contributions as a percentage of ongoing General Fund expenditures changes only slightly across the forecast period, from 28.1% in 2021-2022 to 28.8% in 2025-2026.

For illustration purposes only, Table 2 depicts the Retirement Board approved contribution amounts for 2021-2022 and the Cheiron-projected amounts for the out-years of the Forecast. It should be noted that the City budgetary amounts differ from the Federated and Police and Fire Retirement Board approved amounts due to the budgetary spread across vacant, as well as filled, positions. Cheiron applies retirement contributions to an assumed level of filled positions.

EXPENDITURE FORECAST

TABLE 1 – 2022-2026 CITY RETIREMENT BUDGETED CONTRIBUTION AMOUNTS
GENERAL FUND
($ in Millions)*

Retirement Plan	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Federated Retirement Plan						
Tier 1 Pension (Normal Cost)	$13.5	$14.0	$16.0	$15.0	$14.7	$14.7
Tier 1 Pension (Normal Cost) Rate	*18.0%*	*19.6%*	*19.7%*	*19.9%*	*20.0%*	*20.2%*
Tier 2 Pension+	$7.8	$8.5	$9.6	$11.4	$12.5	$13.3
Tier 2 Pension Rate	*7.9%*	*8.2%*	*8.2%*	*8.3%*	*8.3%*	*8.4%*
Unfunded Actuarial Liability	$69.7	$74.3	$77.5	$80.8	$84.0	$86.8
Retiree Health Care	$9.5	$9.2	$9.4	$9.9	$10.0	$10.1
Total Federated Contributions	**$100.5**	**$106.0**	**$112.5**	**$117.1**	**$121.2**	**$124.9**
Police Retirement Plan						
Tier 1 Pension (Normal Cost)	$35.6	$36.8	$35.9	$35.1	$34.0	$35.9
Tier 1 Pension (Normal Cost) Rate	*31.8%*	*31.4%*	*31.8%*	*32.3%*	*32.9%*	*33.6%*
Tier 2 Pension+	$8.4	$9.5	$12.2	$15.0	$18.2	$18.7
Tier 2 Pension Rate	*14.2%*	*14.4%*	*14.5%*	*14.6%*	*14.7%*	*14.8%*
Unfunded Actuarial Liability	$80.0	$78.4	$80.6	$78.5	$81.5	$82.6
Retiree Health Care	$15.3	$17.2	$18.4	$19.9	$20.7	$21.5
Total Police Contributions	**$139.3**	**$141.9**	**$147.1**	**$148.5**	**$154.4**	**$158.7**
Fire Retirement Plan						
Tier 1 Pension (Normal Cost)	$25.8	$24.8	$26.8	$27.9	$29.2	$30.5
Tier 1 Pension (Normal Cost) Rate	*33.2%*	*32.6%*	*32.7%*	*33.0%*	*33.3%*	*33.6%*
Tier 2 Pension+	$2.6	$3.0	$3.2	$3.4	$3.5	$3.6
Tier 2 Pension Rate	*15.5%*	*15.3%*	*15.4%*	*15.5%*	*15.6%*	*15.7%*
Unfunded Actuarial Liability	$61.2	$68.6	$73.6	$77.6	$78.1	$82.8
Retiree Health Care	$10.1	$11.0	$11.6	$12.4	$12.9	$13.4
Total Fire Contributions	**$99.7**	**$107.4**	**$115.2**	**$121.3**	**$123.7**	**$130.3**
Other Retirement Contributions	**$0.9**	**$0.9**	**$0.9**	**$0.9**	**$0.9**	**$1.0**
Total General Fund	**$340.4**	**$356.2**	**$375.7**	**$387.7**	**$400.2**	**$415.0**
Total All Funds	**$454.3**	**$485.6**	**$506.2**	**$523.6**	**$541.0**	**$560.2**

+Though Tier 2 contributions are overwhelmingly comprised of normal costs, these figures do contain a very small component of Unfunded Actuarial Liability (UAL) related to the Tier 2 program. For Tier 2, UAL is evenly split between the City and employees.

* City budgetary amounts differ from the Federated and Police and Fire Retirement Boards approved amounts due to the budgetary spread of retirement contributions across vacant, as well as filled positions. Cheiron, the Boards' actuary, applies retirement contributions to an assumed level of filled positions. Figures for 2020-2021 are from the 2020-2021 Forecast and are provided only for reference; these amounts differ from the adjusted amounts currently included in the 2020-2021 Modified Budget.

Source: Cheiron Letters dated January 13, 2021 (Federated) and January 27, 2021 (Police and Fire).

EXPENDITURE FORECAST

TABLE 2 – 2022-2026 BOARD APPROVED CITY CONTRIBUTION AMOUNTS ALL FUNDS ($ in Millions)

Retirement Plan	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Federated Retirement Plan						
Tier 1 Pension (Normal Cost)	$25.5	$26.9	$25.0	$23.2	$21.4	$19.8
Tier 1 Pension (Normal Cost) Rate	*18.0%*	*19.6%*	*19.7%*	*19.9%*	*20.0%*	*20.2%*
Tier 2 Pension+	$14.3	$17.5	$19.3	$21.0	$22.8	$24.5
Tier 2 Pension Rate	*7.9%*	*8.2%*	*8.2%*	*8.3%*	*8.3%*	*8.4%*
Unfunded Actuarial Liability	$148.5	$155.6	$162.4	$169.3	$176.0	$181.7
Retiree Health Care	$21.0	$19.9	$19.8	$20.7	$20.9	$21.1
Total Federated Contributions	**$209.3**	**$219.9**	**$226.5**	**$234.2**	**$241.1**	**$247.1**
Police Retirement Plan						
Tier 1 Pension (Normal Cost)	$29.0	$26.5	$24.2	$22.0	$20.2	$18.5
Tier 1 Pension (Normal Cost) Rate	*31.8%*	*31.4%*	*31.8%*	*32.3%*	*32.9%*	*33.6%*
Tier 2 Pension+	$8.3	$9.7	$11.5	$13.4	$15.1	$16.7
Tier 2 Pension Rate	*14.2%*	*14.4%*	*14.5%*	*14.6%*	*14.7%*	*14.8%*
Unfunded Actuarial Liability	$80.0	$78.4	$80.6	$78.5	$81.5	$82.6
Retiree Health Care	$15.3	$17.2	$18.4	$19.9	$20.7	$21.5
Total Police Contributions	**$132.6**	**$131.8**	**$134.7**	**$133.8**	**$137.5**	**$139.3**
Fire Retirement Plan						
Tier 1 Pension (Normal Cost)	$23.6	$23.4	$22.2	$20.9	$19.7	$18.6
Tier 1 Pension (Normal Cost) Rate	*33.2%*	*32.6%*	*32.7%*	*33.0%*	*33.3%*	*33.6%*
Tier 2 Pension+	$3.2	$3.7	$4.8	$6.0	$7.1	$8.2
Tier 2 Pension Rate	*15.5%*	*15.3%*	*15.4%*	*15.5%*	*15.6%*	*15.7%*
Unfunded Actuarial Liability	$61.2	$68.6	$73.6	$77.6	$78.1	$82.8
Retiree Health Care	$10.1	$11.0	$11.6	$12.4	$12.9	$13.4
Total Fire Contributions	**$98.1**	**$106.7**	**$112.2**	**$116.9**	**$117.8**	**$123.0**
Total City Contributions	**$440.0**	**$458.4**	**$473.4**	**$484.9**	**$496.4**	**$509.4**

+Though Tier 2 contributions are overwhelmingly comprised of normal costs, these figures do contain a very small component of Unfunded Actuarial Liability (UAL) related to the Tier 2 program. For Tier 2, UAL is evenly split between the City and employees.

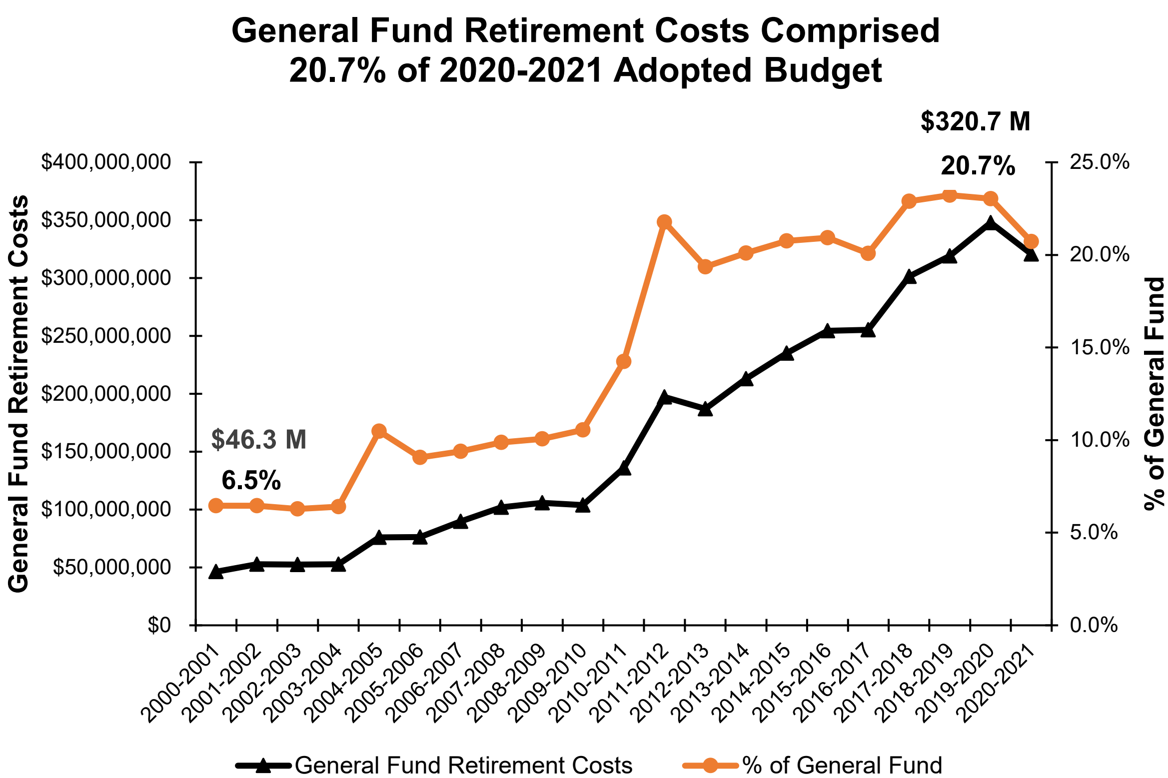
Source: Cheiron Letters dated January 13, 2021 (Federated) and January 27, 2021 (Police and Fire).

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

Personal Services

The chart below describes the history of retirement costs as a share of the total General Fund Adopted Budget. In 2001-2002, retirement costs of $46.3 million accounted for 6.5% of the General Fund, while in 2020-2021, those costs totaled 20.7% of the General Fund Adopted Budget. It is important to note that, because adopted budgets include carryover costs from the previous year, fund balance, and other one-time elements, this percentage is lower than the ongoing average contribution of approximately 28% reflected in the Forecast.



Health and Other Fringe:

A projected health rate increase of 8.0% is included in the 2021-2022 Forecast effective January 2022 based on national and City trend information received from the City's Human Resources Department benefits consultant. The annual health increase assumptions are held constant at 4.0% annually for the out-years of the forecast.

Based on actuarial information from the Human Resources Department and an evaluation of funding levels in the Dental Insurance Fund, a dental rate decrease of 17% is assumed in 2021-2022. These relatively lower levels of contributions are expected to continue into 2022-2023, as the savings from previously accumulated fund balance in the Dental Insurance Fund will be used to equally offset contributions from the City, current employees, and retirees. For the out-years, the Forecast assumes annual dental rate increases of 3% based on City trends and actuarial analysis.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

Personal Services

An increase of 0.58% to the unemployment insurance rate is included in this Forecast based on projected future claims. There are no changes to the life insurance rates in this Forecast based on projected provider charges.

Non-Personal/Equipment

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total $122.8 million in 2021-2022. To determine this ongoing funding level, the City Manager's Budget Office: comprehensively reviews all budgetary actions approved for funding solely in 2020-2021 and decreases or increases corresponding funding levels to account for these one-time additions/deletions; annualizes all partial-year reductions or increases that were approved for 2020-2021; and, analyzes historical usage, rate adjustments, contractual obligations, fleet management, and overall expenditures to project future needs for key non-personal/equipment allocations – utilities, vehicle replacement, vehicle maintenance and operations, contractual services, and data processing (software/information system maintenance). The resulting 2021-2022 estimate represents a decrease of $9.1 million from the 2020-2021 Modified Budget level of $131.9 million, primarily due to the removal of rebudgeted funds for initiatives or projects continuing into 2020-2021 from the prior year.

Departmental funding levels for utilities ($22.7 million), including gas, electricity, and water, for 2020-2021 increase by $1.4 million in this Forecast to reflect projected rate increases, the prorated or annualized costs of new facilities coming online, and estimated changes in consumption. Vehicle maintenance and operations costs in the General Fund, including fuel, inventory, and fleet staffing, are also increased by $195,000, primarily due to increased consumption, fuel, and parts costs for the maintenance of vehicles recently added to the City's fleet. The 2020-2021 non-personal/equipment base also includes $2.5 million of additional funding for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles based on the current replacement schedules and projected costs for these vehicles. Police vehicle replacement costs are expected to fluctuate over remaining years of the Forecast based on anticipated replacements, totaling $27.2 million through 2025-2026. Additional non-personal/equipment increases are included in this Forecast, primarily for: increases for city-wide janitorial services resulting from a competitive procurement ($832,000); various contractual increases for information systems and software license agreements city-wide ($716,000); cost increases for City facilities general maintenance services and supplies ($259,000) and waste collection ($135,000); contractual increases for third-party administration of Workers' Compensation claims ($114,000); and, video redaction software to support the Police Department's response to Public Records Act requests ($100,000).

Growth rates ranging from 0.69% to 2.63% are assumed in the out-years of the Forecast, relative to non-personal/equipment base levels in each of the preceding four years, largely varying due to the projected Police vehicle replacement costs in those years. Excluding these adjustments for vehicle replacements, the average growth rate for the non-personal/equipment category is estimated at 2% annually.

ELEMENTS OF THE GENERAL FUND FORECAST

EXPENDITURE FORECAST

City-Wide

City-Wide Expenses in the first year of the Forecast (2021-2022) total $73.2 million, a decrease of $241.8 million from the 2020-2021 Modified Budget of $315.0 million, largely due to the removal of TRANS Debt Service related to the 2020-2021 pre-payment of retirement contributions ($131.5 million), removal of one-time General Fund resources that directly support to the City's pandemic response ($43.5 million), removal of one-time allocations from 2019-2020 that were rebudgeted into 2020-2021 ($33.4 million) and removal of one-time budget actions from 2020-2021 that are subject to re-evaluation ($31.1 million), and various technical adjustments to ongoing allocations ($2.3 million).

The line-items in this category are primarily made up of cross-departmental, large grant, and general city-wide expenditures. Forecast funding levels for 2021-2022 include cost adjustments based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2021-2022 allocations in the City-Wide Expenditures category include: Workers' Compensation Claims ($18.2 million); San José BEST and Safe Summer Initiative Programs ($6.3 million); General Liability Claims ($6.0 million); Sick Leave Payments Upon Retirement ($5.0 million); Elections and Ballot Measures ($2.1 million); Property Tax Administration Fee ($2.1 million); Homeless Rapid Rehousing ($2.0 million); Measure E 5% Program Administration ($2.0 million); Sidewalk Repairs ($2.0 million); Property Leases ($1.8 million); Homeless Response Team ($1.6 million); Insurance Premiums ($1.5 million); San José Works – Youth Jobs Initiative ($1.5 million); TRANs Debt Service ($1.5 million); Tech Museum of Innovation Subsidy ($1.4 million); Digital Inclusion Program ($1.3 million); Public, Educational and Government Access Facilities – Capital ($1.2 million); and, Senior Nutrition Program ($1.2 million).

For continuing initiatives authorized in 2021-2022, City-Wide Expenses are projected to decrease overall by approximately $2.3 million, largely due to reduced ESCO Debt Service ($2.1 million) for the recent pay-off of a portion of the debt obligation, lower Banking Services costs ($1.0 million) due to the pending implementation of a merchant card transaction fee, reduced revenues available to support the Digital Inclusion Program ($928,000), and lower projected Workers' Compensation Claims payments ($179,000) in 2021-2022. These decreases are partially offset by various base budget increases, including: Measure E 5% Program Administration cost changes to align with anticipated Real Property Transfer Tax revenue levels ($500,000); an increase to Insurance Premiums ($319,000) that reflects changes in premium rates and growth in the insured value of City assets; Senior Nutrition Program increase for the addition of the Northside site bringing the total number of Senior Nutrition Program sites to 14; and various cost-of-living adjustments for Revenue Enhancement Consulting Services ($297,000), Elections and Ballot Measures ($293,000), and Property Tax Administration Fee ($212,000).

While the majority of City-Wide Expenses are expected to remain at 2021-2022 levels during the Forecast period, some categories are expected to experience modest growth over the next five years, including the: Arena Authority ($241,000 to $272,000); Children's Discovery Museum ($337,000 to $380,000); Hammer Theater Center Operations and Maintenance ($318,000 to

EXPENDITURE FORECAST

City-Wide

$358,000); History San José ($876,000 to $986,000); Homeless Response Team ($1.6 million to $1.9 million); Mexican Heritage Plaza Maintenance and Operations ($465,000 to $523,000); Property Leases ($1.8 million to $2.1 million); San José Museum of Art ($557,000 to $627,000); Sports Authority ($416,000 to $468,000); Tech Museum of Innovation ($1.4 million to $1.6 million); Sanitary Sewer Fees ($567,000 to $689,000); San José BEST and Safe Summer Initiative Programs ($6.3 million to $7.0 million); Insurance Premiums ($1.5 million to $2.0 million); and, Property Tax Administration Fee ($2.1 million to $2.6 million).

Overall, Workers' Compensation Claims payments are projected to continue to gradually decrease over the Forecast period, from $18.2 million to $17.4 million.

The General Fund **Capital Projects** category totals $5.3 million in 2021-2022, decreasing by $20,000 in 2022-2023 and remaining at this level in each following year of the Forecast. The largest item in this category is fire apparatus replacement ($3.75 million), which assumes that the Fire Construction and Conveyance Tax Fund will contribute $400,000 annually for these costs over the five-year period. Capital Projects funding also includes the continuation of annual allocations for: the unanticipated maintenance of City facilities ($750,000); fuel tank and methane monitoring control and replacement ($470,000); closed landfill compliance ($450,000); annual capital requirements to maintain power backup for the City Hall and the 9-1-1 Police Communications Building ($200,000); and for Arena Repairs ($100,000). Due to the planned closure of the Las Plumas site, fuel tank monitoring costs ($20,000) are expected to decrease in 2022-2023.

The **Transfers** category totals $23.0 million in 2021-2022 and averages $23.9 million in the remaining years of the Forecast. The transfer to the City Hall Debt Service Fund to cover the General Fund portion of the debt service costs for the construction of City Hall is the largest recurring line-item in this category at $16.3 million in 2021-2022, increasing to $17.0 million by 2025-2026. Other transfers include: funding for capital rehabilitation and enhancements at the SAP Center in accordance with the San José Arena Management Agreement with Sharks Sports and Entertainment ($2.3 million); funding to support the Silicon Valley Regional Interoperability Authority in the Construction and Conveyance Tax Fund – Communications ($1.7 million through 2022-2023, increasing to $1.8 million in 2023-2024) as revenues are insufficient to cover required costs; funding for the Vehicle Maintenance and Operations Fund for general fleet replacement ($1.25 million); and, payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas ($1.0 million to $1.2 million annually).

Transfers from the General Fund to the Municipal Golf Course Fund cease in 2021-2022 due to increasing operating revenues, and payoff of remaining debt obligations for the Rancho del Pueblo Golf Course in 2019-2020 and subsequent payoff for the Los Lagos Golf Course in 2020-2021. Similarly, due to forecast Construction and Conveyance Tax performance throughout the Forecast, the planned transfer ($750,000) to the Construction and Conveyance Tax Fund – Service Yards

City-Wide

ceases in 2021-2022, since revenues are anticipated to be sufficient to cover debt service payments associated with the Central Service Yard.

The **Earmarked Reserves** category totals $40.3 million in 2021-2022 and decreases to $39.1 million in 2022-2023 and throughout the Forecast. This category includes $38.0 million in reserves to be expended on homeless prevention and affordable housing in accordance with Measure E, approved by San José voters on March 3, 2020. Other reserves include the: Deferred Infrastructure and Maintenance Reserve of $1.3 million to fund critical capital maintenance or address urgent technology needs, which will be allocated during development of the 2021-2022 Proposed Budget; and, annual funding of $214,000 for the Artificial Turf Replacement Reserve to set aside funding for the cost of replacing artificial turf fields in various neighborhood parks. These funds are available from the projected field reservation revenues collected above the estimated costs to reserve and maintain the fields and reflect decreased operations due to the impacts of COVID-19. Additionally, the annual allocation to the Cultural Facilities Maintenance Reserve is maintained at $850,000 throughout the Forecast to address the growing deferred infrastructure rehabilitation needs at these facilities.

The Forecast does not include several Earmarked Reserves that may remain unspent in 2020-2021 and later recommended for rebudget or use in 2021-2022. Some of the larger current Earmarked Reserves include the: Budget Stabilization Reserve; Salaries and Benefits Reserve; Measure E – 45% Extremely Low Income Reserve; Workers' Compensation/General Liability Catastrophic Reserve; Measure E – 35% Low Income Reserve; Sick Leave Payments Upon Retirement Reserve; Measure E – 10% Moderate Income Reserve; Google Parking Lots Option Payment Reserve; Information Technology Sinking Fund Reserve; Code Enforcement Permit System Reserve; Business Tax System Replacement Reserve; Measure E – 10% Homelessness Prevention Reserve; and, City Attorney's Office Outside Litigation Reserve.

Per City Council policy, the **Contingency Reserve** ($40.0 million) is projected at the level necessary to comply with the City Council policy to maintain a minimum 3% Contingency Reserve and allows for anticipated rebudget adjustments that will be incorporated into the 2020-2021 budget. This amount would be sufficient to cover approximately one pay period of payroll costs (two weeks). This amount steadily increases each year of the Forecast, ending at $42.5 million in 2024-2025 to remain in compliance with the reserve policy.

Committed Additions to the Base General Fund Forecast

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

Committed Additions to the Base General Fund Forecast

well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

Committed Additions total $2.6 million in 2021-2022 and increase to approximately $21.4 million by 2025-2026, primarily due to the anticipated projects from the passage of Measure T – The Disaster Preparedness, Public Safety and Infrastructure Bond. Several Measure T facilities are anticipated to come online within the five-year forecast period and include Fire Stations 32, 36 and 37. The Police Training Facility, expected to come online in 2023-2024, will trigger the phased activation of the South San José Police Substation once recruit academies and training functions are transferred to the new Police Training Facility. Land acquisition for the new Police Training Facility is in progress, with maintenance costs of $2.1 million representing an early look at potential ongoing impacts of this facility. All estimates will be further refined once a site is selected and fully scoped, the results of which will be brought forward for City Council consideration. Additional maintenance and operations funding were factored for other Measure T projects including the new Emergency Operations Center, Office of Emergency Management relocation, Fire Station 8 Relocation, and the Police Air Support Unit Hangar expansion. In total, the maintenance and operations funding for Measure T facilities coming online will increase from $2.0 million in 2021-2022 to approximately $18.8 million by 2025-2026.

The Committed Additions also include maintenance and operations costs associated with non-bond projects such as new parks and recreation facilities, new traffic infrastructure assets, and the Fire Training Center relocation from its current location on Montgomery Street. The non-bond projects committed additions costs in the Forecast range from $578,000 in 2021-2022 to $2.6 million by 2025-2026.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

The operating margin reflects the variance between the projected General Fund revenues and expenditures for each year of the Forecast, assuming the Base Case with Committed Additions. In 2021-2022, a General Fund deficit of $48.1 million is projected. This projection is derived by comparing estimated revenues with the cost of delivering City Council-approved existing services as well as the services for which the City has already committed, such as the operation of new facilities or other capital projects scheduled to come on-line next year. General Fund surpluses are projected in the remaining years of the Forecast; 2022-2023 ($3.3 million), 2023-2024 ($0.2 million), 2024-2025 ($4.4 million), and 2025-2026 ($1.9 million). These margins are relatively narrow when put into context of the size of the projected General Fund budget, ranging from 0.1% to 0.2% of the projected annual budget. In the first year of the Forecast, a deficit is anticipated, however, in the remaining years the five-year period, a total surplus of $9.9 million are anticipated, which equates to approximately $2.5 million annually. This average shortfall figure equates to 0.02% of the projected General Fund annual budget, which ranges from $1.3 billion to $1.4 billion.

The following table shows how the projected surpluses and shortfalls have changed in the most recent forecasts. It is assumed that each preceding surplus or shortfall is addressed completely with ongoing solutions in the year it appears. Each year of the February 2021 Forecast is compared to the corresponding year in the February 2020 Forecast.

2022-2026 General Fund Forecast
Changes in Operating Margin
($ in Millions)

	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
February 2020 Incremental Surplus/(Shortfall)	**($11.1)**	**$14.0**	**($2.2)**	**$1.0**	**N/A**
June 2020* Incremental Surplus/(Shortfall)	($25.7)	N/A	N/A	N/A	N/A
February 2021 Incremental Surplus/(Shortfall)	**($48.1)**	**$3.3**	**$0.2**	**$4.4**	**$1.9**

* Of the $77.6 million General Fund shortfall resolved by the 2020-2021 Adopted Operating Budget, $25.7 million was resolved on a one-time basis, resulting in the carry-forward of that shortfall amount into 2021-2022.

Note: Does not include 1) costs associated with services that were funded on a one-time basis in 2020-2021; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.

ELEMENTS OF THE GENERAL FUND FORECAST

OPERATING MARGIN

For the February 2021 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2021-2022 and the remaining four years of the forecast period. The 2021-2022 projected deficit of $48.1 million is primarily the result of impacts related to the COVID-19 pandemic that significantly affected General Fund revenue. The numerous revenue and expenditure changes anticipated in 2021-2022 are described in this document.

In the out-years of this Forecast, the General Fund has an operating margin ranging from a surplus of $0.2 million to a surplus of $4.4 million annually, reflective of the fact that future year growth of expenditures and revenues are closely aligned. These margins are extremely narrow when put into context of the size of the projected General Fund budget of over $1.3 billion.