

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** David Sykes

**SUBJECT: 2021-2022 CITY MANAGER’S  
BUDGET REQUEST AND  
2022-2026 FIVE-YEAR FORECAST**

**DATE:** March 1, 2021

## INFORMATION

### EXECUTIVE SUMMARY

In compliance with City Charter Section 1204, and the City Council’s Adopted Budget process, this document provides both the recommended 2021-2022 City Manager’s Budget Request (2021-2022 Budget Balancing Strategy Guidelines) and the 2022-2026 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. Major highlights of this report follow.

As shown in the chart below, a significant General Fund shortfall of \$48.1 million is projected for 2021-2022, which constitutes almost 4% of the General Fund Base Budget. This projection is derived by comparing estimated revenues with the cost of delivering City Council-approved ongoing 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. However, if the 2021-2022 shortfall is fully resolved with ongoing solutions, the remaining four years of the Forecast are essentially flat, with very small General Fund surpluses ranging from \$0.3 million to \$4.4 million (0.0% - 0.3%). Over the five-year period, a total net General Fund shortfall of \$38.2 million translates to an average annual shortfall of \$7.6 million, which equates to 0.6% of the projected General Fund Base Budget.

### **2022-2026 General Fund Forecast Incremental General Fund Surplus/(Shortfall)**

	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Incremental Surplus/(Shortfall)	(\$48.1 M)	\$3.3 M	\$0.2 M	\$4.4 M	\$1.9 M
% of Budget (Based on Expenditures)	(3.8%)	0.3%	0.0%	0.3%	0.1%

- This Forecast reflects the Administration's best estimates on projected revenues and expenditures over the next five years based on the information currently available. It does not, however, incorporate several elements that would impact the General Fund over the forecast period, including: 1) costs associated with services that were funded on a one-time basis in 2020-2021, including resources to support the City's COVID-19 pandemic response and recovery efforts; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.
- The Forecast is built on the assumption of the economy continuing to rebound after the sharp revenue declines experienced as a result of the pandemic. As with all forecasts, there is a level of uncertainty regarding the revenue and expenditure estimates contained in this document. For example, General Fund revenues may exceed or fall below expectations based on changes in economic or non-economic conditions. The City's two largest General Fund revenues, Property Tax and Sales Tax, are sensitive to changes in the local economy and may fluctuate to a significant degree depending on future conditions. Various cost elements can also vary from year to year. While retirement costs as a percentage of the General Fund have stabilized over the past several years, costs fluctuate and will likely continue to experience upward or downward swings based on actual performance of the retirement funds and changes in actuarial economic and demographic assumptions approved by the Federated and Police and Fire Department Retirement Boards.
- Two alternative forecasts have been developed to model the range of budgetary scenarios possible under varying economic conditions. "Optimistic" and "Pessimistic" Cases have been created to model economic scenarios considered possible, but less likely to occur than the "Base Case". Over the five-year period, the Optimistic Case would generate a surplus of \$82.5 million, while the Pessimistic Case would result in a shortfall of \$116.6 million. It is important to note that due to the significant impact the pandemic has had on the local economy, it is challenging to forecast the economic recovery over the next five years.
- The chart on page 3 compares the 2021-2022 General Fund Forecast to the 2020-2021 Adopted Budget. The combined result of the Adopted to Forecast changes is a General Fund shortfall of \$48.1 million. Of the \$77.6 million General Fund ongoing shortfall resolved by the City Council's approval of the 2020-2021 Adopted Operating Budget, \$25.7 million was resolved on a one-time basis, which is then carried forward as a starting point for 2021-2022. The next major comparison element is the change in revenue sources year-over-year. Ongoing revenues are projected to increase by \$6.4 million, driven primarily by increases in the Sales Tax, Property Tax, and Real Property Transfer Tax revenue categories. Partially offsetting these increases are reductions to the Beginning Fund Balance revenue estimates (which primarily reflects one-time expenditures and reserve rebudgets), the Fees, Rates, and Charges (Parks, Recreation and Neighborhood Services Fee Activity), and the Fines, Forfeitures, and Penalties (Parking Fines) revenue estimates. When comparing expenditures (the third element), base costs are expected to increase by \$28.8 million from 2020-2021 ongoing budget levels, with the majority of the net increases for associated with employee general wage increases and retirement contributions.

**2021-2022 General Fund Forecast  
Reconciliation from 2020-2021 Adopted Budget**

<b>2021-2022 General Fund Forecast Components (Ongoing)</b>	<b>\$ in Millions</b>
<b>Carry-Over from 2020-2021 Adopted Budget</b>	<b>(\$ 25.70)</b>
<b>Revenue Changes</b>	
- Sales Tax	37.70
- Property Tax	15.60
- Real Property Transfer Tax	10.00
- Business Taxes	3.60
- Fees, Rates, and Charges (PRNS Fee Activity)	(9.10)
- Fines, Forfeitures, and Penalties (Parking Fines)	(7.00)
- Revenue from Federal Government	(3.00)
- Beginning Fund Balance	(36.40)
- Other Net Revenue Changes	(5.00)
<b>Total Revenue Changes (Increase)</b>	<b>\$ 6.40</b>
<b>Expenditure Changes</b>	
- Employee General Wages	\$ 27.37
- Retirement Contributions	20.21
- Measure E Allocations – Housing and Homelessness Prevention	10.0
- Non-Personal/Equipment (Vehicle O&M, Electricity, Gas, and Police Fleet)	4.18
- Non-Management Step and Management-Pay-for-Performance Program	4.13
- Committed Additions: Operations and Maintenance	2.56
- Health Insurance Plans	1.97
- Community Center Operations Suspension Cost Savings	1.38
- Janitorial Services	0.83
- Software/Information Systems: Contracts/Licenses	0.82
- Living Wage/Minimum Wage Program	0.76
- Aquatics Program Suspension	0.63
- Family Camp Suspension	0.50
- Transfer to the Construction and Conveyance Tax Fund – Communications	0.45
- City Facilities Maintenance and Waste Collection	0.39
- Insurance Premiums	0.32
- Cultural Facilities Maintenance and Operations	0.30
- Revenue Enhancement Consulting Services	0.30
- Property Tax Administration Fee	0.21
- Workers' Compensation Third-Party Administration Contract	0.11
- Transfers to Development Fee Program Funds and Small Cell Permitting Fee Program Fund	(39.38)
- Transfer to the Municipal Golf Course Fund	(9.66)
- Transfer to the City Hall Debt Service Fund	(1.93)
- Library Branch Hours and Operations	(1.04)
- Other Net Expenditure Changes	3.39
<b>Total Expenditure Changes (Increase)</b>	<b>\$ 28.80</b>
<b>2021-2022 Projected General Fund Shortfall</b>	<b>(\$ 48.10)</b>

- 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 is 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, salary and other compensation costs total \$537.3 million (55.9% of projected personal services), retirement costs total \$356.2 million (37.0% of projected personal services), and health and other fringe benefits costs total \$68.2 million (7.1% of projected personal services). In the out years of the forecast, annual personal services growth ranging from 3.1% to 3.6% is projected.
- Committed Additions, expenses that address previous City Council direction, are included and total \$2.6 million in 2021-2022, rising to \$21.4 million by the end of the forecast period. The largest expenses in this category are the operating and maintenance costs for Measure T bond projects, approved by voters in November 2018, such as Fire Stations 32, 36, and 37, the Police Training Facility, and the full activation of South San José Police Substation.
- In approaching the 2021-2022 Proposed Budget, the Administration recommends the use of the budget balancing strategy guidelines outlined in this memorandum (2021-2022 City Manager's Budget Request). The *City of San José Budget Principles*, the *Service Delivery Framework*, and the *City Roadmap* (pending further City Council review) included in Appendix A, combined with City Council approval of the Mayor's March Budget Message will also guide the City's budget development efforts. The Administration recommends City Council approval of the proposed 2021-2022 City Manager's Budget Request, with any desired revisions, as part of the Mayor's March Budget Message review and approval process later in March.
- The anticipated shortfall for 2021-2022 is compounded by a range of existing service gaps that impact our community, the deficiencies of which are compounded by the impact of the pandemic. There are also unmet/deferred infrastructure and maintenance needs that will have a long-term impact on the City. Looking forward, the Administration's goal is to ensure multi-year fiscal stability while also addressing, to the extent possible, the continued impacts from the pandemic, the City's basic service delivery needs, and the backlog of unmet/deferred infrastructure and maintenance needs.
- Projections for the selected Capital Improvement Program (CIP) revenues are also included in this document. These revenue estimates of \$370.9 million are 16% higher than the estimate used to develop the 2021-2025 Adopted CIP (\$319.9 million), as the real estate and construction markets have remained relatively strong in spite of the pandemic's other impacts throughout the economy. When comparing the revenue estimates in this forecast to the 2021-2025 Adopted CIP, Construction and Conveyance (C&C) Tax projections increased by \$26.0 million or 16%, Building and Structure Construction revenue estimates grew by \$17.0 million or 21%, and Construction Excise Tax revenue estimates increased by \$8.0 million or 10%. These three revenue estimates combined total of \$366.0 million.
- Consistent with past practice, as part of the preparation for the 2021-2022 Proposed and Adopted Budgets, the Administration will bring forward revisions to both the revenue and expenditure estimates as new information becomes available.

## **BACKGROUND**

In compliance with City Charter Section 1204 and the City Council's Adopted Budget process, this document provides both the 2021-2022 City Manager's Budget Request and the 2022-2026 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program. The City Manager's Budget Request and Five-Year Forecast are key components of the City's annual budget process and are critical steps in developing the City's annual Operating and Capital Budgets and the Five-Year Capital Improvement Program (CIP).

The City Manager's Budget Request includes budget balancing strategy guidelines that the Administration recommends for use in developing the 2021-2022 Proposed Budget. These guidelines are predicated on the most current projections for expenditure requirements and available revenue in the coming fiscal year. As the City's anticipated budgetary status for 2021-2022 is an integral part of the Administration's proposed approach to preparing the 2021-2022 budget, a detailed discussion of the key economic, revenue, and expenditure assumptions for 2021-2022, and the subsequent four years, is provided as part of this document.

## **ANALYSIS**

This section includes the following: a discussion of the 2021-2022 City Manager's Budget Request; an overview of the 2022-2026 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program; and a description of the next steps in the 2021-2022 budget process.

### **2021-2022 CITY MANAGER'S BUDGET REQUEST**

The City Manager's Budget Request includes a set of general budget balancing strategy guidelines recommended to be used in the development of the 2021-2022 Proposed Budget. These proposed guidelines were formulated in the context of General Fund projections that include a sizeable shortfall for 2021-2022 followed by four years of very small surpluses, and are mindful that the City needs to strategically allocate resources to both respond to the challenges of the pandemic and limit the impact of service reductions that could disproportionately impact those who count on our services the most.

The overarching goals of these guidelines are to continue operational and budget stability while minimizing any service delivery impacts to our community as well as impacts to our employees. These goals are accomplished by keeping General Fund revenues and expenditures in alignment over the long-term while acknowledging that transitional strategies may be appropriate in the short-term; seeking cost savings and revenue generation opportunities; and effectively allocating one-time funding. The potential uses of one-time funding include continuing, in some cases, services funded on a one-time basis in 2020-2021, addressing unmet/deferred infrastructure and maintenance needs, investing in technology that improves efficiency, and increasing funding in reserves to address potential future budget uncertainty. In a very limited number of cases, ongoing budget additions may be necessary to address key service needs identified by the City Council and Administration as priorities.

In addition to City Council's approval of the Mayor's March Budget Message and priorities identified in prior City Council sessions, these guidelines will be used with the overall City Council-approved *City of San José Budget Principles*, the *Service Delivery Framework*, and the *City Roadmap* (scheduled for further City Council review) that are attached as Appendix A to this document.

In accordance with the City Charter, the City is required to adopt a balanced budget each year, allocating any projected surplus or addressing any projected shortfall. In 2021-2022, a General Fund shortfall of \$48.1 million is projected, representing almost 4% of the General Fund Base Budget of \$1.3 billion. In the out years of the Forecast, very small General Fund shortfalls ranging from \$0.2 million to \$4.4 million are projected. While the 2021-2022 shortfall is a seemingly small 3.8%, given that the City is already a very lean organization that went through several rounds of General Fund budget cutting to resolve shortfalls of \$45.0 million at the end of 2019-2020 and \$77.6 million for 2020-2021, resolving an additional \$48.1 million shortfall on an ongoing basis for 2021-2022 would most certainly further negatively impact City service levels.

It is important to note that challenges also remain in addressing other funding needs that are not included in the Forecast. When evaluating the annual General Fund shortfalls or surplus projected in this Forecast, it is important to keep in mind that these figures do not incorporate impacts associated with:

- The costs to continue services funded on a one-time basis in 2020-2021 in the General Fund that totaled over \$15 million. Major items funded on a one-time basis 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. Many of these programs and services will likely need to be re-evaluated for continued funding beyond 2020-2021. This analysis will be conducted during the 2021-2022 budget process and funding recommendations for these programs and services will be included in the 2021-2022 Proposed Operating Budget, as appropriate, and in context of other budgetary needs.
- The costs associated with ongoing unmet/deferred infrastructure and maintenance needs that were updated and presented to the Transportation and Environment Committee on March 1, 2021 at \$19.0 million annually in the General Fund (\$92.8 million all funds). In addition, there is a one-time backlog of infrastructure needs totaling \$128.4 million in the General Fund (\$1.6 billion all funds).

- One-time revenues that may become available or one-time expenditure needs. Because the Forecast compares ongoing revenues and expenditures, it does not factor in one-time funding elements that may be available or required in any given year.

With these considerations in mind, and given the continued uncertainty surrounding the pandemic and its lingering impacts, the Administration recommends using a combination of ongoing and one-time solutions to resolve the General Fund shortfall in 2021-2022 that balances the need to resolve the ongoing shortfall against the community and organizational impact of service level reductions in the short-term. Key to this strategy will be the explicit consideration of equity, remaining nimble during the budget development process to adapt budget development strategies to any additional pandemic relief or stimulus funding from the Federal government, and ensuring the allocation – or reallocation – of resources to meet City Roadmap objectives.

As in past years, the Administration also recommends that one-time funding identified in the budget process be strategically invested to address one-time needs, such as continuing services funded on a one-time basis in 2020-2021, as appropriate and discussed earlier in this section, addressing a portion of the City's unmet/deferred infrastructure and maintenance needs, providing for limited technology investments, and/or building reserves.

The City may also receive additional pandemic relief and stimulus funding from the Federal government. Depending upon the size and allowable uses for these resources, this funding could have a significant positive impact on the City's short-term budgetary position and provide resources to continue the City's pandemic response and recovery efforts that are not currently captured in this Forecast.

### ***2021-2022 Budget Balancing Strategy Guidelines***

The 2021-2022 Budget Balancing Strategy Guidelines, as shown below, provide recommended direction on the general approaches to use in the development of the 2021-2022 Proposed Budget.

## 2021-2022 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of the most essential services to the community with the resources available. Consider current needs in the context of long-term service delivery priorities.
2. Pose explicit questions of equity – including who benefits and who is burdened – when considering changes to City services to achieve a balanced budget.
3. While over the long term the City remains committed to balancing ongoing expenditures with ongoing revenues to maintain the City's high standards of fiscal integrity and financial management, given economic and public health uncertainty related to the COVID-19 pandemic, use a combination of ongoing and one-time solutions to resolve the General Fund shortfall in 2021-2022 that balances the need to resolve the ongoing shortfall against the community and organization impact of service level reductions in the short term.
4. Should additional Federal relief or stimulus funding become available to address the pandemic, allocate funding for response, recovery, and local assistance – with an emphasis on assisting our most vulnerable – and to help backfill lost revenue, as allowable under statutory restrictions and in context of other urgent needs.
5. To the extent possible, maintain or increase General Fund reserve levels to help address any unanticipated budgetary shortfall in the following year as a stopgap measure.
6. Evaluate program-level budgets and determine if there are opportunities to shift resources or reconfigure operations to mitigate service delivery impacts, meet the objectives of the City Roadmap, generate new revenues, address truly significant community or organizational risks, fund services added on a one-time basis in 2020-2021, and/or respond to City Council direction and organizational risks. Review existing vacancies for opportunities to reorganize work groups to realize cost savings or to achieve current service level demands through alternative means. Factor in performance measure data in proposal development.
7. Focus on business process redesign to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, simplifying, reorganizing functions, and reallocating resources).
8. Explore alternative service delivery models (e.g., partnerships with non-profit, public, or private sector for out-or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use City resources more efficiently and effectively.
9. Identify City policy changes that would enable/facilitate service delivery improvements or other budget balancing strategies to ensure equity and inclusion for how services are delivered.
10. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
11. Explore expanding existing revenue sources and/or adding new revenue sources.
12. Establish a fees, charges and rates structure designed to fully recover operating costs, while considering the impacts on fee and rate payers whereby a cost recovery structure may be lower in certain circumstances, and explore opportunities to establish new fees and charges for services, where appropriate.
13. Focus any available one-time resources on investments that 1) continue high-priority programs funded on a one-time basis in 2020-2021 for which ongoing funding is not available; 2) address the City's unmet or deferred infrastructure needs; 3) leverage resources to or improve efficiency/effectiveness through technology and equipment or other one-time additions; 4) increase budget stabilization reserves to address future budget uncertainty; and/or 6) provide for funding needs for non-bond eligible furniture, fixtures, and equipment associated with the continued implementation of Measure T.
14. Engage employees in department and/or city-wide budget proposal idea development.
15. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.
16. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.



### ***Guiding Budget Principles, Service Delivery Framework, and City Roadmap***

When considering changes to the budget, it is important to consider the overall City of San José Budget Principles (included in *Appendix A*) that were initially developed as part of the General Fund Structural Deficit Elimination Plan effort when the City struggled with significant, persistent deficits. These principles, which were approved as part of the City Council's approval of the Mayor's March Budget Message for Fiscal Year 2008-2009 and subsequently amended on September 9, 2008, provide a meaningful framework for maintaining the fiscal discipline crucial to a large organization like the City of San José.

As the City Council is aware, it is important that the City take a holistic approach when either adding or reducing resources and programs. The Service Delivery Framework (included in *Appendix A*) provides a multi-pronged approach to delivering direct services to the community that takes into consideration various factors, including adequate strategic support resources, adequate infrastructure, service delivery methods to ensure efficient and effective operations, service delivery goals and current performance status, service sustainability, and staffing resources.

At a special meeting on February 25, 2021, the City Council approved a preliminary City Roadmap for 2021-2022 (included in *Appendix A*). Though a limited number of items are anticipated to be added during an upcoming City Council meeting, once finalized, the City Roadmap will represent the City's most important programs, strategies, and policies to enact significant organizational change. To the extent feasible and in context of maintaining basic City services and resolving the General Fund shortfall, the budget development process should identify new or reallocate existing funding as necessary to accomplish City Roadmap objectives.

### ***2021-2022 Budget Process***

As noted above, the Administration proposes the use of the general budget balancing strategy guidelines outlined above in the 2021-2022 City Manager's Budget Request combined with the overall City of San José Budget Principles, the Service Delivery Framework, and City Roadmap to approach the 2021-2022 budget development process.

In December 2020, the Administration directed City departments to develop 2021-2022 budget proposals using a draft version of the 2020-2021 Budget Balancing Strategy Guidelines. At that time, with the anticipation that the City would face a General Fund shortfall of approximately \$50 million, departments were directed to submit proposals to achieve a net General Fund savings of \$20 million, with the anticipation that the Administration would recommend a mix of ongoing and one-time solutions to responsibly address the shortfall while still preserving organizational capacity to respond to urgent needs of our community, and in acknowledgment that there is still significant uncertainty regarding the longer-term economic impacts from the pandemic.

Given these considerations, departments were directed to submit both ongoing and one-time cost reduction proposals that were mindful of community and organizational impacts, generate new revenues, and/or restructure departmental operations and staff to effectively deliver services. Departments could also develop proposals that use one-time bridge funding to bring about ongoing reductions that may take time to implement so as to minimize and/or avoid community and employee impacts. In addition, departments were directed to evaluate program-level budgets and determine if there are opportunities to shift resources or reconfigure operations to reduce costs, close service delivery gaps and/or adjust to shifting community needs. Budget proposals requesting a net addition of General Fund resources were to be limited to those that address truly significant community or organizational risks and/or respond to specific City Council direction. For special and capital funds, departments were directed to develop proposals that balance within the total resources of the fund, identify the impact on fees or rates and, to the extent possible, minimize fee and rate increases.

The City's short-term goal is to responsibly achieve a balanced budget that makes progress on reducing the ongoing General Fund shortfall while still positioning the City to respond to urgent community needs exacerbated by the pandemic and maintain essential services as the region begins its economic recovery. The Administration will also prepare strategies to allocate any upcoming emergency relief/stimulus funding from the Federal government as part of the development of the 2021-2022 Proposed Operating Budget. The long-term goal is to fully align ongoing expenditures to ongoing revenues, prioritizing organizational stability as we hopefully build back capacity to address our significant service delivery and infrastructure needs.

The Mayor is currently scheduled to issue a proposed March Budget Message on March 8, 2021, which will then be discussed, amended if necessary, and adopted by the City Council on March 16, 2021. The contents of that Message will provide guidance for the preparation of the City Manager's 2021-2022 Proposed Capital and Operating Budgets currently scheduled to be submitted on April 26, 2021 and May 3, 2021, respectively. As part of the 2021-2022 Mayor's March Budget Message, the Administration requests confirmation of the proposed 2021-2022 Budget Balancing Strategy Guidelines, with any desired revisions. As required by City Charter, those Proposed Budgets will contain comprehensive plans for how the City organization will address the highest priority needs of the community while maintaining the fiscal integrity of the City.

After the release of the Proposed Budgets, there will be a series of Proposed Budget Study Sessions and Public Hearings to discuss the budget proposals and the associated impacts on performance measures and service delivery. The Administration will also work with the City Council to provide informational meetings to the community on the Proposed Budget. Additional input by the City Council and community will be incorporated into the budget through these Proposed Budget Study Sessions, Public Hearings, and the Mayor's June Budget Message during the months of May and June 2021.

## **2022-2026 FIVE-YEAR FORECAST AND REVENUE PROJECTIONS**

The 2022-2026 Five-Year Forecast and Revenue Projections portion of this document is divided into five sections.

1. **Elements of the General Fund Forecast** – This section begins with a description of the overall economic outlook and the expected performance of the economy over the five-year period, followed by detailed descriptions of the assumptions made concerning each of the General Fund revenue and expenditure categories. The Elements of the General Fund Forecast section ends with information regarding the projected General Fund operating margin for each of the five years included in the forecast period.
2. **Base General Fund Forecast** – The forecast model is presented in this section. It includes projections for each of the General Fund revenue and expenditure categories. The expenditure summary is divided into two sections:
  - *Base Case without Committed Additions* – This section describes projections associated with existing expenditures only.
  - *Base Case with Committed Additions* – This section describes the existing expenditures (Base Case) along with those expenditures to which the City is committed by previous City Council direction and has less discretion, such as maintenance and operating costs for capital projects scheduled to come on-line during the next five years.

The Five-Year Forecast discussion is based on the Base Case with Committed Additions scenario, which is considered the most likely scenario for the upcoming year.

3. **Committed Additions to the Base General Fund Forecast** – This section describes the committed additions per previous City Council direction considered in the Forecast, including the financial impact in each year of the Five-Year Forecast. This section also includes a discussion of Budget Principle #8, which pertains to capital projects with General Fund operating and maintenance costs in excess of \$100,000.
4. **Alternative Forecast Scenarios** – Because all forecasts are burdened with a large degree of uncertainty, two plausible alternative forecast scenarios are presented – an Optimistic Case and a Pessimistic Case – that modify revenue assumptions. These cases are compared with the Base Case, with committed additions, to show the range of growth rates for revenues and the associated operating margins.
5. **Capital Revenue Forecast** – This section describes the estimates for construction and real estate related revenues that are major sources of funding for the City's Five-Year Capital Improvement Program.
6. **Appendices** – Three appendices are also included in this document. *Appendix A* includes the following: City Council-approved City of San José Budget Principles, the Service Delivery Framework, and City Roadmap. *Appendix B* provides descriptions of the City's major General Fund revenue categories. *Appendix C*, prepared by the Planning, Building and Code Enforcement Department, documents the basis for that department's five-year projections for construction activity.

**2022-2026 General Fund Forecast**

The following table displays the projected General Fund revenues and expenditures over the next five years and the total cumulative shortfall. In addition to the cumulative shortfall, the incremental surpluses (assuming each preceding shortfall or surplus is addressed completely with ongoing solutions in the year it appears) for each year of the forecast is included. Because it is the City’s goal to remain in balance on an ongoing basis, the incremental figure is useful in that it shows the additional shortfall or surplus attributed to a particular fiscal year. To the extent that a shortfall is not resolved, or a surplus is not expended on an ongoing basis, it is important to understand that the remaining budget gap or surplus will carry over to the following year.

**2022-2026 General Fund Five-Year Forecast**  
(\$ in Millions)

	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
<b>Projected Revenues</b>	\$1,220.6	\$1,262.7	\$1,307.8	\$1,356.9	\$1,404.3
<b>Projected Expenditures</b>	\$1,268.7	\$1,307.5	\$1,352.4	\$1,397.1	\$1,442.5
<b>Total Cumulative Surplus/(Shortfall)</b>	(\$48.1)	(\$44.8)	(\$44.6)	(\$40.2)	(\$38.2)
<b>Total Incremental Surplus/(Shortfall)</b>	<b>(\$48.1)</b>	<b>\$3.3</b>	<b>\$0.2</b>	<b>\$4.4</b>	<b>\$1.9</b>
<b>% of Budget (Based on Expenditures)</b>	<b>(3.8%)</b>	<b>0.3%</b>	<b>0.0%</b>	<b>0.3%</b>	<b>0.1%</b>

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.

In the 2022-2026 Forecast, a significant General Fund shortfall of \$48.1 million is anticipated for 2021-2022, followed by very small incremental surpluses ranging from \$0.2 million to \$4.4 million over the next four years. While the shortfall margin for 2021-2022 will present significant challenges, the incremental margins in the following years are relatively negligible when put into context with the size of the projected General Fund budget, ranging from 0.0% to 0.3% of the projected annual budget of \$1.3 billion to \$1.4 billion. However, as stated previously, there are significant expenditure components that are not incorporated into the Forecast, including programs funded on a one-time basis in 2020-2021 – including funding to continue the City’s pandemic response and recovery efforts – and unmet/deferred infrastructure and maintenance needs.

Given the decreasing level of precision to be expected in the later years of a multi-year forecast, the significance of the projections in the out years is not so much in terms of their absolute amounts, but rather in the relative size of the decrease or increase from the prior year. This information should be used to provide a multi-year perspective to budgetary decision-making, rather than as a precise prediction of what will occur.

When reconciling next year's Forecast to the 2020-2021 Adopted Budget, the projected shortfall of \$48.1 million for 2021-2022 is the result of carrying forward the \$25.7 million shortfall resolved in 2020-2021 on a one-time basis, improved revenues of \$6.4 million, and increased costs of \$28.8 million. General Fund revenues are estimated to improve by a net of \$6.4 million when compared to the ongoing revenue performance assumed in the 2020-2021 Adopted Budget. The largest changes are increases in the Sales Tax, Property Tax, and Real Property Transfer Tax revenue categories. Partially offsetting these increases are reductions to the Beginning Fund Balance revenue estimates (which primarily reflects one-time expenditures and reserve rebudgets), the Fees, Rates, and Charges (Parks, Recreation and Neighborhood Services (PRNS) Fee Activity), and the Fines, Forfeitures, and Penalties (Parking Fines) revenue estimates.

In 2021-2022, several revenue categories are forecasted to grow year-over-year as the economy continues rebounding after the sharp declines experienced as a result of the pandemic. Revenue categories with the largest growth from estimated 2020-2021 revenue include Sales Tax (\$11.2 million), Business Taxes (\$11.1 million, primarily due to the Cardroom Business Taxes), Fees, Rates and Charges (\$8.3 million, primarily due to PRNS Fee Activity), and Transient Occupancy Tax (\$4.5 million). Additionally, Property Tax revenue is anticipated to grow in 2021-2022 due to the reinstatement of a one-time loss in 2020-2021 of tax increment associated with Successor Agency properties (\$7 million), and anticipated Secured Property Tax growth of 3.5%.

On the expenditure side, a number of upward and downward adjustments have been incorporated into this Forecast resulting in a net increase of \$28.8 million in 2021-2022. As with General Fund revenues, the largest expenditure changes are associated with employee general wage increases (\$27.4 million) and retirement contribution costs (\$20.2 million) in accordance with existing labor agreements, estimation of future salary costs, and actuarial assumptions approved by the City's Retirement Boards. Other significant personnel-related cost changes are attributable to compensation related to non-management step and management pay-for-performance program (\$4.1 million), health insurance plans cost increases (\$2.0 million), and increases for living and minimum wage adjustments (\$760,000). Other large expenditure increases include: increases for the allocation Measure E revenues toward affordable housing and homelessness prevention Reserves and Program Administration (\$10.0 million); city-wide vehicle operations and maintenance, electricity, gas, and Police fleet replacements (\$4.2 million); operations and maintenance costs associated with capital projects anticipated to be completed in 2021-2022 (\$2.6 million); the restoration of one-time cost savings related to the partial suspension of community center operations realized in 2021-2022 (\$1.4 million); reinstatement of one-time program suspensions for Aquatics and Family Camp (\$1.1 million); contractual increases for city-wide janitorial services as previously approved by the City Council (\$832,000); and various contractual increases for information systems and software license agreements city-wide (\$816,000). A notable expenditure decrease includes the reinstatement of the reduction of Branch Library hours that were delayed in 2020-2021 using one-time funds (\$1.0 million).

Further detailed information regarding the General Fund revenues and expenditures and the assumptions used in the development of the Forecast can be found in *Section I – Elements of the General Fund Forecast* of this document.

***General Fund Committed Additions***

Cost estimates for specific “Committed Additions” that address previous City Council direction are included in this Forecast in the years that they are projected to be required. The Committed Additions category, summarized in the chart below, reflects projected additional operating and maintenance costs for new or renovated capital projects in the 2021-2025 Adopted Capital Improvement Program, or for projects approved by the City Council during 2020-2021. The costs of the additions total \$2.6 million in 2021-2022 and increase to \$21.4 million by the end of the forecast period.

**2022-2026 General Fund Committed Additions  
Maintenance and Operations Costs**

	<b>2021-2022</b>	<b>2022-2023</b>	<b>2023-2024</b>	<b>2024-2025</b>	<b>2025-2026</b>
New Parks and Recreation Facilities	\$384,000	\$901,000	\$1,362,000	\$1,848,000	\$1,947,000
New Traffic Infrastructure Assets	175,000	287,000	367,000	404,000	428,000
Fire Training Center and Fire Station 20 (Landside Operations)	19,000	156,000	240,000	247,000	256,000
Measure T Bond	1,977,000	4,195,000	9,455,000	14,378,000	18,777,000
<b>Total</b>	<b>\$2,555,000</b>	<b>\$5,539,000</b>	<b>\$11,424,000</b>	<b>\$16,877,000</b>	<b>\$21,408,000</b>

These Committed Additions are related to new parks and recreational facilities, new traffic infrastructure assets, the new Fire Training Center and the expanded Fire Station 20 at the Airport that will include landside (off-Airport) operations, and the new projects funded by Measure T Bond funds. A detailed listing of all committed additions with operating and maintenance costs are included in this 2022-2026 General Fund Forecast and can be found in *Section 3 - Committed Additions to the Base General Fund Forecast* of this document.

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

General Fund Capital Operating and Maintenance Costs/Budget Principle #8 requires City Council certification that funding will be made available in the General Fund for capital projects with an estimated operating budget impact greater than \$100,000 at the time of taking beneficial use of the facility or project, and that this operations and maintenance funding will not require a decrease in existing basic neighborhood services. Capital projects with operating and maintenance costs over \$100,000 that have been previously certified by the City Council, or are recommended for certification in the future, are shown in Chart A in Section III.

***Alternative Forecast Scenarios***

To model the range of budgetary scenarios possible under varying economic conditions, two alternative forecasts have been developed in addition to the “Base Case.” “Optimistic” and “Pessimistic” cases model economic scenarios considered possible, but less likely to occur than the “Base Case.” These alternatives are presented in Section 4 of the report to provide a framework that gives perspective to the Base Case. The Base Case Forecast is still considered, however, the most likely scenario and is being used for planning purposes for the 2021-2022 Proposed Operating Budget. It should be noted that the expenditure assumptions remain constant in each of these alternative scenarios.

**General Fund Operating Margins  
(Base, Optimistic, and Pessimistic Cases)**

	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026	Five-Year Surplus/ (Shortfall)
<b>Base Case</b>	<b>(\$48.1 M)</b>	<b>\$3.3 M</b>	<b>\$0.2 M</b>	<b>\$4.4 M</b>	<b>\$ 1.9 M</b>	<b>(\$38.2 M)</b>
Optimistic Case	(\$13.9 M)	\$17.9 M	\$13.1 M	\$28.2 M	\$37.2 M	\$82.5 M
Pessimistic Case	(\$78.1 M)	(\$8.7 M)	(\$9.9 M)	(\$9.7 M)	(\$10.2 M)	(\$116.6 M)

- Base Case* – The Base Case Forecast is built on the assumption of the economy solidly 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. In this scenario, the total General Fund shortfall over the five-year period totals \$38.2 million.
- 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. In this scenario, there is a General Fund surplus of \$82.5 million over the five-year period.

- 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. In this scenario, the total General Fund shortfall over the five-year period totals \$116.6 million.

***Capital Revenue Forecast***

Section V of this report describes the Capital Revenue Forecast that will be used to develop several major elements of the 2021-2022 Capital Budget and the 2022-2026 Capital Improvement Program (CIP). As in past years, the construction-related revenue estimates included in this report are derived from construction activity projections provided by the Planning, Building and Code Enforcement (PBCE) Department and an analysis of actual collection patterns. The projections and their basis are described in a report prepared by the PBCE Department, which is included as *Appendix C* of this document (Development Activity Highlights and Five-Year Forecast [2022-2026])<sup>1</sup>. This activity forecast includes a review of specific projects that are in progress as well as a general prediction of expected levels of new construction.

The following table compares the estimates for the economically sensitive capital revenue categories included in this Five-Year Forecast with those included in the 2021-2025 Adopted CIP. As shown below, revenues are anticipated to increase by 16% compared to the Adopted CIP, from \$319.9 million to \$370.9 million.

**Capital Revenue  
Forecast Comparison Summary  
(\$ in Thousands)**

	<b>2021-2025 Adopted</b>	<b>2022-2026 Forecast</b>	<b>Difference</b>	<b>% Change</b>
<b>Construction and Conveyance Tax</b>	\$158,000	\$184,000	\$26,000	16%
<b>Building and Structure Construction Tax</b>	79,000	96,000	17,000	21%
<b>Construction Excise Tax</b>	78,000	86,000	8,000	10%
<b>Municipal Water System Fees</b>	375	375	0	0%
<b>Residential Construction Tax</b>	1,000	1,000	0	0%
<b>Sanitary Sewer Connection Fee</b>	2,500	2,500	0	0%
<b>Storm Drainage Connection Fee</b>	1,000	1,000	0	0%
<b>TOTAL</b>	<b>\$319,875</b>	<b>\$370,875</b>	<b>\$51,000</b>	<b>16%</b>

<sup>1</sup> <https://www.sanjoseca.gov/home/showpublisheddocument?id=69689>



Real estate activity (primarily housing sales) determines the collection level of the Construction and Conveyance Tax. After reaching a record setting high of \$49.0 million in 2005-2006, tax collections continuously fell for several years following the real estate slowdown and financial market crisis, dropping to \$20.5 million in 2008-2009. Collections began rebounding again in 2009-2010 and reached peak levels of \$48.1 million in 2017-2018 and \$47.2 million in 2018-2019, before decreasing to \$40.9 million in 2019-2020. C&C collections in 2020-2021 are projected to end the year at \$40.0 million. This collection level is 2% below the actual receipts received in 2019-2020 (\$40.9 million), which is reflective of the strong housing market despite the pandemic. Collections in this extremely volatile revenue category are conservatively forecasted to drop to \$38.0 million in 2021-2022 and 2022-2023, and then drop to \$36.0 million the remainder of the forecast period.

Construction activity valuation is anticipated to be higher than the prior year with \$2.0 billion in 2020-2021, a 10.0% increase compared to \$1.8 billion in 2019-2020. Construction valuation is projected to peak this fiscal year and then estimated to decrease by 40% to \$1.23 billion in 2021-2022, back to a level experienced prior to 2013-2014. For 2022-2023 and 2023-2024, construction activity valuation is expected to decrease by another 3.7% to \$1.18 billion and then increase to \$1.23 billion for the last two years of the five-year period due to declining activity levels for both new construction and alternations. While the pandemic led to some interruptions in the local construction sector, the market showed resilience last year and this year as projects already in progress re-started after the shutdown and other permits were pulled for the first time. Though these estimates may be conservative, they are reflective of the uncertain development environment in the future and an acknowledgement that the extremely high levels experienced over the last several years will likely not continue at the same level.

The five-year projection for the Building and Structure Construction Tax collections total \$96.0 million, \$17.0 million above the estimate included in the 2021-2025 Adopted Capital Improvement Program (CIP). It is projected that collections will drop from the 2020-2021 estimate of \$28 million to \$20 million in 2021-2022 and to \$19 million for the remainder of the forecast period as projects are completed and activity levels decrease. Construction Excise Tax collections are projected to total \$86.0 million over the forecast period, \$8.0 million above the estimate included in the 2021-2025 Adopted Capital Improvement Program (CIP). It is projected that collections will drop from the 2020-2021 estimate of \$21.0 million to \$18.0 million in 2021-2022 and to \$17.0 million for the remainder of the forecast period as projects are completed and activity levels decrease.

## **NEXT STEPS IN THE 2021-2022 BUDGET PROCESS**

The next major steps in the budget development process include the following:

### ***March 2021***

- 2021-2022 Mayor's March Budget Message Released with Public Hearing; Amended/Approved by City Council

### ***April 2021***

- 2021-2022 Proposed Capital Budget and 2022-2026 Capital Improvement Program Released

### ***May 2021***

- 2021-2022 Proposed Operating Budget and 2021-2022 Proposed Fees and Charges Released
- 2021-2022 Community Budget Meetings
- City Council Study Sessions and Initial Public Hearing on 2021-2022 Proposed Operating Budget, 2021-2022 Proposed Capital Budget and 2022-2026 Proposed Capital Improvement Program, and 2021-2022 Proposed Fees and Charges

### ***June 2021***

- 2021-2022 Mayor's June Budget Message Released with Final Public Hearing; Amended/Approved by City Council
- 2021-2022 Operating Budget, 2021-2022 Capital Budget and 2022-2026 Capital Improvement Program, and 2021-2022 Fees and Charges Adopted by City Council

## **CONCLUSION**

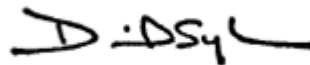
This document compares the projected revenues and expenditures for the General Fund over the next five years as well as provides estimates for some of the key revenues that support the City's Capital Improvement Program. A significant General Fund shortfall of \$48.1 million, almost 4% of the General Fund budget, is projected in 2021-2022, followed by very small surpluses ranging from \$0.2 million to \$4.4 million. These margins are narrow when considering the size of the General Fund budget that totals \$1.3 billion to \$1.4 billion annually over the forecast period (0.0% - 0.3% of the budget).

As with all forecasts, there is uncertainty regarding the revenue and expenditure estimates contained in this document. This is even more true for this Forecast, as the status of the pandemic, the pace of vaccine rollout, the influence that the new COVID-19 virus variants may have on infection rates and vaccine efficacy, and how people and businesses respond and adapt after the pandemic subsides will all have enormous influences on the City's budget. It is also important to keep in mind that this Forecast does not reflect several elements that would impact the General Fund over the forecast period, including: 1) costs associated with services that were funded on a one-time basis in 2020-2021, including resources to support the City's pandemic response and recovery efforts; 2) costs associated with unmet/deferred infrastructure and maintenance needs; and 3) one-time revenue sources or expenditure needs.

The revenue and expenditure projections for 2021-2022 will continue to be refined over the next several months as additional information becomes available. This includes additional Property Tax roll growth data that is updated each month, or any new economic data that would substantially alter assumed revenue growth across economically sensitive categories. The City may also receive news regarding additional pandemic relief and stimulus funding from the Federal government that could have a significant positive impact on the City's short-term budgetary position and provide resources to continue the City's pandemic response and recovery efforts. Based on this additional data, any necessary adjustments will be incorporated into the 2021-2022 Proposed and Adopted Operating Budgets, as appropriate.

This document also provides the recommended 2021-2022 City Manager's Budget Request (Budget Balancing Strategy Guidelines) for consideration by the City Council as part of its review of the Mayor's March Budget Message. The over-arching goals of these guidelines are to continue operational and fiscal stability while delivering services to our community in a cost-effective manner.

Over the past many years, the Mayor and City Council have remained committed to ensuring the fiscal health of the City while delivering essential services in the most cost-effective manner. Continued commitment to these strategies will help ensure the fiscal sustainability of the City's services moving forward.



David Sykes  
City Manager