

*Five-Year Economic Forecast  
and  
Revenue Projections*

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*2016-2020*

# ELEMENTS OF THE GENERAL FUND FORECAST

## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

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### Overview

This document provides three alternative Five-Year Forecast scenarios for General Fund revenues and expenditures: Base Case, Optimistic Case, and Pessimistic Case. The Administration recommends that the Base Case, considered the most likely projection, be used for the development of the 2015-2016 Proposed Operating Budget. Given the uncertainties inherent in any five-year forecast, however, two alternative case forecasts for the General Fund are also provided. These scenarios attempt to model the potential impact of more optimistic and pessimistic views of the future economic environment.

- ❑ **Base Case** – The Base Case Forecast is built on the assumption of continued moderate recovery from the deep global recession on a national level. At the local level, the technology industry continues to drive strong growth with many revenues exceeding pre-recession levels. Local employment levels are expected to continue to experience moderate growth and the unemployment rate is expected to continue to remain around historically normal levels. Home values continue to show steady growth and are anticipated to continue to improve over the five years. In the Base Case Forecast, General Fund revenue collections are anticipated to experience moderate growth over the forecast period.
- ❑ **Optimistic Case** – The Optimistic Case assumes both a faster and more robust recovery than the Base Case anticipated. When compared to the Base Case scenario, the real estate market improves significantly with increases not only in the price of housing, but also the volume of home sales, outpacing the growth rates assumed in the Base Case. This housing market recovery, with both an increase in new home construction and increased prices, is driving growth in inflation higher than in the Base Case. Due to the currently high employment growth, the optimistic case presumes only slightly higher employment levels than the base case. This strong recovery results in increased collections in the economically sensitive revenue categories, such as Property Tax and Sales Tax.
- ❑ **Pessimistic Case** – The Pessimistic Case assumes that a combination of adverse factors impede the moderate recovery underlying the Base Case and keep inflation low, causing a more sluggish recovery. Under this scenario, neither a crash at the international level nor the national level are anticipated. However, it does model lower than expected growth of the key factors and determinants of the City’s revenue; local employment, local housing prices and number of sales, and local inflation are all lower than those of the Base Case. For example, a key assumption for this lower forecast is lower home prices, which are modeled to fall from their current double digit growth rates to 6% growth to 2% growth in this pessimistic case. In this scenario, the City’s revenues, particularly Property Tax and Sales Tax, would be significantly impacted by an economic slowdown.

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### **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 2015-2016 Proposed Operating Budget, scheduled to be published on May 1, 2015.

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**

The U.S. economy is currently growing at a relatively subdued pace. Real U.S. Gross Domestic Product (GDP) increased 2.4% in 2014, compared with an increase of 2.2% in 2013. The year-over-year growth is primarily the result of increased consumer spending, increased business investment, increased exports, increase government spending, and increased residential fixed investment. These gains were partially offset by an increase in imports.<sup>1</sup> National employment saw slightly lower gains than GDP, and continues to reflect a slow recovery from the “Great Recession” of 2009. The U.S. unemployment rate stood at 5.7% in January 2015, down from 6.6% in January 2014, according to the U.S. Department of Labor's Bureau of Labor Statistics February 6, 2015 report. Although the lower rate for 2015 represents improvement, it does not take into account those workers too discouraged to search for work. Overall, the rate remains above the pre-recession levels of 4%-5%.

Perhaps the brightest sector of the U.S. economy has been the consistently high pace of new car sales. Car sales are back to the levels they were at before the recession - about 17 million cars per year. Ample availability of credit and continued improvements in models are pulling buyers into showrooms at a very strong pace. The high level of car sales shows no sign of ebbing any time soon. The automotive sector represents a large and important employment sector in the economy and a base component of the U.S.'s industrial production sector.

Despite the strong growth in automotive sales, there are some weaker sectors that need improvement before the economy returns to its pre-recession levels, including wage growth, energy, and housing. The weakening of the energy sector due to the sudden and sharp decline in oil prices represents an important development since the 2015-2019 Five Year Forecast. The

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<sup>1</sup> U.S. Department of Commerce Bureau of Economic Analysis, GDP Increases in Fourth Quarter, January 30, 2015

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### **Base Case Forecast**

United States has recently become the world's largest single producer of oil and the decline in the price of oil from \$90 a barrel for most of 2014 to around \$50 a barrel (at the time of this forecast) will have serious repercussions throughout the U.S. domestic oil belt as well as our neighbors, Mexico and Canada. Forecasts vary on how this drastic change will impact the economy. There is both good and bad news about this change in price; the price decline will free up consumer disposable income to spend on items other than oil, however, the decline also represents an actual decline in income for domestic oil producers and, in some cases, a loss of investment. This decline in oil prices also exerts downward pressure on inflation rates, and could result in actual price declines for the next few quarters before the economy absorbs the impact and returns to a slightly inflationary path.

On a national level, the real estate market continues to improve, however, existing home sales are being hampered by a lack of available inventory. From December 2014 to January 2015, total housing inventory increased by 0.5% to 1.87 million existing homes for sale, though this level is slightly below prior year levels of 1.88 million. According to Lawrence Yun, NAR Chief Economist, "... [the] overall low housing supply and the ongoing rise in home prices above the pace of inflation appeared to slow sales despite interest rates remaining near historic lows."<sup>2</sup> Nonetheless, from January 2014 to January 2015, the median existing home price is up 6.2% and the number of existing home sales is up 3.2%. Additionally, privately owned housing starts in January of 1.06 million (seasonally adjusted) were 2.0% below the revised December estimate of 1.09 million, but still 18.7% above the January 2014 rate of 897,000.<sup>3</sup> In a normal year, housing starts have historically averaged around 1.5 million. Approximately 31.8% of the housing starts are multi-family residences, which will still exert upward pressure on the economy, but somewhat less than the equivalent amount of single-family homes. Mortgage rates are also anticipated to rise slightly when the Federal Reserve Board lessens its monetary stimulus activities.

### **National Economic Outlook**

Moderate economic growth appears likely for the next several years, driven by growth across most sectors of the economy, combined with increased business spending and an end to the decline in federal, State and local government spending, according to the December 2014 UCLA Anderson Business School Forecast. Typically, the UCLA Anderson Forecast is a significant input to the assumptions in this forecast. Although a critical component of this forecast, the projections in this forecast rely on extrapolation of the trends in the Anderson Forecast, as the December 2014 forecast did not take into account the full effects of the current decline in oil prices.

A modest rate of inflation is a key driver for business and consumer demand, and for future property and sales taxes. The Federal Reserve Board continues to target a core annual inflation rate of 2% and continues to signal that it will begin to gradually raise interested rates in 2015, returning monetary policy to a more neutral position. The Consumer Price Index (CPI) declined

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<sup>2</sup> National Association of Realtors, News Release, February 23, 2015

<sup>3</sup> U.S. Census Bureau and U.S. Department of Housing and Urban Development, News Release, February 18, 2015

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### **Base Case Forecast**

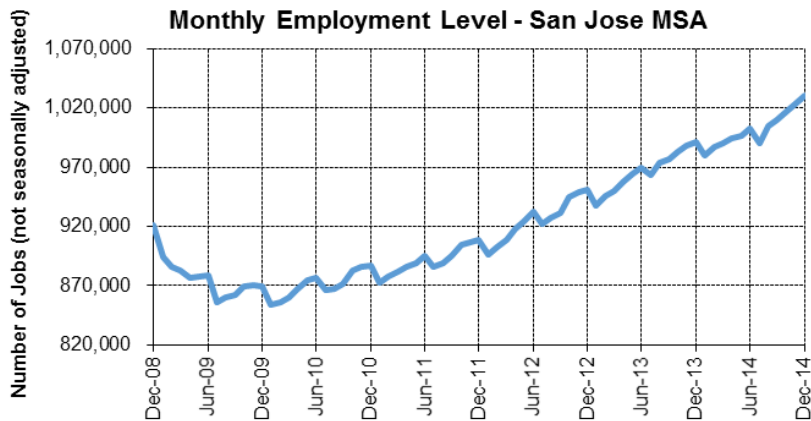
0.4% in December 2014 (seasonally adjusted) and increased 0.8% over the last 12 months (before seasonal adjustment).<sup>4</sup> In January 2015, it actually declined 0.7% (seasonally adjusted), which resulted in a 12 month rate of -0.1% (before seasonal adjustment), the first negative 12 month rate since October 2009, which can be attributed to a significant decline in the gasoline index. The gasoline index declined 18.7% in January, bringing the energy index down 9.7%. Had the gasoline index remained unchanged, the all items index would have risen 0.1% in January. This low rate of CPI growth is further notable given the efforts of the Federal Reserve to inject money into the economy.

The declining oil prices currently being experienced in the U.S. is dampening overall economic growth and will continue to put significant downward pressure on all prices. As a result of this downward pressure, it is anticipated that overall inflation of 2% will not be achieved until midway through the forecast period. Offsetting the impacts of the current energy sector include the continued booming technology industry as well as increased spending in State and local governments, which have only begun to rehire employees previously let go during the recession. At a global level, the slowing of the Chinese economy and the continued turmoil in Europe should not be ignored; however, this forecast anticipates that these weak economies will not crash.

### **Current City of San José Economic Conditions**

Economic performance in Silicon Valley continues to be a bright spot with growth at a robust pace. Most local economic indicators, including employment, local construction, and real estate activity measures, show sustained economic growth.

The San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (MSA) continues to report positive trends in employment. Total employment grew by 39,300, or 4.0%, from the previous peak of 991,900 in December 2013 to a preliminary estimate of 1.03 million in December 2014. Job gains in industries dominated by high-tech, including computer systems design and computer and electronic products manufacturing, accounted for 43.3% of the total job gain (17,000 jobs). The largest single category of growth was Professional and Business Services (11,600 jobs), up 6.0% from last December.<sup>5</sup>



<sup>4</sup> U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index News Release, February 26, 2015

<sup>5</sup> State of California Employment Development Department Labor Market Information Division Press Release, January 23, 2015

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## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

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### **Base Case Forecast**

As noted in the Beacon Employment Report, along with a substantial year-over-year decline in the statewide unemployment rate, workers are becoming more optimistic about their employment prospects by choosing to re-enter the job market. From December 2013 to December 2014, 260,500 residents entered the labor force, the largest December-to-December increase since 1999 to 2000.<sup>6</sup>

In December 2014, the unemployment rate in the San José MSA fell to 4.6%, down from the December 2013 rate of 5.8%. This compares favorably to the revised rate from November 2014 of 5.2%, to the unadjusted employment rate for California of 6.7%, and to the overall rate for the nation of 5.4%. For the City of San José, the December 2014 preliminary unemployment rate was calculated at 5.0%.<sup>7</sup>

#### Unemployment Rate (Unadjusted)

	Dec. 2013	Nov. 2014	Dec. 2014 <sup>2</sup>
San José Metropolitan Statistical Area <sup>1</sup>	5.8%	5.2%	4.6%
State of California	7.9%	7.1%	6.7%
United States	6.5%	5.5%	5.4%

<sup>1</sup> San Benito and Santa Clara Counties

<sup>2</sup> Preliminary Estimate

Source: California Employment Development Department

#### Private Sector Construction Activity (Valuation in \$ Millions)

	July-Dec. 2013	July-Dec. 2014	% Increase/ (Decrease)
Residential	\$ 451.2	\$ 363.3	(19%)
Commercial	\$ 239.5	\$ 130.7	(45%)
Industrial	\$ 379.2	\$ 138.2	(64%)

As expected, development activity has declined compared to the surge experienced in 2013-2014. Through December, construction activity is generally in line with the projections used to develop the 2014-2015 budget and all sectors are on pace to outperform 2011-2012 and 2012-2013.

While this activity level is anticipated to continue to taper off in the next several years, the increased supply of residential, commercial, and industrial buildings is anticipated to provide future economic gains to San José.

Performance in the housing market continues to be strong, though the persistent lack of inventory has restrained growth. The median single-family home price was \$750,000 in December 2014, which is an increase of 9.5% from the median home price of \$685,000 in December 2013. The average days-on-market for single-family and multi-family dwellings was 20, a significant drop from the prior year average days-on-market of 37. The number of listings of new single-family and multi-family dwellings on the market has dropped approximately 15.5%, from 355 listings in December 2013 to 300 in December 2014. The number of property transfers (sales) for all types of residences fell below last year's levels, from 654 in December 2013 to 615 in December 2014.

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<sup>6</sup> Beacon Economics, Employment Report, January 2015

<sup>7</sup> Monthly city and CDP labor force data are derived by multiplying current estimates of county employment and unemployment by the employment and the unemployment shares (ratios) of each city and CDP at the time of the 2000 Census. This method assumes no change in the ratio of employment and unemployment, since 2000 (i.e., that the shares are still accurate). This assumption is untested, therefore, caution should be employed when using this data.

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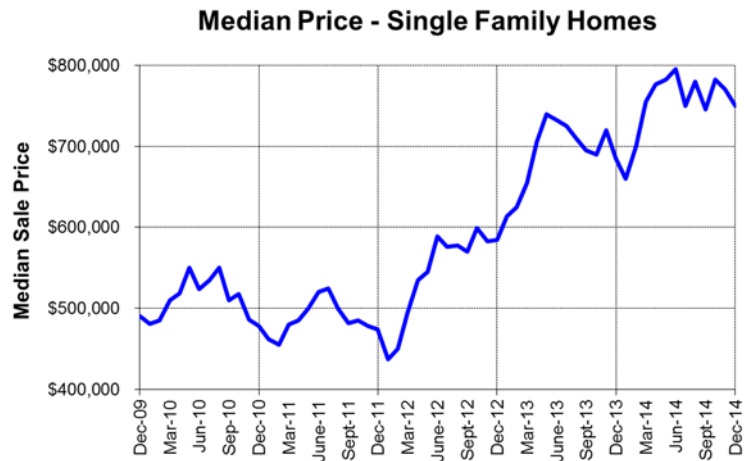
## ASSUMPTIONS REGARDING THE ECONOMIC ENVIRONMENT

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### Base Case Forecast

Cumulatively, property transfers from July through December totaled 4,002, which was down 4.5% from the 4,190 transfers during the first six months of 2013-2014.

Economic conditions will continue to be closely monitored and factored into the development of the 2015-2016 Proposed Budget, scheduled to be released May 1, 2015.



### **City of San José Economic Outlook**

Although the economic indicators driving this forecast are slightly lower than the previous year's forecast, the outlook for Silicon Valley overall, and San José in particular, is positive in the near term and in the out years of this Forecast. Due to the concentration of technology firms in the Silicon Valley, this region is heavily influenced by the technology sector. The strength in the technology sector as well as continued improvement in the housing sector are expected to grow the local economy through 2015.

In the near term, the strength in the technology industry will keep employment levels increasing. In the longer term, rebounds in State and local government hiring, as well as the gains in construction, are expected to bolster the employment rate in the long term. However, signs such as the high stock valuations of many technology companies indicate that the current technology product cycle may be over its peak. As this technology cycle recedes, which has been defined by the emergence of mobile-social networking, employment will continue to grow, but at a more sustainable long-term level. However, caution surrounding this booming technology environment in relation to the current weakened economic environment in China should be monitored. China is a large consumer of technology products both at a consumer level as well as investments directly in the Silicon Valley. Should the economy in China deteriorate, a loss or slowed investment in Santa Clara County may be realized.

Continued strength in private development construction is also expected over the Forecast period, though the growth rates are anticipated to be lower than the peak that was reached in 2013-2014 and are tapering off somewhat. With a continued greater supply of land than in some other areas in the County of Santa Clara, it is likely that both companies and workers will find San José an attractive place to build offices and homes. This will translate to growth in residents and jobs, and bring revenues to the City. However, on the negative side, the limited supply of housing may eventually push prices too high and begin to act as a disincentive for new talent to move into the area, thus dampening growth.

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### **Base Case Forecast**

Taken together, San José can expect a continued recovery from the steep declines experienced during the economic recession and continues to be positioned well to experience moderate growth throughout the forecast period among economically sensitive revenues such as Sales Tax, Property Tax, and Transient Occupancy Tax receipts.

### **Optimistic Case**

In the Optimistic Case, the economy is assumed to grow at a much more rapid pace than assumed in the Base Case. This growth is primarily due to greater employment growth and greater inflation in both the national economy and at the local level.

The higher economic growth rates envisioned by this scenario may come to pass. The economy is at a point in its business cycle where many of the lagging sectors could exhibit much stronger growth than expected, particularly in housing. The Optimistic Case is based partly on the assumption that the real estate sector, nationally and locally, improves faster due to a rapid increase in the number of new home starts over the next several years. With mortgage rates still low, employment increases and a well-performing stock market could spur a greater number of home purchases. As a partial result of more rapid new home construction, the country's overall employment and wage levels would improve.

Under the Optimistic Case, the economically sensitive revenues are expected to experience much stronger performance as general increases in employment and consumer attitudes promote increased spending, which generate Sales Tax for the City. Improvement in the real estate market will result in higher Property Tax revenues. Conversely, Gas Taxes are slightly lower as a result of a faster return to normal oil prices and continued increases in mandated fuel economy, which is anticipated to cause the number of taxable gallons consumed to fall. By the end of the Forecast period, revenues are \$37.6 million above the Base Case.

It should be noted that, as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve, therefore no change in Transient Occupancy Tax growth is modeled as part of this case as there is no impact to the operating margin.

### **Pessimistic Case**

The Pessimistic Case assumes lower than expected growth of the key national and local economic determinants of the City's revenues. Thus, local employment, local housing, and local inflation are all lower than those of the Base Case. Like the Optimistic Case, the prospects for a lower scenario could still occur.

The world economy, already slow to recover, could still encounter setbacks from a variety of sources, including a slowing Chinese economy or problems between Greece and the rest of the



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### **Pessimistic Case**

European Union. However, this pessimistic case does not envision any sort of market crash at either the national or international level. In this scenario, national GDP never rises above 3% and local employment growth and the inflation rate both remain below 2% through the five-year period.

A critical driver for this lower forecast is lower home prices. The Base Case forecasted continued strong increases in local home prices. This lower scenario presumes that prices for local homes fall from their current double-digit growth rates in the first year to a 6% growth rate, to an even lower 2% growth rate in the out years. The result of the lessened U.S. economic activity and lower local home prices in this scenario is that San José's revenues would be much lower, especially in the categories of Property Tax and Sales Tax. By the end of the Forecast period, total revenues are \$32.1 million below the Base Case.

As noted in the Optimistic Case, as directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve, therefore no change in Transient Occupancy Tax growth is modeled as part of this case as there is no impact to the operating margin.

### **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 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 2015-2016 revenue estimates included in this Forecast. Over 450 revenue sources were examined to estimate the outcome in 2014-2015 and build upon those projections to develop the 2015-2016 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 2015-2016 Proposed Operating Budget scheduled to be released on May 1, 2015.

# 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 \$890.1 million in 2015-2016 to \$1.0 billion in 2019-2020, for an average growth rate of 3.1% per year.

### February 2016-2020 Forecast Revenue Summary

General Fund Revenue Category	Modified Budget	Forecast				
	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
<b>General Revenues</b>						
Property Tax	\$ 233,973,240	\$ 253,210,000	\$ 268,453,000	\$ 283,621,000	\$ 298,653,000	\$ 313,346,000
Sales Tax	180,024,000	189,195,000	195,174,000	201,439,000	208,167,000	215,348,000
Transient Occupancy Tax	13,000,000	13,975,000	14,814,000	15,554,000	16,021,000	16,501,000
Franchise Fees	45,346,879	47,205,000	48,418,000	49,488,000	50,463,000	51,341,000
Utility Tax	94,825,000	93,986,000	96,326,000	98,330,000	100,228,000	102,192,000
Telephone Line Tax	20,700,000	20,800,000	20,871,000	20,933,000	21,000,000	21,065,000
Business Tax	43,700,000	44,000,000	44,229,000	44,423,000	44,606,000	44,775,000
Licenses and Permits	46,395,293	49,029,000	50,892,000	52,775,000	54,358,000	55,771,000
Departmental Charges	39,743,435	39,082,000	42,226,000	43,788,000	45,102,000	46,275,000
Fines, Forfeitures & Penalties	14,205,334	14,436,000	14,574,000	14,780,000	14,985,000	15,092,000
Money and Property	2,914,023	3,317,000	3,368,000	3,445,000	3,527,000	3,607,000
Revenue From Local Agencies	27,307,083	22,857,000	22,634,000	22,934,000	23,271,000	23,597,000
Revenue from the State	12,538,099	10,576,000	10,335,000	10,335,000	10,335,000	10,335,000
Federal Revenue	11,466,924	952,000	962,000	990,000	1,019,000	1,048,000
Other Revenue	165,200,681	13,864,000	13,638,000	13,883,000	7,881,000	7,938,000
Gas Tax	15,000,000	16,900,000	16,486,000	16,051,000	15,483,000	14,936,000
<b>Total General Revenues</b>	<b>\$ 966,339,991</b>	<b>\$ 833,384,000</b>	<b>\$ 863,400,000</b>	<b>\$ 892,769,000</b>	<b>\$ 915,099,000</b>	<b>\$ 943,167,000</b>
<b>Transfers &amp; Reimbursements</b>						
Overhead Reimbursements	\$ 38,058,612	\$ 37,067,000	\$ 38,475,000	\$ 39,899,000	\$ 41,096,000	\$ 42,164,000
Transfers	19,558,121	18,931,000	19,138,000	19,449,000	19,680,000	19,926,000
Reimbursements for Services	775,406	723,000	751,000	779,000	802,000	823,000
<b>Total Transfers &amp; Reimbursements</b>	<b>\$ 58,392,139</b>	<b>\$ 56,721,000</b>	<b>\$ 58,364,000</b>	<b>\$ 60,127,000</b>	<b>\$ 61,578,000</b>	<b>\$ 62,913,000</b>
<b>Total General Fund Revenues</b>	<b>\$ 1,024,732,130</b>	<b>\$ 890,105,000</b>	<b>\$ 921,764,000</b>	<b>\$ 952,896,000</b>	<b>\$ 976,677,000</b>	<b>\$ 1,006,080,000</b>
Beginning Fund Balance	\$ 270,638,395	\$ 62,251,000	\$ 62,363,000	\$ 63,257,000	\$ 64,223,000	\$ 62,633,000
<b>Grand Total Sources</b>	<b>\$ 1,295,370,525</b>	<b>\$ 952,356,000</b>	<b>\$ 984,127,000</b>	<b>\$ 1,016,153,000</b>	<b>\$ 1,040,900,000</b>	<b>\$ 1,068,713,000</b>
<b>Growth %</b>			<b>3.34%</b>	<b>3.25%</b>	<b>2.44%</b>	<b>2.67%</b>

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 2015-2016 General Fund Forecast.

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## REVENUE FORECAST

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### Property Tax

Property Tax receipts of \$243.9 million are projected for 2014-2015, which represents 9.1% growth from the prior year and is above the modified budget estimate of \$234.0 million. Growth in 2014-2015 is reflected primarily in the Secured (9.8%) and Airplane (13.3%) categories. As discussed below, a portion of the Secured Property Tax growth is attributed to an estimated one-time payment to the City of \$4.4 million as result of excess Educational Revenue Augmentation Fund (ERAF) funds. Excluding this one-time payment, the property tax category is projected to increase 7.1% over 2013-2014 receipts. This compares to the overall growth experienced in 2013-2014 of 9.1% and continues to be much stronger than the modest year-over-year growth seen in 2011-2012 and 2012-2013, where actual Property Tax receipts were up 2.3% and 1.6%, respectively.

Overall, in 2015-2016, collections are expected to continue to experience solid growth with an increase of 3.8% to \$253.2 million in the category from estimated 2014-2015 levels, including a 1.998% California Consumer Price Index (CCPI) increase that will be assessed in the Secured Property Tax category. Excluding the one-time payment from the 2014-2015 estimated receipts, the adjusted growth in 2015-2016 is projected at 5.7%. 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. In 2014-2015, Secured Property Tax receipts are expected to total \$223.0 million, reflecting an increase of 9.8% from the 2013-2014 collection level. The projected increase can be attributed to an increase of 7.4% in the assessed value for 2014-2015, which reflects both the net increase in residential and commercial valuation resulting from the full or partial restoration of property values that were temporarily reassessed downwards under Proposition 8 due to the declining market value and the change in the California Consumer Price Index (CCPI) of 0.45%. In addition to the assessed value growth, a one-time payment of \$4.4 million is anticipated in 2014-2015 as a result of excess ERAF funds. 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 obligations, the remainder is to be returned to the taxing entities that contributed to it. In 2013-2014, the City received over \$200,000 from excess funds in 2012-2013. Currently, the County of Santa Clara anticipates approximately \$56 million in excess ERAF for Santa Clara County from 2013-2014, of which approximately \$4.4 million is anticipated to be allocated to the City of San José. No ongoing excess ERAF funding is programmed in this forecast. Based on discussions with the County of Santa Clara, these funds are being treated as one-time payments.

In 2015-2016, Secured Property Tax receipts, which will be based on real estate activity through January 1, 2015, are expected to increase by 3.9% to \$231.7 million; excluding the one-time ERAF payment anticipated in 2014-2015 as discussed above, the year-over-year growth rate is 6.0%. This projected increase is related to two factors: the change in the CCPI and the net change in residential and commercial valuation. Under Proposition 13, assessed values of all real property adjust with the CCPI, with a 2% limit, unless there is a change in ownership, new construction, or a property has received a Proposition 8 adjustment. The CCPI adjustment for the 2015-2016 tax

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## REVENUE FORECAST

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### Property Tax

roll is an increase of 1.998%, significantly above the prior year level of 0.45% and nearly at the cap of 2%. A net increase in residential and commercial valuation is also anticipated from the combination of changes in ownership, new construction, and the continued partial or full restoration of property values that had previously been reassessed downward under Proposition 8 due to declining home values. All properties that have received a reduction under Proposition 8 do not automatically receive the CCPI adjustment as these properties are assessed annually and adjusted upward or downward depending on the changes to property values. Proposition 8 partial or full restorations have been a significant driver of the strong growth in both 2013-2014 and 2014-2015. On a County-wide basis, the 2014-2015 roll growth was driven primarily by and changes in ownership (42.9%) and Proposition 8 adjustments (33.4%). In San José, the number of properties receiving Proposition 8 adjustments has dropped significantly from 76,600 in 2012-2013 to 46,500 in 2013-2014 and to approximately 24,000 in 2014-2015. With the continued recovery in the real estate market, it is anticipated that upward adjustments will continue to be realized in 2015-2016. In calendar year 2014, residential real estate experienced gains as the December 2014 median sales price of \$750,000 for single-family homes was 9.5% above the December 2013 level of \$685,000.

It should be noted that final data on the actual tax levy for 2015-2016 is not yet available as adjustments are made through June 30, 2015. Each month, the County of Santa Clara provides information on the status of the property tax roll for the upcoming year. Many of the adjustments, however, are not reflected until the latter months of a given fiscal year (April-June). The impact of reassessments of commercial property will not be known until the end of 2014-2015. As this information becomes available, refinements to the Property Tax estimates may be brought forward during the 2015-2016 budget process.

**Unsecured Property Taxes** are the second largest revenue source in this category. Growth in this category is driven primarily by increases in the value of personal property (e.g. equipment and machinery used by business and industry for manufacturing and production). During the last decade, performance in this category has been volatile with annual growth or declines reaching double-digit levels based primarily on the strength of the local business sector. Based on actual collections through December, Unsecured Property Tax receipts are estimated at \$12.5 million in 2014-2015, which is slightly above the prior year level of \$12.4 million, though below the most recent peak of \$12.6 million in 2012-2013. Collections are expected to increase 4.0% in 2015-2016 to \$13.0 million based on the current economic conditions. While the 2015-2016 estimate exceeds the recent peak of \$12.6 million in 2012-2013, it remains below the peak of \$14.1 million in 2002-2003.

**SB 813 Property Taxes** (supplemental taxes) represent payments for taxes owed on recent housing resales. In recent years, collections in this category had fallen significantly, due, in part, to a substantial number of refunds that were due to property owners as a result of declining home values. In 2014-2015, receipts are estimated to remain at prior year levels of \$5.0 million. This estimate reflects the combined impact of a change in methodology for the SB 813 distribution offset by growth in the category due to the strength in the real estate market. In 2004-2005, the

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### Property Tax

State Motor Vehicle In-Lieu (VLF) Swap involved the permanent conversion of VLF backfill funds to Property Tax that was part of the approved State budget. Since SB 813 Property Tax receipts are pooled receipts allocated to each jurisdiction based on their share of secured property taxes, an increase in the City's Secured Property Taxes increased the City's share of SB 813 receipts. Per conversations with the County of Santa Clara, beginning in 2014-2015, VLF receipts associated with the swap will not be considered Property Tax for the SB 813 calculation and, therefore, will reduce the City's relative share of this tax. Although the 2014-2015 estimate of \$5.0 million is above actual collection levels in recent years of \$3.0 million in 2012-2013 and \$3.3 million in 2011-2012, receipts are expected to remain well below the peak of \$10.1 million received in 2005-2006 and below levels seen just a few years ago (e.g., \$8.0 million in 2006-2007 and \$7.9 million in 2007-2008) based on the revised methodology. In 2015-2016, collections in this category are projected to increase approximately 2.0% to \$5.1 million.

The **Aircraft Property Tax** payment is estimated at \$2.4 million in 2014-2015, a 13.3% increase from prior year levels. In 2015-2016, receipts are anticipated to remain at prior year levels.

The **Homeowners Property Tax Relief** category is projected at \$1.0 million for 2015-2016, which is consistent with the 2014-2015 revenue estimate and 2013-2014 actual collections.

In the out years of the Forecast, annual Property Tax receipts are projected to increase approximately 4.9% to 6.0% annually over the five-year period. A portion of this growth due to an estimated 2% CCPI increase annually.

### Sales Tax

The Sales Tax category includes General Sales Taxes and Proposition 172 Sales Taxes. Overall, 2014-2015 collections are expected to increase 4.5% over prior year levels to \$181.1 million. In 2015-2016, year-over-year growth of 4.5% is again expected, bringing the projected revenue to \$189.2 million.

For the General Sales Tax revenue category, only one quarter of 2014-2015 data is available. Based on this limited information, year-over-year growth of 4.3% is projected in 2014-2015, resulting in collections of \$175.2 million. This increase from the \$168.0 million collected in 2013-2014 factors in one-time adjustments and the "Triple Flip"<sup>1</sup> payments from the State for estimated 2014-2015 collections as well as a true-up payment for 2013-2014. The 2014-2015 estimate reflects actual growth of 6.3% in the first quarter and projected underlying growth of 4.0% in the

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<sup>1</sup> As part of the Proposition 57 State fiscal recovery funding mechanism (passed by the voters in March 2004), starting July 1, 2004, 0.25 percent of the City's one percent Bradley-Burns sales tax has been temporarily suspended and replaced dollar-for-dollar with property tax revenue (primarily Educational Revenue Augmentation Funds). This action is to last only for the life of bonds. The City has, however, continued to record the replacement property tax revenues as sales tax receipts because the growth formula for these receipts is tied to sales tax and because this action is considered temporary.

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Sales Tax**

remaining three quarters based on recent sales tax performance and current economic conditions. With continued strength in the economy, sales tax growth is also expected to continue.

For 2015-2016, the General Sales Tax revenue projection of \$183.0 million assumes moderate growth of 4.0% in taxable sales from 2014-2015 levels. Based on information received from the State of California, it is currently anticipated that during 2015-2016, the Triple Flip will end with the final payment of the State Economic Recovery Bonds projected in July 2015. Once the bonds are repaid, the State Board of Equalization will revert back to the full local 1% tax rate in the first whole quarter at least 90 days after the repayment. While the timing of the bond repayment is subject to change by the State, this action is expected to occur at some point during 2015-2016. It should be noted though that as a result of the wind-down of the Triple Flip methodology, one-time monies are anticipated during either 2015-2016 or 2016-2017 to account for the final quarters of the Triple Flip methodology and the true-up due for 2014-2015 collections. As additional details are available as to both the schedule of the wind-down and the final Triple Flip true-up payment amount, any necessary actions will be brought forward as part of the appropriate budget process. Due to the uncertainty and one-time nature of these funds, no assumption is included in this forecast for these activities.

To put the 2015-2016 estimate into perspective, the projected revenue of \$183.0 million exceeds historic peak collections of \$164.3 million in 2000-2001, and continue to reflect revenues above pre-recession levels and above levels seen during the dotcom boom (not adjusted for inflation). The Sales Tax revenue projections for 2014-2015 will continue to be refined over the next couple of months as additional information becomes available. Sales Tax data for the second quarter of 2014-2015, which covers the 2014 holiday period, will be received in March 2015. Based on this additional data, any necessary adjustments to the estimate will be incorporated into the 2015-2016 Proposed Operating Budget.

Proposition 172 Sales Tax collections (representing the one-half cent tax that is allocated to counties and cities on an ongoing basis for funding public safety programs) are expected to total \$5.9 million in 2014-2015, which represents an 8.4% increase from the prior year collections of \$5.4 million based on activity through the first seven months of 2014-2015. In 2015-2016, collections are projected to increase 5.0%, to \$6.2 million based on historic average growth rates.

In the out-years of the Forecast, annual Sales Tax performance is expected to show moderate growth of 3.2% to 3.5% annually over the five-year period.

### **Transient Occupancy Tax**

Currently, Transient Occupancy Tax (TOT) receipts in 2014-2015 are projected to reach \$13.0 million, reflecting an increase of approximately 10% from the 2013-2014 collection level. Current year receipts mark the fifth year of growth and the fourth year of double-digit strong growth in this category, which is in stark contrast to declines of 11.5% and 18.5% in 2009-2010 and 2008-2009,

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Transient Occupancy Tax**

respectively. Overall, the hotel industry continues to experience solid growth with increases in occupancy levels (approximately 7% year-over-year growth in fiscal year 2014-2015 through January 2015) and average daily room rates (approximately 11% growth) with an average revenue-per-available room reflecting an increase of approximately 22% from prior year levels.

In 2015-2016, growth of 7.5% from the 2014-2015 estimate to \$14.0 million is anticipated which reflects continued strong performance in this category and the addition of hotel rooms including the Hyatt House, the AC Hotel, and the Bay 101 Hotel. In the out years of the forecast, revenues are anticipated to grow between 3.0% to 6.0% annually, with an assumed increase in room capacity inventory in both 2015-2016 and 2016-2017 included in this forecast. As directed in the Mayor's March Budget Message for Fiscal Year 2014-2015, as approved by the City Council, the growth in Transient Occupancy Tax receipts over the 2013-2014 actual collection level are to be set aside in a Cultural and Arts Facilities Capital Replacement and Maintenance Reserve. In this forecast, \$2.1 million beginning in 2015-2016 to \$4.6 million in 2019-2020 is set aside in a reserve for this purpose.

### **Franchise Fees**

Franchise Fees are collected in the Electricity, Gas, Commercial Solid Waste, Cable, Tow, Water, and Nitrogen Gas/Jet Fuel Pipeline categories. Overall, collections are projected at \$46.1 million in 2014-2015, an increase of 0.8% from prior year receipts of \$45.7 million. The projected increase in 2014-2015 is primarily due to higher collections in Cable receipts. In 2015-2016, Franchise Fees are expected to increase 2.3% to \$47.2 million due to growth in the Gas (4.4%), Electric (4.0%), and Cable (1.0%) categories.

Franchise Fees for electricity and gas services provided by Pacific Gas & Electric (PG&E) are based on the revenues of that company in the calendar year (revenues in 2014-2015 are based on the calendar year 2014). 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. When comparing 2013 and 2014 calendar year Utility Tax receipts, Gas receipts showed a decrease of 4.6% and Electric showed an increase of 1.4%. The reconciliation of annual receipts from PG&E for 2014-2015 will be received in April 2015.

In the **Electric Franchise Fee** category, collections in 2014-2015 are expected to reach \$19.5 million, reflecting growth of approximately 1% compared to actual receipts in 2013-2014 and are slightly below the actual growth in Electric Utility Tax receipts in calendar year 2013 compared to 2014. In 2015-2016, growth of 4.0% from 2014-2015 estimates is anticipated reflecting a rate increase of 4% to 6% effective January 2015 per PG&E forecasts. It should be noted that due to the uncertainty regarding the outcome of rate cases, no rate increases associated with any pending rate cases have been assumed.

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### Franchise Fees

In the **Gas Franchise Fee** category, the 2014-2015 estimated collections of \$4.6 million reflect a 3.0% decrease from the \$4.8 million received in the prior year. This is compared to the actual decline in Gas Utility Tax receipts of 4.6% from calendar year 2013 to 2014. In 2015-2016, Gas Franchise Fee collections are projected to increase by approximately 4%. Based on PG&E forecasts, rate increases of 3% to 7% are estimated primarily due to the approval of the 2014 rate case by the California Public Utilities Commission (CPUC) in August 2014, partially offset by changes in consumption levels. It should be noted that due to the uncertainty regarding the outcome of any rate cases, no rate increases associated with pending rate cases have been assumed in 2014-2015.

**Commercial Solid Waste (CSW)** Franchise Fee collections are estimated to reach budgeted levels of \$11.2 million in 2014-2015, 1.4% above the prior year collections. 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 new 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 no increase was approved for 2013-2014; the first increase was approved in 2014-2015. Therefore, the 2015-2016 estimate does not assume growth from 2014-2015 as City Council approval of a rate increase would be required.

In the **Cable Franchise Fee** category, the estimated 2014-2015 collections of \$9.6 million reflect growth of 2.1% from the prior year receipts. In 2015-2016, additional modest growth of 1% is projected, bringing the estimate to \$9.7 million.

In **City Generated Tow**, projected revenues of \$900,000 in 2014-2015 are consistent with prior year levels. Collections are anticipated to remain flat at \$900,000 in 2015-2016.

Remaining categories, including **Water, Nitrogen Gas Pipeline, and Jet Fuel Pipeline**, are estimated to end 2014-2015 at \$362,000 and remain at that level in 2015-2016.

In the out years of the Forecast, Franchise Fee revenues are anticipated to increase from 1.7% to 2.6% annually. Over the next five years, however, it should be noted 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. In addition, the City's current Cable Franchise Fee agreement is scheduled to sunset in 2016.

### Utility Tax

Utility Taxes are imposed on electricity, gas, water, and telephone usage. Collections in 2014-2015 are anticipated to total \$91.1 million, representing a decrease of 2.9% from the 2013-2014



# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### Utility Tax

collection level. The majority of this decline is projected in Telephone receipts, reflecting both a decline in activity and a one-time legal settlement which refunds \$1.3 million to settle claims made by AT&T Mobility on behalf of its customers against California cities and counties that collect utility taxes. The decline in the Telephone Utility Tax category is partially offset by increased Electricity Utility Tax receipts.

In 2015-2016, Utility Tax collections are projected to increase 3.2% to \$94.0 million. Overall, a number of rate cases were approved by the California Public Utilities Commission (CPUC) in August 2014 and additional proposed rate cases have been filed that would impact electricity, gas, and water rates and consequently revenues. Overall, PG&E revenues are estimated to increase 6% between Gas and Electric activity. 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 adjust for anticipated 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 \$42.8 million in 2014-2015, a 4.7% increase from prior year levels. After recent rate cases approved by the California Public Utility Commission (CPUC), rates were adjusted in the fall of 2014 and as outlined by PG&E, an additional 4% to 6% increase took effect in January 2015. In 2015-2016, revenues are estimated to increase 2.8% to \$44.0 million, which adjusts for the January 2015 rate increase, partially offset by slight changes in anticipated consumption levels.

**Gas Utility Taxes** are projected at \$8.7 million in 2014-2015, a 0.8% decrease from 2013-2014 levels. This decrease reflects current collection levels as well as the expected change in rates, consistent with information from PG&E on the anticipated 3% to 7% increase in prices. In 2015-2016, revenues are projected to increase by approximately 2.3% to \$8.9 million once the 2014-2015 rate changes and activity levels are annualized. Actual collections continue to be subject to significant fluctuations from the impact of weather conditions and/or rate changes.

**Water Utility Tax** receipts of \$11.5 million are anticipated to be received in 2014-2015, a 1.0% increase from 2013-2014. The CPUC recently settled a rate case submitted by San Jose Water approving the following approximate rate adjustments: August 2014, 10% increase; September 2014, 10%-11% increase; and January 2015, 3% increase. However, due to the significant measures taken to reduce water usage to address the California drought, consumption levels have been greatly reduced. Through December, receipts are tracking 4% below prior year levels despite the 20% rate changes that went into effect in August and September.

In 2015-2016, receipts are projected to increase 1.7% to \$11.7 million based on the continued rising wholesale price of water with an estimated increase in price in July 2015 with continued dampened consumption levels. It should be noted that on January 5, 2015, San Jose Water Company filed a General Rate Case (GRC), which is under review by the Public Utilities Commission. The GRC recommends a total increase in rates of 20.7% over a three year period – 12.2% in 2016, 3.1% in 2017, and 5.4% in 2018. The current estimates do not factor in additional

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Utility Tax**

rate increases or changes in consumption, rather it annualizes approved rate changes in the 2014-2015 fiscal year and the anticipated July 2015 change in the wholesale price of water as discussed above.

In the **Telephone Utility** category, revenues are collected on landlines, wireless, and VoIP. Based on current tracking, receipts in 2014-2015 are anticipated to reach \$28.1 million, a 14.3% decline from 2013-2014 (\$32.8 million) due to lower receipts in both landlines (-11.9%) and cellular (-17.7%). Approximately one-quarter of the decline reflect a legal settlement of \$1.3 million to refund customers for prior payments, which will settle claims made by AT&T Mobility on behalf of its customers against California cities and counties that collect utility taxes. Once adjusted for this settlement, overall receipts are anticipated to decline 10% from prior year levels. The lower collections reflect significant competition among telecommunication providers and lower average cost per user as well as the impact of increased usage of prepaid contracts not currently taxed (tax application to start in January 2016). In addition, the Internet Tax Freedom Act, which extends the moratorium on taxing internet access, has been extended through 2015; resulting in corresponding declines in tax revenue for the City, most notably AT&T, which had previously applied the utility tax to internet access. In 2015-2016, revenues reflect growth of 4.7% from prior year levels however, once adjusted to exclude the one-time refund accounted for in 2014-2015, no growth is anticipated for 2015-2016. Ongoing implications of the changes in service delivery of telecommunication activities through alternative services such as Wi-Fi and broadband are unknown. As a result of these changes, receipts may reduce further, however, they potentially will be offset by the change in tax application in January 2016 for prepaid contracts.

In the out years of the Forecast, growth ranging from 1.9% to 2.5% annually is expected in the Utility Tax category. As discussed above, there is significant volatility and uncertainty regarding the performance in this category based on outstanding rate cases as well as consumption levels; over the last five years average growth of only 1.8% has been seen in this category. The Water and Gas Utility Tax categories are significantly influenced by weather conditions.

### **Telephone Line Tax**

Based on the current collection trend, receipts in both 2014-2015 and 2015-2016 are anticipated to total \$20.8 million, which is very close to the collection levels seen since 2009-2010. Given the steady nature of collections in this category, receipts are anticipated to remain relatively flat in the out years of the Forecast with annual growth of only 0.3%.

### **Business Taxes**

This category includes General Business Tax, Disposal Facility Tax, Cardroom Tax, and Marijuana Business Tax. In 2014-2015, Business Taxes are estimated to reach \$44.6 million, a 1.9% decline from prior year levels. Collections were higher in 2013-2014 primarily as a result

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Business Taxes**

of the Marijuana Business Tax collections. In 2015-2016, revenues are estimated to decrease 1.3% to \$44.0 million due to a decrease in Disposal Facility Tax as discussed below.

In 2014-2015, **General Business Tax** proceeds are expected to reach \$11.0 million, a slight increase of 1.3% from the prior year level of \$10.9 million and takes into consideration the remaining billing cycles, account closeouts and cleanups anticipated in 2014-2015, and the historical collections rates of invoices. In 2015-2016, revenues are anticipated to remain flat at \$11.0 million, which is slightly below historical levels.

Based on current performance, collections in the **Cardroom Tax** category are estimated at \$17.0 million in 2014-2015, an increase of 4.1% from the prior year collection level (\$16.3 million). In 2015-2016, receipts are anticipated to remain at 2014-2015 levels.

In the **Disposal Facility Tax** category, collections are estimated at \$12.1 million in 2014-2015 based on current collection trends, which assume a slight decline (1.1%) from prior year collection levels of \$12.2 million. Disposal Facility Taxes (DFT) are business taxes based on the tons of solid waste disposed at landfills within the City. This revenue stream varies 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. In recent years, revenues in this category have experienced year-over-year declines due, in large part, to increased waste diversion and the overall slowdown in the economy. However, in 2013-2014, collections spiked due to increased activity from neighboring agencies dumping in San José landfills. In 2015-2016, revenues are projected to return to the former trend of slight declines as a result of waste diversion and fall 5% below estimated 2014-2015 levels to \$11.5 million.

**Marijuana Business Taxes** are currently being collected at a 10% rate on gross receipts as approved by the voters in Ballot Measure U in 2010 on medical and non-medical, legal and illegal sales. In 2014-2015, collections are anticipated to fall to \$4.5 million, a reduction of approximately 25% from prior year levels of \$6.1 million. Beginning in June 2014, enforcement of the Medical Marijuana Regulatory Program significantly impacted activity levels and decreased the number of collectives operating within San José. In 2015-2016, collections are anticipated to remain flat at \$4.5 million until final implications of the implementation of the Medical Marijuana Regulatory Program are known.

In the remaining years of the Forecast, the Business Tax category is expected to experience very minimal growth of less than 1% per year.

### **Licenses and Permits and Departmental Charges**

The Licenses and Permits and Departmental Charges categories contain fees and charges collected by various departments. The most significant revenue sources are development-related fees. Revenue collection levels are projected based on City Council-approved cost-recovery policies

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Licenses and Permits and Departmental Charges**

with the goal of a net-zero impact on the General Fund. In 2015-2016, the Licenses and Permits category is estimated at \$49.0 million and the Departmental Charges category is estimated at \$39.1 million.

For 2015-2016, the development-related revenues are expected to continue strong performance, though they will fall below the recent peak activity levels seen in 2013-2014. In cases where the development-related base costs are projected to exceed revenues, there are sufficient earmarked reserves to bring projected revenues and expenditures into alignment for a net-zero General Fund impact. For 2015-2016, the Building Fee Program, Planning Fee Program, and Public Works Fee Program base expenditures are projected to exceed the base revenue estimates. This Forecast assumes that in 2015-2016 Fee Program Reserves will be used to address these shortfalls as outlined in the Beginning Fund Balance section below. However, beginning in 2016-2017, the Planning Development Fee Program anticipates that revenue collections will be revised to maintain cost recovery levels. In the Fire Development Fee Program, revenues are projected to exceed the base program costs and, for purposes of this Forecast, the revenues in this program have been set at the base cost level. Budget actions will be brought forward in each of these fee programs to maintain cost-recovery and ensure resources are available to address service needs.

For the non-development-related fees and charges, the 2015-2016 estimates are based on current collection trends. Included in these estimates are the revenues associated with the implementation of the Marijuana Regulatory Program Annual Operating Fee and Renewable Permit Fees of \$2.2 million, as approved by the City Council in December 2014, which offsets the corresponding costs associated with this program.

In the out years of the forecast, both the Licenses and Permits and Departmental Charges categories are expected to experience growth ranging from 2.6% to 8.0%. A spike in Departmental Charges growth of 8.0% in 2016-2017 reflects the reallocation from the use of Development Fee Program Reserves to an increase in revenues associated with the Planning Development Fee Program. Currently, the Planning Development Fee Program has insufficient reserve levels to sufficiently offset the base costs that exceed base revenues in the out years of the forecast. The growth rates in the out years are tied to the expected increases in costs which the fees are designed to recover, including increased personal services costs.

### **Fines, Forfeitures and Penalties**

In 2014-2015, the Fines, Forfeitures and Penalties category is expected to generate \$14.7 million. The largest component of this revenue category is Parking Fines, which are currently expected to generate approximately \$10.2 million in 2014-2015, consistent with 2013-2014 collection levels. It should be noted that parking fine revenues have remained below projections and well below the 2011-2012 level of \$11.8 million due to a higher level of staff absences as a result of injuries and non-work related injuries/illnesses. In 2015-2016, Parking Fines are expected to remain flat at \$10.2 million. Total revenue in 2015-2016 is estimated at \$14.4 million in the Fines, Forfeitures,

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Fines, Forfeitures and Penalties**

and Penalties category. In the out years of the Forecast, annual growth of approximately 0.7% to 1.4% is projected.

### **Money and Property**

This category consists of revenue associated with the rental of City-owned property, subrogation recovery efforts, and interest income and is projected to generate \$3.3 million in 2014-2015 and 2015-2016. In 2015-2016, \$1.7 million is expected to be generated from the rental of City-owned facilities. An additional \$350,000 is projected from subrogation recovery efforts and \$1.0 million is projected from various interest earnings. For the General Fund portion of pooled funds, the 2015-2016 estimate for interest earnings assumes an average interest rate of only 0.74% applied to an average cash balance of approximately \$140 million for a total collection level of \$1.0 million. In the out years of the Forecast, growth of 1.5% to 2.4% annually is assumed.

### **Revenue from Local Agencies**

In 2015-2016, revenue of \$22.9 million is projected from other local agencies, such as the Successor Agency to the Redevelopment Agency of San Jose and the Central Fire District. This is slightly lower than levels in prior years due to a number of one-time payments from various grants, reimbursements from the Successor Agency to the Redevelopment Agency of San Jose, and the elimination of the reimbursement from the County of Santa Clara to support the paramedic program.

The largest revenue estimate in this category is a reimbursement from the Successor Agency to the Redevelopment Agency of San Jose for the payment of the Convention Center Debt Service of \$15.3 million. This obligation continues to be evaluated as part of the winding down of the Successor Agency and the method, timing, and ability to reimburse the payment continues to be under review. A corresponding expenditure is assumed in the City-Wide Expenses category for this debt service payment.

The City receives reimbursement from the Central Fire District for the County areas covered by the San José Fire Department. These payments are based on the property tax assessments for fire services collected in those areas, which are passed on to the City. Based on information provided by the Central Fire District staff, 2014-2015 payments of \$5.5 million are anticipated in 2014-2015 including an approximately \$100,000 true-up payment from the prior year. This reflects an 8.2% increase from the prior year levels. In 2015-2016, collections are projected to increase 1.9% to \$5.6 million, this accounts for approximately 4% growth from prior year levels once adjusted to exclude the one-time payment in 2014-2015.

Payment from the County of Santa Clara for the first responder advanced life support program (Paramedic Program) was eliminated from the budget beginning in 2014-2015 and this forecast continues to assume no revenue collections in 2015-2016. In 2013-2014, \$2.2 million in

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### Revenue from Local Agencies

reimbursement from the County was budgeted to offset a portion of the City's paramedic program costs as the delivery of these services is a responsibility of the County. However, because the City had not met the response time performance standards set forth in the agreement with the County, the County withheld payment for this service. Although the 2014-2015 budgeted estimate is currently zero, it is anticipated that approximately \$1.5 million will be received as a result of the completion of recent negotiations and the execution of a Second Amendment to the 911 Emergency Medical Services (EMS) Provider Agreement between the City and the County of Santa Clara that will expire December 2015. The \$1.5 million figure represents only the portion of the agreement associated with EMS Resource Management (Annex B, Category A funds) and is calculated from when the County began withholding payments, beginning the fourth quarter of 2012-2013 through the end of 2014-2015, with the exception of two payments authorized by the County and made by Rural Metro during 2013-2014. Additional Annex B, Category A funds totaling approximately \$400,000 are expected to be received in 2015-2016, but because the agreement ends in December 2015, those funds are considered one-time and will be brought forward later in the budget process. While the Fire Department continues to work on improving their emergency medical response performance, no payments for that portion of the agreement (Annex B, Category B funds) are assumed over the forecast period. It should be noted, however, that the direct incremental cost to the City to provide the advanced life support-level of service totaling over \$5 million annually remains in the Forecast. The opportunity to renegotiate the overall EMS Provider Agreement will occur in 2015-2016 as the master agreement expires on July 1, 2016.

In addition, other projected payments from local agencies total \$2.0 million in 2015-2016, the largest of which are reimbursements for services provided by the Animal Care and Services Program (\$930,000), funding provided by the Valley Transportation Authority related to the Bay Area Rapid Transit (BART) extension (\$400,000), and payments associated with the annexation in the Cambrian area to the City of Campbell (\$199,000).

In the remaining years of the Forecast, the Revenue from Local Agencies category is projected to increase annually by approximately -1.0% to 1.5%. In 2016-2017, the decline of 1.0% reflects the completion of various grant activities of \$610,000 in 2015-2016.

### 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 \$10.6 million in 2015-2016 and decline to \$10.3 million in 2016-2017 through 2019-2020. Tobacco Settlement payments account for the majority of revenue in this category and are estimated at \$8.75 million in 2015-2016, consistent with both the projected 2014-2015 receipts and 2013-2014 actual collections.

The following State grants and reimbursements are expected in 2015-2016: Abandoned Vehicles Abatement Program (\$675,000); Auto Theft reimbursement (\$370,000); California Department

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## REVENUE FORECAST

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### Revenue from the State of California

Conservation Sustainability Community Planning Grant (\$212,000); Highway Maintenance Charges reimbursement (\$105,000); and a Local Enforcement Agency Grant for Planning Building and Code Enforcement Department (\$30,000). Vehicle License Fees Collection in Excess are also estimated at \$435,000 annually and 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.

Adjustments to the grant amounts are reflected in the remaining years of the Forecast. A decrease of \$241,000 is expected in 2016-2017 to reflect the elimination of the California Department Conservation Sustainability Community Planning Grant and Local Enforcement Agency Grant for Planning Building and Code Enforcement department. No annual growth is projected in the remaining three out years of the Forecast.

### Revenue from the Federal Government

The Revenue from the Federal Government category consists of grant revenues and rental income. The following grants are anticipated in 2015-2016: National Forum Capacity-Building Grant OJJDP 2012-2015 (\$99,000) and Urban Area Security Initiative – Police (UASI) (\$60,000). The corresponding expenditures for these grants are also included in this forecast. In addition, rental income of \$793,000 is included in 2015-2016 to account for the lease agreement between the City and the United States Patent and Trade Office (USPTO) for the USPTO to occupy space at City Hall. Lease payments in 2015-2016 are prorated to account for the phased move in schedule, which current anticipated full occupation by September 2015. Additional information regarding this move can be found in a memorandum to the City Council for consideration on March 3, 2015: <http://sanjoseca.gov/DocumentCenter/View/40451>

In the out-years of the Forecast, no grant funding is included, only the current lease schedule for the USPTO is reflected.

### Other Revenue

The Other Revenue category consists of miscellaneous revenues received from a variety of sources, including Arena Rental, Suite, Parking, and Naming revenues, cost reimbursements for the Investment Program, payments from Comcast and AT&T required under the Franchise Agreement, and proceeds from the Sale of Surplus Property. In 2014-2015, this category is expected to generate \$166.5 million. The 2014-2015 estimate includes a number of large adjustments not included in 2015-2016: 1) \$100.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANS) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; 2) \$39.6 million in proceeds related to the sale of 22.8 acres of the Airport West property to Coleman Airport Partners for the Coleman Highline mixed use development; and 3) \$8.7 million in financing proceeds associated with the Energy and Utility Conservation Measures Program.

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Other Revenue**

Factoring out these large adjustments, 2014-2015 collections for this category are estimated to total \$18.2 million.

In 2015-2016, the revenue estimate of \$13.9 million assumes the continuation of current year activity levels with revisions, where appropriate, for 2015-2016 costs or agreements and the elimination of one-time funding sources. This figure excludes revenues associated with the issuance of the TRANs that will be brought forward in 2015-2016 with an offsetting expenditure based on estimated cash flow needs.

In 2015-2016, Arena Rental, Suite, Parking, and Naming revenues are projected at \$5.7 million. The cost reimbursement for the Investment Program is estimated at \$2.0 million based on the current allocation of staff to this function. Payments from Comcast and AT&T are estimated at \$1.9 million. As defined in the Franchise Agreement, these funds will be used to support the Public, Education, and Government (PEG) Access facilities. There is an associated City-Wide Expenses allocation for this purpose. In addition, the proceeds from the Sale of Surplus Property category has been set at \$915,000 based on the anticipated assets that will be sold next fiscal year. Arena Rental, Suite, Parking, and Naming revenues are eliminated beginning in 2018-2019, which represents a significant decline in anticipated revenues in this category, to reflect the expiration of the current agreement with Sharks Sports Entertainment to lease the San José Arena and the naming rights agreement with SAP. Negotiations to extend or modify the lease are currently in progress and any resulting revenue changes will be incorporated into future forecasts, as appropriate. Therefore, growth in the out years range from a decline of 43.2% to slight increases of 1.8%.

### **Gas Tax**

Based on year-to-date performance, the Gas Tax receipts in 2014-2015 are projected to reach \$17.8 million, which is consistent with the prior year level collection level. Collections are expected to decline by approximately 5% to \$16.9 million in 2015-2016, which is similar to experience in past years. Several factors impact collections, including volatile gas prices, the lingering impacts of the economic downturn, and a 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 the out years of the Forecast, collections are expected to decline by between 2.5% and 3.5% annually.

### **Overhead Reimbursements**

The Overhead Reimbursements category includes overhead reimbursements from both operating and capital funds. In 2015-2016, a total of \$37.1 million in reimbursements are projected based on 2015-2016 overhead rates (which are overall lower than the prior year rates) for the majority of City funds prepared by the Finance Department applied against the projected 2015-2016 salaries for those positions for which an overhead rate is applied.



# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Overhead Reimbursements**

In the remaining years of the Forecast, annual increases ranging from 2.6% to 3.8% are 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 \$18.9 million in 2015-2016, which is at anticipated 2014-2015 levels. The largest component of this category (\$10.3 million) is a transfer from the Airport Maintenance and Operating Fund to reimburse the General Fund for Airport Crash Fire Rescue and Airport Police costs. In 2015-2016, these reimbursements have been built to cover the direct 2015-2016 base costs as well as indirect costs. For the Fire Rescue reimbursement, the indirect costs have been discounted to help with cost competitiveness of this service.

Additional large transfers programmed for 2015-2016 include the Construction and Conveyance Tax Fund transfer (\$3.4 million) associated with park maintenance costs; the Construction Excise Tax Fund transfer (\$1.8 million) for pavement maintenance activities; and the Workforce Investment Act Fund transfer (\$548,000) for use of various community centers and Workforce Investment Act program services.

Annual increases in the out years range from 1.1% to 1.6%. 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.

### **Reimbursements for Services**

The Reimbursements for Services category reimburses the City for actual costs associated with the Deferred Compensation Program and the Maintenance Assessment District Funds. These amounts have been set to recover costs in 2015-2016 of \$723,000. In the remaining years of the Forecast, annual increases are expected to recover the projected cost increases from 2.6% to 3.9%.

### **Beginning Fund Balance**

The \$62.3 million forecast estimate of available 2015-2016 Beginning Fund Balance is based on the following assumptions:

- The current Contingency Reserve of \$32.7 million is carried forward at the current level based on the assumption that this amount will not be used in 2014-2015 and will be available for use in 2015-2016. The current funding level is approximately enough to cover General Fund payroll costs for less than two and one-half weeks in an emergency. (On the expenditure side, the Contingency Reserve is increased to \$33.1 million in 2015-2016 to comply with the City Council policy to set aside 3% of expenditures.)

# ELEMENTS OF THE GENERAL FUND FORECAST

## REVENUE FORECAST

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### **Beginning Fund Balance**

- A total of \$23.0 million in fund balance will be achieved from a combination of excess revenues and expenditure savings as well as the liquidation of prior-year carryover encumbrances, consistent with levels assumed in the 2015-2019 Five Year General Fund Forecast.
- An additional \$6.6 million reflects the liquidation of reserves: \$4.2 million from the Building Development Fee Program Reserve; \$1.6 million from the Planning Development Fee Program Reserve; and \$699,000 from the Public Works Development Fee Program Reserve. The use of these reserves have been included in the fund balance estimate to cover a portion of the 2015-2016 base costs associated with these programs that cannot be addressed with fee revenue.

In the out years of the Forecast, the beginning fund balance estimates assume that excess revenue of 1.0% and expenditure savings, including liquidations of carryover encumbrances, of 1.75% would be generated annually; that the revised Contingency Reserve of \$33.1 million would be carried over each year; and the use of the Development Fee Program Reserves for Building and Public Works would continue in the out years to support development fee projected program costs in excess of revenues. In total, the Beginning Fund Balance ranges from \$62.3 million in 2015-2016 to \$62.6 million in 2019-2020.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

An in-depth analysis of the General Fund expenditure categories was completed to develop the 2015-2016 expenditure estimates included in this Forecast. These expenditure estimates will be closely examined and updated again during the preparation of the 2015-2016 Proposed Operating Budget.

As displayed in the Forecast and the chart below, General Fund expenditures are shown to increase from \$943.8 million in 2015-2016 to \$1.05 billion in 2019-2020, for an average growth rate of 2.8% per year.

### February 2015 Forecast Expenditure Summary

Expenditure Category	Modified Budget	Forecast				
	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Personal Services						
Salaries and Other Compensation	\$ 390,905,400	\$403,001,000	\$416,948,000	\$ 431,381,000	\$ 446,314,000	\$ 461,766,000
Retirement	234,649,055	243,880,000	245,990,000	251,586,000	251,394,000	249,915,000
Health and Other Fringe Benefits	53,305,282	53,271,000	56,890,000	60,755,000	64,882,000	69,290,000
<b>Total Personal Services</b>	<b>\$ 678,859,737</b>	<b>\$700,152,000</b>	<b>\$719,828,000</b>	<b>\$ 743,722,000</b>	<b>\$ 762,590,000</b>	<b>\$ 780,971,000</b>
<b>Total Non-Personal/Equipment</b>	<b>\$ 103,545,956</b>	<b>\$ 88,850,000</b>	<b>\$ 90,207,000</b>	<b>\$ 93,236,000</b>	<b>\$ 95,585,000</b>	<b>\$ 96,400,000</b>
City-Wide						
City-Wide Expenses	\$ 263,688,135	\$ 77,578,000	\$ 78,736,000	\$ 80,123,000	\$ 81,378,000	\$ 82,716,000
Capital Projects	44,415,000	5,450,000	6,025,000	6,025,000	6,025,000	6,025,000
Transfers	36,807,380	27,175,000	29,607,000	30,737,000	32,507,000	31,845,000
Earmarked Reserves	135,354,317	10,922,000	11,540,000	13,461,000	15,248,000	17,228,000
Contingency Reserve	32,700,000	33,100,000	33,100,000	33,100,000	33,100,000	33,100,000
<b>Total City-Wide</b>	<b>\$ 512,964,832</b>	<b>\$154,225,000</b>	<b>\$159,008,000</b>	<b>\$ 163,446,000</b>	<b>\$ 168,258,000</b>	<b>\$ 170,914,000</b>
Committed Additions						
New Municipal Improvements Maint & Operations		\$ 48,000	\$ 61,000	\$ 63,000	\$ 64,000	\$ 66,000
New Parks and Recreation Facilities Maint. & Operations		186,000	380,000	580,000	682,000	787,000
New Traffic Infrastructure Assets Maint. & Operations		51,000	148,000	164,000	178,000	185,000
Measure O (Library) Maint. & Operations		228,000	701,000	722,000	743,000	763,000
Measure P (Parks) Maint. & Operations				87,000	88,000	84,000
Measure O (Public Safety) Maint. and Operations - Fire		13,000	26,000	27,000	28,000	28,000
<b>Total Committed Additions</b>		<b>\$ 526,000</b>	<b>\$ 1,316,000</b>	<b>\$ 1,643,000</b>	<b>\$ 1,783,000</b>	<b>\$ 1,913,000</b>
<b>Total Base Exp. w/ Committed Additions</b>	<b>\$ 1,295,370,525</b>	<b>\$943,753,000</b>	<b>\$970,359,000</b>	<b>\$ 1,002,047,000</b>	<b>\$ 1,028,216,000</b>	<b>\$ 1,050,198,000</b>
<b>Growth %</b>			<b>2.8%</b>	<b>3.3%</b>	<b>2.6%</b>	<b>2.1%</b>

It is important to note that adjustments are made to the Forecast to eliminate one-time additions/deletions and annualize partial-year allocations that were included in the 2014-2015 Adopted Budget. Various one-time additions totaling over \$3 million are scheduled to expire in June 2015. The major items include funding for additional enhancements to the San José BEST and Safe Summer Initiative, Police Department Downtown Foot Patrol, Public Works Department Preventative Maintenance Program, Police Department Central ID Unit, Illegal Dumping Rapid Response Program, Anti-Human Trafficking Task Force, and Finance Purchasing Information Technology Manager, among others. There were also programs funded on a two-year basis totaling approximately \$5.1 million, including the Homeless Rapid Rehousing, the Homeless Response Team, an enhanced San José BEST and Safe Summer Initiative Program, and Community Action and Pride Grants. Many of these programs and services will likely need to be re-evaluated for continued funding beyond 2015-2016. This analysis will be conducted during the 2015-2016 budget process and funding recommendations

# ELEMENTS OF THE GENERAL FUND FORECAST

## **EXPENDITURE FORECAST**

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for these programs and services will be included in the 2015-2016 Proposed Operating Budget, as appropriate, and in 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 (2015-2016) projection for personal services costs in this Forecast has been calculated at a detailed level. An extract of payroll system information as of August 2014 was used as the starting point. This individual position-level information was then reviewed, corrected, and updated by each department to include current vacancies and filled positions, ensure accurate salary step and bi-weekly salary, as well as any position reallocations. Also, 2014-2015 ongoing position additions (cost increases) and reductions (cost savings) were annualized and all categories of benefit costs in the coming year were projected. In January 2015, the most recent retirement plan and health plan information for each position was also updated from the payroll system.

For the 2015-2016 General Fund Forecast, personal services costs continue to account for approximately three-quarters of the General Fund's total costs. The personal services category has been broken down into three major components (salaries and other compensation, retirement, and health and other fringe benefits). Of the \$700.2 million projected personal services total for 2015-2016, salaries and other compensation costs amount to \$403.0 million (57.6% of projected personal services), retirement costs amount to \$243.9 million (34.8% of projected personal services), and health and other fringe benefits costs amount to \$53.3 million (7.6% of projected personal services). Over the forecast period, modest growth is expected in each of the personal services categories.

Following is a discussion of the specific factors impacting the salaries and other compensation, retirement, and health and other fringe benefits elements of personal services costs in this Forecast. As with past forecasts, personal services costs in years two through five of this Forecast have been projected on a more global basis, using the detailed costs calculated for the first year as a base, and then growing that base by an overall percentage factor representing expected growth from salary and benefit cost increases. For this Forecast, the out years are projected to inflate at a composite rate of approximately 2.9%.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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### Salaries and Other Compensation:

An Employee Compensation Planning Reserve for all employees except San José Police Officers Association (SJPOA) is included in each year of this Forecast in order to set aside funds for potential employee pay increases. This reserve allocation, totaling \$11.7 million for 2015-2016 increases, represents a modest amount of funding and would require City Council labor negotiations direction and discussions with the City's bargaining groups before any form of distribution could be made. It should be noted that the Employee Compensation Planning Reserve also contains funding totaling \$6.6 million representing potential 2014-2015 employee pay increases for employees represented by the International Association of Fire Fighters (IAFF), Local 230 that have not yet been agreed upon. For employees represented by the SJPOA, the Forecast includes a 3.33% increase in 2015-2016 (\$7.0 million) reflective of the current agreement through December 2015. Total ongoing funding of \$1.25 million is also included in an Employee Market Competitiveness Reserve in 2015-2016 to provide funding for potential salary increases for specific job classifications where recruitment and retention issues are being experienced. Further analysis is underway to determine which classifications may be considered for a special employee compensation pay increase.

Salary step increases for current non-management employees and pay for performance for management employees for 2015-2016 are projected at \$2.9 million, or an increase of 0.42%. With the exception of employees represented by the SJPOA and IAFF, 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. The out years of the Forecast also include salary step increases for eligible non-management employees and pay for performance for management employees.

Overtime expenditures in the General Fund total \$21.3 million for 2015-2016, with the majority of the expenditures for Police Department (\$12.4 million) and Fire Department (\$5.2 million) operations. The out years of the Forecast continue these costs, with small adjustments using salary step growth as the inflationary factor.

### Retirement:

The City's two retirement systems, the Federated 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. 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 police members. Effective January 2, 2015, a lower defined benefit plan (Tier 2) was implemented for new Fire members.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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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). Effective January 18, 2015, Federated employees that had left City employment with prior dental coverage vesting and return to the City, retain that benefit (Tier 2C). 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 2 plan or the Tier 3 plan. The Tier 3 plan provides for a City contribution of 3.75%.

For 2015-2016, retirement costs total \$243.9 million for the General Fund based on the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. To generate budgetary savings, this cost assumes the pre-payment of the City's annual required contribution (ARC) for Federated Retirement System Tier 1 members and contributions for the Police and Fire Department Retirement Plan for Tier 1 police and fire members. For 2015-2016, net budgetary savings are estimated at approximately \$7.5 million in the General Fund (includes borrowing costs) (\$10.2 million in all funds); however, based on a recent conversation with Office of Retirement Services staff, the Retirement Boards' joint investment committee recommended that staff engage in discussions on the prefunding practice in context of the current investment environment. Analysis by the Office of Retirement Services is underway and a meeting will occur within the next few weeks.

Retirement costs, which are up \$9.2 million from the 2014-2015 Modified Budget of \$234.6 million (and includes pay increase assumptions described earlier), represents 25.8% of the total General Fund base expenditure budget with committed additions. Of the \$243.9 million General Fund retirement cost, \$243.1 million is associated with the ARC for pension and retiree healthcare as follows: \$88.4 million is projected to be paid to the Federated Retirement System (\$79.4 million for Tier 1, \$1.4 million for Tier 2A, \$7.5 million for Tier 2B, and \$0.1 million for Tier 2C); and \$154.8 million to the Police and Fire Department Retirement Plan (\$86.3 million for police Tier 1, \$4.2 million for police Tier 2, \$64.2 million for fire Tier 1, and \$0.1 million for fire Tier 2). The remaining \$0.7 million in retirement costs are associated with part-time, contract and temporary employees, the Mayor and City Council, and new employees in Unit 99, who opted to participate in a defined contribution plan versus a defined benefit plan.

In comparison to the February 2014 Forecast for the 2015-2016 retirement cost projections, the 2015-2016 retirement costs experienced an increase of \$2.0 million, from \$241.9 million to \$243.9 million, due to additional positions added as part of the 2014-2015 Adopted Budget and economic and demographic assumption changes approved for the Federated Retirement System and the Police and Fire Department Retirement Plan. The overall increase was partially offset by savings from a larger number of employees anticipated to be part of lower cost Tier 2 plans.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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In 2010-2011, the Retirement Boards adopted an annual required contribution methodology, which requires the City to pay a minimum ARC or a percentage of payroll, whichever is greater. With this ARC funding methodology, if the City's pensionable payroll amount decreases due to staffing reductions or vacancies, the City's total retirement cost will not change if the City's estimated payroll projection drops below the estimate provided by the Retirement Board's actuary. An evaluation is done to compare the independently estimated payroll projections by the Retirement Boards' actuary with the City's forecasted payroll. The higher estimated payroll projection is used to determine whether, for the City retirement contributions for Federated Retirement System Tier 1 and Tier 1 members of the Police and Fire Department Retirement Plan, retirement costs are based on the minimum ARC as required by the Boards or an ARC based on Board approved percentage of budgeted payroll as calculated by the City Manager's Budget Office, whichever is greater. For all years of this Forecast, since the estimated City pensionable payroll is above the estimated payroll projections provided by the Retirement Boards' actuary, the City's payment of retirement costs is assumed as a percentage of payroll. In September 2014 and October 2014, the Federated Retirement System Board and the Police and Fire Department Retirement Plan Board, respectively, approved that for Tier 2 members, the City's contribution shall only be based on a percentage of payroll.

In 2009, the City and bargaining units contributing to the Federated Retirement System reached an agreement to begin a five-year phase-in to fully fund the annual required contribution for retiree healthcare benefits. The last year of the phase-in was originally scheduled for 2012-2013. Extensions of the phase-in for members in the Federated Retirement System were approved by the City Council and are currently set to expire in June 2015. Negotiations between the City and nine Federated Retirement System bargaining units are ongoing regarding potential changes to future retiree healthcare benefits. This Forecast assumes the continuation of the phase-in with previously approved cap increases (0.75% for Tier 1 and Tier 2A/1.5% for Tier 2B and Tier 2C) each year, subject to negotiations with the Federated bargaining units, to allow time for ongoing negotiations until an outcome is known. Should an outcome be determined that would require additional funds in 2015-2016 beyond the capped amount assumed in this Forecast, existing Retiree Healthcare Solutions reserves in most funds are available to offset potential costs.

Per the respective Memoranda of Agreements with SJPOA and IAFF, the annual retiree healthcare contribution rate is capped at 11.0% for the City and 10.0% for employees. The City's retiree healthcare contribution rate for police members assumes the 11% cap through the Five-Year Forecast. The City's retiree healthcare contribution rate for fire members is increasing by 1.3 percentage points from 9.3% in 2014-2015 to 10.6% in 2015-2016, and is projected to increase to the 11% cap in 2016-2017 and remain at that cap through the remaining Forecast period.

Based on projections received from the Retirement Boards' actuary (Cheiron) and the City Manager's Budget Office's independent analysis, the following table details the General Fund's retirement costs and budgetary retirement contribution rates for the Federated Retirement System and the Police and Fire Department Retirement Plan and the respective pension and retiree healthcare costs for the forecast period.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

### 2016-2020 CITY RETIREMENT CONTRIBUTION COSTS AND BUDGETARY CITY RETIREMENT CONTRIBUTION RATES (\$ in Millions and with Pre-Payment Discount)

Retirement Plan	2014- 2015	2015- 2016	2016- 2017	2017- 2018	2018- 2019	2019- 2020
Fed. Ret. System Tier 1 – Pension	\$64.7	\$68.8	\$68.5	\$69.5	\$68.7	\$66.4
Fed. Ret. Syst. Tier 1 – Ret. Healthcare*	\$10.1	\$10.6	\$10.9	\$10.7	\$9.9	\$9.1
<b>Fed. Retirement Plan Tier 1 – Total</b>	<b>\$74.8</b>	<b>\$79.4</b>	<b>\$79.4</b>	<b>\$80.2</b>	<b>\$78.6</b>	<b>\$75.5</b>
<b>Budgetary Contribution Rates</b>	67.3%	73.8%	76.9%	81.4%	83.6%	85.4%
Fed. Ret. System Tier 2A – Pension	\$0.6	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5
Fed. Ret. Syst. Tier 2A – Ret. Healthcare*	\$1.0	\$0.9	\$0.9	\$0.9	\$0.9	\$0.8
<b>Fed. Retirement Plan Tier 2A – Total</b>	<b>\$1.6</b>	<b>\$1.4</b>	<b>\$1.4</b>	<b>\$1.4</b>	<b>\$1.4</b>	<b>\$1.3</b>
<b>Budgetary Contribution Rates</b>	14.9%	15.9%	16.6%	16.9%	16.7%	16.4%
Fed. Ret. System Tier 2B – Pension	\$1.5	\$2.1	\$2.7	\$3.3	\$4.0	\$4.6
Fed. Ret. Syst. Tier 2B – Ret. Healthcare*	\$3.4	\$5.4	\$7.5	\$8.8	\$10.1	\$11.4
<b>Fed. Retirement Plan Tier 2B – Total</b>	<b>\$4.9</b>	<b>\$7.5</b>	<b>\$10.2</b>	<b>\$12.1</b>	<b>\$14.1</b>	<b>\$16.0</b>
<b>Budgetary Contribution Rates</b>	18.2%	19.9%	21.4%	20.9%	20.4%	19.9%
Fed. Ret. System Tier 2C – Pension	N/A	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Fed. Ret. Syst. Tier 2C – Ret. Healthcare*	N/A	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
<b>Fed. Retirement Plan Tier 2C – Total</b>	<b>N/A</b>	<b>\$0.1</b>	<b>\$0.1</b>	<b>\$0.1</b>	<b>\$0.1</b>	<b>\$0.1</b>
<b>Budgetary Contribution Rates</b>	N/A	20.1%	21.6%	21.1%	20.6%	20.1%
Police Ret. Plan Tier 1 – Pension	\$77.2	\$75.0	\$72.7	\$72.5	\$70.3	\$68.1
Police Ret. Plan Tier 1 – Ret. Healthcare**	\$11.8	\$11.3	\$11.2	\$11.0	\$10.8	\$10.4
<b>Police Retirement Plan Tier 1 – Total</b>	<b>\$89.0</b>	<b>\$86.3</b>	<b>\$83.9</b>	<b>\$83.5</b>	<b>\$81.1</b>	<b>\$78.5</b>
<b>Budgetary Contribution Rates</b>	80.3%	81.2%	79.7%	80.7%	80.2%	80.2%
Police Retirement Plan Tier 2 – Pension	\$1.3	\$2.1	\$2.8	\$3.5	\$4.3	\$5.2
Police Ret. Plan Tier 2 – Ret. Healthcare**	\$1.3	\$2.1	\$2.7	\$3.4	\$4.1	\$5.0
<b>Police Retirement Plan Tier 2 – Total</b>	<b>\$2.6</b>	<b>\$4.2</b>	<b>\$5.5</b>	<b>\$6.9</b>	<b>\$8.4</b>	<b>\$10.2</b>
<b>Budgetary Contribution Rates</b>	21.8%	22.3%	22.4%	22.4%	22.4%	22.3%
Fire Retirement Plan Tier 1 – Pension	\$54.2	\$56.2	\$56.0	\$57.3	\$57.1	\$56.9
Fire Ret. Plan Tier 1 – Retiree Healthcare**	\$6.8	\$8.0	\$8.4	\$8.5	\$8.5	\$8.6
<b>Fire Retirement Plan Tier 1 – Total</b>	<b>\$61.0</b>	<b>\$64.2</b>	<b>\$64.4</b>	<b>\$65.8</b>	<b>\$65.6</b>	<b>\$65.5</b>
<b>Budgetary Contribution Rates</b>	80.0%	82.7%	81.5%	82.4%	81.7%	81.5%
Fire Retirement Plan Tier 2 – Pension	N/A	\$0.0	\$0.2	\$0.4	\$0.7	\$1.0
Fire Ret. Plan Tier 2 – Retiree Healthcare**	N/A	\$0.0	\$0.2	\$0.4	\$0.6	\$1.0
<b>Fire Retirement Plan Tier 2 – Total</b>	<b>N/A</b>	<b>\$0.1</b>	<b>\$0.4</b>	<b>\$0.8</b>	<b>\$1.3</b>	<b>\$2.0</b>
<b>Budgetary Contribution Rates</b>	N/A	21.8%	22.2%	22.2%	22.2%	22.2%
<b>Other Retirement Costs</b>	\$0.7	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8
<b>Total General Fund</b>	<b>\$234.6</b>	<b>\$243.9</b>	<b>\$246.0</b>	<b>\$251.6</b>	<b>\$251.4</b>	<b>\$249.9</b>
<b>Total All Funds</b>	<b>\$304.5</b>	<b>\$318.8</b>	<b>\$323.3</b>	<b>\$331.2</b>	<b>\$331.3</b>	<b>\$328.8</b>

\* Federated Retirement System rates in 2015-2016 and 2016-2017 differ from Board approved rates due to ongoing negotiations with nine Federated bargaining units on retiree healthcare costs. Federated Tier 2C rates were approved by the Retirement Board in 2014-2015 with a 0.20% premium on retiree healthcare compared to Tier 2B rates to cover dental coverage included in Tier 2C but not included in Tier 2. This premium is assumed throughout the Forecast period. Cheiron's Letter did not break out Tier 2C due to the timing of the requested information and approval of a Tier 2C plan.

\*\* Police and Fire Retiree Healthcare is capped at the negotiated rate per MOA.

Source: 2014-2015 Modified Budget; Cheiron Letters dated January 30, 2015 and February 2, 2015 with applied pre-payment discount for Federated Retirement System Tier 1, the Police Retirement Plan Tier 1, and the Fire Retirement Plan Tier 1.



# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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During the forecast period, General Fund retirement contributions will increase by approximately \$6.0 million, or 2.5%, from \$243.9 million in 2015-2016 (25.8% of the General Fund) to \$249.9 million in 2019-2020 (23.8% of the General Fund). Projected retirement costs are estimated to peak in 2017-2018 at \$251.6 million (25.1% of the General Fund) before decreasing modestly in the following two years. This decrease is reflective of the combined effect of the leveling off of Police and Fire retirement rates, combined with the impact of new employees entering into lower cost Tier 2 plans. However, the City's budgetary retirement contribution rates show significant increases for the Federated Retirement System Tier 1 participants. During the same period, across all City funds, the retirement contribution is anticipated to increase by \$10.0 million from \$318.8 million in 2015-2016 to \$328.8 million in 2019-2020.

To cover the necessary City payment for Federated Retirement System Tier 1 members, the budgetary retirement contribution rate increases from 73.8% in 2015-2016 to 85.4% in 2019-2020; for Federated Retirement System Tier 2A, the budgetary contribution rate increases from 15.9% in 2015-2016, peak at 16.9% in 2017-2018, and declines slightly to 16.4% in 2019-2020; for Federated Retirement System Tier 2B members, the budgetary City contribution rate increases from 19.9% in 2015-2016, peaks at 20.9% in 2017-2018, and falls to 19.9% in 2019-2020; for Federated Retirement System Tier 2C members, the budgetary City contribution rate increases from 20.1% in 2015-2016, peaks at 21.6% in 2016-2017, and falls to 20.1% in 2019-2020; for police Tier 1 members, the budgetary City contribution rate decreases from 81.2% in 2015-2016 to 80.2% in 2019-2020; for the police Tier 2, the budgetary retirement contribution rate increases from 22.27% in 2015-2016 to 22.34% in 2019-2020; for fire Tier 1 members, the rate decreases from 82.7% in 2015-2016 to 81.5% in 2019-2020; and, for fire Tier 2 members, the rate increases from 21.79% in 2015-2016 and stays flat at 22.17% through the rest of the forecast period.

For illustration purposes only, the following table depicts the Retirement Board approved contribution rates for 2015-2016 and the Cheiron projected rates for the out years of the Forecast.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

It should be noted, as discussed above, that the City budgetary rate differs from the Federated Retirement Board approved rate to reflect continued negotiations regarding retiree healthcare costs and the application of a pre-payment of Federated, Police and Fire Tier 1 member contributions. Subject to negotiations with the Federated bargaining units, a recommendation to change the retiree healthcare rates approved by the Federated Retirement Board may be submitted to the Board for the April 2015 meeting based on the ongoing negotiation of retiree healthcare benefits.

### 2016-2020 BOARD APPROVED CITY CONTRIBUTION RATES

Retirement Plan	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Fed. Ret. System Tier 1 – Pension	60.3%	66.2%	68.6%	73.0%	75.8%	77.7%
Fed. Ret. Syst. Tier 1 – Ret. Healthcare	9.4%	11.6%	11.5%	11.2%	10.9%	10.7%
<b>Fed. Retirement Plan Tier 1 – Total</b>	<b>69.7%</b>	<b>77.8%</b>	<b>80.1%</b>	<b>84.2%</b>	<b>86.7%</b>	<b>88.4%</b>
Fed. Ret. System Tier 2A – Pension	5.5%	5.7%	5.7%	5.7%	5.7%	5.7%
Fed. Ret. Syst. Tier 2A – Ret. Healthcare	9.4%	11.6%	11.5%	11.2%	10.9%	10.7%
<b>Fed. Retirement Plan Tier 2A – Total</b>	<b>14.9%</b>	<b>17.3%</b>	<b>17.2%</b>	<b>16.9%</b>	<b>16.6%</b>	<b>16.4%</b>
Fed. Ret. System Tier 2B – Pension	5.5%	5.7%	5.7%	5.7%	5.7%	5.7%
Fed. Ret. Syst. Tier 2B – Ret. Healthcare	12.7%	16.1%	15.7%	15.2%	14.7%	14.2%
<b>Fed. Retirement Plan Tier 2B – Total</b>	<b>18.2%</b>	<b>21.8%</b>	<b>21.4%</b>	<b>20.9%</b>	<b>20.4%</b>	<b>19.9%</b>
Fed. Ret. System Tier 2C – Pension	5.5%	5.7%	5.7%	5.7%	5.7%	5.7%
Fed. Ret. Syst. Tier 2C – Ret. Healthcare*	12.9%	16.3%	15.9%	15.4%	14.9%	14.4%
<b>Fed. Retirement Plan Tier 2C – Total**</b>	<b>18.4%</b>	<b>22.0%</b>	<b>21.6%</b>	<b>21.1%</b>	<b>20.6%</b>	<b>20.1%</b>
Police Ret. Plan Tier 1 – Pension	72.1%	73.0%	71.4%	72.5%	71.9%	71.9%
Police Ret. Plan Tier 1 – Ret. Healthcare**	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
<b>Police Retirement Plan Tier 1 – Total</b>	<b>83.1%</b>	<b>84.0%</b>	<b>82.4%</b>	<b>83.5%</b>	<b>82.9%</b>	<b>82.9%</b>
Police Retirement Plan Tier 2 – Pension	10.8%	11.3%	11.4%	11.4%	11.4%	11.3%
Police Ret. Plan Tier 2 – Ret. Healthcare**	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
<b>Police Retirement Plan Tier 2 – Total</b>	<b>21.8%</b>	<b>22.3%</b>	<b>22.4%</b>	<b>22.4%</b>	<b>22.4%</b>	<b>22.3%</b>
Fire Retirement Plan Tier 1 – Pension	73.5%	75.0%	73.3%	74.2%	73.5%	73.3%
Fire Ret. Plan Tier 1 – Ret. Healthcare**	9.3%	10.6%	11.0%	11.0%	11.0%	11.0%
<b>Fire Retirement Plan Tier 1 – Total</b>	<b>82.8%</b>	<b>85.6%</b>	<b>84.3%</b>	<b>85.2%</b>	<b>84.5%</b>	<b>84.3%</b>
Fire Retirement Plan Tier 2 – Pension	10.9%	11.2%	11.2%	11.2%	11.2%	11.2%
Fire Ret. Plan Tier 2 – Retiree Healthcare**	9.3%	10.6%	11.0%	11.0%	11.0%	11.0%
<b>Fire Retirement Plan Tier 2 – Total</b>	<b>20.2%</b>	<b>21.8%</b>	<b>22.2%</b>	<b>22.2%</b>	<b>22.2%</b>	<b>22.2%</b>

\* Federated Tier 2C rates were approved by the Retirement Board in 2014-2015 with a 0.20% premium on retiree healthcare compared to Tier 2B rates to cover dental coverage included in Tier 2C but not included in Tier 2. This premium is assumed through the Forecast period. Cheiron's did not break out Tier 2C due to the timing of the requested information and approval of a Tier 2C plan.

\*\* Police and Fire Retiree Healthcare is capped at the negotiated rate per MOA.  
Source: Cheiron Letters dated January 30, 2015 and February 2, 2015.

# ELEMENTS OF THE GENERAL FUND FORECAST

## **EXPENDITURE FORECAST**

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### *Health and Other Fringe:*

A projected health rate increase of 8% is included in the 2015-2016 Forecast based on national and City trend information received from the City's Human Resources Department benefits consultant. The annual rate increase assumptions are held constant at 8% 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 2.5% increase is anticipated in 2015-2016. For the out years, the Forecast assumes annual rate increases of 3% based on City trends and actuarial analysis.

There are no changes to the life insurance rates in this Forecast based on projected provider charges. For the payment of Unemployment Benefit Claims, the City is self-insured. Based on actual claims experienced in 2014-2015, current funding available in the Unemployment Insurance Fund, and projected future claims, the unemployment insurance rate continues to be suspended through the five-year forecast period.

### **Non-Personal/Equipment**

Non-personal/equipment expenditures for the first year of the Forecast have also been calculated at a detailed level and total \$88.9 million in 2015-2016. In general, the process used by the City Manager's Budget Office to calculate this amount includes adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2014-2015, and including projected increases or decreases for specific large non-personal/equipment allocations (e.g., utilities, contractual services, vehicle maintenance and operations costs, and Police Department vehicle replacement). The resulting 2015-2016 estimates represent a decrease of \$14.7 million from the 2014-2015 Modified Budget level of \$103.5 million, primarily due to the elimination of rebudgeted or carryover projects.

Departmental gas and electricity funding for 2015-2016 totaling \$13.3 million has been slightly adjusted in this Forecast to reflect projected rate increases, full year costs of new facilities coming online, and consumption changes. As described further in this section, partial year savings are assumed for 2015-2016 from anticipated energy savings (\$887,000) and lower materials costs (\$460,000) related to Energy Services Company (ESCO) funded projects. Increases for negotiated contracts are included in this section, primarily in the Public Works Department (\$560,000) for custodial and animal care costs, Police Department (\$315,000) for academy, technology, and County lab costs, City Attorney's Office (\$300,000) for outside legal counsel costs, and Information Technology Department (\$290,000) for technology maintenance costs. Vehicle maintenance and operations costs in the General Fund including fuel, inventory, and fleet staffing reflect a \$850,000 decrease (total of \$14.5 million) from the 2014-2015 Adopted Budget, primarily due to decreased fuel costs, partially offset by increases in parts and personnel costs. The 2015-2016 non-personal/equipment base includes an adjustment for the scheduled replacement of marked, covert, and unmarked Police fleet vehicles from the Adopted Budget level of \$3.4 million to \$2.7 million based on the current replacement schedules and

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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projected costs for these vehicles. Police vehicle replacement costs are expected to decline in the first two Forecast years and increase in the last two years, based on the anticipated replacements that will be necessary in those years. Over the five-year period, police vehicle replacement costs are expected to total \$17.6 million.

For the out years of the Forecast, a growth rate of 2.0% has been assumed from the 2015-2016 non-personal/equipment base levels in each of the four years, adjusted for police vehicle replacement costs in those years. With this adjustment, the average growth rate for the non-personal/equipment category is 2.1% annually.

### **City-Wide**

**City-Wide Expenses** in the first year of the Forecast (2015-2016) total \$77.6 million, a decline from the 2014-2015 Modified Budget of \$263.7 million. This large reduction primarily reflects the impact of deleting the \$100.0 million of borrowing proceeds from the Tax and Revenue Anticipation Notes (TRANs) issued for cash flow purposes to facilitate the annual prefunding of employer retirement contributions for pension and retiree health benefits; deleting allocations that were rebudgeted to 2014-2015 (\$20.7 million); and the elimination of one-time budget actions (\$8.7 million).

This category also includes any necessary contributions to Successor Agency to the Redevelopment Agency (Successor Agency). As part of determining the current financial state of the Successor Agency, in the context of the continuing efforts to wind down and dissolve the former Redevelopment Agency of San Jose, the Administration reviewed property tax increment revenues and the current level of enforceable obligations for the forecast period. For the purpose of this Forecast, assumptions regarding Property Tax Increment receipts over the five year period (2% growth annually), as well as sale of property timing, have been made. Based on these assumptions, it is projected that there will not be sufficient property tax increment revenues to pay all enforceable obligations during the forecast period and that the City will continue to assume a portion of certain contractually obligated payments of the Successor Agency (4<sup>th</sup> Street Garage Debt Service, Convention Center Debt Service, HUD 108 Loan payments, and ERAF Loan Payments) as necessary. In addition, it is assumed that the City will also fund Successor Agency administrative support costs over the forecast period. The City's legal challenge of the County's actions of withholding a percentage of former agency tax increment to fund the County employees' retirement plan (the PERS levy) remains unknown, therefore, this forecast does not assume receipt of those revenues. Total General Fund support of \$1.3 million is assumed in 2015-2016 and primarily covers administrative support costs. This figure remains flat at \$1.3 million annually in the out years of this forecast to reflect the status quo of the financial outlook of the Successor Agency. In addition to the General Fund support, the General Purpose Parking Fund and Community Development Block Grant Fund are projected to provide financial support for the 4<sup>th</sup> Street Garage Debt Service and HUD 108 Loan payments, respectively, as necessary.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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The remaining line-items in this category are adjusted to reflect anticipated costs for 2015-2016 based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. The largest 2015-2016 allocations in this category include: Workers' Compensation Claims (\$20.5 million); Convention Center Lease Payments (\$15.3 million); Sick Leave Payments Upon Retirement (\$5.0 million), FMC Debt Service Payments (\$3.4 million), City-owned Facility Operating Agreements (\$3.3 million); San José BEST and Safe Summer Initiative Program (\$3.1 million); General Liability Claims (\$3.0 million), ESCO Debt Service (\$2.5 million), Parking Citations/Jail Courthouse Fees (\$2.3 million); Property Tax Administration Fee (\$2.0 million), Banking Services (\$1.7 million), Property Leases (\$1.4 million), and Successor Agency Legal Obligations Subsidy (\$1.3 million).

In the out years of the Forecast, City-Wide Expenses are projected to increase at an average growth rate of 1.7%. While several of the individual line items are expected to remain at 2014-2015 levels over this period, there are some categories that are expected to experience growth over the five years, including Workers' Compensation Claims (from \$20.5 million to \$24.4 million). The FMC debt service payment is expected to increase in the out years (from \$3.4 million to \$4.2 million) based on higher variable interest rate assumptions. Additionally, this forecast incorporates Energy Services Company (ESCO) Debt Service (\$2.5 million in 2015-2016 increasing to \$2.8 million during the forecast period), partially offset by energy and material cost savings and rebates (\$1.4 million in 2015-2016 increasing to \$1.8 million during the forecast period). When comparing ESCO projected costs and savings, it should be noted that the General Fund cost over the five-year forecast period (\$5.7 million) reflects an increase of \$2.0 million compared to the figures estimated and presented to the City Council in May 2014. This increase is reflective of the combined impact from higher debt services costs (based on higher than projected interest rates) and lower energy savings projected (a 2.0% energy escalation assumed in this forecast compared to a 4.5% increase assumed as part of data provided by Chevron in May 2014).

The anticipated administrative costs to issue TRANs Debt Service are also expected to climb (from \$350,000 to \$750,000 over the forecast period) based on a conservative estimate of the size of the issuance required and anticipated increases in variable interest rates and higher bank fees. Prefunding the City's portion of Tier 1 retirement contributions over the past several years has been successful in generating budgetary savings for the General Fund and other City funds.

The General Fund Capital Projects category totals \$5.5 million in 2015-2016 and remains at this level in each of the out years of the Forecast. The largest item in this category is fire apparatus replacement (\$4.0 million annually). The investment in fire apparatus replacement in this Forecast is based on an analysis of projected replacement schedules, replacement costs, and apparatus changes to meet safety needs. It also assumes that the Fire Construction and Conveyance Tax Fund will pay \$400,000 annually for these costs. The Capital Projects category also includes the continuation of annual allocations for Arena repairs (\$100,000 in the out years), unanticipated maintenance of City facilities (\$750,000, an increase from \$600,000 annually), fuel tanks and methane monitoring control and replacement (\$350,000), and annual capital expenditures (\$200,000, an increase from \$150,000 annually) to maintain sufficient power backup for the City Hall and the 9-1-1 Police Communications Building.

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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The **Transfers** category totals \$27.2 million in 2015-2016 and increases to \$32.4 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 line-item in this category and totals \$18.2 million in 2015-2016 (\$18.9 million to \$21.2 million in the remaining years of the Forecast). Other large transfers include the following: funding to cover a portion of the debt service payments and operating costs for the Hayes Mansion Conference Center (\$3.7 million in 2015-2016) and Rancho del Pueblo and Los Lagos Golf Courses (\$2.7 million in 2015-2016); payments in accordance with the San José Arena Management agreement extension (\$750,000 in each year of the Forecast) for Arena capital rehabilitation and enhancements; and a transfer to the Vehicle Maintenance and Operations Fund for general fleet replacement (\$1.0 million annually).

All of the debt service and maintenance and operations costs for the Hayes Mansion Conference Center and golf courses are funded in the Community Facilities Revenue and Municipal Golf Course Funds; however, revenues in those funds are not projected to be sufficient to completely cover these costs. The transfer for the Hayes Mansion Conference Center decreased from a \$5.4 million subsidy level in the out years of the last forecast to \$3.7 million required in 2015-2016, and then increases to \$5.3 million in 2018-2019, and then decreases to \$4.5 million the last year of this forecast based on projected debt service payments for that facility. These debt service payments are lower than the last Forecast due to a recent debt refunding and principal pay down. The transfer for the golf course subsidy increases from the \$1.7 to \$1.9 million annual funding assumed in the February 2014 Forecast to \$2.7 million in 2015-2016 and \$2.6 million thereafter based on current operational activity. It should be noted that a review of the Municipal Golf Course Fund (revenues and expenditures) has been included in the City Auditor's work plan and will be underway in the next several weeks.

The payments for Arena capital rehabilitation and enhancements are in compliance with the San José Arena Management Agreement Extension from 2009-2018. Though this agreement expires on June 30, 2018, annual funding of \$750,000 is maintained throughout the forecast. Negotiation efforts are underway to renew the agreement beyond the existing term, the result of which could alter the City's capital payment obligations.

In the Service Yards C&C Fund, this forecast includes transfers to cover Central Service Yards Phase 1 debt service payments (\$575,000 annually starting in 2016-2017).

The transfer to the Vehicle Maintenance and Operations Fund (\$1.0 million annually) is included to fund a vehicle replacement schedule for the General Fleet as well as transfers to the Communications C&C Fund (\$600,000 in 2016-2017 to \$925,000 in the out years) to fund the City's share of capital costs for the Silicon Valley Regional Interoperability Authority.

The Transfers category also includes payments to various Maintenance Assessment Districts and Business Improvement Districts for the General Fund's share of landscape services in those areas (\$838,000 to \$881,000 annually).

# ELEMENTS OF THE GENERAL FUND FORECAST

## EXPENDITURE FORECAST

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The **Earmarked Reserves** category includes a Deferred Infrastructure and Maintenance Reserve of \$800,000 to fund critical capital maintenance or address urgent technology needs. These resources will be allocated as part of the 2015-2016 Proposed Budget. In addition, annual funding of \$240,000 is allocated to the General Plan Update Reserve to set aside fees collected by developers toward the future update or revision of the General Plan.

Several Earmarked Reserves are included in this Forecast that were not included in the prior Forecast. Additional funds are allocated for the Police Department Staffing Earmarked Reserve (\$3.5 million in 2015-2016, increasing to \$8.5 million in the last year of the forecast) per City Council Policy to set aside Police Tier 2 retirement savings to fund additional police sworn positions until sworn staffing levels reach 1,250 officers (estimated to cost \$25 million annually). This forecast also includes funding set aside for programs previously covered by Recycle Plus Late Fees that will no longer be collected with the billing transition to the County Property Tax roll, but will require evaluation as part of the 2015-2016 Proposed Budget (\$1.8 million annually), an allocation reflecting Transient Occupancy Tax growth from the 2013-2014 actual collections to fund capital maintenance at the City's cultural facilities per City Council Adopted Budget direction (\$2.1 million in 2015-2016, increasing to \$4.6 million in the last year of the forecast), and potential impacts from the Air Service Incentive Program (\$1.0 million in 2015-2016 and 2016-2017) that would reduce the amount of indirect overhead expenses that the City receives should the percentage growth in annual enplanements at the Airport exceed the annual enplanement growth nationwide.

The Forecast does not include a number of Earmarked Reserves that may remain unspent in 2014-2015 and would be recommended for rebudget or use in 2015-2016. Some of the larger current Earmarked Reserves include the Development Fee Program Reserves, Workers' Compensation/General Liability Catastrophic Reserve, Budget Stabilization Reserve, Salaries and Benefits Reserve, and the 2015-2016 Future Deficit Reserve.

Per City Council policy, the **Contingency Reserve** (\$33.1 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 2015-2016 budget. This amount would be sufficient to cover approximately one pay period of payroll costs (two and one-half weeks). Amounts necessary to remain in compliance with that policy are also included in each of the remaining four years of the Forecast.

### **Committed Additions to the Base General Fund Forecast**

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

# ELEMENTS OF THE GENERAL FUND FORECAST

## **EXPENDITURE FORECAST**

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Committed Additions total \$526,000 in 2015-2016 and increase to approximately \$1.9 million by 2019-2020. These Committed Additions, as well as a discussion of General Fund Capital Operating and Maintenance/Budget Principle #8, are explained in more detail in Section III of this document.

The approved bond measures from the elections of November 2000 and March 2002 will result in new and expanded library (Measure O), park (Measure P), and fire (Measure O) facilities and will require additional maintenance and operations funding (\$241,000 in 2015-2016 and increasing to approximately \$875,000 in 2019-2020). The new facilities anticipated to be opened during this forecast period include the Southeast Branch Library, Fire Station 21, and the Softball Complex.

Also included in the Committed Additions are maintenance and operations costs associated with non-bond projects such as the build out of the United States Patent and Trademark Office in the City Hall Wing, new parks and recreation facilities, and new traffic infrastructure. The non-bond projects committed additions costs in the Forecast range from \$285,000 in 2015-2016 and increases to \$1.0 million by 2019-2020.

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

Budget Principle #8 states that Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding \$100,000 without City Council certification that funding will be made available in the applicable year of the cost impact. Certification shall demonstrate that funding for the entire cost of the project, including operations and maintenance costs, will not require a decrease in existing basic neighborhood services. Consistent with that direction, this Forecast includes a detailed list and discussion of capital projects that were previously certified by the City Council with annual operating and maintenance costs in the General Fund greater than \$100,000. Capital funding for these projects have been included as part of approved Capital Improvement Programs or approved by City Council in 2014-2015. The majority of these costs are associated with the voter-approved General Obligation bonds for Park and Library facilities. The operating and maintenance costs for these facilities are included in the figures presented in this Forecast. The Lake Cunningham Bike Park project, as identified in the Forecast, will need certification in accordance with Budget Principle #8. A recommendation will be brought forward for City Council consideration prior to award of the construction contract.



## ELEMENTS OF THE GENERAL FUND FORECAST

### OPERATING MARGIN

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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 2015-2016, a surplus of \$8.6 million is projected, followed by surpluses in 2016-2017 (\$5.2 million) and 2017-2018 (\$338,000). A small deficit of \$1.4 million is projected in 2018-2019, followed by a surplus of \$5.8 million in 2019-2020. Base Case expenditures, including committed additions, increase from \$943.8 million in 2015-2016 to \$1.05 billion in 2019-2020, for an average annual growth rate of approximately 2.8%. The sources of revenue total \$952.4 million in 2015-2016 and grow to \$1.07 billion in 2019-2020, increasing at a slightly higher average annual growth rate of 3.1%.

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 2015 Forecast is compared to the comparable year in the February 2014 Forecast.

#### 2016-2020 General Fund Forecast Changes in Operating Margin (\$ in Millions)

	<u>2015-2016</u>	<u>2016-2017</u>	<u>2017-2018</u>	<u>2018-2019</u>	<u>2019-2020</u>
<b>February 2014</b> Incremental Surplus/(Shortfall)	(\$4.2)	\$0.4	(\$6.5)	(\$1.7)	N/A
<b>June 2014</b> Incremental Surplus/(Shortfall)	(\$2.4)	N/A	N/A	N/A	N/A
<b>February 2015</b> Incremental Surplus/(Shortfall)	<b>\$8.6</b>	<b>\$5.2</b>	<b>\$0.3</b>	<b>(\$1.4)</b>	<b>\$5.8</b>

Note: Does not incorporate impacts associated with elements of the Fiscal Reform Plan that are not yet implemented; costs associated with fully funding the annual required contributions for retiree healthcare; costs associated with services funded on a one-time basis in 2014-2015; costs associated with restoration of key services (police, fire, libraries, community centers, and street maintenance) to January 1, 2011 levels; costs associated with a Police Staffing Restoration Strategy (to increase the number of budgeted sworn officers from 1,109 to 1,250 positions); costs associated with unmet/deferred infrastructure and maintenance needs; or one-time revenues/expenses. It should also be noted that no net impacts associated with the Development Fee Programs are included due to the cost-recovery nature of these programs.

# ELEMENTS OF THE GENERAL FUND FORECAST

## OPERATING MARGIN

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For the February 2015 General Fund Forecast, the Budget Office completed an in-depth review of anticipated revenues and expenditures for 2015-2016 and the remaining four years of the forecast period. The 2015-2016 projected surplus of \$8.6 million reflects an improvement from the \$2.4 million budget shortfall projected in June 2014 (2014-2015 Adopted Budget). This change is the net result of numerous revenue and expenditure changes. A major factor contributing to this improvement is the result of significant growth in major revenue categories including Property Tax and Sales Tax, which continue to reflect strong annual growth applied to higher base year estimated receipts than previously assumed in the 2015-2019 Five Year Forecast. On the expenditure side, savings generated from lower health and dental rates are partially offset by anticipated general pay increases (set aside in an Employee Compensation Planning Reserve) and the establishment of other reserves as described elsewhere in this section.

In the remaining years of the Forecast, small General Fund surpluses and a shortfall are projected, ranging from -\$1.4 million to \$5.8 million annually. These margins are extremely narrow when put into context of the size of the projected General Fund budget, ranging from -0.1% to 0.5% of the projected annual budget (revenues and expenditures). Over the five-year period, a total surplus of \$18.5 million is anticipated, or approximately \$3.7 million annually. This average surplus figure equates to only 0.2% of the projected average General Fund annual budget (revenues and expenditures).

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