

2016-2017

MID-YEAR  
BUDGET  
REVIEW



**T**RANSMITTAL  
**M**EMORANDUM



# Memorandum

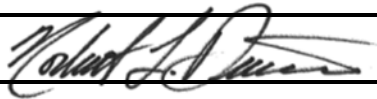
**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Jennifer A. Maguire

**SUBJECT: 2016-2017 MID-YEAR  
BUDGET REVIEW REPORT**

**DATE:** January 31, 2017

Approved



Date 1/31/17

## RECOMMENDATIONS

- A. Approval of the 2016-2017 Mid-Year Budget Review Report.
- B. Adoption of related Appropriation Ordinance and Funding Sources Resolution amendments in various funds as detailed in Section III (Recommended Budget Adjustments and Clean-Up Actions) of the 2016-2017 Mid-Year Budget Review Report.

## OUTCOME

The Mid-Year Budget Review Report provides an assessment of the City's budget condition in the current fiscal year as compared to the 2016-2017 Modified Budget based on actual performance during the first six months of 2016-2017. Based on this analysis, budget revisions are recommended to: implement a number of technical and net-zero adjustments between expenditure appropriations and revenue categories; implement required technical/rebalancing actions to align already approved revenue estimates and expenditure budgets with the most current tracking information or reallocate funding among appropriations based on updated needs; account for new or adjusted grants, reimbursements, or fees; and fund two urgent fiscal/program needs in the General Fund and a limited number of new projects in special and capital funds.

## EXECUTIVE SUMMARY

The 2016-2017 Adopted Operating and Capital Budgets for the City of San José totaled \$3.2 billion. With this funding, the City continues to deliver a wide range of services to the City's residents and businesses. These include, but are not limited to, police, fire, parks, recreation, library, economic development, airport, waste water treatment, sewer system, recycling and garbage, housing, traffic, and other neighborhood services. Although the City's budget is in a fairly stable position, it is not robust, therefore, the lack of resources has not allowed the City to restore services to pre-recession levels. However, the voter approval of a local Sales Tax measure in June 2016 helped begin to address some of the City's most urgent and critical needs (e.g. public safety, street maintenance, and homeless services).

The Adopted Budget balanced many competing community and organizational needs and maintains the City's strong commitment to budget stability. Budget actions in 2016-2017 focused on the following priority themes:

- *Save* (setting aside resources to ensure fiscal stability)
- *Invest and Innovate: Safety* (investments that address public safety needs)
- *Invest and Innovate: Economic Opportunity* (investments that expand opportunities for our residents and businesses)
- *Invest and Innovate: Our Future* (investments that better position the City moving forward)
- *Invest and Innovate: Our Community* (investments that support a vibrant community)
- *Invest in Making San José America's Most Innovative City*: (investments that support innovation and strategic partnerships as well as increase transparency and community input)

The Administration is closely monitoring the City's budget to ensure that current year revenues and expenditures are meeting expectations, which is necessary to maintain budget stability and avoid service disruptions in any given year. Through the first half of the year, City funds are generally performing within expected 2016-2017 budgeted levels, with a few selected funds out-performing anticipated projections.

### ***Mid-Year Budget Review Highlights***

#### **General Fund**

- Based on current collection trends and information, General Fund revenues are anticipated to end the year approximately \$15 million above budgeted levels. Of this amount, approximately \$5 million is attributed to the Development Fee Programs, and any excess revenues as well as expenditure savings in those programs will be set aside in the Development Fee Program Reserves. Overall, General Fund expenditures are tracking below anticipated levels and are expected to generate overall savings by year-end of approximately \$10 million. The combination of excess revenues, expenditure savings, and the liquidation of prior year carryover encumbrances are expected to generate 2016-2017 Ending Fund Balance in the amount of \$20.0 million that will be used as an ongoing funding source in the Five-Year General Fund Forecast and the 2017-2018 Proposed Budget; the budget is on track to meet this level of fund balance required for next year's budget process.
- A series of Mid-Year Budget Review actions are recommended based on actual performance through December and projected activity through the remainder of the year. Major actions include the following:
  - Address two urgent fiscal/program needs with a cost of \$350,000. This includes allocating \$275,000 to Cybersecurity (Payment Card Industry Requirements), including: funding a Payment Card Industry (PCI) security audit, associated penalties, equipment, and software required to ensure compliance with PCI standards; ensuring the Information

Technology Department has sufficient funding for the increased cost of network firewalls and to implement cybersecurity training city-wide; and providing funding for City membership to the Arizona Cyber Threat Response Alliance, a cybersecurity alliance that provides information on how to address cyberattacks. This report also recommends allocating \$75,000 to the Office of Immigrant Affairs to establish a one-time Capacity Building and Streamlining Legal Defense for Families and Youth Program to provide immigrant service delivery coordination and fill a service gap that exists until County programs are in place.

- Implement required technical/rebalancing actions that result in total net savings of \$83,000. Notable actions include increased funding to address higher costs associated with the Business Tax System Replacement project (\$185,000, \$85,000 of which is offset by a decrease to the Finance Department’s Personal Services appropriation) and an increase to the transfer from the General Fund to the Downtown Property and Business Improvement District (\$17,000). In addition, this document recommends the reallocation of funds from personal services vacancy savings to non-personal/equipment in the Parks, Recreation and Neighborhood Services (PRNS) Department (\$1.1 million) to address higher than anticipated water costs; the transfer of \$200,000 from the Neighborhood Security Bond Fund to the General Fund to repay the General Fund for a loan that occurred in 2012-2013 related to a Fire Station 24 project; the reallocation of \$100,000 from the Homeless Rapid Rehousing allocation to the Homeless Response Team appropriation to fund encampment clean-ups; and the shift of funding from the Council District #02 appropriation to the City Council District #02 Participatory Budgeting – Calpine Settlement allocation (\$75,000).
- Implement grants/reimbursements/fees adjustments totaling \$2.4 million with a net-zero impact on the General Fund. The largest adjustments include actions to recognize and appropriate funding to support the following: Parks, Recreation and Neighborhood Services fee activities and grants (\$939,000), Fire Department grants (\$731,000), Department of Transportation Emergency Street Tree Services (\$300,000), and Police Department grants (\$223,000).
- Implement a variety of clean-up actions that result in total net savings of \$267,000, including the following: recognize additional interest earnings from various capital funds (\$272,000), and an adjustment to the Mayor’s Office rebudget to account for the final reconciliation of travel expenses in 2015-2016 that was completed after the rebudget adjustments were brought forward in the 2015-2016 Annual Report (\$5,000). Other net-zero impact actions that correct errors or align revenues and/or expenditures among appropriations for previously approved budget actions are also included.

### **Special/Capital Funds**

- Most of the revenues and expenditures in the City’s special and capital funds are generally performing within expected levels through December. Budget adjustments are recommended in several funds to adjust for revised revenue and cost estimates, to address critical current year funding needs, and to recognize various grants and reimbursements. Some of the highlights and major recommended adjustments are described below.

- The Building and Structure Construction Tax and the Construction Excise Tax, the two largest construction-related revenues, have both already exceeded their Adopted Budget year-end estimates. It is currently anticipated the Building and Structure Construction Tax will total \$24.0 million by year-end (\$11.0 million higher than the Adopted Budget estimate) and the Construction Excise Tax Fund will receive revenues totaling \$32.0 million by year-end (\$15.0 million higher than the Adopted Budget estimate). Though budget adjustments are not recommended as part of this report, the higher revenue estimates will be used in development of the 2017-2018 Proposed Capital Budget.
- Several recommendations are included the various Airport funds, including: establishing the Terminal B Expansion Ramp project (\$551,000), which will reconstruct the ramp area south of Terminal B to a full strength concrete ramp; increasing the Federal Inspection Facility Sterile Corridor Extension project by \$423,000 to ensure sufficient funding is available for the project as previously anticipated grant funding will no longer be received (due to the project not meeting FAA grant requirements); and increasing the Southeast Ramp Construction project (\$400,000) due to project costs being higher an originally estimated. In addition, this report includes recommendations to increase various transfers within the Airport Funds to ensure the Airport meets the minimum bond reserve requirements.
- In the Convention and Cultural Affairs Fund, several actions are recommended including establishing a new appropriation for Center for Performing Arts Rehabilitation (\$730,000), which will allow for an assessment of rehabilitation needs including a draft schedule of capital improvements, and funding to repair two dilapidated catwalks as well as install two additional catwalks. In addition, funding of \$800,000 for the Convention Center Concourse Column Covers (stainless steel diamond plates that will cover the concrete columns in the Convention Center concourse) is recommended to be shifted from the Convention Center Facilities District Fund to the Convention and Cultural Affairs Fund. Funding of \$231,000 is also recommended to install lighting at the Center for Performing Arts and Convention Center garage as part of a PG&E energy efficiency program and install additional security cameras at the Convention Center. These actions will be offset by reductions to various projects, reserves, and the Ending Fund Balance.
- In the Construction Excise Tax Fund recommendations are included to recognize Route 101/Oakland/Mabury Traffic Impact Fees (\$2.9 million) and North San José Traffic Impact Fees (\$1.8 million) and allocate the funding to the corresponding reserve of funds. Projects will be identified through the 2017-2018 budget process for the use of these funds, which are restricted to traffic improvements within the areas for which the fees were developed. Funding is also recommended to update the City’s transportation impact analysis guidelines (\$250,000) and to fund the Kirk Avenue Sidewalks Improvement project (\$200,000).

Looking forward, the Administration is scheduled to release the 2018-2022 General Fund Five-Year Forecast on February 28, 2017, and the 2017-2018 Proposed Capital and Operating Budgets on April 24, 2017 and May 1, 2017, respectively. Analysis from this Mid-Year Budget Review will be factored into both the Forecast and Proposed Budgets, as appropriate.

## **BACKGROUND**

The annual Adopted Budget is a financial plan predicated on the best information available at the time it is prepared. As with any budget, however, changing conditions create the need to modify the original plan. Through its budget policies, the City Council has designated mid-year as the appropriate time to perform a comprehensive review of the current year's budget, and the Mid-Year Budget Review as the appropriate vehicle for consideration of any revisions to the budget. This Mid-Year Budget Review Report complies with that policy. It contains a comprehensive review of the status of the City's 2016-2017 Operating and Capital Budgets as modified through December 2016.

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

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

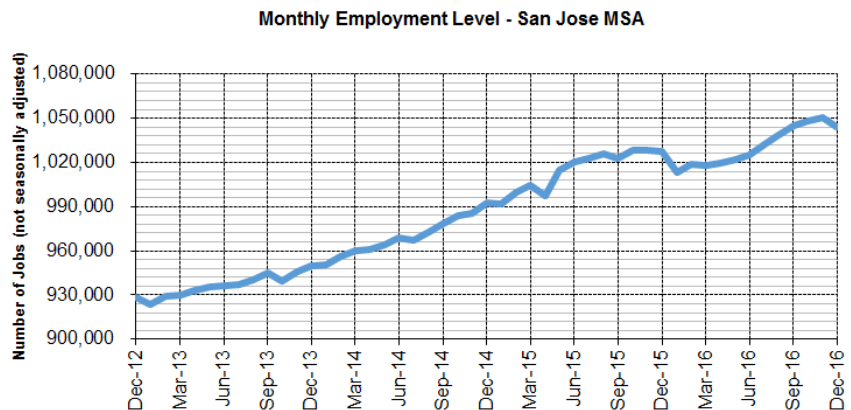
## **ANALYSIS**

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

## ECONOMIC ENVIRONMENT

The Silicon Valley continues to show solid economic performance with a number of the economic indicators showing improvement from the same period a year ago. The local economic indicators remain positive, but some categories are starting to moderate from the extremely strong growth levels experienced in recent years. National economic indicators, including consumer confidence, also demonstrate an economy that continues to grow at a moderate pace. While these indicators are generally positive, it is important to keep in mind that performance in a couple of the economically sensitive revenue categories, namely Sales Tax and Construction and Conveyance Taxes, are down from the prior year and those revenues will be important to monitor to determine if downward trends emerge.

The December 2016 employment level in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (San José MSA) of 1.11 million was 3.4% above the December 2015 level of 1.07 million. Between December 2015 and December 2016, 36,900 jobs were added. This includes 13,600 jobs in professional and business services, marking its 80<sup>th</sup> consecutive monthly gain on a year-over-year basis, as well as 9,000 jobs in private educational and health services.<sup>1</sup>



As noted in the Beacon Employment Report, for all of 2016, monthly job growth in California averaged 27,700 jobs per month. “California wage and salary jobs grew by 2.6% in 2016. This is slower than a year earlier, but is consistent with a tighter labor market, very much like the nation as a whole. There is every reason to expect that we will see continued increases in jobs along with increased wages in the year ahead,” said Robert Kleinhenz, Executive Director of Research at Beacon Economics and the UC Riverside School of Business Center for Economic Forecasting.<sup>2</sup>

<sup>1</sup> State of California Employment Development Department Labor Market Information Division Press Release, January 20, 2017

<sup>2</sup> Beacon Economics, Employment Report, January 2017

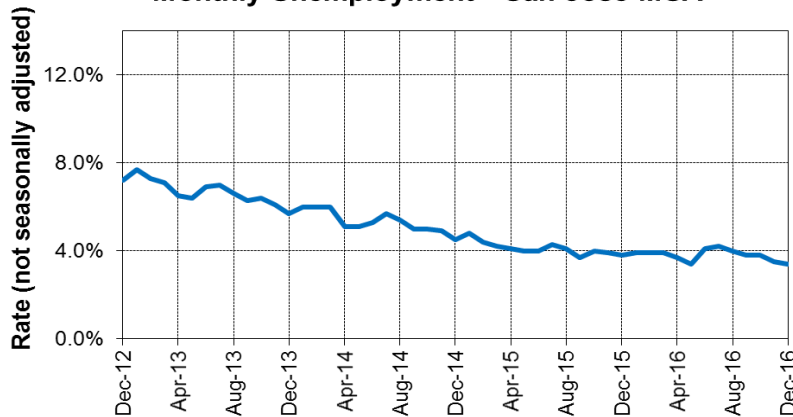
**Unemployment Rate (Unadjusted)**

	<b>Dec. 2015</b>	<b>Nov. 2016</b>	<b>Dec. 2016**</b>
San José Metropolitan Statistical Area*	3.9%	3.5%	3.4%
State of California	5.7%	5.0%	5.0%
United States	4.8%	4.4%	4.5%

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

The unemployment rates at the local, State, and national levels remain very low. In December 2016, the unemployment rate for the San José Metropolitan Statistical Area of 3.4% represents a slight decrease from the November 2016 rate of 3.5%, and is below the 3.9% rate experienced a year ago. In this region, the December 2016 unemployment rate is less than the unadjusted unemployment rate for the State (5.0%) and the nation, which has a current unadjusted unemployment rate of 4.5%.

**Monthly Unemployment - San Jose MSA**



Local construction activity remains very strong through December; and is tracking well above prior year levels. Residential permits for new dwelling units through December totaled 1,424 versus 1,028 last year. Correspondingly, the valuation of new residential construction also increased significantly (\$278.1 million in 2016-2017 vs. \$187.0

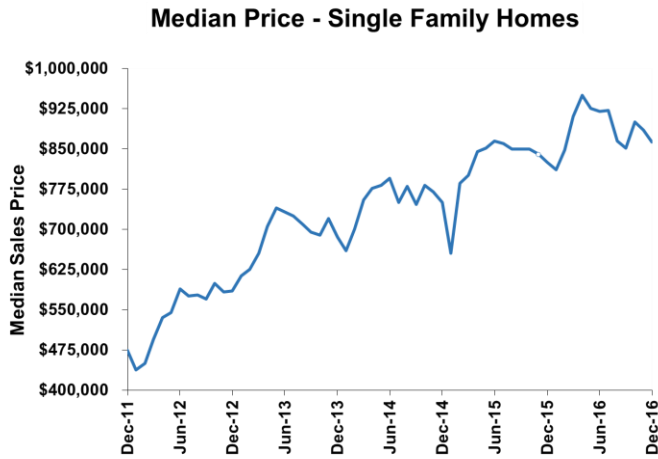
million in 2015-2016), while alteration activity slightly decreased (\$50.0 million in 2016-2017 vs \$57.9 million in 2015-2016). Combined residential valuation of \$328.1 million through December is 33.9% above the prior year level of \$245.0 million. Significant residential activity for December included permits for a 135-unit apartment building on South 2<sup>nd</sup> Street south of Keyes Street.

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

	<b>July-Dec. 2015</b>	<b>July-Dec. 2016</b>	<b>% Increase/ (Decrease)</b>
Residential	\$ 245.0	\$ 328.1	33.9%
Commercial	\$ 137.9	\$ 394.5	186.0%
Industrial	\$ 139.1	\$ 275.5	98.0%

Overall commercial valuation through December is significantly above the 2015-2016 level (\$394.5 million in 2016-2017 vs \$137.9 million in 2015-2016 or 186.0%). New commercial construction and alteration activity are both up compared to prior year levels. Industrial construction valuation through December is 98.0% above the 2015-2016 level (\$275.5 million in 2016-2017 vs. \$139.1 million in 2015-2016). Notable industrial new construction in 2016-2017 includes a permit for a six-story, 184,000 square foot research and development office building on North 1<sup>st</sup> Street south of Highway 237.





The local real estate market, however, is beginning to see declines in property transfers compared to prior year levels. The December 2016 number of property transfers totaled 561, a decrease of 17.6% from the same time period in the prior year. The number of new listings for single-family and multi-family dwellings has also decreased (27.0%) compared to prior year levels. However, the median single-family home price in December 2016 totaled \$863,000, which represents a 4.6% increase from the December 2015

total of \$825,000. In addition, it took less time to sell these homes, with the average days on the market for single-family and multi-family dwellings in December 2016 totaling 34 days, a 13.0% decrease from December 2015.

The leading consumer confidence indicator, the Conference Board's *Consumer Confidence Survey*, reports that consumer confidence of 113.7 in December is up from November's 109.4 (in 1985 it was at 100). In general, consumers' short-term outlook improved considerably in December. Those expecting business conditions to improve over the next six months increased from 16.4 percent to 23.6 percent, while those expecting business conditions to worsen declined from 9.9 percent to 8.7 percent.<sup>3</sup>

According to Lynn Franco, Director of Economic Indicators at The Conference Board, "Consumer Confidence improved further in December, due solely to increasing expectations which hit a 13-year high (Dec. 2003, 107.4). The post-election surge in optimism for the economy, jobs and income prospects, as well as for stock prices which reached a 13-year high, was most pronounced among older consumers. Consumers' assessment of current conditions, which declined, still suggests that economic growth continued through the final months of 2016. Looking ahead to 2017, consumers' continued optimism will depend on whether or not their expectations are realized."<sup>4</sup>

Economic conditions will continue to be closely monitored and factored into the 2018-2022 General Fund Five-Year Forecast, scheduled to be released on February 28, 2017, and the upcoming releases of both the Proposed Capital and Operating Budgets, scheduled to be released on April 24, 2017 and May 1, 2017, respectively.

<sup>3</sup> The Conference Board, Consumer Confidence Survey, December 27, 2016

<sup>4</sup> The Conference Board, Consumer Confidence Survey, December 27, 2016

## **GENERAL FUND PERFORMANCE**

General Fund revenues and transfers through December totaled \$489.4 million, or 44.8% of the budgeted estimate. Based on current collection trends and information, existing revenues are anticipated to end the year approximately \$15.0 million above budgeted levels (variance of approximately 1.4% when excluding the Beginning Fund Balance), most which represents additional revenue from the Property Tax, Utility Tax, Business Taxes, Licenses and Permits, Departmental Charges, and Use of Money and Property revenue categories; offset by declines in Sales Tax and Transfers and Reimbursements. Approximately \$5.0 million is attributed to the Development Fee Programs, and any excess revenues in those programs will be set aside in the Development Fee Program Reserves. It should be noted that the remaining portion of excess revenue (approximately \$10.0 million) is planned as a funding source for the 2017-2018 budget process and is within estimated levels.

In this document, an overall net increase of \$2.8 million to the General Fund revenue estimates is recommended. This is primarily due to the recognition of grants, reimbursements, and/or fee related funds (\$2.36 million) as well as a small number of required technical/rebalancing/clean-up actions to increase revenue estimates by \$472,000 to reflect a transfer of additional anticipated interest earnings from various funds (\$272,000) and a repayment for a General Fund advance that was provided in 2012-2013 to the Neighborhood Security Bond Fund (\$200,000) associated with Fire Station 24. The revenue estimates for this year will continue to be updated and refined as part of the upcoming Five-Year Forecast and Proposed Budget process and will be reported through the release of the Bi-Monthly Financial Reports that are reviewed by the Public Safety, Finance, and Strategic Support Council Committee.

General Fund expenditures through December totaled \$516.3 million, or 37.3% of the total 2016-2017 Modified Budget. This represents a decrease of \$10.7 million, or 2.0%, from the December 2015 level of \$527.0 million. Encumbrances totaling \$55.5 million were \$3.9 million (7.5%) below the December 2015 level of \$51.7 million. Expenditures and encumbrances through December of \$571.8 million constituted 41.3% of the total Modified Budget (including reserves) of \$1.4 billion; without reserves of \$137.3 million, expenditures and encumbrances constituted 45.8% of the total Modified Budget. Overall, General Fund expenditures are tracking below anticipated levels and are expected to end the year with savings of approximately \$10.0 million to assist in meeting the 2016-2017 ending fund balance estimate that will be used as a funding source in the General Fund Five-Year Forecast and the 2017-2018 Proposed Budget. The majority of savings is anticipated to be generated from Personal Services and City-Wide Expenses appropriations.

There are two budget adjustments recommended to address urgent fiscal/program needs. Other technical/rebalancing actions, clean-up actions, and net-zero grants, reimbursements are also recommended in this report. As with revenues, General Fund expenditure adjustments result in a net increase of \$2.8 million.

The revenue and expenditure adjustments are summarized below and described in more detail in Section III, Recommended Budget Adjustments and Clean-Up Actions of this report. A more detailed discussion of both the General Fund revenue and expenditure performance is also provided in Section I of this report.

**RECOMMENDED GENERAL FUND BUDGET ADJUSTMENTS**

As previously stated, the budget actions recommended in the Mid-Year Budget Review result in a net increase of \$2.8 million to General Fund revenues and expenditures. The recommended Mid-Year Budget Review actions accomplish the following: 1) two urgent fiscal/program needs; 2) implement required technical/rebalancing adjustments; 3) recognize various revenue-supported grants, reimbursements, and fee adjustments; and 4) implement clean-up actions.

The chart below summarizes these recommended adjustments.

**2016-2017 MID-YEAR BUDGET REVIEW  
 RECOMMENDED GENERAL FUND BUDGET ACTIONS**

<b>BUDGET CATEGORY</b>	<b>Use of Funds (\$ in Millions)</b>	<b>Source of Funds (\$ in Millions)</b>
<b>Urgent Fiscal/Program Needs</b>		
Cybersecurity (Payment Card Industry Requirements)	\$0.275	
Office of Immigrant Affairs (Capacity Building and Streamlining Legal Defense for Families and Youth)	0.075	
<b>Total Urgent Fiscal/Program Needs</b>	<b>\$0.350</b>	<b>\$0</b>
<b>Required Technical/Rebalancing Actions</b>		
Business Tax System Replacement	\$0.100	
Parks, Recreation and Neighborhood Services Department (Water)	0.000	
Transfer to the Downtown Property/Business Improvement District Fund (City's Assessment)	0.017	
Transfer from the Neighborhood Security Bond Fund (Loan Repayment)		\$0.200
Other Net-Zero Expenditure Adjustments	0.000	
<b>Total Required Technical/Rebalancing Actions</b>	<b>\$0.117</b>	<b>\$0.200</b>
<b>Grants/Reimbursements/Fees</b>		
Various Grants/Reimbursements/Fee Adjustments	<b>\$2.356</b>	<b>\$2.356</b>
<b>Clean-Up Actions</b>		
Salary and Benefits Program (MPP and Health Programs)	\$0.000	
Transfers and Reimbursements. (Interest Earnings from Capital Funds)		\$0.272
Other Net Clean-Up Adjustments	0.005	
Various Net-Zero Adjustments	0.000	0.000
<b>Total Clean-Up Actions</b>	<b>\$0.005</b>	<b>\$0.272</b>
<b>Total Recommended Adjustments</b>	<b>\$2.828</b>	<b>\$2.828</b>

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

**URGENT FISCAL/PROGRAM NEEDS**

- ***Cybersecurity (Payment Card Industry Requirements) (\$275,000):*** Establishes a Cybersecurity appropriation totaling \$275,000. A portion of this funding (\$225,000) is needed to cover the cost of a Payment Card Industry (PCI) security audit, associated penalties, equipment, and software required to ensure compliance with PCI standards. The remaining portion of the funding recommendation (\$50,000) will ensure the Information Technology Department (ITD) has sufficient funding for the increased costs of network firewalls and to implement cybersecurity training city-wide. This funding will also provide City membership to the Arizona Cyber Threat Response Alliance (ACTRA), a cybersecurity alliance that provides information on how to address cyberattacks. In the upcoming months, ITD plans to use temporary resources within its existing budget to develop and implement new procedures and policies designed to protect enterprise communications, systems, and assets for both internal and external cyber threats.
- ***Office of Immigrant Affairs (Capacity Building and Streamlining Legal Defense for Families and Youth) (\$75,000):*** Increases funding to the Office of Immigrant Affairs by \$75,000 (from \$250,000 to \$325,000) to establish a one-time Capacity Building and Streamlining Legal Defense for Families and Youth Program to provide immigrant service delivery coordination and fill a service gap that exists until County programs are in place. On January 10, 2017, the City Council directed the City Administration to identify one-time funding to begin implementation of a coordinated response to immigrant needs. If approved, this funding will provide services to support receiving referrals from lead immigrant-serving community based organizations that are over capacity; referred case assessment; coordination with pro bono attorney's and law firms; tracking and monitoring cases; as well as additional communication, outreach, and collaboration efforts with San José school districts to create an efficient entry point to serve youth.

**REQUIRED TECHNICAL/REBALANCING ACTIONS**

- ***Business Tax System Replacement (\$185,000)/Finance Department Personal Services (-\$85,000):*** Increases the Business Tax System Replacement appropriation by \$185,000 (from \$584,000 to \$769,000). This project has been delayed due to changes in system needs resulting from the Business Tax Modernization ballot measure passed in November 2016, including alterations to the set-up and calculation methods behind billing. Because of this delay, additional funding is needed for staffing costs (\$85,000) and service order extensions for the system consultants (\$100,000) until the go-live date of May 1, 2017. A decrease to the Finance Department's Personal Services appropriation of \$85,000 is also recommended in this report to partially offset this cost.
- ***Parks, Recreation and Neighborhood Services Department (Water) (\$0):*** Increases the Parks, Recreation and Neighborhood Services Non-Personal/Equipment appropriation by \$1,100,000 (from \$4.3 million to \$5.4 million), due to water rate increases and increased usage in response to reduced conservation targets and community feedback that turf and sports fields are in poor condition. In addition, drought surcharges and true-up charges have

contributed to the increased water costs. A corresponding decrease to the Parks, Recreation and Neighborhood Services' Personal Services appropriation of \$1,100,000 is also recommended in this report to offset the increased water costs.

- ***Transfer to the Downtown Property and Business Improvement District Fund (City's Assessment) (\$17,000):*** Increases the transfer from the General Fund to the Downtown Property and Business Improvement District (PBID) Fund by \$17,000 (from \$727,007 to \$744,007) to account for the full amount due from the City. The 2016-2017 Adopted Operating Budget assumed a 3% assessment rate increase, however a 5% rate increase was approved by the PBID Board of Directors in April 2016. The General Fund pays the assessment for City-owned facilities and a contractually determined amount for the downtown transit mall.
- ***Transfer from the Neighborhood Security Bond Fund (Loan Repayment) (\$200,000 Revenue):*** Establishes a transfer from the Neighborhood Security Bond Fund to the General Fund totaling \$200,000. In the 2012-2013 Year-End Budget Review, the General Fund fronted \$200,000 to allow for a new contractor to be retained to complete the construction of Fire Station 24 (a Neighborhood Security Bond Fund project), which allowed for the fire station construction project to continue while the City was in a dispute with the original contractor. A mediated settlement between the City and the Guarantee Company of North America USA, the surety for the original Fire Station 24 contractor, has been received, therefore, this report includes a recommendation to repay the General Fund by transferring funds from the Neighborhood Security Bond Fund.
- ***Other Net Expenditure Adjustments (\$0):*** Includes a number of net-zero adjustments to align already approved revenue estimates and expenditure budgets with the most current tracking information, or reallocate funding among appropriations based on updated needs.
  - ***Homeless Rapid Rehousing (-\$100,000)/Homeless Response Team (\$100,000):*** Shifts \$100,000 from the Homeless Rapid Rehousing allocation to the Homeless Response Team to ensure sufficient funding is available for additional encampment cleanups that are needed. A corresponding decrease to the Homeless Rapid Rehousing appropriation is also recommended in this report, which has sufficient funding to accommodate the shift without impacting service delivery in 2016-2017.
  - ***Fire Department Personal Services (\$0):*** Shifts funding of \$4.0 million in anticipated 2016-2017 vacancy savings from the salary and benefits line items to the overtime line item, increasing the total overtime from \$9.5 million to \$13.5 million in the Fire Department. This adjustment will bring the budget in line with projected overtime expenditures and ensure that sufficient funding is available to maintain minimum staffing levels. Overtime has been used to backfill vacancies and absences in line duty positions (vacation, strike team deployments, modified duty, sick leave, disability, and other absences).
  - ***City Council District #02 Participatory Budgeting – Calpine Settlement/Council District #02 (\$0):*** As directed by the City Council on January 24, 2017, reallocates \$75,000 to the City Council District #02 Participatory Budgeting – Calpine Settlement which will fund

the Free Security Cameras and Signs for C.A.L.M.S Neighborhood allocation, which is a new neighborhood security camera project. A corresponding decrease to the Council District #02 appropriation is also recommended in this report.

#### GRANTS/REIMBURSEMENTS/FEES

- A series of revenue-supported adjustments totaling \$2.4 million (with a net-zero impact on the General Fund) are recommended to reflect new or updated revenues and expenditures for grants, reimbursements, and/or fee activities. The largest grants, reimbursements, and fees support the following: Parks, Recreation and Neighborhood Services Department grants and reimbursements (\$939,000); Fire Department reimbursements (\$731,000); Transportation Department reimbursements (\$300,000); Police Department grants and reimbursements (\$223,000); Library Department grants (\$162,000); Planning Development Fee Program Peak Staffing (\$70,000); Mayor and City Council sponsorship revenue (\$49,000); Public Works Development Fee Program electric vehicle purchase (\$30,000); and Office of Economic Development grants (-\$48,000).

#### CLEAN-UP ACTIONS

- ***Salary and Benefits Program (MPP and Health Programs) (\$0):*** Various actions are recommended to increase various department Personal Services appropriations for Management Pay for Performance Program (MPP) costs where departmental budgets are not tracking to generate sufficient vacancy savings to absorb these additional costs (\$1,395,000 all funds and \$1,171,000 General Fund). In addition, \$139,000 is being returned to the Development Fee Program Reserves due to their non-distribution. To offset these augmentations totaling \$1.3 million, this report includes recommendations to partially decrease the Salary and Benefits Reserve allocation in the General Fund that was set aside for the Management Pay for Performance Program in the 2016-2017 Adopted Budget and reduce the Ending Fund Balances in the Special Funds as appropriate. The savings in the General Fund of approximately \$256,000 will be used to assist in meeting the 2016-2017 Ending Fund Balance estimate used as an ongoing funding source in the Five-Year General Fund Forecast.

In addition, increases to various department Personal Services appropriations are recommended to accommodate the Health Program's lowest cost health plan rate increases (4.9%), effective January 1, 2017, where departmental budgets are not tracking to generate sufficient vacancy savings to absorb these additional costs (\$899,000 in all funds and \$844,000 in the General Fund). To offset these augmentations, decreases to the Salary and Benefits Reserve (\$844,000) and Development Fee Program Reserves (\$23,000) in the General Fund and reductions to Ending Fund Balances in the Special Funds are recommended. Because health rates were forecasted to increase 7.5%, but actually increased only 4.9%, savings of \$688,000 will remain in the Salary and Benefits Reserve. This funding will also be used to assist in meeting the 2016-2017 Ending Fund Balance estimate used as an ongoing funding source in the Five-Year General Fund Forecast and Proposed Budget.

- ***Transfers and Reimbursements - Interest Earnings (\$272,000)***: Increases the transfer of interest earnings from various Capital Funds to the General Fund based on actual collection trends.
- ***Other Net Clean-Up Adjustments (\$5,000)***: A technical adjustment is recommended to reflect an adjustment to the Mayor's Office rebudget to account for the final reconciliation of travel expenses in 2015-2016 that was completed after the rebudget adjustments were brought forward in the 2015-2016 Annual Report (\$5,000).
- ***Various Net-Zero Adjustments (\$0)***: To implement a variety of clean-up actions, a number of technical and net-zero adjustments are recommended, including the reallocation of funding between departmental expenditures, City-Wide Expenses, and revenue categories.

## **STATUS OF SELECTED SPECIAL AND CAPITAL FUNDS**

A comprehensive review of the special and capital funds as well as all of the capital projects is conducted as part of the 2016-2017 Mid-Year Budget Review. The special and capital funds are generally tracking within estimated levels through December. Section II of this report contains the status of selected special and capital funds with issues of interest or variances.

### **Special Funds**

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

- ***Airport Funds*** – Through December, the Norman Y. Mineta San José International Airport (SJC) has enplaned and deplaned 5.8 million passengers, an increase of 11.3% compared to the same period last fiscal year, and exceeds growth projections of 2.0%. Since 2016, SJC has announced or launched eight new destinations. New airlines and destinations in 2015-2016 included Air Canada to Vancouver, Alaska Airlines to Orange County and San Diego, American Airlines to Charlotte, and British Airways to London. In 2016-2017, SJC launched its first ever service from two international airlines: Lufthansa German Airlines to Frankfurt, Germany beginning July 2016 and Air China to Shanghai, China beginning September 2016. Along with the international destinations, new domestic service include Southwest Airlines to Baltimore and Salt Lake City beginning November 2016, JetBlue to Long Beach beginning January 2017, United Airlines to Chicago O'Hare and Newark beginning March 2017, and Alaska Airlines to Newark and Burbank beginning March 2017. These announcements reflect the extraordinary growth at the airport, which translates into jobs, economic growth, and opportunities for the community.
- ***Municipal Golf Course Fund*** – Revenues from the San José Municipal Golf Course totaled \$245,000 through December, which is slightly lower than the prior year actual of \$260,000 through December 2015. Based on historical tracking, it is anticipated that Municipal Golf Course revenues will end 2016-2017 slightly below budgeted levels. Expenditures in this fund are tracking to exceed the budget due to the additional costs (\$75,000) associated with a community outreach project consultant for the Los Lagos Golf Course as well as the higher

net losses at Los Lagos and Rancho del Pueblo Golf Courses (\$75,000). In response to the golf audit, a contract in the amount of \$75,000 was executed for a community outreach project consultant to provide translation services and to oversee the community engagement process for Los Lagos. The community outreach effort will inform the City's future strategy development regarding land use to maximize the value of the Los Lagos' open space relative to current costs and public benefits of operating a golf facility. Net operating losses for Los Lagos is tracking above 2015-2016 levels and total revenue-generating golf rounds are down by 5.0%. Net operating losses for Rancho del Pueblo Golf Course is also tracking higher than 2015-2016 levels and revenue-generating golf rounds are down by 9.0% at this site. Overall, the net losses are projected to exceed the budget at the Los Lagos Golf Course (\$25,000) and the Rancho del Pueblo Golf Course (\$50,000).

- **Water Utility Fund** – Through December, revenues totaled \$22.9 million, or 54.8% of the budgeted estimate. The largest (and most volatile) of these revenues is from the sale of potable water within the Municipal Water System service area. Year-to-date, revenue from potable water sales and services totaled \$19.4 million, or 54.0% of the budgeted estimate of \$35.9 million. However, revenues are projected to fall short of the budgeted estimate by approximately \$259,000 at year-end, due primarily to continued conservation and decreased water sales projected during winter 2017. Recycled water sales are tracking to end the year close to budgeted levels of \$5.5 million; however, this may change as the season progresses, and the extent of the increased storm activity and its effect on water conservation as a whole is known. Late Fees are also recorded in this fund and transferred to the General Fund as an unrestricted source of funds. Expenditures in this fund represent costs of the operation, improvement, and maintenance of the Municipal Water System, including transfers to the Water Utility Capital Fund, as necessary for capital improvements. Through December, \$20.7 million, or 45.7% of the budget, has been expended, and an additional \$1.9 million, or 4.3%, has been encumbered. Spending is lower than anticipated in several appropriations, with the largest savings expected in the Environmental Services Department (ESD) Personal Services appropriation because of vacant positions. Overall, expenses are expected to end the year slightly under budget and will offset lower revenues from water sales.

## **Capital Funds**

Following is a discussion of the major revenues that support the capital program and the major capital program expenditure revisions recommended in this report.

### *Construction-Related Revenues*

Private sector construction activity constitutes a significant source of tax revenues that are reinvested back into the City's transportation system infrastructure. As described in the "Economic Environment" section of this message, overall development activity in 2016-2017 is significantly exceeding expectations. Following is a discussion of the performance for the Building and Structure Construction Tax, Construction Excise Tax, the two largest construction-related revenue sources. These taxes are also an indicator of future activity for several other categories, such as the storm and sanitary sewer system fees.



- ***Building and Structure Construction Tax*** – Through December, Building and Structure Construction Tax receipts totaled \$13.3 million, which already exceeds the budgeted revenue estimate (\$13.0 million) by \$300,000. This collection level is 74.5% higher than receipts during the same time period in the previous fiscal year. Due to the strong tax performance in the first half of the fiscal year, it is anticipated the Building and Structure Construction Tax will exceed the budget estimate by \$11.0 million, totaling \$24.0 million by year-end. Though budget adjustments are not recommended as part of this report, the \$24.0 million estimate for 2016-2017 will be used in development of the 2017-2018 Proposed Capital Budget.
- ***Construction Excise Tax*** – Through December, Construction Excise Tax receipts totaled \$18.5 million, which is \$1.5 million over the budgeted revenue estimate of \$17.0 million. This collection level is 97.6% higher than receipts received during the same time period in the previous fiscal year. Due to the strong tax performance in the first half of the fiscal year, it is anticipated the Construction Excise Tax receipts will total \$32.0 million at year-end. Though budget adjustments are not recommended as part of this report, the \$32 million estimate for 2016-2017 will be used in development of the 2017-2018 Proposed Capital Budget.

#### *Construction and Conveyance Taxes*

A total of 17 Construction and Conveyance (C&C) Tax Funds are budgeted throughout the Capital Budget. A majority of these funds (13) support the Parks and Community Facilities Development Capital Program, with the remaining four funds supporting the Public Safety Capital Program, Library Capital Program, Service Yards Capital Program, and Communications Capital Program.

Nearly 99% of the total C&C Taxes are comprised of conveyance receipts, a tax based on the value of property transfers. C&C Tax revenues received through December total \$13.5 million, however, due to a timing issue, the December Conveyance receipts of \$3.9 million is not accounted for in this figure. After adjusting for the December tax collection, the revised year-to-date receipts total \$17.4 million, or 48.3% of the Adopted Budget estimate of \$36.0 million. Conveyance receipts through December 2016 are slightly below (1.1%) the receipts received during the same time period last year. In addition, Conveyance receipts for January have been received, which represents an additional decline (37.0%) compared to January 2016 Conveyance receipts. Although receipts are tracking lower than the previous fiscal year, it is anticipated they will exceed the budgeted estimate (\$36.0 million) and end the year with receipts of \$38.0 million. This collection level represents an 11.0% decline in tax revenue compared to the 2015-2016 actual collections of \$42.7 million. Though budget adjustments are not recommended as part of this report, the \$38.0 million estimate for 2016-2017 will be used in the development of the 2017-2018 Proposed Capital Budget

*Major Capital Program Expenditure Revisions*

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

- ***Airport Capital Program*** – A recommendation is included to establish a Terminal B Expansion Ramp appropriation in the amount of \$551,000 for reconstruction of the ramp area south of Terminal B to enable ground boarding of passengers when the Airport reaches peak capacity, offset by the Ending Fund Balance in the Airport Renewal and Replacement Fund. Actions also included are to reallocate \$823,000 of project savings in the Terminal A Ground Transportation Island Modification appropriation to the Federal Inspection Facility Sterile Corridor Extension (\$423,000) and Southeast Ramp Reconstruction (\$400,000) project appropriations. In addition, an increase to the Transfer to the Airport Fiscal Agent Fund from the Airport Revenue Fund in the amount of \$1,000,000, offset by a decrease in the Airline Agreement Reserve, is recommended to ensure that the Airport meets the minimum bond reserve requirements. This transfer is necessary to offset the temporary fluctuation of the investment value of the securities, which is used to help meet the bond reserve requirement.
- ***Public Safety Capital Program*** – A recommendation is included to increase the Self-Contained Breathing Apparatus (SCBA) in the Fire Construction and Conveyance Tax Fund by \$42,000 to provide funding for adequate inventory of SCBAs for the annual mask fit test in January 2017 as well as for the upcoming Firefighter Recruit Academy scheduled for April 2017. In addition, there is a recommendation to recognize \$214,167 of revenue related to a mediated settlement between the City and the Guarantee Company of North America USA, the surety for the original Fire Station 24 contractor. Of that amount, \$200,000 is recommended to be transferred to the General Fund, which fronted \$200,000 in the 2012-2013 Year-End Review to retain a new contractor to complete the construction. The remaining \$14,167 is recommended to be allocated to the Fire Station 37 (Willow Glen)/Other Capital Projects Reserve in the Neighborhood Security Bond Fund.
- ***Parks and Community Facilities Development Capital Program*** – A recommendation is included in this report to establish the Cannery Park Design Review and Inspection project and recognize revenue received from a developer (\$355,000). Cannery Park, a turnkey park being designed and constructed by a developer in fulfillment of its parkland dedication obligation, will be a new 1.0 neighborhood park near Mission Street and 10<sup>th</sup> Street. The Del Monte Park Expansion Phase III Land Acquisition allocation is being increased by \$188,000 to reflect higher than anticipated relocation costs (\$13,000) and an expansion of the project scope to include demolition costs (\$175,000). Finally, a recommendation to allocate \$150,000 to the Almaden Lake Park Playground Improvements project is included in this report. Project funding would allow new playground equipment to be installed at Almaden Lake Park and the existing rope structures to be removed, which have severely deteriorated and are causing safety concerns.

- ***Traffic Capital Program*** – This report includes recommendations to allocate revenues from Traffic Impact Fees received through December 2016 to the Route 101/Oakland/Mabury Impact Fees Reserve (\$2,885,363) and North San José Traffic Impact Fees Reserve (\$1,842,249). An increase to the Inter-Agency Encroachment Permit appropriation and corresponding estimate for Licenses and Permits Revenue by \$300,000 is needed to support inspection work for several large regional transportation projects. The Local Transportation and Policy Planning appropriation is recommended to be increased by \$250,000 to support a reevaluation of the City’s transportation impact analysis guidelines. This report includes a recommendation to increase the Pavement Maintenance – City project by \$250,000 to appropriate rebate revenue received from the State for the use of recycled tires in rubberized asphalt. In addition, anticipated project savings from East San José Bike/Pedestrian Transit Connection project (\$200,000) is recommended to be allocated to the Kirk Avenue Sidewalk Improvements project, which is being completed in partnership with the County of Santa Clara. Other budget adjustment recommendations include decreases to the Bikeways Program (\$500,000) and Bicycle and Pedestrian Facilities (\$128,000) to reflect revised project schedules.

### **PUBLIC OUTREACH/INTEREST**

This report is posted on the City’s website for the February 14, 2017 City Council meeting.

### **COORDINATION**

This report was coordinated with the various City Departments and Offices.

### **COMMISSION RECOMMENDATION/INPUT**

This report was not coordinated with any board or commission.

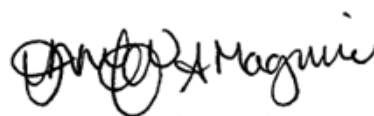
### **CONCLUSION**

Through December, the City’s over 100 operating and capital funds are generally performing within expected levels. The 2016-2017 Adopted Budget was built on the assumption that continued economic growth would be experienced in 2016-2017, and actual collection trends support this assumption. While economic indicators are generally positive, it is important to keep in mind that performance in a couple of the economically sensitive revenue categories, namely Sales Tax and Construction and Conveyance Taxes, are down from the prior year and those revenues will be important to monitor to determine if downward trends emerge.

As part of the Mid-Year Budget Review, budget adjustments are recommended in the General Fund and many special and capital funds to fund a very limited number of urgent fiscal/program needs, to bring projected revenues and expenditures into alignment based on performance

through the first half of the fiscal year, to account for updated cost projections, to implement technical adjustments, and to recognize various grants, reimbursements, and fees. The adjustments brought forward in this report reflect our best estimate of the financial performance of the City's funds based on activity through the first half of the fiscal year.

The Administration will continue to closely monitor performance and provide status reports on the City's budget through the Bi-Monthly Financial Reports. These reports will highlight any significant developments as well as identify any potential budget actions necessary to ensure the City's funds remain in balance by year-end. Diligent monitoring, continued budgetary discipline, and timely actions are critical components to maintaining the City's fiscal health.

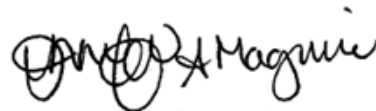
A handwritten signature in black ink, appearing to read "Jennifer A. Maguire". The signature is stylized and cursive.

Jennifer A. Maguire  
Senior Deputy City Manager/  
Budget Director

### Certification of Funds

I hereby certify that there will be available for appropriation in the designated funds and in the amounts as listed below in fiscal year 2016-2017 monies in excess of those heretofore appropriated therefrom:

Airport Fiscal Agent Fund	1,000,000
Benefit Fund	601,000
Community Development Block Grant Fund	2
Construction and Conveyance Tax Fund: Fire Protection Purposes	27,000
Construction and Conveyance Tax Fund: Library Purposes	14,000
Construction and Conveyance Tax Fund: Park Yards Purposes	16,000
Construction and Conveyance Tax Fund: Parks Purposes Central Fund	193,999
Construction and Conveyance Tax Fund: Service Yards Purposes	11,000
Construction Excise Tax Fund	5,212,070
Convention and Cultural Affairs Fund	429,952
Downtown Property and Business Improvement District Fund	17,000
General Fund	2,827,996
General Purpose Parking Fund	31,199
Gift Trust Fund	83,186
Multi-Source Housing Fund	1,839,596
Neighborhood Security Bond Fund	214,167
Residential Construction Tax Fund	7,000
Sewer Service and Use Charge Fund	372,004
Storm Drainage Fee Fund	3,000
Subdivision Park Trust Fund	355,000
Supplemental Law Enforcement Services Fund	213,946
Workforce Development Fund	226,554



Jennifer A. Maguire  
Senior Deputy City Manager/  
Budget Director