

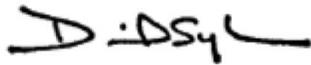
**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Margaret McCahan

**SUBJECT:** 2017-2018 ANNUAL REPORT

**DATE:** September 28, 2018

Approved



Date

09/28/2018

## RECOMMENDATION

It is recommended that the City Council:

- (a) Accept the 2017-2018 City Manager's Annual Report of the Finances of the City of San José in compliance with City Charter Section 701 (F).
- (b) Adopt Appropriation Ordinance and Funding Sources Resolution amendments in various operating and capital funds to implement the 2017-2018 Annual Report recommendations, including appropriate technical adjustments, as detailed in Section IV (Recommended Budget Adjustments and Clean-Up/Rebudget Actions).
- (c) Approve the following position changes in the Public Works Department:
  - (1) Add 2.0 Associate Engineer, 1.0 Associate Construction Inspector, 2.0 Engineering Technician II, and 1.0 Information Systems Analyst.
  - (2) Delete 1.0 Senior Geographic Systems Specialist.
- (d) Approve the addition of 1.0 Geographic Information Systems Specialist in the Department of Transportation.
- (e) Approve the addition of 1.0 Executive Analyst in the Office of Economic Development.
- (f) Approve the deletion of 1.0 Executive Analyst in the City Manager's Office.

## OUTCOME

In accordance with Section 701 (F) of the San José City Charter, the 2017-2018 Annual Report describes the financial status of the City at the end of the 2017-2018 fiscal year. As specified in the City Charter, the focus of the City Manager's Annual Report is a comparison of actual revenue collections and expenditures to projections and appropriations included in the City's budget. This will provide the City Council with the information necessary to review the financial performance of all City funds. In addition, this report provides a comparison of the actual 2017-2018 Ending Fund Balance for each fund to the estimates used in the development of the 2018-2019 Adopted

## **OUTCOME**

Budget as well as information on the status of the year-end reserve levels for each of the City's budgeted funds.

Approval of the recommended budget actions will implement required fund balance reconciliations and necessary rebudget and clean-up adjustments based on the final financial performance (unaudited) for 2017-2018. This report also includes actions that are necessary to: revise the 2018-2019 budget to align budgeted revenue and expenditures with the most current information; correct technical problems; recognize new or adjust existing grant, reimbursement or fee activity revenues and expenditures; fund one urgent fiscal/program need in the General Fund; reflect changes in project and program allocations based on revised cost estimates; and establish a limited number of new projects and programs in special and capital funds.

## **EXECUTIVE SUMMARY**

The Administration proactively managed over 100 budgeted funds in 2017-2018. Budget actions were brought forward during the year to ensure that revenues and expenditures remained in alignment with actual performance. Through this careful management, the various City funds generally ended the year with revenues close to the budgeted estimates and expenditures below the budgeted allocations.

With the local economy's sustained growth over the past several years, the City's budget remained stable. Accordingly, the 2017-2018 Adopted Budget maintained and, in limited instances, enhanced existing service levels. There were also a small number of additions in strategically important areas, capital investments in City infrastructure, and continued adherence to a multi-year approach to budgeting with one-time funding set aside in 2017-2018 to address a projected General Fund shortfall in 2018-2019. The City also continued to seek out innovative ways to efficiently deliver services. The 2017-2018 Adopted Budget also incorporated Program Budgeting and was produced using the City's new Hyperion Budget System. As always, the City will maintain its focus on rebuilding services within available resources to meet the needs of the San José community.

In the General Fund, both the revenues and expenditures ended the year very close to budgeted expectations. The 2017-2018 General Fund Ending Fund Balance of \$249.3 million exceeded the estimate of \$233.6 million used in the development of the 2018-2019 Adopted Budget by \$15.7 million. This variance represents only 0.5% of the 2017-2018 Modified Budget total sources and uses. These funds are recommended to be allocated in the 2017-2018 Annual Report as shown in the table on the following page.

**EXECUTIVE SUMMARY**

**Proposed 2018-2019 General Fund Adjustments (\$000s)**

<b>Additional 2017-2018 Ending Fund Balance</b>	<b>\$15,655</b>
<b>Clean-Up Actions</b>	
Development Fee Programs Reconciliation	(5,865)
Rebudgets/Clean-Up Adjustments	562
<b>Total Clean-Up Actions</b>	<b>(\$5,303)</b>
<b>Fund Balance Available After Clean-up Actions</b>	<b>\$10,352</b>
<b>Recommended Budget Adjustments</b>	
Required Technical/Rebalancing Actions	(4,795)
Grants/Reimbursements/Fee Activities (Sources = \$1.2M; Uses = \$1.2M)	0
Urgent Fiscal/Program Needs	(532)
<b>Total Recommended Budget Adjustments</b>	<b>(\$5,327)</b>
<b>Remaining Fund Balance After Clean-ups/Recommended Adjustments</b>	<b>\$5,025</b>
<b>Distribution of Remaining Fund Balance Per City Council Policy I-18</b>	
City Hall Network Operations Center Main Switchboard Replacement	(\$3,000)
Pavement Maintenance Program	(\$1,325)
Budget Stabilization Reserve	(\$700)
<b>Total Fund Balance Distributed Per Council Policy I-18</b>	<b>(\$5,025)</b>

When bringing forward recommendations for the use of the additional 2017-2018 General Fund Ending Fund Balance, the Administration considers clean-up actions associated with the close-out of the 2017-2018 fiscal year to be essentially non-discretionary and the highest priority. These clean-up actions result in a net decrease to the available fund balance of \$5.3 million and are broken down into two categories: changes to the Development Fee Programs reserves to reconcile actual 2017-2018 performance (decrease to fund balance of \$5.9 million); and adjustments to rebudget amounts that were carried over to 2018-2019 to complete projects and technical adjustments to other revenue and expenditure line items (net increase to fund balance of \$562,000).

After accounting for those clean-up actions, the additional General Fund 2017-2018 Ending Fund Balance was within \$10.4 million (0.3%) of the 2017-2018 Modified Budget (sources and uses). The remaining fund balance of \$10.4 million is recommended to fund various required technical/rebalancing actions (\$4.8 million) and one urgent fiscal/program need (\$0.5 million). The largest of these adjustments include the following: recognition of additional Sales Tax revenue of \$5.0 million to conservatively account for receipts due to the City in 2017-2018 that were not received; an increase to the Police Department overtime budget of \$4.0 million to primarily backfill sworn positions while Police recruits are in training; a reduction of \$2.1 million to the overhead reimbursements based on adjusted overhead rates; an increase of \$1.2 million to the City Hall HVAC Control System Replacement; and an increase of \$532,000 to the Fire Department overtime budget to support active shooter training.

## **EXECUTIVE SUMMARY**

After these adjustments, the remaining fund balance of \$5.0 million is recommended to be distributed in accordance with City Council Policy I-18. These funds are recommended to support unmet/deferred infrastructure needs, including the City Hall Network Operations Center Main Switchboard Replacement (\$3.0 million) and the Pavement Maintenance Program (\$1.3 million), and to increase the Budget Stabilization Reserve (\$0.7 million) from \$16.3 million to \$17 million. The recommended budget actions are summarized later in this message and described in *Section IV: Recommended Budget Adjustments and Clean-Up/Rebudget Actions*.

This report also addresses immediate needs in various special and capital funds, including adding funding for security improvements at Happy Hollow Park and Zoo, adding funding for targeted repairs and improvements at the Convention Center and other cultural facilities, net-zero funding shifts within the Parks Flood Remediation Program to address updated project costs, and a series of adjustments to fund the \$58.0 million Interim Terminal Facility Project with commercial paper rather than reserves.

As we move forward, the Administration will continue to monitor and report on the City's financial performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2017-2018 will also be factored into the development of the 2020-2024 General Fund Five-Year Forecast that will be released in February 2019.

## **BACKGROUND**

Each year the City issues the Annual Report at the end of September, three months after the close of the fiscal year, as required by the City Charter. Following is a description of the various sections of the Annual Report document.

- **Transmittal Memorandum** – This section provides an overall summary of the 2017-2018 Annual Report.
- **Section I: Financial Performance Summary (All Funds)** – This section provides a comparison of the 2017-2018 budget to actual revenues received and expenditures incurred by fund as well as an explanation of revenue and/or expenditure variances of 10% or greater to the budget. This section also provides a comparison of the year-end actual 2017-2018 Ending Fund Balance by fund to the 2017-2018 Ending Fund Balance/2018-2019 Beginning Fund Balance estimate used in the development of the 2018-2019 Adopted Budget. In addition, a listing of the Earmarked and Contingency Reserves that were available at the end of 2017-2018 by fund is included.
- **Section II: General Fund Financial Performance** – This section provides a summary of the General Fund performance in 2017-2018, including the following: Results of Operations in the General Fund; Revenue Performance; and Expenditure Performance.

## **BACKGROUND**

- **Section III: Selected Special/Capital Funds Financial Performance** – This section provides financial information on the 2017-2018 year-end performance for selected special and capital funds that represent major City operations. It includes a discussion of variances between actual and budgeted revenues and expenditures as well as a comparison between the actual ending fund balance and the fund balance estimated for 2017-2018 in the development of the 2018-2019 Adopted Budget.
- **Section IV: Recommended Budget Adjustments and Clean-Up/Rebudget Actions** – This section provides a description of the recommended budget adjustments and clean-up actions for City Council consideration. The proposed actions fall into three categories: (1) adjustments to the 2018-2019 Beginning Fund Balance amounts in various funds, including the General Fund, based on the final reconciliation of 2017-2018; (2) upward and downward adjustments to previously rebudgeted sums to ensure the appropriate amount of unexpended funds are carried over to 2018-2019 to complete projects; and (3) actions based on more recent information that are necessary to revise the 2018-2019 budget to align budgeted revenue and expenditures with the most current information, correct technical problems, recognize new or adjust grant, reimbursement or fee activity revenues and expenditures, fund one urgent fiscal/program need in the General Fund, and reflect changes in project and program allocations based on revised cost estimates as well as establish a limited number of new projects and programs in special and capital funds.
- **Section V: Financial Statements** – This section provides the financial results (unaudited), prepared by the Finance Department, for all budgeted fund groups for 2017-2018. It should be noted that audited financial results will be released later in the fall as part of the 2018 Comprehensive Annual Financial Report (CAFR) for Fiscal Year Ended June 30, 2018. Final fund balance reconciliations to the CAFR will be conducted for all funds and, while few adjustments are typically necessary, any final adjustments will be brought forward for City Council consideration as part of the 2018-2019 Mid-Year Budget Review.

## **ANALYSIS**

This Analysis section includes the following:

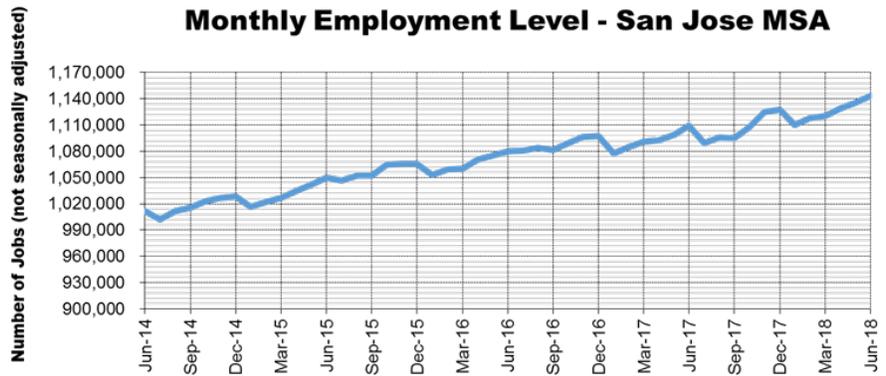
- an overview of the economic environment;
- a discussion of the 2017-2018 budget performance of all City funds;
- a discussion of the 2017-2018 budget performance for the General Fund;
- a discussion of the components of the 2017-2018 General Fund ending fund balance;
- an analysis of the impact of the General Fund performance on the 2018-2019 Adopted Budget; and
- a discussion of the 2017-2018 budget performance of selected special and capital funds.

**ANALYSIS**

**Economic Environment**

When the 2017-2018 Adopted Budget was developed, economic growth was expected to continue throughout the year. This assumption has proven true, with continued improvement in economic indicators and actual revenue performance during 2017-2018. Employment indicators, construction activity, median single-family home prices, and the number of days it took to sell these homes all performed well in 2017-2018.

The June 2018 employment level in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area (San José MSA) of 1.14 million was 3.0% higher than the June 2017 level of 1.11 million. Between June 2017 and June 2018, employment in the San José MSA expanded by 33,800 jobs.



This growth includes an increase of 8,800 jobs in the information sector, which signifies the 101<sup>st</sup> consecutive month of year-over-year increases.

<b>Unemployment Rate (Unadjusted)</b>		
	<b>June 2017</b>	<b>June 2018**</b>
San José Metropolitan Statistical Area*	3.4%	3.0%
State of California	4.8%	4.5%
United States	4.5%	4.2%
* San Benito and Santa Clara Counties Source: California Employment Development Department.		

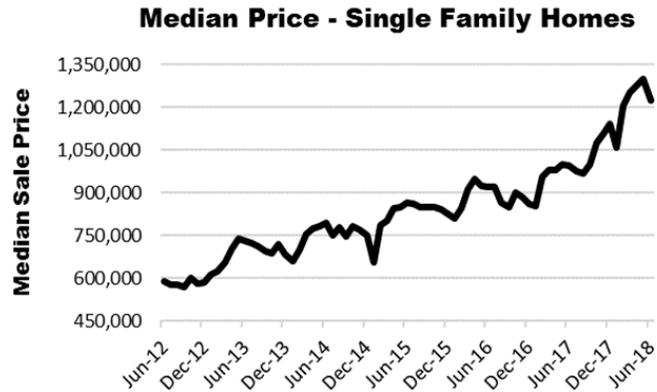
The unemployment rates at the local, State, and national levels have continued to slightly drop compared to the prior year and remain at very low levels. In June 2018, the unemployment rate for the San José Metropolitan Statistical Area of 3.0% was below the 3.4% experienced in June 2017. In this region, the June 2018 unemployment rate continued to be lower than the unadjusted unemployment rate for the State (4.5%) and the nation (4.2%).

Construction valuation was strong in 2017-2018 at \$1.7 billion, but decreased from the record setting level of \$1.9 billion reached in 2016-2017. The number of new residential dwelling units permits issued in 2017-2018 totaled 3,241, which was 19.5% above the prior year level of 2,712 permits issued. Construction activity in the residential category was higher than the prior year level, while commercial and industrial activity dropped. Private construction activity is a driver for several development related taxes and fees and is an indicator of future activity for several other categories, such as storm and sanitary sewer system fees.

## ANALYSIS

### **Economic Environment**

The local real estate market continues to experience strong growth in home prices compared to prior year levels. The median single-family home price in June 2018 of \$1.23 million is up 23.0% from the June 2017 price of \$996,000. It is also taking less time to sell these homes, with the average days-on-market for single-family and multi-family dwellings in June 2018 totaling 15 days, a drop from the 18 days experienced in June 2017. Also of interest is the continued tightening of inventory available in the housing market. The average number of new listings in 2017-2018 totaled 704, which is 6.0% below the average number of new listings recorded in the prior fiscal year. While the median home price has risen and the length of time to sell these more expensive homes has decreased, the number of property transfers (sales) has continued to drop. The number of property transfers in 2017-2018 totaled 7,513, which represents a 4.7% drop from the 7,883 transfers that occurred in 2016-2017. The decrease in the number of property sales compared to prior year levels is primarily attributable to the limited inventory available on the housing market.



### **2017-2018 Budget Performance (All Funds)**

As shown in Section I of this document, City revenues (excluding Beginning Fund Balances) totaled \$3.0 billion in 2017-2018, which was 2.9% (\$92.1 million) below the budgeted estimate of \$3.1 billion.

In 2017-2018, expenditures (excluding Reserves and Ending Fund Balances) totaled \$3.4 billion, which was \$546.4 million (13.9%) below the modified budget of \$3.9 billion. At the end of 2017-2018, the Contingency and Earmarked Reserves for all City funds totaled \$814.2 million, which represented 16.5% of the total 2017-2018 Modified Budget of \$4.9 billion (including interfund transfers, loans, and contributions). In the General Fund, Reserves totaled \$178.3 million.

The financial performance in 2017-2018 is used as the starting point for 2018-2019. The collective 2017-2018 Ending Fund Balances for all City funds totaled \$1.4 billion, which was \$84.1 million above the 2017-2018 Ending Fund Balance estimates of \$1.3 billion used in the development of the 2018-2019 Adopted Budget. After adjusting for additional rebudgets of \$31.8 million recommended in this report, the adjusted 2017-2018 Ending Fund Balance variance for all funds falls to \$52.3 million, or 1.1% of the 2017-2018 Modified Budget. The adjusted fund balance variance totaled \$10.4 million in the General Fund, \$57.8 million in the special funds, and -\$15.9 million in the capital funds.

**ANALYSIS**

**2017-2018 General Fund Budget Performance**

The City's General Fund ended the 2017-2018 fiscal year within budgeted levels. As shown in the chart below, the General Fund Ending Fund Balance of \$249.3 million was \$15.7 million (0.5% of the 2017-2018 Modified Budget total sources and uses) above the fund balance estimate assumed when the 2018-2019 Adopted Budget was developed. The following table summarizes the General Fund performance in 2017-2018, comparing the actual results to the modified budget and the estimates used to develop the 2018-2019 Adopted Budget.

**Table 1  
 General Fund Year-End Status  
 For the Year Ended June 30, 2018  
 (\$000s)**

<b>Sources</b>	<b>2017-2018 Modified Budget</b>	<b>2017-2018 Year-end Estimate</b>	<b>2017-2018 Budgetary Basis Actual</b>	<b>Actual to Budget Variance</b>	<b>Actual to Estimate Variance</b>
<i>Beginning Fund Balance</i>	241,173	241,173	241,173	-	-
<i>Carryover Encumbrances</i>	46,068	46,068	46,068	-	-
<i>Liquidation of Carry- over Encumbrances</i>	-	2,500	2,817	2,817	317
<i>Revenue</i>	<u>1,295,776</u>	<u>1,300,776</u>	<u>1,297,252</u>	<u>1,476</u>	<u>(3,524)</u>
<i>Total Sources</i>	<u>1,583,017</u>	<u>1,590,517</u>	<u>1,587,310</u>	<u>4,293</u>	<u>(3,207)</u>
<b>Uses</b>					
<i>Expenditures/Transfers</i>	1,404,722	1,362,805	1,338,020	(66,702)	(24,785)
<i>Reserves</i>	<u>178,295</u>	<u>(5,923)</u>	-	<u>(178,295)</u>	<u>5,923</u>
<i>Total Uses</i>	<u>1,583,017</u>	<u>1,356,882</u>	<u>1,338,020</u>	<u>(244,997)</u>	<u>(18,862)</u>
<i>Ending Fund Balance</i>	-	<u>233,635</u>	<u>249,290</u>	<u>249,290</u>	<u>15,655</u>

Note: In the chart above, the General Fund excludes the Emergency Reserve Fund and the Cash Reserve Fund, which are budgeted as separate funds and reflected separately in this document. In the 2018-2019 Comprehensive Financial Report (CAFR), the Emergency Reserve Fund and Cash Reserve Fund will be displayed as part of the General Fund to comply with GASB 54 reporting requirements.

In 2017-2018, total revenue in the General Fund was \$1.3 billion, which was within 0.1%, or \$1.5 million, of the 2017-2018 Modified Budget. However, when the 2018-2019 Adopted Budget was developed, it was assumed that revenues would exceed the modified budget by approximately \$5 million and would generate additional fund balance. Revenues fell short of this estimate by \$3.5 million due to the under-disbursement of Sales Tax revenue. The liquidation of prior year carryover encumbrances totaled \$2.8 million, which was \$317,000 above the \$2.5 million estimate.

General Fund expenditures/transfers of \$1.3 billion were \$66.7 million (4.7%) below the 2017-2018 Modified Budget level of \$1.4 billion and \$24.8 million (1.8%) below the estimate used to develop the 2018-2019 Adopted Budget. Budgeted reserves of \$178.3 million remained unexpended at year-end as expected. However, the Reserve balance estimate assumed as part of

## ANALYSIS

### **2017-2018 General Fund Budget Performance**

the 2018-2019 Adopted Budget was overstated due to the over-rebudget of the Development Fee Program Reserves. Downward rebudget adjustments totaling \$6.0 million are recommended to these reserves in the Annual Report to bring them into alignment with the balances available.

When comparing the actual revenue and expenditure performance to the estimates used to develop the 2018-2019 Adopted Budget, a portion of these variances is related to various grants and reimbursements that were not received in 2017-2018, but are expected to be received in 2018-2019. A total of \$3.8 million of grant and reimbursement revenues and expenditures were rebudgeted to 2018-2019 in the 2018-2019 Adopted Budget. This resulted in lower actual revenues and expenditures in 2017-2018, with no net impact to the General Fund. After factoring out the lower revenues and expenditures associated with these grants and reimbursements, revenues were slightly above the estimate (\$137,000; 0.01%) and expenditures savings totaled \$15.2 million (1.1%). Further adjustments to these figures are necessary to account for the recommended clean-up and rebudget actions in the Annual Report.

In this Annual Report document, budget actions are recommended to distribute the additional fund balance of \$15.7 million. Per City Council Policy I-18, when determining the proposed distribution of these funds, the first priority is to complete clean-up actions associated with the final reconciliation of 2017-2018. Recommended clean-up actions result in net decrease of \$5.3 million to the amount of funding available to distribute to reflect reconciliation of the Development Fee Programs (-\$5.9 million) and required expenditure rebudgets and other clean-up adjustments to close-out 2017-2018 (\$0.6 million). The adjusted figure of \$10.4 million in additional funding available to distribute was generated from net expenditure savings of \$12.4 million (0.9%) and higher than estimated liquidation of prior year encumbrances of \$317,000, partially offset by lower revenues of \$2.4 million (-0.2%).

Of the \$10.4 million available for distribution, \$5.3 million is recommended to be allocated to address various required technical and rebalancing actions (\$4.8 million) and one recommended urgent fiscal/program need (\$0.5 million). The remaining balance of \$5.0 million is recommended to be allocated per City Council Policy I-18 to address unmet/deferred infrastructure needs, including the City Hall Network Operations Center Main Switchboard Replacement (\$3.0 million) and the Pavement Maintenance Program (\$1.3 million), and to the Budget Stabilization Reserve (\$0.7 million), which are described later in this transmittal memorandum.

To identify revenue and expenditure trends, Table 2 below compares the City's budget performance in 2017-2018 with the budget performance of the prior year.

**ANALYSIS**

**2017-2018 General Fund Budget Performance**

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

	<b>2016-2017 Actuals</b>	<b>2017-2018 Actuals</b>	<b>Change</b>	<b>% Change</b>
<b>Source of Funds</b>				
Beginning Fund Balance	253,903	241,173	(12,730)	-5.0%
Revenues	1,108,260	1,297,251	188,991	17.1%
<b>Total Source of Funds</b>	<b>1,362,163</b>	<b>1,538,424</b>	<b>176,261</b>	<b>12.9%</b>
<b>Use of Funds</b>				
Personal Services	729,913	807,240	77,327	10.6%
Non-Personal/Equipment/Other	135,728	143,132	7,404	5.5%
City-Wide Expenses	217,142	305,844	88,702	40.8%
Capital Contributions	49,301	47,457	(1,844)	-3.7%
Transfers	28,068	34,347	6,279	22.4%
Reserves	-	-	-	N/A
<b>Total Use of Funds</b>	<b>1,160,152</b>	<b>1,338,020</b>	<b>177,868</b>	<b>15.3%</b>

As shown in Table 2, 2017-2018 General Fund revenues (excluding Beginning Fund Balance) of \$1.3 billion represent an increase of 17.1% from the 2016-2017 collection level of \$1.1 billion. The categories that experienced the largest increases included: Business Taxes, Other Revenue, Property Tax, Revenue from Local Agencies, Sales Tax, and Transient Occupancy Tax. This was due to economic performance as well as other contributing factors such as the Successor Agency to the Redevelopment Agency bond refunding that generated additional Property Tax and reimbursements, the full year implementation of the Local Sales Tax, and the modernization of the Business Tax. The City also issued \$150 million in Tax Revenue Anticipation Notes in 2017-2018, up from \$100 million in 2016-2017 (this revenue is offset by an associated TRANs debt service expenditure). The largest revenue declines from the prior year were experienced in the Fines, Forfeitures and Penalties and Utility Tax categories.

General Fund expenditures of \$1.3 billion in 2017-2018 were 15.3% (\$177.9 million) above prior year expenditure levels of \$1.16 billion. This increase is due to higher City-Wide Expenses (\$88.7 million), Personal Services (\$77.3 million), Non-Personal/Equipment/Other (\$7.4 million), and Transfers (\$6.3 million), partially offset by lower Capital Contributions (\$1.8 million). In the City-Wide Expenses category, the higher expenditure level was primarily the result of higher TRANs debt service payments (up \$50.9 million) and higher FMC debt service payments (up \$36.3 million due to the sale of the Airport West property and the pay down of debt).

A detailed discussion of the General Fund revenue and expenditure performance is provided in Section I of this document.

**ANALYSIS**

**2017-2018 General Fund Ending Fund Balance**

The current budgeting practice of the City is to use the projected level of fund balance expected to remain in the General Fund at the end of any fiscal year as a funding source for the following year. The Ending Fund Balance estimate always contains two components: the portion of the fund balance that is rebudgeted for completing projects or retaining reserves; and the portion which is undesignated and available as a general funding source in the coming year. In the 2018-2019 Adopted Budget, a total fund balance estimate of \$233.6 million was included as a funding source. As discussed earlier, the 2017-2018 General Fund Ending Fund Balance of \$249.3 million was \$15.7 million above this estimate.

The components of the 2017-2018 General Fund Ending Fund Balance include additional funding sources, expenditure/transfer savings, and unexpended reserves as described below:

**2017-2018 General Fund  
Ending Fund Balance Components**

<b>Fund Balance Component</b>	<b>\$ Amount (\$ in 000s)</b>
Additional Funding Sources	4,293
Expenditure/Transfer Savings	66,702
Unexpended Reserves	178,295
<b>TOTAL</b>	<b>\$ 249,290</b>

The total Sources of Funds ended the year \$4.3 million above the modified budget as a result of higher revenues (\$1.5 million) and liquidation of carryover encumbrances (\$2.8 million). For the Uses of Funds, expenditure and transfer savings totaled \$66.7 million, while unexpended reserves totaled \$178.3 million, representing the largest component of the 2018-2019 Ending Fund Balance. Of the \$66.7 million in expenditure savings, a majority of funding was rebudgeted in the 2018-2019 Adopted Budget (\$45.2 million) with additional funding being recommended for rebudget as part of this report (\$6.3 million).

General Fund Reserves, totaling \$178.3 million at the end of 2017-2018, include two categories: Earmarked Reserves (\$141.8 million) established to address specific needs per City Council direction; and the Contingency Reserve (\$36.5 million) set at a minimum of 3% of expenditures per City Council policy.

## ANALYSIS

### **2017-2018 General Fund Ending Fund Balance**

Following is additional information regarding the two reserve categories.

- ***Earmarked Reserves (\$141.8 million)*** – At the end of 2017-2018, the most significant reserves included the following: the 2017-2018 Ending Fund Balance Reserve (\$27.0 million); Building Development Fee Program Reserve (\$22.4 million); 2018-2019 Future Deficit Reserve (\$20.3 million); Budget Stabilization Reserve (\$16.3 million); Workers Compensation/General Liability Catastrophic Reserve (\$15.0 million); Fire Development Fee Program (\$7.6 million); Sick Leave Payments Upon Retirement Reserve (\$6.0 million); Salaries and Benefits Reserve (\$5.3 million); Public Works Development Fee Program Reserve (\$5.3 million); Cultural Facilities Capital Maintenance Reserve (\$4.4 million); and Retiree Healthcare Solutions Reserve (\$4.3 million). The majority of the Earmarked Reserves were either approved for rebudget or used as a funding source in the 2018-2019 Adopted Budget.

The 2017-2018 Ending Fund Balance Reserve of \$27.0 million was proactively set aside to help ensure sufficient fund balance would be available at the end of 2017-2018 to meet the budgeted estimate used in the development of the 2018-2019 Adopted Budget. Annually, as part of the development of the General Fund Forecast and Adopted Budget for the following year, a certain amount of current year unrestricted ending fund balance is estimated to be available at the end of the year as a funding source for the following year's budget. This ending fund balance is expected to be generated from additional revenues above budgeted levels, expenditure savings, and the liquidation of carryover encumbrances during the year. In the 2018-2019 Adopted Budget, it was assumed that \$32.6 million would be generated from these sources. The establishment of the 2017-2018 Ending Fund Balance Reserve of \$27.0 million set aside the majority of this funding, with the assumption that the remaining amount would be realized by year-end from a combination of excess revenues, expenditure savings and the liquidation of prior year carryover encumbrances.

- ***Contingency Reserve (\$36.5 million)*** – The City Council has established a budget policy of maintaining a minimum 3% Contingency Reserve in the General Fund. At the end of 2017-2018, the Contingency Reserve totaled \$36.5 million and had remained unspent during the year. As part of the 2018-2019 Adopted Budget, the full Contingency Reserve was rebudgeted in order to comply with the Council Policy of maintaining a minimum 3% Contingency Reserve in the General Fund. As part of this report, an increase to this reserve of \$500,000 is recommended to comply with the 3% funding requirement and would bring the 2018-2019 Contingency Reserve to \$37.0 million. It is important to note, however, that if this Contingency Reserve is ever needed, it is only sufficient to cover General Fund payroll expenditures for a couple of weeks in the event of an emergency.

## **ANALYSIS**

### **2017-2018 General Fund Ending Fund Balance**

As discussed above, it was assumed that \$233.6 million would remain in the General Fund at the end of 2017-2018 and would be carried over to 2018-2019 as Beginning Fund Balance as part of the adoption of the 2018-2019 Budget. These funds, which were expected to be generated from unexpended reserves, unexpended funds that were rebudgeted to 2018-2019, additional revenue, expenditure savings and the liquidation of carryover encumbrances, were programmed for use in the 2018-2019 Adopted Budget. The actual General Fund Ending Fund Balance was above the estimate used in the 2018-2019 Adopted Budget by \$15.7 million, due to excess revenues and additional expenditure savings, some of which are recommended to be rebudgeted as part of this report.

The following chart details the recommended uses of the \$15.7 million additional fund balance as well as other budget adjustments that are recommended as part of this report. Recommended clean-up actions will result in a decrease to the available fund balance by \$5.3 million, reflecting a downward adjustment of \$5.9 million to reconcile the actual performance of the Development Fee Programs in 2017-2018 and a net upward adjustment of \$562,000 to account for additional rebudget and clean-up actions to close-out 2017-2018. Once these adjustments have been accounted for, the net available fund balance available for allocation totals \$10.4 million. This additional fund balance is proposed to be allocated to address required technical/rebalancing needs as well as a very limited number of urgent fiscal/program needs in the current year.

**ANALYSIS**

**Impacts on the 2018-2019 General Fund Budget**

**PROPOSED 2018-2019 GENERAL FUND ADJUSTMENTS (\$000s)**

<b>Additional 2017-2018 Ending Fund Balance</b>	<b>\$ 15,655</b>
<b>Clean-Up Actions</b>	
Development Fee Programs Reconciliation	(5,865)
Rebudgets/Clean-Up Adjustments	562
<b>Total Clean-Up Actions</b>	<b>\$ (5,303)</b>
<b>Fund Balance Available After Clean-Up Actions</b>	<b>\$ 10,352</b>
<b>Recommended Budget Adjustments</b>	
<b>Required Technical/Rebalancing Actions</b>	
- Sales Tax (2017-2018 Underreporting)	5,000
- Urban Areas Security Initiative Grant - Police 2017	105
- Transfer from Water Utility Fund for Late Fees	92
- Parks, Recreation and Neighborhood Services Personal Services (St. James Park Staffing Funding Reallocation)	12
- Police Department Overtime Budget	(4,000)
- Transfers and Reimbursements - Overhead Rate Adjustments	(2,094)
- City Hall HVAC Control System Replacement	(1,200)
- Building Development Fee Program Reserve (OED Staff Funding Reallocation)	(598)
- Information Technology Non-Personal/Equipment (Converged or Hyper-Converged Infrastructure)	(504)
- Contingency Reserve	(500)
- Elections and Ballot Measures	(470)
- Local Sales Tax - Transfer to the Airport Revenue Fund (Jet Fuel Sales Tax)	(273)
- BeautifySJ Litter Pilot	(200)
- Workers' Compensation Claims System	(145)
- Vietnamese-American Community Center Planning and Fundraising Capital Project	(16)
- Fire Non-Personal/Equipment (City Matching Funds for Fire Prevention and Safety Grant)	(4)
<b>Sub-total Required Technical/Rebalancing Actions</b>	<b>\$ (4,795)</b>
<b>Urgent Fiscal/Program Needs</b>	
- Fire Department Active Shooter Training (Overtime Budget)	(532)
<b>Sub-total Urgent Fiscal/Program Needs</b>	<b>\$ (532)</b>
<b>Grants/Reimbursements/Fee Activities</b> (Sources = \$1.2 million; Uses = \$1.2 million)	<b>\$ 0</b>
<b>Total Recommended Budget Adjustments</b>	<b>\$ (5,327)</b>
<b>Remaining Balance After Recommended Budget Adjustments</b>	<b>\$ 5,025</b>
<b>Recommended Distribution of Remaining Fund Balance in Accordance with City Council Policy I-18*</b>	
- City Hall Network Operations Center Main Switchboard Replacement	(3,000)
- Pavement Maintenance Program	(1,325)
- Budget Stabilization Reserve	(700)
<b>Total Recommended Fund Balance Distributed per City Council Policy I-18</b>	<b>\$ (5,025)</b>
<b>Remaining Fund Balance Available</b>	<b>\$ 0</b>

\* These actions are reflected in the Recommended Budget Adjustments and Clean-Up/Rebudget Actions section of this report under Required Technical/Rebalancing Actions.

## **ANALYSIS**

### **Impacts on the 2018-2019 General Fund Budget**

A summary of the adjustments by category is included below. More detail is provided in *Section IV: Recommended Budget Adjustments and Clean-Up/Rebudget Actions*.

#### **Clean-Up Actions (-\$5.3 million)**

- **Development Fee Programs Reconciliation (-\$5.9 million)** –Year-end reconciliations of the revenues and expenditures in the Development Fee Programs are conducted to determine if revenues exceeded or fell below costs. To ensure that all development fees will be used solely to support development fee activities, any excess revenues and interest earnings above actual costs are placed in Development Fee Program Reserves. Based on 2017-2018 results, \$5.9 million is recommended to be added to the Development Program Fee Reserves (Building, Fire, Planning, and Public Works), preserving any net savings between revenues and expenditures in these programs.
- **Rebudgets/Clean-Up Adjustments (\$562,000)** – A series of adjustments are recommended to complete existing projects in 2018-2019 and to reflect any necessary technical budget adjustments or reconciliation actions. The Annual Report is the point in the budget process where action is required to rebudget unexpended funds from the prior year that were not anticipated when the Adopted Budget was approved, but are required to complete a project in the current year. Also recommended are actions that reduce previous rebudgets to reflect instances where expenditures, for which rebudgets were approved, actually occurred in 2017-2018, therefore, the funds are not available for rebudget to 2018-2019. Other technical adjustments include the reconciliation of restricted program funding (e.g. 4<sup>th</sup> Street Garage Banquet Facility Maintenance and Operations, Artificial Turf Capital Replacement, Certified Access Specialist Program, Contractual Street Tree Planting, General Plan Update, and Government Access activities).

#### **Recommended Budget Adjustments (-\$5.3 million)**

A number of General Fund budget adjustments, with a total net cost of \$5.3 million are recommended and can be classified under three categories: 1) Required Technical/Rebalancing Actions (net cost of \$4.8 million) that align already approved revenue estimates and expenditure budgets with the most current tracking information, reallocate funding among appropriations based on updated needs, to correct technical problems in the 2018-2019 Adopted Budget, or comply with actions previously authorized by the City Council; 2) net-zero Grants/Reimbursement/Fee Activities actions to recognizing new or adjust grant, reimbursement, or fee activity revenue, and adjust the appropriations for these purposes as appropriate; and 3) Urgent Fiscal/Program Needs (cost of \$532,000) brought forward for City Council consideration as part of this report, rather than later through the annual budget process, because the Administration has deemed the need cannot or should not wait until later in the year.

## ANALYSIS

### **Impacts on the 2018-2019 General Fund Budget**

- **Required Technical/Rebalancing Actions (-\$4.8 million)**
  - ***Sales Tax*** – increase the Sales Tax revenue estimate by \$5.0 million, from \$233.5 million to \$238.5 million to recognize additional General Sales Tax. The California Department of Tax and Fee Administration (CDTFA) implemented a new automated system in May 2018, which has resulted in 3<sup>rd</sup> and 4<sup>th</sup> quarter Sales Tax receipts for 2017-2018 not being fully disbursed to jurisdictions during the quarter in which the tax revenue was received. The CDTFA is processing the outstanding payments, and based on information from the City’s Sales Tax consultant, it is anticipated that the CDTFA will include the missed payments in the 1<sup>st</sup> or 2<sup>nd</sup> quarter 2018-2019 disbursements. The recommended increase to the 2018-2019 Sales Tax estimate conservatively accounts for the underpayment in 2017-2018. (\$5.0 million)
  - ***Police Department Personal Services*** – increase the Police Personal Services appropriation by \$4.0 million to address higher than budgeted costs due primarily to increased overtime. The Police Department has worked diligently to fill vacancies in both sworn and civilian positions. In 2017-2018, 176 positions were filled and placed in three Recruit Academies. Vacancy savings have been used to backfill positions in Patrol in recent years. However, as the Department has filled vacancies these savings have decreased. While the goal is to fill the vacancies and eliminate the need to backfill positions, new recruits are in academy training and field training for 10-12 months and are not available to respond to calls for service. Because overtime has been used to staff Patrol while the officers are in training, without the associated vacancy savings, Personal Services are projected to exceed the budget. (-\$4.0 million)
  - ***Transfers and Reimbursements Revenue Estimate*** – decrease the estimate for overhead reimbursements by \$2.1 million to recognize the impact of a recalculation of the overhead rated applied to various Special and Capital Funds. (-\$2.1 million)
  - ***City Hall HVAC Control System Replacement*** – increase the project budget by \$1.2 million (from \$7.8 million to \$9.0 million) to reflect the latest engineer’s estimate, inclusive of soft costs and contingency. Replacement parts for the current HVAC system are no longer manufactured, leaving the equipment at risk for failure. (-\$1.2 million)
  - ***Building Development Fee Program Reserve*** – increase the Building Development Fee Program Reserve by \$598,000 to reflect the savings from two positions that will no longer be funded by the Building Development Fee Program. The positions, a Senior Executive Analyst and an Executive Analyst that administer the Small Business Ambassador program, were inadvertently included in the costs of the Building Development Fee Program in the 2018-2019 Adopted Budget. These positions, however, should have been funded in the General Fund (non-fee supported). Personal services adjustments are also recommended to reflect this funding shift. (-\$598,000)

## ANALYSIS

### **Impacts on the 2018-2019 General Fund Budget**

- ***Information Technology Department Non-Personal/Equipment*** – increase the budget for the Technology Equipment Replacement to Converged or Hyper-Converged Infrastructure Project by \$504,000 to reflect higher than anticipated project bids and the inclusion of Software Defined Networking (SDN). This project replaces the Information Technology Department's central aging computers, storage, and virtualization equipment to converged or hyper-converged infrastructure technologies to support departmental needs for growth, business resumption, and reliability. (-\$504,000)
- ***Contingency Reserve*** – increase the Contingency Reserve by \$500,000, from \$36.5 million to \$37.0 million. Per City Council Policy I-18, Operating Budget and Capital Improvement Program Policy, the General Fund Contingency Reserve is to be set at a minimum of 3% of the operating budget. This adjustment will ensure compliance with the 3% funding requirement for the 2018-2019 Budget. The purpose of this reserve is to meet unexpected circumstances arising from financial and/or public emergencies that require immediate funding that cannot be met by any other means. (-\$500,000)
- ***Elections and Ballot Measures*** – increase the Elections and Ballot Measures appropriation by \$470,000, from \$2.2 million to \$2.7 million, to cover the cost of four city-wide measures in the November 2018 General Election. The 2018-2019 Adopted Budget included funding for two ballot measures. As approved by Council, the four ballot measures include: 1) Measure S: Construction Contract Procurement Modernization (modifies construction contract procurement and the City's bidding process); 2) Measure T: Disaster Preparedness, Public Safety, and Infrastructure Bond (issuance of General Obligation Bonds for the acquisition, construction, and completion of certain municipal improvements); 3) Measure U: 2018 Charter Amendments (related to Mayor and City Councilmember salaries and aligning the Charter with State law regarding competing measures in Municipal Elections); and 4) Measure V: Affordable Housing Bond (issuance of General Obligation Bonds for the acquisition, construction, and completion of affordable housing in the City of San José). 470,000)
- ***Local Sales Tax – Transfer to the Airport Revenue Fund (Jet Fuel)*** – increase the transfer to the Airport Revenue Fund by \$273,000 to account for Local Sales Tax revenue generated from jet fuel sales from October 2016 through June 2018 that had not yet been transferred to the Airport. Federal Aviation Administration (FAA) policy requires Sales Tax revenue from jet fuel sales located on Airport properties to be returned to the Airport. This policy applies to sales tax that went into effect after December 31, 1987, including the City's local Sales Tax. (-\$273,000)

## ANALYSIS

### **Impacts on the 2018-2019 General Fund Budget**

- ***BeautifySJ Litter Pilot*** – add funding in the amount of \$200,000 to support the BeautifySJ Litter Pilot Project. In the Mayor's March Budget Message for Fiscal Year 2018-2019, as approved by the City Council, the Administration was directed to examine the performance of the BeautifySJ landscape efforts and return with a recommendation for continuing or expanding the program in 2019-2020. As part of the pilot, the Administration identified a clear gap in the frequency of litter pick up in high trash load areas and recommends a creative and cost effective approach to test enhanced litter pick up through transitional employment agencies, such as Downtown Streets Team and the Goodwill. The \$200,000 allocation would be used to fill the gap in the frequency of litter pick up, and test the effectiveness of transitional employment services in providing the service at a more manageable cost. The effectiveness of the pilot program will be evaluated as part of the overall direction to examine performance of the BeautifySJ landscape efforts as part of the 2019-2020 budget process. (-\$200,000)
  
- ***Workers' Compensation Claims System*** – establish a Workers' Compensation Claims System appropriation to the Human Resources Department in the amount of \$145,000. The City Council approved a completely outsourced workers' compensation model on June 19, 2018. At that time, the budget for 2018-2019 did not include funding to maintain the current workers' compensation claims system (Navarisk) beyond the transition. An appropriation of \$145,000 is required to provide funding for this contract through 2018-2019. City staff are examining the City's options for termination of the Navarisk contract. (-\$145,000)
  
- ***Other Recommended Adjustments*** – several small adjustments resulting in a net increase of \$189,000 are recommended. These include: a decrease to the Urban Areas Security Initiative Grant – Police 2017 appropriation to correct the budget as the grant was inadvertently appropriated twice in the 2018-2019 Adopted Budget (\$105,000); an increase to the Transfers and Reimbursements revenue estimate to recognize a transfer from the Water Utility Fund to reflect additional Late Fee revenue received in 2017-2018 in the Water Utility Fund (\$92,000); the reallocation of St. James Park staffing costs from the General Fund to the St. James Park Management District Fund (\$12,000); and increase to Vietnamese-American Community Center Planning and Fundraising Capital Project to reflect funding received in 2017-2018 from the San José Parks Foundation (-\$16,000); and an increase to Fire Department Non-Personal/Equipment budget to provide matching funds for the Fire Prevention and Safety Grant (-\$4,000). (\$189,000)

## ANALYSIS

### **Impacts on the 2018-2019 General Fund Budget**

- ***Net-Zero Adjustments/Position Adjustments*** – Several net-zero adjustments are recommended to reallocate funding between Personal Services and Non-Personal/Equipment allocations to deliver services as well as to shift 1.0 Executive Analyst position (Housing Catalyst position added in 2018-2019) from the City Manager’s Office to the Office of Economic Development. In addition, technical adjustments are recommended to implement the actions brought forward to the City Council on June 26, 2018 associated with the Funding and Reimbursement Agreements with Mobilitie and Verizon for small cell permitting. These include the net addition of five positions in the Public Works Department and one position in the Transportation Department and some of the associated net-zero budget actions. Because the position changes and some budget actions were inadvertently omitted from the City Council Agenda, these actions need to be brought forward for City Council approval. (\$0)
  
- **Grants/Reimbursements/Fees (\$0)**
  - A series of net-zero adjustments (net revenues of \$1.2 million offset by net expenditures of \$1.2 million) are recommended to recognize new and updated revenues and expenditures for ***Grants, Reimbursements, and/or Fees*** for the following Departments: Public Works (net-zero expenditure adjustments of \$954,000); Parks, Recreation and Neighborhood Services (revenues and expenditures of \$502,000); Police (revenues and expenditures of \$398,000); Fire (revenues and expenditures of \$162,000); Mayor and City Council (revenues and expenditures of \$136,000); and Library (revenues and expenditures of \$18,000). These adjustments are further described in *Section IV. Recommended Budget Adjustments and Clean-Up/Rebudget Actions*.
  
- **Urgent Fiscal/Program Needs (\$532,000)**
  - This action increases the Fire Department’s Personal Services appropriation by \$532,000 to support staffing costs (overtime) for Active Shooter Training required under AB 1598. This funding will cover overtime for the 6.0 trainers to be trained and to conduct the trainings (\$86,000), and for 624 sworn staff to have 8 hours of active shooter training (\$446,000). AB 1598, filed in September 2014, amended the Health & Safety Code and the Penal Code relating to emergency response services to require the development collaborative protocols and relationships between local and state fire first response entities, including law enforcement agencies, fire departments, and emergency medical service providers and agencies, so these entities will act effectively, and in concert, to address active shooter incidents. This funding provides for the first of these trainings, with four-hour refresher courses to be provided every 18 months, for an annual estimated cost of \$137,000. Given the other scheduled trainings in 2018-2019, this course cannot be absorbed within the existing training allocation as initially envisioned.

## **ANALYSIS**

### **Impacts on the 2018-2019 General Fund Budget**

#### **Recommended Distribution of Remaining Fund Balance per City Council Policy I-18 (-\$5.0 million)**

Per Council Policy I-18, Operating Budget and Capital Improvement Program Policy, any ending fund balance that may be available after the close of the 2017-2018 fiscal year will be allocated 50% for unmet/deferred infrastructure and maintenance needs and 50% to offset any projected deficit for the following fiscal year. Based on the February 2018 Forecast, it is currently estimated that the General Fund will face a shortfall of approximately \$15.5 million in 2019-2020. To fully address this projected shortfall on a one-time basis, the 2018-2019 Adopted Budget includes a 2019-2020 Future Deficit Reserve of \$15.5 million. Because the 2019-2020 Future Deficit Reserve is fully funded, the remaining funds can be allocated to the following: Budget Stabilization Reserve and/or Contingency Reserve, unmet/deferred infrastructure and maintenance needs, and/or other one-time urgent funding needs. The remaining Ending Fund Balance of \$5.0 million is recommended to be allocated to unmet/deferred infrastructure needs and the Budget Stabilization Reserve as follows:

- ***City Hall Network Operations Center Main Switchboard Replacement*** – increase the project budget by \$3.0 million, from \$2.0 million to \$5.0 million, to support the final phase of the project, including the purchase and installation of equipment to transition the existing system to the Uninterrupted Power Supply. Any maintenance to the sole UPS system would take it offline, leaving the Network Operations Center (NOC) reliant on Pacific Gas and Electric power only. Should there be a power loss during that time, the emergency generator would not restore power for a period of seven seconds, which would crash the servers. The sole switchboard serving the NOC is served by one breaker, which cannot be maintained without shutting down the entire NOC. (-\$3.0 million)
- ***Pavement Maintenance Program*** – increase the project General Fund appropriation by \$1.325 million to advance the paving and repair of streets throughout the City. (-\$1.325 million)
- ***Budget Stabilization Reserve*** – increase the Budget Stabilization Reserve by \$700,000, from \$16.3 million to \$17.0 million. The purpose of this reserve is to provide budget stability when there are fluctuations that result in lower than projected revenues and/or higher than projected expenditures that cannot be rebalanced within existing budget resources in any given year.

## ANALYSIS

### 2017-2018 Selected Special/Capital Funds Budget Performance

#### Airport Operating Funds

The Airport served 13.5 million passengers in 2017-2018, which was an overall increase of 17.2% from 2016-2017. Moreover, the 17.2% growth in annual enplanements at the Airport in 2017-2018 far exceeded the estimated level of 3.0%. For 2018-2019, passenger growth is anticipated to increase over the 13.5 million passengers in 2017-2018.



Additional airport activity categories that demonstrated growth as compared to last year include pounds of mail/freight/cargo, traffic operations, landed weights, gallons of aviation fuel sold, parking exits, and ground transportation trips.

Overall, revenue performance exceeded budget by \$14.9 million (9.6%). Airline Rates and Charges (combined total of landing fees and terminal rents) and all other operating categories, excluding transfers, ended the year at \$170.5 million, which was \$14.9 million above the budget of \$155.6 million. The positive variance is mainly attributed to the Parking & Roadway revenue category, which was above the budgeted estimate by \$9.2 million (18.1%) due to higher revenues from both economy and daily (long-term) parking and ground transportation, as well as Terminal Building Concession revenue, which was above the budgeted estimate by \$3.5 million (18.4%) associated with increased passenger levels.

The Airport Customer Facility and Transportation Fee Fund (Fund 519) and Airport Maintenance and Operating Fund (Fund 523) had a combined year-end expenditure savings of \$8.5 million (7.1%) compared to the budgeted levels of \$119.7 million. The \$2.9 million in personal services savings were the result of position vacancies experienced during the year. The non-personal/equipment expenditure savings of \$2.1 million resulted primarily from prioritizing needs and the terminal program. Additionally, the elimination of the Airport Reserve for Retiree Healthcare resulted in an additional \$893,000 of year-end savings. The higher revenue and expenditure savings resulted in a lower than anticipated transfer from the Airport Revenue Fund to the Airport Maintenance and Operating Fund. This allowed for paying down some variable rate commercial paper debt, which resulted in interest savings.

**ANALYSIS**

**2017-2018 Selected Special/Capital Funds Budget Performance**

**Self-Insured Medical Fund**

The Self-Insured Medical Fund was established in November 2016 for a plan effective date of January 1, 2017. Revenue in 2017-2018 ended the year slightly below (\$135,000) estimated levels at \$14.0 million. Expenditures ended the year below estimated levels at \$13.5 million (4.0%). As a result, the actual 2017-2018 total ending fund balance was \$429,000 above the estimate used in the development of the 2018-2019 Adopted Budget. While the fund ended the year in a slightly better position, budget adjustments were necessary in 2017-2018 to lower the revenue estimate to reflect the decline in enrollment and increase the Payment of Claims appropriation. Because this fund would have not been able to cover its costs in 2017-2018, a transfer of \$1.65 million from the General Fund was approved as part of the 2017-2018 year-end process to ensure the fund closed with a positive fund balance.

With continued lower revenues and higher expenditures, a \$3.0 million transfer from the General Fund to the Self-Insured Medical Fund was included in the 2018-2019 Adopted Budget. The Human Resources Department continues to actively pursue options to this self-funded plan and is working with the benefits consultant to evaluate alternative stop loss insurance limits to provide better coverage for large claims.

**Capital Fund Major Revenues**

A number of taxes and fees levied on construction and property resale (conveyance) activity provide a large source of revenue to the City’s Capital program. Except for the Sanitary Sewer Connection Fee, the 2017-2018 actual collections in these capital revenue categories ended the year above budgeted estimates. The chart below provides a comparison of estimated revenues to actual revenues for these types of revenues, and a discussion of the three largest revenue sources follows.

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

	<b>2017-2018 Estimate*</b>	<b>2017-2018 Actuals</b>	<b>% Variance</b>
Construction and Conveyance Tax	\$42,000	\$48,127	14.6%
Building and Structure Construction Tax	\$21,000	\$21,466	2.2%
Construction Excise Tax	\$29,000	\$29,359	1.2%
Municipal Water System Fees	\$75	\$247	229.3%
Residential Construction Tax	\$200	\$328	64.0%
Sanitary Sewer Connection Fee	\$700	\$526	(21.0%)
Storm Drainage Connection Fee	\$200	\$324	62.0%

\* Revenue estimate used in the development of the 2018-2019 Adopted Capital Budget.

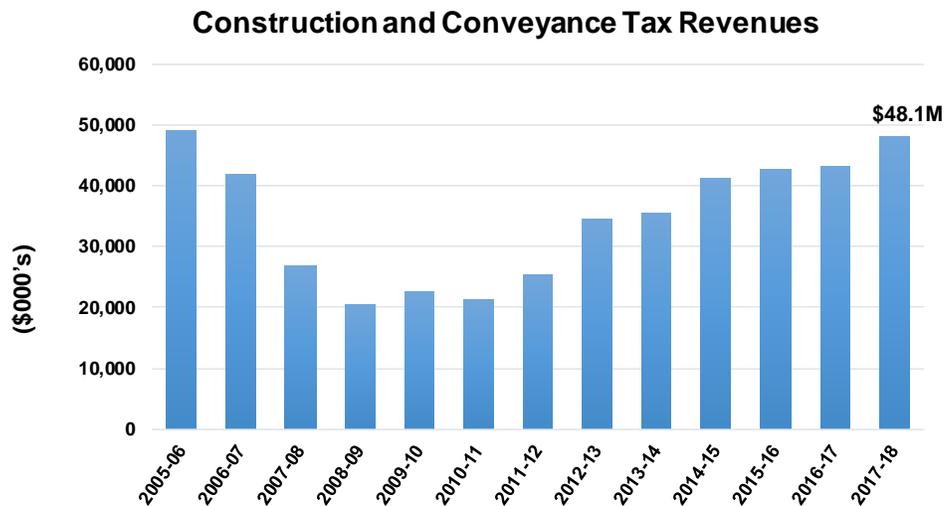
**ANALYSIS**

**2017-2018 Selected Special/Capital Funds Budget Performance**

• **Construction and Conveyance Tax**

Real estate activity (primarily housing re-sales) determines the collection level of one of the major capital revenue sources, the Construction & Conveyance (C&C) Tax. Approximately 99% of C&C Tax is derived from a tax imposed upon each transfer of real property, with the remaining 1% generated from a construction tax levied on most types of construction. C&C Tax revenues, which are a significant source of funds for the Parks and Community Facilities Development, Library, Fire, Service Yards, and Communications capital programs, totaled \$48.1 million in 2017-2018. This collection level was \$4.8 million (11.1%) above 2016-2017 collections of \$43.3 million, and \$6.1 million (14.6%) above the estimate of \$42.0 million that was assumed in the development of the 2018-2019 Adopted Capital Budget. The 2018-2019 Adopted Capital Budget was developed with the assumption that C&C tax receipts would total \$42.0 million in 2017-2018 and decrease to \$38.0 million in 2018-2019. With the stronger than anticipated performance in 2017-2018, the 2018-2019 C&C Tax revenue estimate allows for a 21.0% from 2017-2018 receipts. Collections in 2018-2019 will be closely monitored, and any necessary adjustment will be brought forward later in the fiscal year.

The following graph displays the history of Construction and Conveyance (C&C) Tax receipts.



The 2017-2018 tax receipts represent the highest collection level since the peak of \$49 million in 2005-2006. Changes in home prices and the number of sales are major drivers of C&C Tax receipts. The median home price for single family homes within the City increased from \$996,000 in June 2017 to \$1.225 million in June 2018, which represents a 23.0% increase. However, the number of home sales (single-family and multi-family dwelling units) decreased 4.7% from 7,883 in 2016-2017 to 7,513 in 2017-2018. Finally, the amount of time it takes to sell a home (single-family and multi-family dwelling units) decreased from an average of 18 days in June 2017 to an average 15 days in June 2018.

**ANALYSIS**

**2017-2018 Selected Special/Capital Funds Budget Performance**

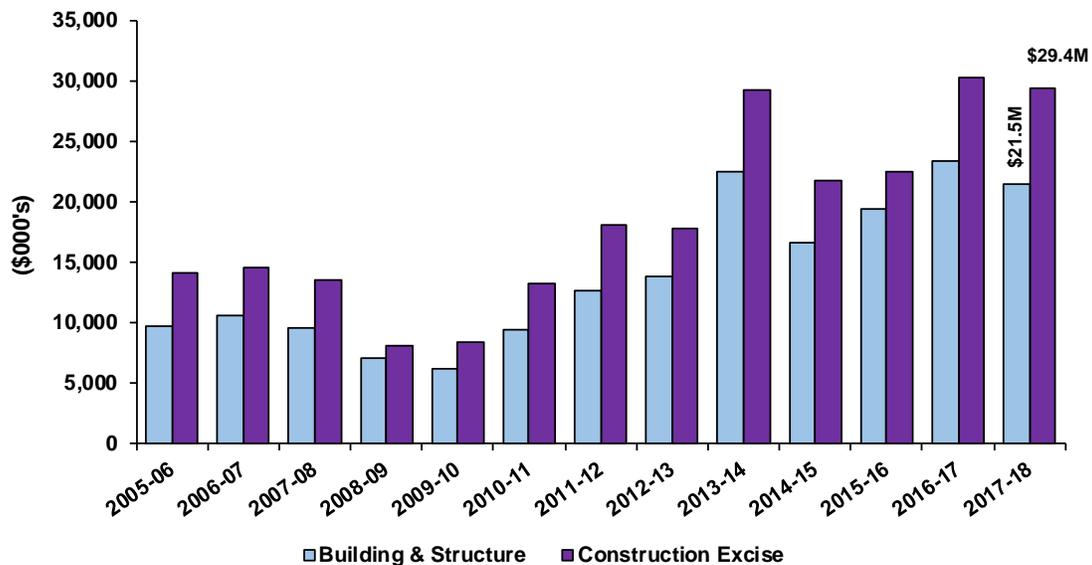
**Capital Fund Major Revenues**

• **Building and Structure Construction Tax and the Construction Excise Tax**

The Building and Structure Construction Tax and the Construction Excise Tax are major sources of funding for the Traffic Capital Program. Year-end collections in the Building and Structure Construction Tax category totaled \$21.5 million in 2017-2018. This collection level was 2.2% (\$500,000) above the revenue estimate of \$21.0 million used to develop the 2018-2019 Adopted Capital Budget, but \$1.9 million lower than the \$23.3 million received in 2016-2017. Construction Excise Tax receipts for 2017-2018 totaled \$29.4 million, 1.2% (\$400,000 million) above the revenue estimate of \$29.0 million used to develop the 2018-2019 Adopted Capital Budget, representing a 2.8% (\$829,000) decrease from 2016-2017 collections of \$30.2 million.

The graph on the following page displays the collection history of both the Building and Structure Construction Tax and Construction Excise Tax receipts. Valuation activity in 2016-2017 surpassed the historically high levels of 2013-2014, setting a new peak, and revenue growth has continued its upward trend from the low in 2009-2010. The status of these volatile taxes will be closely monitored throughout 2018-2019 to determine if budget actions are necessary to revise the revenue estimates

**Construction Tax Revenues**



## **ANALYSIS**

### **2017-2018 Selected Special/Capital Funds Budget Performance**

#### **Special and Capital Funds Budget Adjustments**

Several budget adjustments for both special and capital funds are included in this report, including recognition of grants, net-zero transfers/reallocations, new allocations for a small number of high priority projects and programs, and required fund rebalancing activity.

The Convention and Cultural Affairs Fund reserves total \$2.5 million for future capital improvements to convention and cultural affairs facilities, and provides funding of \$477,000 for targeted repairs and improvements, including: upgrading audio cores, speakers, and touchscreen monitors for digital signage (\$340,000) at the San José McEnery Convention Center, replacing door walls with integrated smoke detectors (\$50,000) and an obsolete portable wheel chair lift (\$40,000) at the San José McEnery Convention Center, replacing structural side arms for lighting fixtures (\$25,000) at the Center for the Performing Arts, replacing washers and dryers (\$12,000) that support multiple venues, and replacing stage and pony wall curtains (\$10,000) in the Montgomery Theater. In addition, \$400,000 is provided through the Convention Center Facility District Capital Fund to install protective stainless steel diamond plate covers for the 21 remaining concrete columns in the San José McEnery Convention Center that have not been addressed through prior authorized projects.

Included in this report are several recommended adjustments in the Parks and Community Facilities Development Capital Program. An allocation of \$309,000 to modify the traffic signal at Story Road and Remillard Court to support pedestrian and bicycle travel, offset by an elimination of the land acquisition project at the Bellevue Park (\$309,000) due to unavailability of land acquisition from private party. Other actions include an allocation of \$259,000 for higher than expected costs for a security fence and video security system at Happy Hollow Park and Zoo. The 2017 Parks Flood Projects, which rehabilitate City parks and recreation facilities damaged by the February 2017 storm event, reallocated funding within the flood remediation program to address updated project costs with a zero net impact to the original Parks budget of \$23.4 million.

In the Airport Capital Program, actions are recommended to fund the Interim Terminal Facility project using \$58.0 million of commercial paper instead of Airport reserves. Transactions during the year-end process facilitated the use of Airport reserves to allow the project to quickly proceed. On August 28, 2018, the City Council approved use of the Commercial Paper Program for the addition of the six gates; thereby preserving Airport reserves for other emergency needs. The new gates are planned to open in the summer of 2019. A notable adjustment in the Traffic Capital Program is the funding of \$300,000 allocated from the Route 101/Oakland/Mabury New Development Reserve to provide support for the transportation study in the Berryessa BART Urban Village area to inform the Urban Village and Flea Market South planning efforts. This work will result in clear direction for a balanced transportation system that advances implementation of the Envision San José General Plan and the Urban Village vision for the area by improving access for all modes in ways that complement the desired urban design.

## **ANALYSIS**

### **2017-2018 Selected Special/Capital Funds Budget Performance**

#### **Special and Capital Funds Budget Adjustments**

The Municipal Improvements Capital program includes an allocation of \$1.2 million to the City Hall HVAC Project, increasing the total project funding from \$7.8 million to \$9.0 million. The revised amount is based on the latest engineer's estimate, including soft costs and contingency. Replacement parts for the current HVAC system are no longer manufactured, leaving the equipment at risk for failure. Also included is an allocation of \$3.0 million for the City Hall Network Operations Control (NOC) Center Switchboard Replacement, increasing the budget from \$2.0 million to \$5.0 million, to fund the final phase of the project. The final phase will include the purchase and installation of equipment to transition the existing system to the uninterrupted power supply. Currently, a power loss would not restore power for a period of seven seconds, which would crash the network servers. The sole switchboard serving the NOC is served by one breaker, which cannot be maintained without cutting power and shutting down the entire NOC.

Finally, the rebudget of unexpended funds for projects and programs extending into 2018-2019 is recommended in this report. Details of these adjustments can be found in Section IV of this report.

#### **NEXT STEPS**

The results of the 2017-2018 Annual Report will provide an updated starting point for monitoring 2018-2019 financial performance, with the observed revenue and expenditure trends factored into the analysis of the General Fund and numerous special and capital funds. Information on the City's budget for 2018-2019 will be provided in the Bi-Monthly Financial Reports and the 2018-2019 Mid-Year Budget Review.

The 2017-2018 Annual Report results will also be factored into the 2019-2020 budget development process. The General Fund Five-Year Forecast is scheduled to be released in late February 2019. The 2019-2020 Proposed Capital and Operating Budgets are scheduled to be released on April 22, 2019 and May 1, 2019, respectively.

#### **PUBLIC OUTREACH/INTEREST**

This document is posted on the City's website for the October 16, 2018, City Council agenda.

#### **COORDINATION**

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

### **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

### **CONCLUSION**

Through careful fiscal management, overall revenues for the various City funds ended the year close to estimated levels and expenditures were below budgeted allocations. When the 2017-2018 Adopted Budget was developed, it was assumed that economic growth would continue. Economic indicators and actual revenue performance supported this general assumption, with a number of revenue categories, such as Property Tax, Transient Occupancy Tax, and Construction and Conveyance Tax, experiencing strong growth. Those revenue categories associated with private development and construction projects, such as development-related fees and taxes, also continued to experience solid performance in 2017-2018.

In the General Fund, the additional fund balance at the end of 2017-2018 after considering clean-up adjustments totaled \$10.4 million. Recommendations are included in this report to allocate those funds to various required technical and rebalancing actions (\$4.8 million) and to address an urgent fiscal/program need (\$532,000). In addition, net-zero adjustments to various grants, reimbursements and fee activities are included along with a series of technical adjustments. After these adjustments, the remaining fund balance of \$5.0 million is recommended to be distributed in accordance with City Council Policy I-18. These funds are recommended to support unmet/deferred infrastructure needs, including the City Hall Network Operations Center Main Switchboard Replacement (\$3.0 million) and the Pavement Maintenance Program (\$1.3 million), and to increase the Budget Stabilization Reserve (\$0.7 million) from \$16.3 million to \$17 million.

The Administration will continue to monitor and report on the City's budget performance through the Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2017-2018, as well as the actual performance in 2018-2019, will be factored into the development of the 2019-2020 budget. The 2020-2024 General Fund Five-Year Forecast will be released in February 2019 for budget planning purposes.



Margaret McCahan  
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 2018-2019 monies in excess of those heretofore appropriated therefrom:

General Fund	\$20,905,072
Airport Passenger Facility Charge Fund	\$4,015,488
Airport Revenue Bond Improvement Fund	\$58,546,763
Airport Revenue Fund	\$514,557
Benefit Funds – Life Insurance Fund	\$5,738
Benefit Funds – Self-Insured Medical Fund	\$353,221
Benefit Funds – Unemployment Insurance Fund	\$160,256
Branch Libraries Bond Projects Fund	\$500,340
Building and Structure Construction Tax Fund	\$13,531,458
Business Improvement District Fund	\$22,224
Cash Reserve Fund	\$21
City Hall Debt Service Fund	\$773,150
Community Development Block Grant Fund	\$1,781,496
Community Facilities District Fund #1	\$38,197
Community Facilities District Fund #11	\$4,736
Community Facilities District Fund #12	\$139,657
Community Facilities District Fund #13	\$49,154
Community Facilities District Fund #14	\$16,502
Community Facilities District Fund #15	\$18,735
Community Facilities District Fund #16	\$140,799
Community Facilities Revenue Fund	\$933,998
Construction and Conveyance Tax – Central Fund	\$477,465
Construction and Conveyance Tax – Communications	\$275,819
Construction and Conveyance Tax – Fire	\$1,564,754
Construction and Conveyance Tax – Library	\$1,293,966
Construction and Conveyance Tax – Council District 1	\$412,405
Construction and Conveyance Tax – Council District 2	\$487,046
Construction and Conveyance Tax – Council District 3	\$138,958
Construction and Conveyance Tax – Council District 4	\$303,598
Construction and Conveyance Tax – Council District 5	\$503,402
Construction and Conveyance Tax – Council District 6	\$272,904
Construction and Conveyance Tax – Council District 7	\$477,880
Construction and Conveyance Tax – Council District 8	\$717,676
Construction and Conveyance Tax – Council District 9	\$239,074
Construction and Conveyance Tax – Council District 10	\$223,710
Construction and Conveyance Tax – Parks Yards	\$207,599
Construction and Conveyance Tax – Service Yards	\$630,152
Construction Excise Tax Fund	\$22,841,428

**CERTIFICATION OF FUNDS**

Contingent Lien District Fund	\$879,239
Convention and Cultural Affairs Fund	\$3,572,721
Convention and Cultural Affairs Capital Fund	\$3,151,203
Convention Center Facilities District Revenue Fund	\$2,934,169
Convention Center Facilities District Capital Fund	\$979,173
Downtown Property and Business Improvement District Fund	\$151,813
Emma Prusch Fund	\$13,435
General Purpose Parking Fund	\$2,715,401
General Purpose Parking Capital Fund	\$8,902,599
Home Investment Partnership Program Fund	\$3,319,479
Housing Trust Fund	\$528,626
Ice Centre Revenue Fund	\$2,375,818
Improvement District Fund	\$24,884
Integrated Waste Management Fund	\$264,957
Lake Cunningham Fund	\$13,714
Library Parcel Tax Fund	\$1,416,209
Library Parcel Tax Capital Fund	\$137,407
Low and Moderate Income Housing Asset Fund Maintenance District Fund #1	\$12,530,549
	\$50,207
Maintenance District Fund #13	\$24,416
Maintenance District Fund #19	\$14,287
Maintenance District Fund #20	\$8,952
Maintenance District Fund #21	\$2,096
Major Facilities Fund	\$475,955
Municipal Golf Course Fund	\$331,032
Neighborhood Security Bond Fund	\$164,006
Parks and Recreation Bond Projects Fund	\$2,381,357
Public Works Program Support Fund	\$1,001,701
Residential Construction Tax Contribution Fund	\$139,517
San José Arena Capital Reserve Fund	\$1,502,047
San José-Santa Clara Treatment Plant Capital Fund	\$10,143,336
San José-Santa Clara Treatment Plant Operating Fund	\$437,149
Sanitary Sewer Connection Fee Fund	\$865,183
Sewage Treatment Plant Connection Fee Fund	\$349,527
Sewer Service and Use Charge Fund	\$569,984
Sewer Service and Use Charge Capital Improvement Fund	\$9,553,353
South Bay Water Recycling Capital Fund	\$3,691,000
St. James Park Management District Fund	\$709,206
State Drug Forfeiture Fund	\$62,221
Storm Drainage Fee Fund	\$69,889
Storm Sewer Capital Fund	\$3,648,690
Subdivision Park Trust Fund	\$2,304,505
Transient Occupancy Tax Fund	\$4,102,938

**CERTIFICATION OF FUNDS**

Underground Utility Fund	\$3,920,127
Water Utility Fund	\$1,085,701
Water Utility Capital Fund	\$49,902
Workforce Development Fund	\$932,672



Margaret McCahan  
Budget Director