CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **2008-2009 MID-YEAR BUDGET REVIEW REPORT**

DATE: January 30, 2009

RECOMMENDATIONS

1. Approval of the 2008-2009 Mid-Year Budget Review Report.
2. 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) in the 2008-2009 Mid-Year Budget Review.
3. Approval of the net elimination of 88.5 positions, comprised of the elimination of 52.0 positions in the Airport Department, the elimination of 3.0 positions in the Fire Department, the elimination of 2.0 positions in the Police Department, the elimination of 28.5 positions in the Public Works Department, the elimination of 9.0 positions in the Transportation Department, offset by the addition of 6.0 positions in Environmental Services Department as described in Section III of the 2008-2009 Mid-Year Review document.

OUTCOME

The Mid-Year Budget Review document is designed to provide an understanding of the City's financial condition during the first six months of 2008-2009. Approval of the budget actions included in the Mid-Year Budget Review will rebalance funds that have been impacted by the severe economic downturn, address current year funding needs, fund various grant-supported activities, and process technical adjustments and corrections.

EXECUTIVE SUMMARY

The Administration is actively managing the City's funds to ensure the continued fiscal health of the City. Despite the difficult economic environment, the City's overall finances remain in relatively sound condition through December with the majority of funds performing within anticipated levels. The severe economic downturn, however, has negatively impacted the performance of a number of City funds, including the General Fund.

The adjustments recommended in this document are designed to bring projected revenues and expenditures into alignment in those funds where there is a high degree of certainty that without such actions there would be a significant negative impact. Given the extreme uncertainty and volatility regarding the economy, additional adjustments may be necessary before the close of the fiscal year. Actions are also proposed to ensure the City is better positioned to address the budget shortfalls projected for next year.

With the rebalancing actions approved for the Building and Planning Development Fee Programs by the City Council on January 27, 2009 and the Mid-Year rebalancing actions contained in this report, difficult decisions have already begun to maintain the fiscal health of the City's funds. In the several funds and programs that are required to be reduced at mid-year, service delivery impacts were carefully weighed to formulate the Administration's recommendations. As we move forward into 2009-2010, the deepening recession will clearly necessitate more significant budget reductions to balance the General Fund as well as a number of other City funds. In November 2008, the General Fund Structural Deficit Elimination Plan identified a base shortfall of $86 million over the next two years that increases to $98 million once the unmet/deferred infrastructure needs are included. It is likely that these deficit figures will get worse when the final 2010-2014 General Fund Forecast is released at the end of February. Diligent monitoring and continued fiscal discipline will be critical during this challenging period.

Mid-Year Budget Adjustment Highlights

Following is a summary of the budget adjustments recommended in the Mid-Year Budget Review.

- ***General Fund:*** The recommended budget actions contained in this report result in a net reduction of $9.0 million to the General Fund revenues and expenditures. Adjustments are proposed to bring revenue estimates in line with current projections, adjust expenditure budgets to meet current needs and produce year-end savings, and to recognize various grants and reimbursements.

  Revenue adjustments include a net decrease of $9.2 million based on revised projections reflecting the impact of the recession on City revenue. Not surprisingly, the largest downward adjustments are proposed in the economically sensitive categories including Sales Tax, Transient Occupancy Tax, Use of Money and Property (Interest Earnings), and Property Tax. In addition, there are a number of other adjustments with offsetting expenditure actions, including: a decrease of $3.5 million to the transfer from the Construction Excise Tax Fund to rebalance that fund; a decrease of $1.0 million to the Fire Development Fee Program revenue estimate to reflect lower development activity; and upward adjustments of $4.6 million to reflect various grants and reimbursements and other adjustments.

  To offset the reduction in revenues projected this year and to begin setting aside ending fund balance assumed available for use in 2009-2010 in the most recent General Fund Forecast, a number of expenditure adjustments are recommended. The largest adjustment would generate $9.4 million in savings from the implementation of current year expenditure reductions submitted by departments in the form of Cost/Position Management Plans. Other adjustments include the elimination of the $5.8 million Street Maintenance and Repair Reserve set aside as part of the 2007-2008 Annual Report actions, and a reduction of $1.4

million to various City-Wide and Capital projects where the funding is no longer necessary. To meet the 2008-2009 ending fund balance estimate used in the development of the 2009-2010 Preliminary Forecast, $16.5 million in expenditure savings is necessary. As a result of the actions described above, a portion of this total ($6.3 million) can be set aside at mid-year as a down payment toward achieving the ending fund balance, a critical funding source for 2009-2010. Additional funding is also recommended for Fire Department training ($0.8 million), and other required adjustments ($0.5 million).

- ***Airport Funds:*** Activity levels at the Airport reflect the severe disruption that the Airline industry is experiencing nation-wide. As a result, passenger traffic, landings, cargo weights, and rental car activity are all below prior year levels. To account for this drop in activity, revenue estimates were reduced by 10% as part of the 2007-2008 Annual Report actions. Budget adjustments are proposed now to begin addressing the significant $35 million deficit projected for both 2009-2010 and 2010-2011 and would also be available to offset any lower revenue collections in the current fiscal year. As part of the 2008-2009 Mid-Year Report, actions are recommended to eliminate 52 positions, of which 6 are filled, and to reduce non-personal/equipment funding for savings of $7.2 million. In agreements made with the rental car companies and airlines, the use of $2.2 million from two rate stabilization reserves is also recommended to help mitigate the impacts of the economy on these Airport partners.

- ***Convention Facilities and Cultural Affairs Fund:*** Operating revenues in this fund are tracking below estimated levels with an anticipated $1.3 million year-end shortfall. This is due to a combination of a decline in 2008-2009 activity ($400,000) and an estimated bad debt expense ($900,000), due in large part to the recent bankruptcy of American Musical Theater. To address the anticipated revenue shortfall, actions are recommended to reduce expenditures by $400,000 and the ending fund balance by $900,000. Additionally, a transfer from the Personal Services allocation ($1.0 million) to the Non-Personal/Equipment allocation is recommended to better align the budget with contract labor costs. It should be noted that the decline in Transient Occupancy Tax revenue in the current year will also have a direct negative impact on the Ending Fund Balance as the 2009-2010 Proposed Budget is developed. The actions recommended in this document are not anticipated to have a significant impact on the overall financing plan for the Convention Center Expansion Project.

- ***Community Facilities Revenue Fund (Hayes Mansion):*** Revenues generated at the Hayes Mansion are tracking below estimated levels through the first half of 2008-2009. To partially offset this lower collection level, the operator of the facility, Dolce, has developed a cost containment strategy that is expected to generate expenditure savings of approximately $500,000. In addition, the action approved by City Council earlier this year to pay off the Comerica line of credit has resulted in lower interest costs ($150,000) and has made available $50,000 that was required to be set aside by the Comerica Bank line of credit agreement. It should be noted that if current trends continue and revenue declines further, the General Fund transfer may need to be increased in the 2009-2010 budget.

- ***Housing Funds:*** The volatility in the financial markets has impacted the City's ability to sell bonds at favorable rates. Actions are recommended in the Low and Moderate Income

Housing Fund to address the possibility that $85 million in bond proceeds may not be received this fiscal year. Funding will remain, however, to support current City Council committed projects. Budget adjustments within the Housing Funds are also recommended to address a cash flow issue in the Multi-Source Housing Fund resulting from State action that temporarily froze $3.4 million in pending reimbursements.

- ***Municipal Golf Course Fund:*** Activity at both the Los Lagos and Rancho del Pueblo Golf Courses are tracking below anticipated levels. This has resulted in lower than estimated net profit for the Los Lagos Golf Course (no net profit assumed in the Adopted Budget for Rancho del Pueblo Golf Course) and higher than projected operating subsidies for both golf courses as payments to the operators are required in the months when revenues do not cover fixed operation costs. This document includes recommendations to decrease the revenue estimate for Los Lagos Golf Course by 30% ($190,000) to reflect the lower net profit, and increase the Los Lagos ($50,000) and the Rancho Del Pueblo ($75,000) operating subsidy appropriations. These adjustments would be offset by a decrease to the ending fund balance in the Municipal Golf Course Fund. To the extent that this activity trend continues, the 2009-2010 General Fund subsidy may need to be increased.

- ***Traffic Capital Funds:*** Development-related taxes that support the Traffic Capital Program are tracking well below expected levels due to significant declines in development activity. To address these lower collection levels, actions are recommended to decrease the Building and Structure Construction Tax revenue estimate by $2.2 million from $8.7 million to $6.5 million and to decrease the Construction Excise Tax revenue estimate by $6.0 million from $13.0 million to $7.0 million. Rebalancing actions in the Traffic Capital Program are recommended to offset this revenue reduction and include reduced transfers to the General Fund (offset by various General Fund expenditure reductions), funding shifts, project deferrals or eliminations, and the elimination or funding shifts of 10.75 positions (of which six positions are filled). The actions recommended in this document rebalance these funds for 2008-2009. The lower revenue collections will also significantly impact the upcoming 2010-2014 Capital Improvement Program.

- ***Construction and Conveyance Tax (C&C) Funds:*** Revenue adjustments include a decrease of $4.0 million from the $23.0 million budgeted in the 2008-2009 Adopted Budget to $19.0 million, reflecting the impact on City collections of the drastic decline in home prices. With the exception of the Fire C&C Tax Fund, funds have sufficient ending fund balance to offset the revenue reduction. Rebalancing actions are necessary in the Fire C&C Tax Fund with reductions to special projects recommended. Moving forward, the lower revenues will impact the projects that can be funded in the 2010-2014 Capital Improvement Program. The planning efforts underway, however, have factored in this lower collection level.

- ***Other Capital Funds:*** Downward revenue adjustments due to the decreased level of development activity are also recommended for Sanitary Sewer Connection Fees, Storm Drainage Fees, Residential Construction Taxes, and Underground In-Lieu Fees. The reallocation of project funds to other sources or sufficient ending fund balances in the corresponding funds are available to offset these revenue reductions. The lower revenue levels will also impact the development of the 2010-2014 Capital Improvement Program.

- ***Position Impacts:*** To implement the various required rebalancing plans, a net reduction of 88.5 positions (12 filled) is recommended as part of this Mid-Year Budget Review. This is in addition to the 52 positions (28 filled) eliminated in the Planning and Building Development Fee Programs by City Council action on January 27, 2009.

In addition to the actions recommended in this document, there are three separate memoranda that are scheduled to be discussed as part of the Mid-Year Budget Review. These memoranda recommend the following: 1) approval of revisions to the Arts Stabilization Loan Fund Guidelines; 2) a $3 increase to the parking penalty fees to enable the City to comply with the requirements of SB1407 without a negative impact on the General Fund; and 3) changes to the Public Entertainment Permit Ordinance and the Zoning Ordinance to a) allow the City to recover costs associated with police enforcement of the Public Entertainment Permit Ordinance in the Downtown Entertainment Zone and b) allow bars and nightclubs in the Downtown Entertainment Zone to stay open until 2:30 a.m. under the Soft Closing Program.

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 document complies with that policy. It contains a comprehensive review of the status of the City's 2008-2009 Operating and Capital budgets. City Council review of this report is agendized for the February 10, 2009 Council meeting.

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

- **Transmittal Memorandum** – An overall summary of the contents of the Mid-Year Budget Review Report.

- **Section I: Operating Budget Status Report** – A review of the General Fund revenues and expenditures through Mid-Year and a review of selected special funds that have revenue and/or expenditure variances from the modified budget or other issues of interest.

- **Section II: Capital Budget Programs Status Report** – A review of the financial status of each Capital Budget Program.

- **Section III: Recommended Budget Adjustments and Clean-up Actions** – A summary of the proposed budget augmentations/reductions in the General Fund and special/capital funds, including impacts of the Cost/Position Management Plans. A summary of clean-up adjustments in a number of funds is also included to provide technical appropriation and revenue estimate adjustments.

- **Section IV: Appendix** – Financial results, prepared by the Finance Department, for all budgeted fund groups for the first six months of the year.

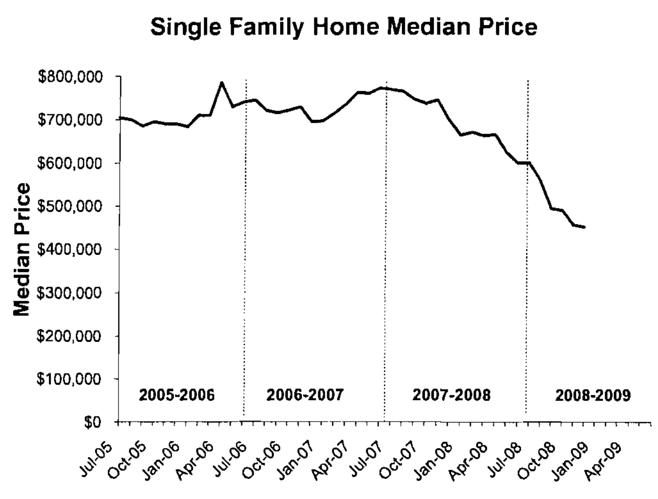
ANALYSIS

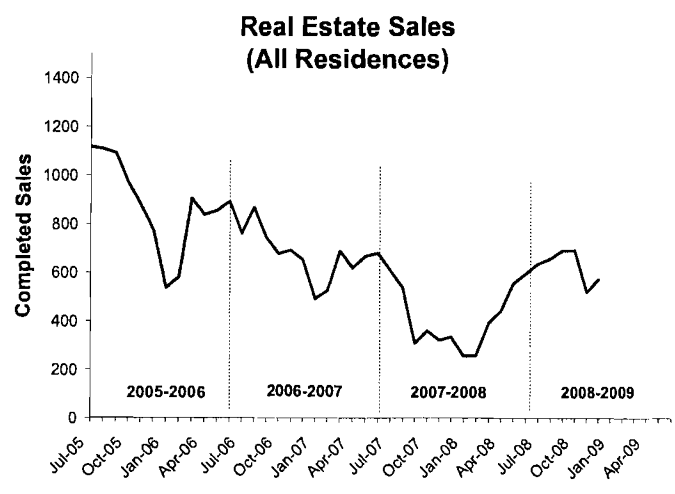
The Analysis section includes the following: an overview of the current economic environment; a discussion of General Fund performance through December; a summary of proposed General Fund budget revisions included in the Mid-Year Budget Review document; a summary of the Cost/Position Management Plan impacts; the status of selected special funds; an overview of capital budget programs; status on two City Council referrals associated with the Crossing Guard Program and the Airport West property proceeds; and next steps in the budget process.

ECONOMIC ENVIRONMENT

When the 2008-2009 Adopted Budget was prepared, it was assumed that an economic slowdown would impact the city for the entire fiscal year and that, as a result, only low levels of economic growth would be experienced during the fiscal year. The impacts of the slowing housing market, the sub-prime mortgage problems, and the rising cost of fuel were expected to continue to hamper growth in this region, along with the State and the nation. What was not foreseen, however, was how quickly and how severely these problems would worsen, plunging the economy into a deep global recession. In fact, many forecasters are now warning that this downturn is likely to set a new postwar record for length and is likely to be more painful than any recession since 1980-1981. Others even predict an economic disruption exceeding any experienced in this country since the Great Depression.

Through the first half of the fiscal year, the economic indicators are alarming. For example, the median home price for single family homes within the City dropped 35% from $699,000 in December 2007 to $452,000 in December 2008. The December 2008 figure represents the lowest median home price within the City since spring 2004. With the home prices dropping significantly, there has, however, been an increase in the number of transfers. In December, the property transfers for all types of residences were up 52% from the extremely low level experienced in December 2007.





It is expected that the housing market will continue to experience weak performance well into the next fiscal year and will negatively impact Construction and Conveyance Tax receipts and the Property Tax receipts. The significant slowdown in this area along with the overall slowdown in the economy is also expected to negatively impact Sales Tax collections. The only questions are how severe the drop will be and for how long a period of time.

Job growth in the area has also started to decline and the unemployment rate continues to move upwards. The labor market continued to deteriorate in December with job losses on a local and national level. December 2008 employment figures for the San Jose Metropolitan Statistical Area of 910,600 were below both November 2008 (916,700) and December 2007 (921,600) levels. On a national level, total non-farm payroll employment fell by 524,000 in December, bringing the total job losses in 2008 to 2.6 million, the highest job loss total since 1945. The majority of these job losses (1.9 million) occurred in the last four months of the year (Source: Bureau of Labor Statistics).

Unemployment Rate (Unadjusted)

	Dec. 2007	**Nov. 2008**	**Dec. 2008**
San José Metropolitan Statistical Area	5.1%	7.2%	7.8%
State of California	5.9%	8.3%	9.1%
United States	4.8%	6.5%	7.1%

Source: California Employment Development Department

The unemployment rate in the San José metropolitan area continues to increase with a rate of 7.8% in December 2008. This figure is up significantly from 5.1% a year ago. When comparing the December 2008 unemployment rate in this region with the State and the nation, this area fares better than the State that has an unadjusted unemployment rate of 9.1%, but is slightly worse than the nation, which currently has an unadjusted unemployment rate of 7.1%.

On a national level, the Conference Board Consumer Confidence Index fell to a new all-time low in December 2008 after a moderate increase in November 2008. The overall outlook remains very negative. "The further erosion of the Consumer Confidence Index reflects the rapid and steep deterioration of economic conditions that occurred in the fourth quarter of 2008....The overall economic outlook remains quite dismal for the first half of 2009, and only a modest recovery is expected in the second half," says Lynn Franco, director of The Conference Board Consumer Research Center.

Looking forward, it is very difficult to predict the potential impacts from the economic bailout packages, the extraordinary efforts being undertaken by the federal government and the Federal Reserve to stabilize the economy, and actions that the new Obama Administration may formulate. In this environment, economic conditions will need to be closely monitored and factored into the assessment of the City's performance in 2008-2009 as well as development of the final 2010-2014 General Fund Forecast. In November 2008, a preliminary forecast was released that projected a General Fund shortfall of almost $60 million in 2009-2010. Considering the City's unmet/deferred infrastructure needs, the deficit grows to $65 million for next year. This forecast was based on very limited data and will be refined as additional information becomes available. A review of the events which have taken place since that Forecast was prepared almost ensure that the shortfall projected for 2009-2010 will worsen. A final 2010-2014 Five-Year General Fund Forecast is scheduled to be released in February 2009.

GENERAL FUND PERFORMANCE

General Fund revenues and transfers through December totaled $320 million, or 39% of the budgeted estimate. While revenues to date were tracking only slightly below projected levels, receipts are expected to experience more significant declines in the second half of the fiscal year as a result of the deepening recession. The economically sensitive revenue categories that are expected to end the year below the budgeted estimates include Property Tax, Sales Tax, Transient Occupancy Tax, Business Tax, Motor Vehicle In-Lieu, and Use of Money and Property. The development-related fees are also expected to fall well below Adopted Budget levels. The lower collections in these categories are expected to be partially offset by higher collections in other categories, such as Transfers and Reimbursements.

The revenue adjustments recommended in this document address current projections for the shortfall expected as a result of the rapidly deteriorating economy. Given the current economic uncertainty and the rapidly changing economic environment, however, additional adjustments may be needed by year-end. Lower projected revenues resulting from the poor economy were factored into the 2010-2014 Preliminary General Fund Forecast that was released in November 2008, although conditions have worsened since that time. The revenue estimates for this year will continue to be updated as part of the final 2010-2014 General Fund Forecast due to be released in February and will serve as the starting point for developing the esimates for 2009-2010.

General Fund expenditures through December totaled $413 million. This represents an increase of $19 million, or 4.8%, from the December 2007 level of $394 million. Encumbrances totaling $54 million were also $6 million (12.5%) above the December 2007 level of $48 million. Expenditures and encumbrances through December of $467 million constituted 48% of the total 2008-2009 modified budgeted use of funds amount (excluding reserves) of $971 million. This was generally consistent with the 46% experienced in last year's budget at this time. Overall, expenditures are tracking as anticipated and are expected to end the year with savings. As a cost savings measure, current year expenditure reductions submitted by departments in the form of Cost/Position Management Plans are recommended in this document that would remove $9.4 million from General Fund appropriations. Minimal General Fund savings are expected to remain after the implementation of these plans.

Section I of this document provides a detailed discussion of the General Fund revenue and expenditure performance through December.

RECOMMENDED GENERAL FUND BUDGET ADJUSTMENTS

Actions resulting in a net reduction of $9.0 million to the General Fund revenues and expenditures are recommended in this Mid-Year Budget Review. For General Fund revenues, this reflects the following: downward adjustments totaling $9.2 million based on revised projections; a downward adjustment of $3.5 million to the transfer from the Construction Excise Tax Fund as a rebalancing action in that fund (offset by General Fund expenditure reductions); a downward adjustment of $1.0 million to the Fire Development Fee Program (offset by expenditure reductions/use of the Fire Development Fee Program Reserve); and upward adjustments of $4.6 million to reflect various grants and reimbursements ($4.4 million) and other adjustments ($0.2 million).

To offset the net reduction in revenues, a number of expenditure adjustments are recommended, including: a reduction of $9.4 million to implement the Cost/Position Management Plans, the elimination of the $5.8 million Street Maintenance and Repair Reserve; a reduction of $3.5 million to Traffic Capital Program projects to offset the loss of General Fund revenue from the Construction Excise Tax Fund; a reduction to Fire Fee Program expenditures/reserve ($1.0 million) to offset lower revenues; and a reduction of $1.4 million to reduce various City-Wide and Capital projects where the funding is no longer necessary. These downward adjustments are partially offset by the establishment of a 2008-2009 Ending Fund Balance of $6.3 million, additional funding for Fire Department training ($0.8 million), and other required adjustments ($0.5 million).

The following chart summarizes these recommended adjustments.

PROPOSED GENERAL FUND ADJUSTMENTS

PROPOSED REVENUE ADJUSTMENTS		
- Revenue Adjustments	$	(9,159,258)
- Traffic Capital Program Rebalancing Plan		(3,500,000)
- Development Fee Programs		(1,000,000)
- Grants/Reimbursements		4,394,117
- Other Revenue Actions		218,311
Total Proposed Revenue Adjustments	$	**(9,046,830)**
PROPOSED EXPENDITURE ADJUSTMENTS		
- Grants/Reimbursements	**$**	4,394,117
- Required Technical/Rebalancing Actions		
Cost/Position Management Plans		(9,372,158)
Street Maintenance and Repair Reserve		(5,802,000)
Traffic Capital Program Rebalancing Plan		(3,500,000)
Review of City-Wide and Capital Project Reductions		(1,392,303)
2008-2009 Ending Fund Balance		6,280,417
Other Expenditure Actions		216,155
Sub-Total Required Technical/Rebalancing Actions		(13,569,889)
- 2008-2009 Fiscal/Program Needs		
Fire Department Training		834,760
Other Required Needs		294,182
Sub-Total 2008-2009 Fiscal/Program Needs		1,128,942
- Development Fee Programs		
Fire Development Fee Program Rebalancing Plan		(1,000,000)
Sub-Total Development Fee Programs		(1,000,000)
Total Proposed Expenditure Adjustments	**$**	**(9,046,830)**

Proposed current year revenue estimate adjustments are described in detail in Sections I and III of this document. Following is a brief description of the General Fund expenditure adjustments recommended in this report. Additional information on these expenditure adjustments is also provided in Section III of this document.

Summary of Proposed Adjustments in the General Fund

GRANTS/REIMBURSEMENTS	
Public Safety Activities – Recognizes and appropriates grants and reimbursements that will be received for Strike Team Reimbursements for mutual aid fire services ($976,159); Police overtime at the Airport in response to Level Orange security reimbursed by Airport funds ($955,000); City Manager's Office interoperability reimbursement ($239,669); and miscellaneous police ($405,303) and fire ($14,000) grants and reimbursements. Offsetting these increases is the elimination of two vacant positions ($247,750) in the Police Department that were previously supported by card room revenues.	$2,342,381
Neighborhood Services Activities – Recognizes and appropriates grants and reimbursements that will be received for the San José After School Program ($980,937), Parks, Recreation and Neighborhood Services Fee Activities ($90,000), Senior Nutrition ($80,515), Landfill Enforcement ($29,650), Neighborhood Revitalization ($22,060), Senior Companion Program ($10,800), Literacy Program ($7,060), and PG&E Summer Cooling Program ($7,000).	$1,228,022
San Jose Redevelopment Agency Adopted Budget Implementation – Recognizes and appropriates funding from San Jose Redevelopment Agency to reflect the recent adoption of its budget for 2008-2009. These projects include: Safe Summer Initiative ($500,000); two additional Code Enforcement Inspector temporary positions for Strong Neighborhoods Initiative and Neighborhood Business District areas ($182,052); and Downtown Nightlife District ($57,713).	$739,765
Miscellaneous Grants and Reimbursements – Recognizes and appropriates funding for various grants and reimbursements received by Planning, Building and Code Enforcement ($120,000), Human Resources ($41,195), and Office of Economic Development ($22,754). Offsetting these increases is a reduction for the Cycling Classic ($100,000) to reflect anticipated performance.	$83,949
Total Grants and Reimbursements	**$4,394,117**

REQUIRED TECHNICAL/REBALANCING ACTIONS	
Cost/Position Management Plans – Reduces General Fund expenditure appropriations by 1% for Public Safety Departments and 3% for all other departments and offices to implement Cost/Position Management Plans as more fully discussed by City Service Area in Section III of this document.	($9,372,158)
Street Maintenance and Repair Reserve – Eliminates the Street Maintenance and Repair Reserve that was established as part of the 2007-2008 Annual Report actions. Per City	($5,802,000)

Council policy, one-half of the unallocated funds remaining at the end of a fiscal year are allocated for this purpose. Due to the projected revenue shortfall in the General Fund, the liquidation of this reserve is recommended for General Fund rebalancing/ending fund balance needs.

Maintenance Backlog-Street Resurfacing (Story Rd & Leigh Ave) – Decreases the Maintenance Backlog-Street Resurfacing (Story Rd & Leigh Ave) project in order to mitigate the impact of a reduced transfer from the Construction Excise Tax Fund to the General Fund. This project is anticipated to be completed by Proposition 1B funds once they are received.	($2,293,000)
Seven Trees Blvd Sidewalk – Decreases the Seven Trees Blvd Sidewalk project in order to mitigate the impact of a reduced transfer from the Construction Excise Tax Fund to the General Fund. Other funding sources have been identified to offset this action and ensure the project construction schedule is not impacted.	($700,000)
Traffic Calming Studies – Decreases funding for traffic calming studies in order to mitigate the impact of a reduced transfer from the Construction Excise Tax Fund to the General Fund. Traffic calming activities will continue in Strong Neighborhoods Initiative areas funded in the San Jose Redevelopment Agency Adopted Budget.	($507,000)
Review of Prior Year Rebudgets-City-Wide Expenses – Decreases City-Wide Expenses where funding is no longer necessary and have no service level impacts after completing a comprehensive review of carryover funds. These projects include: City Free Use of Auditorium and Other Facilities, Emergency Response and Preparedness (grant advance funding), Grand Prix Close Out, Hoffman/Via Monte Neighborhood Center Lease Payments (for payments after 2011-2012), Los Lagos Golf Course Netting, Mexican Heritage Plaza Facility Use Consultant, Planning Area Studies, Relocation of Stockton Warehouse Artifacts, San José Future Teachers Loan Program, Theater Management Realignment, and Workers' Compensation Gainsharing Program.	($1,299,303)
Review of Prior Year Rebudgets-Capital Projects – Decreases Capital Project appropriations where funding is no longer necessary and have no service level impacts after completing a comprehensive review of carryover funds. These projects include: City-Wide Sidewalk Repairs (grants) ($53,000) and Northside Community Center ($40,000).	($93,000)
2008-2009 Ending Fund Balance – Establishes a 2008-2009 Ending Fund Balance in the General Fund. In the 2009-2010 Preliminary General Fund Forecast, it was assumed that $16.5 million would be generated from expenditure savings and the liquidation of carryover encumbrances in 2008-2009. This action sets aside a portion of that amount in preparation for the 2009-2010 fiscal year.	$6,280,417
Arts Stabilization Flexible Fund – Adds funding to the Arts Stabilization Flexible Fund for interest earnings earned from July 1, 2008 through February 10, 2009, per City Council policy.	$71,727
Storm Fees – Adds funding to the Storm Fees City-Wide appropriation that is used to pay storm fees for City facilities. This adjustment is necessary to account for the fee increase that was approved as part of the 2008-2009 Adopted Budget but not factored into the City's Storm Fees liability.	$42,413

Salary Reserve (Surplus Voluntary Furlough/Special Reduced Work Week Program) – Reduces the Salary Reserve by $116,296 to reflect the higher than budgeted savings generated from the Voluntary Furlough/Special Reduced Work Week Program. The 2008-2009 Adopted Budget assumed savings of $300,000 from these programs, which were accounted for in the Salary Reserve. Actual General Fund savings totaled $416,296, which were applied to the Salary Reserve. This action reduces the Salary Reserve by the savings amount over the budgeted level. ($116,296)

Miscellaneous Adjustments – Allocates funding to pay school districts that have executed Waste Reduction and Cooperation agreements with the City (net $218,311 offset by revenue); and return 9-1-1 Call Center Remodel savings to the Emergency Communication System Support Fee Fund ($200,000). $218,311

Total Required Technical/Rebalancing Actions ($13,569,889)

2008-2009 FISCAL/PROGRAM NEEDS

Fire Special Operations Training – Provides funding for Fire staff who attended training in the first half of 2008-2009 for urban search and rescue and the hazardous incident team special operations training as a result of a change in the International Association of Firefighters Memorandum of Agreement regarding premium pays. $634,760

Fire Retirement Payouts – Provides additional funding for vacation and compensatory time balance payouts to Fire sworn personnel due to the large number of sworn retirements experienced this year. $241,618

Fire Airport Rescue and Firefighting Certification Training – Provides partial funding for Fire staff who attended training in fall 2008 for Airport Rescue and Firefighting (AARF) certification. Since Fire Station 20 responds to Mineta International Airport, all personnel staffing Engine 20 must maintain AARF certification. $150,000

Fire Harassment/Discrimination Training – Provides funding for a training consultant and design of a web-based training on harassment and discrimination, which will be delivered to all sworn personnel beginning in spring 2009. $50,000

Miscellaneous Adjustments – Adds funding for the non-reimbursed portion of the Senior Nutrition Program increases ($29,064) and General Plan amendment fees ($23,500) for the affordable housing project Markham Terrace to comply with the Employment Lands Framework Conversion Policy. $52,564

Total 2008-2009 Fiscal/Program Needs $1,128,942

DEVELOPMENT FEE PROGRAMS

Fire Development Fee Program Rebalancing Plan – To address the projected revenue shortfall of $1.0 million in the Fire Development Fee Program, two actions are included: elimination of three vacant positions, one of which is temporary; and a reduction to the Fire Fee Program Reserve ($765,543). **($1,000,000)**

Total Mid-Year Recommended Adjustments ($9,046,830)

2008-2009 COST/POSITION MANAGEMENT PLANS

For the seventh time in eight years, departments were directed in November to submit mid-year Cost/Position Management plans that would create current year expenditure savings. The purpose of these plans is to generate savings in the current fiscal year that could be used to rebalance the 2008-2009 General Fund budget and to set aside a portion of the funds needed to achieve the 2008-2009 Ending Fund Balance estimate of $16.5 million that was assumed in the 2009-2010 Preliminary General Fund Forecast. The plans are also intended to preserve position vacancies in all funding sources to provide redeployment flexibility and minimize employee layoffs in the coming year. If approved, these plans would generate $9.4 million in personal services ($7.1 million), non-personal/equipment ($1.6 million), and non-departmental ($700,000) appropriations. Recommendations to lower various departmental and non-departmental budgets in order to generate savings are included in this document. Detailed descriptions of the plans can be found in Section III of this document.

STATUS OF SELECTED SPECIAL FUNDS

Airport Operating Funds

Activity levels at the Airport reflect the severe disruption that the Airline industry is experiencing nation-wide. Passenger activity continues to fall (down 12% this fiscal year and down 14% in December). Fewer passengers translate into lower revenues from parking, rental cars and concessions. In the upcoming years, the Airport expects to face continued challenges as a result of the problems plaguing the entire Airline industry, the current recession, and additional costs related to new facilities and equipment scheduled to come on line. Rebalancing actions approved as part of the 2007-2008 Annual Report process in October were intended to address the slowdown in activity this year, although worsening activity projections may yet prove to require additional actions later this year. The Airport also projects shortfalls for the next two years with a $35 million deficit estimated for 2009-2010 and 2010-2011. Actions to address this significant deficit are recommended to be taken immediately.

To begin addressing this multi-year shortfall, actions are recommended in this document to eliminate 52 positions (6 filled) and reduce non-personal/equipment funding for savings of $7.2 million. In agreements made with the rental car companies and airlines, the use $2.2 million from two rate stabilization reserves is also recommended to help mitigate the impacts of the economy on these Airport partners.

Community Facilities Revenue Fund (Hayes Mansion)

Revenues in the Community Facilities Revenue Fund (Hayes Mansion Fund) are tracking below estimated levels through the first half of 2008-2009. To partially offset the lower than anticipated revenues being generated at the Hayes Mansion, the operator of the facility, Dolce, has developed a cost containment strategy. This strategy includes a series of expenditure reductions which are anticipated to save approximately $500,000. In addition, the action approved by City Council earlier this year to pay off the Comerica line of credit has resulted in lower interest costs ($150,000) and has made available $50,000 that was required to be set aside by the Comerica Bank line of credit agreement. It should be noted that if current trends continue and revenue declines further, the General Fund transfer may need to be increased in the 2009-2010 budget.

Convention and Cultural Affairs Fund

Operating revenues in the Convention and Cultural Affairs Fund are tracking below estimated levels through the first half of 2008-2009. A year-end shortfall of $1.3 million in operating revenues is anticipated. This is due to a combination of a decline in 2008-2009 activity ($400,000) and an estimated bad debt expense ($900,000), due, in large part, to the recent bankruptcy of American Musical Theater. To offset this lower collection level, a $400,000 reduction to the Miscellaneous Improvements allocation and a $900,000 reduction to Ending Fund Balance are recommended. Also included in this document, is a recommended reduction to the Personal Services appropriation ($1.0 million), with a corresponding increase to the Non-Personal/Equipment allocation, to better align the budget with contract labor costs. Additional cost controls will be necessary to ensure expenditures remain within budgeted levels at year-end. Lastly, it should be noted that the decline in Transient Occupancy Tax (TOT) revenue in the current year will have a direct negative impact on the Ending Fund Balance as the 2009-2010 Proposed Budget is developed. The actions recommended in this document are not anticipated to have a major impact on the overall financing plan for the Convention Center Expansion Project.

Low and Moderate Income Housing Fund

Revenues in the Low and Moderate Income Housing Fund are tracking significantly lower than budgeted levels. The City has had difficulty in selling $85 million in tax allocation bonds at a favorable rate as a result of the current disruptions in the financial markets. A $50 million line-of-credit in this Fund is available to finance expenditures this year. To account for the possibility that bonds will not be issued this year, budget adjustments are recommended in this document to reduce the bond proceeds revenue estimate by $85 million, offset by reductions to the Loans, Grants and Site Acquisition allocation ($40 million) and the Line of Credit Repayment allocation ($45 million). This action would leave $50 million in the Loans, Grants and Site Acquisition allocation, which is sufficient to cover current City Council committed projects. Market conditions will be closely monitored and a bond sale will be brought forward later in the fiscal year if the market is favorable. In the interim, the expenditure budget has been aligned with the available revenue. A $2.7 million transfer to the Multi-Source Housing Fund is also recommended to address the cash flow problem in that fund that has resulted from delays in State payments. This transfer would be offset by a reduction to the Line of Credit Repayment ($2.5 million) allocation and the Ending Fund Balance ($0.2 million).

Multi-Source Housing Fund

Revenues in the Multi-Source Housing Fund are tracking significantly lower than budgeted levels. A portion of revenues in this fund are State grants, which are paid on a reimbursement basis. In late December, the Housing Department received notice that $3.8 billion in committed State funding for infrastructure projects throughout California have been temporarily frozen. As a result, $3.4 million in pending reimbursements in this Fund are not being honored until further notice. This creates a significant cash flow issue in this fund. A multi-tiered strategy for addressing this issue is recommended in this document. Two separate transfers are proposed to cover the majority of the outstanding State grant reimbursements: a transfer from the Low and Moderate Income Housing Fund ($2,675,000) to cover the outstanding reimbursements for affordable housing and relocation projects; and a transfer from the Housing Trust Fund ($126,000) to supplement reimbursements for homeless projects. The remaining shortfall is recommended to be covered by a reduction to the Ending Fund Balance.

Additionally, as a result of the instability of the housing market, revenues from inclusionary in-lieu fees are tracking significantly lower than budgeted levels. To address this lower collection level, the revenue estimate and the corresponding appropriations are recommended to be reduced by $26.9 million in this document. This recommended adjustment would bring the inclusionary in-lieu fee revenue estimate down from $32.0 million to $5.1 million.

Municipal Golf Course Fund

Activity at the Los Lagos and Rancho Del Pueblo Golf Courses are tracking below anticipated levels. Included in this document is a recommendation to decrease the revenue estimate from the Los Lagos Golf Course as net profits are anticipated to end the year $190,000 (30%) below the budgeted estimate of $633,000. No net profits were assumed in the budget for the Rancho del Pueblo Golf Course. The declining revenue collections have resulted in higher than projected operating subsidies for the golf courses, as payments to the operators are required in the months when revenues do not cover fixed operation costs. This document also includes recommendations to increase the Los Lagos ($50,000) and the Rancho Del Pueblo ($75,000) appropriations and decrease the Ending Fund Balance in the Municipal Golf Course Fund, to offset this higher cost. The Municipal Golf Course Fund will continue to be monitored closely, as the subsidy from the General Fund was reduced from $1.25 million in 2007-2008 to $1.0 million in 2008-2009. To the extent that this trend continues, the 2009-2010 subsidy may need to be increased.

Water Utility Fund

Revenue in the Water Utility Fund may end the year as much as $1.5 million under budget due primarily to lower water sales. This shortfall could be offset by lower water costs ($700,000), Environmental Services Department savings ($200,000), and the Ending Fund Balance ($600,000). If this occurs, a portion of the Ending Fund Balance could be replenished in 2009-2010 with capital project savings ($400,000). Due to the volatility of this revenue stream, it is possible for the year-end projection to change significantly, therefore no budget actions are recommended at this time.

Transient Occupancy Tax Fund

Transient Occupancy Tax (TOT) collections are tracking below anticipated levels. The occupancy rate in December 2008 at the 14 major hotels was 42.7%, which is slightly below the December 2007 level of 44.9%. Room rates have also decreased from the December 2007 rate of

$138.95 to $129.27 in December 2008. In 2008-2009, growth of 4.0% is needed to meet the budgeted revenue estimate, however, actual collections are down 5.1% through December. Based on a study performed by the independent consultant Horwath HTL, and after accounting for adjustments from compliance audits, collections are expected to end the year 6.7% below 2007-2008 levels (allowing a drop of 7.7% from January through June 2009). If this drop occurs, revenues would fall short of the budgeted estimate by $1.5 million. There is sufficient ending fund balance to offset this decline in revenue. However, the allocations to the three recipient organizations (Convention Facilities, San Josė Convention/Visitors Bureau, and Cultural Grants) will need to be reduced in the 2009-2010 budget to recoup the overpayments if the TOT decline occurs as projected. The allocations are not recommended to be reduced at this time, however, in order to give the recipient organizations time to plan for the reductions.

STATUS OF CAPITAL BUDGET PROGRAMS

Capital Budget Revenues

Section II of this report contains a detailed update on the financial status of each Capital Program, including a discussion of the major revenue sources. As has been reported in Monthly Financial Reports, the major economically sensitive revenue sources that support the Capital Program are tracking to end the year significantly below budgeted estimates. With the continued slowdown of the local real estate market and national recession, these revenues are recommended to be adjusted downward. In some funds, this will require offsetting expenditure reductions to rebalance program funds. It is anticipated, however, that the major non-economically sensitive revenues, such as transfers and contributions from other agencies, that support many of the capital programs will perform as projected.

The Building and Structure Construction Taxes and the Construction Excise Taxes that support the Traffic Capital Program are recommended to be revised downward significantly due to slower than anticipated development activity. Through December, Building and Structure Construction Taxes totaled $5.2 million, which represents a decrease of 11% when compared through the first six months of last fiscal year and 59% of the current budgeted estimate of $8.7 million. These collections, however, included a high level of December collections considered to be one-time in nature in the form of a large number of residential permits pulled prior to the implementation of new building codes. These collection levels are not considered sustainable for the remainder of the year. As a result, the revenue estimate for Building and Structure Construction Taxes are recommended to be revised downward by $2.2 million to the revised level of $6.5 million. Construction Excise Tax collections through December totaled $5.9 million, down 32% from last year and 46% of the budgeted estimate of $13.0 million. Current projections, as a result of decreased development activity, indicate that revenues will fall far below the budgeted estimate by year-end. Therefore, downward revisions to these revenues are recommended by $6.0 million to a revised estimate of $7.0 million.

As discussed in recent Monthly Financial Reports, Construction and Conveyance Tax (C&C) revenues that support many of the capital programs continue to experience a steep decline, reflecting the significant drop in median home price levels. Since nearly 98% of the C&C taxes are comprised of conveyance receipts, property transfers are the main driver in this revenue category. Through December, C&C taxes totaling $10.0 million have been received, which represents a decline of 25% from last year. In addition to these revenues, the City has since received January Conveyance Tax receipts totaling $1.7 million. This amount is 32% lower than the January 2008 amount of $2.5 million. With this decrease, this indicates that in 30 of the past 33 months revenues have declined compared to the same month in the prior year. The median home price of $452,000 in December 2008 represents a 35% drop from the median home price of $699,000 in December 2007. The December 2008 figure represents the lowest median home price within the City since spring 2004. A $4 million downward revision to the C&C Tax estimate is recommended, reducing the estimate from $23 million to $19 million.

The recent freeze of infrastructure projects due to the State cash flow and budget deficit challenges continues to impact grant reimbursements related to the Traffic and Parks and Community Facilities Development Capital Programs. Staff is carefully monitoring this situation and departments are developing management plans to minimize the impact of the freeze on capital funds.

Revenue adjustments due to the decreased level of development activity are also recommended for Sanitary Sewer Connection Fees, Storm Drainage Fees, Residential Construction Taxes, and Underground In-Lieu Fees. The reallocation of project funds to other sources or sufficient ending fund balances in the corresponding funds are available to offset these revenue reductions. It should be noted, however, that the lower level of overall revenue collections will result in reduced and/or deferred projects in the upcoming 2010-2014 Capital Improvement Program.

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:

Traffic Capital Program Rebalancing Actions

As a result of the reduced revenue estimates previously discussed, several actions are recommended in this document to rebalance program funds. The following summarizes the highlights of the major recommended rebalancing actions:

- Decreases to the revenues estimate for Construction Excise Taxes ($5.975 million) offset by the following actions:
  - Decreases to the Transfer to the General Fund ($3.5 million). In order to offset the impact to the General Fund, the reduction of the Maintenance Backlog – Street Surface Resurfacing (Story Road and Leigh Avenue) ($2.3 million), Seven Trees Boulevard Sidewalk project ($700,000), and Traffic Calming Studies ($507,000) allocations are recommended in the General Fund. Alternative funding opportunities (grants and future State Prop 1B funding) have been identified to replace the General Fund project funding. A reduction of traffic calming activities would also result from this action.

- Funding shifts to the Building and Structure Construction Tax Fund for Project Development Engineering ($400,000), Bicycle/Pedestrian Program Management ($248,000), ITS: Operations and Management ($200,000), and Traffic Flow Management and Signal Retiming ($100,000); and to the Major Collectors and Arterials Fund for Miscellaneous Street Improvements ($250,000).
- Decreases to the following projects: Traffic Safety Data Collection ($315,000), Traffic Calming ($300,000), City-Wide Emergency Repairs ($124,000), BART Program Management ($100,000), Local Transportation Policy and Planning ($100,000), North San Josė Administration ($100,000), Traffic Congestion Studies ($100,000), Rural Road Safety Improvements ($85,000), Ortho Photo Project ($83,000), Transportation Needs Master Plan ($50,000), and Bridge Maintenance and Repair ($47,000).
- Eliminates five positions and shifts 1.75 positions to other funding sources.

• Decreases to the revenue estimate for <u>Building and Structure Construction Taxes</u> ($2.205 million) offset by the following actions:
  - Decreases to the following projects: Traffic Signals ($1.3 million), Reserve – King Road: Penitencia Creek Bridge ($1 million), Capitol Light Rail Transit ($500,000), Hamilton Avenue ($648,000), Branham Lane Improvements ($425,000), ITS: Stevens Creek – West ($159,000), Union Avenue ($75,000), and Traffic Signals Rehabilitation ($50,000).
  - Eliminates four positions.

Construction and Conveyance Tax Rebalancing Actions

As a result of the reduced revenue estimates discussed previously, several actions are recommended in this document to rebalance Construction and Conveyance Tax funds. The following summarizes the highlights the rebalancing of the $4 million revenue adjustment recommended for Construction and Conveyance Taxes:

• In the *Public Safety Capital Program*, decreases to the revenue estimate for <u>Fire Construction and Conveyance Tax</u> collections ($336,000) offset by the following actions:
  - Decreases to the following projects: Fire Department Turnout Cleaning ($100,000), Underground Fuel Tank Renovation/Replacement ($30,000), Traffic Control Equipment ($25,000), Tools and Equipment ($20,000), and Capital Program Management ($27,000).
  - An Ending Fund Balance adjustment of $124,000 generated from Fire Station 2 construction contract savings (approved by the City Council on January 13, 2009).

• Sufficient fund balance is available to offset the Construction and Conveyance Tax revenue estimate adjustments ($3.7 million) to the remaining funds.

Other Major Expenditure Revisions

- Sale of Surplus Property estimated proceeds related to the former Main Yard in Japantown ($14 million) and the sale of Fire Stations 12 and 17 ($1.0 million) are recommended to be reduced as they will be delayed beyond the 2008-2009 fiscal year.

- As a result of declining revenue and a corresponding decrease in capital project expenditures, the elimination of 28.5 vacant positions in the Public Works Department that support capital project delivery is recommended.

- In the *Airport Capital Program*, adjustments to the Terminal Area Improvement, Phase I and North Concourse Building appropriations for Terminal A and B baggage screening systems primarily funded by TSA grants ($18.1 million) are recommended.

- In the *Library Capital Program*, additional funding for the East San José Carnegie Branch from Contingency Reserves is recommended for additional costs related to unforeseen conditions of the historical building ($600,000).

- In the *Public Safety Capital Program*, the reallocation of project savings from Fire Station 17 to Fire Station 19 is recommended in order to cover change orders not included in the construction contract.

- In the *Water Pollution Control Capital Program*, the defunding of the Digester Rehabilitation ($15.9 million), Digester Gas Line Replacement ($1.1 million), and Plant Infrastructure Improvements – Headworks ($3.0 million) projects are recommended to reflect ongoing condition assessment and pre-design studies that will delay the design and construction of these projects. In addition, a reserve for the Electrical Reliability Improvements ($5.3 million) is recommended.

- In the *Parks and Community Facilities Development Capital Program* the reallocation of funding to reserves for the Vietnamese American Community Center ($1.1 million) to preserve funds until the start of the design phase. In addition, funding for Camden Community Center Locker Room Renovations ($150,000) is recommended.

IMPACT ON POSITIONS

The 2008-2009 Mid-Year Budget Review includes the recommended elimination of 94.5 positions and the addition of 6 positions, for a net reduction of 88.5 positions as follows:

- ***Airport Department***: Eliminate 46 vacant positions and 6 filled positions to begin addressing the significant deficit projected for 2009-2010.
- ***Environmental Services***: Add 6 positions to support the Stormwater Permit anticipated to be adopted by the Regional Water Quality Regional Board.

- ***Fire Department***: Eliminate 3 vacant positions in the Fire Development Fee Program to partially offset the lower revenue collections.
- ***Police Department:*** Eliminate 2 vacant positions that were added in 2008-2009 to support the Cardroom audit function. The revenue to support these positions is no longer available.
- ***Public Works:*** Eliminate 28.5 vacant positions that are no longer necessary due to declines in the City's capital program activity.
- ***Transportation:*** Eliminate 3 vacant positions and 6 filled positions as a result of rebalancing actions necessary in the Traffic Capital Program.

COUNCIL REFERRALS

In the Mayor's June Budget Message for Fiscal Year 2008-2009 that was approved by the City Council, items were referred to the 2008-2009 Mid-Year Budget Review for follow-up or potential action. Following is a status report on the School Crossing Guard Program and the Airport West property sale proceeds.

Review of School Crossing Guard Program

In the Mayor's June Budget Message approved by the City Council, the City Manager was directed to: evaluate cost effective programs in other jurisdictions; explore alternative funding sources; work with the Schools/City Collaborative on a solution to ensure the safety of our children; and evaluate which middle school intersections could be adequately secured with the installation of pedestrian activated crosswalks. This analysis was to be brought back as part of the 2008-2009 Mid-Year Budget Review.

In coordination with the Police Department, Department of Transportation and the Schools/City Collaborative, the consultant firm of Management Partners is conducting an independent evaluation of the Adult School Crossing Guard Program including alternatives for effective service delivery and opportunities to reduce costs. In addition, the analysis will include an evaluation of cost sharing and cost recovery strategies and successful crossing guard models from other jurisdictions. Management Partners is expected to complete its analysis in February 2009 and a report will be brought forward to the City Council in April 2009.

Airport West Property Sale Proceeds

In the Mayor's June Budget Message approved by the City Council, the Administration was directed to defer any proposed uses of proceeds associated with the Airport West property sale until the 2008-2009 Mid-Year Budget Review. To date, the property sale transaction has not been completed and the City has not received the sale proceeds. The City has, however, received $6 million in option payments for the Airport West Property in 2008-2009. This reflects option payments for the first year of the two-year option period. The option payments were designed to cover the debt service on the Airport West property during the option period.

Funding from the General Fund and the Airport Operations and Maintenance Fund are used to cover the debt service payments on the Airport West property. In October 2008, budget actions were approved as part of the 2007-2008 Annual Report to apply a portion of the $6 million in option payments received this fiscal year to offset the lease payments from the Airport Operations and Maintenance Fund for this property. The remaining funds were set aside in a $2.3 million Airport West Proceeds Reserve in the General Fund. No actions are recommended in this document to allocate the Airport West Proceeds Reserve. It is recommended that these funds remain in reserve until the status of this property is determined.

LOOKING FORWARD

Planning efforts are well underway on the development of the 2009-2010 Proposed Operating and Capital Budgets. The 2010-2014 General Fund Forecast serves as a starting point in the budget development process as it compares the projected revenues and expenditures for the upcoming five-year period. As reported to the City Council in November, the Preliminary 2010-2014 General Fund Forecast showed a General Fund deficit of $59 million in 2009-2010 that increases to $65 million once the unmet/deferred infrastructure needs are added. Over the next two years, the General Fund structural deficit increases to $98 million. In late February, the Administration will bring forward an updated 2010-2014 General Fund Forecast that will take into consideration the actual performance through the first half of 2008-2009 and revised revenue and expenditure assumptions based on the current economic environment. The rapidly deteriorating economic conditions are expected to negatively impact the revenue estimates that were initially developed in November 2008.

The Mayor's March Budget Message, as reviewed and approved by the City Council, will serve as a guiding document for the Administration in its development of the 2009-2010 Proposed Budget. It is anticipated that the Mayor's March Budget Message will incorporate feedback from the Community Budget Survey, Neighborhood Association/Youth Commission Priority Setting Session, and the City Council/City Management Team Strategic Planning Retreat.

PUBLIC OUTREACH/INTEREST

✓ **Criterion 1:** Requires Council action on the use of public funds equal to $1 million or greater.

☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.

☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.

This document is posted on the City's website for February 10, 2009 Council agenda.

CONCLUSION

Despite the rapid deterioration in the economic environment, the City's overall finances remain in relatively sound condition through the mid-point of the year with the majority of the City funds generally performing within anticipated levels. However, there are a number of funds, including the General Fund, that are not tracking to meet budgeted estimates by year-end as a result of the deteriorating economy. Budget adjustments are recommended in this document to address projected shortfalls in these funds. In the case of the Airport, actions are recommended now to begin addressing the significant $35 million deficit projected for 2009-2010. A net reduction of 88.5 positions (of which 12 are filled) is also recommended in this Mid-Year Budget Review document to implement the various rebalancing plans. This is in addition to the 52 positions (28 filled) that were approved for elimination by the City Council on January 27, 2009 to rebalance the Building and Planning Development Fee Programs.

The adjustments brought forward in this document reflect our best estimate on the impacts of the severe economic downturn on the City's various funds. Given the significant amount of uncertainty and volatility regarding the economy, however, additional adjustments may be necessary by year-end. The Administration will continue to closely monitor performance and will bring forward any addition actions necessary to ensure the City's funds remain in balance. Diligent monitoring, continued fiscal discipline, and timely actions will be critical to maintain the City's fiscal health.

As we move forward into 2009-2010, it is clear that the deep recession will necessitate significant and painful budget reductions to balance the General Fund as well as a number of other City funds. It is also likely that the General Fund deficit projected for 2009-2010 in the Preliminary Forecast issued in November will have worsened when the final 2010-2014 General Fund Forecast is released at the end of February.

The Administration will continue to provide status reports on the City's finances through the Bi-Monthly Financial Reports. This report will highlight any significant developments as well as identify any potential budget actions necessary.

We are confronting the fiscal realities of an unprecedented tumultuous time. Working through the significant transitions facing our work force will, no doubt, result in disruptions to the high level of service delivery our community has grown to expect. Continued patience and understanding will be needed. I would like to thank Jennifer Maguire, Budget Director, members of the Budget Office, and departmental staff for their diligence in preparing the difficult recommendations contained in this report.

Debra Figone
City Manager

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 2008-2009 monies in excess of those herertofore appropriated therefrom:

Airport Capital Improvement Fund	$18,135,000
Airport Passenger Facilities Charge Fund	54,545
Airport Renewal and Replacement Fund	898,000
Airport Revenue Bond Improvement Fund	21,000
Airport Revenue Fund	7,829,107
Airport Surplus Revenue Fund	1,561,000
Anti-Tobacco Settlement Fund	95,456
Benefit Fund	661,200
Cash Reserve Fund	23
Construction & Conveyance Tax – Council District 4	192,977
Dental Insurance Fund	400,000
Emergency Communication System Support Fee Fund	200,000
Gift Trust Fund	400,394
Housing Trust Fund	75,000
Redevelopment Capital Project Fund	39,600
San Jose/Santa Clara Treatment Plant Capital Fund	19,667
Storm Sewer Operating Fund	75,534
Supplemental Law Enforcement Services Fund	10,000
Water Utility Fund	55,002
Workforce Investment Act Fund	10,000

Jennifer A. Maguire
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Budget Director