COUNCIL AGENDA: 02-12-08
ITEM: 3.9

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: City Council

FROM: Mayor Chuck Reed

SUBJECT: **BUDGET SHORTFALL ADVISORY GROUP RECOMMENDATIONS**

DATE: February 1, 2008

Approved Chuck Reed Date 2/1/08

RECOMMENDATION

Review, discuss and provide feedback on the Mayor's Budget Shortfall Advisory Group Recommendations.

BACKGROUND

The General Fund Structural Deficit is estimated at $137 million. This deficit includes our projected shortfall to support existing programs, our unmet/deferred infrastructure needs, and the City's portion of the unfunded liability associated with post-employment health benefits. The City Council unanimously stated that solving our structural deficit was a top City Council priority at the February 20, 2007 City Council Priority Setting Session. The City Council recognized that without implementing immediate strategies to solve the deficit, the City would be forced to balance the budget solely by cutting services.

In March of last year, the City Council unanimously directed the City Manager to work with the Mayor's Budget Shortfall Advisory Group in eliminating our structural budget deficit. The administration was tasked with reviewing the budget from top to bottom to find options and alternatives for the City Council to consider in eliminating the General Fund structural deficit. In reviewing the budget to find alternatives for the Council to consider, the City Manager's Office solicited input and feedback on strategies to address the structural deficit from a variety of stakeholders including the City's Senior Staff, the City Labor Alliance, employees and community and business groups (including City boards and commissions). In addition, the administration, conducted an electronic survey from October 26, 2007 to November 9, 2007. The survey generated 2,033 responses from employees and 656 responses from the community. A summary of the opportunities for stakeholders to provide input to date is attached. Through these various outreach efforts, the City Manager has identified both short-term and long-term strategies that could be adopted by the Council to eliminate the deficit in three years.

The Mayor's Budget Shortfall Advisory Group has reviewed the recommendations from the City Manager's Strategies to Address the City's General Fund Structural Budget Deficit. The Mayor's Budget Shortfall Group has made additional recommendations related to strategies, next steps and amendments to the budget principles as outlined in the attached memo.

On January 30, 2008 the Mayor's Budget Shortfall Advisory Group voted 7-0-1 (Member Biagini Absent) to recommend approval of the attached recommendations.

NEXT STEPS

These recommendations are scheduled to be brought forward for initial discussion and comments from the City Council on February 12, 2008. These recommendations will be considered by the Council for approval as part of the March budget process. The Mayor's Office and City Manager's Office will work to conduct additional outreach to stakeholders for development of her recommendations for revenue increases, cost savings and service reductions. Community input and discussion will continue to be part of the process as we move forward. I fully expect this additional outreach to include consideration and feedback from Community Budget Working Group, the City Labor Alliance, neighborhoods, the Santa Clara Association of Realtors and other individuals who have expressed an interest in this process.

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: MAYOR AND CITY COUNCIL

FROM: Mayor's Budget Shortfall Advisory Group

SUBJECT: BUDGET SHORTFALL ADVISORY GROUP RECOMMENDATIONS

DATE: February 1, 2008

Approved Chuck Reed Date 2/1/08

RECOMMENDATIONS TO THE CITY COUNCIL

1. Allocate one-third of the amount of the structural budget deficit as planning targets to be achieved over three years in three areas:
    1) Revenue Increases (including economic development)
    2) Service Reductions
    3) Cost Savings

2. Direct the City Manager to make recommendations prior to the budget study sessions in May for timing and amounts of revenue increases, cost savings, and service reductions as part of a Three-Year Structural Deficit Elimination Plan to be considered by the Council in the May and June budget process.

3. Direct the City Manager to work with the Mayor to conduct outreach to stakeholders as part of the process for development of her recommendations for revenue increases, cost savings and service reductions. The outreach should include meetings with stakeholders who may be impacted by revenue increases, cost savings and service reductions to give them opportunity to comment on the strategies developed by Management Partners, and to suggest alternatives.

4. Approve the following additions to the annual budget process.
    a. May
        1) City Manager recommends a Three-Year Structural Deficit Elimination Plan.
        2) Discussion and hearings on recommendations as part of budget process

    b. June
        1) Council approves annual budget, and Three-Year Structural Deficit Elimination Plan

    c. November

1) Progress and assumptions of Three-Year Structural Deficit Elimination Plan are reviewed as part of updated forecast in November.

d. March
   1) Progress and assumptions reviewed as part of the five-year forecast.
   2) Adjustments to Three-Year Structural Deficit Elimination Plan recommended by Mayor and considered by Council in March budget message hearings.

5. Adopt the recommended budget principles as detailed in Attachment I. Direct the City Manager to return to the Council during the budget process if any unforeseen implementation issues arise regarding the budget principles.

6. Direct the City Manager to *consider the merits* of the following recommendations from individual members of the Budget Shortfall Advisory Group that were *supported by some, but not all of the members of the group:*

   a. Study the potential implementation of a pilot "Priorities of Government" budgeting process, (as outlined in the "The Price of Government" by Osborne and Hutchinson,) in one City Service Area in a future fiscal year.

   b. Analyze the effects of City Charter Section 1111 salary awards in excess of the City's final offer and their accumulated impact to the General Fund since 1981 implementation. Consider modification of the arbitration rules to ensure that the city's fiscal condition gets greater weight. Consider modifications to the arbitrator selection method to ensure that the potential arbitrator pool is approved by the parties in advance. Consider modification of the arbitration process to respond to the criticism made by the last arbitrator about the lack of negotiation.

   c. During discussions involving changes or extensions of the Redevelopment Agency's authority including, but not limited to, the collection of project area property tax-increment, the issuance of debt, and the revision of the cap on collectable revenues, relevant financial information must be provided to the Council. Relevant financial information includes, but is not limited to: 1. The economic benefits of the proposed Redevelopment Agency action and 2. The effect of the Redevelopment Agency action on the timing and amount of revenue that would have gone to the general fund. In addition, for each project area, the estimated increases in general fund revenues upon the expiration of the Redevelopment Agency's existing authority to collect tax-increment will be listed annually.

   d. During future labor negotiations, attempt to negotiate measurable benefit costs for all employee benefits.

   e. When creating the Three-Year Structural Deficit Implementation Plan, service reductions should be the last priority, ranking behind cost savings and revenue increases.

f. Add to the budget principles: For the Council to disregard any of the stipulated budget principles, the action will require a two-thirds majority vote.

g. Conduct more thorough analyses of carryover encumbrances to ensure that funding is not reserved for projects when it is no longer necessary and can be returned to the General Fund and other funds in a timely manner.

h. Analyze the current effects of the "Gann Limit" on the City of San José. In addition, analyze the increase of General Fund expenditures and revenues in relation to the increase in the Gross Metropolitan Product (GMP) to establish a benchmarked limit to government growth.

BACKGROUND

Starting in January 2007, the City Council began a new process of budgeting that began with a budget community survey and a neighborhood and City Council priority setting sessions. The Neighborhood Priority Setting Sessions have provided the opportunity for neighborhood association leaders to hear about budget challenges facing the City.

On February 20, 2007 the City Council, Council Appointees and Senior Management Staff participated in an all day retreat to develop and discuss the City's three-year goals. Below is a summary of the key outcomes of the session:

Mission Statement

The group engaged in a lengthy discussion and developed the following mission statement for the City of San José.

> ***The Mission of the City of San José is to provide quality services, facilities and opportunities that create, sustain and enhance a safe, livable and vibrant community for its diverse residents, businesses and visitors.***

Three-Year Goals

The group went through an intense process and arrived at the following three-year goals:

1. Maintain our status as the safest big city in America.
2. Eliminate the structural budget deficit.
3. Reduce deferred maintenance and the infrastructure backlog and develop a strategy to improve the infrastructure.
4. Increase economic vitality.
5. Provide full funding for parks, pools, community centers and libraries, including maintenance operations and development.

It was the unanimous support of the City Council that led to the process of talking about eliminating and defining our structural deficit. In order to gain opinion and suggestions regarding potential deficit strategies, staff facilitated focus group sessions with key community

stakeholders identified by the City. Stakeholders who participated in the focus groups included representatives from the City's Senior Staff, City Labor Alliance, City Employees and Community and Business Groups, including Boards and Commissions. To further broaden the level of input by stakeholders, and to cast a wider net of ideas, staff prepared and implemented an electronic survey of current San Jose employees and community members.

Stakeholder outreach needs to continue to be part of the City Manager's Strategies to Address the Structural Budget Deficit, as many of the difficult long term budget trade-offs it comprises requires the informed knowledge of, and participation from, the community and employees. The ultimate solutions required to put San Jose on sustainable fiscal footing while making the investments needed to support the City's myriad needs will require a comprehensive community solution, one in which ownership comes directly from the employees and the public itself, rather than from the technical solutions from City Hall. Therefore, an ongoing dialogue with the community that requires direct outreach from the City has to be maintained for the development and implementations of the Plan and options. Attachment II is a summary of the outreach and input opportunities to date.

In February through May this year, staff will continue to engage stakeholders, in a continued effort to disseminate information about the budget and continue to generate community input on possible solutions. The Mayor and Council will hold additional public budget workshops and hearings during May and June to discuss the budget and the impact of these recommendations.

These recommendations are living and flexible. Each fall and spring, the City will maintain the tradition of transparency and inclusiveness by conducting extensive outreach while updating the plan's assumption and proposals. It is expected that the open dialogue initiated during the past year will continue as a means of managing City operations for years to come.

RECOMMENDED
CITY OF SAN JOSE BUDGET PRINCIPLES

Additions are in bold italics

The Mission of the City of San José is to provide quality services, facilities and opportunities that create, sustain and enhance a safe, livable and vibrant community for its diverse residents, businesses and visitors. The General Fund Budget shall be constructed to support the Mission.

1) STRUCTURALLY BALANCED BUDGET

The annual budget for ***the General Fund*** shall be structurally balanced throughout the budget process. ***A structurally balanced budget means ongoing revenues and ongoing expenditures are in balance each year of the five-year budget projection.*** Ongoing revenues shall equal or exceed ongoing expenditures in both the Proposed and Adopted Budgets. If a structural imbalance occurs, a plan shall be developed and implemented to bring the budget back into structural balance. ***The plan to restore balance may include general objectives as opposed to using specific budget proposals in the forecast out years.***

2) PROPOSED BUDGET REVISIONS

The annual General Fund Proposed Budget balancing plan shall be presented and discussed in context of the five-year forecast. Any revisions to the Proposed Budget shall include an analysis of the impact on the forecast out years. If a revision(s) creates a negative impact on the forecast, a funding plan shall be developed and approved to offset the impact.

3) USE OF ONE-TIME RESOURCES

Once the General Fund budget is brought into structural balance, one-time resources (e.g., revenue spikes, budget savings, sale of property, and similar nonrecurring revenue) shall not be used for current or new ongoing operating expenses. Examples of appropriate uses of one-time resources include rebuilding the Economic Uncertainty Reserve, early retirement of debt, capital expenditures without significant operating and maintenance costs, and other nonrecurring expenditures. ***One time funding for ongoing operating expenses to maintain valuable existing programs may be approved by a majority vote of the Council.***

4) BUDGET REQUESTS DURING THE YEAR

New program, service or staff requests during the year that are unbudgeted shall be considered in light of the City's General Fund Unfunded Initiatives/Programs List and include a spending offset at the time of the request (if costs are known) or before final approval, so that the request has a net-zero effect on the budget.

5) RESERVES

All City Funds shall maintain an adequate reserve level and/or ending fund balance as determined annually as appropriate for each fund. For the General Fund, a contingency reserve amount, which is a minimum of 3% of the operating budget, shall be maintained. Any use of the General Fund Contingency Reserve would require a two-thirds vote of approval by the City Council. ***On an annual basis, specific reserve funds shall be reviewed to determine if they hold greater amounts of funds than are necessary to respond to reasonable calculations of risk. Excess reserve funds may be used for one-time expenses.***

RECOMMENDED
CITY OF SAN JOSE BUDGET PRINCIPLES

6) DEBT ISSUANCE

The City shall not issue long-term (over one year) General Fund debt to support ongoing operating costs (other than debt service) unless such debt issuance achieves net operating cost savings and such savings are verified by appropriate independent analysis. All General Fund debt issuances shall identify the method of repayment (or have a dedicated revenue source).

7) EMPLOYEE COMPENSATION

Negotiations for employee compensation shall ***focus on the cost of*** total compensation (e.g., salary, step increases, benefit cost increases) ***while considering the City's fiscal condition, revenue growth, and changes in the Consumer Price Index (cost of living expenses experienced by employees.)***

8) CAPITAL IMPROVEMENT PROJECTS

Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding $100,000 ***in the General Fund*** without City Council certification that funding will be made available in the applicable year of the cost impact. ***Certification shall demonstrate that funding for the entire cost of the project, including the operations and maintenance costs, will not require a decrease in existing basic neighborhood services.***

9) FEES AND CHARGES

Fee increases shall be utilized, where possible, to assure that fee program operating costs are fully covered by fee revenue and explore opportunities to establish new fees for services where appropriate.

10) GRANTS

City staff shall seek out, apply for and effectively administer federal, State and other grants that address the City's priorities and policy objectives and provide a positive benefit to the City. Before any grant is pursued, staff shall provide a detailed pro-forma that addresses the immediate and long-term costs and benefits to the City. One-time operating grant revenues shall not be used to begin or support the costs of ongoing programs ***with the exception of pilot projects to determine their suitability for long-term funding.***

11) GENERAL PLAN

The General Plan shall be used as a primary long-term fiscal planning tool. The General Plan contains goals for land use, transportation, capital investments, and service delivery based on a specific capacity for new workers and residents. Recommendations to create new development capacity beyond the existing General Plan shall be analyzed to ensure that capital improvements and operating and maintenance costs are within the financial capacity of the City.

12) PERFORMANCE MEASURES

All requests for City Service Area/departmental funding shall include performance measurement data so that funding requests can be reviewed and approved in light of service level outcomes to the community and organization.

ATTACHMENT III

2008-2009 BUDGET PROCESS
COMMUNITY AND EMPLOYEE INPUT OPPORTUNITIES

October 2007 thru February 2008

- Mayor's Budget Shortfall Advisory Group
  - Public meetings scheduled: 10/1/07; 10/17/07; 10/29/07; 11/15/07; 1/10/08; 1/17/08; 1/24/08; 1/30/08
  - Meeting schedule and materials are posted on City's Internet page (www.sanjoseca.gov)

October 22, 2007

- City Manager's General Fund Structural Deficit Task Force 1st Stakeholder Focus Group Meeting conducted:
  - Four stakeholder groups invited to general meeting, including Senior Staff, City Labor Alliance, Employees, and Community and Business Groups (including Boards and Commissions)
    - ✓ Senior Staff and City Labor Alliance - all were invited to participate
    - ✓ Employees - randomly selected from City payroll system
    - ✓ Community and Business Groups (including Boards and Commissions) - recommended by Mayor, City Council and City Manager's Office staff – randomly selected to participate in stakeholder group
  - A total of 85 participants (out of 155 invited) attended meeting to learn about project and brainstorm initial strategies to eliminate deficit

October 26 thru November 9, 2007

- City Manager's General Fund Structural Deficit Task Force Electronic Survey conducted:
  - Separate Community Budget Survey and Employee Budget Survey posted on City's Internet / Intranet web pages – not a scientific survey, people selected to participate
  - Community Budget Survey translated into Spanish and Vietnamese
  - Press release and payroll flyer issued regarding survey
  - 656 community responses and 2033 employee responses were received

November 28-29, 2007

- City Manager's General Fund Structural Deficit Task Force 2nd Stakeholder Focus Group Meetings conducted:
  - Four separate two hour meetings – one with each stakeholder group (Senior Staff, City Labor Alliance, Employees, and Community and Business Groups (including Boards & Commissions))
  - Community and Business Groups (including Boards & Commissions) meeting on November 29, 2007 was open to the public and posted on City's Internet page
  - Focus Groups were updated on the project and provided feedback on the advantages and concerns regarding the preliminary top strategies identified to eliminate the deficit

December 5, 2007

- City Manager Budget Forum conducted for employees on City Manager's General Fund Structural Deficit Task Force work

January 10, 2008

- City Manager's General Fund Structural Deficit Task Force presents final report to Mayor's Budget Shortfall Advisory Group (and Stakeholders) at their meeting that is open to public, 6pm – 8pm

January 2008

- Mayor conducts Community Budget Survey
- Mayor holds Neighborhood Association/Youth Commission Priority Setting Session
  - City Manager's General Fund Structural Deficit Task Force final report will be presented as well as a San Jose Redevelopment Budget overview will be provided

February 12, 2008

- City Council meeting to review Mayor's Budget Shortfall Advisory Committee recommendations

2008-2009 BUDGET PROCESS
COMMUNITY AND EMPLOYEE INPUT OPPORTUNITIES

March 2008

- 2008-2009 Mayor's March Budget Message Study Session
- 2008-2009 Mayor's March Budget Message Public Hearing

May 2008

- Budget Study Sessions on the 2008-2009 Operating and Capital Budgets and Fees and Charges Report
- Initial Public Hearing on the 2008-2009 Proposed Operating Budget, 2008-2009 Proposed Capital Budget and 2009-2013 Capital Improvement Program, and 2008-2009 Proposed Fees and Charges
- City Manager Budget Forum for employees
- Community Budget Meetings in various Council Districts on the 2008-2009 Proposed Budget

June 2008

- Community Budget Meetings in various Council Districts on the 2008-2009 Proposed Budget
- Final Public Hearing on the 2008-2009 Proposed Operating Budget, 2008-2009 Proposed Capital Budget and 2009-2013 Capital Improvement Program, and 2008-2009 Proposed Fees and Charges and 2008-2009 Mayor's June Budget Message
- City Council meeting to approve 2008-2009 Operating Budget, 2008-2009 Capital Budget and 2009-2013 Capital Improvement Program, and 2008-2009 Fees and Charges

ATTACHMENT A –TOP PRIORITY AND MASTER STRATEGIES MATRIX

Top Strategies

R.0 - REVENUE STRATEGIES			
	STRATEGY	POTENTIAL FISCAL IMPACT (estimates in millions)	IMPLEMENTATION CONSIDERATIONS
R.1	Extend the Emergency Communication System Support Fee	$23.4	Council Approval
R.2	Utilize Financing Strategies which have Positive Net Present Value	$1.7 - $6.1	Council Approval
R.3	Ensure Current Fees Fully Cover All City Costs	$2.0 - $9.0	Council Approval
R.4	Restructure Business Tax Rates to Modernize and Reflect Current Business Profile	$6.3 - $15.0	Council / Voter Approval
R.5	Modernize Utility Users Tax and Consider Bringing the Rate into Alignment with other Large Cities having this Tax	$7.9 - $39.6	Council / Voter Approval
R.6	Implement City-Wide Lighting and Landscape Districts or other Proposition 218 "Property-Related" fees	$2.5 - $11.0	Council / Voter Approval
R.7	Levy Parcel Tax or Sales Tax for Public Safety or Other Services	$14.0 - $38.0	Council / Voter Approval
R.8	Increase Transient Occupancy Tax to Market and Shift to General Fund	$4.5-$11.3	Council / Voter Approval / Coordination with Convention Center Plans

SD.0 - SERVICE DELIVERY MODEL CHANGES			
	STRATEGY	**POTENTIAL FISCAL IMPACT** (estimates in millions)	**IMPLEMENTATION CONSIDERATIONS**
SD.1	Formalize and Implement a Rigorous Asset Management Program	$3.3 - $5.0	Council Approval
SD.2	Combine Redevelopment and City Corporate Support Functions and Shift Economic Development Costs to Maximum Extent Possible	$2.2 (rev)	Council / Agency Board Approval
SD.3	Revise Competition Policy, Implement Managed Competition for Service Delivery, and Optimize Work Processes	$8.0 - $13.3	Council Approval / Competition Policy Revision
SD.4	Increase Use of Civilian Positions in Police and Fire	$0.5 - $1.5	Council Approval / Meet & Confer
SD.5	Eliminate Binding Interest Arbitration	Future Cost Avoidance	Council / Voter Approval (City Charter Change)
SD.6	Modify Minimum Fire Staffing Policies Where Appropriate Based on Fire Strategic Plan	TBD	Council Approval / Meet & Confer
SD.7	Implement an Employee Suggestion and Process Streamlining Program	$0.0 - $1.0	Council Approval

EC.0 - EXPENDITURE CONTROLS AND SHIFTS			
	STRATEGY	**POTENTIAL FISCAL IMPACT** (estimates in millions)	**IMPLEMENTATION CONSIDERATIONS**
EC.1	Shift Healthy Neighborhood Venture Fund Funding to General Fund	$5.0 - $9.0	Council Approval
EC.2	Reduce Workers' Compensation, Disability, and Overtime Costs	$3.0 - $4.2	Some Steps May Be Subject to Meet & Confer
EC.3	Shift Construction and Conveyance Tax Funding from Capital Projects to Operating and Maintenance Costs	$6.0 - $12.0	Council / Voter Approval
EC.4	Reduce the Rate of Increase in Employee Salary and Benefit Costs	$6.6 - $10.0	See below
EC.4.a	Increase Time to Reach Maximum Compensation	$1.9	Meet & Confer
EC.4.b	Reduce Entry-Level Compensation for Positions for which the City Receives Many, Qualified Applicants	$0.7-$1.7	Meet & Confer
EC.4.c	Implement Health Care Plan Modifications	$1.2 - $4.6	Provider Contract Negotiations / Meet & Confer
EC.4.d	Implement Sick Leave Payment Upon Retirement Program Modifications	$1.8	Meet & Confer
EC.5	Change Prevailing Wage Applications: Eliminate Service Contracts	$1.2	Council Approval

SR.0 - SERVICE REDUCTIONS			
	STRATEGY	**POTENTIAL FISCAL IMPACT** (estimates in millions)	**IMPLEMENTATION CONSIDERATIONS**
SR.1	Reduce / Eliminate City Services to Funding Capacity	$25.0	Council Approval