COUNCIL AGENDA: 11-15-11
ITEM: 3.6

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **2012-2013 PRELIMINARY GENERAL FUND FORECAST**

DATE: 11-09-11

RECOMMENDATION

As directed by the Rules and Open Government Committee on November 9, 2011, and outlined in the attached memo previously released to Council on November 4, 2011, attached is the report on the 2012-2013 Preliminary General Fund Forecast.

Debra Figone
City Manager

Attachment

Distributed on:
NOV - 4 2011
City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **2012-2013 PRELIMINARY GENERAL FUND FORECAST**

DATE: November 4, 2011

INFORMATION

EXECUTIVE SUMMARY

The City Manager's Budget Office has completed a 2012-2013 Preliminary General Fund Forecast that will be used as an initial planning tool in the development of the 2012-2013 Proposed Budget. Following ten consecutive years of shortfalls, the budget outlook for the General Fund remains dismal as the Preliminary Forecast reflects another projected shortfall of $80.5 million for 2012-2013. It must be emphasized that this is a very preliminary forecast based on the limited data currently available. This Forecast will need to be updated as additional information becomes available on the revenue streams that fund the City's General Fund operations and key expenditure drivers.

Following are the major highlights of the Preliminary Forecast:

- When the 2012-2013 Preliminary Forecast budget figures are compared to the 2011-2012 Adopted Budget, the projected $80.5 million shortfall results from a combination of the carry-over of one-time solutions used to balance the 2011-2012 Adopted Budget shortfall ($34.9 million) and net expenditure increases ($61.8 million), that are partially offset by slightly higher revenue estimates ($16.2 million).

2012-2013 General Fund Shortfall Components (Ongoing)	$ in Millions
Carry-Over from 2011-2012 Adopted Budget	**($ 34.88)**
Major Expenditure Changes	
- Retirement Contributions Increases (Police ($27.1 million), Fire ($13.9 million), Federated/Other ($9.3 million))	(50.33)
- Redevelopment Agency Additional Impact	(10.00)
- 2012-2013 Committed Additions (capital projects scheduled to come on-line)	(6.16)
- Health Care Increase	(2.54)
- Salary Step Increases/Performance Pay	(1.23)
- Unemployment Insurance Savings	2.44
- Sick Leave Payments Upon Retirement Savings	2.00
- Debt Service/Subsidy Net Savings	1.65
- Other Expenditure Net Savings	2.37
Total Expenditure Changes	**($ 61.80)**
Major Revenue Changes	
- Sales Tax Increase	9.11
- Property Tax Increase	4.26
- Other Revenue Net Increases	2.83
Total Revenue Changes	**$ 16.20**
Total 2012-2013 Projected General Fund Shortfall	**($ 80.48)**

- While overall revenues are expected to experience modest growth in 2012-2013, this increase does not keep pace with the projected increase in expenditures. As has been the case for many years, the structural imbalance between General Fund revenues and expenditures continues to result in a significant budget gap. The budget shortfall of $80.5 million for 2012-2013 represents 9.2% of the projected expenditures for next year.

- As shown in the chart on the previous page, the small growth in revenues is driven primarily by increases in the City's two largest General Fund revenue sources, Sales Tax and Property Tax. Updated estimates for the other revenue categories also result in slight improvement from the 2011-2012 Adopted Budget. On the expenditure side, the projected increase in City retirement contributions is the major factor driving up costs in 2012-2013. The additional potential impact associated with the San Jose Redevelopment Agency and the cost of committed additions (capital projects scheduled to come on-line) are also significant components of the 2012-2013 shortfall. Slight upward and downward expenditure adjustments have also been calculated to reflect the latest information on health care, unemployment, debt service/facility subsidies, sick leave payments upon retirement, and other costs. In addition, the 2012-2013 budget starts with a shortfall of $34.9 million that was carried over from the 2011-2012 Adopted Budget due to the use of one-time solutions to resolve the 2011-2012 budget deficit.

- It is important to note that this Preliminary Forecast does not reflect: the impact of potential compensation changes resulting from any Police Officers' Association (POA) arbitration results or negotiations with the City's five employee bargaining groups that do not have agreements for 2012-2013; unmet/deferred infrastructure and maintenance needs; and one-time revenue sources or expenditure needs. In addition, any gaps between revenues and expenditures in the Planning, Building, Public Works, and Fire Development Fee Programs are not reflected. It is assumed that these programs will be adjusted to recover 100% of their costs.

- The Preliminary Forecast will be refined over the next several months as additional information becomes available. There are some revenue and expenditure categories that may experience significant changes based on updated information, including contributions to the retirement plans. For the Federated City Employees' Retirement System, the annual required contribution for pension costs is based on the June 2011 preliminary valuation by the Federated Retirement Board's actuary, combined with the assumption changes approved by the Federated Retirement Board on October 20, 2011; while the required contributions related to retiree healthcare were calculated by the actuary in July 2011. For the Police and Fire retirement plans, the annual required contributions were calculated by the Police and Fire Retirement Board's actuary in July 2011. Because the June 2011 valuation of the Police and Fire Department Plan is not yet available and discussions regarding changes to the assumptions used to calculate the annual required contribution are ongoing, no changes to the contribution levels estimated in July 2011 have been assumed in this forecast. Final City contribution levels for all retirement plans are expected to be known within the next few months and will be incorporated in the February forecast. Other areas that may experience significant changes include San Jose Redevelopment Agency-related impacts, and

economically sensitive revenues, such as sales tax. The formal 2013-2017 General Fund Five-Year Forecast will be issued in February 2012, and updated Base Budget revenue and expenditure estimates will be included in that document. Base Budget estimates will continue to be refined through the release of the City Manager's 2012-2013 Proposed Budget scheduled for May 2012.

- The City developed a *General Fund Structural Deficit Elimination Plan* in 2008 as the blueprint to address the organization's long-term fiscal challenges. This plan outlined three strategies to address the structural deficit: cost-savings strategies; revenue strategies, and service reductions/eliminations. In May 2011, the City issued a *Fiscal Reform Plan* that served as an update to the original plan. The Fiscal Reform Plan focuses on pension reform, other employee compensation changes, as well as potential revenue solutions to help resolve the City's structural deficit and restore essential City services that have recently been reduced or eliminated. The ability of the City to successfully implement fiscal reform strategies will have a profound impact on the budget balancing solutions that will be brought forward in 2012-2013 and, ultimately, the services the City will be able to provide next year.

BACKGROUND

The City Manager's Budget Office has completed very early projections on the status of the General Fund for the next fiscal year. This Preliminary Forecast provides a starting point in the development of the 2012-2013 Proposed Budget. It is designed to provide an order of magnitude of the projected shortfall for the upcoming fiscal year.

The revenue and expenditure estimates update the figures that were last presented in the 2012-2016 General Fund Five-Year Forecast issued in February 2011 and updated through the 2011-2012 Adopted Budget. The projections reflect the following: actual 2010-2011 revenue and expenditure performance; year-end 2011-2012 revenue and expenditure projections based on activity through the first two to three months of the current fiscal year and revised expectations on economic performance; updated salary, benefit and other cost information; and committed additions, such as the operating and maintenance impact of capital projects that are scheduled to come on-line in 2012-2013.

ANALYSIS

Overview

The following table displays the projected General Fund revenues and expenditures for 2012-2013, resulting in the $80.5 million General Fund budget shortfall.

2012-2013 PRELIMINARY GENERAL FUND FORECAST

	($ in millions)
2012-2013 General Fund Source of Funds	$ 794.5
2012-2013 General Fund Use of Funds	$ 875.0
2012-2013 Projected Budget Shortfall	**($ 80.5)**

When compared to the 2011-2012 Adopted Budget, the projected growth in General Fund revenues of $16.2 million is not sufficient to address the projected increase in costs ($61.8 million) or the carry-over of the 2011-2012 Adopted Budget shortfall addressed with one-time solutions ($34.9 million). As a result, another large General Fund shortfall is projected for 2012-2013. Following is a discussion of major forecast components as well as the revenues and expenditures that are not included in the Preliminary Forecast model.

Major Forecast Components

The Preliminary Forecast aggregates the General Fund revenue estimates as well as the expenditure projections for 2012-2013. The expenditure projections include the cost of delivering existing services as well as the cost of delivering additional services to which the City is currently committed, primarily the operating costs of new facilities scheduled to come on-line in the next year. Following is a discussion of each of the major components.

General Fund Revenues

The General Fund revenue estimates for 2012-2013 were prepared by analyzing over 450 individual revenue sources. This includes reviewing actual collection trends, developing revenue growth assumptions based on current economic conditions, evaluating any available information on future rate increases/activity trends that would impact the City's revenues, and updating reimbursement-related revenues based on projected costs. Preparing the revenue projections for 2012-2013 is challenging at this time given the limited or lack of data available for 2011-2012.

The 2012-2013 Preliminary General Fund Forecast is based on the expectation that the economy will continue to experience a slow recovery through 2011-2012 with moderate improvement projected in 2012-2013. The factors which drive the City's revenues continue to show mixed results, though they appear to be trending to reflect positive economic growth. As of September 2011, the number of jobs in the San José-Sunnyvale-Santa Clara Metropolitan Statistical Area was up 1.6% from a year ago, increasing from 900,100 to 914,600. The unemployment rate stands at 9.6%, down from a year ago when the rate stood at 11.0%, but still high by historical standards. At $481,500, the median price of a single-family home is 5.6% below the September 2010 level of $510,000. Over the next several months, the economic conditions will be closely monitored and any related adjustments to the 2012-2013 revenue estimates will be factored into the final 2013-2017 General Fund Forecast.

In addition to the economically sensitive revenues, there are a number of revenue sources that are primarily impacted by other factors, such as rate changes and reimbursement-related costs. For the revenue streams impacts by these factors, such as Utility Taxes, Franchise Fees, and Transfers and Reimbursements, the preliminary revenue estimates have been developed based on available information related to anticipated rate adjustments and costs that will be refined in the final forecast.

Following is a brief summary of the assumptions used for the City's largest two General Fund revenue sources, Property Tax and Sales Tax, along with major other revenue estimate

adjustments and the 2011-2012 Ending Fund Balance/2012-2013 Beginning Fund Balance estimate.

- Property Tax: In 2011-2012, it is assumed that Property Tax revenues will end the year 2.7% above the 2010-2011 actual collections based on current projections provided by the County of Santa Clara. In 2012-2013, Property Tax receipts are expected to increase 2.8% over the estimated 2011-2012 collection level, bringing total collections to $205.7 million in 2012-2013. For Secured Property Taxes, which represent over 90% of the revenues in this category, receipts are expected to increase 0.9% in 2011-2012 from the prior year based on the latest information from the County of Santa Clara and increase an additional 2.5% in 2012-2013. The expected 2.5% growth in 2012-2013 reflects the anticipated 2% increase in the California Consumer Price Index (CCPI), which is used as a primary driver in the Secured Property Tax calculations, as well as minimal additional growth.

- Sales Tax: Factoring out prior year adjustments, underlying Sales Tax growth of 2% to 3% is expected in 2011-2012, with additional growth of 3% projected for 2012-2013. Because there is a sizeable amount of one-time sales tax revenue in 2011-2012, reflecting prior year true-up payments, the year-over-year total growth is anticipated to be 7.6% in 2011-2012 and 0.5% in 2012-2013. To develop the 2012-2013 estimate of $149.2 million, staff analyzed actual 2010-2011 performance and reviewed the economic forecasts provided by MuniServices, the City's Sales Tax consultant, as well as the UCLA Anderson School and Beacon Economics. It should be noted that the $149.2 million collection level remains below the $154.0 million collected in 2007-2008, the City's most recent peak collection year.

- Major Other Revenue Estimate Adjustments: To develop the 2012-2013 estimates, all revenue sources were reviewed to project 2011-2012 collection levels and any anticipated changes for 2012-2013. Major assumptions and adjustments include:

  - *Marijuana Business Tax (MBT):* Collections of $2.5 million were projected in the 2011-2012 Adopted Budget, and collections are assumed to remain flat in 2012-2013. Given the current uncertainty surrounding the Marijuana Regulatory Program, the most recent data for September MBT collections shows an almost 62% decline from the $322,000 average monthly collections since the inception of the tax in March 2011. Given the volatility of this new revenue source, collections and regulations will be closely monitored and adjusted as necessary, as additional information becomes available.

  - *Overhead Reimbursements:* Overhead collections in 2011-2012 are anticipated to decline almost 9% from prior year levels and an additional 6% in 2012-2013 to $29.5 million. This decline reflects the anticipated continued reduction in the size of the City's Capital Improvement Program.

- 2011-2012 Ending Fund Balance/2012-2013 Beginning Fund Balance: Each year, it is expected that an ongoing amount of expenditure savings and excess revenue from the current year will be available in the following year. Through the combination of excess revenues, expenditure savings, and carryover encumbrance liquidations, $13.0 million is assumed to be

available as a funding source for 2012-2013. Revenue collection trends and expenditures will continue to be monitored and this estimate will be revised as appropriate. In addition, it is assumed that the Contingency Reserve of $29.3 million and $57,000 from the Wellness Reserve will be carried over to 2012-2013.

On an overall basis, 2012-2013 General Fund revenues of $752.2 million (excluding the 2011-2012 Ending Fund Balance/2012-2013 Beginning Fund Balance) are expected to be approximately 1.6% below the 2011-2012 Adopted Budget level of $764.8 million. When compared to the Adopted Budget, the largest declines are the result of the elimination of one-time grants and transfers and a reduction in reimbursement from the San Jose Redevelopment Agency. The 2012-2013 Beginning Fund Balance of $42.4 million is expected to be 65.0% below the 2011-2012 Adopted Budget level due primarily to the elimination of rebudgets that were carried over from 2010-2011 to 2011-2012 to complete projects. With the large change in the Fund Balance figure, the total 2012-2013 General Fund sources of funds of $794.6 million are 10.3% below the 2011-2012 Adopted Budget level of $885.8 million.

General Fund Expenditures

To estimate the General Fund expenditures, growth assumptions are developed for each of the General Fund expenditure categories, including Personal Services, Non-Personal/Equipment and Other Expenditures, Development Fee Programs and Committed Additions. Total expenditures are projected at $875.0 million for 2012-2013, which is 1.2% below the 2011-2012 Adopted Budget level of $885.8 million (excludes Carryover Encumbrances). This change reflects the net impact of growth of 8.0% in the Personal Services and 0.88% in Non-Personal/Equipment categories and a decline of 31.6% in the other expenditure categories (City-Wide Expenses, Capital, Transfers, and Reserves). This large decline primarily reflects the elimination of carryover rebudgets from 2010-2011 to 2011-2012 to complete projects and the fact that Earmarked Reserves have not yet been carried over to 2012-2013.

- Personal Services Expenditures: The largest cost category is Personal Services, which represents almost three-fourths ($644.9 million) of the City's Base Budget costs. Personal Services costs are broken down into three major components: Salaries and Other Compensation ($346.8 million); Retirement ($247.6 million); and Health and Other Fringe Benefits ($50.4 million). For 2012-2013 the projection for Personal Services costs has been calculated at a detailed level by analyzing each of these cost components. To develop the 2012-2013 Personal Services projections, an extract of the City's payroll system information as of August 2011 was used as the starting point to identify the salaries, current salary steps, and benefits of existing staff. For 2012-2013, these Personal Services costs are adjusted for scheduled step increases and any other salary-related adjustments. The Personal Services budget for each department is also adjusted to reflect anticipated vacancies during the year. Following is a summary of the major assumptions used in the Personal Services projections:

  - *Salaries and Other Compensation:* For 2012-2013, salary and other compensation costs total $346.8 million or 53.8% of the total base expenditure budget. There are no salary changes assumed in 2012-2013 for any employee group. Agreements for the Association of Building, Mechanical and Electrical Inspectors (ABMEI), Association

of Engineers and Architects (AEA), Association of Maintenance Supervisory Personnel (AMSP), and International Association of Firefighters (IAFF) were approved in 2011 and reflect no approved wage increase in 2012-2013. The imposition of terms by the City Council in June 2011 for the International Union of Operating Engineers, Local No. 3 (OE#3), Municipal Employees' Federation (MEF), International Brotherhood of Electrical Workers (IBEW), and Confidential Employees' Organization (CEO) expire June 30, 2012. The Agreement with the Association of Legal Professionals (ALP) also expires June 30, 2012. The expiration date of the agreement with POA, as well as the ongoing nature of a 10% total compensation reduction approved for 2011-2012, were not agreed upon and will be submitted to binding interest arbitration. For purposes of this Forecast, no wage increases are assumed in 2012-2013 for any employee group. Approval of any negotiated salary increases, without any offsetting increase in revenues or reduction in services or other costs, will have the effect of driving up the City's General Fund shortfall. It is important to note that should an arbitrator determine that the terms of the agreement approved on June 14, 2011 for the POA are one-time in nature rather than ongoing, the increase to the Preliminary Forecast shortfall is currently estimated to total approximately $25 million next year.

The Preliminary Forecast also assumes annual non-management step and management pay for performance increases for employees that have not reached the top step in their classification. The projected average growth rate associated with step and pay for performance increases is approximately 0.2%. This accounts for approximately $1.2 million of the Personal Services costs in 2012-2013. With the exception of employees represented by the POA and IAFF, non-management step increases have been calculated at a 2.5% step increase rate. For POA and IAFF, a 5% step increase rate was applied in this forecast.

- *Retirement:* For 2012-2013, retirement costs total $247.6 million or 38.4% of the total base expenditure budget. Based on the Federated and Police and Fire Retirement Boards' methodology change approved last year, the City's Annual Required Contribution has been set at a fixed amount and assumes that the full retirement payment is made on July 1, 2012 for 2012-2013.

  For purposes of this Preliminary Forecast, the City's estimated retirement contribution for the Federated City Employees' Retirement System (pension and retiree healthcare) is estimated at $128.2 million in all funds (approximately $65.6 million in the General Fund). The portion of these contributions attributed to pension costs is based on the June 2011 preliminary valuation by Cheiron, the Federated Retirement Board's actuary, combined with the assumption changes approved by the Federated Retirement Board on October 20, 2011. The required contributions related to retiree healthcare were calculated by the actuary in July 2011.

  In this Preliminary Forecast, the City's retirement contribution for the Police and Fire Department Retirement Plan (pension and retiree healthcare) totals $181.8 million in all funds ($181.4 million in the General Fund). These estimates were calculated by Cheiron, the Police and Fire Retirement Board's actuary, in July 2011. Because the

June 2011 valuation of the Police and Fire Department Plan is not yet available and Retirement Board discussions regarding changes to the assumptions used to calculate the annual required contribution are ongoing, no changes to the contribution levels estimated in July 2011 have been assumed in this forecast. Final City contribution levels are expected to be known within the next few months for all retirement plans and will be incorporated in the February forecast.

Other retirement contributions, covering the Part-Time, Temporary, and Contract (PTC) 457 Deferred Contribution Plan and the California Public Employees' Retirement System (CalPERS) for the Mayor and City Council, total $0.6 million in this forecast. These costs assume a 3.75% City contribution rate (calculated on base salary) for PTC 457 employees and a 16.1% CalPERS contribution rate based on notification received from CalPERS in October 2011 for 2012-2013.

While the majority of retirement costs are calculated as a fixed contribution amount, it should be noted that these costs are budgeted as a percent of pensionable salary in the City's Automated Budget System in order to spread these costs across departments and funds. In 2012-2013, the budgetary retirement rate required to be applied in order to fund the estimated annual required retirement contribution is estimated at 52.09% for Federated, 96.44% for Police, and 98.62% for Fire. This compares to 2011-2012 rates of 43.69% for Federated, 75.06% for Police, and 74.04% for Fire.

- *Health and Other Fringe Benefits:* Cost increases have been projected based on the scheduled increase to the City's contribution for employee health care of 7.2% effective January 1, 2012 and a projected 11% increase effective January 1, 2013 based on recent information from the Human Resources Department. The value of the increase for 2012-2013 when compared to the 2011-2012 Adopted Budget is $2.5 million.

- Non-Personal/Equipment and Other Expenditures: The remaining cost categories, Non-Personal/Equipment and Other Expenditures (City-Wide Expenses, Capital, Transfers, and Reserves), have also been calculated at a detailed level for 2012-2013. For 2012-2013, the projection for Non-Personal/Equipment and Other Expenditures totals $224.0 million. Following is a summary of the major assumptions used in the Non-Personal/Equipment and Other Expenditures projections:

  - *Non-Personal/Equipment:* The Non-Personal/Equipment allocation totals $81.8 million in 2012-2013, a small increase from the 2011-2012 Adopted Budget level of $81.2 million. The process for determining 2012-2013 expenditure levels utilized by the Budget Office includes adjusting each department's current year budget to eliminate one-time cost allocations, annualizing all partial-year reductions or additions approved for 2011-2012, and including projected adjustments for large non-personal/equipment allocations (eg. utilities, contracted services, fuel, and Police Department vehicle replacement). Departmental gas and electricity funding for 2012-2013 has been slightly adjusted in this Preliminary Forecast to reflect projected rate increases and consumption changes.

- *City-Wide Expenses:* The City-Wide Expenses allocation totals $74.2 million in 2012-2013, a decline from the 2011-2012 Adopted Budget level of $112.9 million. This large reduction primarily reflects the impact of eliminating one-time grants. The line-items in this category are adjusted based on factors such as contractual agreements, debt service schedules, and historical expenditure patterns. For 2012-2013, the Workers' Compensation Claims allocation ($18.5 million) represents an increase of $0.5 million from the 2011-2012 level. The debt service payment for the Convention Center totals $15.3 million. After a detailed eligibility analysis, this Forecast includes an allocation of $7.5 million for Sick Leave Payments Upon Retirement, pending current negotiations with bargaining units.

- *Capital, Transfers, and Reserves:* The Capital, Transfers, and Reserves allocation totals $68.0 million. The Contingency Reserve assumed in this Forecast is set at the same level as in the 2011-2012 Adopted Budget. Per City Council Policy, this reserve is set at a minimum of 3% of total General Fund expenditures, amounting to approximately 2.5 weeks of payroll. Transfers total $30.7 million in 2012-2013. The largest transfer is the General Fund portion of the City Hall debt service costs totaling $15.7 million. Lastly, capital projects in the General Fund total $7.3 million. The largest capital projects allocation is for fire apparatus replacement ($5.3 million), which is necessary to ensure our firefighting equipment is in an acceptable condition at all times.

- *San Jose Redevelopment Agency (SJRA):* On June 28, 2011, as part of the approval of the State budget, the Governor signed Assembly Bill XI 26 which would dissolve redevelopment agencies throughout the State. On August 11, 2011, the California Supreme Court granted a Stay pending the Court's ruling on the dissolution of redevelopment agencies. The Court is expected to make a decision on the dissolution of redevelopment agencies by January 15, 2012.

  Pending the Court's decision, the Administration analyzed the potential impacts to the General Fund, if SJRA continues to operate or dissolve. If SJRA continues to operate, the total current estimated impact to the General Fund is approximately $20 million for 2012-2013 to cover SJRA's payment of the annual Convention Center debt service ($15.3 million) and other obligations. However, it is unclear at this point which SJRA obligations have recourse to the General Fund. If SJRA dissolves, the total potential impact to the General Fund may be less. Since the 2011-2012 Adopted Budget includes $10 million towards payment of the Convention Center debt service, the additional impact to the General Fund if SJRA continues to operate amounts to $10 million; that impact has been included in the Preliminary Forecast. As additional information regarding the status of the SJRA is known, the General Fund impact will be updated as part of the development of the 2013-2017 General Fund Five-Year Forecast scheduled for release in February 2012 and throughout the budget process.

  For purposes of this forecast, it is assumed that tax increment revenue for 2012-2013 remains flat; the General Purpose Parking Fund will be the source for the 4th Street/San Fernando Garage debt service payment and the Community Development Block Grant

fund will be the source for the HUD 108 loan repayment; property sales occur in 2011-2012 as planned; and there will be no changes to the Agency's credit ratings which could impact the interest cost paid on outstanding debt.

- Development Fee Programs: It is assumed that the development fee programs will be 100% cost recovery with General Fund revenues and expenditures brought into alignment, resulting in a net-zero impact on the City's General Fund Forecast. The 2012-2013 costs have been adjusted downwards by $0.2 million in the Fire Fee Program to match the projected 2012-2013 revenues. The revenues and expenditures for the remaining partners, Planning, Building and Public Works, have been aligned with no revenue shortfall currently estimated for 2012-2013. As part of the 2012-2013 Proposed Operating Budget process, budget actions will be brought forward for these programs to maintain cost recovery while meeting service delivery needs.

- Committed Additions: The Committed Additions category reflects anticipated maintenance and operating costs for new capital projects approved in the Adopted Capital Improvement Program. The Committed Additions in 2012-2013 are projected at $6.2 million.

  - *Bond-Financed Facilities ($6.01 million):* This allocation includes $2.9 million for libraries including the new Bascom, Calabazas, Educational Park, and Seven Trees branch libraries; $2.4 million for the South San José Police Substation; and $600,000 for the Bascom Community Center. The opening for these facilities was deferred to fall 2012 as part of the 2011-2012 Adopted Budget due to the significant operations and maintenance impact on the General Fund. The Bascom Community Center was added to the Facility Reuse Program. Should a service provider be identified in the next several months, the funding needs for this facility will be adjusted downward as part of the 2013-2017 Five-Year Forecast and Revenue Projections document that will be released in February .

  - *Other Operating Impacts of Capital Programs ($152,000):* Funding is allocated for new parks and recreation facilities such as trails ($72,000) and new traffic infrastructure such as new traffic signals, landscaping, street lighting, and the Traffic Incident Management Center ($80,000).

Given the large General Fund shortfall projected for 2012-2013, a continuation of the City Council-approved strategy to defer or delay opening facilities or pursue alternative funding sources included in the 2011-2012 Adopted Budgets may be required. An evaluation of the project schedules and/or the staffing necessary to maintain and operate these facilities will be included in the upcoming budget process.

Significant Risk Factors/Revenues and Expenditures Not Reflected in Forecast Model

It is important to note that there are a number of significant factors that may impact the City's General Fund condition during the next fiscal year. The revenue and expenditure categories that may experience significant changes based on updated information include contributions to the retirement plans, San Jose Redevelopment Agency-related impacts, and economically sensitive revenues, such as sales tax.

In addition, the forecast model does not incorporate the following:

- Police Officers' Association (POA) Arbitration Results/Negotiated Labor Agreements: The Preliminary Forecast assumes the compensation reductions approved in 2011-2012 for employees represented by the POA will be ongoing. However, it is currently unsettled whether those reductions were one-time or ongoing in nature, and the issue is scheduled for arbitration in the near future. If the City does not prevail and the arbitrator determines that the compensation reductions are one-time, the 2011-2012 budget shortfall would increase by approximately $25 million. In addition, as discussed above, there are no agreements in place for five of the City's bargaining units (ALP, MEF, CEO, OE3, and IBEW) and no salary adjustments have been factored in for those groups.
- Unmet/Deferred Infrastructure and Maintenance Needs: As reported to the City Council in May 2011, the annual ongoing need in the General Fund totals $105 million, assuming a one-time General Fund backlog of approximately $474 million is met. The Forecast does not assume additional funding to address this need.
- One-Time Revenues/Expenditures: Because the Forecast compares ongoing revenues and expenditures, it generally does not factor in one-time funding sources or one-time expenditure needs.

NEXT STEPS

The City will be faced with another extremely challenging budget process for 2012-2013. Over the next several months, efforts will be underway to refine revenue and expenditure estimates for 2012-2013, pursue fiscal reform efforts to address the General Fund structural imbalance, and develop a budget balancing plan. In developing the 2012-2013 budget, feedback from various stakeholders will also be solicited.

Following is a timeline for the budget development process:

January 2012

- Community Budget Survey
- Neighborhood Association/Youth Commission Priority Setting Session
- 2011-2012 Mid-Year Budget Review Released

February 2012

- 2012-2013 City Manager's Budget Request and 2013-2017 Five-Year Forecast and Revenue Projections for the General Fund and Capital Improvement Program Released
- 2011-2012 Mid-Year Budget Review Approved by the City Council

March 2012

- 2012-2013 Mayor's March Budget Message Released, Public Hearing, 2012-2013 Mayor's March Budget Message Amended/Approved by the City Council

April 2012

- 2012-2013 Proposed Capital Budget and 2013-2017 Capital Improvement Program Released

May 2012

- 2012-2013 Proposed Operating Budget and 2012-2013 Proposed Fees and Charges Released
- Council District Community Meetings to Discuss 2012-2013 Proposed Budget (April/May)
- City Council Study Sessions and Initial Public Hearing on 2012-2013 Proposed Operating Budget, 2013-2017 Proposed Capital Budget and Capital Improvement Program, and 2012-2013 Proposed Fees and Charges

June 2012

- 2012-2013 Mayor's June Budget Message Released, Final Public Hearing, 2012-2013 Mayor's June Budget Message Amended/Approved by the City Council
- 2012-2013 Operating Budget, 2012-2013 Capital Budget and 2013-2017 Capital Improvement Program, and 2012-2013 Fees and Charges Adopted by the City Council

CONCLUSION

In the 2012-2013 Preliminary General Fund Forecast, a General Fund shortfall of $80.5 million is projected. This early data is provided to assist in planning efforts and will be refined over the next several months as additional information becomes available. It must be emphasized that the forecast figures presented in this document have been developed based on the limited data currently available. As additional information becomes available, changes to these estimates will likely be necessary and will be incorporated into the formal 2013-2017 General Fund Forecast that is scheduled to be released in February 2012. This later and updated forecast will provide a more in-depth analysis of revenue and expenditure trends and will present optimistic and pessimistic cases that will illustrate the impacts of lower or higher revenue and expenditure growth on the City's General Fund. In addition, base budget estimates will continue to be refined through the release of the City Manager's 2012-2013 Proposed Budget scheduled for May 2012.

With the 2012-2013 budget, the City of San José will be facing its eleventh consecutive year of General Fund budget shortfalls. Over the last decade, General Fund budget deficits totaling

almost $700 million have been addressed and 28% of the City workforce (2,054 positions) has been eliminated. These impacts have been more severe over the past three years with budget shortfalls of over $300 million and the elimination of over 20% of the workforce. The budgetary challenges facing the organization in 2012-2013 are expected to be even more severe and will be unacceptable to the San José community given the budget balancing actions that have already been implemented. Fundamental changes to the City's revenue and cost structures are needed to create a sustainable organization that can meet the most critical needs of our community. The Fiscal Reform Plan issued in May 2011 outlines strategies to address the General Fund structural imbalance. The success of those efforts will have a major impact on the development of the 2012-2013 Proposed Budget and, ultimately, the services that will be provided to our community.

DEBRA FIGONE
City Manager