

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: 2006-2007 ANNUAL REPORT

DATE: September 28, 2007

RECOMMENDATIONS

It is recommended that the City Council:

1. Accept the 2006-2007 City Manager's Annual Report of the Financing of the City of San José in compliance with City Charter Section 701 (F).
2. Adopt Appropriation Ordinance and Funding Sources Resolution amendments in various operating and capital funds to implement the 2006-2007 Annual Report recommendations, including appropriate technical adjustments, as detailed in Section III (Appropriation/Clean-Up Adjustment Actions).
3. Adopt a resolution to amend the 2007-2008 Schedule of Fees and Charges to standardize the photocopying fee at \$0.20 per page for standard copies (8 1/2"x11" and 11"x17") for each department within the City of San José. This does not apply to fees set by State or federal law or specialized services, such as blueprints and optical imaging reproduction.
4. Approve the addition of 1.5 positions in the Parks, Recreation and Neighborhood Services Department to support grant-funded augmentations to the Senior Nutrition Program discussed elsewhere in this document, including a 0.5 Food Services Coordinator position and two 0.5 Cook positions.

OUTCOME

In accordance with Section 701(F) of the San José City Charter, the 2006-2007 Annual Report describes the financial status of the City at the end of the 2006-2007 fiscal year. As specified in the City Charter, the focus of the City Manager's Annual Report is a comparison of actual revenue collections and expenditures to projections included in the City's budget. This will provide the City Council with the information necessary to review the financial performance of the City's funds and an understanding of the City's General Fund fund balance. The linkage to both the current year budget and the upcoming budget process will also be discussed.

Approval of the recommended budget actions will implement the technical budget adjustments necessary based on the final 2006-2007 performance, including fund balance reconciliations and rebudget actions to carry over funds to 2007-2008 to complete projects. Other adjustments are recommended to allocate the additional 2006-2007 General Fund Ending Fund Balance/2007-2008 Beginning Fund Balance, to address current year needs, and to recognize grant funding. The recommended adjustment to the 2007-2008 Fees and Charges Resolution will standardize the photocopy fee charged by all City departments.

EXECUTIVE SUMMARY

The City enjoyed solid financial performance in 2006-2007. With prudent budgeting and management of the City's numerous funds, there are no major problems to report. With only a few exceptions, expenditures and revenues occurred within budgeted levels, and relatively stable fund balances remained in all City funds at year end. The steady performance in 2006-2007 serves as a solid starting point for 2007-2008.

The overall local economic environment exhibited mixed signals in 2006-2007. Positive indicators included steady job growth, low unemployment, continued growth in hotel occupancy rates, and a decline in office and manufacturing vacancy rates. The relatively encouraging performance in these areas was tempered, however, by the slowdown in the housing market, the lack of airport passenger growth, and the lack of Sales Tax growth. Concerns remain that the deterioration of the housing market will continue for at least the next year and will negatively impact the City's largest General Fund revenue sources, Property Tax and Sales Tax. The most recent economic news has also not been positive, with the number of jobs declining in the first two months of 2007-2008, a slightly higher unemployment rate in August (5%) over the prior year figure (4.5%), and consumer confidence dropping to almost a two year low in September 2007. Based on these factors, minimal economic growth is still projected for 2007-2008. Because the 2007-2008 Adopted Budget assumed only modest growth, it is currently anticipated that the 2007-2008 revenue estimates will be met.

The General Fund ended 2006-2007 with a fund balance of \$247.6 million, which was \$42.2 million above the estimate used in the development of the 2007-2008 Adopted Budget. Expenditure savings, which reflected the impact of cost controls that continue to be in place, accounted for the large majority of the additional fund balance. Of this amount, \$16.4 million is recommended to be rebudgeted to 2007-2008 to complete projects and to reconcile the development fee programs. The remaining \$25.7 million is recommended to be allocated to address current year needs, to replenish the Economic Uncertainty Reserve, to establish the 2008-2009 Future Deficit Reserve and the Street Maintenance allocation as described below.

PROPOSED ALLOCATION OF FUND BALANCE IN THE GENERAL FUND (\$000s)

Additional Fund Balance	\$ 42,161
Technical/Rebudget Adjustments	
Changes to Fee Reserves	1,157
Rebudgets/Technical Adjustments	15,261
Sub-total Technical/Rebudget Adjustments	16,418
Recommended Adjustments	
Required/Recommended Current Year Adjustments	12,071
2008-2009 Future Deficit Reserve	6,836
Street Maintenance and Repair	6,836
Sub-total Recommended Adjustments	\$ 25,743
Total Allocation of Fund Balance	\$ 42,161

As we move forward, the Administration will continue to monitor and report on the City's financial performance through Bi-Monthly Financial Reports and the Mid-Year Budget Review. The financial results of 2006-2007 will also be factored into the development of the 2009-2013 General Fund Forecast. The preliminary forecast is expected to be released this October.

BACKGROUND

Each year the City issues the Annual Report at the end of September, three months after the close of the fiscal year as required by the City Charter. The Annual Report document includes the following sections:

- **Transmittal Memorandum** - An overall summary of the contents of the 2006-2007 Annual Report. This memorandum also provides information on the proposed standardization of the photocopying fee, a detailed description of Reserves, and the next steps of the budget process.
- **Section I: General Fund** – This section describes the General Fund performance in 2006-2007 and includes the following: Results of Operations in the General Fund; Revenue Performance; and Expenditure Performance.
- **Section II: Special/Capital Funds** – This section provides financial information on the 2006-2007 year-end performance for each special and capital fund, including a description of variances for revenues, expenditures, and the estimated fund balances.
- **Section III: Appropriation/Clean-Up Adjustment Actions** – This section describes recommended budget augmentations/reductions in the General Fund and special/capital funds. A summary of clean-up adjustments in a number of funds is also included to provide technical appropriation and revenue estimate adjustments. These actions also generally fall into three categories: (1) rebudgeting prior year funds for projects not completed last year; (2) reconciling budgeted Beginning Fund Balance amounts in various funds, including the General Fund, with the actual results; and (3) actions that based on more recent information are necessary to revise the 2007-2008 budget to correct technical problems, complete City Council direction and/or address newly emerging, urgent budget issues.
- **Section IV: Financial Statements** - Financial results, prepared by the Finance Department, for all budgeted fund groups for 2006-2007.

ANALYSIS

This Transmittal Letter provides a summary of the City's financial performance in 2006-2007. It includes the following: an overview of the economic environment; the 2006-2007 General Fund financial performance; an analysis of the impact of the General Fund performance on the 2007-2008 Adopted Budget; a discussion of the financial status of selected other City funds; and descriptions of recommendations for revisions to the 2007-2008 Adopted Budgets in a number of funds, including the General Fund. This section also includes a discussion of the standardization of the photocopy fee as well as the next steps in the budget process.

Economic Environment

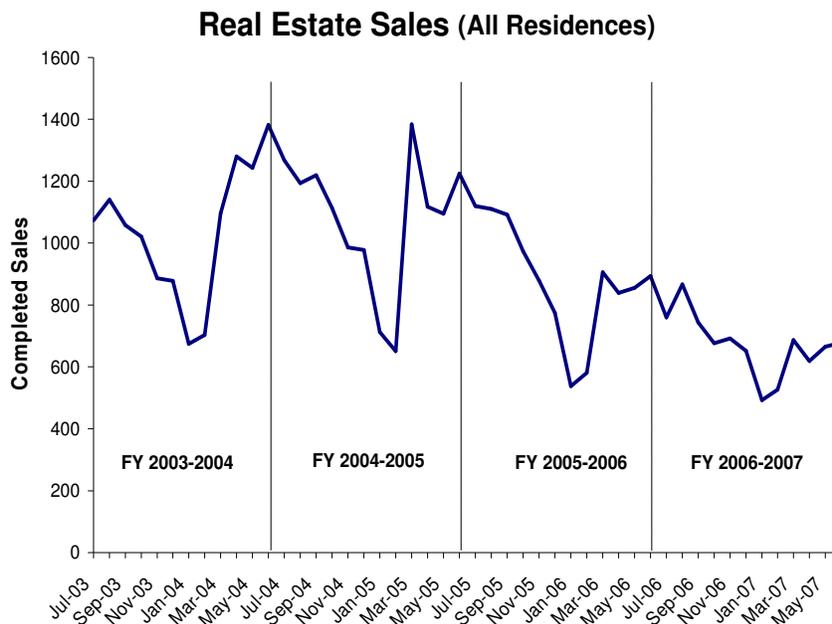
While the City ended the year in sound fiscal shape, the overall economic environment was not overly encouraging and does not lead to an expectation for strong growth in the near future. While some economic indicators were positive in 2006-2007, such as steady job growth and low unemployment, there were other areas of weakness, including the continued slowdown in the

Economic Environment (Cont'd.)

housing market, volatility in the stock market, and the lack of Sales Tax and Airport passenger growth.

The housing market continued to slow in this region, although to a lesser extent than in many parts of California and the U.S. The slowing housing market negatively impacts a number of the City's revenue sources, including Property Taxes and Construction and Conveyance Taxes. The slowdown in this area can also indirectly impact Sales Tax collections with the downward spending in construction materials and the reduction of consumer spending as the "wealth effect" associated with housing appreciation diminishes.

As shown in the chart below, the number of housing sales dropped significantly in 2006-2007, with a decline of almost 24%. This impacted Construction and Conveyance Tax revenues, which dropped 15% in 2006-2007, and SB 813 Property Tax (retroactive collections back to the point of sale for reassessment of value due to property resale), which dropped 21% in 2007-2008. The impact of the current housing slowdown on property tax receipts will not, however, be fully realized until 2007-2008 and 2008-2009, since the 2006-2007 Secured Property Tax receipts were based on the value of property assessed as of January 1, 2006, with adjustments for roll corrections. Since real estate activity was still performing well through calendar year 2005, Secured Property Tax receipts experienced strong growth in 2006-2007.



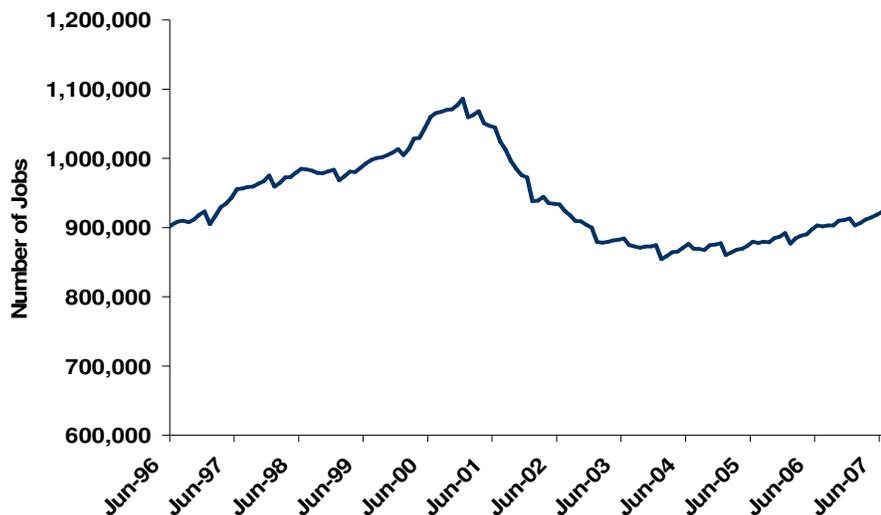
The economic impacts of the slowing housing market remain a major concern. As reported in the 2007 third quarterly report of the UCLA Anderson Forecast, the real estate markets are expected to be a drag on California growth for at least a year to come. This slowdown is

Economic Environment (Cont'd.)

considered a major barrier to economic growth for the City that was factored into the 2007-2008 revenue estimates. Staff will continue to closely monitor activity in this area and performance of the impacted revenue categories.

While the housing market presented challenges, the number of jobs in the San José region continued to grow in 2006-2007, with an increase of 2.1% to 922,100 jobs as shown in the chart below. Through June 2007, this region had experienced 33 consecutive months of year-over-year job gains.

**San José Metropolitan Statistical Area
(Santa Clara County)
Employment: Total Jobs Comparison**



It should be noted, however, that through June 2007, the number of jobs in this region was still 164,000 below the peak in December 2000 of 1.1 million jobs. Between this peak and the low point in January 2004, approximately 232,000 jobs were lost. Of this amount, 67,700 (29%) have been added back, bringing the number of jobs to 922,100.

In addition to the gains in the number of jobs, the local unemployment rate remained relatively low. The June 2007 unemployment rate for the San José area (unadjusted) was 4.8%, up slightly from 4.4% in May 2007 and the June 2006 level of 4.7%. The June 2007 unemployment rate was also slightly below the unadjusted figure for the State (5.2%) and very close to the results for the nation (4.7%).

The performance in the first couple of months of 2007-2008 indicates a fall off from these trends may be occurring. The San José region lost jobs in both July and August of 2007 and the unemployment rate in August 2007 of 5%, while unchanged from the July 2007 figure, was up

Economic Environment (Cont'd.)

slightly from 4.5% a year ago. In addition, consumer confidence sank in September 2007 to almost a two-year low according to the most recent Consumer Confidence report issued by the Conference Board. “Weaker business conditions combined with a less favorable job market continue to cast a cloud over consumers and heighten their sense of uncertainty and concern,” said Lynn Franco, the group’s research director.

2006-2007 General Fund Performance

The City’s General Fund ended the 2006-2007 fiscal year well within budget. The General Fund Ending Fund Balance of \$247.6 million was approximately \$42.2 million above the fund balance estimate assumed when the 2007-2008 Adopted Budget was developed, primarily as a result of expenditure savings.

The following table summarizes the General Fund performance in 2006-2007, comparing the actual results to the modified budget and the estimates used to develop the 2007-2008 Adopted Budget.

Table 1
Results of Operations in the General Fund
For the Year Ended June 30, 2007
(\$000’s)

Sources	2006-2007 Revised Budget	2006-2007 Year-end Estimate	2006-2007 Budgetary Basis Actual	Actual to Budget Variance	Actual to Estimate Variance
<i>Beginning Fund Balance</i>	234,542	234,542	234,542	-	-
<i>Liquidation of Carry- over Encumbrances</i>	-	1,000	1,238	1,238	238
<i>Revenue *</i>	807,193	807,193	805,961	(1,232)	(1,232)
<i>Totals</i>	<u>1,041,735</u>	<u>1,042,735</u>	<u>1,041,741</u>	<u>6</u>	<u>(994)</u>
Uses					
<i>Expenditures *</i>	853,550	806,408	764,652	88,898	41,756
<i>Transfers</i>	29,459	29,459	29,459	-	-
<i>Reserves</i>	158,726	1,399	-	158,726	1,399
<i>Totals</i>	<u>1,041,735</u>	<u>837,266</u>	<u>794,111</u>	<u>247,624</u>	<u>43,155</u>
<i>Available Ending Fund Balance</i>	<u>-</u>	<u>205,469</u>	<u>247,630</u>	<u>247,630</u>	<u>42,161</u>

* After adjusting for a net-zero \$8.5 million of grant and reimbursement related revenues and expenditures not received or expended in 2006-2007, but carried over to 2007-2008, the revenue variance resulted in a surplus of \$7.2 million and the expenditures variance actually totaled \$34.7 million.

2006-2007 General Fund Performance (Cont'd.)

Based on actual 2006-2007 results, there is an additional \$42.2 million in General Fund fund balance that will carry over to 2007-2008. This surplus was the result of expenditure and reserve savings (\$43.2 million), partially offset by lower than anticipated funding sources (\$1.0 million). This presentation, however, slightly understates the revenue performance and overstates the expenditure savings. At the end of 2006-2007, \$8.5 million in revenue-related projects were rebudgeted to 2007-2008. This accounted for \$8.5 million in the expenditure savings and \$8.5 million in lower revenue collections. After adjusting for net-zero grant and reimbursement related rebudgets, a more accurate depiction of the General Fund variances would be a revenue surplus of \$7.2 million, and expenditure savings of \$34.7 million.

Of the \$42.2 million in additional fund balance, \$16.4 million is recommended to be reinvested or rebudgeted as a part of this report to complete previously approved departmental or City-wide projects (\$15.3 million), and to comply with the current policy regarding Development Fee Programs, where any excess revenues over costs are set aside in reserve (\$1.1 million). After adjusting for the rebudgets and technical adjustments, the remaining unallocated General Fund fund balance is \$25.7 million, which is recommended to be allocated in this document.

In addition to comparing the 2006-2007 General Fund actuals to the modified budget and estimates, the revenues and expenditures are also compared to the prior year to identify revenue and expenditure trends. In 2006-2007, the General Fund revenues (excluding Beginning Fund Balance) increased by 5.6% over the 2005-2006 levels, while the expenditures and transfers grew by a slightly larger rate of 7.0%. Table 2 below compares the City's financial performance in 2006-2007, with the financial performance of the prior year (2005-2006).

Table 2
General Fund
Comparison of Year-End Actuals With Prior Year
(\$ in millions)

Sources	2005-2006	2006-2007	Change	% Change
<i>Beginning Fund Balance</i>	188.6	235.7	47.1	25.0%
<i>Revenue</i>	763.1	806.0	42.9	5.6%
<i>Total Source</i>	951.7	1,041.7	90.0	9.5%
Uses				
<i>Expenditures</i>	735.9	764.7	28.8	3.9%
<i>Transfers</i>	6.4	29.4	23.0	359.4%
<i>Total Use</i>	742.3	794.1	51.8	7.0%
<i>Available Ending Fund Balance</i>	209.4	247.6	38.2	18.2%

2006-2007 General Fund Performance (Cont'd.)

As shown in Table 2, 2006-2007 General Fund revenues of \$806.0 million represented an increase of 5.6% from the 2005-2006 collection level. A significant portion of the revenue growth from the prior year actually reflects, however, the discontinuation of the State budget action that diverted \$11.1 million from the City's Property Tax revenue in both 2004-2005 and 2005-2006. In 2006-2007, real growth was experienced in many of the revenue categories, including Property Tax, Transient Occupancy Tax, Franchise Fees, Utility Tax, and Use of Money and Property. Growth in those categories was partially offset by a large decline in the Other Revenue category, which had been extremely high in 2005-2006 due to a one-time transfer of \$25 million associated with the HUD Loan for the FMC property, and small declines in the Fines, Forfeitures and Penalties and Licenses and Permits categories.

General Fund expenditures of \$794.1 million in 2006-2007 increased 7.0% (\$51.8 million) when compared to the prior year expenditure level of \$742.3 million. As shown in Table 3 below, the largest component of growth was in the personal services category, which increased by 8.4% (\$42.0 million). Almost half of this increase (\$20.5 million) occurred in the Police Department, which increased 9.4% in 2006-2007. This increase was driven by cost-of-living adjustment of 5.7% for sworn personnel and 3.75% for non-sworn personnel, step increases and promotions, additional overtime for Orange Alert staffing at the Airport; additional retirement costs associated with the enhanced retirement benefit in the Police Memorandum of Agreement, and the addition of new staff.

Table 3
General Fund
Comparison of Year-End Actuals With Prior Year By Expenditure Category
(\$'000's)

Category	2005-2006 Actual	2006-2007 Actual	Variance	% Variance
<i>Personal Services</i>	501,712	543,684	41,972	8.4%
<i>Non-Personal/Equipment/Other</i>	93,488	105,817	12,329	13.2%
<i>City-Wide Expenses</i>	130,235	102,494	(27,741)	(21.3%)
<i>Capital Contributions</i>	10,465	12,657	2,192	20.9%
<i>Transfers</i>	6,432	29,459	23,027	358.0%
<i>Reserves</i>	-	-	-	N/A
TOTAL GENERAL FUND	742,332	794,111	51,779	7.0%

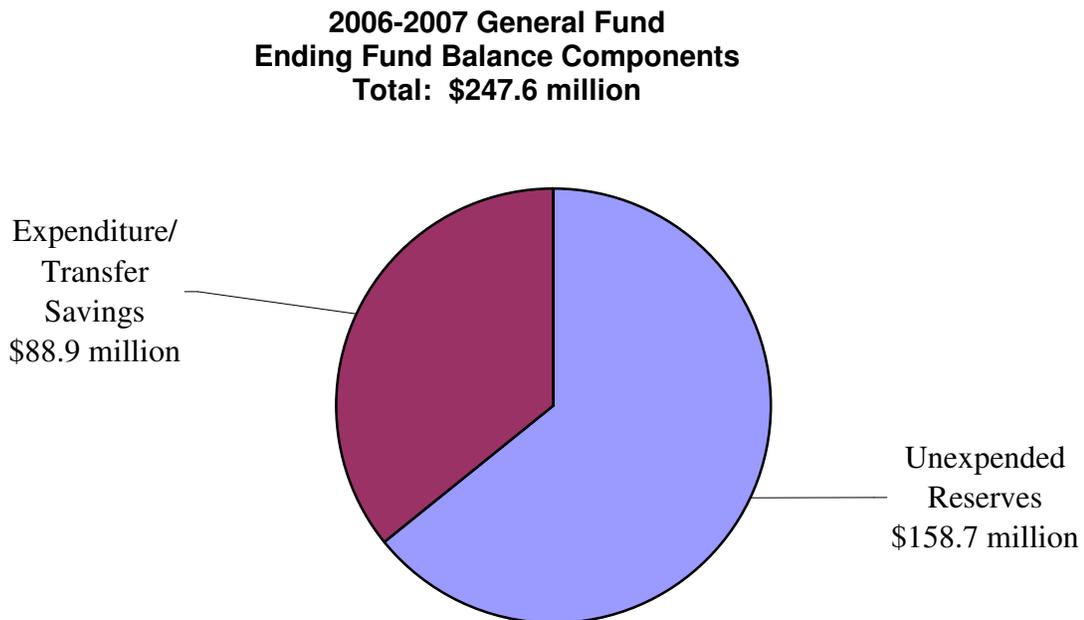
The Transfers category also experienced significant growth in 2006-2007, primarily due to the addition of a Transfer to the Civic Center Debt Service Fund (\$20.0 million) to cover the General Fund's portion of the City Hall debt service costs. The City-Wide category declined significantly in 2006-2007 due to the elimination of a one-time HUD Loan payment in 2005-2006 associated with the FMC property acquisition.

Ending Fund Balance

The current budgeting practice of the City is to use the projected level of fund balance expected to remain in the General Fund at the end of any fiscal year as a funding source for the following year. Thus, each year during the budget process, a detailed estimate of the unused balance in the General Fund is incorporated into the Adopted Budget.

The Ending Fund Balance estimate always contains two components: the portion of the fund balance that needs to be rebudgeted for completing projects or retaining reserves; and that portion which is truly undesignated and available as a general funding source in the coming year. The components of ending fund balance in any year are unexpended reserves, expenditure/transfer savings, excess revenue, and liquidated encumbrances.

When the 2007-2008 Operating Budget was developed, it was estimated that the 2006-2007 ending fund balance would total approximately \$205.5 million. As discussed earlier, the actual ending fund balance of \$247.6 million was \$42.2 million above that estimated level, and \$38.2 million above the prior year level. The components of the 2006-2007 General Fund Ending Fund Balance are described below:



As expected, the largest component of the Ending Fund Balance was unexpended reserves totaling \$158.7 million. General Fund Reserve categories include: Earmarked Reserves (\$101.8 million) established to address specific needs; the Contingency Reserve (\$28.8 million) set at 3% of expenditures per City Council policy; and the Ending Fund Balance Reserve (\$28.1 million) established at the end of 2006-2007 from excess revenues and expenditure savings. Of the \$158.7 million in 2006-2007 Reserves, \$104.4 million was approved for rebudget to 2007-2008

Ending Fund Balance (Cont'd.)

as part of the Adopted Budget and \$52.9 million was used in balancing the 2007-2008 Adopted Budget. The \$157.3 million in Reserves that were rebudgeted or used in the 2007-2008 Adopted Budget accounted for almost 77% of the 2007-2008 Beginning Fund Balance estimate of \$205.5 million. Following is additional information regarding the three reserve categories.

- ***Earmarked Reserves (\$101.8 million)*** – this represented the large majority of reserve dollars and have been set aside by City Council action for specific purposes. At the end of 2006-2007, the largest Earmarked Reserves, which accounted for over 80% of these reserves, were the Salary and Benefits Reserve (\$28.2 million); Development Fee Program Reserves (\$15.3 million); 2007-2008 Future Deficit Reserve (\$10.6 million); Workers' Compensation Reserve (\$10.0 million); Enhanced Park Maintenance (\$7.0 million), Future Capital Projects (FF&E) Reserve (\$6.8 million); and the Hayes Mansion Line of Credit (\$5.0 million). Of the \$101.8 million in Earmarked Reserves, \$101.4 million was either rebudgeted to 2007-2008 (\$76.6 million) or was used in balancing the 2007-2008 Adopted Budget (\$24.8 million). The Reserves that were used as part of the 2007-2008 Budget balancing included the 2007-2008 Future Deficit Reserve (\$10.6 million) that was established for that purpose, the Technology Reserve (\$2.0 million), and portions of the Salary Reserve (\$6.5 million), Development Fee Program Reserves (\$3.4 million), and the Enhanced Parks Maintenance Reserve (\$2.0 million).
- ***Ending Fund Balance Reserve (\$28.1 million)*** – this Reserve was established at the end of 2006-2007 and was funded from 2006-2007 revenue surpluses and expenditure savings. This Reserve matched the excess revenue and expenditure savings assumptions that were assumed in the development of the 2007-2008 Adopted Budget and was used as part of the 2007-2008 budget balancing plan.
- ***Contingency Reserve (\$28.8 million)*** – During 2006-2007, the Contingency Reserve increased by a net total of \$1.8 million from the Adopted Budget level of \$27.0 million to ensure that the Reserve remained at 3% of budgeted expenditures. As part of the 2007-2008 Adopted Budget, \$27.8 million of the Contingency Reserve was rebudgeted to 2007-2008. It is recommended that the remaining uncommitted amount of \$1.0 million be rebudgeted as part of this report.

Expenditure/Transfer savings totaled \$88.9 million. Over 60% of these savings (\$55.2 million) was rebudgeted to 2007-2008 to complete projects. Additional expenditure/transfer rebudgets totaling \$12.2 million are recommended as part of this report. After factoring out these rebudgets, expenditure/transfer savings totaled \$21.5 million at year-end, or 2.5% of the modified budget.

Ending Fund Balance (Cont'd.)

The total revenue variance (-\$1.2 million) was offset by the liquidation of carryover encumbrances (\$1.2 million), resulting in additional fund balance of only \$6,000 attributed to funding sources. After adjusting for grant and reimbursement related revenues that were carried over to 2007-2008 (\$8.5 million), however, revenue actually ended the year \$7.2 million (0.9%) above the modified budget level. (As discussed above, corresponding expenditure savings were also achieved and rebudgeted to 2007-2008 for a net zero impact on the General Fund.)

Impacts on the 2007-2008 General Fund Budget

Beginning Fund Balance

With the City's current budget practice, ending fund balance amounts carried into the next fiscal year as beginning fund balance is a significant source of funding for the budget. In the 2007-2008 Adopted Budget, it was assumed that \$205.5 million would remain at the end of 2006-2007 and would be carried over to 2007-2008 as Beginning Fund Balance. These funds were expected to be generated from unexpended reserves, expenditure savings that were rebudgeted to 2007-2008, and excess revenues, expenditure savings and the liquidation of carryover encumbrances that would be available in 2007-2008. As described previously, the actual General Fund ending balance was above the estimate used in the 2007-2008 Adopted Budget by \$42.2 million, primarily due to additional expenditure savings.

The following chart details the recommendation included in this document for use of the \$42.2 million additional fund balance. It is recommended that almost 40% (\$16.4 million) of the additional fund balance be allocated to address rebudgets and technical adjustments. Of the remaining \$25.8 million, it is recommended that \$12.1 million be allocated to address a limited number of funding needs that have arisen in 2007-2008. The remaining \$13.7 million is recommended to be distributed to the 2008-2009 Future Deficit Reserve and the Street Maintenance and Repair allocation per City Council policy.

PROPOSED ALLOCATION OF ADDITIONAL FUND BALANCE (\$000s)

Fund Balance Variance	\$ 42,161
Technical/Rebudget Adjustments	
Changes to Fee Reserves	1,157
Rebudgets/Technical Adjustments	15,261
Sub-total Technical/Rebudget Adjustments	16,418
Recommended Adjustments	
Required/Recommended Current Year Adjustments	12,071
2008-2009 Future Deficit Reserve	6,836
Street Maintenance and Repair	6,836
Sub-total Recommended Adjustments	\$ 25,743
Total Allocation of Fund Balance	42,161

Impacts on the 2007-2008 General Fund Budget (Cont'd.)

- **Changes to Fee Reserves (\$1.2 million)** – Consistent with the budget policy enacted several years ago, year-end reconciliations of the revenues and expenditures in the development fee programs are conducted to determine if revenues exceeded or fell below costs. To meet the commitment to the development community that all development fees will be used solely to support the development fee activities, any excess revenues and interest earnings over costs are placed in Development Fee Program Reserves. Based on the 2006-2007 results, a net \$1.2 million is recommended to be added to the Development Program Fee Reserves (Building, Planning, Fire, and Public Works), preserving all expenditure savings and/or excess revenue in these programs. In addition, use of the Development Fee Program Reserves is recommended to offset a projected shortfall in 2007-2008 in Building Fee Program Revenues (\$233,000) and one-time actions in Fire (\$22,000) and Public Works (\$50,000) Fee Programs.
- **Rebudgets/Technical Adjustments (\$15.3 million)** – As discussed above, a series of adjustments are recommended to complete existing projects in 2007-2008 and to reflect any necessary technical budget adjustments. The Annual Report is the point in the budget process where action is required to provide for the rebudgeting of year-end savings not anticipated when the Adopted Budget was approved, but required to complete a significant City Council approved project. Also recommended are a few actions that actually reduce previous rebudgets in various departments, Capital Contributions, and the City-Wide Expenses category, to reflect instances where greater than expected expenditures occurred in 2006-2007 and previously rebudgeted funds are, therefore, not needed in the current year. A net total of \$15.3 million of Rebudgets/Technical Adjustments are identified in this report that need to be carried to the 2007-2008 fiscal year in order to complete the specific projects and programs. The three largest components of this rebudget/technical adjustment recommendation are a transfer of excess Construction and Conveyance Tax revenue to the Park Maintenance Reserve (\$1.5 million) as required by current Council policy; Capital Contributions (\$6.1 million); and City-Wide Expenses (\$3.2 million).

With this action the Park Maintenance Reserve, funded by Council policy through transfer of 15% of Parks Construction and Conveyance Tax proceeds will total \$6.2 million. The City is in the first year (of three) of an approved budget action, approved for the 2007-2008 fiscal year, to transfer \$2.0 million per year of this reserve to the General Fund to help mitigate the need for additional reductions to Parks maintenance services as well as to provide funding to address critical deferred parks maintenance needs.

- **Required/Recommended Current Year Adjustments (\$12.1 million)** – A number of General Fund budget additions are recommended to address current year funding needs that have emerged since the 2007-2008 budget was approved. These adjustments can be classified under three categories: Previous Council Direction; Required Adjustments; and City Manager Initiatives. The following augmentations are recommended and explained in more detail elsewhere in this document:

Impacts on the 2007-2008 General Fund Budget (Cont'd.)

Previous Council Direction (\$6.9 million)

- Add funding to the Economic Uncertainty Reserve to bring the total Reserve to \$10.0 million. These funds would help address any volatility in the City's economic performance and is consistent with the 2006-2007 June Budget Message that states "other unanticipated funds that may become available during the year should be used to bring the Economic Uncertainty Reserve back up to a reasonable level" (\$6.0 million).
- Add funding for future City Manager Office Operational Improvements. In the Mayor's June Budget Message, the new City Manager was given authority to evaluate resources in the City Manager's Office and the flexibility to propose changes (\$300,000).
- Add funding for actuary and consultant services for the Retiree Health Care Team to seek stakeholder input on the City's liability under GASB 43/45 and develop options to address this liability (\$200,000).
- Restore funding to the Contingency Reserve for completion of the Evergreen-East Hills Development Policy Update that is scheduled for City Council consideration on October 16, 2007 (\$150,000).
- Add funding for predevelopment activities for the iStar/FMC properties related to the return of Major League Soccer to San José (\$100,000).
- Add funding for maintenance costs for the lease agreement with Our City Forest for office space that was approved by City Council on September 25, 2007(\$55,000).
- Add funding for contractual costs associated with the recruitment of a new City Auditor (\$50,000).
- Establish funding for consultant services to determine the feasibility of separating the responsibility of managing some or all of the theaters from that of managing the Convention Facilities in preparation for a December 17, 2007 City Council Study Session (\$50,000).

Required Adjustments (\$4.1 million)

- Add funding for capital improvements to mitigate elevated levels of landfill methane gas recently detected at Martin Park (\$1.5 million). The City will also apply for a matching grant with the State to potentially offset a portion of this cost.
- Establish a reserve of \$1.0 million for potential repayment to the Airport for prior year police services. The time period being reviewed to determine actual amount of Police staff time worked against the amount of funding transferred is 2003-2004 through 2006-2007.
- Add funding for June 2008 local elections based on a revised fees and charges schedule from the County Registrar of Voters (\$760,000).

Impacts on the 2007-2008 General Fund Budget (Cont'd.)

Required Adjustments (Cont'd.)

- Augment the existing funding for the City Hall Network Operations Center project that will provide emergency cooling of the NOC and electrical upgrades to maintain network operations and protect all server and telephone equipment based on a more detailed engineering analysis of the structural and capacity requirements of the upgraded system (\$400,000).
- Add funding of \$200,000 for the remediation of Watson Park to close a project on Terrace Drive involving residents impacted by the 2006 Terrace Drive soil removal project (\$200,000).
- Reduce the Revenue from the State estimate to reflect the lower than projected Public Library Fund payment based on the final State budget (\$179,000).
- Add net funding to relocate and clean artifacts for History San José from the Stockton Street Warehouse to an environmentally controlled environment at the Central Service Yard due to the scheduled demolition of the warehouse. These funds will also be used to add additional shelving to store the collection (\$125,000).
- Add funding for the City Auditor severance and vacation payouts package (\$110,000).
- Eliminate funding for City support of the 2008 San José Grand Prix race as the race will no longer take place (\$374,000).
- Add funding for payment of interest earnings on a prior year short-term loan from the Sewage Treatment Plant Connection Fee Fund to the City Hall Renovation Construction Fund. It has been recently determined that the loan was repaid in March 2004 without the required interest component (\$65,000).
- Add funding to enable the Human Resources Department to conduct employment testing and establish candidate pools for key city-wide job classifications (\$50,000).
- Add funding for Mexican Heritage Corporation (MHC) Plaza to reflect the revised subsidy agreement and consultant costs to conduct analysis of highest and best uses of the Plaza (\$35,000).
- Add funding for the City's assessment of Storm Sewer Fees for its own properties to reflect the final Storm Sewer rate increases approved in the development of the 2007-2008 Operating Budget (\$30,000).
- Add funding to appropriate the City's matching portion of a County grant for the Northside Community Center's Senior Nutrition Program to provide for additional staff hours and for additional staffing resources (\$8,000).
- Implement net-zero adjustments to reflect the revenues and expenditures for grant and reimbursement type activity such as: increased funding from the Redevelopment Agency for the San José BEST program (\$1.0 million) as approved in the Redevelopment Agency's budget; grant received for Mayor's Gang Prevention Task Force activities (\$394,890); a grant for Fire Apparatus Purchase (\$150,000); a Police grant for overtime

Impacts on the 2007-2008 General Fund Budget (Cont'd.)

Required Adjustments (Cont'd.)

and vehicles to support the South Bay Metro Task Force (\$104,000); and a downward adjustment to reflect a change in anticipated reimbursement from the Redevelopment Agency for City Auditor services (-\$75,000). In addition, a technical adjustment to reallocate three capital projects between the General Fund and the Civic Center Construction Fund to allow for tax-exempt bond proceeds in the Civic Center Construction Fund to be spent consistent with IRS regulations that require that the funds be expended or appropriated toward eligible expenditures in a timely manner. A more complete listing of the net-zero adjustments can be found in section III of this document.

City Manager Initiatives (\$1.0 million)

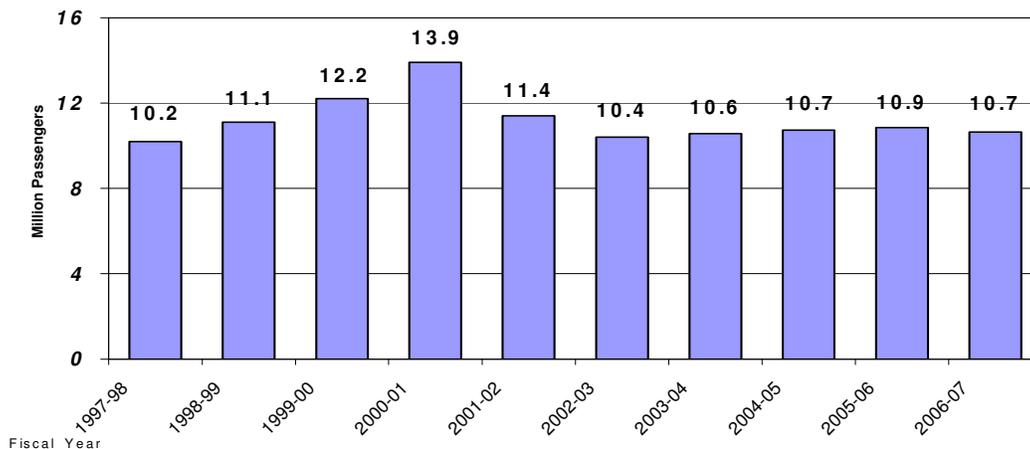
- Establish a reserve to potentially build-out the 4th Street portion of City Hall and the Employee Parking Garage that had originally been designated for retail should the City Council determine this to be the final disposition of this issue. A separate staff memorandum on this matter will be issued and agendaized for the October 16, 2007 City Council meeting (\$1.0 million).
- **2008-2009 Future Deficit Reserve (\$6.8 million)** – After the above actions, per City Council policy, one-half of the remaining \$13.6 million in unallocated funds is recommended to be used to establish a 2008-2009 Future Deficit Reserve. Doing so will help prepare the organization to address what is projected be another challenging budget year, and is consistent with the fiscally conservative approach that has served the City so well up to this point.
- **Street Maintenance and Repair (\$6.8 million)** – Per City Council policy, one-half of the remaining \$13.6 million in unallocated funds is recommended to be used for street maintenance and repair projects. The current plan for the expenditure of these funds is to expand the traffic sign replacement program (\$205,000); to replace old landscape with less landscape-maintenance intensive landscaping (\$120,000); and finally the majority of the funding to reseal and resurface existing streets (\$6.5 million).

Status of Selected Special/Capital Funds

Airport Operating Funds

Although the Airport served almost 10.7 million passengers for 2006-2007, passenger activity actually represented a 1.8% decrease compared to the prior year. The most significant event regarding air service during the year was the discontinuation of the American Narita Japan Flight in November 2006. Other Airport activity including: parking exits, pounds of mail/freight/cargo, traffic operations and gallons of aviation fuel each experienced declines in comparison to last fiscal year.

**Norman Y. Mineta San José International Airport
10 Year History Passenger Activity**



Although Airport activity was lower than anticipated, conservative revenue estimates allowed the Airport to meet budget projections. Overall, Airport operating revenues completed the year 2% greater than budgeted levels. Revenue in all categories was greater than the modified budget, except for Terminal Rentals and Parking and Roadway revenues. The Airport continued its practice of setting service priorities, establishing savings targets and closely monitoring all expenditures in an effort to maintain customer service levels while controlling operating expenses. The Airport set a target to save a total of \$4.8 million in direct personal services and non-personal/equipment expenses during 2006-2007. The savings target was exceeded by over \$3.5 million due in large part to the number of vacancies experienced in the department over the course of the year. These actions contributed to higher than anticipated fund balances in the Airport funds at year-end.

Transient Occupancy Tax Fund

Actual 2006-2007 revenues in the Transient Occupancy Tax (TOT) Fund exceeded the budgeted amount by almost \$1.7 million. When the 2006-2007 Adopted Operating Budget estimate (\$11.24 million) was developed, a 7% increase over the anticipated 2005-2006 year-end

Status of Selected Special/Capital Funds (Cont'd.)

Transient Occupancy Tax Fund (Cont'd.)

estimates was assumed. Revenues in 2006-2007, however, ended the year 11.1% above the 2005-2006 actuals due to higher than anticipated room rates and occupancy levels. The average room rate for the City's fourteen largest hotels grew from \$120 to \$133 over the year. The average occupancy rate for the same hotels grew from 57.7% to 59.9%.

Convention and Cultural Affairs Fund

The Convention and Cultural Affairs Fund accounts for the operation of the City's Convention Facilities that are managed by Team San José. In 2006-2007, activity at the Convention Facilities generated higher than anticipated revenues. The actual revenue collections were \$952,000 above the budgeted level due to higher than anticipated space rental and concessionary income (\$921,000) and higher than estimated interest earnings.

In addition to higher than anticipated revenues, expenditure savings of \$384,000 were realized in this fund. The combination of excess revenue and expenditure savings result in a higher than anticipated fund balance. Per prior City Council direction, \$500,000 of the additional fund balance is recommended to be set aside in a sinking fund for future capital improvements as part of this report.

Community Facilities Revenue Fund (Hayes Mansion)

Effective January 1, 2004, Dolce International/San José, Inc. (Dolce) was appointed the new manager of the facility under the terms of a ten-year management agreement with the City. As part of the agreement, Dolce transfers the necessary money from Hayes Mansion operations to this fund for debt service and to reimburse the City for some operating costs, such as insurance.

When the 2006-2007 Adopted Operating Budget was developed, it was determined that insufficient revenues would be realized in this fund and a \$4.43 million subsidy transfer from the General Fund was budgeted. Overall, for Hayes Mansion operations, revenues slightly exceeded the budgeted estimate and there was a small amount of expenditure savings. The exact level of required subsidy for this operation will be reviewed for both the current year and the coming year, as part of the upcoming forecast, to see if any adjustment to the General Fund subsidy can be made.

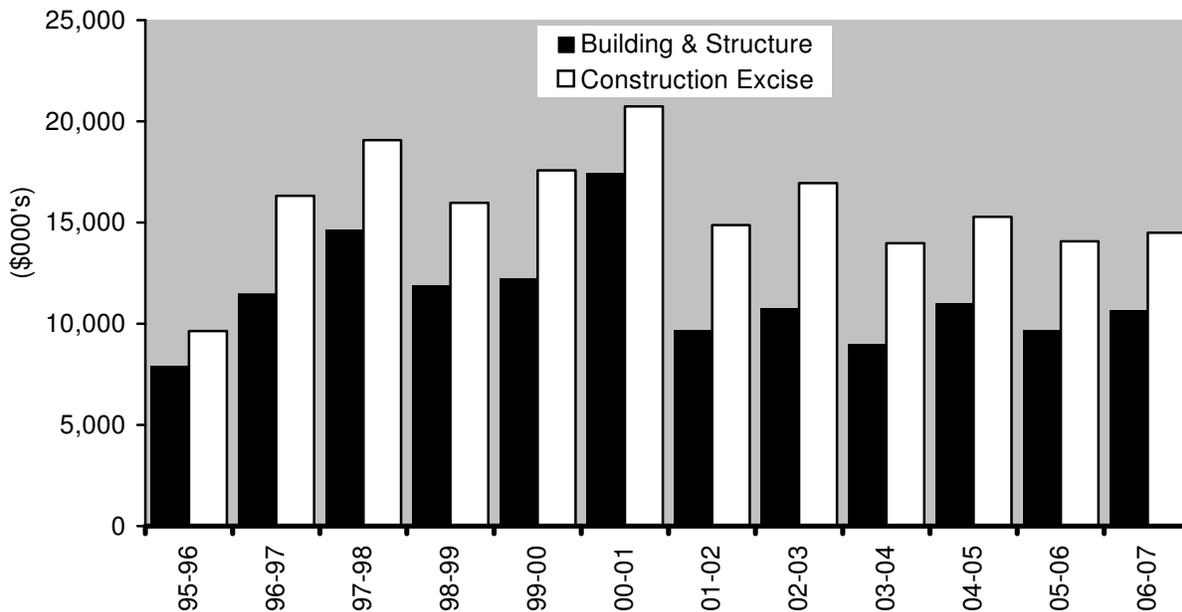
Status of Selected Special/Capital Funds (Cont'd.)

Capital Improvement Program Funds

As reported in Monthly Financial Reports, 2006-2007 collections in several of the major capital tax revenue categories exceeded the estimates included in the modified budget. Year-end collections in the Building and Structure Construction Tax category totaled \$10.6 million, which was \$952,000 above the modified budget estimate of \$9.69 million, and \$977,000 (10.1%) above the 2005-2006 collection level of \$9.7 million. The 2006-2007 collections were, however, below the 2004-2005 receipts of \$11.0 million. With a similar trend, Construction Excise Tax receipts of \$14.5 million exceeded the modified budget estimate of \$13.7 million by \$793,000, and was approximately \$418,000 (3.0%) above the 2005-2006 collection level of \$14.1 million. The 2006-2007 level of activity was, however, below 2004-2005 levels in which \$15.3 million was received.

The following graph displays the collection history of both the Building and Structure and Construction Excise Tax receipts over the past decade and illustrates the dramatic growth during the latter part of the 1990's. While collections have fallen from the peak in 2000-2001, they have remained relatively strong when considering the historical performance of these taxes.

Construction Tax Revenues



Status of Selected Special/Capital Funds (Cont'd.)

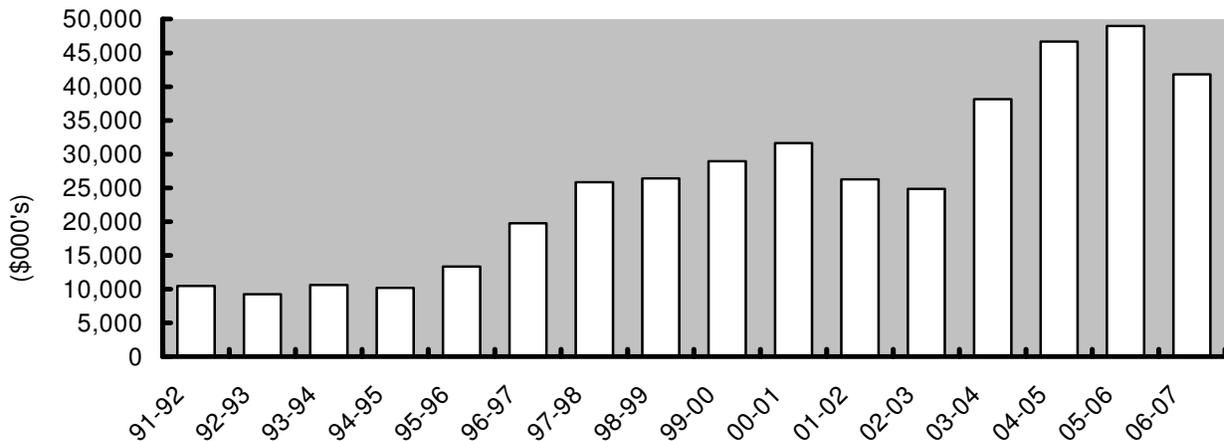
Construction and Conveyance Tax revenues, which are a significant source of funds for the Parks and Community Facilities Development, Library, Fire, Service Yards, and Communications capital programs, experienced a decline of 14.7% in 2006-2007. Actual receipts totaled \$41.8 million, representing declines of \$7.2 million compared to 2005-2006 collections of \$49.0 million. This decline reflects the continued slowdown in the local real estate market, as described in previous Monthly Financial Reports, after extraordinary growth of almost 100% between 2002-2003 and 2005-2006. The decline in 2006-2007 was the first decline since the two years of declines experienced in 2001-2002 and 2002-2003. When the 2006-2007 budget was developed, it correctly assumed that there would be a slowdown in the real estate market that would result in lower revenue collections. The 2006-2007 budget estimate of \$34 million, however, assumed a decline of 31% (compared to the actual decline of 14.7%) from 2005-2006 levels and as a result, actual year-end collections were \$7.8 million above the modified estimated collection level.

It should be noted, however, that the slowdown in the housing market and recent concern over sub-prime lending may indicate that the local real estate slowdown has not bottomed out. In fact, Construction and Conveyance Tax collections have declined in 13 of the past 14 months when compared to the same month in the prior year. The overall number of real estate transactions continues to drop with the second half of the year (January to June 2007) experiencing a 20.5% decline from the same period in the prior year (January to June 2006). The average days on market has increased from 34 days in June 2006 to 44 days in June 2007. The single-family median home price of \$772,000 as of June 2007, however, was 4.3% above the June 2006 figure of \$740,000. When reviewing the home prices in the last few years, these figures are still significantly higher than the June 2005 median home price of \$706,000 and the June 2004 figure of \$585,000.

The following graph displays the collection history of Construction and Conveyance Tax receipts. As can be seen, during the recession years in the early 1990s collections hovered around the \$9-11 million level for approximately five years. Following that recession, collections surged, with receipts reaching \$31.6 million in 2000-2001. After reaching this peak, collections dropped in both 2001-2002 and 2002-2003. The unprecedented growth of 54% in 2003-2004 followed by additional 22% growth in 2004-2005 and 5% growth in 2005-2006 ended this downward trend. The decline experienced in 2006-2007 of 14.7% reflects the current local real estate slowdown. We believe that the housing market will continue to soften, impacting receipts in this category. A slowdown in the real estate market continues to be a major theme of the California forecast produced by the prestigious UCLA Anderson Business School. Even given the continued slowdown, the 2007-2008 Adopted Budget estimate of \$27.0 million is a conservative one. This estimate allows for a drop of 35% from the actual 2006-2007 collection level. Staff will closely monitor receipts in this area to determine if this revenue category can be adjusted upwards during the year.

Status of Selected Special/Capital Funds (Cont'd.)

Construction and Conveyance Tax Revenues



Airport Capital Funds

Major projects with expenditures and encumbrances in 2006-2007 include the North Concourse (\$179.3 million), Terminal Area Improvement, Phase I (\$54.0 million), Noise Attenuation – Category 1B (\$22.8 million), Taxiway Y Reconstruction (\$16.8 million), Consolidated Rental Car Facility (\$13.2 million), Utility Infrastructure (\$6.1 million); Central Plant Expansion (\$3.6 million), Terminal Area Improvement, Phase II (\$3.3 million), and Public Parking Garage (\$3.4 million). The North Concourse is expected to be completed by mid-2008.

In the Airport Capital Program, several projects were completed in 2006-2007 including Utility Infrastructure, Terminal C Mezzanine Fire Sprinklers, Terminal A Door Replacement, Phase II, Renzel Airfield Improvements, Part 139 Compliance Projects, FMC Site Clearance and Preparation, and various building modifications.

Public Safety, Library, and Parks and Community Facilities General Obligation Bond Funds

Major improvements continue in the City’s parks, community centers, libraries and public safety facilities as a result of voter-approved bond measures that will generate a total of \$599 million for these purposes. In 2006-2007, \$104.5 million was expended or encumbered in the Public Safety (\$32.9 million), Library (\$41.9 million), and Parks and Community Facility (\$29.7 million) General Obligation Bond Funds. With the increased cost of construction in recent years, adjustments to the various bond projects have been implemented in an effort to provide quality facilities with the funding available. Staff will continue to closely monitor the costs in these projects and, if shortfalls occur, bring forward recommended options to address the shortfalls.

Status of Selected Special/Capital Funds (Cont'd.)

In the Public Safety Program, the projects with the largest expenditures and encumbrances included the following: Fire Station 34-Berryessa (\$5.8 million); Fire Station 35-Cottle/Poughkeepsie (\$5.5 million); Fire Station 25-Alviso (\$4.4 million); South San José Substation (\$4.3 million); Fire Station 12-Calero (\$3.7 million); Fire Station 17-Cambrian (\$3.3 million); and Land Acquisition (\$1.6 million). In 2006-2007, construction contracts for the Fire Stations 12 and 17 projects were awarded and upgrades at fire stations 5, 10, and 18 were completed.

In the Library Program, the projects with the largest expenditures and encumbrances in 2006-2007 included the following: Edenvale Branch Library (\$8.2 million); Joyce Ellington Branch Library (\$8.2 million); Willow Glen Branch Library (\$7.5 million); Pearl Avenue Branch Library (\$6.9 million); Cambrian Branch Library (\$2.0 million); Hillview Branch Library (\$1.6 million); Bascom Branch Library (\$1.3 million); Seventrees Branch Library (\$1.3 million); Santa Teresa Branch Library (\$1.1 million); and the East San José Carnegie Branch (\$1.0 million). In 2006-2007, the Hillview Branch Library, the Evergreen Branch Library, and the Cambrian Branch Library were completed.

In the Parks and Community Facilities Program, the projects with the largest expenditures and encumbrances included the following: Roosevelt Community Center (\$16.8 million); City-Wide Skateboard Park Development (\$5.6 million); Happy Hollow Park and Zoo Renovations and Improvements (\$4.5 million); Bascom Community Center (\$2.4 million); Solari Community Center (\$2.1 million); and Almaden Lake Park (\$1.1 million). In 2006-2007, several projects were completed including the Trail: Los Alamitos/ Calero Creek Pedestrian Safety Improvements, Emma Prusch Memorial Park, Emma Prusch Memorial Park – LeFevre House. In addition, the construction contracts for the Mayfair Community Center and Roosevelt Community Center – Multi-Service projects were awarded.

Traffic Capital Program Funds

In 2006-2007, a total of \$68.8 million was spent or encumbered for traffic capital projects. The projects with the largest expenditures and encumbrances included Federal Street Maintenance (\$7.4 million), Street Maintenance (\$6.4 million), Traffic Signals (\$3.9 million), Senter Road: Tully to Singleton (\$3.7 million), Oakland Road: Route 101 to Montague (\$2.6 million), Prop 42 Street Pavement Maintenance (\$2.2 million), Traffic Signals – Rehabilitation (\$2.2 million), Route 880 Coleman Interchange Utility Relocation (\$1.8 million), Bicycle and Pedestrian Facilities (\$1.5 million), Bailey/Route 101 Improvements (\$1.4 million), Taylor Street: First to Coleman (\$1.4 million), North San José Deficiency Plan Improvements (\$1.3 million), and Lucretia: Story to Phelan (\$1.2 million). Projects completed in 2006-2007 include Quito Road: Saratoga to Bucknall, Bailey Avenue Street Resurfacing, 4th and Santa Clara Streets Sidewalk Improvements, Marburg Way/33rd Street Sidewalk Improvements, Park Avenue Streetscape Improvements, Second/San Carlos Garage Seismic Upgrade, Seventh Street Traffic Calming, Taylor Street: First to Coleman, Taylor Underpass Pedestrian Improvements, Zanker Road Median Island Improvements, Oakland Road: Brokaw to Montague, Alum Rock Median Island

Status of Selected Special/Capital Funds (Cont'd.)

Modification, Lincoln Avenue Enhanced Crosswalks Phase II, Street Lights: Hannah-Gregory Neighborhood, Willow Glen Way: Guadalupe River Bridge, Holly Hill Infrastructure Improvements, Union Avenue at Los Gatos-Almaden Blvd., Street Resurfacing, and City-wide Accessibility Ramp Project.

Many Strong Neighborhoods Initiative projects were also completed, including the Winchester ADA Accessibility Ramps, Hensley Historic District Pedestrian Street Lighting Phase II, Backesto Park Perimeter Lighting, Gardner Area Street Reconstruction, Traffic Calming Improvements, Pedestrian Access to Gardner Academy, Traffic Signal Installation at Oak/Almaden and Oak/Vine, Traffic Signal Installation at Balbach and Market Streets, Traffic Calming Studies, Mayfair ADA Accessibility Ramps, Auzerais Avenue Improvements, Scott Street Improvements, Lucretia Avenue Improvements, Lower Silver Creek Improvements, and ADA Pedestrian Ramps.

Recommended Capital Budget Actions

In addition to the fund balance reconciliations completed for every fund and the numerous rebudget adjustments to properly account for project costs, there are a number of budget actions recommended in this report. The largest increase is in the Traffic Capital Program. The recent passage of the State budget allocated \$15.7 million of Proposition 1B – Local Street and Roads Improvement Funds to the City. This document recommends the appropriation of these funds towards Street Maintenance (\$11.7 million) and the Route 101/Tully Interchange Upgrade project (\$4.0 million). In addition, noteworthy augmentations in the Traffic Capital Program are recommended for the following projects: Seismic Bridge Retrofit – Southwest Expressway (\$407,000) to fund design and construction costs, Traffic Signal: Hostetter and Piedmont Roads (\$591,000), Fiber Optics Permit Engineering (\$950,000), Traffic Signals (\$280,000), and Bicycle and Pedestrian Facilities (\$240,000).

In the Public Safety Capital Program, additional funding is recommended in the Fire Construction and Conveyance Tax Fund for the Fire Department Records Management System (\$200,000), Fire Station 12 – Calero (\$400,000) to fund additional construction contingency due to ancient Native American remains found at the site, and for improvements at Fire Station 33 – Communications Hill (\$123,000 – developer contribution).

In the General Obligation Bond Funds, augmentations are included to fund projected arbitrage rebate liabilities in each program. The liabilities occurred due to the City earning a higher interest rate than what is paid on the debt and must be returned in the form of a rebate payment. These include adjustments in the Public Safety Neighborhood Security Bond Fund (\$254,000), Branch Libraries Bond Projects Fund (\$683,000), and the Parks and Recreation Bond Projects Fund (\$274,000). In addition, funding for arbitrage liabilities related to the Civic Center (\$100,000) is recommended in this document.

Status of Selected Special/Capital Funds (Cont'd.)

In the Parks Capital Program, there are a series of augmentations to address needs or reallocate funding. In the Park Trust Fund, the following project adjustments are recommended: increases to the Reserve: Spartan Keyes Area Park Development (\$200,000) – offset by a reduction in the Reserve: Future PDO/PIFO; Berryessa Creek Park Playlot Renovation (\$235,000 – offset by a reduction in the Reserve: Future PDO/PIFO of \$66,000 and Reserve: District 4 Parksite Acquisition by \$169,000); Solari Park Renovation (\$446,000) – offset by a reduction in Reserve: Solari Park Renovation; Guadalupe Gardens Community Garden (\$150,000) – offset by a reduction in the Reserve: Future PDO/PIFO Projects; and Bellevue Park Improvements (\$100,000) – offset by a reduction in the Reserve: Bellevue Park Improvements. In the Parks Construction and Conveyance Tax Fund – District 3, funding is recommended for the Yu Ai-Kai Roof Improvements (\$50,000) project.

In the Airport Capital Program, additional funding (\$311,000) is recommended to fund the relocation of a CTX (screening) machine in Terminal A. The relocation of Mexicana Airlines to Terminal A resulted in the need for an additional machine for baggage screening. This action is offset by decreases to the Refurbish/Replacement of Parking Cashier Booths (\$149,000) and Refurbish/Replacement of Shuttle Bus Shelters (\$162,000) projects. In addition, increases to the Consolidated Rental Car Facility (\$200,000) project to fund an Inter-Terminal Passenger Connection study, Terminal C Carpet Replacement (\$140,000), Central Plant Expansion (\$10,000), Terminal Area Improvement, Phase II (\$73,000) adjustments for construction lay-down costs, and the Terminal Seating (\$100,000) project are recommended as part of this document.

Photocopy Fee Standardization

As a result of a Sunshine Reform Task Force inquiry, staff recognized that there are currently different fees and charges for photocopying standard records and documents in the various City departments. The City of San José sets and amends fees and charges annually by Resolution. Fees are set or increased primarily to reflect changes proposed in conformance with Council direction to maintain full cost recovery in most fee supported program areas. The California Public Records Act restricts photocopying fees to the “direct cost of duplication”, and in accordance current photocopying fees have been established by considering the actual cost for reproducing a record, which includes staff time and equipment costs.

In order to remedy this situation, in this document we are recommending a standardization of typical photocopy fees. The same methodology was employed to calculate the fee across City departments, with the lowest cost recovery fee being utilized as the common fee. Therefore, staff is recommending to the City Council, as part of this document, that the various City departments adopt one standardized fee of \$0.20 for copying records and documents. This standard fee will not apply to photocopying fees set by State or federal law such as Political Reform Act Forms, or specialized photocopying services such as blueprints, Microfilm/Microfiche, and Optical Imaging Reproduction.

NEXT STEPS

The results of the 2006-2007 Annual Report will provide an updated starting point for monitoring 2007-2008 financial performance. The revenue and expenditure trends will be factored into the analysis of the General Fund and the numerous special and capital funds. Information on the City's finances for 2007-2008 will be provided in Bi-Monthly Financial Reports and the 2007-2008 Mid-Year Budget Review. These reports will also provide information on the current economic environment and its impact on the City's revenue collections.

The 2006-2007 Annual Report results will also be factored into the development of the 2008-2009 Proposed Budget. A preliminary 2009-2013 General Fund Forecast is anticipated to be released at the end of October 2007, with a final General Fund Forecast planned to be released in February 2008. The Annual Report results will also serve as a resource for the General Fund Structural Deficit Task Force that plans to release its final report in January 2008 for inclusion in the development of the 2008-2009 Proposed Budget. The 2008-2009 Proposed Operating Budget is scheduled to be released on May 1, 2008.

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 October 16, 2007 Council agenda. Additional outreach efforts have been conducted for certain projects, such as Watson Park, by various City departments.

COORDINATION

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

CONCLUSION

At the close of the 2006-2007 fiscal year, the City's finances remain in sound condition. The various City funds generally ended the year with revenues generally at or above estimated levels and expenditures within the budgeted allocations. As a result, I am pleased that there are no major financial problems to report in any City fund as of the end of the last fiscal year.

While the City ended the year in sound fiscal shape, and in the General Fund we were able to accumulate a higher than anticipated ending fund balance, we must be cautious in interpreting this news as a significant change from prior projections for the next few years.

The additional General Fund fund balance dollars generated at the end of 2006-2007, for example, resulted almost entirely from expenditure savings, primarily generated by our continuing cost control measures. Revenue performance in the General Fund, in fact, ended the year almost exactly as projected, exhibiting the very modest growth levels that were the foundation of our economic forecast for that year. Nothing in the actual collection performance in the General Fund would indicate any change to the overall presumption used in the 2007-2008 budget, and in our most recent five-year forecast – (1) that modest revenue growth at best can be anticipated for the foreseeable future, (2) that expenditure growth levels will continue to outpace the rate of growth of those revenues, and (3) that the result will be the continuation of a structural deficit in the General Fund for a number of years.

Although we will continue our many aggressive initiatives to stimulate and improve our local economy, and we have an excellent track record of progress in this area, we cannot lose sight of the fact that we are unavoidably connected to the health of the state and national economy. Of concern, therefore, is the fact that the current economic environment is exhibiting signs of worsening, particularly on a national basis. It appears likely that the deterioration of the housing market, for example, will almost certainly continue for at least the next year, and may well worsen, which would negatively impact the City's largest General Fund revenue sources, Property Tax and Sales Tax. Other recent economic news both nationally and locally has also been worrisome, with declines in the number of jobs, a slight increase in the unemployment rate from the prior year, and a drop in consumer confidence.

Based on these factors, minimal economic growth is projected for 2007-2008. Because the 2007-2008 Adopted Budget assumed such modest growth levels, however, it is currently anticipated that the 2007-2008 revenue estimates should be met. In developing the 2008-2009 budget and our upcoming preliminary five year forecast, the Administration will closely analyze economic trends and the projected impacts of those trends on the City's revenues.

The Administration will continue to closely monitor the current year financial status and report to the City Council any significant developments through the regular Bi-Monthly Financial Reports.

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 2007-2008 monies in excess of those heretofore appropriated therefrom:

General Fund	\$ 43,423,362
Cash Reserve	62
Emma Prusch Memorial Park Improvement	8,423
Municipal Health Services Program	1,696
Public Works Program Support	2,381,407
Emergency Communication System Support Fee	751,468
Dental Insurance	230,422
Downtown Property & Business Imprvt District	1,767,500
Unemployment Insurance	299,753
Benefit Fund	236,884
Workforce Investment Act Fund	132,811
Maintenance Assessment District Fund #1	89,717
Maintenance Assessment District Fund #2	11,311
Maintenance Assessment District Fund #8	44,734
Maintenance Assessment District Fund #9	13,582
Maintenance Assessment District Fund #10	3,327
Maintenance. Assessment District Fund #11	2,535
Maintenance. Assessment District Fund #15	167,552
Maintenance. Assessment District Fund #18	7,130
Maintenance. Assessment District Fund #19	3,772
Maintenance. Assessment District Fund #20	22,398
Subdivision Park Trust Fund	5,673,742
Construction & Conveyance Tax – Council District 1	939,514
Construction & Conveyance Tax – Council District 2	608,249
Construction & Conveyance Tax – Council District 3	893,406
Construction & Conveyance Tax – Council District 4	802,378
Construction & Conveyance Tax – Council District 5	2,111,363
Construction & Conveyance Tax – Council District 6	1,133,336
Construction & Conveyance Tax – Council District 7	1,080,728
Construction & Conveyance Tax – Council District 8	1,332,060
Construction & Conveyance Tax – Council District 9	833,764
Construction & Conveyance Tax – Council District 10	674,181
Construction & Conveyance Tax – Central Fund	874,589
Construction & Conveyance Tax – City-Wide	3,432,054
Construction & Conveyance Tax – Fire	2,481,302
Construction & Conveyance Tax – Library	2,162,926
Construction & Conveyance Tax – Service Yards	2,451,003
Construction & Conveyance Tax – Communications	383,533
Construction & Conveyance Tax – Parks Maintenance	81,269

Certification of Funds (Cont'd.)

Storm Drainage Fee	26,389
Federal Local Law Enforcement Block Grant	259
State Drug Forfeiture	37,105
Library Parcel Tax	3,167,034
Federal Drug Forfeiture	377,080
Community Facilities Revenue	429,461
Integrated Waste Management	3,949,737
Civic Center Construction	1,987,196
Anti-Tobacco Settlement	821,389
Building & Structures Construction Tax	7,886,422
Civic Center Parking Fund	55,172
Hayes Mansion Phase III	140,803
Development Enhancement	222,821
Housing Trust	7,740,331
Community Development Block Grant	1,776,562
Low & Moderate Income Housing	13,112
Economic Development Administration	4,271
Home Investment Partnership Program	119,482
Storm Sewer Operating	2,193,042
Multi-Source Housing	2,020,004
Redevelopment Agency Capital Projects (City side)	2,297,705
Transient Occupancy Tax	423,566
Lake Cunningham	57,998
Construction Excise Tax	12,044,206
Storm Sewer Capital	518,076
Parks & Recreation Bond Project	6,389,292
Branch Library Bond Project	1,391,042
Neighborhood Security Bond Fund	3,734,741
Water Utility Capital	54,980
Muni Water Major Facility Fee	40,600
SJ-SC Treatment Plant Capital	5,595,806
SJ-SC Treatment Plant Operating	3,590,236
SJ-SC Treatment Plant Income	33,340
Municipal Golf Course	135,167
Airport Capital Improvement	1,567,369
Airport Revenue	9,861,594
Airport Maintenance & Operations	475,422
Airport Renewal & Replacement	961,089
Airport Passenger Facilities Charge	14,798,643
General Purpose Parking	1,228,687
Convention/Cultural Affairs	2,141,877
Sewage Treatment Plant Connection Fee	1,830,985
Sanitary Sewer Connection Fee	6,315,094
Sewer Service & Use Charge	3,527,665

Certification of Funds (Cont'd.)

Sewer Service & Use Charge Capital	17,543,970
Stores	552,384
Parking Capital Development Fund	5,100,000

Larry D. Lisenbee
Budget Director