

## **SUBJECT: Mayor's Proposed Budget Strategy**

### **INTRODUCTION**

Over the past year we have seen a sharp change in our local, state, and national economy that has seriously reduced our revenue projections for both the current and coming year. As a result of the protracted and deepening recession, the City Administration announced in December that the City General Fund would face a shortfall of approximately \$63 million.

Since then, Governor Davis has proposed additional measures to address the state's overwhelming budget crisis that would seriously impair the ability of San José and other California cities to provide basic services. If adopted, the Governor's proposed budget strategy for the 2003-2004 fiscal year would increase our General Fund shortfall to \$120 million. The Governor also proposed shifting Redevelopment tax revenues away from local investments to replace statewide education funding, thus potentially ending our Redevelopment Agency's ability to stimulate the local economy, produce affordable housing, and make improvements in blighted neighborhoods.

Combined with the impact of the recession, the state budget proposals would seriously jeopardize all of the City's major initiatives, increase our already high local unemployment rate, and drastically limit our ability to stimulate the local economy. They could end our affordable housing programs, the Strong Neighborhoods Initiative, and other essential projects and services critically important to the people of San José. We are living through tremendously difficult economic times that are having an enormous impact on San Jose families. However, I am confident that as a community we will rise to the challenge as we have before.

In recent years we have balanced our budgets through prudent cost cutting while setting aside reserves to deal with economic uncertainty. However, the scope and length of the current downturn has surprised us all. Now, in response to this extremely serious fiscal challenge, I have outlined a strategy that will balance our ability to continue providing basic vital services to our community, revive our economy, build strong neighborhoods, stabilize our budget, and as much as possible, prevent the layoffs of the dedicated employees who serve the people of San José. It is a strategy, however, that will require all of us to make difficult choices during one of the most challenging periods of our history. We must approach this difficult task together, recognizing that everything we do as a City must be on the table for purposes of discussion.

### **RECOMMENDATION**

I recommend that the City Council and Redevelopment Agency Board adopt the following direction to all Council Appointees. As part of this recommendation, all projects and services to be frozen or reduced will have an effective date to the fullest extent legally possible of January 10, 2003, when Governor Davis announced his state budget proposals. These actions would remain in effect until Council directs changes based on the return of positive financial projections.

#### **A. General Principles**

Because of the extraordinary challenge we face, I recommend using following general principles as we consider our budget actions for both the current and next fiscal year budgets:

1. We must work together with our employee bargaining units to find ways to limit the number of employee layoffs.
2. We must focus on protecting our vital core city services.
3. We must focus on using our limited resources to stimulate our local economy and job creation.
4. We must continue to emphasize prevention and expenditures that reduce costs to the City and our community.
5. We must be open to alternative ways to deliver services through appropriate community partnerships, public-private partnerships, and by outsourcing or bringing services back in-house to be delivered by city staff.
6. We must not enter new commitments that we cannot fund.
7. We must continue to streamline, innovate, and simplify our operations.

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**B. Economic Recovery**

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1. Direct the City Manager and Redevelopment Executive Director to evaluate any new proposed business regulations in terms of its impact on the ability of businesses to operate successfully and competitively in San José and its impact on creating and sustaining jobs.
2. Direct the Manager and Executive Director to begin reviewing all existing business regulations to remove obsolete or cumbersome ordinances, streamline City review and approval processes, and develop non-subsidy incentives to encourage private sector investment and job creation. This should include a structured process to gather input and collaboration with the business community.
3. Direct the Manager and Executive Director to reprioritize all Capital Improvement Program schedules to accelerate items that have beneficial or neutral impacts on the General Fund and defer those that have negative impacts. This should also apply to all projects in our bond programs. Our goal should be to help spur construction spending to help local economic recovery.
4. Direct the Mayor to send a letter to all local government agencies, including school districts, recommending their consideration of a similar plan to accelerate their own capital projects and bond programs.

**C. Expenditure Control**

1. Direct the Manager to meet with all bargaining units and request that they reopen existing contracts (and where appropriate begin discussions regarding new contracts) with specific attention to minimizing potential layoffs through deferral or reduction of scheduled salary or benefit increases.
2. Direct the Executive Director to review and recommend proposals for salary savings in the Redevelopment Agency operating budget.

3. Direct the Manager to defer or suspend advance land use planning efforts that do not have outside funding or outside funding agreements in place. During the current economic climate, we cannot afford to have neither the General Fund nor the reserves of the Development Services departments subsidizing these efforts.
4. Direct the Manager to review all General Fund resources that have been transferred to other funds and are unencumbered, and restore them to the General Fund where possible.
5. Direct the Manager to seek every opportunity to rebid contracts to save costs. This shall include review of any contracts, which have options for renewal.
6. Direct the Manager to freeze all vehicle replacements unless they will have a beneficial impact on the General Fund and are approved by the Manager's Office.
7. Direct the Manager to review discretionary funding to all outside entities (both non-profit and for profit) that provide City services and develop proposals to reduce overall funding levels proportionate to average departmental reductions for FY 03-04.
8. Direct the Manager to review all discretionary spending that is not related to vital core services of the City of San José and return with recommendations to delete or substantially reduce such spending.
9. Direct the Manager and Executive Director to cease all meal expenditures.
10. Direct the Manager and Executive Director to cancel all City travel expenditures unless approved by the Manager's Office, and require specific Mayor Budget Office approval for all direct Council Appointee offices (including the Manager's Office) in this area.
11. Strongly urge Councilmembers to severely reduce or eliminate all travel expenditures unless they are related to state and federal activities and opportunities to obtain funding for San José projects and programs. I will do this for the Mayor's Office.
12. Direct the Manager and Executive Director to defer to the extent possible any General Fund capital or contractual expenditures in the current fiscal year unless they will have a beneficial impact on the General Fund
13. Direct the Executive Director to freeze all spending on consultant contracts at the Redevelopment Agency that do not relate to contractually obligated projects.
13. The Manager has asked departments to achieve budget savings targets for the current fiscal year, and these are included in the Manager's Mid-Year Budget recommendations. In keeping with this approach, the Mayor's office will also give back to the General Fund the same 2.9 percent that is the average of departmental reductions. I recommend the same for Councilmembers' office budgets.
14. Direct the Manager and Executive Director to receive applications for City or Agency loan and grant programs that are funded by discretionary funds or Redevelopment funds and hold them as contingent upon further budget actions.
15. Direct the Manager and Executive Director to freeze all space and office renovations.
16. Direct the Manager to freeze all technology expenditures, including individual personal computer

purchases, unless they will have a beneficial impact on the General Fund.

17. Direct the Manager to suspend all unencumbered marketing efforts and only authorize further expenditures if they have beneficial impact for economic development, public safety, demand management, or if they either increase revenues or reduce costs to the General Fund.

18. Direct the Manager to require specific City Manager's Office approval for all consultant expenditures not related to the capital budget regardless of funding source.

19. Direct the Manager to create procedures that ensure that all overtime expenditures are personally pre-approved by department directors and that overtime will be used for only emergency or genuinely unavoidable purposes. The Manager shall regularly report back via informational memo to the City Council regarding departmental overtime expenditures.

- 20. Direct the Manager to evaluate the possibility of cost savings by using outside project managers for capital projects rather than Public Works project management.
- 21. Direct the Executive Director to further refine Attachments II a, II b, and II c, and during the budget process bring to the Board her recommendations for maximizing the Board's flexibility to proceed with priority projects. In addition, the Executive Director should review the possibility of adopting a one-year CIP for the coming year if substantial uncertainty remains regarding the impact on the Agency from state budget actions.

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## **BACKGROUND**

### **Economic Recovery**

Especially in these challenging times for the City of San José, we must do all that we can to make a positive impact on the local economy through our public projects, services, and activities. Private industry is the fundamental generator of jobs in Silicon Valley, and job creation will be essential for economic recovery. It is our responsibility to help make it easier.

San José will continue to protect our environment and open space, and we will continue to make sure that workers are treated fairly according to the law. Where there is appropriate regulation, however, we must also understand and balance its potential benefit with its economic impact. Therefore, we must look for places where regulations have made it more difficult for doing business, creating jobs, and increasing opportunities for San José families. We must be make sure that our own regulations do not make San José less competitive as a desirable business location. For this reason I recommend that any new regulation we might propose in San José must be evaluated in terms of its potential impact on local business success, on creating jobs, and on our ability to compete with other cities and regions for economic development.

I also recommend that we use this opportunity to review all our business regulations to remove cumbersome or obsolete ordinances and requirements, streamline our review and permitting processes that affect business schedules, and provide incentives that will encourage business investment and job growth in San José. We should strenuously avoid measures that would increase the cost of doing business in our community or with the City of San José. We have made a good start with the implementation of the Developer Roundtable and the recent business community review of the draft Zucker Report that reviewed the efficiency of our development services. We must do more to engage our business community to evaluate how we can facilitate economic growth.

The City also can help stimulate our local economy and the creation of local jobs. Our capital improvement program can exceed \$1 billion over the next five years. Our planned investment in a broad range of community improvements, infrastructure, and neighborhoods represents a major opportunity to direct hundreds of millions of dollars for a substantial local economic impact. I recommend, therefore, that we reprioritize our capital projects to accelerate those that will have a beneficial or neutral General Fund impact.

As an illustration, replacing old park irrigation systems can reduce water consumption and eliminate the need for regular repair. Renovation of existing fire stations funded by Measure O bonds will result in more efficient buildings that save energy and reduce current maintenance requirements. Other local government agencies have similar capital projects that can help spur construction spending in our community and strengthen economic activity. San José can lead by example, and we should urge other local agencies to join us and accelerate their construction spending that does not negatively impact their operating expenses. Together, these projects can create thousands of construction jobs in our region in the coming year while continuing to improve service to our residents.

### **Expenditure Control**

Unfortunately, our current budget situation was made drastically worse by the state's recent budget proposals. It is very likely that the terrible combination of the current recession and the state's unfair diversion of local resources will force us to make workforce reductions in San José in order to balance our own budget.

We should consider layoffs as a last resort. Layoffs are more than numbers – each job cut represents a family that would be hurt, and it would hurt the families in our community who count on that employee who delivers valuable service to the people in our community. I therefore recommend that we consider all possibilities to reduce our costs as much we can in every area of our operations while protecting our core services as much as possible. Before we must consider a reduction in force, we must exhaust other alternatives.

Approximately 70 percent of the General Fund pays for salaries and benefits for our employees who deliver police, fire, library, parks, and other general services. There are only two ways to reduce the projected costs for personnel: layoffs or wage rollbacks or deferrals. Neither of these is pleasant to consider. Over the past year we have gone to extraordinary efforts to prevent layoffs by cutting vacant positions, redeploying staff, and freezing hiring to fill vacancies. We will continue on this path as long as we need to.

In addition, however, I ask our City's labor organizations to become partners in our efforts to protect public services for our community. I am urging the City Manager and our bargaining units to begin immediately to work together to determine employee support for wage and benefit freezes or roll backs in order to avoid or minimize layoffs that still might be needed to balance our budget and ensure basic services.

To illustrate, City employees under current contracts are scheduled to receive a five to six percent salary increase next fiscal year. As an example, if employees were to defer or accept a rollback of two percent of the scheduled increase, it would save between \$9 and \$12 million. This could save the jobs of between 100 and 135 fulltime employees. As we head into this drastic budget time we must weigh the impact of lay offs against salary increases.

While the budget challenges for the Redevelopment Agency are very different in nature, we must also look

for cost savings in its operating budget.

Although advance land use planning is valuable for charting the long-term development of our community, at this time neither the General Fund nor the reserves of the development services departments can afford to subsidize these efforts given our current economic climate. We must cease any advance planning efforts that do not have outside funding or outside funding agreements in place.

We also should review all General Fund resources that have been transferred to other funds that are currently unencumbered with the intent of returning those funds to General Fund as much as possible to protect vital services and minimize layoffs. In light of the outstanding savings identified in a recent report from the City Auditor, we should explore freezing all vehicle replacement spending to maximize cost reductions in this area.

During the upcoming budget process, it is imperative that the City Council seriously evaluates our current expenditures in terms of the City's most essential services and our vital priorities. During good times, we invested our money wisely in many different areas, expanded the scope and quality of services, and began to catch up to meet growing demand and overdue needs left over from the past. However, in difficult times such as these, our most important responsibility is to focus on the services that are most critical to our residents. The Council Appointees can facilitate this discussion of the City Council by bringing forward budget proposals for reductions based on core municipal services.

Due to recent actions in Sacramento there is tremendous uncertainty as to the stability of future Redevelopment revenues. It is possible that we will be unable to proceed with any projects in the approved five-year CIP that do not already have binding contracts for performance. I have requested that Redevelopment Agency staff compile an inventory of our redevelopment projects that do or do not have contractual obligations. This information can be found in Attachments II a, II b, and II c. It may be necessary in upcoming budget discussions for the Board to begin the difficult task of either deleting projects or severely reducing proposed expenditures for projects, even to the point of not proceeding with any previously unencumbered projects. An equally serious consequence of any proposal that would call for an ongoing shift is that it may require the City to make payments to the State if the Redevelopment Agency does not have sufficient funds available for the 100% shift of funds to schools because of pre-existing obligations, such as payment of existing debt service. This would be the result of insufficient property tax revenue available to the Agency following the proposed diversion to the State for education.

Finally, it is necessary for the Mayor and City Council to lead by example. The City Manager has already asked all departments to reduce spending by three percent this fiscal year, and they achieved a 2.9 percent reduction so far. The Mayor and City Council offices should make similar spending reductions to their office budgets and participate in budget solutions, as all other city services must do. We must show the way and stand by our city staff as we meet this challenge together. Although Mayor and Council office budgets are small compared to the overall General Fund, our cooperation to reduce expenditures can add up enough to save a vital project or an employee's job.

We are faced with a great challenge in the coming months. If adopted, the Governor's proposed budget strategy for the 2003-2004 fiscal year would increase our General Fund shortfall to \$120 million. This is not a small number when one recognizes the enormity of this amount within the City's budget. Attachment III indicates one example of how much of the City's budget is equal to \$120 million.

## **CONCLUSION**

I have outlined a strategy that will balance our ability to continue providing basic services to our

community, revive our economy, build strong neighborhoods, stabilize our budget, and as much as possible, prevent the layoffs of the dedicated employees who serve the people of San José. I urge approval by my colleagues.

## Attachment I

### 2003-2004 Staffing Cost Analysis Annualized 1% Salary Increase (Includes benefits)

This table illustrates the value of each one percent of scheduled or potential salary increases in the next fiscal year for each category of employees and how that could translate into jobs saved or laid off as a result. This table is **not** a proposal for service reductions or layoffs.

Specific recommendations for budget reductions will be determined during the development of next year's budget over the next several months after careful review by the Administration, City Council, employee organizations, and the public.

Bargaining Group	Number of FTEs		Average Cost per FTE		Each 1% Salary Cost		Number of FTEs Impacted	
	General Fund	All Funds	General Fund	All Funds	General Fund	All Funds	General Fund	All Funds
Police Officer Assn.	1377.00	1377.00	116,084	116,084	1,480,777	1,480,777	12.76	12.76
Firefighters	714.00	715.00	118,922	118,940	789,720	790,944	6.64	6.65
Inspectors	82.00	97.00	111,141	109,630	84,310	98,273	0.76	0.90
Engineers & Architects	60.67	250.00	106,739	104,381	60,085	242,322	0.56	2.32
Municipal Employees Fed.	1977.06	2891.24	65,766	68,336	1,178,934	1,788,192	17.93	26.17
Operating Engineers	418.94	908.69	63,954	69,391	237,466	562,250	3.71	8.10
Electrical Workers	42.45	92.00	97,734	97,886	38,392	83,085	0.39	0.85
Unrep Non-Management	29.91	30.91	31,224	31,274	8,716	8,960	0.28	0.29
Confidential	155.23	258.00	80,447	84,835	118,367	200,922	1.47	2.37
Maintenance Supervisors	37.76	106.00	102,460	99,474	35,463	97,245	0.35	0.98
City Assoc Mgt Personnel	163.87	351.50	110,740	109,454	169,427	358,275	1.53	3.27
Executive Management	150.27	243.62	135,989	135,813	193,230	312,233	1.42	2.30
Exec Mgt - SEPP	70.57	108.00	176,676	175,209	121,343	179,615	0.69	1.03
	5279.73	7428.96			4,516,230	6,203,093	<b>48.48</b>	<b>67.97</b>

FTE is Full Time Equivalent

### Attachment III

These two tables illustrate the overall magnitude of \$120 million in our General Fund. The San José General Fund budget is approximately \$800 million and supports basic services including police, fire, libraries, parks, streets, and other general services. This table is **not** a proposal for service reductions or layoffs. Specific recommendations for budget reductions will be determined during the course of the development of next year’s budget over the next several months after careful review by the Administration, City Council, employee organizations, and the public.

#### Option 1 - Total: \$120 Million

Departments	Total Dollars and Employees
<b>Fire Department</b>	\$108.2 million - 838 employees
<b>Office of Economic Development</b>	\$5.0 million - 49 employees
<b>Office of the City Attorney</b>	\$11.1 million - 100 employees
<b>Total Departments: 3</b>	<b>Total Dollars: \$124.3</b> <b>Total Employees: 987</b>

#### Option 2 - Total: \$120 million

Departments	<u>Total Dollars and Employees</u>
<b>Parks Recreation and Neighborhood Services</b>	\$68.1 million -878 employees
<b>Finance Department</b>	\$10 million - 119 employees
<b>Office of Emergency Services</b>	\$347, 550.00 - 4 employees
<b>Library Department</b>	\$26.4 million - 360 employees
<b>Office of the City Attorney</b>	\$11.1 million - 100 employees
<b>Office of the City Auditor</b>	\$2.4 million - 20 employees
<b>Independent Police Auditor</b>	\$647,866.00 - 6 employees
<b>Office of Economic Development</b>	\$5.0 million - 49 employees
<b>Total Departments: 8</b>	<b>Total dollars: \$124 million</b> <b>Total Employees: 1536</b>