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MEMORANDUM

Department of Financial Services

To: Honorable Mayor and City Council

Through: Tom Williams, City Manager

From: Emma C. Karlen, Director of Financial Services

Subject: **General Fund Five Year Forecast**

Date: May 31, 2011

At the May 17, 2011 City Council meeting, the Mayor requested information on several items related to the FY 2011-12 operating budget. One of the requested items is a five year forecast for the General Fund. Staff prepared the attached five year forecast (see Attachment 1) with the assumption that employees cost reduction will continue. Staff also prepared an alternative five year forecast for the General Fund (Attachment 2) to show the results without employees cost reduction. Under the alternative scenario, the deficit amount is significantly bigger in each of the five years.

Revenue Discussion:

Property tax revenues are expected to increase 3% in FY 12-13, 3.5% in FY 13-14 and FY 14-15, 3% in FY 15-16 through FY 16-17. Although Proposition 13 allows the annual assessed value to increase by the lesser of 2% or the California consumer price index, local area housing market has been in a decline for about 3 years. The County Assessor temporarily reduced the assessed valuation for a lot of properties. Staff projected that the housing market will slowly recover in the next two years. Staff also expected that some of the development activities will resume in the next few years which will add to the assessed valuation and then return to a more normal growth of 3%.

Sales tax revenues are projected to increase 5% in FY 12-13, 4% in FY 13-14 , 3.5% in FY 14-15 and 3% in FY 15-16 and FY 16-17. The increase of 5% in FY 12-13 reflects a moderate economic recovery. Given sales tax revenue decline in the last few years, there are some pent-up demands on the consumers side as well as the need to replace inventories on the commercial/industrial sectors. It is anticipated that some of the residential developments that are currently on hold will resume. With the addition of residents as some of residential developments are completed and occupied, it is assumed that Milpitas businesses will capture a portion of the consumers' spending, especially in the retail, auto and restaurant economic segments.

Other Taxes include real estate transfer tax, franchise tax and business license tax. As residential units are being developed and occupied, it is anticipated that the City will collect more real estate transfer tax and franchise tax from utility and cable companies. It is also assumed that utility and cable companies will increase their rates to offset cost increases. The projection is a modest increase of 2.8% in FY 12-13 through FY 14-15, and 2.9% and 3% increase respectively in FY 15-16 and FY 16-17.

Hotel tax revenues are projected to increase 3% in FY 12-13 through FY 16-17. Hotel occupancy declined significantly for two years and has stabilized in FY 10-11. It is assumed that the hotel operators will increase room price by the average consumer price index which is approximately 2% to recover costs in addition to increased occupancy.

License and permits consist of building permits and fire permits which are primarily construction related. It is projected that these revenues after an average of 28% decline for two years in FY 08-09 and FY 09-10, will begin to pick up in significantly. In anticipation of rebound of residential developments in the Midtown and the Transit area, staff projected a higher growth level at 5% in FY 12-13 and at 7% in FY 13-14 through FY 14-15. The projections for FY 15-16 and FY 16-17 are 5% and 3% increase respectively.

Charges for Services include charges for private development related services, engineering fees and recreation services charges. It is anticipated that the increases in charges to developers will be similar to the increases for license and permits. The projection for non-development related charges is a 3% increase annually. The combined projection is 3.5% increase in FY 12-13, 3.9% increase in FY 13-14, 3.5% in FY 14-15, and tapering off to 3% increase in FY 15-16 and FY 16-17.

Operating transfers are mainly reimbursements from other funds for the staff support and administrative overhead provided by the General Fund. These transfers will increase in conjunction with operating expenditure increases. The projected increases range from 0.8% to 3.2% in the next five years.

Expenditure Discussion:

Salaries and benefits other than medical insurance and employer's contribution to California Public Employee Retirement System ("CalPERS") are anticipated to be flat in the next five years, with 0% increase. One of the long term strategies to deal with structural deficit of the General Fund is to consider compensation as a package to balance various components of the cost increase. Given that health insurance premium is projected to increase from 5% to 8% annually, compensation to employees in terms of salaries and other benefits will have to remain flat in the future. In addition, the City will focus on implementing "cafeteria style" benefit plan to control benefits cost. The projection assumed that employer contribution to the CalPERS will increase 4% in FY 12-13, 14% in FY 13-14 and then remain flat in FY 14-15 through FY 16-17. The increase in FY 13-14 reflects the market value loss suffered by the CalPERS investment portfolio in FY 07-08 and FY 08-09 and actuarial assumption changes. The Five-Year General Fund forecasts also include pre-funding of retiree medical benefits which is projected to increase 3% per year.

Services and Supplies costs are anticipated to increase by 2% annually reflecting consumer price increase but also assuming City departments continue to hold the line on this expenditure category.

Debt Service The General Fund does not have any outstanding debt and does not contemplate issuing another General Fund debt in the next five years.

Attachment 1

General Fund
Five Year Forecast (With Employee Concession)
(in thoursands)

	FY12-13	FY13-14	FY14-15	FY15-16	FY16-17
	$	$	$	$	$
Estimated Revenues					
Property Tax	17,103	17,701	18,320	18,870	19,436
Sales & Use Tax	17,703	18,411	19,056	19,627	20,216
Other Taxes	3,788	3,896	4,006	4,121	4,242
Hotel/Motel Tax	4,955	5,103	5,256	5,412	5,576
License & Permits	3,616	3,869	4,138	4,346	4,476
Charges for Services	3,871	4,021	4,161	4,285	4,414
Other Revenues	1,603	1,645	1,678	1,720	1,769
Operating Transfers	9,195	9,488	9,594	9,676	9,782
Total Estimated Revenues and Other Financing Sources	61,834	64,134	66,209	68,057	69,911
Estimated Expenditures					
Salaries	34,190	34,190	34,190	34,190	34,190
Benefits	22,121	24,105	24,584	25,041	25,520
Supplies & Contractual Services	10,722	10,858	11,150	11,295	11,592
Total Estimated Expenditures	67,033	69,153	69,924	70,526	71,302
Operating Surplus/(Deficit)	**(5,199)**	**(5,019)**	**(3,715)**	**(2,469)**	**(1,391)**

Attachment 2

General Fund
Five Year Forecast (Without Employee Concession)
(in thoursands)

	FY12-13	FY13-14	FY14-15	FY15-16	FY16-17
	$	$	$	$	$
Estimated Revenues					
Property Tax	17,103	17,701	18,320	18,870	19,436
Sales & Use Tax	17,703	18,411	19,056	19,627	20,216
Other Taxes	3,788	3,896	4,006	4,121	4,242
Hotel/Motel Tax	4,955	5,103	5,256	5,412	5,576
License & Permits	3,616	3,869	4,138	4,346	4,476
Charges for Services	3,871	4,021	4,161	4,285	4,414
Other Revenues	1,603	1,645	1,678	1,720	1,769
Operating Transfers	9,765	10,056	10,162	10,243	10,348
Total Estimated Revenues and Other Financing Sources	62,404	64,702	66,777	68,624	70,477
Estimated Expenditures					
Salaries	39,040	39,040	39,040	39,040	39,040
Benefits	22,121	24,105	24,584	25,041	25,520
Supplies & Contractual Services	10,722	10,858	11,150	11,295	11,592
Total Estimated Expenditures	71,883	74,003	74,774	75,376	76,152
Operating Surplus/(Deficit)	**(9,479)**	**(9,301)**	**(7,997)**	**(6,752)**	**(5,675)**

MEMORANDUM

Department of Financial Services

To: Honorable Mayor and City Council

Through: Tom Williams, City Manager

From: Emma C. Karlen, Director of Financial Services

Subject: **FY 2011-12 Salary and Benefits Cost Reduction**

Date: May 31, 2011

At the May 17, 2011 City Council meeting, the Mayor requested information on several items related to the FY 2011-12 operating budget. One of the requested items is the percentage of benefits to salary before and after employees' cost reduction and the average compensation per union group. The tables below provide this information.

FY 2011-12 Budget Before Employees' Cost Concession

	No. of FTE	Base Salary	PERSable benefits	Non-PERSable benefits	Total Salary and benefits	Average per FTE	Benefits as a % of base salary
IAFF	56.0	$6,641,886	$710,217	$4,329,195	$11,681,298	$208,595	75.87%
MEA	71.5	5,010,333	232,353	3,201,083	8,443,769	118,095	68.53%
MSA	4.0	419,652	36,525	275,688	731,865	182,966	74.40%
POA	105.0	11,613,566	1,970,106	7,701,826	21,285,498	202,719	83.28%
ProTech	84.5	7,053,080	57,492	3,826,462	10,937,034	129,432	55.07%
Mid-Management	35.0	3.707,196	31,188	1,807,110	5,545,494	158,443	49.59%
Unrep-Misc	13.0	2,011,872	0	832,102	2,843,974	218,767	41.36%
Unrep-Safety	10.0	1,687,442	36,288	974,167	2,697,897	269,790	59.88%
Total	379.0	$38,145,027	$3,074,169	$22,947,633	$64,166,829		

FY 2011-12 Budget After Employees' Cost Concession

	No. of FTE	Base Salary	PERSable benefits	Non-PERSable benefits	Total Salary and benefits	Average per FTE	Benefits as a % of base salary
IAFF	56.0	$6,543,642	$699,854	$3,778,501	$11,021,997	$196,821	68.44%
MEA	71.5	4,219,681	190,465	2,963,375	7,373,521	103,126	74.74%
MSA	4.0	372,924	10,086	253,575	636,585	159,146	70.70%
POA	105.0	10,811,723	1,836,662	7,391,213	20,039,598	190,853	85.35%
ProTech	84.5	7,053,080	57,492	2,744,440	9,855,012	116,627	39.73%
Mid-Management	35.0	3.459,558	29,100	1,743,41	5,232,072	149,488	51.24%
Unrep-Misc	13.0	2,011,872	0	691,271	2,703,143	207,934	34.36%
Unrep-Safety	10.0	1,687,442	36,288	863,505	2,587,235	258,724	53.32%
Total	379.0	$36,159,922	$2,859,947	$20,429,294	$59,449,163		

It should be noted that different union groups chose different methods to reduce compensation. POA, MEA and Mid-management employees chose to reduce salaries while IAFF, ProTech and un-represented management employees chose to reduce benefits by contributing to employer's share of the PERS retirement costs. MSA chose a combination of salary reduction and eliminates benefits such as longevity and deferred compensation. As a result of these various ways to reduce compensation, the changes in the percentages of benefits to base pay are not uniform. In fact, for those employee groups that elected to reduce salaries, the ratio of benefits to base pay actually increased due to the fact the amount of benefits is now divided by a smaller amount of base pay.

It is important to remember that employees' cost concession saves the City about $4.7 million in FY 11-12, without including overtime cost savings and future savings on 2 Tiered retirement formulas. The City's goal continues to be reduction of total compensation costs and will focus on strategies to implement "cafeteria style" benefits plan in the next round of negotiations.