



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jim Shannon

SUBJECT: See Below

DATE: February 9, 2026

Approved

Date:

2/19/26

COUNCIL DISTRICT: Citywide

SUBJECT: Revisions to City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy

RECOMMENDATION

Adopt a resolution revising City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy, Section 17, Fees, to provide guidelines for cost recovery and revenue sufficiency; considerations of ratepayer impacts; reserves and fund balance; and annual review.

SUMMARY AND OUTCOME

Revisions to City Council Policy 1-18 will address four audit recommendations. The guidelines on Fees, Rates, and Charges will promote transparency, ensure regulatory compliance, accountability, and budget stability, while aligning fee-setting with City policy goals and considering community cost impacts.

BACKGROUND

The 2026 audit report, *Sewer Rates: Reviewing Rate Model Assumptions and Developing Reserve Policies Would Improve the Rate-Setting Process*, included Recommendation #4 "To better manage risk and plan for future needs in the Sewer Service and Use Charge Fund, the Environmental Services Department should develop and adopt a formal sewer reserve policy that defines reserve types with intended uses and target levels."

The 2020 audit report, *Development Partners Work-In-Progress Reserves: Better Monitoring Can Ensure Reserves Align with Resource Needs*, contained Recommendation #4 "To ensure that the Development Partners have adequate funding

to support their development work, Public Works, the Fire Department, and Planning, Building and Code Enforcement should work with the Budget Office and the City Attorney's Office to develop reserve policies or guidelines around the appropriate uses of funds, including work-in-progress reserves."

The 2012 audit report *Environmental Services* contained two recommendations.

Recommendation #13 states "the Administration should propose the City Council establish a City Council Policy which includes guiding principles so as not to raise rates in years in which ratepayer fund balances exceed reasonable targets."

Recommendation #22 states "the Administration should propose the City Council adopt a City Council Policy which includes guiding principles for evaluating ratepayer costs and rate increases for fairness and appropriateness, and balancing priorities, such as safe and reliable services, cost efficiency, ratepayer impacts, and environmental outcomes."

ANALYSIS

The Attachment - City Council Policy 1-18, Section 17, Fees (Revised Policy and Existing Policy) includes the recommended revised policy to address audit recommendations, as well as makes several clarifications, which are highlighted below.

- **Cost Recovery and Revenue Sufficiency:** Provides guidelines for fees, rates, and charges to help to recover the full cost of providing services, with limited exceptions to full cost recovery, while ensuring fairness, transparency, and fiscal responsibility. Specifies that revenue generation is designed to support day-to-day operations and maintenance costs; long-term capital rehabilitation, replacement, and infrastructure improvements; and future service delivery demands, environmental standards, and other regulatory obligations, as applicable.
- **Consideration of Ratepayer Impacts:** Services are to be delivered in a cost-effective and cost-efficient manner as possible, and rates are proportional to the cost of service for each customer class. Where appropriate, consider financing large capital improvement projects to spread the rate impacts over multiple years and to reduce immediate impacts on ratepayers.
- **Reserves and Fund Balance:** Operating, development-related, and other types of reserves are maintained to handle emergencies, unexpected expenses, multi-year projects, and bond or financing obligations. The target levels for the reserves and the intended uses of reserves are to be clearly defined and governed by internal documents, as appropriate. The Ending Fund Balance should be used only for one-time or minor adjustments that may be needed during the year.

- **Annual Review:** All fees, rates, and charges are reviewed each year during the budget process to ensure alignment with service costs, reserves, and fund balance requirements.

EVALUATION AND FOLLOW-UP

No additional follow-up is required.

COST SUMMARY/IMPLICATIONS

There are no revenue or cost implications related to the recommended policy changes. In addition to addressing audit recommendations, these revisions also document many existing practices used during the budget process to ensure that fees, rates and charges ensure regulatory compliance and budgetary stability while considering community cost impacts.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, City Auditor's Office, Environmental Services Department, and Planning, Building, and Code Enforcement Department.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the March 3, 2026 City Council meeting.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

HONORABLE MAYOR AND CITY COUNCIL

February 9, 2026

**Subject: Revisions to City Council Policy 1-18 – Operating Budget and Capital Improvement
Program Policy**

Page 4

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

A handwritten signature in cursive script that reads "Jim Shannon".

JIM SHANNON
Budget Director

For questions, please contact Jim Shannon, Budget Director, City Manager's Office at jim.shannon@sanjoseca.gov

ATTACHMENT

City Council Policy 1-18, Section 17, Fees (Revised Policy and Existing Policy)

**ATTACHMENT: City Council Policy 1-18, Section 17, Fees
(Revised Policy)**

17. Fees, Rates, and Charges

To ensure regulatory compliance and budgetary stability while considering community cost impacts, the City shall establish fees, rates and charges in accordance with the following principles.

- a. Cost Recovery and Revenue Sufficiency
 - i. All fees, rates, and charges for delivery of City services shall be set to cover 100% of the budgeted cost of service, including all direct, indirect, overhead, debt service and other financing obligations, and capital costs.
 - ii. Limited exceptions to full cost recovery may be authorized by the City Council to help mitigate the cost of certain services or to take into account market forces or other competitive positions; if fees are set at less than 100% of the budgeted cost, the General Fund or other eligible funding source would contribute the balance.
 - iii. Revenue generation shall be sufficient to support day-to-day operating and maintenance costs; long-term capital rehabilitation, replacement, and infrastructure improvement needs; future service delivery demands, environmental standards, and other regulatory obligations, as applicable.
- b. Consideration of Ratepayer Impacts
 - i. All reasonable efforts shall be taken to ensure that City services are delivered in a cost-effective and cost-efficient manner.
 - ii. Rates shall be proportionate to the cost of providing service to each customer class, consistent with principles of fairness, transparency, and legal compliance.
 - iii. Where appropriate, consider the financing of large-scale capital improvement projects to spread the rate impacts over a multiple-year period.
- c. Reserves and Fund Balance
 - i. The amount within each reserve will be subject to annual review in accordance with service level needs, industry best practices, and reasonable calculation of risk.
 - ii. An operating reserve may be maintained within each major utility, enterprise, development services, or other fee-supported operating fund sufficient to address significant unanticipated expenditure requirements, emergencies, temporary revenue shortfalls, and as included in the Municipal Code. The intended use of the reserve should be clear and target levels for the reserves should be identified and will be governed by documented internal procedures, as appropriate. The amount may vary depending on service level needs and industry best practices.
 - iii. A reserve may be maintained within the Development Fee Programs Funds to ensure that previously received revenue for a project expected to be delivered over a multi-year period remains available to fund development-related services in the year it is expected to occur.
 - iv. Other reserves may be established in compliance with bond covenants or other financing obligations.
 - v. Any remaining unallocated resources as represented within the Ending Fund Balance should be sufficient to offset one-time or minor adjustments that may be needed within the fiscal year.

d. Annual Review

i. All fees, rates, and charges will be reviewed annually as part of the budget development process to ensure that revenues are aligned with required costs, reserves, and fund balance as described above.

**ATTACHMENT: City Council Policy 1-18, Section 17, Fees
(Existing Policy)**

17. Fees

Fees shall be set to cover 100% of the cost of service delivery, unless such amount prevents residents from obtaining an essential service. Fees or service charges should not be established to generate money in excess of the costs of providing services.

Fees may be less than 100% if Council determines that other factors (e.g., market forces, competitive position, etc.) need to be recognized.