



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jim Shannon  
Lee Wilcox

**SUBJECT: GOVERNMENT ACCOUNTABILITY MEASURES**      **DATE:** September 11, 2020

Approved

Date

9/16/2020

## SUPPLEMENTAL

### REASON FOR SUPPLEMENTAL

The recommendations included in this memorandum provide alternatives to achieve the accountability and transparency objectives referenced in Councilmember Diep's memorandum received by the Rules and Open Government Committee on August 19, 2020.

### RECOMMENDATION

- (a) Accept the response from the Administration on the Government Accountability Measures discussed in the memorandum from Councilmember Diep referred to the City Council from the Rules and Open Government Committee on August 19, 2020.
- (b) Adopt a resolution amending City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy, to modify Section 4 (Fund Balance) and Section 15 (Public Involvement).

### BACKGROUND

The memorandum from Councilmember Diep and heard by the Rules and Open Government Committee on August 19, 2020 seeks to build upon the City's already substantial accountability and transparency efforts, which include a well-defined and publicly available budgeting development and approval process guided by City Council Policy 1-18<sup>1</sup>, frequent monitoring of the current budget, detailed budget documents published on the City's website, and review and oversight of existing revenue measures provided by City Council-appointed committees. Further, the City has an active intergovernmental relations team with a strong focus on advocating for additional revenues that make a positive and meaningful impact in San José, and an independent City Auditor that provides thoughtful recommendations to improve service delivery.

<sup>1</sup> <https://www.sanjoseca.gov/Home/ShowDocument?id=50375>

The Administration agrees that accountability, budgetary resilience, and maximizing external revenue opportunities from federal, state, and regional governments gains further importance as the San José community continues to grapple with the public health and economic impacts from the COVID-19 pandemic. Discussed below is the Administration's response to the recommendations included in Councilmember Diep's memorandum.

## **ANALYSIS**

Much of the development, monitoring and adjustment of the budget is guided by City Council Policy 1-18. The Administration recommends modifications to this policy as an alternative to the first two recommendations of Councilmember Diep's memorandum. The objectives of the third recommendation are currently being performed by the Intergovernmental Relations team. The fourth recommendation is left to the City Auditor to address.

### **1. Budget Stabilization Reserve**

City Council Policy 1-18, Section 3, identifies three reserves in the General Fund that serve as a safety net for operations and service delivery: the Contingency Reserve, which is set at 3% of the General Fund operating budget; the Budget Stabilization Reserve, which provides a buffer or bridge funding against lower than projected revenues or higher than projected expenditures in any given year; and the Workers' Compensation/General Liability Claims Catastrophic Reserve, which provides additional funding for potential workers' compensation or general liability claims that exceed budgeted amounts. These reserves are identified by the Policy as "General Purpose Reserves" with a goal to achieve 10% of General Fund operating budget expenditures.

The 10% target is informed by the 2015 City Auditor *Fund Balance and Reserves: San Jose Should Aim to Have Higher Safety Net Reserves Within the General Fund* audit<sup>2</sup>. The audit included a recommendation for the Budget Office to "propose revisions to Council Policy 1-18 [Operating Budget and Capital Improvement Program Policy] that would establish an overall reserve target level range for the Contingency Reserve and the Budget Stabilization Reserve. Such a range should be approximately 10% of expenditures (the minimum of benchmarked California cities) to 16.6% (the Government Finance Officers Association recommended best practice)." In response to that audit, the Administration brought forward adjustments to Council Policy 1-18 as a Manager's Budget Addendum during the 2015-2016 budget development process to establish a General Purpose Reserves – comprised of the Budget Stabilization Reserve, the Contingency Reserve, and the Workers' Compensation/General Liability Claims Reserve – target of 10% of General Fund operating budget expenditures.

City Council Policy 1-18, Section 4, describes how any additional General Fund fund balance should be allocated as part of the Annual Report process, after addressing all necessary appropriation adjustments to rebudget funds, correct errors, or reflect updated cost information. Currently, the Policy provides direction to first ensure that any shortfall anticipated for the following fiscal year is set aside in reserve and then directs any remaining funding to be

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<sup>2</sup> <https://www.sanjoseca.gov/Home/ShowDocument?id=33838>

allocated to the Budget Stabilization and/or Contingency Reserve, address unmet/deferred infrastructure needs, or address other one-time urgent funding needs.

Recommendation 1 in Councilmember Diep’s memorandum would allocate 50% of any excess fund balance to the Budget Stabilization Reserve, “until an amount equal to 15% of the General Fund balance has been achieved or be used to pay municipal debt.” The Administration agrees that prioritizing resources for the Budget Stabilization Fund will be necessary to help buffer the difficult choices that will need to be made in future budget processes, and also agrees with the continued pay down of debt as has been directed by the Mayor and City Council in recent budget cycles.

Though, as shown in Table 1 below, a 15% target for the Budget Stabilization Reserve is large: holding everything else constant in the 2020-2021 Adopted Operating Budget, a Budget Stabilization Reserve that equals 15% of General Fund operating expenditures would be approximately \$193 million, compared to the current level of \$21 million, and would result in a total reserve level of \$248 million (19% of General Fund expenditures).

*Table 1. General Purpose Reserve Levels (\$ Millions)*

<b>Reserve</b>	<b>2020-2021 Adopted Budget</b>	<b>Combined Target of 10%</b>	<b>Combined Target of 15%</b>	<b>Budget Stabilization Reserve Target of 15%</b>
Contingency	\$40	\$40	\$40	\$40
Budget Stabilization	<b>\$21</b>	<b>\$74</b>	<b>\$138</b>	<b>\$193</b>
Workers’ Comp/General Liability Claims	\$15	\$15	\$15	\$15
<b>Total Amount</b>	<b>\$76</b>	<b>\$129</b>	<b>\$193</b>	<b>\$248</b>
% of GF Operating Expenditures	6%	10%	15%	19%

As an alternative to Recommendation 1 in Councilmember Diep’s memorandum, the Administration recommends retaining the overall target for General Purpose Reserves in the General Fund at 10% and modifying City Council Policy 1-18, Section 4, to:

- a. Allocate 50% of any remaining fund balance to the Budget Stabilization Reserve after addressing any necessary corrections/adjustments, ensuring that the Contingency Reserve equals 3% in accordance with existing City Council Policy while also ensuring that the Workers’ Compensation/General Liability Claims Reserve has been set at an appropriate level, and ensuring that sufficient funding is reserved to address the following year’s anticipated deficit; and
- b. Include the paydown of outstanding General Fund debt obligations eligible for prepayment as an identified use for the remaining 50% of available fund balance. It is important to note that accelerated paydown of outstanding debt obligations may be constrained by the governing documents, so the proposed policy modifications focus on prepayment of those obligations eligible for prepayment.

This modification aligns with the spirit of Councilmember Diep's recommendation to continue building the Budget Stabilization Reserve and paying down General Fund debt obligations – actions the City Council has previously directed in recent budget cycles – while acknowledging that setting aside funding to build reserves to a much higher level would likely be infeasible for the foreseeable future. A redline version of the Section 4 with the recommended changes is shown below and captured in the accompanying resolution.

*Excerpt of City Council Policy 1-18, Section 4 – Recommended Changes*

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**4. Fund Balance**

The appropriation of carryover fund balances must be approved judiciously. This should ensure that ongoing expenditures will be budgeted only to the extent that proven revenue streams exist.

In the annual budget, and in subsequent reports, there will be a presentation on fund balances and their anticipated uses.

**Any General Fund “Ending Fund Balance” identified in the City Manager’s Annual Report shall be allocated in the following manner.**

- a) ~~The first increment of any General Fund “Ending Fund Balance” identified in the City Manager’s Annual Report shall be allocated to offset any projected **shortfall deficit** for the following fiscal year, after necessary appropriation adjustment actions to re-budget funds, correct errors, or reflect updated cost information have been accounted for in the fund balance reconciliation, **including ensuring that the Contingency Reserve achieves the minimum target of 3% of the General Fund Operating Budget, as described in Section 3. Contingency Funds or Accounts.**~~
- b) After setting aside funding to address the projected **shortfall deficit** for the following year, **50% of the remaining funds shall be allocated to the Budget Stabilization Reserve until the total of General Purpose Reserves reaches 10% of General Fund Operating Budget expenditures, as described in Section 3. Contingency Funds or Accounts.** ~~the remaining funds shall be allocated for the following uses:~~
  - ~~1) Budget Stabilization Reserve and/or Contingency Reserve.~~
  - ~~2) Unmet/deferred infrastructure and maintenance needs.~~
  - ~~3) Other one-time urgent funding needs.~~
- c) **The remaining 50% of the fund balance shall be allocated for the following uses:**
  - 1) Further contributions to the Budget Stabilization Reserve and/or Contingency Reserve, and/or Workers’ Compensation/General Liability Claims Reserve.**
  - 2) Accelerated paydown of outstanding debt obligations payable from the General Fund eligible for prepayment.**

- 3) Unmet/deferred infrastructure and maintenance needs.**
- 4) Other one-time urgent funding needs.**

- d) Annual surplus funds shall not be used for **new ongoing** expenditures, unless those expenditures can be accommodated in Year Two and possibly Year Three of the five-year financial forecast. Any available carryover balance should only be used to offset one-time costs or to increase revenues.

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## **2. Oversight of Revenue-Generating Ballot Measures and Policy Proposals**

The City currently benefits from residents serving in an oversight role of expenditures related to various ballot measures. The general obligation bond measures approved by voters in the early 2000s to construct or rehabilitate police, fire, library, parks, and recreation facilities were overseen by committees of residents who certified that funds were spent as originally identified. Similarly, Measure T, a \$650 million general obligation bond authorization approved by voters in November 2018 to rehabilitate a variety of public infrastructure, including \$300 million for street resurfacing, is also overseen by a City Council-appointed committee of residents. Measure B, a local quarter-cent sales tax increase approved by voters in June 2016, is overseen by the Neighborhoods Commission. Measure E, a real property transfer tax approved by the voters in March 2020 will receive oversight by the Housing and Community Development Commission.

During discussion at the Rules and Open Government Committee meeting on August 19<sup>th</sup>, both Councilmember Diep and members of the Committee expressed interest that Recommendation 2 from Councilmember Diep's memorandum address major new revenue sources; the intent was not to require additional oversight of numerous minor revenue changes or fee increases considered in the budget development process. Discussion also indicated that, instead of another new standing body of residents, that the Neighborhoods Commission could potentially serve to provide oversight of new future ballot measures.

With the above in mind, the Administration recommends modifying City Council Policy 1-18, Section 15 (Public Involvement) to:

- a. Designate the Neighborhoods Commission as the default choice to provide oversight of General Fund revenues generated by ballot measures, with an option to designate other commissions or bodies if deemed appropriate;
- b. Specify that the City Council will identify the ballot measures to be reviewed by the Neighborhoods Commission;
- c. Provide direction to the Neighborhoods Commission that their oversight, unless otherwise specified by the City Council, would include a high-level review of the General Fund budget to assess the extent to which the increased revenues were allocated to support community priorities; and

The objective of the policy changes is to create a flexible framework that allows for resident input and oversight for how revenues that are unrestricted in their use are allocated in the General Fund. Resident oversight over special taxes that are restricted by federal and state regulations (e.g. general obligation bonds) is straightforward – the revenues and expenditures generated by the tax often must be held in separate funds and can only be spent on certain activities as identified in the tax measure. Oversight over a general tax where the City Council has previously identified specific uses that the revenues would support (e.g. Measure E) is also straightforward.

Oversight is less straightforward when the tax revenues are received in the General Fund without a specific allocation of uses and are instead incorporated into the Base Budget to help pay for the wide array of City services in the General Fund. The oversight provided by the Neighborhoods Commission on Measure B is an example of this instance.

Sales Tax revenues from Measure B were first received in October 2016 and incorporated into the Sales Tax Base Budget revenue estimate for 2017-2018. While the City Council gave direction for how the partial year proceeds would be budgeted in 2016-2017, the revenues were incorporated into the ongoing Base Budget beginning in 2017-2018. However, the Neighborhoods Commission interpreted their oversight role to compare Measure B revenues with specific expenditures on a dollar-for-dollar basis, which is not possible when the revenues are received in the General Fund and made available for wide range of uses. To address this issue, the Administration began issuing a Manager's Budget Addendum (MBA) during each budget development cycle for incorporation into the Mayor's June Budget Message, beginning in 2018-2019 and continuing through 2020-2021<sup>3</sup>, that identified specific General Fund budget proposals in the Proposed Budget to associate with Measure B revenues. While approving the MBA addressed the issue of linking Measure B revenues to individual expenditure allocations, because Sales Tax is incorporated into the City's overall General Fund, focusing only on the expenditure allocations identified in the MBA limits the Committee's ability to understand how a broader range of City services are impacted by Sales Tax revenue.

Modifying City Council Policy 1-18 to give direction to the Neighborhoods Commission to consider ballot measure revenues in context of the broader General Fund budget and how the budget aligns to community priorities would increase the level of independent oversight over City Council-approved budget allocations and provide an informed forum for alternative perspectives on how the budget should reflect community priorities.

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<sup>3</sup> As an example, see MBA #22, Local Sales Tax Budget Allocation, issued during the 2020-2021 budget development cycle: <https://www.sanjoseca.gov/home/showdocument?id=59554>

*Excerpt of City Council Policy 1-18, Section 15– Recommended Changes*

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**15. Public Involvement**

Public involvement shall be encouraged in the annual budget decision-making process through public hearings, public outreach and information, and informal meetings.

**For ballot measures approved by the voters that result in increased tax revenues available to be spent for any governmental purpose, the Neighborhoods Commission shall serve as the primary resident oversight body over how such revenues are allocated within the General Fund on an annual basis. Subsequent to the release of the City Manager’s Annual Report, the Neighborhoods Commission will perform the following tasks for each ballot measure identified by the City Council to be reviewed by the Neighborhoods Commission:**

- a) Compare the actual revenue received with the budgeted estimate.**
- b) If the City Council approved specific uses for the revenue through a budget action, compare actual expenditures with the budgeted amount.**
- c) If the City Council did not approve specific uses of the revenue through a budget action, provide a high-level review of the General Fund budget to assess how the increased revenues from the ballot measure or policy were allocated to support community priorities.**
- d) Produce a report to the City Council summarizing all findings and stating whether and how the revenues were used to support previously identified uses and/or community priorities.**

**As deemed appropriate, the City Council may designate a separate commission or other body of San Jose residents to provide oversight of ballot measures that increase City revenues.**

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**3. Intergovernmental Relations Reports**

Recommendation 3 from Councilmember Diep’s memorandum seeks to ensure that the City’s budgetary process and priority setting sessions is informed by the status of state and federal legislation so as to maximize resources and benefits for San José residents. The Administration agrees and the Intergovernmental Relations team will continue to keep the City Council informed of state and federal legislation and its potential impact to the City’s budget. Intergovernmental Relations currently provides regular reports to the City Council during the year, including during March and June which aligns with the City’s existing budget process, as well as information memoranda analyzing the Governor’s January Budget Proposal and May Revise. Though it is critically important to be informed by potential grant opportunities from the federal and state governments – as well as potential takeaways – the Administration will continue to be careful to not build a budget around federal or state legislation that has not been signed into law or on grant funding that is not formally secured.

**CONCLUSION**

The recommended modifications to City Council Policy 1-18 as described above and contained in the accompanying resolution attempts to provide implementable actions addressing the important goals of Councilmember Diep's memorandum to increase budgetary resiliency and governmental transparency.

**EVALUATION AND FOLLOW-UP**

No follow up actions are expected at this time.

**CLIMATE SMART SAN JOSE**

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

**PUBLIC OUTREACH**

This memorandum will be posted on the City Council's Agenda Website for the September 22, 2020 City Council Meeting.

**COORDINATION**

This memorandum has been coordinated with the Finance Department and the City Attorney's Office.

**CEQA**

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



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