



ADMINISTRATIVE SERVICES

CITY HALL

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**CITY COUNCIL STAFF REPORT**

Meeting: March 6, 2018

**Subject**

Approve the Mid-Year Financial Report and recommended budget adjustments for Fiscal Year 2017-18

**Recommended Action**

1. Accept the City Manager's Mid-Year Financial Report for FY 2017-18
2. Approve the Mid-Year adjustments for FY 2017-18 as described in the Mid-Year Financial Report
3. Adopt a resolution approving Mid-Year budget adjustments

**Background**

On June 20, 2017, the City Council adopted the Fiscal Year (FY) 2017-18 Budget, a \$148.9 million spending plan for the City of Cupertino. On December 5, 2017, Council received an update on the City's spending plan as part of the City Manager's First Quarter Financial Report, which revised the budget to account for encumbrances of \$10,532,154 and carryover appropriations of \$41,133,535 from FY 2016-17. In the first two quarters of FY 2017-18, Council approved \$4,815,182 in adjustments mostly related to the acquisition of property on Byrne Road, the Vallco Specific Plan, and a donation for the City's Bike Plan Implementation. In addition, there was a decrease of \$3,925,080 in the Internal Service Fund (ISF) mostly related to an operating transfer to the General Fund in order to consolidate the City Channel/Web internal service fund with the City's General Fund.

This resulted in an amended budget of \$205,349,050. These FY 2017-18 budget adjustments are summarized in the table below:

Fund	FY 17-18 Final Adopted	Carryovers	Encumbrances	Adjustments Approved in 1st-2nd Quarters	FY 17-18 Amended Budget as Dec 31, 2017
General	\$75,051,233	\$11,974,549	\$4,529,247	\$6,256,918	\$97,811,947
Special Revenue	\$24,872,591	\$21,061,815	\$4,362,855	\$213,344	\$50,510,605
Debt Service	\$3,167,538	-	-	-	\$3,167,538
Capital Projects	\$23,509,762	\$5,971,870	\$839,842	\$2,270,000	\$32,591,474
Enterprise	\$10,576,992	\$1,438,826	\$38,195		\$12,054,013
Internal Service	\$11,690,063	\$686,475	\$762,015	-\$3,925,080	\$9,213,473
Total All Funds	\$148,868,179	\$41,133,535	\$10,532,154	\$4,815,182	\$205,349,050

## Discussion

The Mid-Year Financial Report focuses on the status of the City's budget as of December 31, 2017, and recommends adjustments to ensure the budget reflects the City's current revenue outlook and is responsive to changing spending priorities. As shown in the chart below, \$12,144,705 in budget adjustments are being requested, of which \$10,000,000 involves a transfer of excess fund balance to the Capital Reserve per the City's Reserve and One Time Use Policy. If approved, the City's new spending plan would total \$217,493,755 across all funds.

### Mid-Year Financial Report Summary by Fund

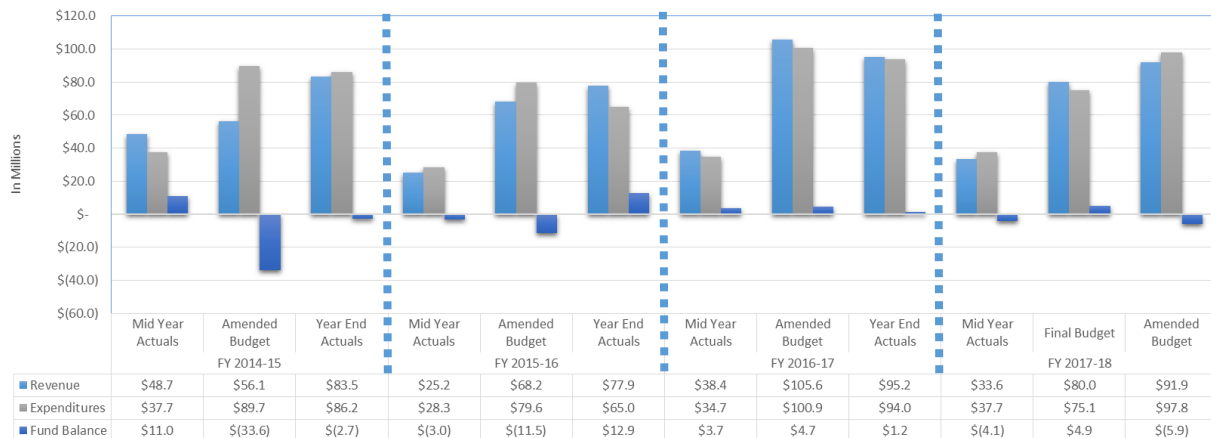
Fund	Amended Budget as of Dec 31, 2017	Requested Mid-Year Adjustments	Year End Projections
<b>General</b>	\$97,811,947	\$12,068,805	\$109,880,752
<b>Special Revenue</b>	\$50,510,605	-	\$50,510,605
<b>Debt Service</b>	\$3,167,538	-	\$3,167,538
<b>Capital Projects</b>	\$32,591,474	-	\$32,591,474
<b>Enterprise</b>	\$12,054,013	-	\$12,054,013
<b>Internal Service</b>	\$9,213,473	\$75,900	\$9,289,373
<b>Total All Funds</b>	<b>\$205,349,050</b>	<b>\$12,144,705</b>	<b>\$217,493,755</b>

The recommended budget adjustments would be funded through the use of department revenue of \$14,144,900, of which \$11,400,000 is a movement of cash from the General Fund to the Capital Reserve and Retiree Health Fund. A projected increase to unassigned fund balance in the amount of \$2,000,195 across all funds would occur as summarized in the table below:

Fund	Department	10,			Description
		Expenditure	Revenue	Fund Balance	
General Fund	Administrative Services	\$ 384,820	\$ -	\$ (384,820)	Contract Adjustment - Sales Tax Consultant Muni Services
General Fund	Administrative Services	\$ 29,185	\$ -	\$ (29,185)	FT Permanent Account Clerk I/II position
General Fund	City Manager's Office	\$ 9,900	\$ -	\$ (9,900)	Matching Funds to Remove Barrier to Fish Passage
General Fund	City Manager's Office	\$ 4,400	\$ -	\$ (4,400)	FT Community Outreach Specialist position
General Fund	Innovation and Technology	\$ 43,400	\$ -	\$ (43,400)	Disaster Modeling and Planning for Seismic Activity
General Fund	Law Enforcement	\$ 60,000	\$ 69,000	\$ 9,000	Sheriff Pass Thru Expenses, Revenue, and Admin. Fee
General Fund	Recreation and Community	\$ 37,100	\$ -	\$ (37,100)	Part-Time staff costs for Neighborhood Events Planning
General Fund	Public Works	\$ 100,000	\$ -	\$ (100,000)	Carmen Road Ped/Bike Bridge Study
General Fund	Non-Departmental	\$ -	\$ 2,600,000	\$ 2,600,000	Increase in projected Sales Tax and Property Tax Revenue
General Fund	Non-Departmental	\$ 1,400,000	\$ -	\$ (1,400,000)	Transfer out fund balance to Retiree Health Fund
General Fund	Non-Departmental	\$ 10,000,000	\$ -	\$ (10,000,000)	Transfer out fund balance to the Capital Reserve
<b>Total General Fund</b>		<b>\$ 12,068,805</b>	<b>\$ 2,669,000</b>	<b>\$ (9,399,805)</b>	
Capital Fund	Non-Departmental	\$ -	\$ 10,000,000	\$ 10,000,000	Transfer in fund balance to the Capital Reserve
Internal Service Fund	Administrative Services	\$ -	\$ 1,400,000	\$ 1,400,000	Transfer in fund balance to Retiree Health Fund
Internal Service Fund	Administrative Services	\$ 75,900	\$ 75,900	\$ -	Short Disability Budget in the ISF Funds
<b>Total Other Funds</b>		<b>\$ 75,900</b>	<b>\$ 11,475,900</b>	<b>\$ 11,400,000</b>	
<b>Total All Funds</b>		<b>\$ 12,144,705</b>	<b>\$ 14,144,900</b>	<b>\$ 2,000,195</b>	

## General Fund Update

### 4-year Comparison of Revenues, Expenditures and Changes to Fund Balance



#### Revenue

As of Mid-Year, General Fund revenues are at \$33.6 million, which represents 37% percent of the Amended Budget revenue. Sales Tax revenue is expected to come in higher than originally projected as reported by our sales tax consultant, HDL. This is primarily due to the positive effect of sales tax localization due to the Apple Park development. Furthermore, County estimates indicate that property tax revenues are expected to come in higher than previously projected. This is partially attributed to properties associated with Apple Park, which had an assessed value increase of \$822 million. Transient Occupancy Tax revenues have increased primarily due to the opening of the Residence Inn Marriot in Main Street. In total, staff is recommending to increase budgeted revenues in the General Fund by \$2.6 million.

#### Expenditures

As of Mid-Year, General Fund departments are requesting adjustments totaling \$12,068,805. These requests involve a contract adjustment for the City's previous sales tax consultant Muni Services as they close out audits they began in prior fiscal years, staffing requests, matching funds to remove a barrier to fish passage at Deep Cliff Golf Course, disaster modeling and planning for seismic activity, Sheriff pass thru expenses, a Carmen Road pedestrian/bike bridge study, funding for the retiree health fund, and the transfer of excess fund balance to the Capital Reserve per the City's Reserve Policy. These requests would be funded by an increase in projected sales and property tax revenue and the use of General Fund unassigned fund balance as summarized in the table below:

Fund	Department	Expenditure	Revenue	Fund Balance	Description
General Fund	Administrative Services	\$ 384,820	\$ -	\$ (384,820)	Contract Adjustment - Sales Tax Consultant Muni Services
General Fund	Administrative Services	\$ 29,185	\$ -	\$ (29,185)	FT Permanent Account Clerk I/II position
General Fund	City Manager's Office	\$ 9,900	\$ -	\$ (9,900)	Matching Funds to Remove Barrier to Fish Passage
General Fund	City Manager's Office	\$ 4,400		\$ (4,400)	FT Community Outreach Specialist position
General Fund	Innovation and Technology	\$ 43,400	\$ -	\$ (43,400)	Disaster Modeling and Planning for Seismic Activity
General Fund	Law Enforcement	\$ 60,000	\$ 69,000	\$ 9,000	Sheriff Pass Thru Expenses, Revenue, and Admin. Fee
General Fund	Recreation and Community Services	\$ 37,100		\$ (37,100)	Part-Time staff costs for Neighborhood Events Planning
General Fund	Public Works	\$ 100,000	\$ -	\$ (100,000)	Carmen Road Ped/Bike Bridge Study
General Fund	Non-Departmental	\$ -	\$ 2,600,000	\$ 2,600,000	Increase in projected Sales Tax and Property Tax Revenue
General Fund	Non-Departmental	\$ 1,400,000		\$ (1,400,000)	Transfer out fund balance to Retiree Health Fund
General Fund	Non-Departmental	\$ 10,000,000		\$ (10,000,000)	Transfer out fund balance to the Capital Reserve
Total General Fund		\$ 12,068,805	\$ 2,669,000	\$ (9,399,805)	

### *Retiree Health Fund*

The Administrative Services Department is requesting a transfer of \$1.4 million dollars from the General Fund to the Retiree Health fund in order to restore the fund to a positive cash balance. In FY 2015-16, the City used fund balance in retiree health to fund a large portion of expenses in that fund. In the subsequent year, it was discovered that these dollars should not have been used and the fund was in a cash deficit position. If approved, this will restore the fund to a positive position.

### *Matching Funds to Remove Barrier to Fish Passage*

In 2016, the Friends of Stevens Creek Trail were awarded a grant from the Santa Clara Valley Water District (SCVWD) to fund a feasibility study evaluating solutions to improve fish passage along Stevens Creek. Council agreed to sign on as a grant partner, providing a contribution of \$6,380, one-third of the local match requirement. The study was completed in November 2017 and eight barriers to fish migration on Stevens Creek were identified.

At the February 6, 2018 Council meeting, the Santa Clara County Creeks Coalition submitted a written request (Attachment E) to Mayor Paul and the Council to discuss the possibility of contributing \$9,900 towards matching funds for another SCVWD grant proposal to remove one of the identified barriers at Deep Cliff Golf Course in Cupertino. The estimated total cost for removing the Deep Cliff barrier is \$140,000-\$160,000. If the Creeks Coalition can secure \$9,900 from four agencies, the resulting \$39,600 would amount to the 25% match requirement. The Creeks Coalition has also approached Sunnyvale, Mountain View, Los Altos, and the Open Space District requesting contributions. The Sustainability Division is requesting \$9,900 to commit towards the matching fund requirement if the grant is awarded.

### *Neighborhood Events Planning for Summer 2018*

Recreation and Community Services staff are planning on expanding special events, such as outdoor movies and concerts, into neighborhood parks beginning this summer on a trial basis. Currently, most all events are held in Memorial park which requires many people to drive to the park. The intent is to provide walkable events, coordinated

with neighbors to provide a sense of community. Funding is needed to hire one (1) PT Community Coordinator and one (1) PT Leisure Programs Specialist, to plan the trial series of events at Jollyman, Creekside, Civic Center, and Main Street for the summer of 2018. Neighborhood events will greatly enhance the City's program offerings and relationships with neighbors as they will be offered in coordination with neighbors, block leaders, private groups, and more. For these part-time staff, \$37,100 is requested for the planning stage. Funds to implement the trial program will be requested in the upcoming budget process. It is estimated that the trial program implementation would cost \$98,000, but the final amount will be determined through the planning process.

### *Fund Balance*

The City's General Fund ended FY 2016-17 with \$53.49 million in total fund balance. As part of the FY 2017-18 Final Budget the City projected ending the fiscal year with \$45.41 million in total fund balance. As of the First Quarter Report, the City updated its year-end projections for FY 2017-18 to \$55.77 million in GF fund balance, an increase of \$10.36 million due to increases in revenues received and lower expenditures in FY 2016-17. Projected year-end fund balance is being decreased by \$5.66 million over the first quarter projections due to a transfer of cash out of the General Fund to the Capital Reserve and the Retiree Health Fund.

CLASSIFICATION	Year End Projections 2016-17	Actuals 2016-17	Adopted Budget 2017-18	First Quarter 2017-18	Mid-Year Projections 2017-18
Non Spendable	0.94	0.88	1.10	0.94	0.94
Restricted	0.69	1.02	0.76	0.69	1.01
Committed	11.60	19.00	- *	10.43	19.00
Assigned	20.50	4.64	36.80	23.86	15.95
UnAssigned	11.28	28.05	6.75	19.85	13.21
<b>TOTAL FUND BALANCE</b>	<b>45.01</b>	<b>53.59</b>	<b>45.41</b>	<b>55.77</b>	<b>50.11</b>

\* The FY 2017-18 adopted budget reported an Economic Uncertainty reserve in "assigned" fund balance. The FY 2017-18 First Quarter Report incorrectly classified encumbrances as "committed" fund balance. The FY 2017-18 Mid-Year Report corrected these classifications by reporting the Economic Uncertainty reserve as "committed" fund balance and encumbrances as "assigned" fund balance.

As of Mid-year, staff recommends the transfer of \$10 million in fund balance to the Capital Reserve to fund future years of the Capital Improvement Plan.

### **Staffing**

Currently, the city has a total of 193.75 FTEs. As of Mid-Year, staff is requesting a full-time Account Clerk I/II in Administrative Services and the conversion of a Limited Term Special Programs Coordinator to a full-time Community Outreach Specialist for Recreation and Community Services and Public Affairs. If approved, this would bring the full-time benefited employee count to 194.75.

### *Community Outreach Specialist*

Staff recommends making permanent one limited-term Special Programs Coordinator position in the Recreation and Community Services Department (RCSD) and reclassifying the position to a Community Outreach Specialist to better reflect actual duties performed. The position performs graphic design and marketing work consistent with a Community Outreach Specialist. The position was funded as part of the FY 2016-17 as a two year limited term position, set to expire in August 2018.

This position has resulted in increased social media traffic related to RCSD by 60% with 325% more posts reaching customers weekly in addition to increasing the open rate for email marketing. The Recreation Schedule has improved visuals and is more intuitive for the customer. Overall, RCSD has seen increased enrollment in many programs.

Given the City's efforts to create unified branding standards, staff recommends partial oversight from the Public Affairs Division. This change would ensure that the Community Outreach Specialist supporting RCSD is up-to-date on broader community interests, concerns, and sensitivities; as well as ensuring alignment to City-wide branding and marketing strategies. Realigning the position would also allow greater flexibility for both Public Affairs and RCSD in meeting marketing demands.

### *Account Clerk I/II*

A new full time permanent Account Clerk I/II position is being requested to serve as the liaison between the Sheriff's Office and private entities requiring private law enforcement services, commonly referred to as "paid jobs" by the Sheriff's Office and to serve as additional support for our business license function. In late FY 2016-17, the Sheriff's Office advised the City that per their County Counsel the Sheriff would no longer be available to contract with private entities for paid jobs. Any requests for paid jobs would need to first go through the City and be requested by the City as part of its contract with the Sheriff for law enforcement services. Since, there is no indication from the County that this administrative process will be returning to the Sheriff's Office, this will be an ongoing service that the City will need to provide.

In addition, this new position will provide relief for the business license function in the department. Business licenses have seen a significant increase in volume in the past few years. This coupled with a change in process to industry best practices as part of a system upgrade which eliminated the batch renewal functionality, has resulted in a significant workload increase in the department. Since, there are no technical solutions on the horizon to alleviate workload issues in business licenses, the department would like to move forward with a permanent long-term solution for the position. In addition, consistency in this position allows for building a great business relationship with our most frequent requestors. Furthermore, offsetting revenue is anticipated for this

position, through the administrative fee that the department charges for being the pass thru for paid jobs services.

### **Performance Measures**

Updated performance measures that align with government and private industry best practices have been included in the Mid-Year Financial Report. Staff will continue to provide updates to Council on the performance measures as part of the Mid-Year Budget Report, including prior year totals and current year results through December. Attachment C represents the status of the performance measures as of Mid-Year.

### **Irrevocable Trust**

Significant investment losses experienced by CalPERS during the great recession have resulted in the overall funded status of the retirement system falling below desired levels. As a result, on December 21, 2016, the CalPERS Board of Administration voted to lower the CalPERS discount rate assumption from 7.5% to 7.0% over three years. Although this will reduce the long-term probability of funded ratios falling below desired levels and improve the likelihood of CalPERS investments earning the assumed rate of return, it will result in considerable increases to the City's annual required contributions, which include both the Normal Cost and Unfunded Accrued Liability (UAL) payments.

As of June 30, 2016, the City's Unfunded Accrued Liability is \$40.6 million. For FY 2017-18, the City's estimated contribution to CalPERS is \$4.0 million (Normal Costs: \$1.6 million; UAL Contribution: \$2.4 million). Assuming the adopted changes to the discount rate, by 2024-2025, the City's CalPERS costs are projected to rise to \$7.2 million (Normal Costs: \$2.3 million; UAL Contribution: \$4.9 million), an increase of 81.7% (CalPERS Actuarial Valuation Report as of June 30, 2016).

In addition, as of February 13, 2018, the CalPERS board voted to decrease the amortization period for new pension liabilities from 30 years to 20 years effective July 1, 2019 for all agencies. CalPERS estimates that this will result in the normal cost rate increasing by 0% to 0.6% and UAL costs changing by -1.3% to 4.3% for Tier 1 members; for Tier 2 members, it is estimated that the normal cost rate will change by -0.3% to 0% and UAL costs will decrease by -5.5% to -3.1%; for PEPRAs members, the normal cost rate is estimated to change by -0.1% to 0% (CalPERS Circular Letter 200-014-18). Reducing the amortization period is expected to increase future average funding ratios, provide faster recovery of funded status following market downturns, and decrease cumulative interest contributions.

If there are any further reductions in the discount rate or if CalPERS investment returns continue to fall below the 7.0% assumption, there may be further increases to the City's

annual required contributions. To reduce the risk of contribution increases in the future, the City has several options:

1. Pre-paying the UAL
2. Establishing a Section 115 Trust
3. Expedite amortizing the UAL over 20 years instead of 30 years

City staff recommends establishing a Section 115 Irrevocable Trust. A Section 115 Trust is a tax-exempt investment tool that allows local governments to pre-fund pension and OPEB costs. Once contributions are placed into the trust, assets from the trust can only be used for retirement plan purposes. Withdrawals may be made to either reimburse the City for retirement system contributions or to directly pay CalPERS. City staff also recommends expediting the change in amortization of the UAL over 20 years instead of 30 years.

The benefits of Section 115 Trusts include the following:

- **Local control over assets:** City controls the contributions, withdrawals, investment strategy, and risk level;
- **Pension rate stabilization:** Assets can be transferred to CalPERS at City's discretion;
- **Potential for higher investment returns:** Investment requirements that apply to the City's General Funds are not applicable to assets held in a Section 115 Trust;
- **Potential for lower net pension liability:** Contributions to the trust may be able to reduce the City's net pension liability for financial reporting purposes.

In addition to establishing a trust, City staff is preparing a funding strategy with recommendations on how to grow the trust to City Council as part of the FY 2018-19 Proposed Budget. One option for increasing the assets of the trust is to allocate a portion of year-end excess fund balance to the trust.

### **Conclusion**

City staff recommends adjustments of \$12,144,705 in appropriations and \$14,144,900 in projected revenue resulting in \$2,000,195 added to fund balance across all funds. Staff will continue to monitor the FY 2017-18 Amended Budget and be prepared to make recommendations and changes based on business needs and Council priorities before June 30, 2018 to ensure that the City ends the year within budgeted appropriations.



Prepared by: Budget Team Members - Karen Bernard-Guerin, Zach Korach, Thomas Leung, Katy Nomura, and Toni Oasay-Anderson

Reviewed for submission by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: David Brandt, City Manager

Attachments:

A - Mid-Year Financial Report – FY 2017-18

B - Draft Resolution

C - Performance Measures for each Department

D - Mid-Year Budget Journal

E - Santa Clara County Creeks Coalition Letter