



## ADMINISTRATIVE SERVICES DEPARTMENT

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### CITY COUNCIL STAFF REPORT

Meeting: January 17, 2024

#### Subject

Provide input to staff on potential service-level reductions for the FY 2024-25 Proposed and Final Budgets

#### Recommended Action

Provide input to staff on potential service-level reductions for the FY 2024-25 Proposed and Final Budgets

#### Executive Summary

As the Fiscal Year (FY) 2024-25 budget process approaches, this study session aims to provide an update on the City's budget forecast and gather City Council input on priority areas for a balanced budget.

Multiple strategies for addressing the structural deficit are under consideration. These strategies aim to strike a balance between expense reductions and revenue generation to ensure the continuity of core city services. They fall into three strategic categories:

- Revenue-generating opportunities
- Service-level reductions
- Fee increases

On December 5, the Council provided direction to staff on revenue-generating opportunities. That work is ongoing, and staff will provide an update in February.

This study session is meant to explore the second element: service-level reductions.

A comprehensive study of the City's fees and charges is in the final stages. This will allow for the comparison of current city fees to cost recovery rates and to market rates (for example, in Parks and Recreation fees). The results and recommendations of that study will be provided to Council in February as well.

After Council discussions, these sources of revenue generation or expense reductions will be refined and consolidated into one package for Council consideration during the comprehensive discussion of the next fiscal year's budget, beginning in May. This approach allows the Council and the public to consider each strategy individually, followed by the combined budget discussion where tradeoffs between approaches will lead to a balanced budget.

### Reasons for Recommendation

#### **Background**

In May 2022, a California Department of Tax and Fee Administration (CDTFA) audit of a taxpayer was highlighted to the Council, raising concerns about potential budget impacts.

Information associated with the audit, including financial figures, decisions impacting other jurisdictions statewide that may indicate future outcomes for Cupertino, and discussions with stakeholders such as the CDTFA, shaped an evolving forecast. Staff remains committed to providing ongoing updates to ensure that budgeting decisions are based on the most current forecast.

Following discussions with the affected taxpayer and the CDTFA, an updated forecast was presented to the Council on April 13, 2023. The impact was estimated to be a 73% decline in sales tax revenue, equating to an ongoing \$30 million decrease. This shifted the City's financial outlook from a surplus to a structural deficit, where ongoing expenses exceed revenue.

#### **Council Actions**

The Council and staff have demonstrated proactive fiscal stewardship in response to the evolving financial landscape. The FY 2023-24 Adopted Budget, which Council adopted on June 6, 2023, incorporated significant expenditure reductions of more than \$15 million dollars, including:

- Eliminating 14 vacant positions (\$2.6 million)
- Decreasing materials, contract services, special projects, capital outlays, and contingency expenditures (\$5.9 million)
- Decreasing transfers from the General Fund to other funds (\$5.5 million)
- Using the City's Section 115 Trust to fund OPEB (Other Post-Employment Benefits) costs (\$1.4 million)

Additionally, on October 10, 2023, the Council established a committed Sales Tax Repayment Reserve with an initial allocation of \$56.5 million. This reserve was designed to address a potential adverse CDTFA decision and the uncertain outcome of the anticipated legal challenge. Funding came from Unassigned fund balance, the Capital Projects Reserve, and the Economic Uncertainty Reserve.

On November 21, 2023, as part of the FY 2023-24 First Quarter Financial Report, staff sought Council direction on several potential FY 2024-25 budget reductions. These required earlier discussion as the planning and implementation of these items required advance commitments. The Council approved the defunding of \$138,000 of the \$145,000 budgeted for the 4th of July event in FY 2024-25, with \$7,000 retained for morning events. The Council further directed staff to explore funding options and return to Council with recommendations. The Council also voted to cap the Community Grant Funding Program at \$32,500 (saving up to \$57,500) and defund the Weed Abatement subsidy (saving approximately \$8,000).

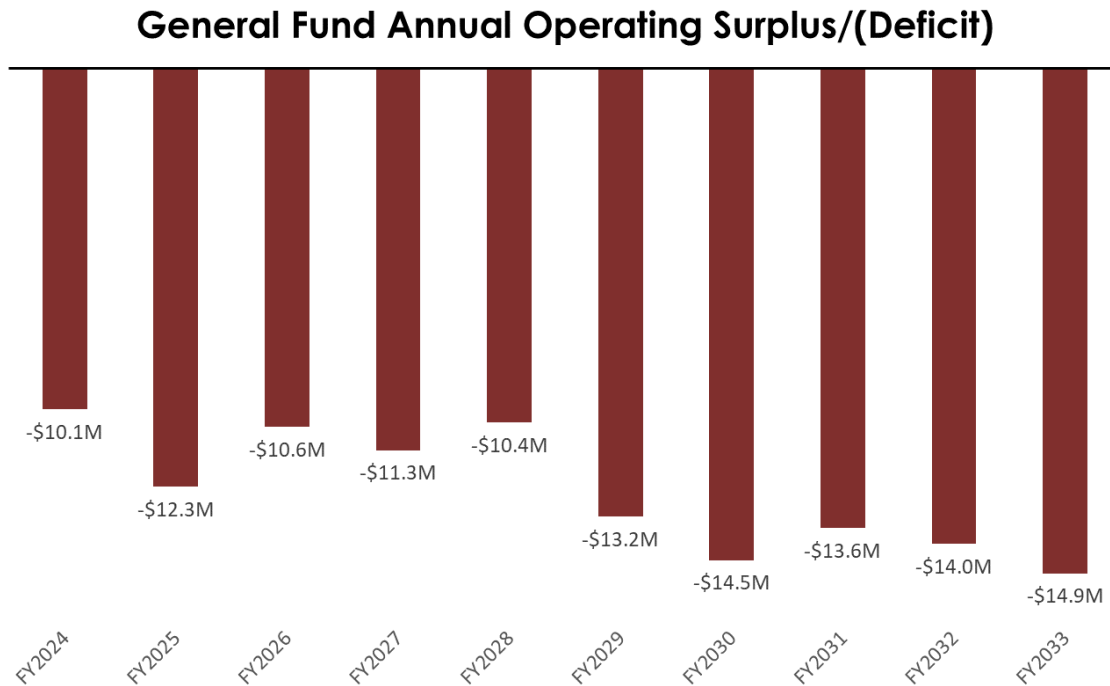
Moreover, on December 5, 2023, staff sought Council direction to explore the feasibility of potential revenue tax measures through opinion research. Urban Futures, Inc. (UFI), a consultant, presented various revenue tax measure options, highlighting the advantages, disadvantages, comparisons with neighboring cities, and projected revenue impacts of each option. The Council decided to revisit the issue in early 2024 after staff had the opportunity to engage the business community regarding potential measures.

### **Budget Forecast**

Annually, staff constructs a financial forecast to guide budget decisions. The forecast is not a rigid plan, but rather a dynamic model dependent on assumptions that are continually updated as new information emerges.

This forecast assumes the complete repayment of facility debt by FY 2029-30, \$2 million in annual funding for capital projects, and \$1 million in annual funding for Special Projects and City Work Program projects. Salaries and benefits reflect the cost-of-living adjustments approved by the Council on November 7, 2023. Salaries are expected to increase by the CalPERS payroll growth rate in subsequent years.

Additionally, the forecast anticipates periods of economic downturn, reflecting no revenue growth in FY 2024-25 and FY 2028-29. The ongoing impacts of new development projects are not factored in until the developments are entitled and permitted. HdL, the City's retained consultant, provides the sales tax and property tax forecasts. Sales tax revenues account for an ongoing decrease due to the CDTFA audit.



Even with the implemented expenditure reductions, a \$15 million structural deficit persists due to the significant loss in sales tax revenue. Although the City's conservative budgeting has allowed the City to accumulate fund balance in previous years, use of this fund balance is only a short-term measure. It gives the City a window to explore and gradually implement revenue-generation and expenditure-reduction strategies, but is not an ongoing solution to the fiscal challenge.

#### **Potential Service-Level Reductions**

Staff requests the Council's input on potential service-level reductions. Staff will use this input to develop the proposed budget, which is scheduled for a study session in May and adoption in June.

In October, departments conducted an extensive review of their budgets, evaluating all line items to identify areas for potential reductions. This thorough review aimed to uncover opportunities to help address the City's \$15 million structural deficit.

In evaluating these potential service-level reductions, staff conducted a thorough assessment based on multiple criteria. The criteria encompass financial impacts, service implications, operational efficiencies, and community impacts. Each proposed reduction was scrutinized for its financial ramifications and its impact on community services. Additionally, consideration was given to potential implications on our workforce, including any necessary adjustments or reassignments, as well as potential community feedback. This detailed evaluation aims to provide the Council with a comprehensive understanding of the implications associated with the proposed reductions, facilitating

informed decision-making aligned with the City's long-term objectives and community priorities.

Recognizing the significant role of community feedback in decision-making, the approach involves engaging the community through multiple avenues. Interactive town hall meetings in February and April will encourage open dialogue between Council members, city staff, and the public, allowing for direct input and discussion on financial matters affecting the community. In addition, surveys and focus groups will gather diverse perspectives from residents, businesses, and other stakeholders. This feedback will be integrated into the recommendations, ensuring that the voices and concerns of the community are actively considered in the decision-making process. The goal is to nurture transparency, responsiveness, and a collaborative environment where the community's input helps shape the City's direction and service priorities.

The potential service-level reductions include various operational adjustments and realignment of responsibilities. If approved, the reductions marked with a footnote would take place over time. Staffing reductions will occur through attrition as positions become vacant. Attachment A describes each reduction.

The reductions fall into two categories: Service-Level Reductions (\$8.0 million) and Fiscal Accountability (\$2.6 million). Service-Level Reductions (SLR) aim to lower expenses or modify how services are provided, while Fiscal Accountability measures focus on aligning budgets with actual costs and streamlining expenses. These strategies blend cost reduction with service adjustment, reflecting an effort to manage financial constraints, optimize resource allocation, and consider potential impacts on community services.

### **Next Steps**

Regular reports on the City's budget will be provided to the Council. This study session, in addition to a Council check-in in April and the mid-year budget update in February, will provide opportunities to communicate progress on the CDTFA audit and strategy to balance the budget.

To encourage community involvement, interactive town hall meetings in February and April will engage residents, businesses, and stakeholders. These sessions aim to enhance transparency and collaboration, fostering inclusive decision-making processes.

### **Sustainability Impact**

No sustainability impact.

### **Fiscal Impact**

Proposed service-level reductions are estimated to reduce ongoing expenditures by approximately \$10.5 million annually. Implementing these reductions would significantly help reduce the \$15 million structural deficit.

California Environmental Quality Act

Not applicable.

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Attachments:

A – Potential Service-Level Reductions Summary