



## ADMINISTRATIVE SERVICES

CITY HALL

10300 TORRE AVENUE • CUPERTINO, CA 95014-3255

TELEPHONE: (408) 777-3220 [www.cupertino.org](http://www.cupertino.org)

## CITY COUNCIL STAFF REPORT

Meeting: June 5, 2018

### Subject

Public hearing to consider the Capital Improvement Plan (CIP); and a finding of General Plan conformance; and the Recommended Budget for Fiscal Year (FY) 2018-19; and the Adoption of the Recommended Budget; and Establishment of the Appropriation Limit, and related actions.

### Recommended Action

- a. Adopt Resolution No. 18- \_\_\_\_ establishing a special project budget for Public Works Traffic Engineering Program for costs related to Apple Pass through Revenues for FY 2018-19
- b. Adopt Resolution No. 18- \_\_\_\_ establishing an Operating Budget and Capital Budget for FY 2018-19
- c. Adopt Resolution No. 18- \_\_\_\_ establishing an Appropriation Limit for FY 2018-19
- d. Approve the appropriation of \$22,000 in Public Works for the Senior Mobility/RIDE Program
- e. Approve the appropriation of \$175,000 in Community Development for BMR linkage fees update
- f. Approve the appropriation of \$67,000 in Recreation and Community Services for a Performing Arts program
- g. Approve the appropriation of \$25,000 in Administration for the Cities Association Ad Hoc Committee for the Santa Clara/Santa Cruz Counties Airport/Community Roundtable
- h. Approve the appropriation of \$3,500 for Sheriff's costs related to the Tournament of Bands.

### Description

The California Government Code requires a Public Hearing be held prior to the adoption of the City's budget. The purpose of the public hearing is to provide an opportunity for residents to voice their opinions on the City's budget and the appropriations limit. In prior years the budget hearing and adoption were held in separate meetings. California Government Code permits the budget hearing and adoption of budget to take place in the same meeting. Staff is recommending Council

do both at the same meeting for FY 2018-19. Council will first hold the public hearing then after the public hearing is closed, move to consider budget adoption. In addition, Article XIII B of the California Constitution established appropriations limits on government agencies within California. Originally established by Proposition 4 in 1979, the appropriations limit places a maximum limit on the appropriations of tax proceeds that can be made by the state, school districts, and local governments in California.

### Fiscal Impact

The Proposed Budget reflects a total City budget of \$131.4 million, an decrease of \$17.5 million or 12% when compared to the FY 2017-18 Final Adopted Budget. The recommended budget is summarized by fund and source of funding in the following table and pie chart:

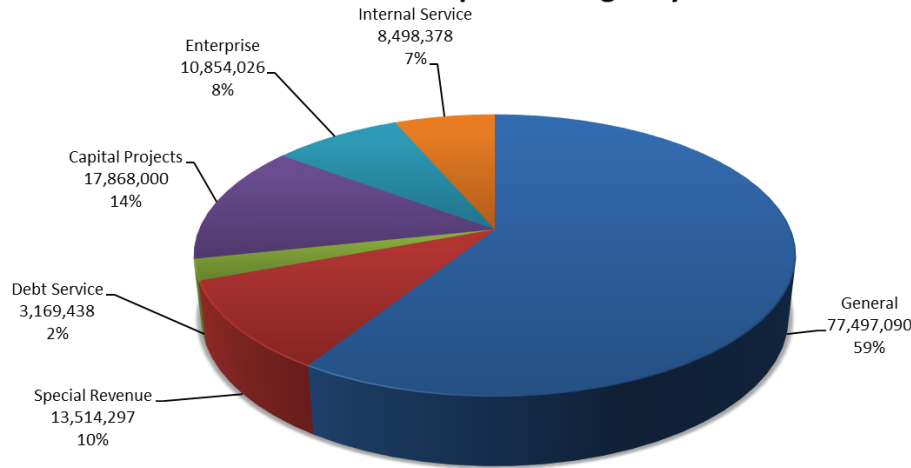
Fund Type	Total Proposed Expenditures	Total Proposed Revenue	Change in Fund Balance/Net Position
General	\$ 77,497,090	\$ 76,888,476	\$ (608,614)
Special Revenue	\$ 13,514,297	\$ 12,390,191	\$ (1,124,106)
Debt Service	\$ 3,169,438	\$ 3,169,438	\$ -
Capital Projects	\$ 17,868,000	\$ 9,051,500	\$ (8,816,500)
Enterprise	\$ 10,854,026	\$ 7,344,400	\$ (3,509,626)
Internal Service	\$ 8,498,378	\$ 7,024,288	\$ (1,474,090)
<b>Total</b>	<b>\$ 131,401,229</b>	<b>\$ 115,868,293</b>	<b>\$ (15,532,936)</b>

### FY 2018-19 Proposed Budget by Fund \$131,401,229

#### **General Fund**

The General Fund pays for core services such as public safety, parks and recreation, planning and community development, streets and trees, and a host of other vital services. The revenue used to pay for these services comes primarily from local taxes such as property tax and sales tax, franchise fees, charges for services, and a variety of other discretionary sources.

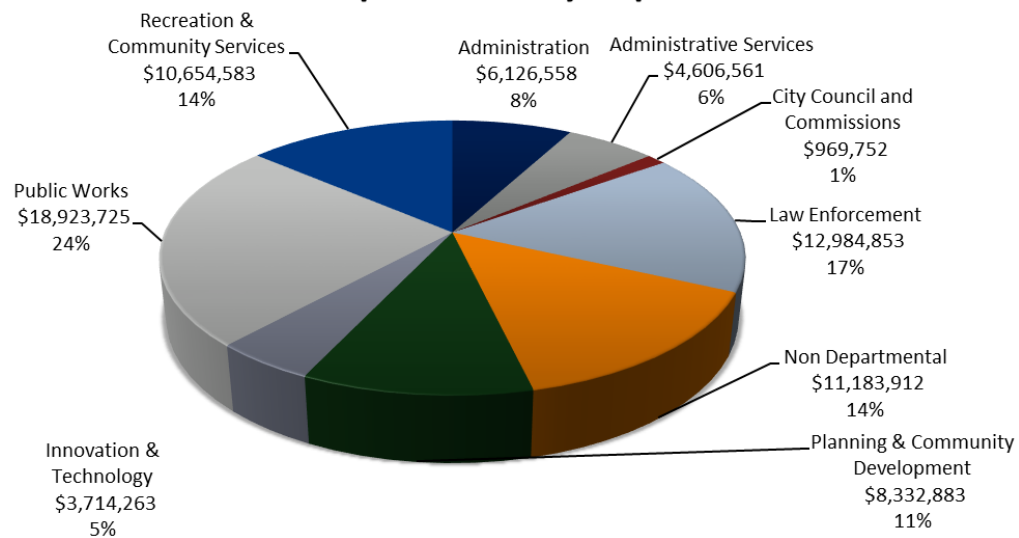
### FY 2018-19 Proposed Budget by Fund



As illustrated in the following chart, the majority of the General Fund supports costs for public works, planning and community development, and law enforcement.

### FY 2018-19 Proposed General Fund Budget by Department \$77,497,090

#### General Fund Expenditures by Department



The City's General Fund is recommended at \$77.5 million, an increase of \$2.4 million or 3.2% from the FY 2018 Adopted Budget. The General Fund is balanced through the use of General Fund revenue of \$76.9 million and is projected to end FY 2019 with approximately \$9 million in unassigned fund balance that may be transferred to the Capital Reserve per the Reserve and One Time Use Policy as part of the City's year-end process. The transfer is not reflected in the Proposed Budget.

## General Fund Revenue

For FY 2018-19, General Fund revenue estimates (excluding fund balance) total \$76.9 million, representing a 4% decrease from the FY 2017-18 Adopted Budget. The following table represents the total General Fund revenue:

GENERAL FUND REVENUE SUMMARY					
REVENUES	FY 16-17 Actuals	FY 17-18 Adopted	FY 17-18 Estimate	FY 18-19 Proposed	Percent Change*
Sales Tax	26,932,012	22,790,000	23,790,000	23,637,000	3.7%
Property Tax	20,219,077	20,757,000	22,357,000	22,766,000	9.7%
Transient Occupancy	6,023,681	6,708,000	6,708,000	8,252,000	23.0%
Utility Tax	3,082,408	3,200,000	3,200,000	3,200,000	0.0%
Franchise Fees	3,409,572	3,040,000	3,040,000	3,042,000	0.1%
Other Taxes	2,981,883	2,850,000	2,850,000	1,150,000	-59.6%
Licenses & Permits	2,536,924	2,145,000	2,145,000	2,685,000	25.2%
Use of Money & Property	1,210,231	1,647,790	1,647,790	692,000	-58.0%
Intergovernmental	330,107	484,000	484,000	326,000	-32.6%
Charges for Services	17,913,165	13,337,897	15,259,770	9,419,276	-29.4%
Fines & Forfeitures	593,122	600,000	600,000	615,000	2.5%
Miscellaneous	9,931,554	2,435,960	12,499,274	1,104,200	-54.7%
<b>TOTAL REVENUE</b>	<b>95,163,736</b>	<b>79,995,647</b>	<b>94,580,834</b>	<b>76,888,476</b>	<b>-3.9%</b>

\*Percentage change of the Adopted Budget 17-18 from the Proposed Budget 18-18

Decreases in revenue are mostly due to a wind down in development resulting in less revenue in Charges for Services and Construction Tax. When fund balance carryover is included, General Fund fund balance total \$45.4 million, which is consistent with the FY 2017-18 Adopted Budget.

## General Fund – Fund Balance

The General Fund unassigned fund balance is projected to decrease from the current year estimate of \$9.6 million to \$9.0 million in FY 2019. As shown in the chart below, the FY 2019 ending fund balance is estimated to be \$45.4 million, or 1% lower than the FY 2018 year end estimate. The decrease in unassigned fund balance is due to decreases in revenue sources and increases in expenditures mostly related to employee compensation and benefits as well as materials and contract services.

The following table shows changes to fund balance for the General Fund since the close of FY 2015-16:

GENERAL FUND BALANCE					
Classification	FY 15-16 Actual	FY 16-17 Actual	FY 17-18 Estimated	FY 18-19 Proposed	Percent Change
Unassigned	29,869,085	28,057,799	9,645,226	9,036,612	-6%
All other classification	22,325,755	25,531,891	36,316,546	36,316,546	0%
Total Fund Bal.	\$52,194,840	\$53,589,690	\$45,961,772	\$45,353,158	-1%

### *Special Revenue Funds*

Special Revenue Funds are a fund type used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. Special Revenue Funds account for 10% of the citywide expenditure budget. The largest Special Revenue Fund accounts for streets, roads, and transportation. Other funds account for storm drain management, affordable housing programs, and park development. The Proposed Budget for Special Revenue Funds for FY 2019 is \$13.5 million, which is an \$11.4 million decrease from FY 2018 Adopted Budget primarily due to the completion of capital and BMR projects in FY 2017-18.

Budgets within the Special Revenue Funds are funded by \$4.5 million in restricted department revenue, and \$7.9 million transfers from the General Fund, bringing total funding sources for the fund to \$12.4 million. This will result in a projected decrease to fund balance of \$1.1 million. The Special Revenue Funds are projected to end the year with fund balances of \$3.1 million.

### *Capital Projects Funds*

The Capital Improvement Project Fund, Stevens Creek Corridor Park Fund, and Capital Reserve Fund are currently in the Capital Projects Fund type category. This fund type is typically used to account for financial resources that are used for the acquisition or construction of major capital facilities or to provide facilities for City departments, and are identified in the five-year Capital Improvement Program (CIP).

The Proposed budget for the Capital Projects Funds for FY 2019 is \$17.9 million, comprised of \$7.2 million in new capital projects and \$10.7 million in transfers out to the Special Revenue and Enterprise funds to fund capital projects. The FY 2019 budget is \$5.6 million lower than FY 2018 budget expenditures based on the cost of the recommended capital projects.

### *Enterprise Funds*

Enterprise Funds are set up for specific services that are funded directly by fees charged for goods or services. Enterprise Funds consist of Resource Recovery for the solid waste collection franchise, Blackberry Farm for the City-owned golf course, the Cupertino Sports Center, and Recreation Programs for cultural, youth, teen, sports, and physical recreation programs.

The proposed budget for Enterprise Funds for FY 2019 is \$10.9 million, an increase of \$0.3 million from the FY 2018 Adopted Budget. Budgets within the Enterprise Funds are funded by \$7.3 million in program revenue including \$75,000 in transfers from the General Fund. The Enterprise Funds also rely on \$8.2 million of prior year fund balance, bringing total funding sources for the funds to \$15.5 million. The Enterprise Funds are projected to begin the fiscal year with \$8.2 million in retained earnings and are projected to end the year with retained earnings of \$4.7 million.

### *Internal Service Funds*

Internal Service Funds are used for areas where goods or services are provided to other City departments or governments on a cost-reimbursement basis. Internal Service Funds include funds and programs for information technology, workers' compensation, equipment, compensated absence, long-term disability, and retiree medical insurance.

The Proposed Budget for the Internal Service Funds is \$8.5 million, which is \$3.2 million lower than the FY 2018 Adopted Budget. This decrease is primarily attributed to the transfer of the City Channel to the General Fund. Budgets within Internal Service Funds are funded by \$5.0 million in department revenue, \$1.6 million from the General Fund, and \$473,000 from a combination of depreciation reserves and retained earnings.

## **STAFFING**

### *Personnel Assumptions*

Negotiated salary increases are assumed in the FY 2019 Proposed Budget. The Council ratified three-year agreements with its two bargaining units in October 2016, including a 5.75% net salary increase and 10% increase in health benefits over the contract period.

In addition, budgeted personnel expenditures factor in salary step increases for approximately 49% of employees who have yet to reach the top step in their classification's salary range. Typically, a step increase is equivalent to a five percent increase in salary with a range of five salary steps.

### *New Position Requests*

A total of 202.75 positions are budgeted in FY 2019. Staff is requesting 3.0 new positions to: (1) improve the City's contracting and procurement process by managing the inherent liabilities involved in providing municipal service and advising as to the appropriate types and levels of insurance; (2) ensure current analytical and technical projects and system implementations are completed; and (3) assume many already existing duties for Development Services which will allow current staff to allocate resources to additional street maintenance projects and grant management due to SB1 and Measure B. Staff is also requesting the conversion of two positions from Limited Term to Permanent based on a continued need for additional resources. The proposed positions are outlined below:

<b><i>FY 2017-18 Adopted Budget</i></b>	<b>197.75</b>
Senior Assistant Attorney (Council Item)	1.00
Account Clerk I/II (Mid-Year)	1.00
<b><i>Proposed Conversions from Limited Term to Permanent</i></b>	
Environmental Programs Assistant	0.00
Associate Civil Engineer	0.00
<b><i>FY 2018-2019 Proposed Budget</i></b>	
Risk Manager (Assistant to the City Manager)	1.00
Senior Management Analyst, Limited Term	1.00
Engineering Technician	1.00
<b>FY 2018-19 Benefitted Positions</b>	<b>202.75</b>

## **ONGOING CHALLENGES**

### *Retirement Benefits*

Cupertino provides retirement benefits for its employees through the California Public Employee's Retirement System (CalPERS). Poor investment returns during the Great Recession and actuarial assumption changes have increased the gap between the pension system's assets and liabilities, resulting in the overall funded status of the system falling significantly. The funded status is currently estimated at 68%, down from 69% last year due to lower than expected investment returns.

As a result, the CalPERS Board has adopted revised actuarial policies to improve the financial sustainability of the system. In February 2018, the CalPERS board voted to decrease the amortization period for new pension liabilities from 30 years to 20 years, effective July 1, 2019. In addition, in December 2016, the CalPERS Board voted to reduce the discount rate, also known as the assumed rate of return for investments, by 0.5

percentage points to 7.0%. The result of this change is significant and will result in considerable increases in retirement costs well above what the City had previously forecasted for retirement expenses as noted in the table below. The FY 2019 Proposed Budget includes these additional expenses and proposes the creation of a Pension Rate Stabilization Program (PRSP), a Section 115 Trust that will act to stabilize pension rate volatility and minimize the impact on the General Fund's operating budget from year to year. The FY 2019 Proposed Budget also includes an increase to the City's CalPERS Reserve from \$4.8 million to \$8.0 million to achieve this stabilization through the following ramp-up period:

	FY19-20	FY20-21	FY21-22	FY22-23	FY23-24	FY24-25
<b>Projected Payroll</b>	\$17,041,226	\$17,552,463	\$18,079,037	\$18,621,408	\$19,180,050	\$19,755,452
<b>Normal Cost (%)</b>	10.6%	11.6%	11.6%	11.6%	11.6%	11.6%
<b>Normal Cost</b>	\$1,806,370	\$2,036,086	\$2,097,168	\$2,160,083	\$2,224,886	\$2,291,632
<b>UAL Payment</b>	\$3,201,000	\$3,584,000	\$4,029,000	\$4,420,000	\$4,698,000	\$4,940,000
<b>Total Contribution</b>	\$5,007,370	\$5,620,086	\$6,126,168	\$6,580,083	\$6,922,886	\$7,231,632
<b>Total Contribution (%)</b>	29.4%	32.0%	33.9%	35.3%	36.1%	36.6%

#### *Revenue Volatility*

The City's revenue mix is heavily reliant on volatile business-to-business sales tax, which makes up approximately 19% of the City's annual General Fund revenues. Business-to-business sales taxes are very sensitive to economic fluctuations as evidenced by Cupertino's experience during the dotcom bust from 2000-2004. Our heavy reliance on the volatile high tech industry also makes us vulnerable. The loss of one of our top three sales tax producers in FY 2013-14 only made the City more reliant on a single tax producer, making us more vulnerable to its business volatility.

#### *Health Benefits*

There is uncertainty around potential repeal and replacement of the Affordable Care Act (ACA) and how it would affect health care costs. Rate increases have stabilized with the implementation of the ACA.

#### **Budget Study Session**

On May 15, 2018, the City Council held a Budget Study Session to review in detail the City Manager's FY 2018-19 Proposed Budget. At the study session, Council directed staff to come back with new or additional information on a variety of items. Attachment D is a listing of these Council requests and staff responses.



## **General Plan Consistency and Environmental Compliance of the Capital Improvement Plan**

State law and the Cupertino Municipal Code (Section 2.32.070.C) require the Planning Commission to review the CIP for consistency with the City's General Plan (General Plan: Community Vision 2015 - 2040). At its May 8, 2018 meeting, the Planning Commission considered and then made a finding that the Proposed Capital Improvement Program is consistent with the General Plan.

City staff has independently studied the Proposed CIP and has determined that the CIP is exempt from environmental review pursuant to the exemption in Title 14-California Code of Regulations, §15061(b) (3), and §15378, in that it can be seen with certainty that there is no possibility that this CIP budget action will have a significant effect on the environment due to the approval of the budget, and does not involve approval of any specific project that may have a significant effect on the environment.

Each project of the Proposed CIP projects will be evaluated for the application of CEQA to it and, as applicable, each project will conduct the appropriate level of environmental analysis.

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

Reviewed by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: David Brandt, City Manager

Attachments:

A: Draft Resolution – Pass through Revenue Budget for FY 2018-19

B: Draft Resolution – Operating and Capital Budget for FY 2018-19

C: Draft Resolution – Appropriation limit for FY 2018-19

D: Budget Study Session Follow-Up Items

D1: Community Funding Additional Responses

D2: Community Funding Other City Comparison

D3: Risk Manager/CAO Other City Comparison

D4: Transportation Staffing Comparison