



May 1, 2019

To the Residents of Cupertino, Honorable Mayor, and Members of the City Council:

I am pleased to inform the community that the City of Cupertino's healthy financial position of years past will continue into Fiscal Year 2019-2020. With revenues continuing to outpace expenditures in the short term, coupled with the City's conservative budgeting approach, the City is able to maintain excellent service, high-quality programs and initiatives, and healthy reserves. The City prides itself on being a financially stable organization, so it is a pleasure to submit a balanced budget for Fiscal Year 2019-2020.

The City's top three sources of revenue continue to be sales, property, and transient occupancy taxes. All three revenue streams are expected to grow, although the pace of that growth will slow. The last five years were a boon to the City's coffers due to major development projects, such as Main Street and Apple Park. However, these were one-off projects that have been completed. As large-scale development begins to decline in Cupertino, the City will see the effects of that in reduced short-term revenue.

This year, the City conducted a zero-base budget in which all expenses were justified for Fiscal Year 2019-2020. The process starts from a "zero base" and every function of the City is analyzed for its needs and costs. The budget is then built around what is needed for the upcoming period, regardless of whether each budget is higher or lower than the previous fiscal year. In addition to increased transparency and more accurate forecasts, this best practice resulted in total City base budget savings of approximately \$3.6 million over the previous fiscal year's budget.

City staff continued to include a medium-term (5 year) and a long-term (20 year) budget projection. While long-term projections are inherently less reliable than short-term projections, they can help detect structural budget issues that can be mitigated if identified early. In the next 10 years, our projections show healthy operating surpluses despite consistent, yet modest, declines year-over-year due to expenditure growth outpacing revenue growth.

Expenditure growth is being driven by pension liability costs that are projected to increase by more than 36% in the next five years of the forecast. Although pension costs are projected to level off in future years, the City's contract with the Santa Clara County Sheriff's Office is expected to continue increasing at a much faster rate of approximately 5.9% per year.

Executive Highlights

The City, through focus and effort, was able to accomplish a lot together in the past year.

Parks and Recreation System Master Plan

The citywide Parks and Recreation System Master Plan is nearing completion and will be a blueprint for future development of our parks. Our parks offer green space, respite, and protected natural resources, as well as facilities, programs and events that support community celebrations, health, and lifelong learning. The Master Plan integrates the community's vision and aspiration into a cohesive strategy to guide development, management, and renovation of our City's parks and recreation facilities.

Transportation

The City also continued to move forward with alternative transportation projects that will give residents a choice when it comes to traveling for work or pleasure. Cupertino kicked off the McClellan Road Separated Bike Lanes project in May 2019. The City's first leg of a new network of separated bike lanes was built on McClellan Road from Imperial Avenue to Stelling Road. Cupertino's separated bike lanes will physically separate cyclists from motor vehicles using posts and curbs, bringing an extra level of safety to Cupertino's roadways. In addition, the City will be pursuing an on-demand community shuttle pilot program, which was endorsed by Council in April 2019.

Policy and Software Applications to Ensure Financial Safety

In the fall of 2018, the Parks and Recreation Department implemented a new management software suite which significantly improved service to the public and increased efficiency in processing and administering activities for the community. In addition to the enhanced software system, City staff implemented a new cash handling policy for the purpose of establishing and maintaining an internal control system designed to ensure financial safety and high-level customer service.

Furthermore, City staff implemented a Debt Management Policy to establish guidelines for the effective issuance and management of the City's debt as well as to support the City's strategic and capital plan objectives through the most cost-effective means of debt issuance in accordance with guidelines prescribed by the Government Finance Officers Association (GFOA) and California Government Code.

Community Engagement on Budget Process

The City Council requested that staff work to create a community budget event to educate and inform our residents about the budget, budget process, and how they might get involved. The City's Budget Team took this opportunity to showcase important aspects of the budget like major funding sources and expenditures on social media through fun, yet informative posts and videos. The posts also served to market the City's first community budget workshop. The event titled "Budget & Bites" as well as the social media take over leading up to the event were both great successes. Social media hits including views, reactions and comments far exceeded anything the City had ever seen. This really provided the City a new platform to engage our residents. The event itself had over forty participants and highlighted the City's financial transparency portal and utilized Open City Hall for a practical in person exercise.

Increased Efforts to Work on Cupertino's Interest

In order to support Cupertino's interest, the City is working to contract with a lobbying firm to support the City's priorities at the State level. The lobbying firm will support the City by providing the following services:

- Legislative tracking, updates, and analysis
- Legislative strategy development
- Legislative advocacy and lobbying

During the selection process, special consideration will be given to firms with experience with housing and transportation legislation. Staff plans to engage the City's Legislative Review Committee and the City Council to discuss proposed legislation as well as recommend positions on bills affecting the City.

Capital Investment Needs

Over the last five years, the City's budget has mainly focused on operational needs such as staffing, software systems and prudent investments in long term unfunded liabilities associated with retiree health and retirement benefits. In regard to capital needs, some dollars went toward major capital initiatives such as improving the City's pavement condition index (PCI) and other smaller projects throughout the City. The current proposed budget does not include funding to capital investments as those will have been discussed the day prior to the printing of this document on April 30, 2019 at a study session on the Capital Improvement Program (CIP). This section of the budget message will be updated as part of the printing of the final budget document.

Maintaining Existing Talent

The Bay Area provides the City of Cupertino with many benefits such as a large talent pool of highly skilled candidates. However, there are multiple challenges that the City faces in recruiting and retaining top talent. For example, the Bay Area's housing costs are among the

most expensive in the country, making housing options difficult for employees. Additionally, Cupertino is in direct competition with other government agencies and private sector companies such as Apple Inc, Google, and Facebook. Furthermore, with PEPRA (Public Employees' Pension Reform Act) that took effect for all new employees hired after December 31, 2012, retirement benefits which historically attracted people to government have been reduced. In anticipation of PEPRA going into effect, the City decided to adopt a new retirement tier. What seemed like a prudent move at the time has further impacted the City's ability to recruit and retain top talent. Experienced personnel coming to the City of Cupertino will in most cases have a significantly reduced retirement benefit coming to Cupertino unless they've been employed with Cupertino in the past in tier 1.

When we look to retention of employees a few issues are at play. First, other cities in the area do have the ability to hire and place classic employees into tier 1. Second, Cupertino is a transit desert with no easy access to high-speed transit such as BART or Caltrain, making the commute to Cupertino difficult, with little to no alternatives. Lastly, instability at top leadership levels over the past year creates a level of uncertainty within the organization.

Pension Liability Funding

Cupertino, like most California cities, provides retirement benefits for its employees through the California Public Employee's Retirement System (CalPERS), which administers benefits for its more than 1.5 million members. The CalPERS retirement plan is structured as a defined benefit plan. This means the plan provides benefits that are calculated using a formula, rather than accounting for individual member's contributions and earnings in a savings plan, which occurs with a 401k.

During the recession, CalPERS investment assets decreased substantially and actuarial methods and economic and demographic assumptions were adjusted, significantly decreasing asset valuations. Together, the investment decline and actuarial changes created a gap between pension assets and liabilities. This gap is known as an "Unfunded Accrued Liability" (UAL).

Prior to 2014, CalPERS agencies received their retirement rate as a percentage of payroll that included both the normal and UAL costs. In 2014, CalPERS separated the UAL from the normal annual service cost in the annual valuation report, in addition to moving from a percent of pay to a flat amount for UAL, normal cost rates remained unchanged as a percent of pay calculation.

Two years later, in December 2016, the CalPERS Board voted to decrease the rate of return on investments, also known as the discount rate, from 7.5% to 7.0%. Since then, cities across the state have been faced with an unprecedented escalation in employee pension costs. Each city has chosen to confront the challenge in its own way. The City of Cupertino decided last fiscal

year to increase our CalPERS retirement reserve from \$4.8 million to \$8 million. This approach, based on a 20-year projection, should allow the City to weather the significant projected increases to employer retirement rates while minimizing its impact on City operations. In addition, should rates exceed those currently forecasted by CalPERS due to investment returns or assumption changes, the City will be able to utilize these dollars to offset any unexpected cost. If rates stabilize, these dollars could be used as a direct payment to offset UAL costs and result in the City reaching an 80% funded status in a shorter time frame.

In Fiscal Year 2018-2019, the City formally established a Section 115 Pension Trust (Pension Rate Stabilization Program) and used the PERS reserve to fund the trust with an initial investment of \$8,000,000. The purpose of this trust is to mitigate potential impacts of pension rate volatility on the General Fund's operating budget. Despite these efforts to improve the City's posture in the face of the pension issue, these costs will become increasingly unaffordable without growing revenues through sales, property, and other taxes that have yet to be approved by the electorate.

Efficiencies Gained Through Technology

Along with its investments in physical infrastructure, the City recently focused on four key initiatives:

1. Implementing business applications that provide enhanced accessibility and transparency to its residents
2. Strengthening the City's cybersecurity posture
3. Enhancing citizen engagement
4. Solidifying business continuity and disaster recovery plans

Over the past few years, the City acquired and implemented new applications to improve operational efficiencies and customer service, including an enterprise resource planning software for budget, payroll, and human resources processes, land management application, a Recreation software, an Asset Management module; along with transparency platforms like OpenGov.

Citizen engagement, always a priority with Cupertino staff, will continue to be enhanced through the Open City Hall application. This application is utilized to inform and involve citizens by sharing information more effectively and collecting broader resident feedback. Community engagement is also improved through the use of social media platforms and provides community members with a view into City projects and processes while also providing an opportunity for feedback.

Conclusion

The FY 2019-20 Proposed Budget is a balanced and fiscally responsible spending plan. Although the growth of the City's expenditures is forecasted to outpace the growth of its revenues, through fiscally responsible initiatives in recent years, the City is well-positioned to make decisions that ensure continued financial stability in the future. Lastly, I would like to thank the hard work and collaboration from City employees and the leadership and direction of the City Council that made this operating budget possible.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'Timm Borden', with a stylized, flowing script.

Timm Borden
Interim City Manager

Notable Accomplishments and New Initiatives

NOTABLE ACCOMPLISHMENTS IN FISCAL YEAR 2018-19

Recruitment Software Implementation

NeoGov, an online system for recruitment and applicant tracking, as well as onboarding, is being implemented to streamline the recruitment and hiring process for all departments. Implementation includes staff training, and inputting recruitment, salary, and job specifications into the test module. The system will be more user-friendly for job candidates and hiring managers. Staff will complete implementation of the recruitment and application tracking model by the end of the fiscal year.

Tree City USA Growth Award Designation

The City of Cupertino celebrated its 7th straight year as being designated a Tree City USA, and its 5th year of obtaining a Growth Award. The Growth Award recognizes higher levels of tree care by participating Tree City USA communities. The Growth Award highlights innovative programs and projects as well as increased commitment of resources for urban forestry. It also provides an opportunity to share new ideas and successes across the country.

DeAnza Boulevard Medians

The Public Works Department completed work on a project to renovate the De Anza median islands between Bollinger Road and Rodrigues Ave. The project consisted of replacing the existing arbors, reducing the height of the berm and installing water efficient irrigation facilities in order to reduce water use, and replacing the ground level planting with drought tolerant, California native plants.

McClellan Road Sidewalk Infill

The Public Works Department completed a sidewalk infill project on McClellan Road, between Byrne Ave and Homestead Rd. The project involved filling in unimproved frontage gaps in order to provide a more continuous sidewalk to enhance pedestrian safety for residents in the area and students walking to Monta Vista High School, Lincoln Elementary and Kennedy Middle School. The project involved extensive neighborhood outreach and coordination, and in some cases relied upon the donation of land from adjacent property owners in order to complete the project.

Various Landscaping Renovation projects

The Public Works Trees and Right of Way division undertook numerous projects to enhance and renovate landscaping with the public right of way. The medians along Vicksburg Dr and the southwest corner of Lazaneo Dr and Vista Dr were both renovated by removing cobbles and other hardscape features and replacing them with drought tolerant plants, thus enhancing stormwater quality and beautifying the areas. The existing landscaping on E. Homestead Road, between DeAnza Blvd and Bluejay Dr was replaced with drought tolerant plants, and the irrigation systems were updated with drip irrigation to enhance water conservation efforts.

McClellan Road Class IV (separated) Bike Lanes Phase 1

The Public Works Capital Improvement Program will begin construction of the McClellan Road Bicycle Boulevard Phase 1. This project consists of constructing separated bike lanes along McClellan Road, from Imperial Ave to just east of Stelling Road. Modifications and enhancements to the Bubb Rd/McClellan Ave and Stelling Rd/ McClellan Ave traffic signals will also occur. The project will begin construction in earnest at the end of the school season and will continue through the summer. In order to minimize impacts to residents and school commuters, the project is anticipated to be complete prior to the start of school next year.

18-month Bicycle Share Pilot Program

An 18-month bike share pilot program has been approved and allows bike sharing vendors to operate within Cupertino. City will be accepting applications from qualified vendors and will be monitoring the public e-assist bicycle fleet through FY19-20.

City Receives "Volunteer of the Year" Award

On December 3, 2018, the City received one of the Santa Clara Valley Water District's "Volunteer of the Year" awards for showing outstanding performance in taking on a leadership role in coordinated creek cleanups in Santa Clara County. The award recognized the City of Cupertino for removing trash and recyclables from our creeks as well as regularly drawing in over 90 community volunteers of all ages. Cupertino's Volunteer Creek Cleanup events are held on the third Saturday of May and September from 9am to noon.

Recognition of the Safe Routes 2 School (SR2S) Program

As part of the City of Cupertino's Volunteer Fair, Cupertino Safe Routes to School was recognized by Assembly member Marc Berman, and Senator Jim Beall, for Safe Routes to School's commitment and dedication to serving the community. Specifically, Assembly member Berman thanked the Cupertino Safe Routes to School team for the opportunities they have created and the time and services that the program has dedicated to bettering the community. Senator Beall recognized Cupertino Safe Routes to School for the program's commitment to going above and beyond to serve Cupertino.

Comprehensive Annual Financial Report (CAFR) Builder Module

During FY 2018-19, the City's Finance staff began implementation of its CAFR Builder module. This module will assist in the compilation of the City's Comprehensive Annual Financial Report. While system implementations require significant staff resources, this reporting module will provide opportunities for efficiency as well as cost-savings in the production of the report.

Investment Management Services

Through a formal Request for Proposal (RFP) process, the Finance Division engaged Chandler Asset Management for investment management services in FY 2018-19. Under the City's Treasurer's direction, Chandler Asset Management will be managing the City's investment portfolio with three key principles in mind: safety to ensure the preservation of capital in the overall portfolio, provide sufficient liquidity for cash needs and a market rate of return consistent with the investment program. The performance objective for the City's portfolio is to earn a total rate of return through a market cycle that is equal to or above the return on the benchmark index. In order to achieve these objectives, the portfolio invests in high quality fixed income securities consistent with the City's investment policy and California Government Code.

Budget Community Workshop

The City's Budget Team held a Community Workshop in the spring of FY 2018-19 to provide an overview on the City's budget process. Promoted through social media outreach and engagement, this event also included an interactive exercise where participants were provided the opportunity to balance their own version of the City's budget. This workshop was also available to attendees through Facebook live streaming and Open City Hall.

Emergency Operations Plan

An Emergency Services Coordinator was hired in 2017 to prepare the City for any natural disaster or emergency. In FY 2018-19, the Coordinator completed a new, updated Emergency Operations Plan and a Continuity of Government Plan while focusing on volunteer and employee support and development and greater communication processes.

Audio/Visual Environments

The Innovation and Technology Department completed a two-year total rebuild of the City's compute and audio visual (AV) environments. Areas of attention included cybersecurity, server/storage environments, wired and wireless networks, phone system, City Hall A/V Control Room, Community Hall AV elements and conference room within City Hall. Additionally, business continuity and disaster recovery technologies were significantly enhanced. Projects include:

- Hyperconverged solution for the City's server and storage environment

- Replacement of all wired switches and wireless access points. Extended the network to include Monta Vista Preschool and the Teen Center
- Cybersecurity – total replacement of all security components from endpoints, firewalls, and virtual LANs. Started a citywide mandatory cybersecurity training and added staff photos to all internal mail as an additional security step
- Replaced twenty-year old phone system with a Voice over IP phone system
- Replaced all large scale multi-function printers throughout City facilities
- Complete rebuild to the City's Teen Center computer environment

Application Upgrades

The Innovation and Technology Department replaced, enhanced, or modified a majority of the City's software applications including:

- ActiveNet – Parks and Recreation application for class registration and facilities rental
- Accela – Land Management System that includes urban planning, permitting and building inspections. Accela is the main application for the Community Development Department
- Trafficware ATMS – Utilized by the Traffic Engineering team for traffic control and monitoring
- Bid Management – This application was developed by City staff and utilized by Public Works Department for major CIP projects
- ZoneIQ – three dimensional planning tool to envision changes to the Zoning Code
- BossDesk – Helpdesk application utilized by Innovation and Technology staff

Ongoing Software Modifications

- Cityworks – City's Asset Management Application
- Addition of storeroom module
- Update to Aerial mapping and impervious surface imagery
- Update to Storm Drain data
- City wide tree inventory collection (25,084 trees)
- Cupertino Awarded the Cityworks Excellence in Departmental Practice Award.
- New World – City's Financial System
 - Integration to ActiveNet, Accela and ProjectDox
 - Annual Upgrade

Department Name Change

The realignment of Code Enforcement, Emergency Management, Block Leaders/Neighborhood Watch and Leadership Training from the Recreation and Community Services Department last fall has allowed staff to focus on a more traditional Parks & Recreation mission. As a result, effective May 1, 2019, the name of the department will revert to the Cupertino Parks and Recreation Department. It is our hope that this will clear up confusion in the community over the name as well as maintain alignment with the Parks & Recreation Commission's name.

New Recreation Software

On October 2, 2018, the Recreation Department went "Live" with a new Recreation Management Software Suite. Support for the current management software, "CLASS," is soon to be discontinued, necessitating the change. The new system will significantly improve service to the public and create ease on the staff side. All activity registration, membership management, facility reservations, and Point of Sale transactions are now integrated into one system. In addition to increased functionality, staff will benefit from improved reporting capabilities.

One of the greater improvements for the department and customers is that all of our facilities are now on the same system and in real time. Previously, we had been working out of four different systems. On the public side, community members can now enroll in memberships, reserve picnic spaces, and register for classes online without staff assistance. Staff expects this will result in a greater online presence for registration.

Implementation of any major recreation software system requires a phased approach, and staff will continue to implement new and different parts of the system over the next year. This project had many champions and was a seamless transition for our community due to the tremendous efforts of staff from the Parks and Recreation Department and the Innovation and Technology Department.

Neighborhood Events

The "mobile" Neighborhood Events program was introduced as a pilot program with the goal of offering events at neighborhood parks throughout the city. The program operated from June-September 2018 and offered activities at 11 different sites, including two partner sites. The program included themed activities, 9 Movies, 15 Concerts, 12 Free Fitness in the Parks classes (Zumba, Qi Gong and Yoga), 4 Music/Art in the park Parent/Child classes. It also included dance lessons, music lessons, art classes and recreational activities for all ages. Attendance was slightly under 6,000. We also offered events highlighting celebrity guests, non-profits, and local partnerships. This program fulfilled our mission to enhance the quality of people's lives through recreational, educational, and cultural experiences.

Teen Offerings

Teen programs were enhanced to address the teen stress levels in Cupertino through innovative, collaborative and educational approaches while addressing community livability amongst the teens.

- *Bobatino* - the Teen Commission and the Mayor's Office organized Bobatino, a youth and teen event which provided Cupertino students ages 12-18 a platform to socialize with friends and enjoy a day out with various activities while drinking free milk tea provided by the City. Bobatino was presented as a way for teens to have a respite from daily stresses and discover mental health resources. Event partners included Main Street, TP Tea, Café LaTTea, Kaiser Permanente, San Jose Sharks, Adolescent Counseling Services, the LGBTQ Youth Space, DeAnza College, McClellan Ranch Preserve, and YES! For Schools Bay Area. Activities for teens included a Chill on the Hill space, Caffeinated Letters, a Slime Station, Sharks Slapshot Booth, and free Boba milk tea. The event saw 700 youth and teens coming from various Cupertino High Schools.
- *Lawson Middle School-Satellite Teen Program* - From October 15th – November 8th, the Parks and Recreation Department and Lawson Middle School partnered in a mobile recreational pilot program to bring the Cupertino Teen Center to teens in a space that is easily accessible and familiar. Recreation staff brought various activities and games to Lawson Middle School with the goal of introducing youth to recreational activities that are stress-reducing, engaging, and fun. The space is also meant to provide a haven for teens who may not have the ability to participate in afterschool programs.
- *Youth Activity Board* - The YAB was formally created in September 2018 with the purpose of creating activities for youth and teens and encouraging them to de-stress and socialize. To achieve their vision, the YAB will work with Recreation staff to develop ideas, implement youth and teen programs, and encourage youth and teen involvement in their community.

Volunteers, Wellness, and Collaboration

The Senior Center strives to create a culture of collaboration and engages the community at all levels—this can be noted in the diverse program offerings at the facility. The Cupertino Senior Center celebrated the commitment of its 230 volunteers who have devoted 24,750 hours to serving the community through various volunteer opportunities at the Senior Center. *The Smart Living and Wellness Health Fair* provided valuable information and services to the 50+ community on how best to maintain a healthy and independent lifestyle, coordinated by our own Case Management team. Lastly, connections were made as local youth performed musical classics from the past and present. These innovative services for the 50+ population continue to respond to our changing community needs.

Economic Development Strategic Plan

As part of the Economic Development Strategic Plan (EDSP) adopted by Council in October 2016, the EDSP is framed around eleven core strategies to strengthen existing businesses, foster a healthy economy, and maintain a healthy fiscal position. In early 2018, three specific project initiatives were started to implement the identified strategies:

- Mobile Vendors Regulations (Strategy 9 Action 9.4 & 9.5). Develop new regulations and policies to allow mobile vendors to provide their services in designated areas of the City.
- Incubator and Co-working Space Use (Strategy 4 Action 4.1). Allow for and encourage creation of space for smaller-sized start-up businesses with shared on-site resources and amenities.
- Innovation District Vision Plan (Strategy 3 and 3.4). Develop a long-term vision for transforming the Bubb Road Special Area into a vibrant district that expands opportunities for emerging and small businesses and supports significant pedestrian activity and associated amenities.

With public outreach and further direction from Council, City staff will be completing the Plan's core strategies which is anticipated by Winter 2020.

NEW INITIATIVES FOR FISCAL YEAR 2019-20

Internal Audit Function

The Finance Division will be conducting a formal Request for Proposal (RFP) for an internal audit function. This function will assist the City in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Workforce Planning

Administration and Human Resource Divisions staff are implementing a Workforce Planning program to use data in the City's enterprise resource planning system and several City documents such as the budget, Capital Improvement Program, and City Work Program to identify key positions needed and how to attract, retain, and train staff to ensure the availability of those positions when needed.

Parks and Recreation Marketing Plan and Program Review

Parks and Recreation staff will be implementing a plan to place a greater emphasis on business functions within the Parks and Recreation Department to include completion of a program review of programs and activities offered as well as a marketing plan. A contract for service was awarded in 2018 and is slated for completion in the winter of 2019.

Recreation Activities and Events

Kids Challenge, an obstacle course/parkour team challenge that will emphasize fitness for children; *Corridor Stroll*—community members will stroll along the Stevens Creek Corridor for an evening of leisurely activities, entertainment and wine/food pairings; *Winter Ball*, a family friendly dance for youth including meal, crafts, and of course music and dancing; *Cultures of the World*—a youth and family event that will showcase the diversity of the world we live in by encouraging community participation and inclusion. The Senior Center will offer a *Classics Concert Series*, *Asian film series* and a *50+ Art show*.

Blacksmith Shop at McClellan Ranch

Our newly renovated replica of Charlie Baers Blacksmith Shop will begin offering demonstrations, workshops, classes and new opportunities for volunteering.

Emergency Services Continuity of Operations Plan (COOP)

In FY 2018-19, an Emergency Operations Plan (EOP) was completed and served as a precursor to the COOP. Staff will be retaining a contractor to provide service to establish and complete the COOP for purposes of resuming and continuing operations of the City after a major emergency. The project is anticipated to be completed in the summer of 2020.

Public Safety Surveillance Support

Innovation and Technology and City Manager's Office will be working with Santa Clara County Sheriff's Office to update and replace the City's currently antiquated closed-circuit television (CCTV) system. Staff will be implementing surveillance cameras for safety and anti-crime practices for the benefit of both community members and City staff.

Enterprise Content Management (ECM)

The Innovation and Technology Department began a major planning exercise for Enterprise Content Management in FY 2018-19 that will be carried out during FY 2019-20. The City prides itself on its paperless initiative and this is one more step in ensuring data is captured in an efficient and effective manner. Innovation and Technology will continue to enhance the City's access to information over the web providing access to more services and information. Data transparency, along with data analytics will be improved to allow for data driven decision making.

Lawn Buster Drought Tolerant Planting Pilot

The City's Manager's Office has begun the process to develop a program that allows residents to easily elect water-wise turf conversion, including pre-set landscape plans, pre-approved contractors, and fixed prices. Staff are working on a Request for Quotation (RFQ) to identify suitable partners, program design and firms prior to formally launching the program in the summer or fall of 2019.

Shuttle Bus Pilot Program

Pursuant to City Council direction, staff will be pursuing a shuttle bus pilot program in FY 2019-20. Upon authorization of funding and completion of the Request for Proposal (RFP) process, City staff will begin work on system planning, which includes details such as fares, fare programs, system area, operations, etc. Staff anticipates that after an agreement is negotiated, service would begin within a three-month period, with service as early as summer 2019. Staff will monitor the effectiveness of the program and will provide Council updates on the shuttle with information including overall ridership at the midpoint of the pilot, and again several months prior to the end of the pilot to discuss ongoing shuttle service.

Bike Implementation Plan Projects

The Public Works Department will undertake various bicycle related infrastructure projects in this fiscal year:

- Stevens Creek Boulevard Bike Lanes – Begin construction of Phase 1
- McClellan Separated Bikelane Projects – Continue to work with property owners on land acquisitions for phases 2 & 3.
- Bicycle Boulevard Phase 1 & 2 - If authorized by Council, complete design and construction.
- Regnart Creek Trail – If authorized by Council, proceed with design and construction.
- Junipero Serra Trail (I-280 Trail) – If authorized by Council, proceed with design and work with stakeholders and the community.
- UPRR Trail Feasibility Study – Develop alternatives in coordination with UPRR.

City Hall

Implement Council decision on City Hall project and initiate design and construction of interim City Hall.

Regnart Road Rehabilitation

Design and begin construction on Priority #1 and #2 as defined in the Regnart Road Investigation Report.

Byrne Avenue Sidewalk Infill Project

Begin construction of the infill project to create continuous pedestrian access for residents and students.

Lawrence-Mitty Property Purchase

If authorized by Council, Staff will negotiate the purchase of the Lawrence-Mitty property and begin the process of annexing the property into Cupertino's jurisdiction.

School Walk Audit

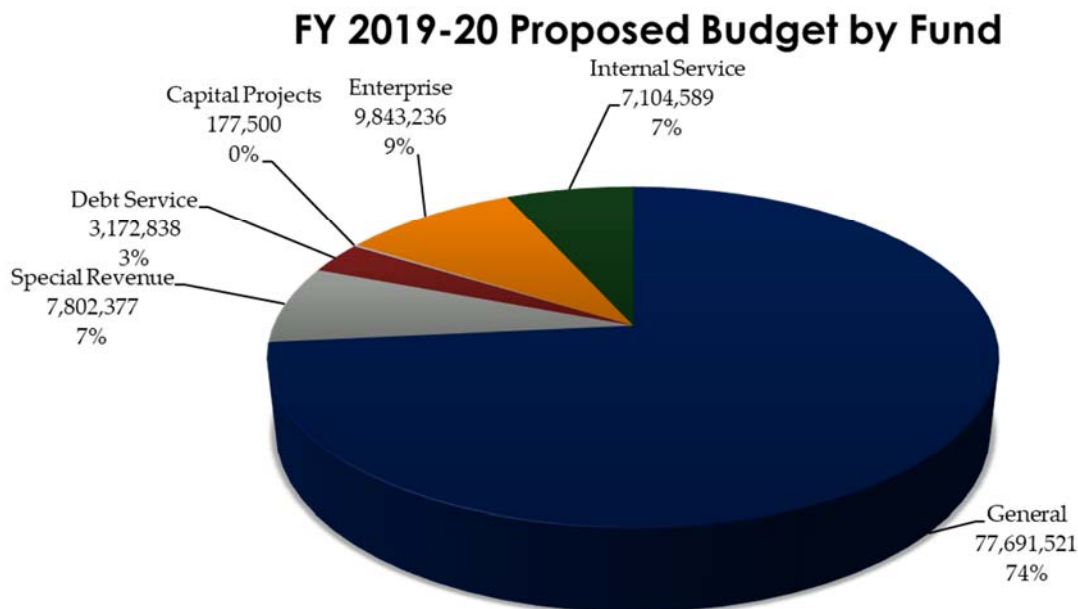
If authorized by Council, design and construct recommended improvements in coordination with the schools throughout the City.

Proposed Budget Overview

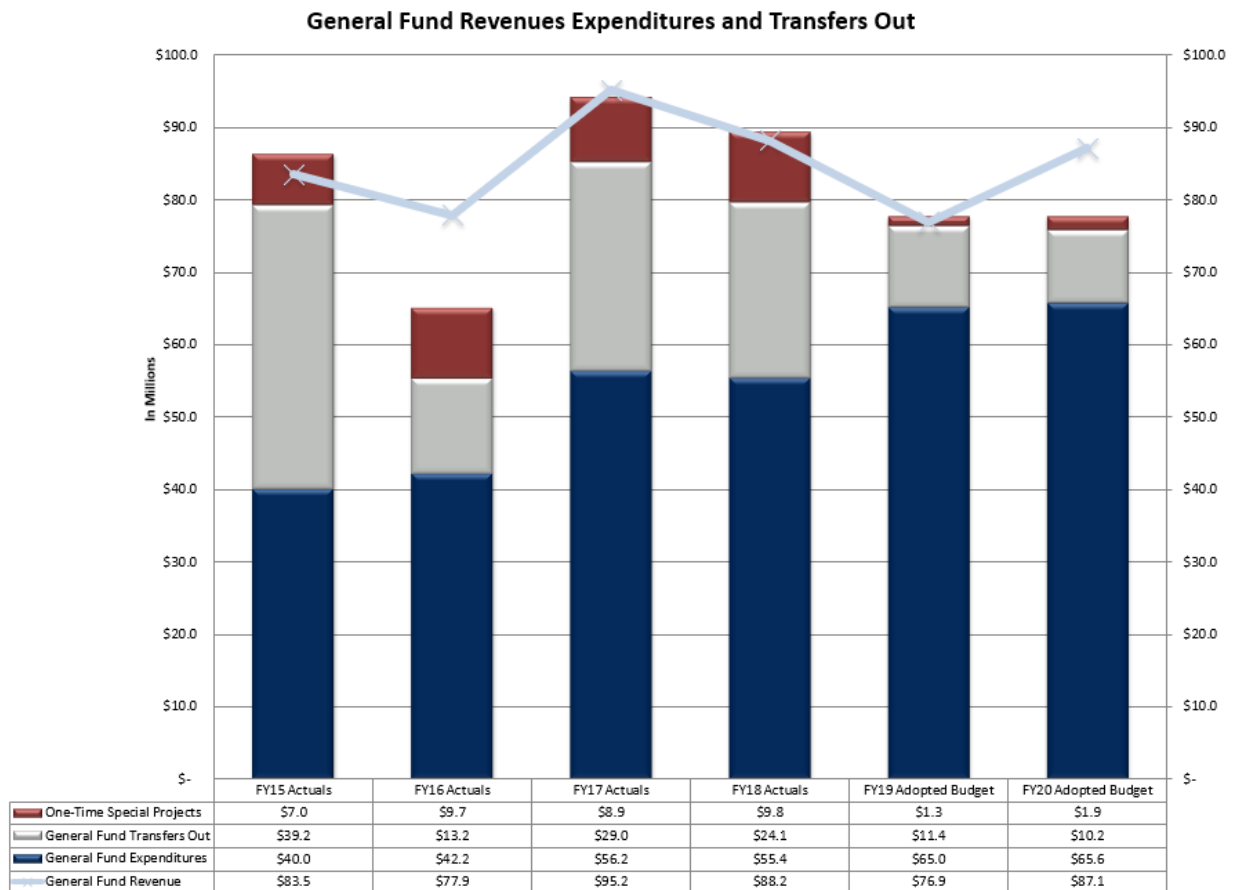
The Proposed Budget reflects a total City budget of \$105.8 million, a decrease of \$25.9 million or 19.7% when compared to the FY 2019 Adopted Budget. The City's General Fund is proposed at \$77.7 million, and remained consistent with the FY 2019 Adopted Budget. The General Fund is balanced through the use of General Fund revenue of \$87.1 million and is projected to end FY 2020 with approximately \$9.4 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 FY19-20 Mid-Year Financial Report. The transfer is not reflected in the Proposed Budget.

Fund Type	Total Adopted Expenditures		Total Adopted Revenue		Change in Fund Balance/Net Position
General	\$	77,691,521	\$	87,100,152	\$ 9,408,631
Special Revenue	\$	7,802,377	\$	9,906,203	\$ 2,103,826
Debt Service	\$	3,172,838	\$	3,172,838	\$ -
Capital Projects	\$	177,500	\$	-	\$ (177,500)
Enterprise	\$	9,843,236	\$	8,091,827	\$ (1,751,409)
Internal Service	\$	7,104,589	\$	8,129,553	\$ 1,024,964
Total	\$	105,792,061	\$	116,400,573	\$ 10,608,512

As shown in the chart below, the Proposed Budget's largest fund is the General fund at 74%.



The graph below summarizes the changes in the City's General Fund for a five-year period:



A total of 201.25 positions are proposed in FY 2019-20, this includes two new positions being requested as part of the proposed budget. These new positions will: (1) achieve staff continuity and administrative efficiencies through a conversion of two part-time staff to one full-time staff; and (2) provide sufficient resources for tree maintenance.

FY 2018-19 Adopted Budget		201.75
Limited Term Public Works Project Manager (Council Item)		1.00
Senior Office Assistant (1st Quarter)		1.00
HR Manager 6-month Double Fill (1st Quarter)		0.50
City Attorney Office Outsourcing		-4.00
Building Inspector (Term Ended)		-1.00
FY 2019-20 Proposed Budget		
Senior Office Assistant		1.00
Maintenance Worker I/II		1.00
FY 2019-20 Benefitted Positions		201.25

In the past, staff recommended adding positions only on a limited term basis unless staff was confident that the needed level of service would be permanent, or ongoing revenues could support the position long term, or staff could not recruit and/or retain the staff resource on a limited term basis. Staff believes that the need for both positions will be on a permanent basis.

Changes to the Budget and Policies

City staff performed a zero-base budget for the FY 2020 budget document in which all expenses were justified and every function within the City was analyzed for its needs and costs. Below are a few highlights from the budget and process:

Revised Fees and Cost Allocation Plan (CAP)

While the Cost Allocation Plan remained relatively consistent over the previous fiscal year, a change in methodology was implemented in the FY 2019-20 model. Costs attributable to grounds and facilities are now being charged out for more equitable and reasonable cost sharing among service providers in the City.

Additionally, City Council approved the fee schedules effective for FY 2019-20 on April 16, 2019. The increases to the various fee schedules are estimated to result in increased revenues of approximately \$215,000 over the previous fiscal year.

Investment Policy

The City Council annually updates and adopts a City Investment Policy that is in compliance with State statutes on allowable investments. By policy, the Audit Committee reviews the policy and acts as an oversight committee on investments. The policy directs that an external auditor perform agreed-upon procedures to review City compliance with the policy. The full policy will be available on the City website as part of the May 14, 2019 City Council agenda packet.

GANN Appropriations Limit

For FY 2020, the City's estimated appropriations of proceeds from taxes, less statutory exclusions, are unchanged as of the Proposed Budget. Data needed to calculate the FY 2020 appropriations limit will not be available until mid-May. If a city exceeds the legal limit, excess tax revenue must be returned to the State or citizens through a process of refunds, rebates, or other means that may be determined at that time. The appropriations limit is not expected to present a constraint on current or future budget deliberations. This reflects the prior year limit and will not be updated until the Adopted Budget when the information required for this calculation is available.

Revised Community Funding Policy

The first Community Funding policy was adopted by City Council in FY 2012-13, and the most recent policy was adopted as part of the FY 2015-16 Adopted Budget. At the Budget Adoption hearing in June 2018, City Council requested that the Community Funding Program be updated in order to assure that all applications received due consideration and that City Council is provided with all information necessary to make final funding decisions. At that meeting, City

Council requested that the Parks and Recreation Commission evaluate all grant applications, and provide funding recommendations to Council for consideration. All grant applications are first reviewed by the Administrative Services Department for compliance with eligibility criteria. As a result of these changes, the Parks and Recreation Commission, along with staff, have made further revisions to the Policy for Council consideration as part of the FY 2019-20 budget process.

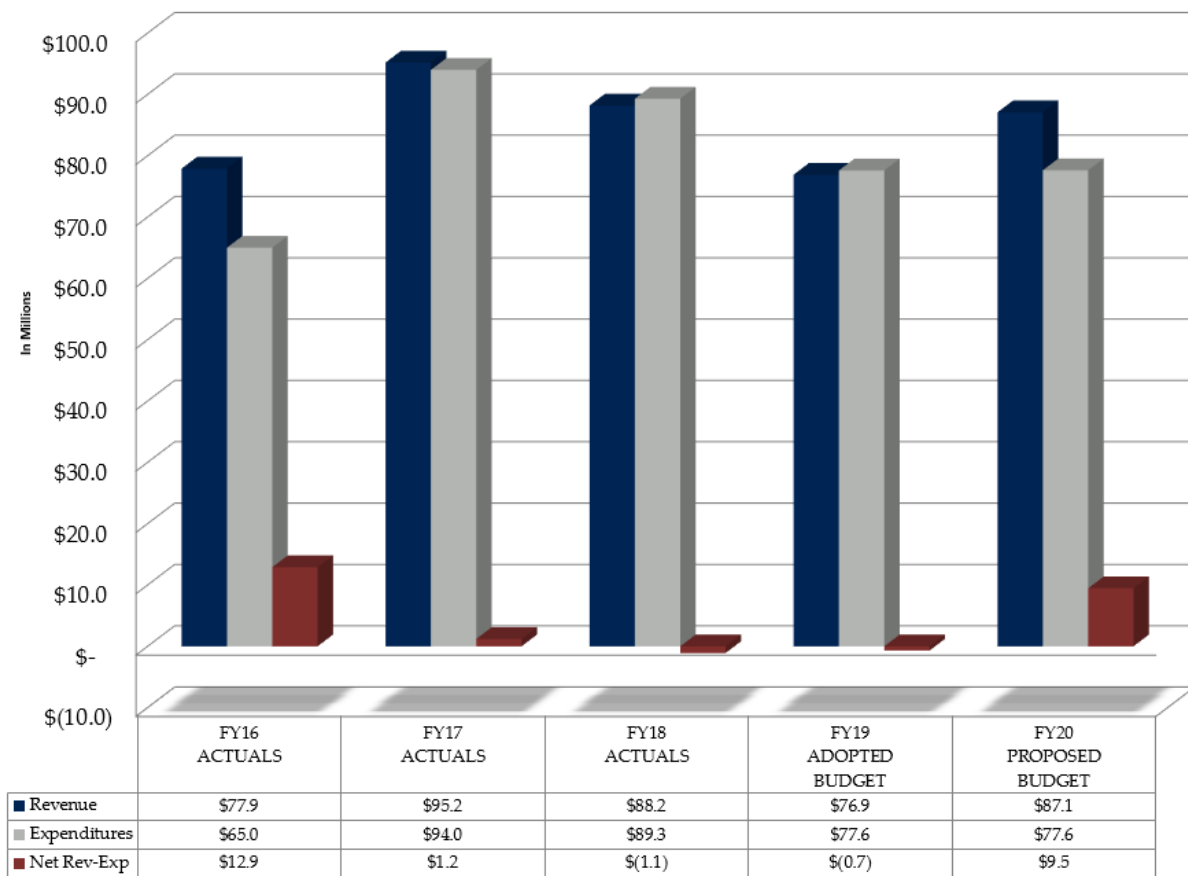
Budget by Fund

General Fund

The General Fund pays for core services such as public safety, recreation and community services, 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, transient occupancy tax, charges for service, and a variety of other discretionary sources.

General Fund revenue is estimated at \$87.1 million in the FY 2020 Proposed Budget. This is an overall increase of \$10.2 million (13.3%) when compared to the FY 2019 Adopted Budget. In recent years, the City has experienced local economic boom that had driven strong gains in sales tax, property tax, and transient occupancy tax revenues, which were partially offset by decreases in development-related fees. While the General Fund's revenues and expenditures continue to return to a trend of normalcy, FY 2020 is projected to experience growth in its primary revenue generators. Sales tax, property tax, transient occupancy tax are projected to increase \$2.0 million (8%), \$1.9 million (9%), and \$1.4 million, (17%), respectively. Moderate local economic growth, continued assessed property value growth, new hotels opening within the City, as well as short-term rental collections are the primary factors causing the increase. A change in methodology for allocating internal charges for facilities and grounds is also contributing \$3.8 million to the increase. The following chart shows four years of total revenue, expenditures and changes to fund balance for the General Fund:

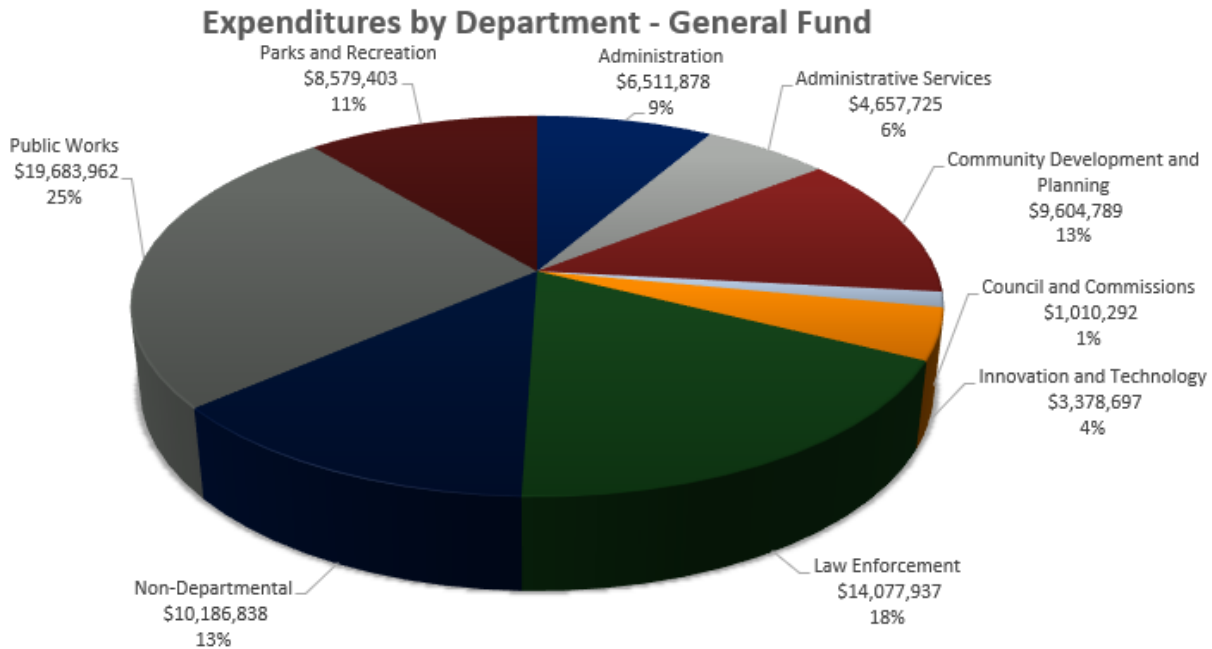
General Fund Revenue, Expenditures and Changes in Fund Balance



The General Fund unassigned fund balance is projected to increase from the current year estimate of \$6.2 million to \$15.3 million in FY 2020. As shown in the chart below, the FY 2020 ending fund balance is estimated to be \$49.0 million, or 24% higher than the FY 2019 year-end estimate. This is primarily attributable to significant appropriation carryovers from FY 2018 that are projected to be spent in FY 2019.

GENERAL FUND FUND BALANCE					
	FY 16-17	FY 17-18	FY 18-19	FY 19-20	Percent
Classification	Actual	Actual	Estimated	Proposed	Change
Unassigned	\$28,057,799	\$21,704,922	\$ 6,241,291	\$15,255,948	144%
All Other Classification	25,531,891	30,805,535	33,390,499	33,784,473	1%
Total Fund Balance	\$53,589,690	\$52,510,457	\$39,631,790	\$49,040,421	24%

As shown in the graph below, the majority of city resources are used to support Public Works (25%), Non-Departmental expenditures (13%), Law Enforcement (18%), Parks and Recreation (11%), and Community Development and Planning (13%).



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 7% 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 2020 is \$7.8 million, which is a \$5.9 million decrease from FY 2019 Adopted Budget primarily due to a temporary absence of capital projects which will be included in the FY 2020 Adopted Budget.

Budgets within the Special Revenue Funds are funded by \$8.6 million in restricted department revenue, and \$1.3 million in transfers, bringing total funding sources for the fund to \$9.9 million. This will result in a projected increase to fund balance of \$2.1 million. The Special Revenue Funds are projected to end the year with fund balances of \$13.7 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 2020 is \$177,500. The FY 2020 budget is \$17.7 million lower than FY 2019 Adopted Budget appropriations until the Capital Improvement Program budget is incorporated in the Adopted Budget.

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 2020 is \$9.8 million, a decrease of \$1.1 million from the FY 2019 Adopted Budget. Budgets within the Enterprise Funds are funded by \$6.0 million in program revenue and \$2.1 million in transfers from the General Fund. The Enterprise Funds also rely on \$7.1 million of prior year fund balance, bringing total funding sources for the funds to \$15.2 million. The Enterprise Funds are projected to begin the fiscal year with \$7.1 million in retained earnings and are projected to end the year with retained earnings of \$5.4 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 \$7.1 million, which is \$1.4 million lower than the FY 2019 Adopted Budget. Budgets within Internal Service Funds are funded by \$4.1 million in department revenue, \$3.5 million from the General Fund, and \$473,000 from a combination of depreciation reserves and retained earnings. The Internal Service Funds are projected to begin the fiscal year with \$4.7 million in retained earnings and are projected to end the year with retained earnings of \$5.7 million.

Special Projects

The FY 2020 Adopted Budget includes funding for several one-time Special Projects. These projects are identified as part of the Special Project section within each program and are summarized in the table on the next page. This list excludes one-time capital outlays and ongoing pavement management costs.

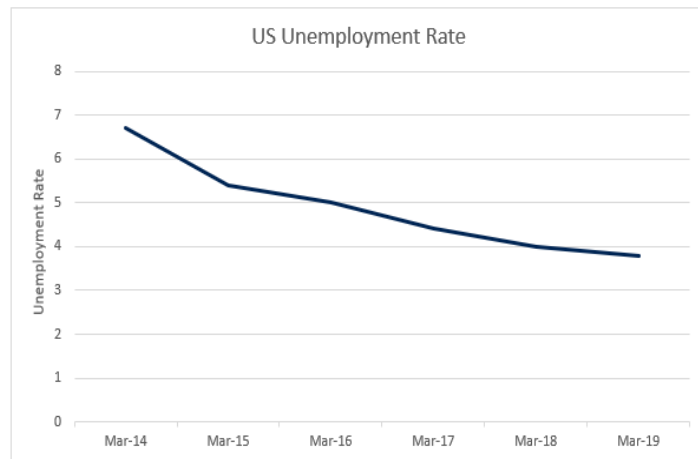
FY 2019-20 Special Projects				
Program Budget	Project Name	Expenditure	Funding Source	Work Program
126 Public Affairs	Public Relations	\$ 50,000	General Fund	Yes
305 Video	Cupertino Room Audio/Video Upgrade	\$ 155,000	General Fund	
310 Infrastructure	City Facility Security and Video	\$ 110,500	Internal Service Fund	Yes
620 Outdoor Recreation	Sports & Outdoor Field Use Analysis	\$ 30,500	Enterprise Fund	Yes
621 Sports Center Operations	Health & Safety Equipment	\$ 27,000	Enterprise Fund	
633 Disaster Preparedness	Continuity of Operations Contract	\$ 75,000	General Fund	Yes
701 Current Planning	Short Term Rentals Outreach	\$ 8,500	General Fund	Yes
702 Mid and Long Term Planning	Urban Village	\$ 250,000	General Fund	Yes
702 Mid and Long Term Planning	Municipal Code Updates	\$ 25,000	General Fund	Yes
702 Mid and Long Term Planning	Dark Sky	\$ 5,000	General Fund	Yes
702 Mid and Long Term Planning	General Plan Amendment Authorization Applications	\$ 1,000,000	General Fund	Yes
711 BMR Affordable Housing Fund	Housing Strategies	\$ 20,000	Housing Fund	Yes
711 BMR Affordable Housing Fund	Homelessness	\$ 10,000	Housing Fund	Yes
711 BMR Affordable Housing Fund	Habitat for Humanity	\$ 150,000	Housing Fund	Yes
714 Construction Plan Check	Green Building Code Standards	\$ 35,000	General Fund	Yes
801 Resources Recovery	Solid Waste Hauler Franchise Agreement	\$ 250,000	Enterprise Fund	Yes
807 Service Center Administration	Office Reconfigurations	\$ 75,000	Enterprise Fund	
812 School Site Maintenance	Kennedy Middle School Field Maintenance	\$ 19,500	General Fund	
812 School Site Maintenance	BBF Windmill & Fence Refinishing	\$ 12,610	General Fund	
820 Sidewalk Curb and Gutter	Annual Sidewalk Curb & Gutter Project	\$ 1,100,000	Transportation Fund	
821 Street Pavement Maintenance	Pavement Maintenance	\$ 2,000,000	Transportation Fund	
825 Street Tree Maintenance	Street Tree Maintenance	\$ 12,000	General Fund	
830 Building Maintenance Quinlan	Quinlan Community Center Reception Remodel	\$ 40,000	General Fund	
831 Building Maintenance Senior Center	Senior Center Exterior Deck Resealing	\$ 12,000	General Fund	
832 Building Maintenance McClellan Ranch	Environmental Education Center HVAC	\$ 30,000	General Fund	
836 Sports Center Maintenance	Sports Center Water Bottle Filler/Fountains	\$ 14,000	Enterprise Fund	
839 Teen Center Maintenance	Infinity Room Glass Door Installation	\$ 17,000	General Fund	
848 Street Lighting	Torre Ave Streetlight LED Upgrade	\$ 11,500	General Fund	
852 Franco Traffic Operations Center	Traffic Box Art Coating	\$ 7,500	General Fund	
985 Fixed Assets Acquisition	Vehicle Replacement	\$ 594,100	Internal Service Fund	
TOTAL		\$ 6,146,710		

Current Economic Update

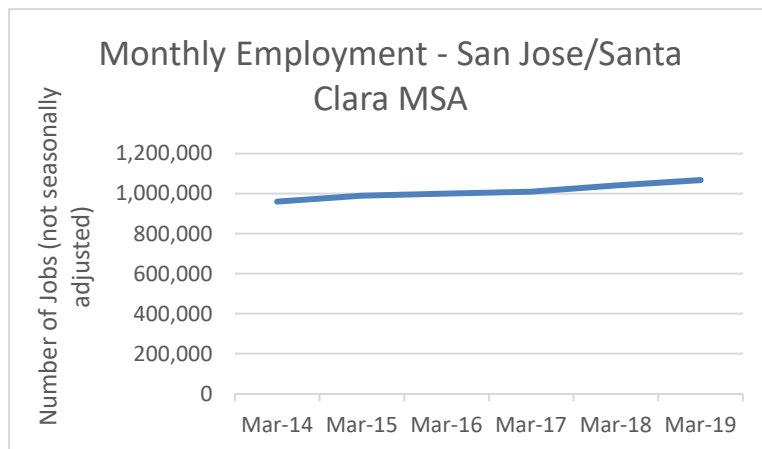
National and State Economic Conditions

The U.S. economy is continuing to show steady growth. U.S. Gross Domestic Product (GDP) increased by 2.2% in 2018 according to the Bureau of Economic Analysis, compared with an increase of 2.9% in 2017. The increase in real GDP in 2018 primarily reflected positive contributions from personal consumption, local and federal government spending, and exports that were partially offset by contractions in residential gross private domestic investment as well as non-residential structures.

Unemployment is continuing to hit record lows while over two and a half million jobs were created in 2018. The U.S. unemployment rate stood at 3.8% in March 2019 representing a 0.3% percentage point drop compared to the March 2018 unemployment rate of 4.1%, according to the Bureau of Labor Statistics. The unemployment rate has improved significantly from a high of 9.6% in 2010 and is at the full employment level.



Consumer confidence, as reflected by the Conference Board Consumer Confidence Index, decreased over the previous year and stands at 124.1 as of March 2019, including a 7.3 point decrease over the previous month. The year-over-year decrease is the result of consumers having to weather volatility in the financial markets, a partial government shutdown and a volatile jobs report. Despite these dynamics, consumers remain confident that the economy will continue expanding in the near term; however, the overall trend in confidence has been softening since last summer, pointing to a moderation in economic growth.



California's unemployment rate fell to 4.2% in March 2019, an improvement compared to last year's unemployment rate of 4.3%. Per capita personal income increased 4.3% in 2018 over 2017, mostly due to faster growth in wages. Growth in the housing market slowed over the prior year with the prices of single family homes up 2.2% and sales down 5.6% compared to February of last

year according to the California Association of Realtors (CAR). Recognizing that the state has a chronic housing shortage and understanding that inadequate housing has the potential to impede economic growth, state legislators have succeeded in passing a legislative housing package that has the potential to make a difference.

Cupertino Economic Conditions

Strong economic performance continues in Silicon Valley and Cupertino. Data from the State of California Employment Development Department paints a similar picture. Employment in the San José/Sunnyvale/Santa Clara Metropolitan Statistical Area (MSA) continues to increase. The preliminary estimate of the March 2019 employment level in the MSA was 1.06 million, virtually unchanged from the March 2018 level. The March 2019 preliminary unemployment rate of 3.0% has increased slightly from the 2.8% rate experienced a year ago. Our local unemployment rate is lower than the national unemployment rate of 3.8%.

Housing prices remain strong compared to the same period in 2019. In March 2019, single family homes sold for a median home price of \$1.92 million, a notable decrease over the past year. Despite the decrease in the median home price, property tax revenue is expected to increase slightly compared to last year due to reassessments of development projects, and additional TEA property tax share. Construction activity, although strong in previous years, will continue to flatten out as development projects, particularly Apple Park, are completed.

Key Budget Assumptions

Revenue Assumptions

The FY 2020 Proposed Budget assumes moderate economic growth. Revenue projections for each category were based upon a careful examination of the collection history and patterns as they relate to such factors as seasonality and performance in the economic environment that the City is most likely to encounter in the coming year. Revenue assumptions are discussed in detail in the Fund Summary section under Financial Policies and Schedules.

Personnel Assumptions

The City is currently in negotiations with its bargaining groups, CEA and OE3. The only increases in compensation in the FY 2020 Proposed Budget include step increases as well as benefit increases in retirement and health.

In addition, budgeted personnel expenditures factor in salary step increases for approximately 54% 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. These projections do not include any cost of living (COLA) or equity adjustments.

Non-Personnel Assumptions

Non-Personnel budgets were developed based on actual expenditures in prior years, and then adjusted for FY 2020 funding needs. In addition, one-time projects have been separated out in FY 2020 to ensure that expenditure trends reflect ongoing expenditure needs. Contingency budgets are remaining consistent with the prior year at 5% of the total General Fund budget for contractual services and supplies and materials for operating programs. Consistent with past budgets, an additional 5% is allocated to the City Manager's discretionary budget to cover unanticipated program expenses.

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 as of June 30, 2018 is estimated at 71%, up from 68% over the prior 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 2020 Proposed Budget includes these additional expenses. As part of the FY 2019 Adopted Budget, City Council approved 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. During FY 2019, the City contributed an initial investment of \$8.0 million to the trust. The FY 2020 Proposed Budget includes this \$8.0 million as restricted fund balance to provide stabilization through the following ramp-up period as necessary:

	FY19-20	FY20-21	FY21-22	FY22-23	FY23-24	FY24-25
Projected Payroll	\$ 17,811,423	\$ 18,256,790	\$ 18,758,851	\$ 19,274,720	\$ 19,804,775	\$ 20,349,407
Normal Cost (%)	10.7%	11.4%	11.4%	11.4%	11.4%	11.4%
Normal Cost	\$ 1,897,095	\$ 2,081,274	\$ 2,138,509	\$ 2,197,318	\$ 2,257,744	\$ 2,319,832
UAL Payment	\$ 3,192,065	\$ 3,557,000	\$ 3,952,000	\$ 4,288,000	\$ 4,505,000	\$ 4,720,000
Total Contribution	\$ 5,089,160	\$ 5,638,274	\$ 6,090,509	\$ 6,485,318	\$ 6,762,744	\$ 7,039,832
Total Contribution (%)	28.6%	30.9%	32.5%	33.6%	34.1%	34.6%

Revenue Volatility

The City's revenue mix is heavily reliant on volatile business-to-business sales tax, which makes up a large portion 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.