

Memorandum



Sunnyvale

Date: 5/6/2019
To: Honorable Mayor, Councilmembers, and Sunnyvale Community
From: Kent Steffens, City Manager
Subject: Fiscal Year 2019/20 Recommended Budget

I am pleased to present the FY 2019/20 Recommended Budget and Twenty-Year Resource Allocation Plan. Sunnyvale's budget process alternates each year between an operating and projects budget. This year our focus turns to the City's projects plan, which is comprised of capital and infrastructure projects, strategic initiatives, and multi-year efforts not requiring on-going funds over 20 years. As we focus on the projects budget, part of the normal course of this process includes some operating budget adjustments.

This Recommended Budget maintains the high level of service that our community enjoys, and invests in projects needed to sustain and improve our public services. This year's Recommended Budget includes:

- A portfolio of projects that make significant investments in the City's transportation, parks, and public facilities infrastructure.
- Significant investments in public safety including an additional \$22.3 million over the twenty-year plan for recruitment and training, and the acceleration of \$1.8 million for the replacement of two fire engines and the rescue unit within three years.
- The formalization of the first phase of the Civic Center Modernization project, appropriating \$212 million for design and construction of a new City Hall.
- Investment in the City's transportation infrastructure, including the allocation of funds to street and sidewalk maintenance from the Road Maintenance and Rehabilitation Act Senate Bill 1 (SB1) and Measure B half cent sales tax.
- Continued investment in the significant needs of our aging wastewater infrastructure including continued investment in the Sunnyvale Clean Water Program.
- Investments in personnel-related costs to ensure we attract and retain a high-quality workforce.
- Closing the fiscal strategies included in the FY 2018/19 Budget required to balance the General Fund over the long term.
- \$1.6 million in funding for the implementation of the City's Climate Action Plan.

Economic Climate

Sunnyvale's economy is both affected by and impacts the national and global economy. As the Heart of Silicon Valley, we host companies with both a strong global and local presence. We continue to experience an extended multi-year period of economic growth reflected in both our revenues and expenditures. The economic climate and fiscal condition in Sunnyvale are complex

and dynamic with key indicators, such as:

- Extremely low unemployment rates for the region (2.4% locally).
- A dynamic downtown with a major development project underway.
- Property tax growth that continues to exceed projections, adding \$180.6 million over 20 years from the FY 2018/19 Adopted Budget.
- Strong growth in Transient Occupancy Tax revenue, adding \$58.4 million over 20 years.
- A continued drop in sales tax revenue, showcasing the volatility and shifting climate of the retail economic sector, resulting in a projected \$55.1 million reduction in sales tax over 20 years.
- Strong development throughout the City with properties continuing to change ownership and developers focusing on multiple specific plan areas for development.
- All time high revenues from development impact fees for housing, parks, and traffic.

Historically, periods of expansion are followed by periods of economic contraction. Economists have been expressing an expectation that a recession is likely within the next several years. With the average economic boom lasting five to eight years, our current economic expansion has extended well beyond the average term. However, there are indicators a slowdown may be on the horizon. A flat yield curve, uncertain political climate nationally and globally, and the Federal Reserve Bank's recent reversal on raising the Federal Funds Rate, all indicate potential near-term volatility. This Recommended Budget carries through the themes of the last several budgets, bolstering the City's reserves to sustain the negative effects of a potential downturn in the short run, and allowing for thoughtful, data driven course correction over the long run.

In short, Sunnyvale's economic climate and fiscal condition are complex with many moving parts. While the underlying financial foundation of the City is solidly fueled by a strong economy, economic uncertainty, strong competition in the labor market, and significant expenditure pressures require a thoughtful and vigilant approach to budgeting.

Legal and Policy Framework

The Recommended Budget and Twenty-Year Resource Allocation Plan reflects the Council's public policies and the related resources needed to implement them. Unlike many other public agencies, Sunnyvale is relatively unique in that it does not budget year-to-year. Sunnyvale's reputation of strong financial management rests in the community's values expressed through the City Charter and long-established City Council Policies that together require the City remain fiscally strategic and sustainable. These disciplined laws and policies promote fiscal solvency over the long term, for example:

- 10 Year Balanced Budget Mandate – Sunnyvale voters have mandated a City Charter provision requiring "At least thirty-five days prior to the beginning of each fiscal year, the City Manager shall submit to the City Council the proposed budget as prepared by



him/her. Said budget shall be a balanced ten-year budget, reflect a minimum of ten years long-range financial planning” (Article 1302);

- 20 Year Resource Allocation Plan Requirement – In addition to voter mandates, City Council Policy 7.1.1 requires decision making focused on long-range implications of short-range budgeting decisions, with specific focus on the following:
 - A.1.3 A balanced Twenty-Year Resource Allocation Plan shall be presented to the City Council annually.
 - A.2.1 The City shall maintain a long-term fiscal perspective by annually preparing a Twenty-Year Long Term Financial Plan for each fund. Those funds which account for intergovernmental grants will only include known entitlements.
 - A.2.2 Major financial decisions should be made in the context of the Twenty-Year Long Term Financial Plan.
 - A.2.3 Long term financial planning should enable the current service level provided to be sustained over time through the strategic use of reserves.
 - A.2.4 The Long Term Financial Plans should be used to communicate the fiscal impact of City decisions to all stakeholders whenever possible.
- Budget Stabilization Fund Threshold Requirement – City Council Policy 7.1.1 (E.1.4) requires that the General Fund “Budget Stabilization Fund will be a minimum of 15% of projected revenues for the first two years of the 20-year planning period. Beyond year two, the Budget Stabilization Fund will always have a balance of at least zero.”

The FY 2019/20 Recommended Budget strives to balance the distribution of resources between core operations and projects. We are deliberate in investing in present day needs, continue to sufficiently plan for unanticipated events that cause additional expenditures, and ensure our approach allows for agile reaction to quickly changing service needs while maintaining a long-term fiscal context.

Recommended Budget and Significant Impacts

We develop the budget through the thoughtful review of revenue and expenditure trends and projections. Over the last several years we have addressed significant challenges, investing in our employees through negotiated labor agreements, accounting for long- term pension cost increases, making improvements in our internal services, increasing infrastructure investment, and prioritizing Council adopted priorities. This budget, which is focused on projects, was developed with Council Strategic Policy Priorities in mind. The City Council established strategic policy priorities two years ago and has revisited them annually to help guide the development of the Recommended Budget. The following lists those priorities and how this Recommended Budget continues them:



1. Civic Center Campus and Main Library – The Recommended Budget segregates funding for Civic Center Phase 1 (City Hall) to a separate project. In addition, \$1 million has been added to begin the planning efforts for Phase 2 (the Main Library) starting in FY 2022/23.
2. Ability of Infrastructure to Support Development and Traffic – Funds from the State SB 1 gasoline tax increase and Santa Clara County Measure B as well as the continuation of multiple significant capital improvements are included in the Recommended Budget.
3. Open Space Acquisition Planning: Future of Golf Courses – The Recommended Budget includes increases to the General Fund subsidy to Golf through FY 2023/24 to support the negative results of a wet winter, and allows space to study and evaluate the appropriate level of subsidy.
4. Downtown Sunnyvale – Developer construction is underway, the extension of Murphy Avenue is complete and the construction of more housing, retail, a movie theater and grocery store is underway. This budget anticipates the benefit of additional sales tax revenue from the downtown development starting in FY 2020/21.
5. Improved Processes and Services through the use of Technology – The Recommended Budget includes the implementation of several major initiatives, including the addition of \$1.1 million to server operating system upgrades, funding to evaluate and potentially procure a new utility billing system, and continued support of the Enterprise Resource Planning and Community Development permitting system implementations.
6. Accelerate the Climate Action Plan (CAP) – The Recommended Budget includes \$1.6 for implementation of CAP 2.0, a robust approach to address climate change.

The Recommended Budget continues the advancement of each of these priorities, applying resources both at a high level and on a very specific and targeted basis through the projects budget process.

Maintaining a Competitive Edge

One of the most imminent challenges at hand is maintaining the City's ability to attract and retain talent. Employees in skilled positions with public sector experience are in high demand and the market is very competitive. While Sunnyvale has been successful in attracting staff from other agencies, we have also lost many talented staff at all levels. In addition, recruitment and training for public safety officers continues to be a key challenge; high attrition rates due to retirements and other separations are expected to continue. The Recommended Budget includes an effort to address this. We take a careful approach to budgeting total compensation, as the components of compensation (salaries, benefits, and retirement) all escalate at different rates, and some (e.g. pensions) compound the fiscal impact of increases in salary. Overall, compensation costs are budgeted to increase between 2% to 6% annually



(dependent largely on the growing impact of pension rates) over the first ten years of the planning period. These assumptions include increases in pensions and healthcare, as well as salaries designed to enable us to stay competitive in the regional labor market and help to retain staff.

In this Recommended Budget, we also continue our contribution to the newly established Pension Stabilization Trust Fund, including \$9 million over nine years in deposits into the trust. This fund will enable the City to reserve funds for pension cost uncertainty, keep those funds locally controlled, prefund our pension costs, all the while earning a higher return than we could on our regular pooled cash investments. We start drawing on the fund in FY 2028/29 to help stabilize the peak years of CalPERS payments.

While overall our strategic position on pension funding remains stable, we must be mindful that this is a significant appropriation of resources. CalPERS returns have exceeded targets over the last two years, but their ten-year average (5.6%) remains below their targeted rate. We are watching the current year returns carefully, which have dipped in the current volatile market. Underperformance in the current year would affect rates going into the FY 2020/21 Recommended Budget.

Investments in Infrastructure

While the City has made great strides forward with regards to infrastructure funding, challenges continue. In this projects budget cycle, we reviewed all current projects, and proposed a group of new projects to support the City's efforts. The following summarizes some of the projects updated or new to this budget.

Sunnyvale Clean Water Program

The Sunnyvale Clean Water Program (SCWP), which is funded to renovate the City's aging Wastewater Pollution Control Plant, is budgeted across multiple projects and includes the renovation of existing facilities, as well as construction of some new facilities to replace existing infrastructure that is in too poor of a condition to rehabilitate. The program is planned as a series of design and construction projects over the next twenty years in various phases, and some project expenditures beyond our twenty-year horizon. Total cost of the program over the twenty-year planning period is approximately \$850 million.

Sunnyvale Clean Water projects in the Recommended Budget are up \$203 million over twenty years to reflect significant increases in the cost of construction, as well as a 10% bid market factor to account for the lack of competition in this highly specialized market.

Civic Center Modernization

The City has been actively planning an effort to modernize the Civic Center campus since early 2015. Buildings at the Civic Center are decades old and in need of renovation or replacement. A Master Plan and Environmental Impact Report were approved by the City Council in September 2018 and the design contract for Phase 1 which includes City Hall and a Public Safety Emergency



Operations Center Addition and Renovation was awarded by the City Council in December 2018. The design process is expected to take 16 months with the project scheduled to go out to bid for construction in spring 2020. The project is being financed by a combination of sources, largely from the sale of property and the issuance of bonds, which will be re-paid with rent from various funds, including the General Fund and Enterprise Funds.

Parks Renovation Projects

The majority of Parks and Recreation projects are funded by Park Dedication Fees, which may be used to pay for developing new or rehabilitating existing neighborhood or community parks or recreational facilities. The FY 2019/20 Projects Budget reflects an update to several park rehabilitation and enhancement projects to reflect the latest labor and construction costs. The Recommended Budget has \$244.7 million in park and recreation projects. This is up approximately \$40 million from the prior year. Increases are due to cost escalations, an additional \$6 million needed for the Washington Community Swim Center, and \$25 million for park and open space improvements related to the Civic Center.

Traffic and Transportation Projects

Maintaining and improving our transportation infrastructure is critical to ensuring livable local communities, balancing housing and jobs, and supporting economic development. Sunnyvale has developed an excellent transportation infrastructure, however much of it is old and requires rehabilitation and modernization. The City has proactively conducted long-range planning for traffic and transportation needs for several years and is actively involved in countywide planning efforts. We also leverage federal and state funds where possible to fund many of these very expensive projects.

Investments included in this Recommended Budget include \$23 million for the rehabilitation of the Fair Oaks Bridge, the City's share of Mathilda/237/101 Interchange improvements, the study of Caltrain Grade Separations at Mary and Sunnyvale avenue, preliminary design for the Bernardo Ave Undercrossing, and an EIR for the Mary Avenue Overcrossing. We've also continued our investment in both pavement and sidewalk, curb, and gutter rehabilitation, leveraging Measure B funds, SB1 Funds along with traditional General Fund, Gas Tax, and Vehicle Registration Fee funding sources for a total investment of \$205 million over twenty years.

Water Distribution and Sewer Collection Infrastructure

In addition to the Sunnyvale Clean Water Program, the City also has projects to maintain and rehabilitate our aging water distribution and sewer collection infrastructure. Funded by revenues from utility rates, these projects ensure that our community receives a clean and reliable water supply, and that our sewer system safely and sustainably transports sewage to the Water Pollution Control Plant. The Recommended Budget includes \$84.7 million over twenty years in water main replacement and \$31.6 million in sewer collection system projects.

Public Safety

With this Recommended Budget, we continue significant investments in public safety. The most significant investment continues to be in support of recruitment efforts, where we have planned \$102 million over 20 years. More importantly, \$40 million of that is planned in the near term, from FY 2018/19 to FY 2021/22. The Recommended Budget also includes moving two additional fire trucks and the fire rescue unit forward for replacement, and shortening the estimated life of fire apparatus from 20 to 15 years. Other projects include the Fire Station Master Plan (discussed more below), and several current grant related efforts.

Library and Community Facilities

The most significant general public facility project after the Civic Center Modernization project is the Lakewood Branch Library project which funds construction of a new branch library and learning center at the Lakewood School site. This will increase the availability of library services for those living in North Sunnyvale by making it more convenient for residents to visit. The total project is budgeted for \$20.9 million. Currently, the City is exploring a partnership with Sunnyvale School District and Fremont Union School District to construct and operate the new branch library. The design contract is expected to be awarded in the Summer of 2019.

We are also making progress on other significant efforts around facilities. The Fire Station Master Plan, which will evaluate the current condition of our fire stations and make recommendations for replacement or renovation is underway. The Recommended Budget also includes funding for master planning the corporation yard and the replacement of that facility as well as several other smaller projects related to facilities maintenance throughout the City.

Budget Stabilization Fund

One of the key tools the City uses in its budget are reserves. Reserves are intended for many different needs, including emergencies, holding restricted monies, or to balance out cash flow and economic volatility. We frequently discuss the Budget Stabilization Fund in the General Fund, which serves as the General Fund's economic volatility and cash flow reserve. In the Recommended Budget, the projected Budget Stabilization Fund maintains a stable position throughout the twenty-year plan.

This Recommended Budget maintains a stable Budget Stabilization Fund without the use of fiscal strategies as identified in prior years. Some of the risks to the reserve outside of the risk presented by a dynamic economy include poor CalPERS returns requiring unplanned additional contributions, continued construction cost escalation, uncertainty in the healthcare market, and unfunded infrastructure investments.

Budget Supplements

The Recommended Budget also includes thirteen proposed Budget Supplements totaling up to \$10.5 million. The majority of the Supplements (\$795,000) are one-time costs. One Supplement that considers an increased contribution to the Pension Trust Fund, costs up to an additional \$9 million over a ten-year period. Supplements are provided in a separate

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section of the Recommended Budget. Eleven of the thirteen are recommended for funding totaling \$1.1 million over 20 years.

In conclusion, this Recommended Budget provides the City with a projects plan that maintains the high level of service that our community enjoys, and invests in projects needed to sustain and improve our public services. In the following pages, the FY 2019/20 Recommended Budget Highlights provides greater detail on key components of this budget.

Sincerely,

A handwritten signature in blue ink that reads "Kent Steffens". The signature is written in a cursive, flowing style.

Kent Steffens
City Manager

Overview of the Recommended Budget and Twenty-Year Resource Allocation Plan

FY 2019/20 Recommended Budget Highlights

The FY 2019/20 Recommended Budget totals \$493 million and includes all City operations and project expenditures, as well as withdrawals and contributions to the City's reserves. Citywide budgeted expenditures are funded from multiple sources including general taxes and revenues (General Fund), restricted enterprise funds (Water, Wastewater, Solid Waste, Development Enterprise and Golf and Tennis), restricted special revenue funds (Housing, Park Dedication and Gas Tax), grant funding which includes transportation related grants for capital projects and federal and state workforce grants for employment development, and significant loans and debt proceeds largely related to the Sunnyvale Clean Water Program and Civic Center Modernization. Restricted funds make up over half of the budget.

Sunnyvale is a full-service city, providing a host of essential services to the community. Many traditional services (public safety, library, parks, streets, trees) are funded through general taxes from the City's General Fund. The General Fund, which accounts for 44% of the budget, has proposed expenditures (including all transfers and capital projects) of \$215 million in FY 2019/20. The General Fund is balanced over the twenty-year financial plan through the use of the Budget Stabilization Fund Reserve. This reserve is used strategically over the twenty-year planning period to ensure our ability to provide consistent service over the long term while remaining fiscally sustainable.

The local economy continues to be very active. As a result, several sources of revenue are at historical highs and growing at historically high rates. In addition, the voters passed Ballot Measure K in 2018 to increase the Transient Occupancy Tax rate from 10.5% to 12.5%, yielding additional revenue for the City's General Fund. The Recommended Budget reflects these higher revenues, especially in the short-term, while positioning the City to absorb a downturn. This is done by taking care to budget to historical growth averages over the long-term plan. The City has experienced periods of slow revenue growth and dramatic revenue reductions during the last 20 years, which warrants this caution to avoid committing to unsustainable service levels.

The local economic condition has also impacted the City's personnel expenditures. A tightening labor market is pushing up salary costs, which are amplified by corrective actions taken to mitigate the effects of rising pension costs. This budget includes projected increases for employee salaries and benefits over twenty years, however does not make an allowance to grow the labor force to meet increasing demands.

As part of the development of the budget, the City performs a detailed review of operations and projects in alternating years. For the FY 2019/20 Recommended Budget, the focus is on projects. Our staff completed a detailed review of existing projects and each department was given the opportunity to propose new projects. New projects were significantly constrained by the ability project administration staff to deliver projects, as the division is already carrying a full project load. With this in mind, some projects were deferred or scheduled to commence at a later date.

The FY 2019/20 Recommended Budget also includes Budget Supplements totaling up to \$10.5 million over twenty years, which provide funding for a variety of services or initiatives. Detail is provided in the "Budget Supplements" section. These Budget Supplements require specific Council approval; however, the funding is included in the Recommended Budget for those supplements recommended by the City Manager.

City's Budget and Resource Allocation Plan

There are three (3) key elements to the City's budget and resource allocation plan that provide the financial picture of the City for both the short and long term: revenues, expenditures and reserves. The following sections discuss the highlights, key assumptions and changes included in this recommended budget for each of these elements. It is important to note these elements are budgeted into specific funds, such as the Park Dedication Fund and the Gas Tax Fund, primarily to ensure that revenues restricted to specific purposes can transparently be tracked as spent for those purposes. While the discussion here is not organized by fund, this important structure is reflected in the budget document with the presentation of twenty-year financial plans for each of the City's funds. Detailed discussions about revenues, expenditures, and reserves by specific fund are included at the beginning of each financial plan section.

I. City Revenues and Resources

The City relies on many sources of revenues and the strategic use of reserves to fund services to the community at a stable and sustainable level. The largest revenue categories are taxes and service fees, followed by federal and state revenues (e.g. gas tax), bond and loan proceeds being used to fund the Sunnyvale Clean Water Program.

Taxes

Taxes, imposed by a government for the purpose of raising revenue to support governmental activities, are distinct from fees in that a tax does not need to be levied in proportion to the specific benefit received by a person or property. Almost all the City's tax revenues are general taxes received by the General Fund, the primary general purpose fund of the City. There are several significant exceptions, specifically in relation to transportation funding, which are discussed in more detail further in this overview. Taxes account for 75% of revenues in the General Fund (excluding the sale of property), supporting many of the City's most visible and essential services such as police, fire, road maintenance, libraries and parks maintenance. Figure 1 presents recent revenue received and projections for the top tax revenues.

Figure 1 – Top Tax Revenues

| Revenue Source | 2016/17 Actual | 2017/18 Actual | 2018/19 Budget | 2018/19 Revised Projection | 2019/20 Proposed Projection |
|-------------------------------|-----------------------|-----------------------|-----------------------|----------------------------------|-----------------------------------|
| Property Tax | \$ 66,608,795 | \$ 74,349,897 | \$ 75,105,869 | \$ 83,822,456 | \$ 88,427,248 |
| Sales Tax | 31,029,332 | 33,011,138 | 31,913,429 | 33,334,705 | 30,568,479 |
| Transient Occupancy Tax | 16,589,743 | 17,741,915 | 16,541,424 | 20,660,255 | 22,449,576 |
| Utility Users Tax | 7,334,491 | 7,854,383 | 8,297,656 | 8,195,716 | 8,326,918 |
| Gas Tax | 2,824,559 | 3,163,259 | 3,805,275 | 3,263,827 | 3,812,544 |
| RMRA Funds ¹ | – | 877,943 | 2,488,101 | 2,432,292 | 2,538,839 |
| Measure B Funds ² | – | – | – | – | 2,896,545 |
| Construction Tax | 4,718,733 | 4,960,540 | 4,582,427 | 4,839,637 | 4,325,817 |
| Total Top Tax Revenues | \$ 129,105,653 | \$ 141,959,075 | \$ 142,734,181 | \$ 156,548,888 | \$ 163,345,966 |

1. Road Maintenance and Rehabilitation Funds (Senate Bill 1)

2. Measure B is a half cent County-Wide sales tax for transportation funding

The revenue projections present an overall positive short-term outlook, with 14% growth from the original FY 2018/19 Budget to the FY 2019/20 Recommended Budget, but also reflect the volatility in key tax revenue sources such as sales tax, which is projected to decrease 4.2% over that period. As part of the development of the recommended budget, the current year's projections are also updated. Based on year-to-date figures, FY 2018/19 revenues will exceed prior year actual returns.

Property tax revenue has continued to experience very strong growth. The increased revenue is due to bustling development activity in both the residential and commercial real estate markets. Sunnyvale home sales hit record levels with an average sale price of just over \$1.9 million. Residential sector revenues increased 8.4% in FY 2018/19, while the commercial/industrial sector experienced 15.7% growth. While growth was forecasted in the FY 2018/19 Adopted Budget, actual growth is higher than estimated and the City's property tax revenue base has been adjusted upward to reflect this. Continued strong growth in property tax revenue is anticipated for the next three years. The residential growth projection is adjusted to 6.0% for FY 2019/20. On the commercial side, staff has analyzed significant approved development projects. Three years of high growth is projected as these projects are added to the tax roll. Beginning in FY 2022/23, forecasted property tax growth returns to a long-term historical average of 4.0%. The higher property tax base and revised growth assumptions result in property tax revenue being up in the General Fund long-term financial plan by \$180 million over 20 years.

The City is also the recipient of excess Educational Revenue Augmentation Funds (ERAF) over two years. ERAF is local property tax revenue that is shifted to public school systems in each county. When county auditors determine the fund has enough money to meet the minimum state funding requirements for its public schools and community colleges, the remaining funds are returned to local governments. In FY 2018/19, the City received \$4.2 million in excess ERAF and is anticipating to receive \$5.5 million in FY 2019/20. These funds have been programmed, with the exception of \$1.1 million for a storm pump station project, to the Capital Improvement Project Reserve in the General Fund for appropriation at a later time.

Sales tax, the City's second largest tax revenue source, continues to provide unstable returns. The largest segment of activity in the City's sales tax base is business-to-business sales, which have been highly volatile. Additionally, the twenty-year plan anticipates the loss of a significant sales tax producer. Given the ongoing volatility and erosion of the sales tax base with the trend towards a service based economy, the City forecasts modest growth projections. Projections for additional sales tax revenue from the redevelopment of the downtown begin in FY 2019/20, ramping up over time to a total of approximately \$1 million annually. The overall impact of all these adjustments to the City's General Fund long-term financial plan is significant at a \$55.1 million decrease over 20 years.

Transient occupancy tax (TOT) revenue has shown significant growth over recent years, coming in over revised estimates for FY 2017/18 and will exceed estimates for FY 2018/19. Currently, TOT is one of the City's strongest growth revenues, and the Recommended Budget anticipates that room rates and occupancy levels will remain strong in the short term, stepping down from current record levels but remaining well above historical averages through FY 2020/21. The Recommended Budget also reflects construction of new hotels, as well as an increase in the TOT rate from 10.5% to 12.5% passed by voters in November 2018. It is important to note that hotel activity in Sunnyvale is heavily reliant on business travel activity, and therefore this revenue source can be quite volatile and is tied to the economic climate. In the update of revenue projections for the FY 2019/20 Recommended Budget, staff has adjusted the timing of projected new hotels reflected in the budget to only include developments actively in progress. Historical room and occupancy rates are used for projections starting in FY 2019/20 but have been revised to reflect more recent trends.

Utility users tax (UUT) revenue, generated from the sale of electricity, telecom services and gas, is forecasted to grow over the long term but holding the same base as compared when compared to the FY 2018/19 Budget (i.e. the first year is flat). UUT has been up over the past several years. This increase is driven by the City's modernization of its UUT ordinance in November 2016. Additionally, development activity, particularly the impact of additional buildings within the City, is growing the base. However, this growth has been substantially offset by increases in energy efficiency, resulting in modest growth in revenue for gas, and electricity usage.

Gas tax, levied as a flat rate per gallon sold, is projected to remain flat over the twenty-year financial plan. The tax is largely based on volume sold and not on the price of gasoline, and therefore, our projections consider advancements in fuel economy offsetting increases in population and number of vehicles. Short-term volatility is due to a true-up rate set by the State for the portion that is based on prices, from two years back. While this revenue source is projected to remain flat over time, the costs and needs for street maintenance and improvements continue to climb.

In 2017, the State passed the Road Repair and Accountability Act (SB1). This allocates 50% of a new gas tax to cities and counties, after a series of specific program cost appropriations. City apportionments are based on population. These funds must be used for projects that include: road maintenance and rehabilitation, safety projects, railroad grade separations, traffic control devices, complete street components, active transportation purposes, pedestrian and bicycle safety projects, transit facilities, and drainage and stormwater capture projects in conjunction with any other allowable project. If a city or county has an average Pavement Condition Index that meets or exceeds 80, the city or county may spend its RMRA funds on transportation priorities other than these types of projects discussed above. This new source adds approximately \$2.4 million per year.

Measure B, a half-cent sales tax passed by voters in 2016, was tied up in litigation for several years. With the resolution of the litigation, funds began flowing to cities in the current year. Measure B funds, much like SB1 funds, are restricted to transportation purposes. Funds are distributed based on population through a reimbursement basis. The Recommended Budget includes an estimated \$2.9 million in Measure B funds for FY 2019/20, with \$1.8 million going to sidewalk repair and the remainder to street maintenance.

Construction tax returns have been very strong, an indication of the high level of development activity that the City has sustained for three consecutive years. Staff anticipates the current peak level will cool off, stepping down over the next four years, although still estimated at elevated amounts as compared to historical averages.

Service Fees

Service fees are the City’s largest source of revenue. A diverse set of fees are charged to recover all or a portion of the City’s costs for providing a service or access to public property, or for mitigating the impacts of the fee payer’s activities on the community. Intended for cost recovery, a fee may not exceed the estimated reasonable cost of providing the service or facility for which the fee is charged. Due to this requirement and legal restrictions related to their expenditure, many City’s fees are accounted for in separate funds. By far, the largest source of fee revenue comes from the provision of water, wastewater and solid waste collection services. The proposed increases in utility rates are discussed below, as well as highlights in other fee categories.

Utility Rates provide funding for the City’s three self-supporting utility funds: the Water Supply and Distribution Fund, the Solid Waste Management Fund, and the Wastewater Management Fund. Each year, staff analyzes the current condition and long-term outlook for all three funds. The analysis includes a review of fund balances; state and federal environmental requirements; revenues; anticipated capital, infrastructure, and operational requirements; and a detailed inspection of significant expenditure areas. The results of this analysis lead to proposed adjustments to rates that will generate the revenues necessary to meet planned expenditures. Through the long-term planning model, staff attempts to keep utility rates as stable as possible with modest increases annually. The overall recommended increase for FY 2019/20 is shown below, in Figure 2, with a comparison to the original projection made in the FY 2018/19 Adopted Budget:

Figure 2. Utility Rates

| Utility | Original Projection | Recommended FY 2018/19 | Change in Percentage Points |
|-------------|---------------------|------------------------|-----------------------------|
| Water | 4.0% | 0.0% | (4.0)% |
| Wastewater | 7.0% | 4.0% | (3.0)% |
| Solid Waste | 2.0% | 1.0% | (1.0)% |

Each of the utility enterprises has its own unique pressures that drive rate adjustments. The FY 2019/20 Recommended Budget is a capital budget cycle. As such, each utility updated current projects as well as added new projects.

In the water utility, the two drivers affecting rates are the recovery from the drought and increased infrastructure needs. Water demand over the last five years has been volatile, reducing significantly with the drought and now rebounding.

Overall, measures taken during the drought and a demographic shift in the industry in Sunnyvale have permanently

changed water demand. Over the next three years, it is expected that demand will increase approximately 13%, bringing consumption in line with levels last seen prior to the drought in 2013. With landscape and water smart appliance incentives available, staff projects water consumption will remain relatively flat with moderate growth over the long term.

The long-term plan anticipates changes to rates charged by the City's wholesalers, which account for the vast majority of water supplied to the City. The San Francisco Public Utilities Commission has projected four consecutive years of no increases, while Valley Water (formerly Santa Clara Valley Water District) has reduced its expected rate increase by 3% to an estimated 6.6% increase annually over the next ten years. Since these rates were lower than expected in the FY 2018/19 financial plan, water rates are unchanged for FY 2019/20.

As with all utilities, there are fixed costs to operate the water system that are not based on the volume of water delivered. These include large capital needs in the fund, mainly associated with pipe, tank, and well replacements and rehabilitation, but the age of the system also required modest requests for additional equipment and contract services needed to maintain the system. The Recommended Budget includes approximately \$130 million in projects over 20 years, the most significant of which is \$88 million for water pipe and main replacements.

Wastewater rates are rising, driven primarily by costs associated with planned improvements to the City's wastewater collection and treatment system, and stricter regulatory requirements. The main driver of rates in the Wastewater Management Fund is the need to replace the City's aging wastewater treatment plant. The rates include an assumption that the City will issue debt to fund the project over many years; annual debt service costs start at \$8.6 million annually in FY 2021/22, and will increase as new debt is issued over the twenty-year financial plan. By the end of the twenty-year plan, over \$42 million in annual debt service costs are expected. This debt service expense is substantial as it will eventually make up over one-third of the fund's total expenditure requirements.

The anticipated debt service has changed since the FY 2019/20 financial plan, with much of the debt service cost being shifted towards the second ten years of the financial plan. This reduces the need for required rate increases over the short term, with FY 2019/20 through FY 2023/24 rate increases expected to be lower than projected in the previous financial plan. It is notable that the City received \$127 million in State Clean Water Revolving funds for the project, which came at a significantly lower rate than traditional municipal bonds.

Solid waste rates are rising by 1%, which is less than expected in the FY 2018/19 financial plan. The rates for different customer classes and individual service rates will vary from the overall 1% increase to reflect changes identified in a recently completed cost of service study. The study was last updated five years ago, and the current study recalibrates rates so that they reflect the current costs of providing service to each customer class and service type. The primary finding in the study is that there have been reductions in the amount of garbage collected from customers as a result of the new FoodCycle services. This results in lower costs and enables a decrease to residential solid waste rates.

Revenue to the fund provides the resources to support the City's zero waste efforts, including the FoodCycle program. Solid waste rates also include the costs of operating and maintaining the Sunnyvale Materials Recovery and Transfer Station (SMaRT Station®). These costs are shared by the cities of Mountain View and Palo Alto proportionally by the amount of recyclable material processed.

Overall, the utility funds remain on solid footing and are performing well. The City's disciplined annual review of these critical funds allows sufficient time to adjust the financial plans and minimize the fiscal impact on each utility's customers over the twenty-year horizon.

Development-Related Fees include revenue from all development-related fees (e.g. plan check fees, inspection fees and permit application fees). In FY 2014/15, the City established a separate Development Enterprise Fund that includes these fees and related expenditures. In addition to ensuring full cost recovery, the fund allows for the segregation of these revenues, and building and drawing down on a separate reserve. This is especially important as development-related fee revenues are highly volatile and, as large development projects take many years to complete, expenditures related to specific fees can occur in later fiscal years than when the revenue was collected.

With large development projects in the Moffett Park, Peery Park, Lawrence Station and downtown areas, staff estimates revenue to remain elevated over historical averages through FY 2020/21, however projections are stepped down from peak year numbers. History has shown this revenue to be volatile with wide swings between peaks and valleys. As a result, a historical average is budgeted starting in FY 2021/22.

On the expenditure side, the plan assumes the current level of staffing will be needed going forward, even under an average revenue scenario, as expenditures have not kept pace with revenues. Once revenue projections drop to historical averages, as indicated in the out-years of the financial plan, fees will need to be increased or expenses reduced. Careful monitoring of development activity and the effects on the Development Enterprise Fund will be key in coming years.

Development Impact Fees are imposed to mitigate the impact of a development on the community. These four (4) fees include: Park Dedication fees, Transportation Impact fees, Housing Mitigation fees, and Sense of Place fees. Impact fees have strict requirements, set by state government code, that require fees to be roughly proportional to the impacts of the project and imposed for purposes related to the impacts of the project. Therefore, each of these fees is accounted for separately in its own fund or sub-fund. With development activity in the City at record levels, revenue from these fees has been significant. The City collected \$49.3 million in revenue from these fees in FY 2017/18. Based on year-to-date figures and approved projects, staff estimates collecting \$23.2 million in FY 2018/19. With the known development projects in the permitting process currently, a high level of revenue is anticipated for FY 2019/20, peaking in FY 2020/21 at a projected \$81.6 million. Because of the volatile nature of development projects, it is challenging to forecast impact fee revenue beyond the most immediate years. The revenue projected above last year's budget is primarily appropriated in projects, or reflected as increases to fund reserves that will be dedicated to future projects in the upcoming projects budget cycle.

Figure 3. Impact Fee Revenue

| Revenue Source | 2017/18 Actual | 2018/19 Budget | 2019/20 Plan | 2020/21 Plan | 2021/22 Plan |
|----------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Park Dedication Fee | 26,131,034 | 8,547,788 | 36,578,495 | 47,700,805 | 10,193,040 |
| Housing Mitigation Fee | 12,807,464 | 5,782,941 | 15,171,589 | 21,320,335 | 4,130,239 |
| Transportation Impact Fee | 8,226,540 | 7,263,868 | 6,381,121 | 11,324,190 | 2,638,341 |
| Sense of Place Fee | 2,110,296 | 1,627,298 | 2,944,017 | 1,208,476 | 177,993 |
| IMPACT FEES - TOTAL | 49,275,334 | 23,221,895 | 61,075,222 | 81,553,806 | 17,139,613 |

Golf Fees support the Golf and Tennis Fund, which has been operating at a deficit and is not currently a self-supporting enterprise fund. This has been a strategic focus for Council, and staff has made progress in restructuring activities to reduce expenditures. However, growing revenues has been a challenge and the fund will require continued subsidy. Recently, staff contracted with new restaurant operators, with restaurants at both courses now open for business. The impact of these new concessions has been included in the long-term financial plan.

While staff will continue to explore cost saving opportunities, General Fund monies transferred to the Golf and Tennis Operations Fund will be required until a permanent plan is in place, and have been increased by \$1,060,000 over six years to adjust for a wet season and corresponding revenue reduction, as well as a subsidy for the restaurant operations at the Municipal Golf Course, which is anticipated to operate at a loss over several years before turning a profit. An additional longer-term pressure is the funding of capital improvements. Current planned capital projects are funded by Park Dedication Fees through FY 2032/33, but a funding source has not yet been identified for future needed golf capital and infrastructure projects.

Other Revenue Sources

The remaining revenue sources are varied, including franchises, rents, fines, licenses and interest income. There are also one-time revenues in this category such as bond proceeds, federal and state grants and sale of property. Highlights of other revenue sources are discussed below.

Debt Financing is used as a tool for paying certain expenditures and managing cash flow when large, one-time outlays are required, generally for large infrastructure projects.

The City currently carries debt for both the Water and Wastewater Systems, the SMaRT Station®, the Redevelopment Successor Agency and the Government Center property at 505 West Olive Avenue (“Sunnyvale Office Center”). All of the currently held debt is funded by rate revenues, former tax increment or lease payments paid by various funds. The City does not maintain any general obligation debt (commonly called “GO Bonds”) and continues to maintain the highest issuer credit rating issued by Standard & Poor’s (AAA) and Moody’s (Aaa). The City also has a State Revolving Fund loan for approximately \$127 million for the Sunnyvale Clean Water Program. This loan provides cost effective funding for the first significant phase of the project, construction of new primary treatment facilities and headworks. The City has also been invited to apply for \$166 million in Water Infrastructure Finance and Innovation Act (WIFIA) funds, a federal low-interest loan program that would be used for portions of the second phase of the project. While the interest rates on WIFIA loans are not as low as State Revolving Fund loans, they are still favorable to the public market.

Sale of Property includes one-time proceeds from the sale of property. These revenues go to the fund that owned or purchased the property. By City policy, one-time revenues are spent on one-time expenditures. As such, in the General Fund, sale of property revenue is placed in the Capital Improvement Reserve. For FY 2018/19, the Infrastructure Fund reflects \$33 million from the sale of the Unilever Margarine Plant property. This revenue is being used to help fund the Civic Center Modernization project.

II. City Expenditures

City expenditures fall into three broad categories: operating, projects and equipment, and debt service.

Operating Expenditures

This year is the second year of an operating budget cycle, so the only changes made to operations were on an exception basis. City departments are extremely integrated and highly reliant on each other to deliver services and achieve the goals and results established by the City Council. The departments are:

- Office of the City Attorney
- Office of the City Manager
- Community Development Department
- Environmental Services Department
- Finance Department
- Human Resources Department
- Information Technology Department
- Library and Community Services Department
- NOVA Workforce Services Department
- Department of Public Safety
- Department of Public Works

Citywide Operations

Employee Compensation

As a service delivery organization, salaries and benefits costs for personnel make up the majority of operating expenditures. Managing total compensation costs is a key component of long-term financial sustainability. The Recommended Budget addresses this in several ways. The City accounts for pension costs in a separate Employee Benefits Fund. The Recommended Budget for this fund contains several assumptions to mitigate pension cost volatility, including holding healthy reserves. The most significant change in the last budget was the addition of a pension trust fund. This budget continues the contribution to the fund of approximately \$1 million per year. The City’s current consulting actuary is assisting with the management of the trust and the City will begin drawing from the trust in FY 2028/29. Over the next five years, the trust is expected to yield approximately \$15.6 million in payments to help stabilize the peak years of CalPERS contributions. The most significant impact from the increase in pension cost is in the General Fund and therefore the largest benefit (approximately \$12.7 million) from the trust is gained in the General Fund.

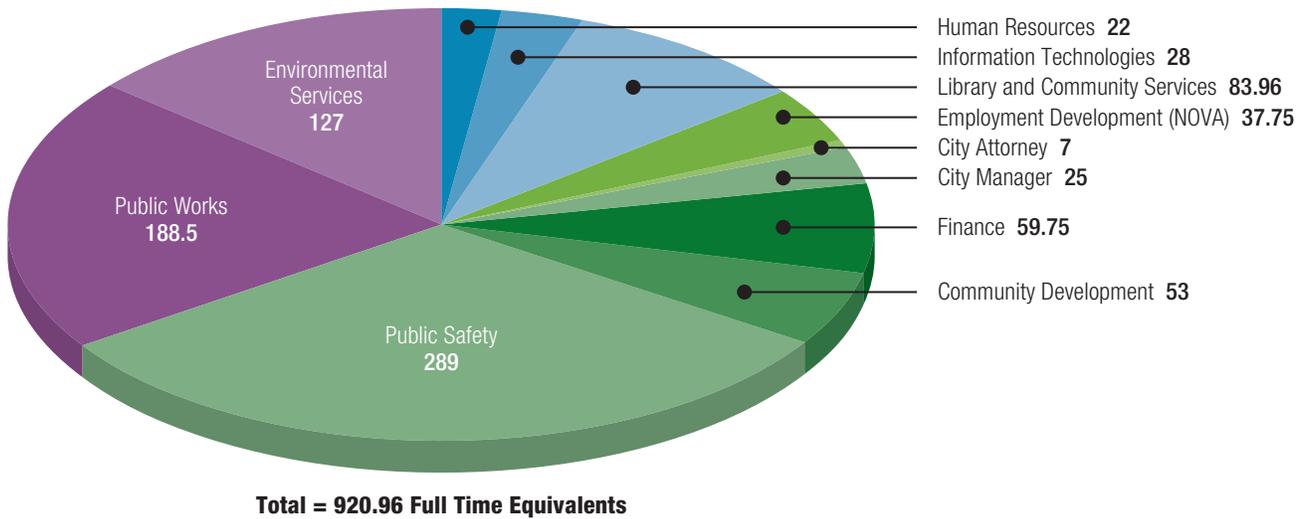
The Recommended Budget also includes updated assumptions on insurances and salaries. A tightened and highly competitive labor market is creating stiff competition for talent. Just as the City does not project revenues off a peak economy, annual increases in salaries are not projected at peak levels. This budget includes resources to maintain competitiveness in the short term, while moderating salary growth in the long term.

Changing workforce demographics have continued to keep insurance costs under projections. Fewer employees are insuring families as younger employees take advantage of alternate coverage and have fewer dependents. The total for all insurances is down \$8 million across all funds over twenty years. As with pensions, the City carries reserves for insurance rate uncertainty and projects insurance rate increases based on longer term averages, which are generally above inflation.

Total compensation in the General Fund (salaries, pensions, and insurances) is projected to rise by approximately \$50.7 million over twenty years from the FY 2018/19 Adopted Budget. This increase has been offset by the addition of new revenue, primarily property tax and transient occupancy tax as discussed above. Over the past several years, the City has taken actions to provide competitive compensation while managing long-term liabilities. Growth in total compensation is actively tracked against the growth in the cost of living. Growth in pensions and healthcare costs has exceeded inflation, placing downward pressure on salaries as those components consume a larger percentage of available resources. However, as revenues have rebounded, the Recommended Budget has been able to absorb these increases while maintaining reasonable anticipated growth in salaries.

The Recommended Budget includes 920.96 Full Time Equivalent (FTE) Employees. The City added thirteen positions over the year, mostly associated with the implementation of a new Enterprise Resource Planning System. Term limited positions were added in Finance (5), Human Resources (2), and Information Technology (2) in support of the project. The other five positions were added in the Community Development Department, where workload continues to stretch the current staffing resources. Three of the Community Development positions were added just prior to the release of the Recommended Budget. As such, while included in this chart, they were not included in the departmental summary, however will be incorporated into the Adopted Budget.

Figure 4.



As this year is the second year of an operating budget cycle, no additional changes have been made to non-personnel costs in the budget.

Projects Budget

Sunnyvale’s projects budget is a complex document involving four separate and distinct categories of projects: capital, infrastructure, special, and outside group funding. Totaling over \$2.1 billion over twenty years, the projects themselves are budgeted and accounted for in various funds, most notably the General and Gas Tax Funds, the Capital Projects and Infrastructure Funds, and the Utility Funds. These projects are separated in this Recommended Budget into fourteen categories:

- Traffic and Transportation
- Downtown
- Housing
- Water
- Solid Waste
- Outside Group Funding
- Wastewater
- Clean Water Program
- Public Safety
- Community Development Block Grant (CDBG)
- Parks and Recreation
- Library
- Governance and Community Engagement
- Administrative Facilities

Each of these categories carries a portfolio of projects that address the subject area. As part of the annual budget preparation process, City staff reviewed and updated all projects, and identified new projects for inclusion. Some of the new projects identified are intended to address major initiatives and actions. Additionally, the past few years have seen two new sources of funding for transportation projects, specifically street maintenance. These revenue streams include the Santa Clara County half-cent Sales Tax for transportation (Measure B), and the Road Rehabilitation and Maintenance Act (SBI) gas tax. Impact fees have also provided significant funding streams for many of the projects identified in this Recommended Budget.

Along with the new initiatives and funding opportunities, the City also has several challenges in the projects area. Most significantly, cost escalation heavily impacted the City’s budget. The City faces stiff competition for contractors in the local economy. Smaller projects, like park building or pump station rehabilitations, are getting less interest from the construction community. For the Sunnyvale Clean Water Program, total costs are up \$202 million over twenty years, due to cost escalation and the inclusion of a 10% bid market factor for this very competitive market. Park projects are up \$11 million over twenty years, half of which is due to escalations related to the Washington Community Swim Center. These factors are resulting in new revenue from a vibrant economy, and savings obtained through low-interest loans, being consumed to absorb these increases.

Figure 5 shows the year over year change of the total 20 year project budget by fund for the period from FY 2017/18 to FY 2037/38

Figure 5.

| Fund | FY 2018/19 | FY 2019/20 | Increase/(Decrease) |
|--------------------------------|----------------------|----------------------|---------------------|
| General Fund | 116,966,960 | 150,850,260 | 33,883,300 |
| Combined Housing Fund | 24,361,610 | 18,342,919 | (6,018,691) |
| HOME Fund | 1,606,785 | 1,504,217 | (102,568) |
| Redevelopment Housing Fund | 1,616,645 | 1,616,645 | - |
| CDBG Fund | 9,449,284 | 10,182,569 | 733,285 |
| CFD No. 3-Estates at Sunnyvale | 104,752 | 89,882 | (14,870) |
| Gas Tax Fund | 889,100 | 742,707 | (146,393) |
| Capital Projects Fund | 144,636,848 | 119,710,426 | (24,926,422) |
| Water Fund | 120,707,174 | 131,363,509 | 10,656,335 |
| Wastewater Fund | 767,829,921 | 981,480,024 | 213,650,103 |
| Solid Waste Fund | 36,061,338 | 33,532,924 | (2,528,414) |
| Development Enterprise Fund | 3,613,938 | 2,982,302 | (631,636) |
| General Services Fund | 27,605,599 | 30,111,007 | 2,505,408 |
| Infrastructure Fund | 498,293,715 | 704,638,974 | 206,345,259 |
| Asset Forfeiture | 240,574 | 245,613 | 5,039 |
| Supplemental Law Enforcement | 28,746 | 122,101 | 93,355 |
| Parking District | 861,058 | 1,064,858 | 203,800 |
| Transportation Development Act | - | 120,887 | 120,887 |
| Total | 1,754,874,047 | 2,188,701,824 | 433,827,777 |

Budget Supplements and Unfunded Needs

As part of the development of the FY 2019/20 Recommended Budget, departments identified unfunded needs and Budget Supplements resulting from the Study/Budget Issues Workshop are brought forward. The list of unfunded needs is intended to assist the City in establishing funding priorities in a larger and long-term context. The Recommended Budget also includes a series of 13 Budget Supplements, all of which impact the General Fund.

With the recommended supplements in place, the Recommended Long-Term General Fund Financial Plan reaches a low point of approximately \$10 million in FY 2028/29 in the Budget Stabilization Fund. To the extent that Council eliminates expenditures included in the Recommended Budget, identifies additional revenues, or draws reserves, Council can repurpose those resources to add supplements, service level adjustments, or begin to address unfunded needs.

The following list includes all Budget Supplements and currently identified unfunded needs for the evaluation discussed above. The City Manager has recommended certain Budget Supplements for inclusion in the Recommended Budget. No new unfunded needs have been addressed at this time as many are still in the early stages of development or other funding requirements were prioritized.

Budget Supplements

Each supplement is presented separately and recommended for inclusion or exclusion from the FY 2019/20 Recommended Budget. This year the budget includes thirteen Budget Supplements. Figure 5 lists the supplements and the City Manager’s recommendation. If the supplement is recommended for funding, it will be included in the financial plan of the affected fund for budget adoption. Details of each supplement can be found in the Budget Supplements section.

Figure 6. Proposed Budget Supplements

| No. | Title | Cost | Fund | Recommendation |
|--------------------------|--|---------------------------------------|-----------------------------|-------------------------|
| 1 | Evaluation of Right to Lease Ordinance | \$60,000 one-time | General Fund | Recommended for Funding |
| 2 | Update and Review Heritage Resource Inventory and Include Potential Resources Associated with Technological Innovation | \$325,000 one-time | General Fund | Not Recommended |
| 3 | Responsible Construction Ordinance | \$25,000 one-time | General Fund | Recommended for Funding |
| 4 | Ascertain Suitable Location(s) for the Installation of Youth Cricket Batting Cages and Potential Funding Sources | \$25,000 one-time | General Fund | Recommended for Funding |
| 5 | Improving Traffic Operations at Fremont/Bernardo/Hwy 85 | \$150,000 one-time | General Fund | Recommended for Funding |
| 6 | Consider the Feasibility of Establishing and Eruv in Sunnyvale | \$50,000 one-time | General Fund | Recommended for Funding |
| 7 | Single Use Plastics Strategy | \$50,000 one-time | Solid Waste Enterprise Fund | Recommended for Funding |
| 8 | Evaluate Options for Revisions to the Sunnyvale Business License Tax | \$50,000 one-time | General Fund | Recommended for Funding |
| 9 | Explore Strategies to Promote Cultural Inclusion in City Programs and Services | \$60,000 one-time | General Fund | Recommended for Funding |
| 10 | Increase the Service Level Pertaining to City Advocacy in Sacramento and the Regional Area | \$70,000 each for five years | General Fund | Recommended for Funding |
| 11 | Increase Community Event Grants Funding | \$10,500 on-going | General Fund | Recommended for Funding |
| 12 | Increase Neighborhood Grant Program Funding | \$3,250 on-going | General Fund | Recommended for Funding |
| 13 | Increase the Planned Contribution to the Pension Trust Fund | Up to \$1 million each for nine years | Multiple Funds | Not Recommended |
| Twenty Year Total | | \$ 10,507,000 | | |

Unfunded Programs and Projects

The following list enumerates known areas that are unfunded or underfunded. These issues all require additional scoping to identify. It is important to note this list is dynamic and will change with each budget cycle and as the City identifies new needs or funds items on the list.

Unfunded Projects Listing

| Short Description |
|--|
| Community, Economic & Workforce Development |
| Transportation, Streets and Infrastructure |
| Transportation Strategic Plan Projects |
| Bicycle CIP Improvement Program Projects |
| Downtown Specific Plan Projects |
| Traffic Signal Infrastructure Replacement |
| Sidewalk Repair |
| Street Maintenance (additional to maintain PCI) |
| Environment and Sustainability |
| Climate Action Plan Program Funding |
| Water Infrastructure |
| Wastewater Collection Infrastructure |
| Stormwater Collection Infrastructure |
| Stormwater Program Funding |
| Library, Community Services & Public Facilities |
| Civic Center Modernization |
| Corporation Yard Modernization |
| Fire Station Replacements/Rehabilitation |
| Gap Funding for Repairs to the Corporation yard |
| Golf Building Replacements |
| Golf Course Infrastructure |
| Golf Operations Subsidy |
| Branch Library Operating and Ongoing Costs |
| Public Safety |
| Evidence Storage |
| Work order and Asset Management Systems |
| Administrative Services |
| Modernization of various customer interface systems (POS, non-CDD permitting, etc) |

III. City Reserves

The backbone of our financial planning process is the Twenty-Year Resource Allocation Plan. This planning document provides the framework to maintain a structurally balanced budget by requiring financial discipline in making policy and service level decisions. One of the key components of the financial plans is the various reserves contained within each plan, which is considered a best practice. While many organizations have reserves, the City's strategic and disciplined use of reserves is unique and more active than a typical city. The City maintains reserves for different purposes; some are restricted in use while others are available for a variety of priorities. Examples of restricted reserves include debt service reserves or reserves of special revenues. Unrestricted reserves are used strategically over the twenty-year planning period to balance each fund. The City plans to increase or decrease reserve levels as business and economic cycles pass, allowing stable and consistent levels of service. This is especially critical in periods of revenue volatility. Reviewing reserves over a long period forces policymakers, staff and the community to think carefully before adding services that must be sustained through growing and recessionary economic periods.

In the General Fund, the unrestricted reserve is the Budget Stabilization Fund. Disciplined and strategic use of this reserve allowed the City to weather the great recession, and is helping to strategically add back services in a planned way to ensure sustainability over the long run. Most significantly, in the past several years, the reserve helped manage the significant increase in projected pension costs. In this Recommended Budget, the reserve continues to absorb significant increases in total compensation costs, as well as provides a resource for the next downturn, however it recovers to \$56 million by the end of the plan. It is important to note that while this seems like a large number in today's dollars, it is only 16% of the total revenues projected in the twentieth year.

This Recommended Budget enables the City to set aside \$23.2 million over 20 years for to-be-identified increasing demands in service. This allows the City to adapt to the ever-changing service needs of our community, whether rolling out new services (e.g. new operating costs at the Lakewood Branch Library), or increasing current operating program budgets (e.g. to support additional City parks). Identifying this capacity is the strength of the City's twenty-year planning and setting the funding aside provides time to thoughtfully address the issue in the upcoming operating budget cycle.

In the utility funds, the use of the Rate Stabilization Reserves allows for the measured increase of rates to cover increasing costs, such as wholesale water costs and tightening regulations on wastewater discharge. This reserve also allows the City to incrementally increase rates to the level needed to support the replacement of the WPCP.

In both these cases, and throughout the budget, reserves also allow the City to deal with unexpected expenditures. In the most extreme case, each significant fund carries large contingency reserves for emergencies such as natural disasters. Reserves also allow the City to address projects that may be more expensive than estimated or absorb unanticipated operating costs. In all cases, reserves are one of our most critical tools to achieve and maintain financial sustainability.

Conclusion

The City's continued discipline in crafting balanced budgets enables us to anticipate and respond to the evolving needs of our community. With our economy in full swing, this budget deploys resources strategically to meet growing demands for service, improve infrastructure and address projected pension and retiree medical liabilities. We are strategic in advancing the City Council's goals and the services so highly valued by residents, all while safeguarding the City's long-term financial health. While more work is ahead of us in the coming years, we are confident this budget sets us on a sustainable path to respond to future needs.

In closing, we would like to thank our City Council for its dedication to advancing the strategic priorities which guide our budget development process. The preparation of this budget was also made possible by the collaborative efforts of our Executive Leadership Team and City staff. Thank you all for your commitment and hard work in preparing this Recommended Budget.