



City of Sunnyvale

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL

SUBJECT

Receive and File the FY 2014/15 Budgetary Year-End Financial Report, Comprehensive Annual Financial Report, and Sunnyvale Financing Authority Financial Report and Approve Budget Modification No. 18

REPORT IN BRIEF

This report is intended to provide the year-end financial condition of the City of Sunnyvale on a budgetary basis for the fiscal year ended June 30, 2015. In addition, the City's audited Comprehensive Annual Financial Report (CAFR) and Sunnyvale Financing Authority Financial Report for FY 2014/15 are being presented for Council's information.

Overall, the City's General Fund ended the year in a more favorable financial position from that estimated in the FY 2015/16 Adopted Budget by approximately \$7.4 million. General Fund revenues finished the year strong. Property Tax, Business License Tax, and Transient Occupancy Tax revenues all ended higher than estimated.

Expenditures in the General Fund performed better than expected, ending under budget. After accounting for project carryovers, expenditures ended approximately \$2.4 million under what was anticipated in the FY 2015/16 Adopted Budget. Much of this was due to staffing vacancies in both the Department of Public Safety and the Library and Community Services Department. As such, these savings are one-time and are eliminated once the vacancies are filled. As a result of higher than estimated revenue and under spending of expenditures, there was no drawdown on the Budget Stabilization Fund, compared to a \$7.4 million drawdown that was projected in the budget.

The City's CAFR was independently audited by the firm of Macias Gini & O'Connell (MGO) who rendered an unmodified opinion and found no material weaknesses during the audit of the City's CAFR. Receiving an unmodified opinion is the optimal result from the independent audit.

As part of this report, staff recommends Council approval of Budget Modification No. 18 to close out items from the prior year. This budget modification seeks to better align Payroll and Human Resources staffing with the work by moving the funding for a Payroll Technician III from the Department of Finance to the Department of Human Resources. Human Resources will use the funding to add a Human Resources Analyst position. In addition, as recommended last year, because the General Fund's Budget Stabilization Fund ended the year better than estimated, the budget modification proposes to appropriate \$1.4 million from the Budget Stabilization Fund to pay down the City's unfunded pension liability.

BACKGROUND

Each year, staff provides a report to the Council detailing the year-end financial condition of the City on a budgetary basis. Final results are compared with the most recent projection. As part of developing the recommended Budget for FY 2015/16, the revenue anticipated for FY 2014/15 is updated at the same time, in the February to March timeframe. Staff also typically reviews General Fund operating expenditures to date and estimates expenditure savings for FY 2014/15 in the General Fund twenty-year financial plan, if applicable, to provide the best estimate for the financial position of the fund.

EXISTING POLICY

Council Policy 7.1.1 *Fiscal -Long Range Goals and Financial Policies*, Statement G.1.7: the City Council shall be provided with periodic summary financial reports, by fund, comparing actual revenues and expenditures to budgeted amounts.

City Charter, Section 1318, *Independent Audit*, requires that an independent audit be conducted of the City's financial transactions at the end of each fiscal year.

ENVIRONMENTAL REVIEW

N/A

DISCUSSION

Fiscal Year 2014/15 Year-End Financial Update

Staff has reviewed the City's year-end financial results. The following is an analysis of the changes between the projected revenues and expenditures estimated in the City Manager's Recommended Budget with the actual year end results.

General Fund

Revenues

General Fund revenues for FY 2014/15 are shown in the table below.

FY 2014/15 General Fund Revenues - Estimated vs. Actual

Description	Revised Budget	Actual Revenues	Variance Favorable (Unfavorable)	Percent Variance
Property Taxes	\$53,511,242	\$54,940,570	1,429,328	2.67%
Sales Taxes:				
Sales and Use Tax - City	29,849,173	29,676,176	(172,997)	-0.58%
Sales and Use Tax - Public Safety	1,463,755	1,542,805	79,050	5.40%
Total Sales Tax	31,312,928	31,218,980	(93,948)	-0.30%
Other Taxes:				
Construction Tax	3,067,503	3,066,351	(1,152)	-0.04%
Business License Tax	1,700,000	1,845,883	145,883	8.58%
Real Property Transfer Tax	1,707,939	1,764,551	56,612	3.31%
Total Other Taxes	6,475,441	6,676,784	201,343	3.11%
Transient Occupancy Tax	12,436,990	14,137,069	1,700,079	13.67%
Utility Users Tax	6,720,489	6,774,027	53,538	0.80%
Franchises	6,871,846	6,897,803	25,957	0.38%
Rents & Concessions	2,369,316	2,439,797	70,482	2.97%
Federal & Intergovernmental Revenues	1,764,911	612,397	(1,152,514)	-65.30%
State Revenues	644,186	996,742	352,556	54.73%
Permits & Licenses	1,175,805	1,308,386	132,581	11.28%
Fines & Forfeitures	966,574	1,093,087	126,513	13.09%
Service Fees:				
Abandoned Vehicles (AVASA)	175,000	142,676	(32,324)	-18.47%
Community Development Fees	532,218	857,034	324,816	61.03%
Finance Fees	15,606	11,948	(3,658)	-23.44%
Library Fees	10,086	10,223	137	1.35%
Public Safety Fees	1,331,935	1,430,371	98,437	7.39%
Public Works Fees	55,785	124,059	68,274	122.39%
Parks and Recreation Fees	3,303,261	3,451,956	148,695	4.50%
Total Service Fees	5,423,891	6,028,267	604,376	11.14%
Interest Income	644,913	668,696	23,784	3.69%
Other Revenues:				
Sale of Property	0	14,069	14,069	0.00%
Interfund Revenues	6,864,358	6,864,357	(1)	0.00%
Miscellaneous Revenues	229,309	378,649	149,340	65.13%
Private Grants & Donations	0	170,128	170,128	0.00%
Total Other Revenues	7,093,666	7,427,203	333,536	4.70%
Transfers In/In Lieu Fees	9,654,601	9,267,775	(386,826)	-4.01%
Revenue Sub-Total	147,066,800	150,487,584	3,420,784	2.33%
Deferred Revenues (Project Related)		1,018,960	1,018,960	0.00%
Deferred Transfers In (Project Related)		373,479	373,479	0.00%
Revenue Total	\$147,066,800	\$151,880,024	4,813,224	3.27%

Total General Fund revenue exceeded estimates from the FY 2015/16 Recommended Budget by \$3.4 million. Approximately \$1.7 million of this amount is attributable to higher than anticipated Transient Occupancy Tax (TOT) revenue. The City has experienced record high levels of TOT revenue for two consecutive years. Property tax revenue growth was the next largest contributor to the excess revenue. Driven by high supplemental and unsecured returns, Property Tax revenue exceeded estimates by an additional \$1.4 million. In prior years, Development Revenue was one of the largest revenue categories in the General Fund. The majority of these revenues were shifted to the new Development Enterprise Fund, effective FY 2014/15, so the growth in that category is not reflected in the General Fund. While the tax revenue growth speaks to the current strong economic recovery in the Silicon Valley, there is also reason for caution as tax revenues do fluctuate with economic cycles. This issue is discussed in more detail in the *Current Fiscal and Economic Environment* section of this report.

Property Tax revenue in FY 2014/15 came in approximately \$1.4 million better than projected in the Recommended Budget. Overall, Property Tax grew more than \$4.6 million, or 9.2%, over FY 2013/14 revenue. This was the result of significant growth of both residential and commercial property values. Sunnyvale has seen dramatic increases in prices for all types of property across the City. Commercial / Industrial assessed values grew at a very high rate of 9.7%, largely due to new construction. Residential property values increased 8.1%. Because residential properties account for approximately 63% of the net assessed value on the Sunnyvale property tax roll, the residential growth has a significant impact. The FY 2015/16 Recommended Budget projects that Property Tax revenue will increase again in FY 2015/16 by 5.5%. However, recent information from the County, along with higher than estimated revenue for FY 2014/15, indicates that the growth will be considerably higher than the original projection. Staff will be revising the projection upward for the next recommended budget.

Final City Sales and Use Tax revenue for FY 2014/15 was approximately \$94,000 under the estimate made in the FY 2015/16 Budget. Sales Tax revenue has been flat year over year since FY 2011/12. These sales tax results present a very concerning trend: despite the local economic recovery, sales tax revenue has been sluggish and uneven. The stagnation and potential decline of the second largest source of revenue to the General Fund presents a considerable risk to the City's finances with the constraint it imposes on the General Fund. FY 2015/16 sales tax revenue was projected to climb to approximately \$31.9 million, or 7% above the revised FY 2014/15 estimate. However, given the lower than anticipated FY 2014/15 results, Staff anticipates adjusting this revenue estimate downward. Staff has engaged on a pilot project with the Government Finance Officers Association (GFOA) and Stanford University to enhance our sales tax revenue forecasting methodology. Results may include revised estimates for FY 2015/16 revenue as well as revisions for future year projections to reflect the volatility and risk associated with this revenue source.

Transient Occupancy Tax (TOT) revenue for FY 2014/15 exceeded the projection made for the FY 2015/16 Budget by \$1.7 million. The thriving local economy has led to continued high levels of business related travel in Sunnyvale. The average room rates and average occupancy levels have each increased dramatically from FY 2013/14 to FY 2014/15. Additionally, FY 2014/15 was the first full year of collections with the 10.5% tax rate that became effective January 1, 2014. Further, one new hotel opened in October 2014, and two other hotels were significantly remodeled, resulting in increased revenue. The General Fund long term financial plan reflects the addition of two additional new hotels in the City, which further strengthens this tax base. However, it is important to note that historically, TOT revenue has shown high volatility with substantial declines in periods of economic

recession.

Other Taxes finished the year \$173,000 higher than FY 2013/14 and \$201,000 above projection. Construction Tax, while slightly under projection, experienced its highest year on record. As noted above, the majority of development related revenues were shifted to the Development Enterprise Fund this year. However, as a tax, Construction Tax revenue remains in the General Fund. Real Property Transfer Tax revenues exceeded projections by more than \$50,000. As a tax on the transfer of interests in real estate, it is driven by the rate of property turnover and changes in valuation. The increase reflects the continued recovery in the real estate market locally. Business License Tax revenue was higher than projections by over \$145,000 as the result of staff's audit efforts and increased business activity.

Utility Users Tax (UUT) revenue for FY 2014/15 came in slightly above planned in the FY 2015/16 Recommended Budget, and was up by approximately \$20,000 compared to FY 2013/14 revenues. However, a significant portion of this revenue source continues to decline, due to the gradual shift in the way consumers are using telecommunication devices, as more and more usage is not subject to UUT (e.g. text and data). A study issue on the potential for a UUT ballot measure to address this issue was presented at a City Council study session on December 1, 2015.

Outside of taxes, most revenue categories ended the year with small variances as compared to estimates in the Recommended Budget. Notable areas include: Federal & Intergovernmental Revenues, State Revenues, Community Development Fees, Public Works Fees, Miscellaneous Revenues, and Deferred Transfers In.

Federal and Intergovernmental revenues fund specific projects and is received on a reimbursement basis. Therefore, the budget for most of the revenue not received is carried over into the next fiscal year in conjunction with the unspent budgeted project expenditures, and reflected on the 'Deferred Revenues (Project Related)' line near the bottom of the table. State Revenue exceeded projections by over \$350,000 due to the greater than anticipated receipt of state mandated cost reimbursements (SB90 program). Community Development Fees exceeded projection by over \$324,000. This result is primarily due to General Plan Maintenance Fee revenue, which increased to the continued high development activity in Sunnyvale. This is a committed revenue source, which is used to fund periodic projects to revise General Plan Elements. Public Works Fees exceeded budget because of higher than anticipated Transportation Study Review Fees. Miscellaneous Revenues were high because the General Fund collected over \$312,000 for Damage to City Property versus the estimated \$130,000. Finally, the table includes Deferred Transfers In, which are transfers to be made from other City funds for specific General Fund projects that are reflected on the expenditure-side as project carryover.

Expenditures

General Fund expenditures for the fiscal year ending June 30, 2015 are shown in the following table.

FY 2014/2015 General Fund Expenditures and Transfers - Estimated vs. Actual

Description	Revised Budget	Actual Expenditures	Variance Favorable (Unfavorable)	Percent Variance
Equipment	\$578,671	\$410,060	\$168,611	29.14 %
Operations	131,248,438	128,958,313	2,290,125	1.74 %
Projects	12,697,745	7,728,019	4,969,726	39.14 %
Transfers	25,221,713	16,827,840	8,393,873	33.28 %
Expenditures Subtotal	169,746,567	153,924,232	15,822,335	9.32 %
CAFR adjustment	-	13,328	(13,328)	0.00%
Total Expenditures	169,746,567	153,937,560	15,809,007	9.31 %
Equipment Carryovers	-	175,966	(175,966)	0.00%
Project Carryovers	-	4,713,276	(4,713,276)	0.00%
Deferred Transfers	-	8,558,312	(8,558,312)	0.00%
Total Carryovers	-	13,447,553	(13,447,553)	0.00 %
Expenditures Grand Total	169,746,567	167,385,114	2,361,453	1.39 %

The details of FY 2014/15 expenditures as compared to the budget are contained in Attachment 1 of this report by fund. It is important to note that the budget values in Attachment 1 represent the Council-appropriated budget amounts for each fund and may not match the amounts for FY 2014/15 in the Recommended Budget. In order to capture the most accurate financial position of each fund heading into the next fiscal year, updated estimates may be included in the 20-year long-term financial plans for the current year. However, Council-appropriated budgets are not modified and individual programs are still held to those budgets as they were approved by Council.

Year-end expenditures are lower than planned, primarily as a result of operating savings in two departments, Public Safety and Library and Community Services. In the Department of Public Safety (DPS) approximately \$1.3 million in savings were from personnel costs as the department is currently experiencing a high number of vacancies. This is in addition to \$1 million in salary savings already factored in to mitigate the impact of accelerated funding for recruitment projects through a FY 2014/15 budget modification. The FY 2015/16 Budget also assumes \$1 million in DPS salary savings. Library and Community Services (LCS) came in approximately \$600,000 under budget. These savings were also primarily from staffing vacancies in both the Community Services and Library programs.

The General Fund also provides funding for numerous capital and infrastructure projects. Due to the long-term nature of capital projects, unspent budget amounts are committed to the next fiscal year for

those projects that are still in progress. \$13.3 million is being carried forward to FY 2015/16 to cover expenditures related to projects. This amount consists of \$4.7 million in General Fund projects, which includes \$1.7 million for the Public Safety FY 2014/15 recruitment project, \$653,000 for the Comprehensive Update of the Precise Plan for El Camino Real, and an assortment of smaller projects. In addition to the \$4.7 million for General Fund projects, \$8.6 million is being carried forward in order to transfer to other funds for project expenses. Of that amount, \$5.8 million is budgeted to transfer to the Infrastructure Fund (primarily to fund the Pavement Rehabilitation project), and \$2.7 million is budgeted to transfer to the Capital Projects Fund (primarily to fund various projects related to the Town Center).

Overall, expenditures in the General Fund ended \$2.4 million under budget due to savings in the operating programs. Because the savings are primarily due to staffing vacancies, it is not anticipated that the savings will be ongoing.

Final Fund Results

The final position of the General Fund, as reflected in this Year-End Financial Report, is \$7.4 million more favorable to the City in comparison to the results estimated for the City Manager's Recommended Budget. These results positively impact the Budget Stabilization Fund, however it is important to note that this only slows the pace of the City's need to draw from the Budget Stabilization Fund balance future anticipated needs. These results will be reflected in the development of the FY 2016/17 Recommended Budget.

FY 2014/15 General Fund Financial Position Year End Results

	Revised Budget	Actual Results	Variance Favorable (Unfavorable)
Beginning Balance	\$116,061,692	\$116,061,692	\$ 0
Revenues and Transfers In	147,066,800	150,487,584	3,420,784
Deferred Revenues (Project Related)	0	1,392,440	1,392,440
Total Revenues	147,066,800	151,880,024	4,813,223
<u>Expenditures</u>			
Expenditures and Transfers Out	169,746,567	153,937,560	(15,809,007)
Carryovers for Projects and Equipment	0	13,447,553	13,447,553
Total Expenditures	169,746,567	167,385,113	(2,361,454)
<u>Reserves</u>			
Contingencies	19,500,279	19,142,594	(357,684)
Capital Improvement	13,254,116	13,268,185	14,069
Payment to the State - RDA Dissolution	14,037,223	14,128,459	91,236
Budget Stabilization Fund	46,590,308	54,017,364	7,427,056

It is important to note that despite these favorable results, no funds were added to the Budget Stabilization Fund. The plan in the Adopted Budget was to draw down the Budget Stabilization Fund by \$7.4 million in FY 2014/15. This is due to a continued imbalance between revenues and

expenditures, where expenditure growth, primarily in personnel costs, continues to exceed revenue growth as we move revenues to a sustainable base. With elevated revenues resulting from the continued strength of the economic recovery and operating savings due to staffing vacancies, the Budget Stabilization Fund was able maintain a balance of \$54 million, the same amount the General Fund began the fiscal year.

While the positive results put the General Fund in a strong position, the volatility of the City's major revenue sources, increasing demands on services and infrastructure, and continued growth in personnel costs, require a strategic and disciplined approach in the allocation of resources over the short and long term.

Other Funds

In addition to the General Fund, other funds that warrant further discussion are highlighted below:

Park Dedication, Gas Tax, Capital Projects, and Infrastructure Funds

The Park Dedication, Gas Tax, Capital Projects, and Infrastructure Funds are utilized for funding capital, infrastructure, and special projects, as well as for the maintenance of capital assets, throughout the City. These projects are usually long-term in nature and take several years to complete. As a result, every year many of these projects have unspent appropriations that will be used in the following fiscal year. Revenues for these funds are either transfers into the fund from other funds or grants and contributions from developers. Many of the grant revenues budgeted for this year were not received as these funds are on a reimbursement basis and will only be available to the City once the expenditures have been incurred. The projected grant revenues, therefore, will also be received in the following year.

Ongoing projects in the Capital Projects Fund had unspent funds of approximately \$39.8 million, of which most is being carried forward to be spent in FY 2015/16. The major ongoing projects utilizing this carryover funding include the Fair Oaks Avenue Overhead Bridge project, the Calabazas Creek Bridge at Old Mt. View-Alviso Rd project, the Mathilda/237/101 Interchange Improvements Study, and the Hendy Avenue Complete Street project.

In the Infrastructure Fund, there was \$18 million in unspent project funds, primarily associated with the Pavement Rehabilitation project and the Community Center Comprehensive Infrastructure Renovation project. Both these projects are underway and expected to spend significantly in the current fiscal year. Part of the \$18 million is also made up of approximately \$5 million for the renovation of Lakewood Park, which has been deferred pending the outcome of the sale of the Raynor Activity Center and construction of a branch library at Lakewood Park.

The Pavement Rehabilitation Project is also partially funded by Gas Tax funds. Revenue to the Gas Tax Fund fell short by approximately \$452,000 due to declining gas prices and increases in fuel efficiency. This was offset by \$290,000 in project savings from the Mathilda Avenue overpass project. However, it is anticipated that Gas Tax revenues will continue to decline into the future.

Ongoing projects funded by Park Dedication Fee revenues had unspent funds of approximately \$13.6 million, \$6.8 million of which is being carried forward to be spent in FY 2015/16. The remainder is primarily associated with the Lakewood Park Renovation project which has been deferred as noted above. The majority of the remaining carryover funding is for the transfer of funds to the Infrastructure

Fund primarily for the rehabilitation of infrastructure at the Community Center. Revenues in the Park Dedication Fund came in approximately \$1.5 million less than planned primarily due to delays in development projects and the corresponding timing of the receipt of revenue. This will not affect the fund as year to date revenue in FY 2015/16 already exceeds the current budget by \$6.7 million. It is also important to note that a major update to the capital improvement plan for park and recreation facilities was included with the FY 2015/16 Budget. Project scopes were updated and costs revised to reflect the most recent bidding environment, which is resulting in higher estimated construction costs due to demand. The fund also includes a set aside for land acquisition. Council policy sets aside 20 percent of the Park Dedication Fee Revenue into a reserve specifically designated for land acquisition. At the end of FY 2014/15 this reserve will have a balance of \$4.5 million. These funds will be used to acquire land for the purpose of constructing parks, open space, trails and other recreational facilities.

Development Enterprise Fund

The Development Enterprise Fund was established in FY 2014/15 to account for the revenues and expenditures associated with supporting development activity throughout the City. The operating programs that support development activity span across multiple departments, with the largest programs in the Community Development and Public Works departments. FY 2014/15 was a fourth consecutive record-breaking year for development activity in Sunnyvale, causing both CDD and DPW operating programs to exceed budget given the high demand for service. However, higher expenses were estimated in the recommended budget, with total expenses in the Development Enterprise Fund finishing approximately \$29,000 less than the revised estimate. Actual revenue exceeded the planned amount by \$652,000. The net fiscal impact to the fund was an increase in the Development Enterprise Reserve of approximately \$680,000.

Water Supply and Distribution Fund

The Water Supply and Distribution Fund accounts for the operations and expenses of the City's water system. This fund receives the majority of its revenues from user fees collected from the City's water rate payers. During the review of this fund for the FY 2015/16 rate setting process, staff revised revenue estimates to account for projected water sales.

The region continued to experience an ongoing drought throughout the fiscal year with the Santa Clara Valley Water District making significant investments in conservation outreach and offering financial incentives to conserve. As a result, water sales revenue decreased 17% from FY 2013/14 to FY 2014/15 with revenues to the fund falling short of estimates by \$1.6 million. The shortfall in water sales revenue was \$1.9 million but other revenues exceeded estimates, offsetting the impact to the fund.

After accounting for unspent project funds, total expenses ended approximately \$750,000 less than planned. This came primarily from savings in water purchases, but was offset by expenses associated with maintaining the aging water system which is experiencing an increasing number of main breaks. The total fund ended the year approximately \$630,000 worse than planned. Staff continues to watch the position of this fund carefully as fiscal year to date sales continue to be down, again expressing the same volatility in demand seen in recent years and reflecting the impact of conservation efforts. There is also some uncertainty regarding the City's cost to purchase water should current drought conditions continue throughout the year with both wholesale water providers indicating impending large rate increases.

Solid Waste Management and SMaRT Station® Funds

The Solid Waste Management Fund accounts for the operation of the City's solid waste collection and disposal system. Revenues are received from user fees and from the sale of recyclable materials. This fund's expenses primarily consist of charges for the Sunnyvale Materials Recovery and Transfer (SMaRT) Station® operations, disposal fees at Kirby Canyon Landfill, and the contractor payment to Bay Counties Waste Services (Specialty Solid Waste and Recycling) for collection of garbage, yard trimmings, and recyclable materials. Revenues in this fund are driven primarily by the volume of garbage collected, and to a lesser extent, curbside recyclables and recyclables diverted from the general waste stream. Fund expenses are driven partially by quantities of garbage, but are largely fixed costs for the collection system and SMaRT Station equipment and infrastructure. Overall, the Solid Waste Management Fund revenues finished FY 2014/15 approximately \$1 million better than planned primarily due to expenses coming in under budget and revenues coming in slightly better than estimates. More than half of the savings on the expenditure side were from a lower than anticipated payment to Specialty Solid Waste and Recycling.

The SMaRT Station fund accounts for revenues and expenses related to operation of the SMaRT Station by the three partner cities, Sunnyvale, Mountain View and Palo Alto. Each City makes quarterly contributions to the fund on a budgetary basis. At the end of the year, the fund is reconciled and each of the cities either owes more, or receives a refund based on each city's individual use of the facility. The SMaRT Station Fund net position for the year ended approximately \$480,000 less than planned requiring each of the partners to make end of year true up payments. Revenues underperformed budget due to volatility in materials markets for recyclables from previous years as well as the addition of the recovery of more lower value materials. Expenses were also higher than projected by approximately \$232,000, mostly due to increased tonnage to the landfill. As the costs for the SMaRT Station are based on the allocation of tons across the three cities, approximately half is attributable to Sunnyvale, which is paid for by the Solid Waste Management Fund. It is important to note that as increases in tons are driven by increased activity in the economy, revenue to the Solid Waste Management Fund (discussed above) is available to offset the increase in expense.

Wastewater Management Fund

The Wastewater Management Fund accounts for operations of the City's wastewater collection and treatment facilities. User fees account for the bulk of the revenues, with the remainder coming from connection fees and fees from the small area outside the City served by the wastewater system. Total revenues excluding project related transfers and bond proceeds, were \$290,000 higher than projections. The majority of the increase was attributable to development related sewer connection fee revenue. Actual fees for service came in slightly under projections due to consumption related charges for commercial sewer customers being down as a result of reduced water sales.

FY 2014/15 Wastewater Management Fund operating expenses ended approximately \$550,000 lower than expected primarily due to personnel savings resulting from vacancies. The overall fund position remains in good fiscal condition ending approximately as planned after accounting for unspent project costs and project related revenues. However, there are significant capital needs in this fund coming up in the near future, including the replacement of the existing Water Pollution Control Plant (WPCP). As this is the primary cost driver, the excess revenue related to connection fees, which is restricted for capital, does benefit the fund. Cost estimates for the WPCP project have been included in the long-term financial plan. The project is now underway, and staff is applying for Clean Water State Revolving Fund financing to fund the first phase of this very large capital expense. It is anticipated that borrowing will begin in the current fiscal year.

Golf and Tennis Operations Fund

The Golf and Tennis Operations Fund accounts for revenues and expenditures related to the two City-operated golf courses and the tennis center. FY 2014/15 was the third year of this Fund's operation, as starting July 1, 2012, recreation operations were moved into the General Fund and the golf and tennis operations formed a new enterprise fund. Revenues ended approximately \$55,000 over revised estimates and operations ended the year approximately as planned, only slightly over revised projections. As a result, the fund ended in a positive fiscal position, mainly as a result of better revenues and an unplanned mid-year \$140,000 transfer from the General Fund to keep the fund solvent. It is important to note that this fund continues to run a very tight fund balance. A transfer of \$450,000 from the General Fund is also budgeted for FY 2015/16 to keep the fund in a positive cash position. A proposed study issue to evaluate strategies for the golf course properties will be considered by Council in January 2016.

General Services Fund

The General Services Fund accounts for the expenditures associated with the internal services provided by the City to user departments such as fleet management, building maintenance, technology / communication services, and the print shop. These activities are funded by charging rental rates to the operating programs that use the services. Overall, the General Services Fund finished approximately \$1.6 million better than was projected in the FY 2015/16 Recommended Budget. Approximately \$1 million of this amount is attributable to information technology equipment that was budgeted for replacement, which the department deferred to future years. Fleet equipment and facilities equipment finished the year under budget, however these funds were committed to replace specific assets that were purchased but not received and therefore the funding will carryover into FY 2015/16. The largest operating programs in the fund are in the Public Works and Information Technology departments, and these programs finished under budget due to staffing vacancies.

Employee Benefits and Liability and Property Insurance Funds

These two internal service funds provide a mechanism to cover expenditures related to pension costs, insurance plans, workers' compensation costs, leave time, and liability and property insurance while applying the principles of full-cost accounting.

Collections to the Employee Benefits Fund to cover the cost of employee benefits come from the operating departments in the form of an "additive rate" that is charged to every hour an employee works. The Employee Benefits Fund ended FY 2014/15 approximately as estimated in the Recommended Budget with a total of \$17.2 million in reserves, compared with \$17.3 million planned. It should be noted that year-over-year variances in collections, either over-collections or under-collections, are expected, and annual rate adjustments take this into account. Further, reserves in this fund are set to accommodate these year-over-year fluctuations.

Due to the small number of claims paid out in FY 2014/15, the Liability and Property Insurance Fund coming in under budget by approximately \$400,000. Because there can be significant variances in claims expenses year-over-year, staff has budgeted the average with a sufficient reserve level to be drawn down and replenished on a year-to-year basis. The reserve was not drawn down in FY 2014/15.

Current Fiscal and Economic Environment

The positive year end results for FY 2014/15 provide good news and reflect the result of strong

leadership from Council, the good work of City staff, the long-term fiscal planning framework, and the continued strong economy. However, these results don't moderate the caution required as staff begins development of the FY 2016/17 Recommended Budget. The City is faced with balancing strong revenue growth in some stable categories (e.g. Property Tax) against revenues like development-related revenues, Sales Tax, Transient Occupancy Tax, and Real Property Transfer Tax, that can be highly volatile with significant fluctuations through economic cycles. As such, a thoughtful and disciplined approach to budgeting and spending against these elevated levels is necessary in order to ensure the City can continue to address many of its growing expenses and long term liabilities.

Providing stability to the City's position, Property Tax revenues continue to be steady through economic cycles and have shown healthy gains in the taxable base. The FY 2015/16 tax roll grew 11% over the prior year, the result of significant new construction activity in the commercial/industrial sector and a robust and active residential market. While staff included strong growth projections for the next several years, the FY 2015/16 roll growth is higher than estimated. Staff is analyzing the results and will be adjusting the long term revenue projections for the FY 2016/17 Recommended Budget. With elevated development activity continuing into the first quarter of FY 2015/16, staff anticipates continued growth in property tax revenue for the next few years.

Just as important as the City's revenue base, several expenditure pressures provide challenges to the General Fund. As the largest expense category, addressing personnel expenditure growth remains a priority. On the salary side, with the cooperation of the bargaining units, salary adjustments have largely aligned with budgetary assumptions to date. For the Public Safety units, where salary adjustments are based on a regional survey, the October 2015 survey resulted in a salary increase of just over three percent, which is slightly over what was anticipated. Moderating salary growth has been beneficial to keeping the General Fund balanced, but builds pressure for higher salary adjustments in the future. With several labor contracts currently open for negotiation, salary adjustments will be a key component of the discussion.

In addition to salary, a significant area of rising personnel costs continues to be the cost of benefits. The largest expenditure in this area is for pension benefits. The City, working together with bargaining units, has taken several actions to control the growth of pension costs. However, even with the implementation of reduced benefit second and third tier pension plans for new employees and the additional pick up of employee contribution rates by employees, pension costs continue to rise sharply. Currently, the City is projected to pay \$30.1 million for pensions to CalPERS. That is anticipated to increase to \$40 million within 10 years, more than a 30 percent increase in cost. Approximately half of the City's pension cost is payment on the unfunded liability. The City's two plans (Safety and Miscellaneous) are both 70 percent funded, with a total unfunded liability of \$268 million as of June 30, 2013. In addition, due to CalPERS' changes in its amortization and rate smoothing policies, increased short term volatility in the City's employer payment for pensions is adding another layer of challenges. As such, the City has set aside increased funding in the Employee Benefits Fund and made additional payments to CalPERS. However, pressure on rates continues. CalPERS has recently approved a plan to lower its assumed rate of return from 7.5% to 6.5% over an extended period of time, which will result in an increase to employer contribution rates. With these continued challenges, it is critical that the City continue to make progress in controlling its salary and pension costs. As such, a budget modification is proposed to appropriate \$1.4 million from the General Fund's Budget Stabilization Fund to make an additional payment to CalPERS to pay down the unfunded liability.

The City is also experiencing pressures from increasing demand for services including:

- Development Related Demands - the current level of development also brings with it a demand for services including safety, parks and open space, traffic management, utilities and more. The City has begun to address these demands with funding for additional staff. As demands continue to pressure our existing assets, staff will continue to look to strategically add resources where appropriate.
- Environmental and Regulatory Demands - increasing regulations in storm water management, pressure from the drought, and efforts to reduce greenhouse gas emissions through the implementation of the Climate Action Plan impact costs and resources in many ways across both the General Fund and the Utility Funds.
- Demands from aging infrastructure - the City's aging administrative, parks, and utility infrastructure require resources to renovate and bring up to today's standards. In the current bidding climate, costs for repairs of infrastructure are rising due to competition for work. For the FY 2015/16 Budget, staff adjusted many of the City's planned capital and infrastructure projects for current market conditions.

To the extent possible, all of these pressures, while manageable, should be taken in context together through the City's budget process. Balancing priorities will be a critical piece of the budget going forward to ensure continued balance and fiscal sustainability.

All revenue sources will be evaluated over the next several months to update current year estimates and develop projections for each year of the twenty-year plan. Setting the right revenue baseline will be a significant factor in determining the City's capacity to meet the increasing demands on our services.

A mid-year financial update and more detail on the factors affecting the City's fiscal environment and development of the recommended budget will be presented at the Study and Budget Issues Workshop at the end of January.

In summary, the City is in a solid position financially based on past efforts made to restructure itself to operate more efficiently and better contain costs. The City is also benefitting from an accelerated economic recovery that drove revenues higher than expected. While vulnerabilities exist, the City is in a positive and stable position and is well situated to meet the future head on. The challenges facing the City are opportunities that the City Council, workforce and community are well poised to resolve in the best interest of Sunnyvale.

Comprehensive Annual Financial Report

City Charter Section 1318 requires that "At the end of each fiscal year, a final audit and report shall be submitted by [a Certified Public Accountant] to the City Council." The City's Comprehensive Annual Financial Report (CAFR) is prepared annually to meet this requirement and is submitted to Council as Attachment 3 to this report.

The CAFR, which is prepared in the format prescribed by the Governmental Accounting Standards Board (GASB), contains several major sections. The Financial Section contains the Management's

Discussion and Analysis, the Basic Financial Statements, Required Supplementary Information, and Supplementary Information. All information in the Financial Section has been audited. The CAFR also contains a Statistical Section, which provides additional financial information not subject to audit.

FY 2014/15 Audit

The City's independent audit was performed by the firm of Macias Gini & O'Connell (MGO) who rendered an unmodified opinion on the City's CAFR. Receiving an unmodified opinion is the optimal result from the independent audit. In addition to the opinion on the CAFR, the independent auditors also issue a Report to the City Council. It contains their findings including any material weaknesses or significant issues found during the audit. The audit found no material weaknesses or significant issues. The report is provided as Attachment 2.

Effective this reporting year, the City became subject to the provisions within Governmental Accounting Standards Board Statement (GASB) No. 68, Accounting and Financial Reporting for Pensions and related GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date. These rulings significantly change how governments measure and report the long-term obligations and annual costs associated with pension benefits provided. The existing long-term liability was previously not specifically required to be quantified and included into the City's financial statements but was provided as part of the *Notes to the Basic Financial Statements* section of the CAFR. The net pension liability, representing unfunded pension obligations, is now a new liability on the statement of net position. This newly reported liability for fiscal year 2015 reflecting the cumulative effect of implementing GASB No. 68 and GASB Statement No. 71 appears as a Net Pension Liability line item with a value of \$255.5 million. It is important to note that the City, like most other local agencies, has had a significant unfunded pension liability for several years and the reporting of this liability does not change the City's financial position. Additionally, through the City's long term financial planning process, Sunnyvale began to address the liability several years ago, with higher than required contributions to CalPERS and funding of a pension reserve that will continue to address the liability into the future.

Administrative Budget Modifications

Administrative budget modifications, which are listed below, are a set of specific budget modifications that do not need to be approved and appropriated by City Council. Council Policy 7.1.5 was modified in FY 2014/15 so that the City Manager may appropriate grants up to \$100,000 (level amended March 24, 2015 from \$5,000 to \$100,000) that are also free of local match requirements and do not obligate the City to ongoing expenses not already planned in the City's Resource Allocation Plan. The following table reports out to Council the Administrative Budget Modifications approved by the City Manager in FY 2014/15.

Admin Budget #	Title	Fund Name	Fund #	Amount
1	Administrative Budget Modification No. 5 to appropriate \$7,000 of Grant Funding from the Santa Clara County funded Emergency Medical Services Trust Fund	General Fund - Grant	35/100	\$ 7,000
2	Administrative Budget Modification No. 6 to appropriate \$95,000 of Grant Funding from the Santa Clara County Public Health Department Partnership to Increase Public Health (PICH)	General Fund - Grant	35/100	\$ 95,000

FISCAL IMPACT

The fiscal impact of each fund's results is discussed in detail in the body of this report. As discussed, the General Fund finished FY 2014/15 \$7.4 million more favorable than expected. This is positive news as the General Fund faces many pressures on both the revenue and expenditure side in the next several years. To help address one significant pressure, staff is proposing to appropriate \$1.4 million from the Budget Stabilization Fund to pay down the City's unfunded pension liability. As the City has begun development of the FY 2016/17 Recommended Budget, staff is facing increasing demands for service in many areas, as discuss earlier in this report. Therefore, staff recommends keeping the remaining \$6 million in the Budget Stabilization Fund pending the development of the FY 2016/17 Recommended Budget.

In addition to the modifications mentioned above, this report also addresses one clean up item from FY 2014/15. To better organize the City's Payroll and Human Resources functions, the Department of Finance is transferring the budget for one Payroll Technician III to the Human Resources Department to add one Human Resources Analyst to the department's benefits division. Budget Modification No. 18 has been prepared to re-appropriate the funding between the two departments. The Human Resources Analyst position is approximately \$27,000 more expensive than the Payroll Technician III, however the Human Resources Department Operating Budget can absorb the difference for the remainder of this fiscal year, with the full budget being included in FY 2016/17.

**BUDGET MODIFICATION NO. 18
FISCAL YEAR 2015/16**

	<u>Current</u>	<u>Increase (Decrease)</u>	<u>Revised</u>
General Fund			
<u>Expenditures</u>			
Department of Finance Operating Budget 706 – Accounting and Financial Services	\$1,645,235	(\$128,286)	\$1,516,949
Department of Human Resources Operating Budget 754 – Human Resources	\$4,291,399	\$128,286	\$4,419,685
Additional Contribution to CalPERS to reduce unfunded pension liability	\$0	\$1,400,000	\$1,400,000
<u>Reserves</u>			
Budget Stabilization Fund	\$54,017,364	(\$1,400,000)	\$52,617,364

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

ALTERNATIVES

1. Receive and file the budgetary Year-End Financial Report, the audited Comprehensive Annual Financial Report, the Report to the City Council issued by the independent auditors, and the Sunnyvale Financing Authority Financial Report.
2. Other action as determined by Council.

STAFF RECOMMENDATION

Alternative 1: Receive and file the budgetary Year-End Financial Report, the audited Comprehensive Annual Financial Report, the Report to the City Council issued by the independent auditors, and the Sunnyvale Financing Authority Financial Report.

Prepared by: Timothy J. Kirby, Assistant Director of Finance

Reviewed by: Grace K. Leung, Director, Finance

Reviewed by: Kent Steffens, Assistant City Manager

Approved by: Deanna J. Santana, City Manager

ATTACHMENTS

1. Schedule of Appropriations by Fund

2. Auditor's Report to the City Council
3. Comprehensive Annual Financial Report*
4. Sunnyvale Financing Authority Financial Report*

*Attachments 3 and 4 available at the City Website:
www.cafr.inSunnyvale.com