



City of Sunnyvale

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL AND SUNNYVALE FINANCING AUTHORITY

SUBJECT

Receive and File the FY 2015/16 Budgetary Year-End Financial Report, Comprehensive Annual Financial Report (CAFR) and Approve Budget Modification No. 21 and Sunnyvale Financing Authority Financial Report

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, 2016 and recommends approval of the FY 2016/2017 Budget Modification No. 21. In addition, the City's audited Comprehensive Annual Financial Report (CAFR) and Sunnyvale Financing Authority Financial Report for FY 2015/16 are being presented for Council and the Authority Board's information.

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.

Overall, the City's General Fund ended the year generally as planned in the estimated in the FY 2016/17 Adopted Budget. General Fund revenues finished the year with approximately \$4.04 million higher than anticipated. Property Tax, Transient Occupancy Tax, and Construction Tax revenues were also on target and slightly higher than estimated. Expenditures in the General Fund were below budgeted levels, with many departments ending under budget. After accounting for project carryovers, expenditures ended approximately \$1.55 million under what was anticipated in the FY 2016/17 Adopted Budget. Much of this was due to staffing vacancies in both the Department of Public Works and the Library and Community Services Department. As such, these savings are one-time and are eliminated once the vacancies are filled. Reserve savings based on actual expenditures totaled \$0.34 million. These actions have a positive impact of \$5.9 million to the Budget Stabilization Fund (approximately 1% of total General Fund revenues and expenses), increasing the projected balance for FY 2034/35 to approximately \$11 million. However, it is important to note that this only slows the draw on the Budget Stabilization Fund which is slated to drop from \$45 million to only \$11 million not adjusted for inflation over twenty years. This projection also does not take into account anticipated costs related to actions that CalPERS may take in February 2017 or additional costs relative to actuarial reviews underway on pensions and retiree healthcare.

In addition, several technical adjustments are recommended in this staff report. The return of funds to the General Fund that are no longer necessary from Budget Modification No. 10, which addressed remediation costs at the Onizuka site, due to these expenditures occurring in FY 2015/16 is recommended (\$203,719). An adjustment to correct an inadvertent error in the FY 2016/17 Adopted Budget related to the treatment of Public Safety recruitment project budget carryover resulted in \$1.6 million of additional funds. As detailed in the Fiscal Impact Section, staff recommends that with FY

2016/17 Budget Modification No. 21 a portion (\$1.3 million) of this amount is reallocated to the FY 2014/15 Recruitment and Training for Sworn Officers project to fully fund the completion of that academy class based on the most recent analysis of anticipated remaining project costs.

In total, \$6.4 million of additional funding is recommended to be allocated to the Budget Stabilization Fund through Budget Modification No. 21.

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 2016/17, the revenue anticipated for FY 2015/16 is revised at the same time based on the most recent information available. Staff also typically reviews General Fund operating expenditures to date and estimates expenditure savings for FY 2015/16 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

The action being considered does not constitute a "project" with the meaning of the California Environmental Quality Act ("CEQA") pursuant to CEQA Guidelines section 15378 (b) (4) in that it is a fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment.

DISCUSSION

Fiscal Year 2015/16 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 2015/16 are shown in the table below.

Table 1 - FY 2015/16 General Fund Revenue - Estimated vs. Actual

Description	Revised Budget	Actual Revenues With Grant Revenue Carryover	Variance Favorable (Unfavorable)	Percent Variance
Property Taxes	\$61,748,736	\$62,390,637	\$641,901	1.04%
Sales Taxes:				
Sales and Use Tax – City	30,352,481	31,356,775	1,004,294	3.31%
Sales and Use Tax - Public Safety	1,566,638	1,552,394	(14,244)	-0.91%
Total Sales Tax	31,919,119	32,909,169	990,050	3.10%
Other Taxes:				
Construction Tax	2,948,440	3,298,178	349,738	11.86%
Business License Tax	1,734,000	1,871,848	137,848	7.95%
Real Property Transfer Tax	1,911,527	1,971,841	60,314	3.16%
Total Other Taxes	6,593,967	7,141,867	547,900	8.31%
Transient Occupancy Tax	16,383,291	16,295,589	(87,702)	-0.54%
Utility Users Tax	6,809,616	6,900,881	91,265	1.34%
Franchises	7,011,274	7,056,709	45,435	0.65%
Rents & Concessions	2,426,454	2,464,256	37,802	1.56%
Federal & Intergovernmental Revenues	1,501,586	2,039,664	538,078	35.83%
State Revenues	564,479	567,379	2,900	0.51%
Permits & Licenses	1,247,915	1,296,765	48,850	3.91%
Fines & Forfeitures	942,261	1,257,930	315,669	33.50%
Service Fees:				
Community Development Fees	822,511	925,223	102,712	12.49%
Finance Fees	15,918	7,177	(8,741)	-54.91%
Library Fees	9,179	8,329	(850)	-9.26%
Public Safety Fees	1,450,015	1,542,734	92,719	6.39%
Public Works Fees	302,271	350,370	48,099	15.91%
Parks and Recreation Fees	3,188,384	3,329,490	141,106	4.43%
Total Service Fees	5,788,278	6,163,323	375,045	6.48%
Interest Income	873,650	765,901	(107,749)	-12.33%
Other Revenues:				
Sale of Property	14,000,000	13,928,317	(71,683)	0.00%
Interfund Revenues	6,272,017	6,272,017	0	0.00%
Miscellaneous Revenues	660,853	1,279,934	619,081	93.68%
Private Grants & Donations	0	127,445	127,445	0.00%
Total Other Revenues	20,932,870	21,607,713	674,843	3.22%
Transfers In/In Lieu Fees	11,052,214	10,975,550	(76,664)	-0.69%
Revenue Total	175,795,710	179,833,333	4,037,623	2.30%

Total General Fund revenue, including grant revenue carryover, exceeded revised FY 2015/16 estimates used to develop the FY 2016/17 Adopted Budget by \$4.0 million as detailed below. Comparing General Fund revenue from FY 2014/15 to FY 2015/16, actual receipts were up \$27.9 million (18.6%) from \$151.9 million to \$179.8 million. Approximately \$13.9 million of this growth is due to one-time revenue from the Sale of Property. Excluding the sale of property revenue, the total year-

over-year growth in General Fund revenue was \$14 million or 9.3% growth. The revenue sources with the largest year-over-year increases were the following revenue sources: Property Tax revenues increased \$7.4 million; Transient Occupancy Tax grew \$2.2 million; and, Sales Tax increased \$1.7 million.

Of the \$4.0 million positive revenue revised budget versus actual variance, the largest component, approximately \$1 million, is attributable to higher than anticipated sales tax revenue. While the sales tax result was positive in comparison with the budget, it should be noted that the City lowered projections with the FY 2016/17 Adopted Budget. Also, this revenue source has experienced significant volatility for many years. The second largest contributor to the positive variance was Property Taxes. Property Tax revenue exceeded estimates by an additional \$0.6 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. While the modest tax revenue growth speaks to the continued economic recovery in Santa Clara County, there is also reason for caution given that tax revenues fluctuate with economic cycles. This issue is discussed in more detail in the *Current Fiscal and Economic Environment* section of this staff report.

Final City Sales and Use Tax revenue for FY 2015/16 was approximately \$1.0 million over the estimate made in the FY 2016/17 Budget. Sales Tax revenue has been flat year-over-year since FY 2011/12. Despite the positive result, the overall trend for this revenue source is concerning: despite the regional economic recovery, sales tax revenue has been flat. 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 originally projected to climb to approximately \$33.5 million, or 7% above the FY 2014/15 result. However, after results for the first two quarters came in lower than anticipated, staff revised the revenue projection downward to \$31.9 million.

Property Tax revenue in FY 2015/16 came in approximately \$0.6 million better than revised projections assumed in the development of the FY 2016/17 Adopted Budget. Overall, Property Tax grew more than \$7.4 million, or 13.6%, over FY 2014/15 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 13.2%, due largely to new construction and change of ownership. Residential property values increased 8.2%. Because residential properties account for approximately 63% of the net assessed value on the Sunnyvale property tax roll, the residential growth has had a significant impact. The FY 2016/17 Budget projected that Property Tax revenue will increase again in FY 2016/17 by 1.6%. However, based on reports received from the County Assessor's office, it is likely that returns will exceed the original estimate. A revised projection will be included in the FY 2017/18 Recommended Budget.

Transient Occupancy Tax (TOT) revenue for FY 2015/16 was the highest year recorded for this revenue source. Actual returns, while below the projection made in the FY 2016/17 Budget by \$0.1 million, were up year-over-year by \$2.2 million. Business-related travel, which accounts for the large majority of hotel occupancy in Sunnyvale, remained very strong through FY 2015/16. Average room rates increased approximately 10% in FY 2015/16 and occupancy levels were sustained at a record-highs for Sunnyvale. Since the tax rate was changed to 10.5% on January 1, 2014, the City has averaged \$1.3 million in TOT revenue each month. The General Fund long term financial plan reflects the addition of three new hotels in the City and two hotel renovations, which will further

strengthen the TOT tax base. However, it is important to note that historically, TOT revenue has been extremely volatile with substantial declines in periods of economic recession.

Other Taxes finished the year \$465,000 higher than FY 2014/15 and \$548,000 above projection. Construction Tax experienced its highest year on record, exceeding the estimate by \$350,000. While the majority of development related revenues are accounted for in the Development Enterprise Fund, Construction Tax revenue remains in the General Fund because it is a general tax. Real Property Transfer Tax revenues exceeded projections by more than \$60,000. 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 sustained strength in the Sunnyvale real estate market. Median home prices (single and multi-family) increased 10% in FY 2015/16, from \$1.06 million to \$1.17 million. Actual sales increased 9.7% to 1,086 over the fiscal year. Business License Tax revenue was higher than projections by over \$137,000 as the result of staff's audit efforts and increased business activity.

Utility Users Tax (UUT) revenue for FY 2015/16 came in slightly above (\$91,000) planned in the FY 2016/17 Recommended Budget, and was up by approximately \$127,000 compared to FY 2014/15 revenues. Despite the increase, 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). In November 2016, Sunnyvale residents approved ballot Measure N to address this issue by modernizing the City's UUT ordinance. Staff will monitor the progress of actual collections and, if necessary, revise the revenue projection for UUT as part of the FY 2017/18 Recommended Budget.

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, Finance Fees, and Interest Income.

Federal and Intergovernmental revenues fund specific projects and are 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. The assumption of the receipt of these revenues is assumed as part of the figures in Table 1. State Revenue was below projections by over \$69,000 due to the lower than anticipated receipt of state mandated cost reimbursements (SB90 program). Income ended the year lower than projection by over \$107,000 due to lower than anticipated interest earnings. However, the \$765,000 collected is an increase from the prior year by \$97,000. Finally, the Table 1 also 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, 2016 are shown in the following table.

**Table 2 - FY 2015/2016 General Fund Expenditures and Transfers -
Estimated vs. Actual**

Description	Revised Budget *	Actual Expenditures	Variance Favorable (Unfavorable)	Percent Variance
Equipment	787,274	426,948	360,326	45.77 %
Operations	135,414,132	133,858,796	1,555,336	1.15 %
Projects **	20,906,814	15,547,198	5,359,616	25.64 %
Transfers	31,889,275	20,125,604	11,763,671	36.89 %
Expenditures Subtotal	188,997,495	169,958,546	19,038,949	10.07 %
CAFR adjustment	-	80,476	(80,476)	0.00%
Total Expenditures	188,997,495	170,039,022	18,958,473	10.03 %
Equipment Carryovers	-	360,326	(360,326)	0.00%
Project Carryovers	-	5,093,998	(5,093,998)	0.00%
Deferred Transfers	-	11,948,584	(11,948,584)	0.00%
Total Carryovers	-	17,402,908	(17,402,908)	0.00 %
	-	-	-	
Expenditures Grand Total	188,997,495	187,441,930	1,555,565	0.82 %

* Includes Recommended Budget amounts plus Budget Modifications

** Reflects correction to Adopted Budget General Fund Financial Plan
for Public Safety Recruitment Projects

The details of FY 2015/16 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 budget amounts for each fund including mid-year budget modifications. 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.

Year-end expenditures are lower than planned, primarily the result of operating savings in two departments, Public Works and Library and Community Services. In the Department of Public Works (DPW), the \$540,000 favorable variance is due to savings in the Street Tree Services and Neighborhood Parks and Open Space Management programs. The Street Trees program was under budget as a result of funds not spent on a tree contract that began in FY 2016/17. The Parks program achieved savings through reductions to purchased water. A portion of the savings in these programs was offset by higher than anticipated costs for Transportation and Traffic Services due to a high level of emergency repair work required, and Street Light Services, which was due to the cost of electricity exceeding planned levels. Library and Community Services (LCS) came in approximately \$476,000

under budget. These savings were 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. Approximately \$17.4 million is being carried forward to FY 2016/17 to cover expenditures related to projects. This amount consists of \$5.5 million in General Fund projects, which includes \$1.5 million for the Public Safety recruitment projects, \$462,000 for the Comprehensive Update of the Precise Plan for El Camino Real, and an assortment of smaller projects. In addition to the \$5.5 million for General Fund projects, \$11.9 million transfers to other funds are carried forward for project expenses. Of that amount, \$8.5 million is budgeted to transfer to the Infrastructure Fund (primarily to fund the Pavement Rehabilitation and LED Streetlights projects), and \$3.3 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 \$1.5 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 is \$5.9 million more favorable to the City in comparison to the results assumed for the development of the FY 2016/17 Adopted Budget, as detailed in Table 3. When accounting for several additional technical corrections and the recommended actions included in Budget Modification No. 21, a net \$6.4 million is recommended to be added to the Budget Stabilization Fund, detailed further in Table 4. While these results positively impact the Budget Stabilization Fund, it is important to note that this only slows the pace of the City's need to draw from the Budget Stabilization Fund balance to meet future anticipated needs. The projected balance at the end of the 20-Year Financial Plan is anticipated to total approximately \$11 million without any adjustments for future inflation. These results will be reflected in the development of the FY 2017/18 Recommended Budget. It is anticipated that these savings will only partially offset changes in projected expenditures (e.g., higher costs for service, Council priorities, and healthcare and pension costs).

Table 3 - FY 2015/16 General Fund Financial Position Year End Results

	Revised Budget	Actual Results	Variance Favorable (Unfavorable)
Beginning Balance	\$ 112,566,377	\$ 112,566,377	\$ -
Revenues and Transfers In	175,795,710	179,833,333	4,037,623
Total Revenues	175,795,710	179,833,333	4,037,623
<u>Expenditures</u>			
Expenditures and Transfers Out	188,997,495	187,441,930	1,555,565
Total Expenditures	188,997,495	187,441,930	1,555,565
<u>Reserves</u>			
Contingencies	20,312,120	20,081,497	(230,623)
Capital Improvement	22,809,268	22,726,502	(82,766)
Budget Stabilization Fund	56,243,204*	62,149,781	5,906,577*

* The FY 2015/16 Budget Stabilization Fund assumed in the FY 2016/17 Adopted Budget totaled \$54,631,955. This figure has been revised to account for an inadvertent technical error in the FY 2016/17 Adopted Budget related to the treatment of Public Safety recruitment project budget carryover.

The plan in the FY 2016/17 Adopted Budget was to add approximately \$0.6 million to the FY 2015/16 Budget Stabilization Fund. The General Fund did outperform the plan, with positive results on revenues, expenditures and reserves that contributed an additional \$5.9 million to the General Fund Budget Stabilization Fund. Several technical corrections are included also in this report. The FY 2016/17 Adopted Budget included a technical error regarding the treatment of Public Safety Recruitment Projects carryover (\$1.6 million) that resulted in an additional Budget Stabilization Fund allocation. A portion of these funds are recommended to be allocated to the Public Safety FY 2014/15 Recruitment project (\$1.3 million) based on the most recent evaluation of the anticipated costs needed to complete that academy class resulting in a \$0.3 million increase to the Budget Stabilization Fund. Budget Modification No. 10 (16-0831) allocated \$203,719 to fund Onizuka Demolition Costs. Subsequent to the approval of the budget modification, it has been determined that the funding provided for Onizuka Demolition Costs were charged to FY2015/16 and those funds are no longer needed in FY 2016/17. As part of this document, it is recommended that \$203,719 allocated in Budget Modification No. 10 be allocated back to the Budget Stabilization Fund. The actual increase to the Budget Stabilization Fund after accounting for these technical actions and recommendations is \$6.4 million above what was assumed in the Adopted Budget.

The details in the Table 4 summarize the impact on the Budget Stabilization Fund

Table 4 – Summary Impact on Budget Stabilization Fund

FY 2015/16 Additional Budget Stabilization Reserve:	
Higher than Anticipated Revenue	\$4,037,623
Expenditure Savings	1,555,565
Planned Contribution to Reserves	313,389
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Additional Budget Stabilization Funds from FY 2015/16 Actual Performance	\$5,906,577
Technical Corrections and Recommended Actions:	
Public Safety Recruitment Projects Carryover Correction	1,611,249
Return of funds from Budget Modification No. 10	203,719
Recommended Funding for Project 826300 – FY 2014/15 Recruitment and Training for Sworn Officers	(1,300,000)
	<hr/>
Net Additional Funds for Budget Stabilization Fund	\$514,968
Total Additional Funds for Budget Stabilization Fund (Budget Modification No. 21)	\$6,421,545

It should be cautioned, the General Fund long term financial plan does anticipate drawing down this reserve in future years. The planned draw-downs are due to a continued imbalance between revenues and expenditures, where expenditure growth, primarily in personnel costs, continue to outpace revenue growth.

While the positive results put the General Fund in an improved financial 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, Capital Projects, and Infrastructure Funds

The Park Dedication, 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 \$44.4 million, of which most is being carried forward to be spent in FY 2016/17. 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, and the Mathilda/237/101 Interchange Improvements Study.

In the Infrastructure Fund, there was \$24.5 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 be spent significantly in the current fiscal year. Part of the \$24.5 million includes carryover funding for Community Center Comprehensive Infrastructure (\$4.5 million), Pavement Rehabilitation (\$3.6 million), Park Buildings Rehabilitation (\$2.4 million), and LED Streetlights Conversion Program project (\$2.3 million).

Ongoing projects funded by Park Dedication Fee revenues had unspent funds of approximately \$13.4 million, \$13.0 million of which is being carried forward to be spent in FY 2016/17. The remainder is primarily associated with the Lakewood Park Renovation project which has been deferred. The majority of the carryover funding is for the transfer of funds to the Infrastructure Fund primarily for the rehabilitation of infrastructure at the Community Center, funding for park buildings rehabilitation, and playground equipment replacement. Revenues in the Park Dedication Fund came in approximately \$50,000 more than planned at \$23.05 million, the highest year in the City's history. It is also important to note that a major update to the capital improvement plan for park and recreation facilities will be included with the FY 2017/18 Budget. Project scopes will be further 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 2015/16 this reserve will have a balance of \$9.4 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 2015/16 was another record-breaking year (the fifth consecutive) for development activity in Sunnyvale, causing both CDD and DPW operating programs to continue to exceed budget, given the high demand for service. Nevertheless, total operating expenses in the Development Enterprise Fund finished approximately \$97,000 better than the revised estimate. Actual revenue exceeded the planned amount by \$2.6 million. The net fiscal impact to the fund was an increase in the Development Enterprise Reserve of \$2.7 million.

Water Supply and Distribution Fund

The Water Supply and Distribution Fund accounts for the operations of the City's water system. This fund receives the majority of its revenue from user fees collected from the City's water rate payers. During the FY 2016/17 rate setting process, staff revised revenue estimates in this fund 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. While total water revenues increased 8% from FY 2014/15 to FY 2015/16, total revenue to the fund ended the year lower than estimated by approximately \$368,000. A shortfall in water sales revenue accounted for the majority of this variance.

After accounting for unspent project funds, total expenses ended approximately \$4.1 million less than planned primarily due to savings in personnel and water purchase costs. When compared to the assumptions used to develop the FY 2016/17 Adopted Budget, the total fund ended the year approximately \$2.8 million better than planned. Staff continues to watch the position of this fund carefully as fiscal year-to-date water 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 2015/16 approximately \$1.2 million better than budgeted. Expenses came in under budget by \$537,000, attributed by various lower than estimated operational savings. When comparing to the assumptions used to develop the FY 2016/17 Adopted Budget, reserve balance for this fund matched planned total.

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 \$20,000 more than planned resulting from completion of Structural Stormwater BMPs project under budgeted costs. Revenues and expenses came in-line as projected. 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 \$339,000 lower than projections. 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; which is consistent with prior year. FY 2015/16 Wastewater Management Fund total expenses, after accounting for unspent project funds, ended approximately \$1.3 million lower than expected. The Wastewater Collection Systems operating program exceeded budget, primarily due to unplanned equipment repairs and maintenance expenses related to an increasing number of pipe failures. Overall fund position remains in good fiscal condition ending approximately as planned. 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). 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 2015/16 was the fourth 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 \$18,000 over revised projections and operations ended the year approximately \$40,000 better than revised estimate. The fund ended in a positive fiscal position, mainly as a result of the planned \$450,000 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. Another transfer of \$550,000 from the General Fund is budgeted for FY 2016/17 to keep the fund in a positive cash position while conducting further analysis and study of long-term strategies for the golf courses.

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 \$0.8 million better than was projected in the FY 2016/17 Adopted Budget. Approximately \$750,000 of this amount is attributable to operating savings in the Department of Public Works. Fleet operations finished the year under budget due to lower than estimated fuel prices.

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 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 2015/16 with reserves of \$17.3 million, approximately \$1.8 million worse than \$19.9 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 2015/16, the Liability and Property Insurance Fund coming in under budget by approximately \$340,000. 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 2015/16; it increased more than planned.

Current Fiscal and Economic Environment

The year end results for FY 2015/16 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 2017/18 Recommended Budget. The City is faced with balancing 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 revenues at the peak of an economic cycle 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 2016/17 tax roll grew 9.5% over the prior year, the result of significant new construction activity in the commercial/industrial sector and the continuation of a robust residential market. Staff included growth projections for the next several years in the adopted budget that reflect stronger than average growth. However, the FY 2016/17 roll growth is 3 percentage points higher than the originally estimated 6.5% growth included in the budget. This is the fourth consecutive year in which the property tax roll growth has exceeded 7%. Staff is analyzing the FY 2016/17 results and will be adjusting the long term revenue projections for the FY 2017/18 Recommended Budget.

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. With the cooperation and leadership of many of the bargaining units, the City has continued to be able to maintain a sustainable long term cost for total compensation. Negotiations with the Sunnyvale Employee Association, the City's largest bargaining unit, are ongoing. For the Public Safety units, where salary adjustments are based on a regional survey, the August 2016 survey resulted in a salary increase of just over one percent, which is under the 3 percent included in the budget. Moderating growth in total compensation has been beneficial to keeping the General Fund balanced. However, caution is warranted as a twenty year review of the history of the Public Safety salary survey shows higher salary increases following low years for an annual average increase of approximately 4 percent per year.

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, pension costs continue to rise sharply. Currently, the City is projected to pay \$32.6 million for pensions to CalPERS. That is anticipated to increase to \$55.8 million within 10 years, more than a 70 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 approximately 75% funded, as of the June 2014 valuation. In addition, due to CalPERS' changes in its amortization and rate smoothing policies has increased short term volatility in the City's employer payment for pensions, presenting further challenges. As such, the City is carefully evaluating how best to address year over year volatility in payments. Further, CalPERS has 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. More recently, CalPERS has been considering accelerating this change in the assumed rate of return. With these many pressures, it is critical that the City continue to make progress in managing

costs for total compensation while balancing the needs of our employees and community.

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

- Development Related Demands - the current high 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. However, the additional resources are modest and only begin to address the gap between workload and staff capacity. 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 2017/18 Budget, staff will adjust 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 enters Fiscal Year 2016/17 in a solid position financially based on past efforts made to operate more efficiently and better contain costs. It has also benefitted from an ongoing economic recovery that is driving revenues higher than expected. While vulnerabilities exist, some within the City's control and some not, the City believes it has taken, and will continue to take, the actions necessary to maintain its solid financial foundation. 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 the Independent Auditor's Report, Management's Discussion and Analysis, Basic Financial Statements with Notes and Required Supplementary Information, Supplementary Information, and the Statistical Section.

Sunnyvale Financing Authority Report

The Joint Exercise of Powers Agreement Creating the Sunnyvale Financing Authority by and between the City of Sunnyvale and the former Redevelopment Agency of the City of Sunnyvale requires that "the Controller of the Authority shall either make, or contract with a certified public accountant or public accountant to make, an annual audit of the accounts and records of the Authority...a report thereof shall be filed as a public record with each of the Member Agencies." The Sunnyvale Financing Authority Report is prepared annually to meet this requirement and is submitted to Council as Attachment 4 to this report.

The Sunnyvale Financing Authority Report, which is prepared in the format prescribed by the Governmental Accounting Standards Board (GASB), contains the Independent Auditor's Report, Management's Discussion and Analysis, Basic Financial Statements, and the Notes to Basic Financial Statements.

FY 2015/16 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 with the FY 2014/15 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 changed 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 presented as a liability on the statement of net position. This liability reflects the cumulative effect of implementing GASB No. 68 and GASB Statement No. 71, and appears as a Net Pension Liability line item with a value of \$274.2 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 publicly approved and appropriated by City Council To aid City Council and administration efficiency, Council Policy 7.1.5 was modified in FY 2015/16 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 2015/16.

Admin Budget #	Title	Fund Name	Fund #	Amount
1	Approve Administrative Budget Modification No. 1 to Appropriate \$5,000 of Library Services and Technology Grant Funds for Pass It On: An Intergenerational Sewing Project	General Fund - Grant	35/100	\$ 5,000
2	Approve Administrative Budget Modification No. 2 to Appropriate \$24,194 of Department of Homeland Security, State Homeland Security Grant Program Funds for FY2015 SHSGP Urban Shield	General Fund - Grant	35/100	\$ 24,194
3	Approve Administrative Budget Modification No. 3 to Appropriate \$20,000 of Pacific Gas & Electric Company (PG&E) Funds in Support of Sunnyvale's Georgetown University Energy Prize Challenge Efforts	General Fund - Grant	35/100	\$ 20,000
4	Approve Administrative Budget Modification No. 4 to Appropriate \$40,000 of Santa Clara County Department of Public Health PIPH Grant Funds for planning and implementation of the Tobacco-free Environment Initiative.	General Fund - Grant	35/100	\$ 40,000
6	Approve Administrative Budget Modification No. 6 to Appropriate \$18,000 of Sourcewise Grant Funds for Care Management Services	General Fund - Grant	35/100	\$ 18,000

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 2015/16 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. Staff recommends keeping the additional funds, detailed in Table 4, in the Budget Stabilization Fund pending the development of the FY 2017/18 Recommended Budget.

Budget Modification No. 21 has been prepared to appropriate additional funding to FY to the Budget Stabilization Fund

	Budget Modification No. 21		
	FY 2016/17		
	Current	Increase/ (Decrease)	Revised
General Fund			
<u>Reserves</u>			
Budget Stabilization Fund	\$43,842,476	\$6,421,545	\$50,264,021
<u>Expenditures</u>			
Project 826300 - FY 2014/15	\$750,000	\$1,300,000	\$2,050,000
Recruitment and Training for Sworn Officers			

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

City Council:

1. Receive and file the budgetary Year-End Financial Report, the audited Comprehensive Annual Financial Report, and the Report to the City Council issued by the independent auditors and Approve Budget Modification No. 21.
2. Other action as determined by Council.

Sunnyvale Financing Authority:

1. Receive and file the Sunnyvale Financing Authority Financial Report.
2. Other action as determined by the Authority Board.

STAFF RECOMMENDATION

City Council:

Alternative 1: Receive and file the budgetary Year-End Financial Report, the audited Comprehensive Annual Financial Report, and the Report to the City Council issued by the independent auditors and Approve Budget Modification No. 21.

Sunnyvale Financing Authority:

Alternative 1: Receive and file the Sunnyvale Financing Authority Financial Report.

Prepared by: Kenn Lee, Assistant Director of Finance

Reviewed by: Timothy J. Kirby, Director of Finance
Reviewed by: Walter C. Rossmann, 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 web site:
www.cafr.inSunnyvale.com