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REPORT TO COUNCIL AND SUNNYVALE FINANCING AUTHORITY

SUBJECT

Receive and File the FY 2017/18 Budgetary Year-End Financial Report, Comprehensive Annual Financial Report (CAFR), the Sunnyvale Financing Authority Financial Report, the Report to the City Council Issued by the Independent Auditors, and Approve Budget Modification No. 13 and the list of Proposed Closed Projects

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, 2018 and recommends approval of Budget Modification No. 13. In addition, the City's audited Comprehensive Annual Financial Report (CAFR) and Sunnyvale Financing Authority Financial Report for FY 2017/18 are being presented for Council and the Authority Board's information.

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

Overall, the General Fund ended the FY 2017/18 year in a much better fiscal position than expected. General Fund revenues finished the year approximately \$7.0 million to the good. Higher than planned Transient Occupancy Tax, Property Tax, Sales Tax, Community Development Fees and Public Safety Fees represented the largest positive variances. Real Property Transfer Tax and Construction Tax performed below projections. General Fund expenditures ended the year approximately \$7.1 million below budgeted levels primarily due to vacancy savings in the Departments of Public Safety and Library and Community Services.

A budgetary summary of the Sunnyvale Financing Authority is also included in this report as is a summary of approved Administrative Budget Modifications made in FY 2017/18 and a list of six projects staff is recommending as no longer needed.

Adjustments to General Fund revenue, Capital Improvement Projects Reserve and the Budget Stabilization Fund are recommended through Budget Modification No. 13. Additionally, due to the favorable position, staff is recommending appropriation of \$1.0 million to the Pension Trust Fund, \$1.0 million to the OPEB Trust fund, an additional payment to CalPERS of \$2.0 million (\$1.0 million each to pay down the miscellaneous and safety unfunded liabilities), and an appropriation of \$2.0 million to the Capital Improvement Projects Reserve to fund future improvements. \$5.7 million will be returned to the General Fund Budget Stabilization Fund.

BACKGROUND

Each year, staff provides a report to the Council detailing the year-end financial condition of the City on a budgetary basis. The results are compared with the most recent projection. As part of development of the FY 2018/19 Recommended Budget, the revenue projections for FY 2017/18 are updated in the February to March timeframe. Staff also reviews General Fund operating expenditures to date and estimates expenditure savings for FY 2017/18 in the General Fund twenty-year financial plan, if applicable, to provide the best estimate for the financial position of the fund. For FY 2017/18, staff assumed \$3.0 million in expenditure savings. The Budget Modification included in the year-end budgetary report reconciles the Budget Stabilization Fund and Capital Improvement Projects Reserve positions based on actual FY 2017/18 performance compared to the level estimated in the development of the FY 2018/19 Budget.

Additionally, each year, staff coordinates and facilitates completion of the annual audit with the independent auditor. For the annual audit process, staff prepare a number of audit schedules and responds to audit queries while the auditor examines the City's financial transactions and reviews records. The independent auditor conducts the audit, according to the auditing standards generally accepted in the United States of America and the Governmental Auditing Standards issued by the Comptroller General of the United States. Along with completion of the audit, each year, staff prepares the City's CAFR and Sunnyvale Financing Authority Financial Report, which includes the auditor's opinion and audited financial statements.

EXISTING POLICY

City Charter Article XIII Fiscal Administration Section 1305 - Budget Appropriations: All appropriations shall lapse at the end of the fiscal year to the extent that they shall not have been expended or lawfully encumbered. However approved appropriations for Capital Improvement Projects shall not lapse at the end of the fiscal year unless the Capital Improvement Project has been completed and closed out or the City Council takes affirmative action to modify the budget appropriation for the Capital Improvement Project).

At any meeting after the adoption of the budget, the City Council may amend or supplement the budget by motion adopted by affirmative votes of at least four members so as to authorize the transfer of unused balances appropriated for one purpose to another, or to appropriate available revenue not included in the budget.

City Charter Article XIII Fiscal Administration Section 1318 - Independent Audit, requires that an independent audit be conducted of the City's financial transactions at the end of each fiscal year. A final audit and report shall be submitted by a Certified Public Accountant to the City Council.

City Council Resolution No. 878-18 Section 5: All appropriations shall lapse at the end of the fiscal year to the extent that they shall not have been expended or lawfully encumbered. Pursuant to Sunnyvale City Charter section 1305 approved appropriations for Capital Improvement Projects shall not lapse at the end of the fiscal year unless the Capital Improvement Project has been completed and closed out or the City Council takes affirmative action to modify the budget appropriation for the Capital Improvement Project. Unobligated Special Project appropriations in existence on June 30, 2018 shall carryover into FY 2018/19. The City Council shall be provided a complete listing of Special Project funds carried over in the FY 2017/18 Budgetary Year-End Report for City Council approval no later than December 31, 2018.

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

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 2017/18 Year-End Financial Update

Staff has reviewed the City’s year-end financial results. The following is an analysis of the changes between the final budgetary amounts with the actual year end results.

General Fund

Revenues

General Fund revenues results for FY 2017/18 are shown in Table 1.

Table 1 - FY 2017/2018 General Fund Revenue and Transfers In
Final Budget vs. Actual

Description	Final Budget*	Actual Revenue	Variance Favorable (Unfavorable)	Percent Variance
Property Taxes	\$ 73,799,066	\$ 74,349,897	\$ 550,830	0.8%
Sales Taxes:				
Sales and Use Tax - City	30,244,896	31,314,096	1,069,200	3.5%
Sales and Use Tax - Public Safety	1,546,134	1,697,043	150,909	9.8%
Total Sales Tax	31,791,030	33,011,138	1,220,108	3.8%
Other Taxes:				
Construction Tax	5,039,241	4,960,540	(78,701)	(1.6%)
Business License Tax	1,804,053	1,837,527	33,474	1.9%
Real Property Transfer Tax	2,500,701	2,075,141	(425,560)	(17.0%)
Total Other Taxes	9,343,995	8,873,208	(470,787)	(5.0%)
Transient Occupancy Tax	16,294,653	17,741,915	1,447,262	8.9%
Utility Users Tax	8,207,302	7,854,383	(352,918)	(4.3%)
Franchises	7,181,772	7,160,176	(21,596)	(0.3%)
Rents & Concessions	2,652,442	2,676,784	24,342	0.9%
Federal & Intergovernmental Revenues	517,714	626,148	108,434	20.9%
State Revenues	418,037	443,435	25,398	6.1%
Permits & Licenses	1,463,346	1,698,986	235,640	16.1%
Fines & Forfeitures	1,014,070	1,098,226	84,156	8.3%
Service Fees:				
Community Development Fees	1,215,670	1,481,016	265,346	21.8%
Library Fees	3,000	4,079	1,079	36.0%
Public Safety Fees	1,349,116	1,764,929	415,813	30.8%
Public Works Fees	400,431	208,622	(191,809)	(47.9%)
Parks and Recreation Fees	3,288,905	3,577,513	288,608	8.8%
Total Service Fees	6,257,122	7,036,159	779,037	12.5%
Interest Income	1,438,635	2,109,607	670,971	46.6%
Other Revenues:				
Sale of Property	21,000,000	21,010,581	10,581	0.1%
Interfund Revenues	5,731,407	6,676,174	944,767	16.5%
Miscellaneous Revenues	2,528,708	3,086,227	557,518	22.1%
Private Grants & Donations	9,400	154,774	145,374	0.0%
Total Other Revenues	29,269,516	30,927,756	1,658,240	5.7%
Transfers In/In Lieu Fees	13,859,677	13,720,616	(139,061)	(1.0%)
	203,508,377	209,328,434	5,820,057	2.9%
Revenue Carryover	-	1,208,037	(1,208,037)	-
Revenue Total	203,508,377	210,536,471	7,028,094	3.5%
Revenue Total (Excluding Sale of Property)	182,508,377	189,525,889	7,017,512	3.9%

* Final Budget includes budget modifications that occurred after adoption of the FY 2018/19 Budget

Total General Fund revenue, including grant revenue carryover, ended above the updated estimate for the 2017/18 fiscal year in the FY 2018/19 Adopted Budget by \$7.0 million.

Comparison with Prior Year

Overall, General Fund revenue was up by \$40.3 million (23.6%) from actual FY 2016/17 revenue of \$170.3 million. The increase is primarily due to one-time revenue from the Sale of Property (\$21.0 million) that was received this year. Excluding the sale of property revenue, the total year-over-year

growth in General Fund revenue was \$19.2 million for 11.3 % growth, largely driven by strong property taxes with a \$7.7 million or 11.6% increase from the prior year. Sales Tax was up by \$2.0 million compared to FY 2016/17 due to revenue from a major tax payer being remitted to the City rather than the County Pool as previously anticipated. In addition to Property Tax and Sales Tax, the largest year-over-year General Fund revenue increases were: Transient Occupancy Tax with a \$1.2 million increase and Miscellaneous Revenue with a \$2.5 million increase, \$1.7 million of which is from the payoff of two executive mortgages. Other Taxes, which includes Construction Tax, Business License Tax, and Real Property Transfer Tax was 6.8% (\$0.6 million) more than the year before and Service Fees also performed well with a 7.0% increase (\$0.5 million) over the prior year. Additionally, interest income increased by \$0.9 million when compared with FY 2016/17 due to an influx of resources and higher Federal Reserve rates.

Comparison with Final Budget

Total revenue of \$210.5 million was collected in the General Fund in FY 2017/18, which is \$7.0 million above the Final Budget. The FY 2018/19 Adopted Budget included \$21.0 million in estimated revenue for the sale of property and this revenue was received as anticipated. Given that revenue from the sale of property is one-time and, by policy, does not impact the Budget Stabilization Fund reserve, a better comparison is to review Total Revenue (excluding Sale of Property) against the Revised Budget. With one-time revenue from the sale of property excluded, actual revenue exceeded the revised budget by \$7.0 million. This positive revenue variance is attributable to several factors, notably, higher than anticipated Transient Occupancy Tax. Other revenues that performed favorably against the revised budget include Sales Tax and Property Tax as well as Community Development and Public Safety Fees. These positive performing revenue sources were offset by shortfalls against revised budgets for Construction Tax, Real Property Transfer Tax, and Utility Users tax.

Property Tax revenue in FY 2017/18 came in approximately \$0.6 million higher than projected in the FY 2018/19 Adopted Budget. Growth in Secured Property Tax revenue, the largest component of total property taxes, was \$4.0 million, equivalent to 9.0% of the total. Overall, Property Tax revenue growth came from increases to the assessed valuation in both the residential and commercial / industrial sectors across the City as well as change of ownership and new construction. Residential assessed value increased 8.3%, while commercial and industrial assessed value increased 5.4%. Residential property accounts for approximately 59.2% of secured assessed value on the Sunnyvale property tax roll, which has decreased from 64% in FY 2014/15, which was a peak period for residential property in Sunnyvale, due to dramatic growth in the commercial/industrial category. The FY 2018/19 Budget projects that Property Tax revenue will increase further in FY 2018/19 by 5.8%. However, based on reports received from the County Assessor's office reflecting overall growth of 11.2%, fueled by over 21% growth in commercial assessed value, returns will exceed the original estimate. A revised projection will be included in the FY 2019/20 Recommended Budget.

Sales and Use Tax revenue for FY 2017/18 ended the year \$1.2 million above estimates. The original projection for sales tax revenue in the FY 2017/18 General Fund Long-Term Financial Plan assumed modest growth of 3.0%, reflecting numerous positive economic indicators. Based on data collected through the first quarter of FY 2017/18, the estimate for FY 2017/18 was lowered slightly in the FY 2018/19 Adopted Budget from \$32.8 million to \$31.8 million. However, sales tax returns improved in the second half of the fiscal year as a result of revenue returned to Sunnyvale from a major sales tax payer that had previously gone to the County Pool. Due to the uncertainty regarding the final position (with the City or as part of the County Pool) of this sales tax, we believe it prudent to set aside a portion of this revenue for possible return to the County Pool. Accordingly, revenue from this sales tax

payer is not included in further sales tax forecasts and it is anticipated that sales tax will continue to show a modest decline or remain flat, particularly returns from the Business and Industry (B&I) category, as the B&I category is the largest component of the Sunnyvale sales tax “base” and is a highly volatile source of revenue that is challenging to forecast.

Transient Occupancy Tax (TOT) revenue reached its highest level in FY 2017/18, totaling \$17.7 million, which was 8.9% above the projection for the fiscal year. Further, the TOT revenue collected in FY 2017/18 increased \$1.2 million from the prior year mainly due to strong occupancy rates and higher room rates. The large majority of TOT generated in Sunnyvale is business-related travel and this sector remained very strong through the fiscal year. In addition, after adoption of a voluntary collection agreement with Airbnb, the City’s short-term rental TOT remittance has improved in FY 2017/18. Based on year-to-date returns, it is estimated that revenue from short-term rentals will reach \$0.7 million in the current year. The Long Term Financial Plan also forecasts TOT revenue growth in future years to reflect City-approved construction and renovation projects that will further strengthen the TOT base. Additionally, the voter-approved Measure K tax increase of 2.0%, is anticipated to increase TOT revenue. While not yet included in the Long Term Financial Plan, it is expected that this new revenue will bring in approximately \$3.0 million annually, which will be reflected in the FY 2019/20 Recommended Budget. It should be noted that even with strong TOT returns projected in the near future, we do take caution with our projections as, historically, TOT revenue has shown high volatility with substantial declines in periods of economic recession.

Other Taxes finished the year 6.8% (\$0.6 million) better than FY 2016/17, but 5.0% below the revised projection. While the Other Taxes category is comprised of Construction Tax, Business License Tax, and Real Property Transfer Tax, Business License Tax was the only tax in this category to beat the revised estimate for FY 2017/18 with a 1.9% positive variance when compared to budget. Construction Tax experienced its highest year on record in FY 2016/17 and the FY 2017/18 budget was revised upward by \$2.0 million to reflect the robust construction activity in the City. To this end, the Construction Tax grew by 5.1% (\$0.2 million) when compared with FY2016/17, but missed the FY 2017/18 revised projection by 1.6%.

Real Property Transfer Tax revenue also missed revised projections by \$0.04 million (17.0%) when compared to the FY 2017/18 revised budget, though still grew by 17.2% (\$0.3 million) when compared against FY 2016/17. As a tax on the transfer of interests in real estate, it is driven by the rate of property turnover and changes in sales prices and the year-over-year increase reflects the sustained strength in the Sunnyvale real estate market.

Utility Users Tax (UUT) revenue for FY 2017/18 showed an 8.9% increase of \$0.5 million from the prior year. But missed the revised projection for the year by \$0.35 million. Sunnyvale voters approved an ordinance to modernize UUT in November 2016 and the methodology for estimating revenue for this category is still being refined as actual data is collected and impact of the ordinance is better understood. Therefore, despite the year-over-year growth in revenue, long-term projections for UUT revenue remain cautious given the evolving nature of energy-efficiency and telecommunications technologies as well as tax credit incentive programs.

Federal and Intergovernmental revenues fund specific projects and revenue is typically received on a reimbursement basis. Therefore, current year budget may be carried over to the following 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. Federal and Intergovernmental revenue reflects grant funding exceeding projections by \$0.1 million. State Shared revenue includes funds

from Senate Bill 90, which reimburses local agencies for mandated costs as well as numerous public safety grants.

Interest income also ended the year more than projection by almost \$0.7 million due to higher than anticipated interest rates. Finally, Table 1 includes Revenue Carryover, which includes grant revenue and deferred transfers that will be made from other City funds for specific General Fund projects.

Expenditures

General Fund expenditures for the fiscal year ending June 30, 2018 are shown in Table 2.

**Table 2 - FY 2017/2018 General Fund Expenditures and Transfers Out
Final Budget vs. Actual**

Description	Final Budget *	Actual Expenditures	Variance to Final Budget Favorable (Unfavorable)	Percent Variance
Equipment	\$ 1,113,455	\$ 624,551	\$ 488,904	43.9 %
Operations	156,611,827	151,561,399	5,077,528	3.2 %
Projects	19,610,116	11,572,778	8,037,338	41.0 %
Lease Payments	1,201,625	1,208,788	(7,163)	(0.6)%
Transfers	60,808,376	38,774,106	22,034,270	36.2 %
Total Expenditures	239,345,399	203,741,622	35,603,777	14.9 %
Equipment Carryover	-	488,904	(488,904)	
Project Carryover	-	2,013,864	(2,013,864)	
Deferred Transfers	-	21,907,477	(21,907,477)	
Budget Modification No. 13				
Special Projects Carryover	-	4,506,950	(4,506,950)	
Deferred Transfers Out (Special Projects)	-	191,241	(191,241)	
Unappropriated placeholder for Project #833750	-	2,000,000	(2,000,000)	
Total Carryovers	-	31,108,436	(31,108,436)	
Grand Total	239,345,399	234,850,058	4,495,341	1.9 %

* Final Budget includes budget modifications that occurred after adoption of the FY 2018/19 Budget

The details of FY 2017/18 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 estimated amounts for FY 2017/18 assumed in the production of the FY 2018/19 Adopted Budget. To capture the most accurate financial position of each fund heading into the next fiscal year, updated expenditure estimates, such as projected salary or vacancy savings, were included in the General Fund Long Term Financial Plan. However, Council-appropriated budgets are not modified and individual programs are still held to those budgets as they were approved by Council.

Operating expenditures finished the fiscal year favorably at \$5.1 million below budget. This was primarily the result of savings in the Department of Public Safety, Department of Library and Community Services and Office of the City Manager due to vacancy savings.

While the Department of Public Safety was under budget for the year, vacancies resulted in a high use of overtime; driving three of nine programs to exceed appropriations. Retirements and corresponding vacancies drove overtime use in the Fire Services program over budget and vacancies in the Administrative Services division as well as higher than anticipated Personnel and

Training costs also contributed to the overage. While sworn vacancies fluctuated throughout the fiscal year, however, 188 of the 201 approved sworn positions were filled with an additional 24 recruits in training. To that end, the City has appropriated significant funds over the last several years to recruit and train public safety officers and the Finance Department continues to work closely with the Department of Public Safety to anticipate future attrition to ensure appropriate funding levels during the budget process.

In addition to the Department of Public Safety, the Library and Community Services Department was under budget due to vacancies, mostly in the Library Program and the Arts and Recreation Program. The Office of City Manager also had vacancy savings that contributed to the \$5.1 million operating savings.

The Department of Public Works exceeded its expenditure appropriation primarily due to activity in the Neighborhood Parks and Open Space Management program, which absorbed a significant increase to the cost of water. More specifically, the program's overage was caused by sharp increases in water rates where the rate adjustments shifted most costs to a fixed charge for service, better reflecting the costs of operating the City's water system. The Finance Department is working with the Department to ensure that the water budget is revised based on the water rate adjustments and trend usage as part of the Recommended FY 2019/20 budget.

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 \$31.1 million is being carried forward to FY 2018/19 to cover expenditures related to projects and equipment. This amount largely consists of \$8.5 million for projects directly-charged in the General Fund and \$22.1 million for projects budgeted in other funds (Transfers Out of the General Fund). The project carryovers in the General Fund include Public Safety recruitment projects and various other ongoing projects. Of the \$22.1 million being carried forward to transfer to other funds for project expenses, approximately \$8.0 million is for the Enterprise Resource Planning project and \$8.5 million is budgeted to transfer to the Infrastructure Fund, primarily to fund the Pavement Rehabilitation and Sidewalk, Curb and Gutters projects. In addition, \$3.9 million is budgeted to transfer to the Capital Projects Fund for the Lakewood Branch Library project and several downtown projects, which are funded by the Reserve for Capital Improvement Projects.

Overall, expenditures in the General Fund ended \$7.0 million under budget due mostly due to savings in the operating programs. Thus, it is not anticipated that the savings will be ongoing as staff vacancies largely contributed to this favorable position.

Final Fund Results

The final position of the General Fund is \$11.5 million favorable. It is important to note that the Final Budget figures include all approved Council adjustments through June 30, 2018. Due to the timing of the production of the FY 2018/19 Adopted Budget, these figures differ from the estimates for FY 2017/18 assumed during the development of the budget.

**Table 3 - FY 2017/18 General Fund Financial Position
Year End Results**

	Final Budget*	Actual Results	Variance to Final Budget Favorable (Unfavorable)
Beginning Balance	\$ 126,046,827	\$ 126,046,827	\$ -
Revenue			
Revenue and Transfers In	203,508,377	209,328,434	5,820,057
Revenue and Transfers In Carryover	-	1,208,037	1,208,037
Total Revenue	203,508,377	210,536,471	7,028,094
Expenditures			
Expenditures and Transfers Out	239,345,399	203,741,622	35,603,777
Expenditures and Transfers Out Carryover	-	31,108,436	(31,108,436)
Total Expenditures	239,345,399	234,850,058	4,495,341
Reserves			
Contingencies	23,041,774	22,734,210	(307,564)
Capital Improvement Projects	21,497,418	21,597,884	100,466
Budget Stabilization Fund	45,654,070	57,401,145	11,747,075
Total Reserves	90,193,262	101,733,239	11,539,977

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

Table 4 - Summary of Impact on FY 2017/18 Budget Stabilization Fund

FY 2017/18 Budget Stabilization Fund Reserve:

Higher than Estimated Revenue	\$ 7,017,512
Lower than Estimated Expenditures	4,495,341
CAFR Adjustment/Reserve Reconciliations	234,222
Net Increase to FY 2017/18 Budget Stabilization Fund	11,747,075
(Budget Modification No. 13)	

The positive variance of \$11.7 million reflects better than expected revenues and unanticipated operating savings due to staff vacancies. This favorable year end position, combined with the fiscal strategies included in the out-years of the FY 2018/19 Adopted Long Term Financial Plan, contribute to the City's overall resources to cover the volatility of the City's major revenue sources, increasing demands on services and infrastructure as well as continued growth in personnel costs over the next twenty years. Consequently, the City will continue to approach budget development with a balance of service delivery evaluation, use of reserves, additional revenue, and a 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, 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. Therefore, 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 \$110.0 million, of which most is being carried forward to be spent in FY 2018/19. The major ongoing projects utilizing this carryover funding include the Fair Oaks Avenue Overhead Bridge project, the Mathilda/237/101 Interchange Improvements, the Lakewood Branch Library and Learning Center, and other various transportation projects.

In the Infrastructure Fund, there was \$34.7 million in unspent project funds being carried over, primarily associated with the Fair Oaks Park Renovation project (\$5.6 million carryover), \$13.2 million for the Lakewood Park Renovation, and \$2.3 for the Park Buildings - Rehabilitation project. \$3.4 million in funding is also being carried over for the Pavement Rehabilitation project.

Ongoing projects funded by Park Dedication Fee revenues had unspent funds of approximately \$33.5 million, \$33.4 of which is being carried forward to be spent in FY 2018/19. The carryover funding is for the transfer of funds to the Infrastructure Fund mainly for funding for the Fair Oaks and Lakewood parks renovation projects as well as funding for park buildings rehabilitation and playground equipment replacement. Revenues in the Park Dedication Fund came in approximately \$0.3 million higher than planned at \$27.1 million. The unplanned revenue that was collected in FY 2017/18 is accounted for in fund balance as part of the two reserve accounts: Capital Projects Reserve and Land Acquisition Reserve accounts. Council policy sets aside 20% of the Park Dedication Fee revenue into a reserve specifically designated for land acquisition and these funds will be used to acquire land to construct 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 2017/18 was another record-breaking year for development activity in Sunnyvale. Revenue reached \$21.9 million and expenses amounted to \$13.7 million. The net fiscal impact to the fund was an increase in the Development Enterprise Reserve of \$7.9 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 most of its revenue from user fees collected from the City's water rate payers, with the

remainder coming from connection fees. Total water revenues were \$61.2 million and exceeded the revised projection by \$5.2 million, primarily driven by \$4.5 million more than projected in water connection fees. The City's water connection fees were revised in FY 2017/18 to better reflect the cost of buying into the City's water system by developers.

Based on current year revenues and expenditures (and excluding ongoing project costs), the net position of the fund increased by \$8.4 million. As compared to budget, after accounting for unspent project funds to be carried forward, total expenses ended less than forecast by \$3.2 million. Water purchase costs were less than forecast by \$0.8 million contributing to operating savings. Given that development related fees are restricted to capital related costs, staff will program the additional revenue into the FY 2019/20 Recommended Long Term Financial Plan as part of the capital budget process.

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, food waste, yard trimmings, and recyclable materials. Revenues in this fund are driven primarily by the volume of material 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 2017/18 at \$50.7 million, approximately \$1.3 million less than projected, but still an increase of 5.4% from the prior year. Performance has been hindered by poor markets for recyclable materials, with the City having to expend money to recycle materials where previously the materials could be sold. After accounting for unspent project funds, the reserve balance for this fund increased by almost \$0.4 million.

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 with an approximate \$0.4 million unfavorable net position. This was due primarily to diversion rates coming in slightly lower than projected and higher than anticipated costs for maintenance.

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, were \$53.2 million, which was \$12.1 million more than anticipated. This is all attributable to connection fees due to continuing high levels of development activity. In addition, FY 2017/18 Wastewater Management Fund operating expenses ended \$0.7 million less than budgeted with cost savings in the Regulatory and Wastewater Collection Systems programs. Overall fund position remains in good fiscal condition; ending with a positive position for the year before accounting for ongoing project costs and any bond proceeds. However,

there are significant capital projects that have started in this fund, including the replacement of the existing Water Pollution Control Plant (WPCP). Cost estimates for the WPCP project as well as anticipated draws on the State Revolving Fund Loan have been included in the Long Term Financial Plan.

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 2017/18 was the sixth year of this Fund's operation. Beginning July 1, 2012, recreation operations were moved into the General Fund and the golf and tennis operations formed a new enterprise fund. Golf operating revenues ended approximately \$0.04 million better than projections, increasing almost \$0.3 million from FY 2016/17. Operational expenditures were approximately \$0.02 million over budget due to increases in water fees. Nonetheless, the fund ended in a positive fiscal position, mainly because of the planned \$1.4 million transfer from the General Fund required to keep the fund solvent. Also to note, the fund balance ended the year \$.01 better than the level estimated in the FY 2018/19 Adopted Budget. To this end, it is important to note that this fund continues to run a very tight fund balance and another transfer of \$1.2 million from the General Fund is budgeted for FY 2018/19 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, project administration, 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 in-line with what was projected in the FY 2018/19 Adopted Budget.

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. Revenues 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 2017/18 with reserves of \$22.4 million, approximately \$1.0 million less than the \$23.3 projected. 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 numerous number of claims paid out and related legal fee increases in FY 2017/18, the Liability and Property Insurance Fund came in over budget by approximately \$0.2 million. 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 drawn down in FY 2017/18 and it ended the year with \$0.6 million versus the \$0.7 million reserve forecast.

Closed Projects

The following projects are being presented to Council for closeout and to have funds returned to fund balance as outlined in the chart below.

Sub-Fund Display Name	Number	Name	Year Identified	Project Type	Department	Available Budget
035-100 - City General Fund - General	832630	Administrative Hearing Officer	2018	Gov. & Comm. Engagement	C30 - Finance	\$ 51,000
035-100 - City General Fund - General	830960	Participate in NLC's Youth, Education and Family Council	2015	Gov. & Comm. Engagement	C50 - Library and Community Services	\$ 10,000
070-100 - Housing - Housing Mitigation	832030	Orchard Gardens Apartments Redevelopment	2017	Housing	C15 - Community Development	\$ 6,000,000
385-100 - Capital Projects - General Fund Assets	831910	E. Washington Ave and E. Evelyn Ave Park Design	2016	Parks & Recreation	C90 - Public Works	\$ 51,000
385-100 - Capital Projects - General Fund Assets	831920	Fair Oaks/Highway 237 Preliminary Park Design	2016	Parks & Recreation	C90 - Public Works	\$ 102,000
610-500 - Infrastructure Renov & Replace - Community Rec Fund Assets	820311	Golf Course Irrigation System Replacement	1999	Parks & Recreation	C90 - Public Works	\$ 244,800

Staff no longer recommends that these projects move forward due to changing circumstances since the projects were initially appropriated. For example, the Orchard Garden Apartments project has been canceled and the Golf Course Irrigation System replacement project is being closed as capital needs will be assessed as part of the overall golf operations study. In addition, the E. Washington Ave/E. Evelyn Ave Park Design project as well as the Fair Oaks/Highway 237 Design project are being closed as the sites' size and location were determined not to be viable candidates for conversion into City parks.

Current Fiscal and Economic Environment

The positive year end results for FY 2017/18 compared to planned estimates leaves the City positioned in the coming budget to address the fiscal strategies presented in the current budget, which were deemed necessary. The Finance Department continues to evaluate maximizing current revenues. Additionally, staff continues to monitor increased costs related to personnel, including projected retirement contributions with the City's actuary. The strong economy has continued to be reflected in our elevated revenue performance. As over the past several years, the City is faced with balancing strong revenue growth in some stable categories (e.g. Property Tax) against Sales Tax, Transient Occupancy Tax, Real Property Transfer Tax, and other development-related revenues that can be highly volatile and fluctuate significantly through economic cycles. As such, a thoughtful and disciplined approach to budgeting and spending against these elevated levels is necessary to ensure the City can continue to address many of its growing expenses and long-term liabilities.

Providing stability to the City's fiscal position, Property Tax revenues continue to be steady through economic cycles and have shown healthy gains in the taxable base. The FY 2018/19 secured tax roll grew 11.2% 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 strong growth projections for the next several years in the adopted budget. However, the FY 2018/19 roll growth is 5.7 percentage points higher than the original estimate of 5.5% growth included in the budget. This is the sixth consecutive year in which the property tax roll growth (Secured and Unsecured) has exceeded 7.0%. The Sales Tax revenue category, however, continues to express volatility. Current projections indicate that actual performance will fall short in FY 2018/19. Staff will continue to monitor and analyze FY 2018/19 results and will be adjusting the revenue projections for the FY 2019/20 Recommended Budget.

Just as important as the City's revenue base, expenditure pressures continue to provide challenges to the General Fund. As the largest expense category, addressing personnel expenditure growth remains a priority. For the Public Safety units, where salary adjustments are based on a regional survey, the May 2018 survey resulted in a salary increase of almost half a percentage higher than planned.

In addition to salary, the cost of benefits continues to be a significant area of rising personnel costs. Pension benefits are the largest of these expenses. The City, working together with bargaining units, has taken several actions to control the growth of pension costs as well as fund the known growth through actions like the establishment of a Pension Trust. 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 \$40.2 million for pensions to CalPERS. That is anticipated to increase to \$69.4 million within ten years, growing 73% over that period. The City's two plans (Safety and Miscellaneous) are both approximately 67 percent and 69 percent funded respectively. In addition, due to CalPERS' changes in its amortization and rate smoothing policies, there has been increased short-term volatility in the City's employer payment for pensions, presenting further challenges. Initial CalPERS performance ending June 30, 2018 was reported at 8.6% compared to a 7.0% rate of return assumption. Even with this good news, negative pressure to de-risk the CalPERS plan is expected to continue. CalPERS has recently approved a plan to lower its assumed rate of return over an extended period, which will result in an increase to employer contribution rates.

With these many pressures, it is critical that the City continue manage its costs for total compensation to maintain a sustainable fiscal position.

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 address demand through a mix of solutions.

Environmental and Regulatory Demands - increasing regulations in storm water management, wastewater treatment, and efforts to accelerate climate action and reduce greenhouse gas emissions 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 modernize to current standards. In the present bidding climate, costs for repairs of infrastructure are rising rapidly due to high demand for qualified contractors.

To the extent possible, these pressures, while manageable, should be taken in context together through the City's budget process. Balancing priorities will be a critical function 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 for 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 beginning of March 2019. In summary, the City enters Fiscal Year 2019/20 in a sound position financially based on past efforts made to restructure itself to operate more efficiently and better contain costs. It has also benefited from an ongoing economic recovery that drove 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 City is in a positive and stable position and is well situated to meet the future head on.

Sunnyvale Financing Authority Budget Summary

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 Sunnyvale Finance Authority Board review and approve the annual budget. The Sunnyvale Financing Authority receives lease payments from the City and makes debt service payments to the fiscal agent when due. The fiscal agent (trustee of the bond reserve funds) handles the transactions for the Sunnyvale Financing Authority. The 2009 Government Center Certificates of Participation is the only outstanding debt of the Sunnyvale Financing Authority. During FY 2017/18, all debt service payments were made as planned. At the end of FY 2017/18, an ending fund balance of \$1.1 million remained in the debt service fund. These funds are restricted for the purposes of meeting future debt service requirements. The outstanding debt of the Sunnyvale Financing Authority totals \$11.0 million.

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 3 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.

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 audit findings including any material weaknesses or significant issues discovered 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, with the implementation of the GASB Statement No. 68, the City's net pension liability, representing unfunded pension obligations, is now presented as a liability on the statement of net position, previously the information was provided as part of the *Notes to the Basic Financial Statements* section of the CAFR. The Net Pension Liability line totaled \$365.4 million as of June 30, 2018, which increased by 10.9% from the prior fiscal year. The City, like most other local agencies, has had a significant unfunded pension liability for several years; however, the reporting of this liability does not require changes to the City's plans to fund its pension liability. While, 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 uncertainty reserve to continue to address the liability into the future. In addition, continuing to address the pension liabilities on a long-term basis, a Section 115 Pension Trust was established in May 2018, which received its initial contribution in the amount of \$1.0 million in July 2018 for FY 2018/19. The Trust is managed by investment professionals and owned by the City. The current twenty-year plan includes an annual commitment of \$10.0 million to the Trust to accumulate monies to fund future pension liabilities.

A new reporting standard, the GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* is effective for FY 2017/18. This Statement requires that governmental agencies that provide other post-employment benefits (OPEB) to their employees present the net OPEB liability on the Statement of Net Position. Preparing for implementation of the new OPEB reporting standard, an audited stand-alone report of the Sunnyvale Retiree Healthcare Plan was issued at the end of June 30, 2017. The Report established the beginning OPEB fund balance of \$83.0 million that was used in the calculation of the net OPEB liability. As of June 30, 2018, the outstanding balance of net OPEB liability was \$83.9 million. The OPEB liability reporting standard is parallel to the pension liability reporting standard (GASB Statement No. 68) and does not require changes to the City's plan to fund its OPEB liability. With the requirement to disclose the OPEB liability, the City began funding the OPEB Trust Fund since 2011 and has budgeted to pay the full annual required contribution over the long-term plan until the OPEB liability is fully funded, which is anticipated to occur at the end of the 20-year planning period.

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. The City Manager may appropriate grants up 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 summarizes the Administrative Budget Modifications approved by the City Manager in FY 2017/18.

Admin Budget #	Title	Fund Name	Fund #	\$ Amount
1	Approve Administrative Budget Modification No. 1 to Appropriate \$4,000 of Advanced Micro Devices (AMD) Grant Funds for Family Harvest, Family Fun Day and On-Going Community Outreach at Columbia Neighborhood Center in FY 2017/18	General Fund - Grant	35/100	\$ 4,000
2	Approve Administrative Budget Modification No. 2 to Appropriate \$54,441 of Office of Traffic Safety Grant Funds for FY 2017/18 OTS Selective Traffic Enforcement Program (STEP) Grant	General Fund - Grant	35/100	\$ 54,441
3	Approve Administrative Budget Modification No. 3 to Appropriate \$2,000 of VRS Properties Donation for Tuition Reimbursement Program	General Fund - Grant	35/100	\$ 2,000
5	Approve Administrative Budget Modification No. 5 to Appropriate \$36,402 as a Sub-Grant through Health Trust from Sourcewise Older Americans Act Grant Funds for Disease Prevention and Health Promotion	General Fund - Grant	35/100	\$ 36,402

** Admin Budget #4 was not used*

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 2017/18 more favorably than expected. As the General Fund faces many pressures on both the revenue and expenditure side in the next several years, a rebalancing of the 20-Year Financial Plan, including FY 2017/18 actual performance, will be required and included in the upcoming FY 2019/20 Recommended Budget.

Budget Modification No. 13 has been prepared to restate the FY 2018/19 Budget Stabilization Fund and the Capital Improvement Projects balance based on FY 2017/18 actual results. Additionally, due to the favorable position, staff is recommending appropriation of \$1.0 million each to the Pension and OPEB Trust Funds, an additional payment to CalPERS of \$2.0 million (to pay down the miscellaneous and safety unfunded liabilities at \$1.0 million each), and the appropriation of \$2.0 million to the Capital Improvement Projects Reserve to fund future capital improvements.

**Budget Modification No. 13
FY 2018/19**

	Current	Increase/ (Decrease)	Revised
General Fund			
<u>Expenditures</u>			
Transfer to OPEB Trust	\$3,819,000	\$1,000,000	\$4,819,000
Transfer to Pension Trust	\$1,000,000	\$1,000,000	\$2,000,000
Transfer to CalPERS to reduce unfunded liability	\$0	\$2,000,000	\$2,000,000
<u>Reserves</u>			
Contribution to the General Fund Capital Improvement Projects Reserve	\$3,348,280	\$2,000,000	\$5,348,280
Increase to Budget Stabilization Fund	\$34,546,568	\$11,747,075	\$46,293,643
Revised Budget Stabilization Fund	\$46,293,643	(\$6,000,000)	\$40,293,643

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. 13 and the list of Proposed Closed Projects.
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

Recommendation:

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. 13 and the list of Proposed Closed Projects.

Sunnyvale Financing Authority:

1. Receive and file the Sunnyvale Financing Authority Financial Report

Prepared by: Inderdeep Dhillon, Finance Manager

Prepared by: Felicia Silva, Budget Manager

Reviewed by: Grace Zheng, Assistant Director of Finance

Reviewed by: Timothy J. Kirby, Director of Finance

Approved by: Kent Steffens, Interim City Manager

ATTACHMENTS

1. Year-End Budgetary Report 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 are posted on the City website at

<https://sunnyvale.ca.gov/government/budget.htm>