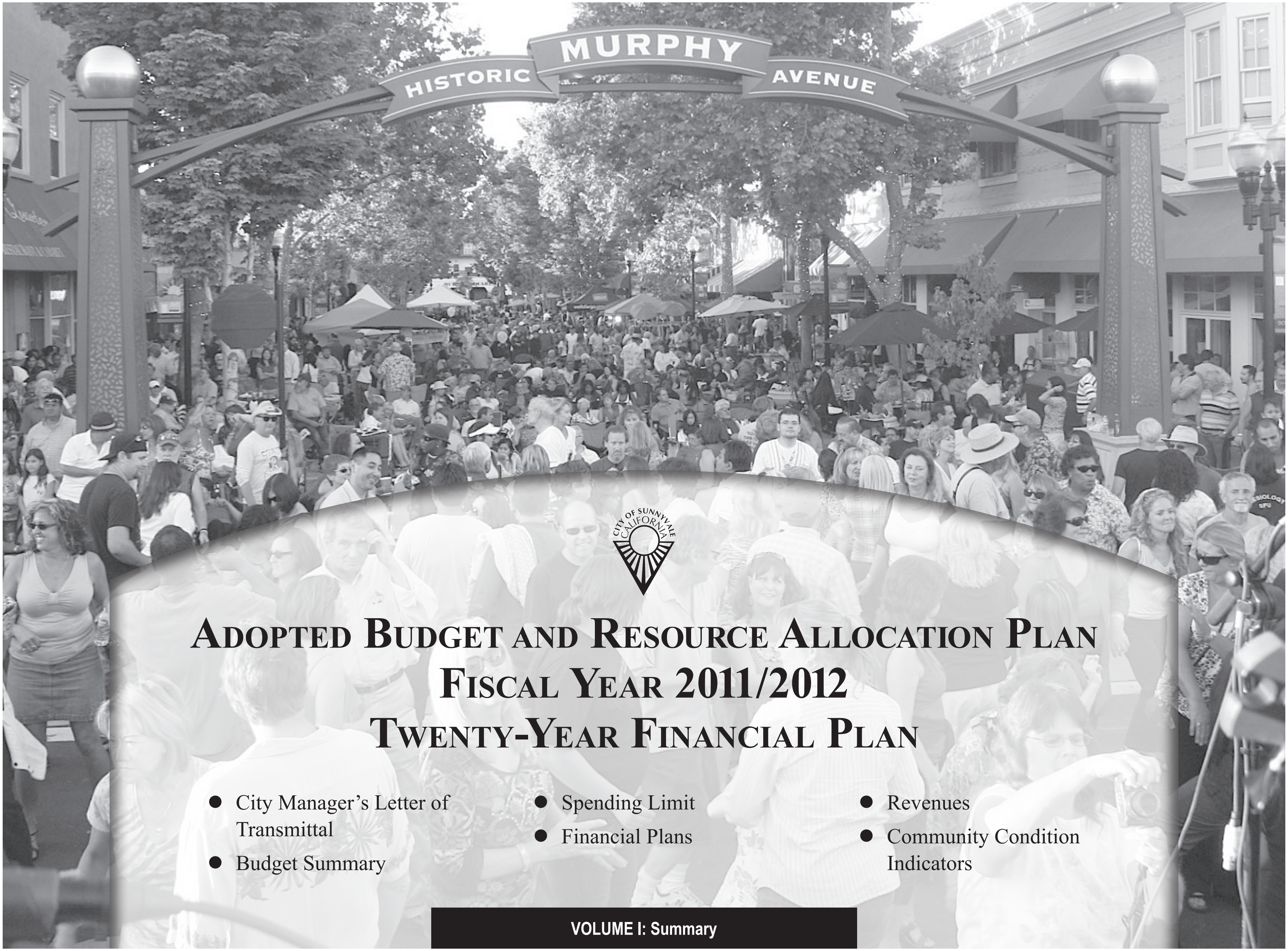

Adopted Budget and Resource Allocation Plan
Fiscal Year 2011/2012
Twenty-Year Financial Plan

- City Manager's Letter of Transmittal
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VOLUME I: Summary

Photograph by Richard Chen

City Manager's
Letter of Transmittal

Adopted 2011/2012 Budget
and
Twenty-Year Resource Allocation Plan

City Manager's
Adopted Budget Message

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CITY MANAGER'S ADOPTED BUDGET MESSAGE

I am pleased to present the FY 2011/2012 Budget and accompanying Twenty-Year Resource Allocation Plan, as adopted on June 28, 2011 by the Sunnyvale City Council. The specifics of the budget as recommended to Council are discussed in detail beginning with the Letter of Transmittal, which follows this message. This addendum addresses the adoption of amendments to the Recommended Budget, as well as the changes to the budget that were made between the delivery of the Recommended Budget to Council on May 6, 2011 and the approval of the Adopted Budget on June 28, 2011.

One formal amendment was made when the budget was adopted. Council amended the budget to maintain some of the after school programs at Sunnyvale Middle School that had been recommended to be cut. This action, however, was not intended to have a negative fiscal impact, as Council direction was to raise fees for these programs to cover the costs.

The more significant Council direction came as the result of the Budget Workshop, held on June 2, 2011, and the Public Hearing, held on June 14, 2011. The FY 2011/2012 Recommended Budget included $500,000 of budgeted cost reductions that were distributed on a pro rata basis to City departments. These reductions were aimed at partially addressing the City's structural deficit and extending the life the Budget Stabilization Fund until FY 2021/2022. These reductions were referred to as the Level 1 reductions and are included with this message. Because the Level 1 reductions still resulted in the depletion of the Budget Stabilization Fund within 10 years, I instructed staff to develop an additional set of reductions, referred to as the Level 2 reductions, which were introduced at the Budget Workshop. While not fully addressing the structural deficit, the Level 2 reductions did extend the life of the Budget Stabilization Fund until FY 2027/2028, the point at which the RDA loan repayment to the City ends, resulting in a net $9 million annual loss to the General Fund. Based on the Level 2 reductions introduced at the Budget Workshop, Council directed staff to present at the June 14th Public Hearing an updated 20-year financial plan with the Level 2 reductions implemented. The final Level 2 reductions are also included with this message. In total, the Level 1 and Level 2 reductions amount to approximately $2.1 million annually.

The development of the FY 2011/2012 Budget was a long and challenging process; however, I believe the budget that Council has adopted is the most comprehensive and policy-driven budget as has been adopted in recent memory. This budget has laid the groundwork for future years' budgets and Council policy decisions by setting aggressive assumptions for personnel cost containment that will require concessions from the City's bargaining units. If those assumptions aren't met and concessions are not achieved, further cuts in other areas will be required. This level of policy discussion also resulted in a study issue to develop City Council policies in the Budget Stabilization Fund and Contingency Reserve areas. Fortunately, this budget has clearly articulated the task at hand for Council by specifically identifying the assumed concessions. Now comes the hard part: execution of the plan to ensure the assumptions hold.

Despite the aggressive personnel cost containment assumptions in the budget, the FY 2011/2012 Adopted Budget required reductions to service levels. In previous years, we had been able to reduce expenditures through efficiencies and organizational restructure; however, there comes a point when cuts to service levels are unavoidable in order to address a structural deficit. We are at that point with the FY 2011/2012 Adopted Budget. As you can see from the attached Level 1 and Level 2 reductions, many of the actions being taken go beyond efficiencies and result in some level of decreased services in certain areas. And while cuts to services were minimized as much as possible and actions such as layoffs and furloughs have managed to be avoided so far, there is no more room to cut without directly impacting service levels and therefore personnel. Over the past three years, over 60 positions that have become vacant have either been eliminated or left vacant indefinitely. This has contributed to the City's ability to avoid layoffs and furloughs; however, our staffing is at its lowest point since 1996 and is not sufficient to meet service-level demands. Continuing to operate in this manner will have a negative impact on City services, therefore it is imperative that we all work towards slowing the growth of personnel cost increases in order to stabilize the size of our workforce at an acceptable level and avoid further service-level reductions. This will be the main focus during the development of the FY 2012/2013 Recommended Budget, which is already underway, as well as during our ongoing discussions with the bargaining units.

This policy-driven approach to budgeting in both the short and long term will enhance our already proven use of 20-year financial planning. But as with any strategic plan, knee-jerk reaction to events of the day or a compromise of the integrity of the plan through City Council turnover, staff turnover, or external pressures will minimize its success.

Respectfully Submitted,

Gary Luebbers
City Manager

Summary of Recommended Cost Savings and Alternatives

	Recommended Cost Savings	Council Priority	Savings
Community Development			
Level 1	Eliminate funding for dispute resolution services	4	$25,240
Level 2	Eliminate all Planning Program Overtime	N/A	$16,805
Level 2	Eliminate consultant contract hours in Building Division	N/A	$36,634
Level 2	Reduce advertising and postage expense	N/A	$5,000
Finance			
Level 1	Position Reclassifications	N/A	$26,125
Level 2	Eliminate Accounting Technician position (attrition)	3	$100,800
Human Resources			
Level 1	Indefinite hold on Principal HR Analyst vacancy	3	$168,109
Information Technology			
Level 1	Position Reclassifications	N/A	$18,838
Level 2	Eliminate vacant Network Engineer position	3	$120,305
Library and Community Services - Library			
Level 1	Close Library at 6 p.m. on Thursdays (Library Specialist III - Vacant)	3	$38,493
Level 2	Eliminate vacant Sr. Office Assistant position	N/A	$99,720
Library and Community Services - Recreation			
Level 1	Portion of savings from 4 position eliminations and 1 transfer (attrition)	N/A	$74,706
Level 2	Improve Contractual Terms for Gymnastics	3	$10,000
Level 2	Close Lakewood Pool	4	$37,581
Level 2	Reduce Subsidy for Teen Programming	4	$20,079
Level 2	Eliminate Senior Lunch Program Subsidy	3	$13,296
Level 2	Eliminate Adult Pottery and High Fire Gas Kiln Productions Subsidy	5	$83,913
Office of the City Attorney			
Level 1	Downgrade vacant Administrative Aide position to Legal Secretary	N/A	$7,884
Level 2	Reduce Court and Litigation Expenses Budget	N/A	$5,000
Level 2	Reduce Professional Services Budget	N/A	$5,000
Level 2	Reduce Legal Services Budget	N/A	$11,398
Office of the City Manager			
Level 1	Eliminate Intergovernmental Relations Officer	5	$165,205
Level 1	Eliminate Mail Clerk position	N/A	$50,690
Level 1	Continue elimination of US Conference of Mayors	N/A	$12,000
Level 1	Reduce Council and Mayor Travel Budget	N/A	$10,900
Level 1	Reduce Council Meals budget	N/A	$1,000
Level 1	Reduce General Supplies	N/A	$1,000

Summary of Recommended Cost Savings and Alternatives

	Recommended Cost Savings	Council Priority	Savings
Public Safety			
Level 1	Eliminate Community Services Officer vacancy	N/A	$112,470
Level 1	Reduce 664 hours of Overtime	2	$77,448
Level 1	Eliminate Crime Prevention Assistant vacancies	3	$17,420
Level 1	Implement efficiencies in the dispatch schedule	N/A	$50,000
Level 1	Remove Station #2 modular trailer	N/A	$11,340
Level 1	Reduce Specialty Pay for Training Officer positions	N/A	$40,019
Level 2	Eliminate Neighborhood Preservation Manager position (filled - under study)	N/A	$184,403
Level 2	Reclassify Deputy Chief position to Public Safety Captain	N/A	$34,087
Level 2	Eliminate Senior Office Assistant position (filled)	N/A	$96,948
Public Works			
Level 1	Reduce Shopping Cart Removal activity	5	$43,126
Level 2	Eliminate Shopping Cart Removal activity	5	$53,648
Level 2	Reduce Sidewalk Replacement Contract	3	$35,000
Level 2	Reduce Curb and Gutter Replacement Contract	3	$30,000
Public Works - Parks			
Level 1	Eliminate 1 Groundsworker position (vacant)	4	$60,084
Level 2	Eliminate 1 Groundsworker position (vacant)	4	$60,084
Level 2	Reduce Ornamental Turf	4	$19,000

Total Recommended Cost Savings: $2,090,798

FY 2011/2012 Recommended Budget
and
Twenty Year Resource Allocation Plan

City Manager's
Budget Message

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Honorable Mayor and Members of the City Council:

Introduction

In presenting the recommended FY 2011/2012 Budget, there is reason for cautious optimism, especially given where we were just one year ago. Last year at this time, the City, like most California cities, was grappling with the effects of the housing market meltdown and subsequent global recession. Revenues had dropped precipitously and concerns of a potential double dip were strong. In the ensuing year, the recovery has taken hold with the high tech sector leading the way. In the heart of Silicon Valley, Sunnyvale has reaped the benefits with strong growth in sales tax revenues and development activity. The City's downtown has seen great progress with more soon to come with the new development team in place. The projections for recovery that were incorporated into the budget are bearing out.

On the expenditure side, there are positive developments as well. Since my arrival 2 ½ years ago, I have focused on streamlining the organization to operate effectively in this "new normal" economic environment. The final major reorganizational piece was detailed this past month and will be implemented over the next several months. I believe the City is in optimal position to take advantage of efficiencies and adapt to the fiscal realities of how we must conduct business in the future.

While there are several strong components on which to build the budget, a significant challenge persists, keeping the goal of a truly balanced budget out of reach any time soon. **Sunnyvale has a structural deficit.** That is, we are spending more on an annual basis than we are taking in. The City does not have the funds to deal with its deteriorating infrastructure and service levels have been reduced in areas such as tree and road maintenance. For example, the City's Pavement Condition Index has dropped from 80 to 70.

And what is especially disconcerting, this proposed budget may not have adequately addressed future costs of compensation. Personnel costs take up 79% of all General Fund revenues, up from 62% 10 years ago. Even a small change in the salary assumptions can have a dramatic effect. For example, we have budgeted less than the historical average salary increases for our public safety personnel. The historical average increase is 4.6%; we have budgeted between 3% and 4%. To make the adjustment to the historical average appears to be a modest change. However, because of the compounding effect of a rapidly increasing salary base, the amount quickly becomes so significant that an additional $8 million would be required annually and a total of $194 million over 20 years just to make this one adjustment. This vulnerability needs to be recognized and addressed, not minimized or rationalized.

The continued funding of these rising personnel costs is coming through the use of the Budget Stabilization Fund reserves. Of course, reserves are one-time funds and this reserve is projected to be drawn down to $1.6 million in 10 years. Adjusted for the contribution to fund retiree medical liabilities, this reserve was $51.1 million 10 years ago and $46.7 million just five years ago.

The Budget Stabilization Fund is meant to go up and down, functioning as a shock absorber for the economic peaks and valleys. When continually drawn down, and to such a low level, the long-term financial plan stabilizer is lost. The longer we wait to address this problem, the more severe the remedy and the more quickly it will have to take effect.

FY 2011/2012 Recommended Budget
Key Facts

FY 2011/2012 General Fund Revenues: $131M

FY 2011/2012 General Fund Expenditures/Additional Reserves: $137.5M

FY 2011/2012 General Fund Deficit: $6.5M

Consecutive Years of General Fund Deficits: Last 3 Years

Largest General Fund Revenue Source: Property Tax $42M (35% of Total)

Personnel Costs as a % of General Fund Operations: 82% ($104M)

Increase in Salaries and Benefits over FY 2010/2011: 6% ($6M)

FY 2011/2012 Projects Budget: $31M / 20 Year Project Budget Total: $704M

FY 2010/2011 Budget Stabilization Fund Balance: $35M

FY 2020/2021 Budget Stabilization Fund Balance: $1.6M

General Fund Contingency Reserves Increases from $23M in 2010 to $33M in 2021

FY 2011/2012 General Fund Support for Recreation Activities: $4.8M

Positions Eliminated/Frozen since FY 2009/2010: 54

Increase in CalPERS Pension Rates over next 3 Years: 45% (Misc) / 32% (Safety)

Increase in City Paid Pension Costs over last 10 Years: 250% (Misc) / 400% (Safety)

Increase in Medical Premiums in January 2011: 10.5%

Increase in Medical Premiums Estimated for January 2012: 10%

Over last 12 Years, City Population Increased 6% / Full Time City Employees Decreased 8% (922 to 845)

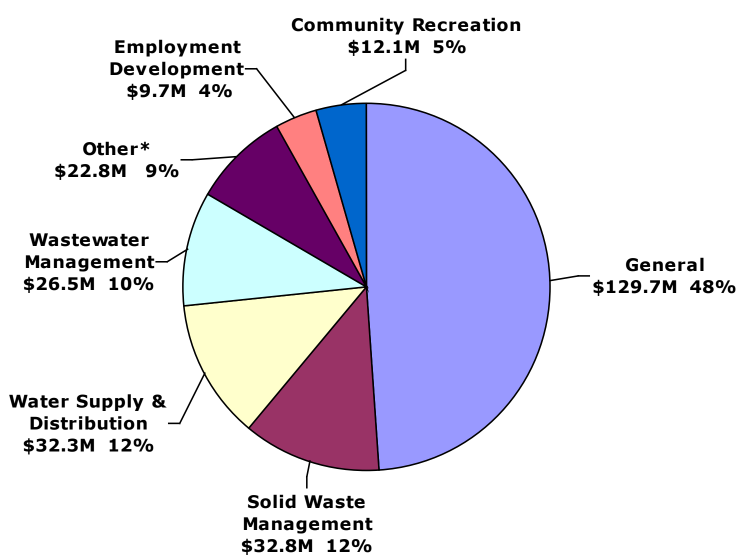
Full Time City Staffing is at its Lowest Level since 1995

Current Financial Condition

▪ *Citywide Budget*

The citywide recommended FY 2011/2012 Budget and 20-Year Resource Allocation Plan as presented for Council consideration totals $265.9 million. This encompasses all City funds, the largest of which are the General Fund and the Utilities Funds. Also included are the Capital Projects Funds and all of the Special Revenue Funds including the Redevelopment Agency Fund and Park Dedication Fund.

Figure 1: Recommended FY 2011/2012 Citywide Expenditures by Fund

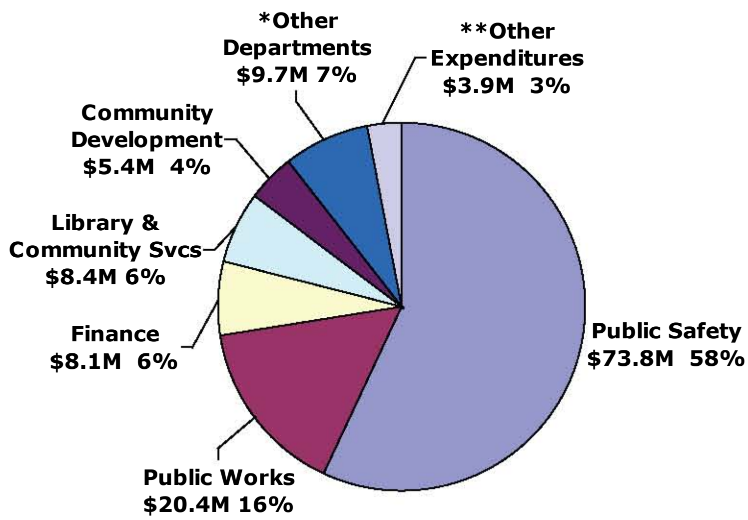


Total Expenditures: $265.9M

* Other includes Gas Tax, Youth and Neighborhood Services, Capital, Infrastructure, Housing/ CDBG, Park Dedication and Redevelopment Agency Funds.

Because the citywide total combines all of these funds, a more useful way to understand the City's financial condition is to look at the General Fund, which makes up nearly half of the citywide total budget and supports many of the most visible and essential City services, such as police, fire, road maintenance, libraries, parks and open space maintenance, land use planning, legal services and financial management. As Figure 2 shows, public safety expenditures make up more than half of the General Fund budget.

Figure 2: Recommended FY 2011/2012 General Fund Expenditures by Department



Total Expenditures: $129.7M

*Other Departments include the Human Resources Department ($3.6M), the Office of the City Attorney ($1.7M), and the Office of the City Manager ($4.4M).

**Other Expenditures include equipment, projects, lease payments, infrastructure investment, and $500,000 in cost reductions that will be identified across all departments.

Total expenditures do not include interfund transfers, including the $5.4M in transfers from the General Fund to support recreation activities and the Youth and Neighborhood Services Fund.

- *General Fund*

The table below outlines the estimated revenues and recommended expenditures and transfers for the General Fund.

Figure 3: Recommended General Fund Revenues and Expenditures

	Actual 2009/2010	Current 2010/2011	Budget 2011/2012	Plan 2012/2013	Plan 2013/2014
CURRENT RESOURCES:					
Property Tax	43,699,859	41,937,637	42,033,969	43,709,279	45,586,327
Sales Tax	25,431,711	27,286,190	28,144,466	29,447,306	30,994,562
Transient Occupancy Tax	5,578,196	6,430,805	6,689,607	6,975,954	7,367,693
Utility Users Tax	6,797,768	6,801,741	6,947,373	7,173,629	7,350,453
Other Taxes	4,030,224	4,499,071	4,735,887	4,975,151	5,009,406
Franchises	5,979,301	6,309,686	6,398,220	6,582,354	6,762,329
Permits and Licenses	4,666,794	5,544,598	5,643,631	5,770,343	5,627,260
Other Permits/Fees/Fines	4,372,161	4,817,448	4,870,304	5,112,346	5,111,727
Inter-Fund Revenues	8,599,600	9,330,898	12,297,794	14,805,033	16,821,881
In-Lieu Charges	8,899,467	9,101,032	8,751,278	9,075,101	9,374,737
Other	8,431,389	4,480,377	4,506,650	4,377,213	7,672,693
Total Current Resources	**126,486,470**	**126,539,482**	**131,015,098**	**138,003,909**	**147,679,071**
CURRENT REQUIREMENTS:					
Projects & Equipment	4,491,330	4,676,387	601,055	473,437	2,678,581
Operations - Safety Compensation	52,148,780	53,561,783	56,167,163	58,408,292	62,314,720
Operations - Misc. Compensation	44,174,817	44,282,847	47,441,090	47,965,821	48,744,289
Operations - Other	19,558,182	19,373,908	20,195,380	20,243,458	20,798,845
Lease Payments	4,001,530	3,068,322	3,209,761	3,285,881	4,057,176
Service Level Reductions	0	0	(500,000)	(518,293)	(540,225)
Infrastructure Investment	0	0	2,550,000	2,550,000	2,550,000
Transfers to Other Funds	7,661,880	9,852,800	6,088,768	6,153,385	6,333,037
Total Current Requirements	**132,036,519**	**134,716,047**	**135,753,217**	**138,561,980**	**146,936,424**
RESERVES:					
Contingencies (20%)	23,176,356	23,423,708	25,170,727	25,729,855	26,773,526
Capital Improvement Projects	8,222,181	5,617,963	5,617,963	5,617,963	7,748,781
BUDGET STABILIZATION FUND	**40,847,051**	**35,027,352**	**28,542,214**	**27,424,814**	**24,992,972**

As Figure 3 indicates, total expenditures for FY 2011/2012 are expected to be $135.8 million, up 0.8% from the revised FY 2010/2011 budget. Because certain aspects of the budget can change dramatically from year to year, notably projects and related transfers, a more precise understanding of the comparative budget is in the operating area. The operating portion is $123.8 million and up 5.7%, or $6.7 million from FY 2010/2011 to FY 2011/2012. This increase is predominately due to rising employee compensation costs despite the reduction of 54 positions over the past three years.

Employee compensation is discussed in detail in the *Significant Factors and Assumptions* section below. In addition, the Contingencies Reserve is up by $1.7 million since, by fiscal policy, it must be equal to 20% of the operating budget.

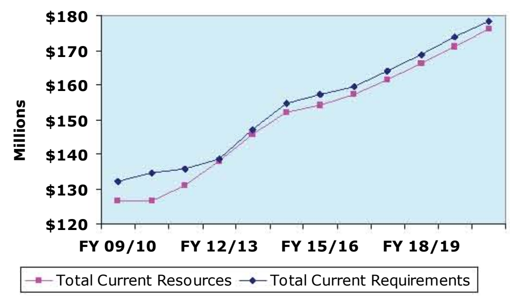
Figure 3 also shows that revenues are anticipated to be up $4.5 million in FY 2011/2012 from the revised FY 2010/2011 estimates. This reflects the impact of the economic recovery which was budgeted last year. However, it appears the recovery is slightly stronger and occurring faster than originally estimated. In addition, $3 million of the $4.5 million difference is due to an increase in loan repayments from the Wastewater, Solid Waste, and Redevelopment Agency Funds. Even with the increase in revenue, total requirements including expenditures and reserves for FY 2011/2012 are greater than total resources by $6.5 million. As a result, the Budget Stabilization Fund will again be drawn down, by $6.5 million.

Structural Deficit

As required by the City Charter, each fund is balanced over the 10-year planning period and all reserve requirements are met. In accordance with the City's fiscal policies, a balanced 20-year financial plan is presented for all funds. While all funds are balanced, service level reductions and a drawdown of reserves is utilized in several funds to achieve that balance. The drawdown of reserves is expected in the context of the 20-year planning period to deal with the effects of economic cycles, but it is important to note when the continued use of reserves indicates a structural deficit. This is the case with the General Fund and the Community Recreation Fund.

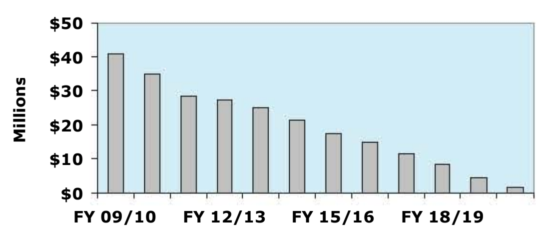
As Figure 4 indicates, the General Fund has a sustained structural deficit. At no point in the next 10 years are there more resources than requirements.

Figure 4: General Fund Resources and Requirements – 10 Year Projection



As a result of this continued structural deficit, the Budget Stabilization Fund is estimated to be drawn down to $1.6 million by FY 2020/2021.

Figure 5: Budget Stabilization Fund – 10 Year Projection



Because the Budget Stabilization Fund is projected to be drawn down so low, significant service level reductions will be required beginning in FY 2021/2022 in order to balance the budget. Exacerbating the gap between expenditures and revenues in the latter 10 years is the completion of loan repayments from other funds. The Solid Waste Fund will make its last loan repayment in FY 2022/2023, resulting in a loss of $4.7 million annually thereafter. Loan repayments from the Redevelopment Agency will end in FY 2027/2028 when the project area is set to expire. At that time, RDA loan repayments to the General Fund are estimated to be $11.5 million annually. A total of $97.8 million will be required in either cost savings or increased revenue from FY 2021/2022 through FY 2030/2031. It is patently clear that the growth in expenditures **cannot** be supported by the projected revenue trends. The recommended FY 2011/2012 Budget and 20-year financial plan is only balanced through the use of the Budget Stabilization Fund. When this reserve runs out, severe corrective actions will be necessary.

Fortunately, Sunnyvale's long-term financial program modeling can serve us well. It gives us the time to address this issue sooner rather than later. The earlier the structural deficit is identified, the less severe the future reductions or revenue increases will have to be. For example, the recommended budget includes $500,000 in anticipated service level reductions beginning in FY 2011/2012. If an additional $1.75 million in ongoing reductions were implemented now, severe reductions would not be necessary until FY 2028/2029 when the RDA loan repayments are gone. Instead of needing to cut $97.8 million in the back 10 years, only $36 million is required. This is a considerable difference and exemplifies the benefits of taking action earlier.

In addition to the structural deficit in the General Fund, the Community Recreation Fund, which is largely dependent on the General Fund, also faces a severe structural deficit. The General Fund currently provides a net subsidy of $3.8 million to the Community Recreation Fund annually. Last year, the Community Recreation Fund faced an additional $600,000 structural deficit and staff has been working to close this gap. Due to the continued decline in golf revenues, the additional structural deficit has grown to $1.4 million. Recreation staff has already implemented $200,000 in cost savings and anticipates an additional $200,000 in reductions through efficiencies and elimination of vacancies. For the recommended budget, the remaining $1 million will come from the General Fund. Half of the $1 million will be from a variety of cost reductions in the FY 2011/2012 General Fund Budget which will be identified by all the General Fund departments on a proportionate share basis. The other half will draw from the Budget Stabilization Fund.

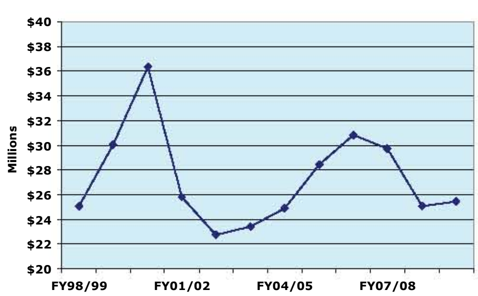
Significant Issues and Assumptions

- *Recovery Underway*

Sales Tax

Year-to-date data indicates that recovery from the "Great Recession" took hold in FY 2010/2011. Sales tax revenue, the second largest source of General Fund revenues, has made a strong rebound with sharp increases in the business and industry sector. While it is important to emphasize that recovery is built into the 20-year financial plan, recent sales tax receipts indicate the recovery occurred much sooner and slightly better than budgeted. As a result, total sales tax revenues for the 20-year planning period are up $19 million over the previous budget, with the majority of this gain occurring in the first five years of the plan. While this is certainly good news, it is important to note that we are estimating $28.1 million in sales tax revenue for FY 2011/2012 while we received $30.9 million five years earlier in FY 2006/2007. Clearly, sales tax is a highly volatile revenue source, as evidenced by the 12-year history in Figure 6. The volatility has made long term projections challenging. For example, in the Adopted FY 2005/2006 Budget, we had projected $32.9 million for FY 2011/2012, which is 17% higher than our current estimate.

Figure 6: Sales Tax Revenue – 12 Year History



With this level of volatility, the usefulness of the Budget Stabilization Fund cannot be over-emphasized. This reserve allows us to handle the volatility while maintaining a fairly consistent level of service. Of course, as the Budget Stabilization Fund is continually drawn down and not replenished, it is less able to handle the volatility.

Long term projections include additional sales tax revenue from the completion of the Town Center project. Additional revenue is budgeted beginning in FY 2012/2013, with the full projection of $1.5 million recognized in FY 2014/2015.

Transient Occupancy Tax

Another revenue source positively impacted by the rebound in the business and industry sector is Transient Occupancy Tax (TOT) revenue. Because Sunnyvale's occupancy of hotel and motel rooms is primarily driven by business travel, this revenue source, 5.5% of General Fund revenues, has followed the Sales Tax revenue pattern. TOT revenue has seen real growth in FY 2010/2011 and is expected to finish at approximately $6.4 million, a 16% increase over the previous year. TOT revenue is expected to grow with the economic recovery, but not more than what is already projected over the long-term financial plan. With volatility levels similar to Sales Tax revenues, TOT has also been challenging to forecast. As an example, the Adopted FY 2005/2006 Budget forecast $7.2 million in TOT revenue for FY 2010/2011, 13% higher than the current estimate.

Development Related Revenue

Development related activity began to rebound late in FY 2009/2010 and has continued to grow in FY 2010/11. In fact, FY 2010/2011 is on pace to exceed its inflation-adjusted historical baseline, with expected revenues up 29% over last fiscal year. Projections for FY 2011/2012 and FY 2012/2013 reflect activity above the standard baseline, as there are several significant projects in process, including continued work in the downtown, that are expected to bring in additional revenues. After FY 2012/2013, projections are adjusted to the sustainable baseline, based on historical revenues. These again are highly volatile revenues with peaks and valleys that can occur very abruptly. Dependence on this revenue over the long term should be considered "soft".

While the recovery, particularly the acceleration, is welcome news, it is important to note that recovery was already planned into the current budget. The acceleration has increased revenues in the earlier years, but, with the exception of Sales Tax, there are no additional revenues anticipated over the long-term financial plan.

▪ *Effects of Downturn Still Being Felt*

Property Tax

While there are areas of strong revenue growth with the sustained recovery, Property Tax is not one of them. Property Tax is considered a lagging revenue because of the length of time it takes for reassessments and appeals to hit the tax rolls. With the County's current backlog of appeals for commercial properties valued at $21 billion countywide, the City has yet to see the full impact of the recession. Some of the impact to the City began to be felt in FY 2010/2011, with non-residential assessed value down 4%. The County Tax Assessor has advised us the appeals will be completed during FY 2011/2012; accordingly, the budget assumes the City's revenue related to non-residential properties will be down another 3% next fiscal year. Because the City has historically experienced sharp increases following a reduction in assessed values, staff has programmed a full recovery to $32.5 million by FY 2015/2016.

Utilities Revenue

Although the consumption of these essential services would not seem to be impacted by the recession, a significant portion of each utility's revenues is driven by demand from businesses and other non-residential uses. As a result, the economic downturn has been one factor in utilities revenues coming in under projections and requiring rate increases in the next year.

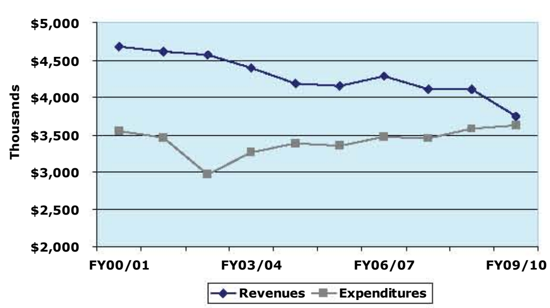
The impact from declining revenues has been most significant in the solid waste utility. Approximately 62% of solid waste revenues come from commercial accounts who utilize larger garbage bins, subscribe to more frequent pick ups, and use construction debris removal services. With the increase in commercial vacancies over the last two years, and the corresponding drop in solid waste generation, revenues have come in below projections. This is particularly problematic because most of the expenditures are fixed. As a result, the Solid Waste Management Fund has drawn down on its rate stabilization reserve the past two years and will finish FY 2010/2011 with minimal reserves. With the recommend increase in rates, growth in the economy, and savings achieved through the extension of the solid waste collection contract, we project this reserve will be built back up beginning in FY 2011/2012.

The Water Supply and Distribution Fund also experienced revenue volatility related to the economic downturn. The negative impact is further exacerbated by two above average wet weather years combined with successful efforts by the community to conserve water. In the water fund, the distribution of revenues is more even than in solid waste, with about 27% from Commercial, 35% from Residential, and 27% from Multi-Family customers. However the downturn and wet weather have caused more of the consumption across all classes to fall into the lowest pricing tiers, reducing the revenue per unit of water sold and forcing the drawdown of the rate stabilization reserve. In the proposed rates for FY 2011/2012, the rate structure has been adjusted to align the tiers with the cost of service. With these adjustments, it is anticipated reserves will stabilize over the next several years despite projected large increases in the cost for water.

Golf Revenues

The downturn in the economy appears to be one factor in the continued decline of golf revenues over the last several years. Historically, the two golf courses in Sunnyvale have been a profitable operation for the City, generating well over $1 million in net revenue at its peak. Combined in the same Community Recreation Fund with recreational services, these revenues provided significant funding for recreational programs, reducing the level of support required from the General Fund. However, as Figure 7 indicates, golf revenues have now reached a point where they are barely able to cover their own expenses let alone support other programs.

Figure 7: Golf Course Revenues and Expenditures – 10 Year History



In addition to the economy, weather also has an impact on golf revenues. The above average wet weather the last two years directly resulted in fewer rounds of golf played at both courses. The long-term downward trend however, is also influenced by the continuing deterioration of the golf course infrastructure, including course conditions and facilities at both sites. In part, this is a result of golf profits being used to address the gap between revenues and expenditures for recreation activities, which are accounted for in the same fund with golf operations, rather than for golf infrastructure. Although the current trends indicate golf operations will have a structural deficit beginning in FY 2012/2013, with investment in the golf course infrastructure and improving operational efficiencies, this trend can be reversed. Staff has already begun this work with projects such as the construction of continuous cart paths and splitting golf and tennis operations from recreation activities into its own enterprise fund.

▪ *Personnel Costs*

The City is a service driven operation, as such, the largest component of the City's budget is employee salaries and benefits. In the General Fund, they constitute 82% of the total operating budget. For FY 2011/2012 total General Fund salaries and benefits are budgeted to be $103.6 million. To fund this amount requires the combined total of the top five revenue sources in the General Fund: Property Tax, Sales Tax, Transient Occupancy Tax, Utility Users Tax and Franchise Fees, and Development Related Revenue. Because salaries and benefits make up so much of the budget, increases in this area have a dramatic impact on the financial condition of the City. As such, addressing the sharply-rising costs of personnel has been a key part of the plan to bring the budget back into balance over the long term.

To their credit, the City's bargaining units have come forward to address this issue. All bargaining units either took no salary increase or deferred their increase in FY 2008/2009 or FY 2009/2010. The Executive Leadership Team took no salary increase in FY 2009/2010, FY 2010/2011 and will do so again in 2011/2012. In addition, the Public

Safety Managers Association (PSMA), as part of their Memorandum of Understanding (MOU) signed in 2010, agreed to phase in employee contributions of 3% toward retirement costs and to implement a two-tier retirement system for new employees when the Public Safety Officers Association (PSOA) adopts such a plan. The PSOA did just that when they came forward with concessions in exchange for a contract extension. The PSOA will phase in employee contributions of 3% toward retirement costs and adopted the two-tier retirement system, with the 3% @ 55 plan for new employees, effective July 2011. The Sunnyvale Management Association (SMA) also came forward with concessions in exchange for a contract extension. The SMA will take no salary increases in FY 2012/2013 and 2013/2014, contribute an additional 2% towards retirement costs, and will implement a two-tier retirement system when the other miscellaneous bargaining units adopt such a plan. Savings from these concessions total $1.4 million in FY 2012/2013 and $58 million over 20 years.

Salary Assumptions

The salary assumptions built into the recommended FY 2011/2012 budget incorporate all of the current MOUs, including the recently amended MOUs for PSOA and SMA. The current MOU for the Sunnyvale Employees Association (SEA) includes a 2% salary increase in October 2011. The SMA MOU includes a 3% salary increase in July 2011. Following these salary increases there are no salary increases for any miscellaneous employee budgeted through FY 2013/2014, which aligns with the SMA MOU. Beyond that, 2% salary increases are assumed through FY 2020/2021 and 3% for the remaining 10 years of the financial plan.

For PSOA and PSMA, because the recent concessions by PSOA did not touch on salaries, the salary assumptions are based on the existing salary survey formula as specified in the MOU. The survey uses a modified total compensation base and includes base salaries, employer paid contributions to retirement, and employer paid health benefits. Twelve agencies are surveyed and the four lowest agencies are deleted. The total compensation for the remaining eight agencies is averaged and the PSOA members are compensated 11% above that average. This salary survey formula, with minor modifications to the survey items, has been in place for decades. The history of salary increases provided as a result of the survey is shown in Figure 8.

Figure 8: PSOA Annual Salary Increases – Historical Averages

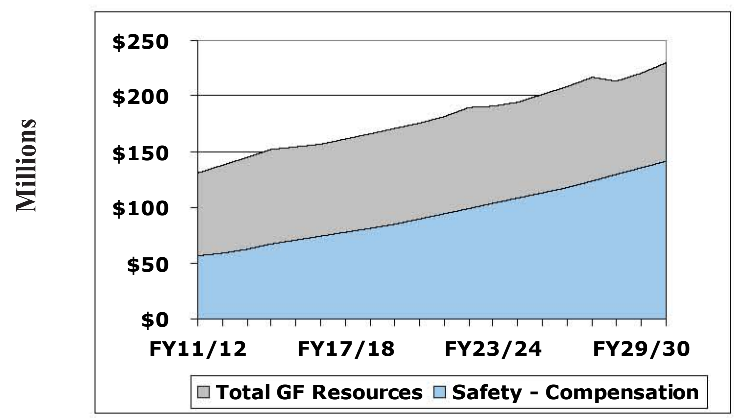
PSOA Average Annual Salary Increases	
Over the last 20 years	4.54%
Over the last 15 years	4.85%
Over the last 10 years	4.90%
Over the last 5 years	4.56%

Historical data shows that the salary survey has resulted in an increase every year over the past 30 years with the average falling at 4.6% on the low end. In the recommended budget, 4% salary increases have been budgeted for PSOA and PSMA members through 2015, the term of the PSOA MOU. Then 3% salary increases are budgeted through FY 2020/2021 and 4% for the remaining 10 years of the financial plan.

Although the historical data would indicate we have not budgeted enough, staff did not reflect the historical average for two reasons. First, there is a strong likelihood that in the near term, there should be limited or no salary increases in the survey agencies in the current fiscal environment. There are a few vulnerabilities with this assumption. Layoffs and furloughs are not factored into the survey formula. If a survey agency lays off several police officers and gives the remaining officers a pay increase, our survey formula will only recognize the pay increase. In addition, if other survey agencies provide more contribution for health benefits due to a rise in medical premiums, the PSOA survey formula accounts for that by increasing the salary.

The second reason for not budgeting the historical averages for salary increases is the assumption that there will be some adjustments to the survey formula when the MOU expires in 2015. Clearly, this will require a negotiated solution. The fiscal impact of continuing to provide annual increases of 4.6% cannot be emphasized enough. The total salaries and benefits for public safety employees is estimated to be $56.2 million for FY 2011/2012. This represents almost 43% of all General Fund resources available. If safety salaries continue to increase 4.6% annually, by FY 2030/2031, 62% of General Fund resources will go to fund safety compensation. This cannot be sustained without reductions in other City services because the Budget Stabilization Fund is projected to go down to $1.6 million in FY 2020/2021 and significant reductions ranging from $3.8 million to $17.4 million are already required to keep the Budget Stabilization Fund at zero for the back ten years of the financial plan.

Figure 9: Public Safety Salaries and Benefits as a % of General Fund Resources (with salaries increasing 4.6% annually)



Budgeting salaries, such a critical and large component of the budget, has always been challenging, but is even more so in a time of fiscal constraint. The salary assumptions in this recommended budget are based on projected policy direction just as much as on historical data. To the extent these assumptions do not hold, the City will face an even larger deficit much sooner than in 10 years. And to address this deficit, it is clear layoffs, outsourcing, and ongoing furloughs must be on the table. From FY 2009/2010 through FY 2011/2012, 54 positions have been eliminated citywide. To date, layoffs have been avoided through attrition and vacancies. This is no longer possible without strategic reductions weighed against service-level impacts.

- *Retirement Costs*

The costs of public pensions and pension reform made headlines over the last year due to the size of unfunded liabilities and sharply increasing contributions required of public agencies to fund these costs. As part of the California Public Employees Retirement System (CalPERS), Sunnyvale is faced with the same issues as all other agencies. Losses experienced in the CalPERS investment portfolio since 2000 have had a very negative effect on the City's employer contribution rates for retirement. With the recent unprecedented losses suffered in the global recession, Sunnyvale's unfunded liability has grown from $107 million to $148 million. The City's miscellaneous and safety plans were approximately 85% funded and are now 57% funded.

As a result of these losses, CalPERS will increase rates over the next three years to phase in the impact beginning with the FY 2011/2012 rates. While the phased approach mitigates the impact, it also comes at a cost. Agencies end up paying more in the long term as rates will have to stay high and continue to increase incrementally for the foreseeable future to make up for the fact that the necessary contributions were not made up front. Further, this plan leaves agencies more vulnerable to volatile rates in the future when investment return projections do not hit their target. This has become more likely with the CalPERS Board's recent decision to maintain the current investment earnings at 7.75%, despite the recommendation by their Chief Actuary to lower the rate to 7.50%. To ensure our retirement plans are prudently funded, staff has worked with our consulting actuary for the last few years and developed a contribution plan that will minimize volatility in rates over the long term by addressing our unfunded actuarial liability on the front end and over a fixed 30-year period. This plan is reflected in the budget.

In addition to rate increases to make up for the investment losses, CalPERS has also increased rates as a result of their latest demographic experience study. This study, conducted every five years to identify any changes that may need to be made in actuarial assumptions used to set employer retirement contribution rates, was released last year. The study contained three main findings: longer post-retirement life expectancy; earlier retirement ages for miscellaneous members; and higher salary increases for members with high service. Changes in the actuarial assumptions to adjust for these findings resulted in higher contribution rates. The increase in rates has been implemented for FY 2011/2012.

The combined impact for all of these factors is reflected in Figure 10. The rates reflect the proposed contribution rates as developed with our consulting actuary. Included in the table, for comparison purposes, are the rates that CalPERS has provided for the same years, with the FY 2012/2013 and FY 2013/2014 rates being estimates at this point.

Figure 10: Recommended Pension Contribution Rates v. CalPERS Rates by Retirement Plan

	Miscellaneous			
	CalPERS Contribution Rate	Cost of CalPERS Contribution	Sunnyvale Contribution Rate	Cost of Sunnyvale Contribution
FY 2009/10	15.3%	$8.5M	15.3%	$8.5M
FY 2010/11	16.6%	$9.3M	16.6%	$9.3M
FY 2011/12	19.5%	$11.1M	20.2%	$11.5M
FY 2012/13	20.5%	$11.7M	23.8%	$13.6M
FY 2013/14	23.1%	$13.3M	24.0%	$13.8M

	Safety			
	CalPERS Contribution Rate	Cost of CalPERS Contribution	Sunnyvale Contribution Rate	Cost of Sunnyvale Contribution
FY 2009/10	29.80%	$9.3M	29.80%	$9.3M
FY 2010/11	29.40%	$9.6M	29.40%	$9.6M
FY 2011/12	31.50%	$10.3M	34.70%	$11.4M
FY 2012/13	33.20%	$11.3M	36.70%	$12.5M
FY 2013/14	37.80%	$13.4M	38.70%	$13.7M

As you can see in Figure 10, we recommend contributing to CalPERS at a rate above what CalPERS is actually requiring us to contribute. As noted previously, taking this action puts the City in position to reduce rate volatility going forward and pay off our unfunded liability over a fixed 30-year period. Neither of these things is possible if the City opts to utilize the CalPERS rates. Over the next three years, the City will spend nearly $5.4 million above what CalPERS is projecting will be required. However, taking this action will end up costing the City less over the long term and protects the City from some of the rate shocks that may come in the future.

It should be noted that these rates are only the employer contribution rates. The pension plans are also funded by an employee contribution rate, which is fixed. The miscellaneous plan's employee rate is 8%, of which 1% is paid by the employee. As discussed previously, SMA has agreed to pay an additional 2% beginning in July 2012. The recommended budget projects all miscellaneous employees will do the same beginning in 2012. If the miscellaneous employees do not come to the same agreement as SMA with respect to employee contributions and a second-tier pension benefit, the General Fund will be required to make service cuts of approximately $1.5 million annually.

The safety plan's employee rate is 11.25%. PSMA and PSOA have agreed to contribute 3%, phased in over two years. Combining the employer and employee contribution rates, the total cost of the pension plans are 46.0% of salary for safety employees and 28.2% of salary for miscellaneous employees. The dollar impact of these costs for an average employee in each bargaining unit is illustrated in Figure 11 below.

Figure 11: Average Employee Pension Cost

PSOA	
PSO II Base Salary	$120,000
Employee Paid PERS (3%)	$3,600
City Paid PERS (43%)	$51,600
Total Pension Cost (46%)	**$55,200**

SMA	
Average SMA Salary	$117,000
Employee Paid PERS (3%)	$3,510
City Paid PERS (25.2%)	$29,484
Total Pension Cost (28.2%)	**$32,994**

- *Medical Costs*

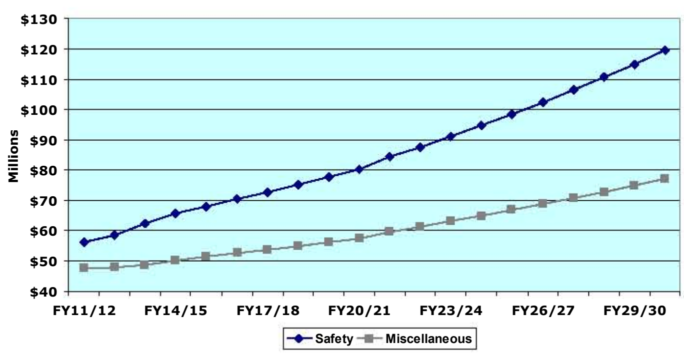
Another personnel cost that is increasing more rapidly than inflation is medical insurance for active and retired employees purchased through CalPERS. Medical premiums increased 10.5% in FY 2010/2011 and are projected to increase another 10% in FY 2011/2012. The budget then assumes costs will rise 8% annually for the next five years through FY 2016/2017 and then 5% annually for the remainder of the financial plan. It is unknown at this time what impact the healthcare reforms at the federal level will have on medical costs. In addition to the increase in medical premiums for active employees, the growing number of retirees will continue to impact the City's long term medical costs. To address this and the unfunded liability for retiree medical benefits, the City began funding a retiree medical trust fund in FY 2010/2011 with an initial one-time contribution of $32.6 million. The City will then make annual contributions into the fund until the liability is fully satisfied. Under current actuarial assumptions, it is anticipated this will occur towards the end of the 20-year financial plan. At that time, a portion of the ongoing costs will be offset by the interest earnings on the trust funds, reducing the annual amount that the City needs to contribute going forward.

▪ *Total Employee Compensation Costs*

As the previous sections on these costs detail, the elements of our employee compensation are both significant today and in the future. For FY 2011/2012, total compensation is up 9% for safety employees and 5% for miscellaneous employees. Not only does this have an impact on the budget, but this also impacts our fees for service, as all City fees that are labored based will need to be adjusted by these increases to ensure full cost recovery. For example, planning fees, building fees, and fire safety operations permits will all need to increase between 5% and 9% to account for the increased labor costs.

This increase in employee compensation is not limited to one year. As Figure 12 below illustrates, employee costs are increasing by an average of 4.1% annually for safety employees and 2.6% annually for miscellaneous employees. This translates to average annual increases in compensation costs of $3.3 million for the safety group and $1.6 million for the miscellaneous group of employees. Based on current projections, the total compensation costs for a safety employee will more than double over the next 20 years.

Figure 12: Projected Personnel Cost Increases for the Next 20 Years



▪ *Utilities Rate Increases*

Each year, as part of the yearly process of reviewing the financial condition of the utility enterprise funds, recommendations are made to the City Council to adopt annual changes in utility rates. Each of the utility enterprises is facing its own unique challenges. In the Solid Waste Management Fund, declining revenues have complicated rate setting. In the Wastewater Management Fund, the City is challenged with funding the very large infrastructure requirements that include a $335 million Water Pollution Control Plant. And in the Water Supply and Distribution Fund, large wholesale rate increases combined with needed adjustments to the City's pricing structure have added a level of complexity to this year's water rate setting. In particular, the San Francisco Public Utilities Commission (which provides about 46% of the City water) recommendation of rate increases in the range of

41% to 53% is especially challenging.

Despite these challenges, the recommended solid waste and wastewater rate increases are lower than what was originally projected in the FY 2010/2011 Adopted Budget for FY 2011/2012. Solid Waste rates are one percentage point lower than projected, and wastewater rates are two percentage points lower than projected. This helps to mitigate the impact of water rates that were increased nine percentage points over previous projections to fund the significant increases in wholesale rates.

Figure 13: Comparison of Recommended Utility Rates v. Original Projection in FY 2010/2011 Budget

Utility	Original Projection	Recommended FY 2011/12	Change in Percentage Points
Water	9.00%	18.00%	9%
Wastewater	7.50%	5.50%	-2%
Solid Waste	7.00%	6.00%	-1%

Figure 14 compares what an average monthly bill would have looked like under the previous projections to what it will be under the revised rates. Comparisons are based on a 5/8" meter charge, 12 ccf of water use, and a 65 gallon garbage container. As is illustrated, the difference in the total average bill is only $1.41 per month, or $16.92 per year.

Figure 14: Comparison of Previous to Revised Average Monthly Utility Bills

	Water	Wastewater	Solid Waste	Total
Original Projection	$39.70	$31.42	$37.50	$108.62
Revised	$42.04	$30.84	$37.15	$110.03

- *Organizational Restructure*

In April 2011 I unveiled the last wave of major reorganization, part of my focused efforts to streamline the organization and best position us in this new economic environment. While the transition is underway, due to the timing of the budget development process, the new organizational structures are not in the budget system. However, as much of the framework has been put in place to the extent possible. For example, the recommended budget document includes the operating budget by department with the new Utilities Department and combined Library and Community Services Department. Programs have been moved to the appropriate department sections; if the activities within a program are being split, the program has been placed with the primary department for now. In addition, the elimination of the Community Services Director and Intergovernmental Relations Officer positions has been reflected in the General Fund financial plan. Other reductions in staffing will occur, but over time on an "as the opportunity presents itself" basis. It is anticipated the program budgets and positions will be aligned as part of the development of the FY 2012/2013 two-year operating budget.

One of the reorganization efforts begun last year was the civilianization of eight sworn positions to community service officers. This will ensure the level of sworn officers "on the street" is maintained while effectively providing all public safety services for less money. It was estimated the transition would occur over two years and the recommended FY 2011/2012 Budget reflects the conversion of the final four positions. This transition is dependent on the retirement of sworn officers, which has not occurred as anticipated to date. Budget targets are still anticipated to be met, but it may require adjustments in other areas within

Public Safety until this transition is successfully completed.

▪ Service Level Reductions

As discussed in the *Structural Deficit* section, the General Fund 20-year financial plan includes service level reductions beginning in FY 2011/2012. The dollar amounts in this line item are set differently for the first 10 years of the financial versus the amounts set in the latter 10 years. For the first 10 years, a $500,000 savings target has been budgeted. These savings will need to be generated by the operating programs beyond any savings and/or efficiencies that were already programmed into their FY 2011/2012 operating budget. The savings targets will be distributed proportionately based on departmental General Fund operating expenditures. The total savings target is a modest one because the General Fund is also relying on the draw down of the Budget Stabilization Fund during the first 10 years.

In the second 10 years, there will be nothing left in the Budget Stabilization Fund. As a result, the service level reductions must be increased dramatically in order to balance the budget while addressing the loss of interfund loan repayments and the continuing imbalance between revenues and expenditures.

▪ Infrastructure Investment Funding

The General Fund financial plan includes funds for investment in the City's infrastructure beginning in FY 2011/2012. The amount budgeted represents the estimated cost to the City to accelerate street repairs to return the Pavement Condition Indicator to a level of 80 over the next five years and then maintain that level going forward. These funds have not been specifically budgeted and therefore can be used for any purpose, such as reducing the target for Service Level Reductions or adding the amount to the Budget Stabilization Fund reserve. However, this is the only amount budgeted for this purpose in the recommended budget. As discussed further in the *Major Projects* section, the City's infrastructure is deteriorating and the lack of funding to address these needs in a timely manner is a particular area of concern.

In FY 2004/2005, over $2 million annually was budgeted in the General Fund as contributions to the Infrastructure Fund for a total of $65 million over 20 years. During this same 20 year planning period, a total of $70 million in infrastructure projects were budgeted, including the rehabilitation and maintenance of the civic center, corporation yard, parks facilities, and some streets related projects. Since that time, General Fund contributions have been reduced and supplanted by Park Dedication and Gas Tax and other street-specific funds for parks and street-related infrastructure projects. From FY 2004/2005 through FY 2010/2011, only $3.9 million in General Fund contributions have been made to the Infrastructure Fund and no additional contributions have been budgeted since FY 2006/2007. Funds originally budgeted in this category were diverted to other uses and not replenished. This budget seeks to correct that course of action. While parks infrastructure and some streets maintenance are addressed by the special funding mentioned above, the reduced transfers from the General Fund have left the City's aging administrative buildings and much of the City's streets maintenance unfunded.

▪ Impact of State Budget Actions

Since coming into office in January 2011, Governor Jerry Brown has been working with legislators to resolve the massive California state budget deficit, estimated to be $25.4 billion. To date, he has fallen short in his efforts to achieve a budget for FY 2011/2012, together with a ballot measure seeking approval of the voters for the extension of certain tax increases that are scheduled to end in June 2011. The Legislature has enacted $12.2 billion in state budget cuts but more action, either in cuts or revenue increases, is needed to close the state budget gap in the coming months. In this current, very fluid situation, there are several issues that may impact Sunnyvale.

There are some significant impacts in the area of public safety due to certain tax increases not being extended. Under current law, the COPS/SLESF program will terminate after June 2011. The City had received $100,000 annually in recent years that provided partial funding for a traffic enforcement public safety officer. Staff has not budgeted these funds for FY 2011/2012. There are discussions at the state level to restore this funding. If funds are not restored, one public safety officer position will be eliminated. Also scheduled to end after June 2011 is state funding for booking fees. Absent the state funding, the law provides that counties may charge fees to arresting agencies to recover costs for booking persons into county detention facilities. Based on previous fees paid, staff has budgeted $250,000 in FY 2011/2012 for this expense. Because the future funding situation is uncertain at this time, this has only been budgeted for one year.

Funding for the Public Library Fund has been reduced significantly. The City does not budget these funds until they are received and they are utilized for supplemental library activities, so there is no budgetary impact. In addition, reimbursement for state mandates for pre-2004 mandates has again been suspended. The City has not budgeted for this reimbursement to begin again until FY 2012/2013 so there is no fiscal impact at this time.

Elimination of RDA

By far the biggest potential impact to the City is the Governor's proposal to eliminate all redevelopment agencies (RDAs). To date, the Governor's proposal has not garnered sufficient votes for passage, but remains a part of on-going budget negotiations. If RDAs are eliminated, the City's RDA may be in a vulnerable position in regards to the interpretation of what debt obligations will be recognized for repayment. Although the legislation does not explicitly state that agreements between the City and Agency are not legally enforceable contracts, the language does state that all debts that are not enforceable contracts shall be extinguished. The interpretation staff has received so far indicates that agreements between cities and agencies are not legally enforceable clients.

If so, Sunnyvale is in a position to lose approximately $5.8 million in FY 2011/2012 in loan repayments to the General Fund. The loan repayments grow in future years to a high of approximately $11.5 million in FY 2027/2028. The budget anticipates $139.2 million in loan repayments to the General Fund over the 20-year financial plan, with $75.1 million of the total projected in the first 10 years. Clearly, if RDAs are eliminated and the General Fund loan to the RDA is not recognized, the City's financial situation would be altered drastically. Staff continues to monitor developments related to the state budget.

- *Changing the Community Recreation Fund Model*

With the structural deficit in the Community Recreation Fund, staff has been evaluating the appropriateness of the enterprise fund model in the course of the overall review of the operations in this fund. As a result, in April 2011, Council dissolved the Community Recreation Fund due to concerns regarding its ability to support all of the services contained within the fund through user fees alone, and without support from tax dollars.

Moving forward, golf and tennis operations will continue to operate as a true enterprise fund, with all other recreation activities of the City, including social services such as those provided by the Senior Center, returning to the General Fund.

Because of the timing of this decision, the recommended budget still contains the Community Recreation Fund, but it is presented as two sub-funds: one containing the golf and tennis revenues and operations, and the other containing the recreation activities. With the separation of the sub-funds, the reliance of recreation activities on the profits of the golf operations is evident. Ending FY 2010/2011 reserves for golf operations is expected to be $3.8 million while the ending reserve for recreation is anticipated to be negative $3.8 million. To minimize the impact on the General Fund, the Golf and Tennis sub-fund will transfer enough funds into recreation to ensure the Recreation sub-fund balance is zero when it moves to the General Fund. In recognition of golf's support of recreation activities over the years, existing golf and tennis capital projects that are currently funded by Park Dedication revenues will continue to have this funding support. Any new projects will require funding from golf and tennis revenues.

Because the recreation activities will be folded into the General Fund, the structural deficit in this sub-fund has been addressed in the context of the General Fund. The golf and tennis operations sub-fund also shows a structural deficit beginning in FY 2012/2013. As discussed previously, through investment in the golf course and operational efficiencies, staff expects to resolve this deficit before it occurs. If there is a deficit, as a stand alone enterprise fund, it will be handled within this fund.

Major Projects

FY 2011/2012 is the first year of the projects budget cycle and the second year of the two-year operating budget cycle. All projects proposed for the 20-year planning period underwent a thorough review by Department Directors and the Director of Finance prior to being recommended to the City Manager. As a result of the project budget process this year, the recommended FY 2011/2012 Budget contains $30.9 million in capital, infrastructure, and special projects in FY 2011/2012 and a total of $703.6 million in projects over 20 years. Grant funds will support $33.2 million of the project budgets. The remaining budgets are covered through fees and directly from funds such as the General Fund and Utilities Funds. There are a total of 221 funded projects and 33 unfunded projects. The unfunded projects, which consists primarily of revenue dependent, grant eligible projects and City facilities rehabilitation projects, total $91.7 million over 20 years. It should be noted that estimates for the Civic Center rehabilitation project have not been budgeted, as options are currently being explored. Significant projects and strategic planning efforts for major components of the City's physical assets are highlighted below.

▪ *Replacement of the Water Pollution Control Plant*

Infrastructure maintenance and repair has been and remains the largest issue for the City's wastewater collection and treatment system. Capital projects included in the recommended FY 2011/2012 Budget include the continued refinement of plans and funding for a new Water Pollution Control Plant and additional projects needed to manage the gap between the old and new plants.

The FY 2007/2008 Long Term Financial Plan identified the need for a new Water Pollution Control Plant. An Asset Condition Assessment of the Water Pollution Control Plant (WPCP) completed in August 2006 identified the aging and deteriorating condition of the plant and recommended that a master plan for the long-term needs of the plant be completed. In response, a project for a comprehensive Strategic Infrastructure Plan (SIP) study was funded in the FY 2007/2008 Project Budget. The purpose of this study, which is complete, was to determine the most cost-effective alternative, including re-build or mix of rehabilitation and replacement, in order to maintain current service levels and meet future needs at the plant. In FY 2010/2011, an additional project was funded to conduct a Peer Review of the SIP to validate its findings. That project is also complete.

To plan for the recommendations anticipated from the SIP, a project was submitted in FY 2007/2008 as a "placeholder" to provide up to full replacement of the plant. As specific projects are identified, the financial impact will be netted out of the "placeholder" and reflected as a new project. The first example of this is the design work for the Primary Treatment facilities. The results of both the SIP and the subsequent Peer Review have determined that the first step in replacement of the WPCP is the construction of new Head-Works and Primary Treatment Facilities. The recommended FY 2011/2012 Budget includes a project for $7.7 million to design new primary treatment infrastructure. It is anticipated that construction on this phase of the project will cost approximately $50 million.

Work also continues on certain critical projects which were previously identified as necessary in the short-term to address the most advanced areas of deterioration and are in increasing danger for failure. These projects fall primarily into two categories 1) projects in which technology has not changed significantly since they were originally built and will therefore become part of the new plant, and 2) projects that address infrastructure that may be replaced with different technology or processes, but that will not last the interim period and therefore must be repaired or replaced.

Some of these projects were financed through the 2010 Wastewater Revenue Bonds. It is anticipated that due to their size, additional borrowing will be required to fund future projects. The recommended FY 2011/2012 Budget includes additional borrowing to fund critical short term projects as well as the large "placeholder" project.

▪ *Utilities Infrastructure*

The City of Sunnyvale owns, operates, and maintains a water supply and distribution system, a wastewater collection system and a solid waste management system. Each of the systems relies on significant infrastructure, much of which (primarily in the water and wastewater systems) is at or near the end of its useful life. The recommended FY 2011/2012 Budget addresses significant infrastructure issues for all three funds.

Water Supply and Distribution

The water system has three pressure zones, eight wells, and over 280 miles in pipe with diameters ranging from 4 inches to 30 inches. Additionally, there are 10 potable water storage reservoirs at five different locations throughout the City with a total storage capacity of 26 million gallons. There is also one recycled water reservoir with a storage capacity of two million gallons.

The City's water supply and distribution system is aging and is in need of rehabilitation. Over the past few years, staff has been working to identify and scope projects to improve the system. As a result, $42.2 million in capital, special and infrastructure projects are included in the 20-year financial plan.

These projects address the three primary areas of the City's distribution system: storage, pipes, and wells. Due to the age of the system, the projects are front loaded in the first 10 years of the Long-Term Financial Plan. There is already $10 million budgeted in projects for FY 2010/2011 that will continue into the next year. In addition, $22 million is budgeted from FY 2011/2012 through FY 2020/2021. The largest projects over the first 10 years are $6.6 million for water line replacements, $2.3 million for interior coating of water tanks, $2.4 million for exterior painting of water tanks, and $2 million for rehabilitation of the Central Water Plant Building and equipment.

In mid 2010 the City issued Water Revenue Bonds, providing $17.8 million in funding for water projects, all of which will be spent in three years. This helps to fund these projects and spread their costs over their useful life for rate-setting purposes. No additional financing is planned in the Water Fund, with the remainder of the projects being funded through rate revenue.

Wastewater Collection System

The wastewater collection system consists of approximately 610 miles of sewer and storm mains, seven pump or lift stations, and a two mile sewer force main. The system has five major sewer trunk lines that terminate at the WPCP where sewage is treated for discharge.

The City's wastewater collection systems are in need of significant rehabilitation due to their age. The recommended FY 2011/2012 Budget includes approximately $18.7 million in the first 10 years in projects related to sewer and storm water collection and an additional $17.4 million of fully identified projects in the second 10 years of the plan. Major projects over the first 10 years include $10.2 million for sewer pipe improvements, $3.8 million for rehabilitation of the Lawrence Expressway trunk line, $3.5 million for sewer and storm pump and lift station rebuilds, and $900,000 for trash capture devices for storm water management.

In mid 2010 the City issued Wastewater Revenue Bonds, providing $22.6 million in funding for sewer treatment and collection projects, all of which will be spent in three years. This financing approach helps to fund these projects while spreading their costs over their useful lives for rate-setting purposes.

Solid Waste Management System

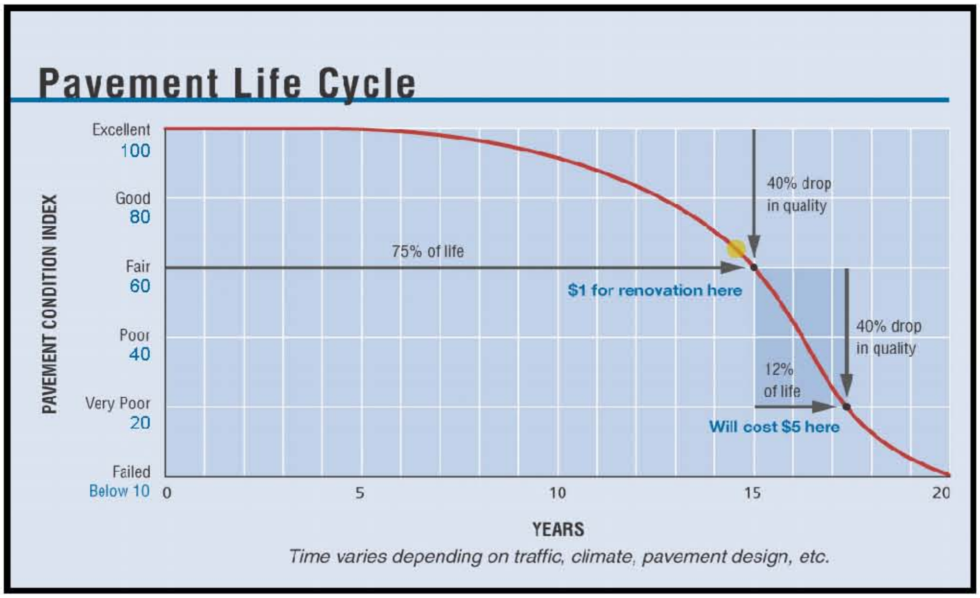
The City's solid waste management system infrastructure is comprised of the closed Sunnyvale Landfill and the Sunnyvale Materials Recovery and Transfer Station (SMaRT Station®).

The recommended FY 2011/2012 Budget includes a variety of small projects in the short term to address primarily periodic maintenance or regulatory issues. The most significant project is a $30 million placeholder project for the replacement of the SMaRT Station in FY 2023/2024. The current agreement between the cities of Sunnyvale, Mountain View, and Palo Alto for the use of the SMaRT Station expires in 2021. This also coincides with the estimated useful remaining life of the SMaRT Station and therefore will become a decision point as to how Sunnyvale manages its waste and recyclables. The placeholder is to insure that some funding is identified to either replace the SMaRT Station, or fund some other solution for the management of solid waste and recyclables in the City.

▪ *Streets and Roadway Infrastructure Maintenance*

The continued maintenance of our street surfaces has been affected by the economy as much, if not more, as any program, and the impact of this on the condition of our City's streets has been significant. In 2006, the City's Pavement Condition Index (PCI) was 85, which put us firmly in the VERY GOOD category with respect to the condition of our streets. With expenditures, particularly those related to personnel, increasing at a rate greater than revenues, funds for materials were held flat or even reduced, including those necessary for streets maintenance. Factor in an increase in the cost of street maintenance materials, many of which are impacted by the price of oil, and the result was the City's streets were getting less and less maintenance on an annual basis. By 2010 this reduction in maintenance resulted in a PCI of 75; and although a PCI of 75 is still considered GOOD, it is not the optimal level from a cost-benefit perspective.

Figure 15: PCI and The Pavement Life Cycle



As you can see by Figure 15, as the PCI degrades, the cost to maintain increases significantly. The key to this chart is the change in slope as the PCI dips below 80, and even more so as it approaches 70. Analysis of the chart shows that missing the right rating by one or two years can severely impact the street condition, and the cost of improving the pavement. When a street falls below a PCI of 50 it is then no longer worth spending a lot of effort on maintaining. It is placed on the list to reconstruct. With reductions in maintenance performed due to budgetary constraints, the number of street segments falling into this category has increased. The total area of streets in this category has gone from 0.8 million SF in 2005 to 2.0 million SF in 2009. Pavement maintenance staff responds to calls for pot holes on such streets, but provide little additional maintenance until the street is reconstructed.

The City is currently seeing the impacts of its decision to not keep up with the previous service level for street maintenance. Prior to 2006, when the City's PCI was 85, annual funding for street maintenance was approximately $3.85 million. Since then, funding for street maintenance has dropped to approximately $3.1 million annually. As previously noted, we have seen a corresponding drop in PCI to 75, which is below the most cost effective PCI of 80. The decision to reduce total funding to the streets maintenance program saved the City $3.8 million over the past five years; however, the deterioration of our streets will now require $12.5 million over five years to return us to a PCI of 80. The five-year delay in maintenance will cost the City $8.7 million above what it would have cost had we continued to fund at the $3.85 million level annually. Continued delay and degradation to our streets will become even more expensive, as another five-year delay in maintenance will cost $19.5 million because major overlay and reconstruction will be required.

It is clear that the City must reconsider the level at which it funds its streets maintenance. To that end, funds have been programmed into the General Fund to reflect the planned ongoing investment, starting in FY 2011/2012, in the City's infrastructure. The amount budgeted represents the estimated cost to the City to accelerate street repairs to return the PCI to a level of 80 over the next five years and then maintain that level going forward. Although it has not been decided if those funds will be used for that purpose, as there are a number of infrastructure needs throughout the City, the amounts listed in the *Infrastructure Investment* line item throughout the General Fund Long-Term Financial Plan reflect using the funds for additional street repairs.

▪ *Calabazas Creek Bridge at Old Mt. View-Alviso Road*

The Calabazas Creek Bridge, which is located on Old Mountain View Road near Highway 237, is shared by the cities of Sunnyvale and Santa Clara. The Bridge has been rated "structurally deficient" by Caltrans. The City has received a commitment of Federal Highway Bridge program funding in the amount of $1.2 million or 88.53% of the estimated preliminary design cost for bridge replacement. The required local match for the preliminary design portion will be split between both cities. Staff will submit a proposal to obtain construction funding after preliminary design, including right-of-way certification, and environmental clearance is complete. The total project is estimated to cost $9.9 million. Sunnyvale's share of the local match would be $565,000. Sunnyvale will act as lead agency for construction of the project. When completed in 2014, the useful life of the new bridge is estimated to be 40 years.

▪ *Fair Oaks Bridge over Caltrain and Hendy Avenue*

The Fair Oaks Bridge has been rated as "structurally deficient," by Caltrans. The bridge project will improve guard rails, pedestrian access, roadway widths and clearances, deck rehabilitation, and lighting. The City has received a commitment of Federal Highway Bridge program funding in the amount of $2.6 million or 88.53% of the estimated preliminary design cost to rehabilitate the bridge. Staff will submit a proposal to obtain construction funding after preliminary design, including right-of-way certification, and environmental clearance is complete. The total project is estimated to cost $21.9 million. Sunnyvale's share of the local match would be $2.5 million. When completed in 2015 the useful life of the new bridge is estimated to be 40 years.

- ### *Mathilda Avenue Bridge over Caltrain and Evelyn*

Caltrans rated this bridge "functionally obsolete", not meeting several standards for bridge pier clearance, deceleration lane, shoulder width, and bridge railing, and pedestrian access.



City staff has successfully secured federal funds for 88.53% of this project. The project cost is currently expected to be $25.6 million, much less than original estimates due to the favorable construction bidding climate. The City's local share is funded by Measure A funds, Traffic Mitigation fees and Gas Tax funds. The bridge improvements, currently in construction, include reconfiguring the off ramp to Evelyn Avenue to allow both east and west access to Evelyn from southbound Mathilda Avenue, new pedestrian ramps, bridge widening, streetlights, landscaping, and a reconfigured signalized intersection at California Avenue and Mathilda and a new signalized intersection at Charles Street and Evelyn Avenue. The project is scheduled for completion in January 2012.

- ### *Morse Avenue Neighborhood Park Development*

In light of greater than anticipated redevelopment of the Industrial-to-Residential (ITR) area into housing, development of the Morse Avenue neighborhood park began in FY 2009/2010. This project includes the closing of the Fair Oaks Industrial Park, which has been completed, and the construction of a neighborhood park on the site. The Fair Oaks Industrial Park was purchased by the City in 1990 in anticipation of future park needs for the area between State Highway 237 and U.S. Route 101 and Tasman.

This project is currently in the design phase, which is anticipated to conclude in FY 2010/2011 with Council's consideration and approval of a conceptual design. FY 2011/2012 will largely be dedicated to the removal of soil contaminants and the preparation of a clean site for construction. Currently further analysis is being performed to ascertain the true cost of anticipated clean-up efforts. Assuming those costs are not prohibitive, staff anticipates construction will commence and conclude in FY 2012/2013. This project is funded through Park Dedication Fees and operating costs for the Morse Neighborhood Park will be absorbed by existing Parks Division staff.

- ### *Recruitment and Training for Sworn Officers*

The Public Safety Department budgets for the recruitment, selection, and training of new public safety officers in a series of recurring Special Projects rather than in the operating budget. This methodology allows expenditures to fluctuate each year based on the number of recruitments and allows for better monitoring and tracking of costs. Current staffing and pending separations are such that staff does not plan to hire public safety officers during this fiscal year, therefore, no funding is required in this fiscal year. A total of $53.1 million is included in the proposed budget over the 20-year period in these recurring special projects; and is adjusted each year, based on projected needs.

The Public Safety Department will continue to define the Civilianization Professional Model in FY 2011/2012. The department is following a long-term plan to reduce the number of higher cost sworn staff, through attrition, and utilize civilian professionals at a much lower cost to deliver services wherever possible. The department is currently working to revise job classifications to prepare for the civilianization of several work functions and units within the department. Staff anticipates hiring the first Civilian Professionals during the 2011/2012 fiscal year.

▪ *Parks Infrastructure Projects*

A total of $36 million of parks, golf, and recreation-related capital and infrastructure projects are

programmed throughout the long-term plan, including $8.2 million in FY 2011/2012. The two major projects for FY 2011/2012 are Morse Avenue Neighborhood Park Development and Community Center Comprehensive Infrastructure. All of the projects currently programmed in the 20-year plan related to parks, golf, and recreation are funded by Park Dedication Fee revenues. The use of Park Dedication Fee revenues to fund these categories of projects has been the source of significant study, which will continue well into FY 2011/2012.

In a study session conducted in April 2011, staff advised Council of its plans to develop for Council's consideration more detailed policies related to implementation of the Park Dedication Fund revenues. Since those policies are still in the process of being developed, staff did inform Council at that time that this year's budget submittal would focus on and prioritize the rehabilitation of existing parks, golf, and recreation infrastructure. A proposal for prioritizing new capital projects to be funded by Park Dedication Fee revenue will be brought to Council with all other proposed policies for the Park Dedication Fund later in the calendar year. As such, the $36 million programmed over the 20-year plan only reflect the existing parks, golf, and recreation infrastructure, with the exception of the Morse Park project.

One such change to the policies relating to the use of Park Dedication Fund revenues that has already been determined is that any new projects related to the City's golf courses and tennis center will be funded by revenues from the new Golf and Tennis Fund and not from Park Dedication Fee revenues. As discussed earlier in this transmittal, Golf and Tennis are now in their own enterprise fund, and revenues collected from golf and tennis services will be required to cover operations, overhead, capital, and infrastructure.

Based on projections for new fee-eligible dwelling units being built over the next 20 years, it is expected that the Park Dedication Fund will generate significant revenues over the long-term to fund a number of new capital and infrastructure projects and/or acquire land for future park development, pending Council's decision related to policies for Park Dedication Fee revenue usage. The recommended FY 2011/2012

Budget includes $72 million in projected revenue available over the 20-year plan for yet to be identified projects. This revenue projection is based on the current park facility standard and the current fair market value per square foot. The revenue projection is updated annually and will adjust with changes to these factors.

Civic Center/City Facilities

The long-term infrastructure needs of City facilities remain a significant issue. The entire Civic Center campus, which includes City Hall, City Hall Annex, South Annex, Library, Sunnyvale Office Center, and the Department of Public Safety building, as well as the City's Corporation Yard, are in need of significant rehabilitation or outright reconstruction. In addition to these buildings being past their useful lives, which makes them difficult and very expensive to maintain, these buildings do not meet the space needs for the City's current workforce. *Of particular concern is that no funds have been put aside for our City facilities.*

Over the past several years, the City has contracted for two major studies to assess the situation with the City's facilities and provide options for addressing these issues. Staff presented the most recent study options, which focused on the Civic Center campus, to Council in January 2011, at its strategic planning workshop. Based on the options presented, Council directed staff to pursue two options. The first option would be to move City Hall into a new downtown location, which would include exploring a financing plan that would involve selling and/or land swapping all or a portion of the existing City Hall campus. The second option to explore would be to rebuild City Hall on its existing campus, anchored by a new library financed through the issuance of bonds. As a part of this, the old library would be renovated to allow for its use by other City functions, particularly those currently housed at the South Annex and the Sunnyvale Office Center. The second option also includes the City Manager presenting other viable options.

These two options are currently being studied, and as such, there is no cost estimate for either at this point. While the construction of a new Library could be funded by a bond measure if approved by the voters, the City Hall facility reconstruction has no dedicated funds set aside at this point. Thus, pursuing either option would require selling and/or swapping City assets or setting aside funding in a reserve over a number of years, or a combination of the two. Once an option is selected and a detailed cost estimate for that option is established, the next step will be to identify the funding mechanism(s).

Financing Our Infrastructure Needs

During the adoption of the FY 2010/2011 Budget, Council directed staff to explore the potential use of impact fees and other revenues, such as assessment districts and impact fees, to pay for increased service levels or facilities needs. To begin this analysis, staff contracted with an outside firm to develop a public improvement financing strategy for the City and provide recommendations for the best options to move forward with. The strategy was completed in March 2011 and determined no one solution or strategy will resolve the funding gap for the City's infrastructure needs. The recommendation advised utilizing a mix of fiscal policies, existing and new revenue sources, and exploring alternate financing arrangements. In addition, it suggests the City may have to reprioritize its infrastructure needs and levels of service to fit within revenue projections.

The strategy recommends exploring a landscape and lighting district which the City can potentially utilize in the areas of street tree services, concrete maintenance, street lighting, and traffic signal maintenance. In all of these areas, service levels have been reduced and therefore, the increase in service levels can be set to meet the special benefit analysis requirements. The report emphasizes that assessment districts require voter approval and time must be taken to develop public support for the assessments. The strategy also states that the City is well positioned to implement impact fees for police and fire. While these fees are one time and dependent on development, they would provide a source of revenue for rehabilitation of the public safety building and fire stations.

Staff is currently evaluating the recommendations and will be coming forward to Council with specific options.

Addressing the Long Term Structural Deficit

As this transmittal letter details, the City continues to grapple with an expenditure problem and the continuing structural deficit as a result. We have been aware of this problem for the last three years and begun steps to address it. So far, the steps have been modest and the size of the problem, already large, continues to grow. This is not a problem that began overnight or a result of one single factor; as such, the solution will take time and will have to come through various forms. Therefore, I continue to approach the structural deficit from different angles:

1. **Increase organizational efficiencies** – The foundation has been laid with the last piece of my re-organization and I expect to drive more efficiencies from it. We will continue to evaluate every vacancy that opens up, but as there becomes less open positions, layoffs must be on the table as well.

FY 2011/2012 Recommended Budget
Key Decision Points

CalPERS Pension Contributions: The recommended Budget includes higher contribution rates than what CalPERS requires in order to minimize rate volatility over the long term and address our unfunded liability. *Additional Cost in the Budget: $5.4M over 3 years.*

Public Safety Salary Assumptions: The recommended Budget does not budget Public Safety salary increases at the historical annual average of 4.6%. Instead, 4% is budgeted through 2015, then 3% through FY 2020/2021 and 4% for the remaining 10 years of the financial plan. This is based on the assumption that there will be some adjustments to the salary survey formula when the MOU expires in 2015. *Savings Assumed in the Budget: $194M over 20 years.*

Infrastructure Investment: The recommended Budget includes enough funding to accelerate street repairs and return the Pavement Condition Indicator to 80 over the next five years and then maintain that level going forward. *Additional Cost in the Budget: $28M over 20 years.*

Miscellaneous Employees Compensation: The recommended Budget assumes all employees in the miscellaneous group will follow the recent SMA concessions: no salary increases for 2 years, 2% additional contribution towards retirement costs, and a two-tier retirement system for new hires. *Savings Assumed in the Budget: $74M over 20 years.*

Addressing the Structural Deficit: Again in FY 2011/2012, a deficit is projected for the General Fund. This marks the fourth straight year this will occurr. As it is in part designed, the Budget Stabilization Fund has stabilized the deficit over that period. What it was not meant to do was become an ongoing funding source. It has. Rather than funding down trends, it is projected to decrease from $35 million at the end of FY 2010/2011 to $28.5 million in FY 2011/2012 and down to $1.6 million in 2021. Simply put, the fund can not be counted on as it has in the past as a stabilizer or even as a long term funding source without balancing the budget through expenditure reductions that creates the optimum cost/ revenue balance.

2. **Contracting out** – The proposed update to the contracting out policy will be distributed for Council review shortly. With the cost of employee compensation, this must be in the toolbox as we evaluate the delivery of City services.

3. **Revenue Enhancement** – As discussed earlier, we will develop options from the public improvement financing strategy including landscape and lighting districts and impact fees. However, if we move forward with any revenue enhancement, public support will be critical. In order to achieve this support, the expenditure side of our house must be in order.

4. **Addressing Personnel Costs with Bargaining Units** – This is the single most important component for addressing the long term structural deficit. Pension reform and adjustments to survey formulas must be part of the solution.

While these options will require effort and sacrifice from our City staff, I have no doubt we can work together as a team to be successful. Our City staff has already shown their commitment to providing all essential services in this challenging fiscal environment. I'm extremely proud of their dedication and commitment to Sunnyvale, and how each and every member of our organization stepped up when we've needed them.

Respectfully Submitted,

Gary Luebbers
City Manager

May 5, 2011