



# RECOMMENDED BUDGET AND RESOURCE ALLOCATION PLAN

Fiscal Year 2014/2015

FREMONT HIGH SCHOOL

FIREBIRD  
Marching Band



Sunnyvale,  
California

Volume I: Summary & Operating Budget

**City Manager's  
Letter of Transmittal**



*Honorable Mayor and Members of the City Council:*

I am pleased to present for your review and consideration the FY 2014/15 Recommended Budget and Twenty-Year Resource Allocation Plan. While there has been transition at the executive level midway through the development of this recommended budget, the comprehensive plan developed over the last several years and the continuing economic recovery have allowed us to stay the course and continue on the path of long-term fiscal sustainability.

The citywide FY 2014/15 Recommended Budget totals \$314.6 million and includes all City operations and project expenditures. The City's General Fund, which accounts for 50% of the citywide budget, has proposed expenditures of \$157.3 million. While the General Fund is projected to be balanced over the short and long term, challenges continue to put pressure on the Fund, requiring us to remain vigilant and disciplined to ensure we maintain our financial stability for the long term.

### **Moderate Economic Recovery Continues**

The country continues to recover from the worst recession since World War II at a slow and modest pace that began in June 2009. The economy ended 2013 on a strong note with increased consumer spending, continued decline in the jobless rate, a solid gains in the stock market and more stable housing sector recovery. California's Bay Area region has been at the forefront of the recovery with significant growth in job creation and rising home prices. Sunnyvale has helped lead the recovery as evidenced by several key indicators:

- The Sunnyvale metro area jobless rate of 6.3% is below the State (8.5%) and Federal (6.7%) rates as of February 2014;
- The vacancy rate for R&D/Office space has fallen from 23.7% in 2009 to 9.88% as of March 2014;
- Average rents for R&D/Office space have risen 138% from 2009 to March 2014;
- The median sales price for single family homes hit an all-time high of \$748,750 in 2013, surpassing the last peak in 2007; and
- Construction activity has been at record levels for three consecutive years with a fourth year anticipated.

While the signs are positive and most economists are forecasting 2014 will be better than 2013, there are many risks and vulnerabilities as well. At the national level, the Federal Reserve is still unwinding the federal stimulus policies, bank credit remains tight and there are growing concerns about the widening income inequality gap. Of particular concern to Sunnyvale is the potential for corrections in the financial and housing markets and the continued restraint in business investment spending. These elements have a direct impact on the City's major revenue sources such as Property Tax at 37% and Sales Tax at 22% of General Fund revenue, respectively. In fact, while the City's Property Tax revenues have shown solid gains through this recovery period, our revenue from Sales Tax, which has a significant business-to-business sales component, has been more volatile with FY 2012/13 total revenues unexpectedly coming in less than FY 2011/12 revenues. With this kind of volatility from the second largest revenue source in the General Fund, we took

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## *FY 2014/15 Recommended Budget*

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care in the development of the long-range revenue projections to incorporate continued recovery in the economy but also moderate for the anticipated year-to-year volatility and the inevitable cooling off from peak activity levels we are currently experiencing.

### **Five Key Commitments**

The strong financial picture for the City would not have been possible without the adherence to the five key commitments first detailed in the budget two years ago. These five commitments have provided a plan of action and clear direction in the development of the long-term financial plan:

- Manage our personnel costs;
- Fund retirement costs for long-term sustainability;
- Get to optimum service levels through strategic review/analysis;
- Establish long-term funding for the City's infrastructure needs;
- Commit to a long-term comprehensive solution and stay the course.

The City has made significant progress in all of these areas by:

- Negotiating with all employee bargaining units no salary increases for one to three years;
- Holding FY 2013/14 salary increases to the amount budgeted;
- Putting in place reduced benefit second- and third-tier retirement plans for all new employees;
- Increasing employee contributions for retirement costs;
- Growing the City's OPEB trust to pre-fund retiree medical costs, which is now over \$50 million and 38% funded;
- Reorganizing and realigning services and departments;
- Implementing the Community Services Officer (CSO) model in the Public Safety Department;
- Adding seven positions in the FY 2013/14 Budget across four departments;
- Adding five additional positions after the adoption of the FY 2013/14 Budget: one public safety officer, one dispatcher, one parks worker, one assistant planner and one building inspector;
- Increasing the Pavement Condition Index (PCI) to 79, which is on target to reach the optimal level of 80 as a result of additional funding we committed over the twenty-year plan to accelerate street rehabilitation and reconstruction work;
- Restoring the seven-year tree trimming cycle; and
- Programming \$1.5 million annually, totaling \$30 million over twenty years, toward additional investment in our infrastructure.

With this recommended budget, we are building upon this substantial progress. We maintain the more modest salary increases that have been assumed over the twenty-year plan. We continue to build into the long-term plan the full employee contribution of the employee portion of retirement costs by 2019 for non-sworn employees and 2020 for sworn employees. While we had already incorporated increased employer contribution rates for the retirement plans into the long-term financial plan, we have updated our projections with the latest actuarial and demographic assumption data. We also continue to strategically add resources in key areas:

- Two additional positions to support the Water Pollution Control Plant reconstruction project;
- One additional programmer analyst to support the growing technology demands within the organization;

- Supplemental resources for the traffic division for two years;
- Funding to restore red curb painting; and
- Additional funds for two years to address the increasing backlog for sidewalk repairs.

We also are increasing funding for wastewater operations to address additional regulatory requirements and the rising costs of maintaining a deteriorating Water Pollution Control Plant. Because the overall approach as we developed this budget was to “hold the line,” we added these additional resources to areas with the most urgent and critical needs, and only after much analysis and discussion.

### Pressures and Challenges

While the FY 2014/15 Recommended Budget and Twenty-Year Resource Allocation Plan presents a structurally balanced plan over the short and long term, there are several pressures and challenges that will impact our long-term sustainability if we do not address them in a timely manner.

#### *Increasing Service Demands*

The most significant pressure is the increasing demand on City services. Due to the global recession, City staffing was reduced out of necessity by eliminating certain vacant positions. Because personnel-related costs outpaced revenue growth following the recession, we added positions very judiciously since. As a result, the City has a nearly 20% smaller workforce now compared to a decade ago, despite a population that is 10% larger during that same period. We have used technology, reorganized departments and implemented different staffing models to meet service demands as cost effectively as possible; however, the pressure continues, especially with many new and increasing demands on the organization such as: sustainability initiatives,

impacts from the growth in development activity and our continually aging infrastructure. There are also internal demands that require resources, particularly in the area of technology. The City’s outdated building permitting system is currently in the replacement process and we are beginning the first phase to replace the seventeen-year old financial system. As part of the replacement of the financial system, we have the opportunity to re-examine our performance-based budgeting model and ensure it continues to meet the needs of the Council, community and staff for allocating the City’s resources.

#### *Addressing the City’s Aging Infrastructure*

We have made great progress in addressing the funding needs for the City’s infrastructure, but there is still more work to do. For both our utilities and public roadway infrastructure, we have developed funding plans for the short and long term and have made real progress by completing projects as we execute to our plan. While the funding side has been the focus, another important aspect is determining the appropriate service level for maintaining City infrastructure such as sidewalks, trees and sewer lines. Better defining the service levels will be a focus in the coming year.

For our City administrative facilities, we have set aside \$30 million over twenty years to address infrastructure needs and we continue to grow the balance in the Capital Improvement Reserve of the General Fund for one-time capital projects. The key next step will be to confirm Council’s decisions regarding the Civic Center campus and administrative facilities. Part of this confirmation will include funding levels and sources. With clear direction, we can then appropriate these set-aside funds to specific projects and proceed with rehabilitating and/or renovating our facilities.

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### *Rising Costs in Utilities Operations*

Another pressure is the rising costs related to operating our utilities. Regulatory requirements are tightening. Wastewater discharge requirements in our portion of the Bay are the most stringent, and storm water and air quality regulations are driving operating costs up. The Zero Waste Policy will cost the City a significant amount to implement, potentially driving solid waste costs up by several percentage points. Solid waste and wastewater rates will also be impacted by the trash reduction plan to keep litter from the City's storm water system. Additionally, maintaining and operating the deteriorating Water Pollution Control Plant while simultaneously building a new facility requires increased staff and potentially costs more in materials such as chemicals. The City's wholesale water providers are facing infrastructure needs similar to ours, and are now engaged in managing drought conditions, which can have financial impacts as well as impacts on the community's day-to-day activities.

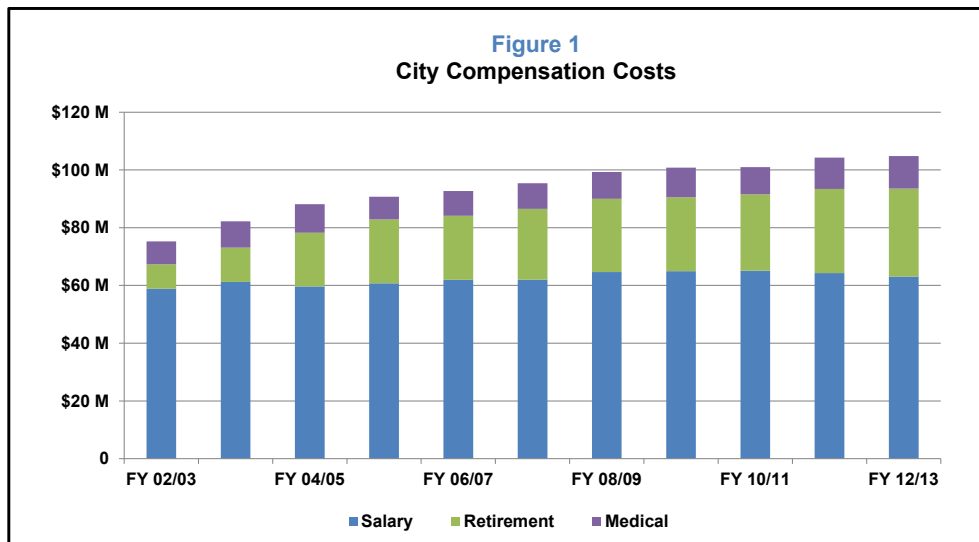
### *Containing Personnel Costs*

As a service organization, employee salaries and benefits are the largest component of the City's operating expenditures, accounting for 58% of the total citywide budget. Containing this growth has been central to achieving structural balance in the City's budget over the short and long term. Working together with our bargaining units, we have made considerable progress. Furthermore, the long-term financial plan lays out assumptions for salary increases and increased employee contributions to retirement over the next several years that provide the parameters to maintain structural balance. However, these assumptions are only good as long as we implement them. With several labor agreements expiring in 2014 and 2015, this will be the challenge. In particular, this budget assumes:

- Salary increases of no more than 2% for the first ten years and 3% for the second ten years for all non-sworn employees after the expiration of current contracts.
- For sworn employees, a salary increase of 4% for FY 2014/15, then 3% for the remaining first ten years and 4% in the second ten years. Because the contract with the Public Safety Officers' Association (PSOA) uses a salary survey to determine salary increases and the Public Safety Managers' Association (PSMA) salary adjustments are tied to those of PSOA, the City's ability to contain salary increases for these two groups is limited. The historical average annual salary increase has been higher than 4% so the budget assumes the salary survey will be modified as a result of negotiations with PSOA when the contract expires in 2015.
- All employees will pay the entire employee contribution rate for retirement benefits over the next several years. The budget assumes all non-sworn employees will contribute 8% of pay by FY 2018/19 and sworn employees will contribute 9% of pay by FY 2019/20.

We must continue to be vigilant and focused because the costs for our two largest benefits, retirement and medical, are driven by many factors outside of our control. Further, as Figure 1 on the following page indicates, it is the cost for these two benefits, particularly retirement, that is driving much of the growth in compensation. Figure 1 includes salaries, retirement costs and medical premiums paid by the City for all full-time and part-time employees over the last eleven years. As noted earlier, the City's workforce declined nearly 20% over this same period.

Because of our long-term approach, we have already anticipated increasing employer contributions rates from CalPERS and have been contributing more than CalPERS required for several years. As a result, the City already has budgeted most of the impact of the recent



actuarial and demographic assumptions changes CalPERS has just adopted which will increase rates by approximately 40% over the next five years. The rate methodology changes will improve the long-term fiscal sustainability of the retirement plans by paying down unfunded liabilities over a fixed period. However, the changes also will result in more volatile rate increases year-over-year as gains and losses are recognized over a much shorter period. To deal with this volatility, we have increased budgeted contribution rates and continue to build reserves in this recommended budget.

There also is greater uncertainty with increases in medical premiums over the next several years. The City contracts with CalPERS for medical benefits and CalPERS is currently adjusting their geographical areas that help set the pricing structure. Our preliminary information indicates Bay Area premiums will rise as a result of the changes. Another part of the uncertainty is the impact of the Affordable Care Act on our premiums. With the continually changing regulations, we do not know the full impact at this time. To address these uncertainties, we have adjusted our assumptions for medical premium increases upward.

With these significant uncertainties and uncontrollable factors, it is especially important to stay the course with our plan and those elements that we can control.

### *Strengthening Our Long-Term Revenue Base*

While our focus over the past several years has been on controlling our expenses, we must also strengthen our revenue base. We have begun this effort with the recent increase to our Transient Occupancy Tax (TOT) rate from 9.5% to 10.5%. With the increased hotel development activity and current level of demand, this rate increase occurred at a beneficial time. As a result, we have increased projections for this revenue source significantly in this recommended budget. It is worth noting that even with this increase, Sunnyvale's TOT rate is less than several surrounding communities and a neighboring city is considering an increase from 12% to 14%.



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Even though TOT revenues currently look strong, it is important to note that three out of five of our largest tax sources are highly volatile. Sales Tax, TOT and Construction Tax are heavily impacted by economic business cycles and consequently our revenue fluctuations have been significant. In addition, the Sales Tax and Utility Users Tax (UUT) both have an eroding base that is resulting in declining revenue over the long term. Although changes to the application of Sales Tax will need to occur at the State and Federal level, the UUT is a local tax and we will be exploring ways to modernize the ordinance and a potential increase to the rate in 2015.

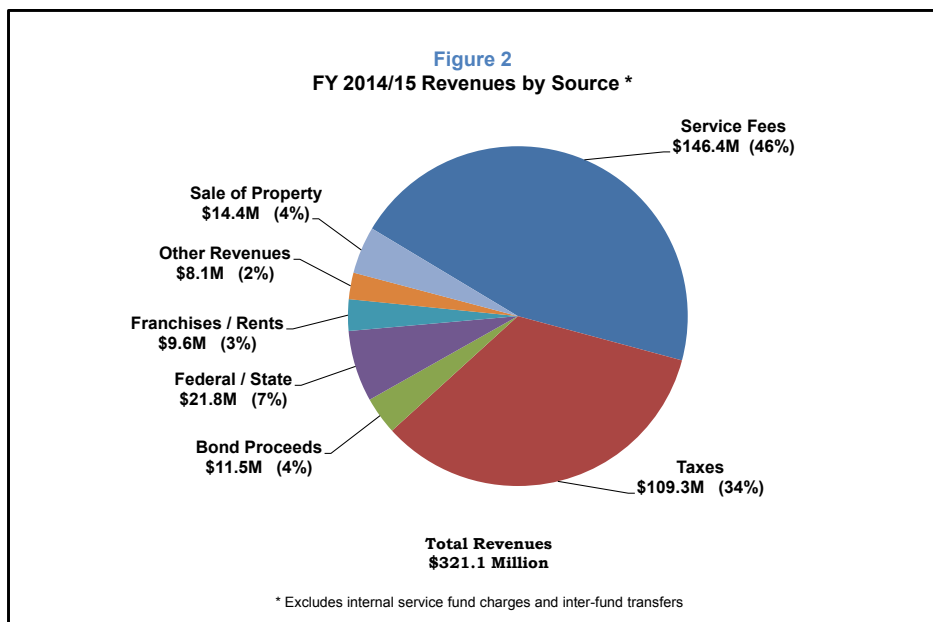


### Overview of the Recommended Budget

There are three key elements to the City's budget and resource allocation plan that provide the financial picture of the City for both the short and long term: revenues, expenditures and reserves. The following sections discuss the highlights, key assumptions and changes included in this recommended budget for each of these elements. It is important to note these elements are budgeted into specific funds, such as the Park Dedication Fund and the Gas Tax Fund, primarily to ensure that revenues restricted to specific purposes are spent for those purposes. While the discussion here is not organized by fund, this important structure is reflected in the budget document with the presentation of twenty-year financial plans for each of the City's 27 funds. Detailed discussions about revenues, expenditures and reserves by specific fund are included with the financial plans.

### City Revenues and Resources

The City relies on many sources of revenues and the strategic use of reserves to fund services to the community at a stable and sustainable level. As Figure 2 shows, the largest revenue categories are taxes and service fees.



### Taxes

Taxes, imposed by a government for the purpose of raising revenue to support governmental activities, are distinctly different from fees in that a tax does not need to be levied in proportion to the specific benefit received by a person or property. Therefore, almost all of the City's tax revenues are in the General Fund, the primary general purpose fund of the City. Taxes account for 73% of the total revenues in the General Fund, supporting many of the most visible and essential city services such as police, fire, road

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**Figure 3**

**Top Citywide Tax Revenues**

Revenue Source	2011/12 Actual	2012/13 Actual	2013/14 Revised Projection	2014/15 Proposed Projection	% Change 2014/15 over 2013/14
Property Tax	43,407,026	47,555,857	49,778,401	51,931,017	4.32%
Sales Tax	30,345,514	30,028,067	29,755,382	30,184,219	1.44%
Transient Occupancy Tax	7,777,583	9,016,052	10,136,188	10,674,737	5.31%
Utility Users Tax	6,830,496	6,549,144	6,774,352	6,971,420	2.91%
Gas Tax	3,940,053	3,246,768	3,560,301	3,572,845	0.35%
Construction Tax	3,058,607	2,724,864	2,643,589	2,009,127	-24.00%
<b>TOP TAX REVENUES - TOTAL</b>	<b>95,359,280</b>	<b>99,120,752</b>	<b>102,648,213</b>	<b>105,343,365</b>	<b>2.63%</b>

maintenance, library and parks maintenance. The only tax revenue accounted for in a separate fund is the Gas Tax, which is levied and distributed by the State. Gas Tax funds must be spent on maintenance and capital projects related to public streets and highways. Figure 3 above presents recent revenue received and projections for the top tax revenues.

The proposed revenues present a mixed outlook and reflect the volatility in key tax revenue sources. As part of the development of the recommended budget, the current year projections are also updated. Based on year-to-date figures, we anticipate FY 2013/14 revenues for Property Tax, Transient Occupancy Tax (TOT) and Construction Tax to exceed initial projections made for the FY 2013/14 Adopted Budget. We have revised estimates downward for Sales Tax, Utility Users Tax (UUT) and Gas Tax revenues.

**Property Tax** revenue has experienced strong growth in the last year, driven by activity in the residential real estate market. Revenues from the commercial/industrial sector also have increased significantly. We anticipate continued strong revenue growth in Property Tax revenue for the next two years, led by the commercial sector, due to the lag time in getting major developments onto

the tax roll. Beginning in FY 2016/17, we forecast Property Tax growth at a long-term historical average.

**Sales Tax**, the City's second largest tax revenue source, continues to show great volatility. The major segment of activity in our Sales Tax base is business-to-business sales. Due to large fluctuations in this sector, FY 2012/13 revenue actually decreased from the prior year and the projection for FY 2013/14 has been adjusted downward by approximately \$1.7 million. In addition, a large negative adjustment, the result of a State audit that goes back over several years, further reduces revenues for FY 2014/15 and FY 2015/16. Given the ongoing volatility and the erosion of the Sales Tax base as we continue to move into more of a service-based economy, we feel an adjustment to the base is warranted as we look out over the long term. The overall impact of reducing the Sales Tax base to the City's General Fund long-term financial plan is a \$42 million decrease over twenty years.

**Transient Occupancy Tax** has shown significant growth in the last two years, coming in above estimates for FY 2012/13 and anticipated to be above estimates for FY 2013/14. Historically, because business-related travel is the core business

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for Sunnyvale's hotels, this revenue source has correlated with the level of economic activity and followed Sales Tax revenue trends. Currently, TOT is not tracking with Sales Tax; instead TOT revenue continues to remain strong and is anticipated to stay strong through FY 2014/15. Two additional factors impact the positive forecast. Effective January 1, 2014, the City increased the TOT rate by 1% to 10.5%. In addition, the FY 2014/15 Recommended Budget assumes that three new hotels will be operating by FY 2016/17, one more than was forecast in last year's budget. Because of the heavy reliance on business travel and the resulting volatility, we have used historical room and occupancy rates for projections starting in FY 2015/16.

**Utility Users Tax** revenue, generated from the sale of electricity, telecom services, and the sale of gas, is forecasted to show modest growth overall. Increased development activity, in particular the impact of additional buildings within the City, is growing the base. However, the impact of this growth has been substantially negated by energy efficiency. The telecom tax base has been deteriorating because the bulk of the growth is related to areas not included in the tax calculation, such as data transmission. This recommended budget continues to anticipate a decline in this portion of the UUT over the long term.

**Gas Tax**, levied as a flat rate per gallon sold, is projected to hold flat in the long-term financial plan. Because the tax is based on volume sold and not on the price of gasoline, our projections consider that advancements in fuel economy will offset increased population and number of vehicles. While this revenue source holds flat, or declines over time, the costs and needs for street maintenance and improvements continue to climb. There is discussion at the State and Federal level to make changes to the Gas Tax and how it is levied. In the meantime, the City's General Fund

is picking up the increased funding requirement for these important expenditures.

**Construction Tax** returns have been very strong, an indication of the high level of development activity that the City has sustained for three consecutive years. We anticipate that this historically high level will cool off, with an elevated amount estimated for FY 2014/15 and the historical average level planned beginning in FY 2015/16.

### *Service Fees*

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

**Utility Rates** - The City has three utility funds that are fully self-supporting: the Water Supply and Distribution Fund, the Solid Waste Management Fund and the Wastewater Management Fund. Each year, as part of the budget process, staff analyzes the current condition and long-term outlook for all three funds. The analysis includes a review of fund balances; State and Federal environmental requirements; revenues; anticipated capital, infrastructure and operational requirements; and a detailed inspection of significant expenditure

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**Figure 4**  
**Utility Rate Changes**

Utility	Original Projection	Recommended FY 2014/15	Change in Percentage Points
Water	5.00%	5.00%	0.00%
Wastewater	7.00%	9.00%	2.00%
Solid Waste	4.00%	6.00%	2.00%

areas. The results lead to proposed adjustments to rates that will generate the revenues necessary to meet planned expenditures. Through the long-term planning model, staff attempts to keep utility rates as stable as possible with modest increases annually, versus keeping rates flat and impacting customers with a high increase in one year. The overall recommended increase for FY 2014/15 is shown above, in Figure 4, with the total planned increase established last fiscal year.

Each of the utility enterprises has its own unique pressures that are driving rate adjustments. The FY 2014/15 Recommended Budget is the first year in the two year operating budget cycle. As such, each utility went through a detailed review of operating expenditures. Additionally, although not a capital budget cycle, the utility capital and infrastructure projects are significant enough that adjustments have been made based on the changing priorities in each of the utilities.

In the water utility, the costs of purchasing water from wholesale water providers and infrastructure rehabilitation continue to drive rate increases. This year, the drought has added a layer of financial uncertainty to the Fund. Both of the City's water wholesale suppliers are calling for reductions in water use. Although not mandatory yet, the financial plan assumes that the drought will affect both revenues and expenditures. The rates include an anticipated 10% reduction in water use, which

will reduce revenues by an estimated 10%. Both the wholesalers have agreed to reduce the City's minimum purchase requirements, so the revenue loss will be largely offset by savings in buying less water. However, as with all utilities, there are fixed costs to operate the water system which are not based on the volume of water delivered. As such, there is some risk that drought reductions will result in higher than anticipated rates in the future.

The wastewater rates are being driven primarily by costs associated with improvements to the City's wastewater collection and treatment system and stricter regulatory requirements. The main driver of rates in the Wastewater Management Fund is the need to replace the City's aging wastewater treatment plant. The rates include an assumption that the City will issue utility revenue bonds to fund the project over many years; annual debt service costs are expected to be over \$22 million by FY 2023/24 after all the bonds have been issued. This debt service expense is substantial – it will make up a third of the Fund's total expenditure requirements.

The operating costs for this Fund are also up significantly to address both capital and operating needs. Costs for chemicals to treat wastewater are up over \$300,000 per year due to increased usage. The recommended budget also includes adding two full-time positions related to supporting the

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construction of the treatment plant while we are still maintaining current operations. These factors drive the need for an increase that is two percentage points higher than projected in the current budget.

Solid waste rates are driven by increases in the costs for the collection of solid waste; potential increases resulting from the current procurement process underway to award a new contract for the operation of the SMaRT Station; and the costs for beginning the implementation of the City's Zero Waste Policy. A portion of the increases in cost were offset by savings through the extension and restructuring of the landfill disposal contract. However, because economic cycles impact demand for solid waste services and revenues as a result, the Fund is still recovering from the Great Recession and is unable to absorb many of these cost increases through the use of reserves. Therefore, solid waste rates are increasing two percentage points more than anticipated last year.

**Development-Related Fees** - Development-related fees (e.g., plan check fees, inspection fees and permit application fees) and related expenditures have been in the General Fund, where total development-related revenue was one of the top five revenue sources in that Fund. Over the last several years, staff has been evaluating the fees and costs to ensure the City is charging the appropriate level of fees and obtaining full cost recovery. As part of this evaluation, we determined a separate fund would be beneficial for several reasons: the fund will allow us to track revenues and expenditures separately, because these fee revenues are highly volatile and expenditures related to specific fees can occur later than when the revenue is collected; and a separate fund allows us to build and draw down on a separate reserve. We are creating this separate fund starting in FY 2014/15. In preparation for the start of this fund, a separate *Development Enterprise Reserve* was created in the

General Fund to hold revenues collected in excess of what was budgeted for development-related revenue for FY 2012/13. Development activity has continued at record levels through FY 2013/14 so additional excess revenue is anticipated to be carried over into the new fund for FY 2014/15. It should be noted that Construction Tax, while tied to development activity, is a tax and will therefore remain in the General Fund.

With several large-scale development projects in the Moffett Park and Peery Park areas, staff estimates an elevated level of revenue for FY 2014/15. However, this will be the fourth year of increased activity, and history has shown us that this revenue is highly volatile with very wide swings between the peaks and valleys. As a result, a historical average has been budgeted starting in FY 2015/16. On the expenditure side, a detailed analysis was conducted to ensure all related costs are reflected in the new fund. This was a complex process to identify costs across several departments including Community Development, Public Works, Public Safety, Environmental Services, Offices of the City Manager and City Attorney, and Library and Recreation Services. To ensure a careful, methodic approach, our focus this year was to identify the direct costs. Over the next year, along with the structure of the fees, we will identify indirect costs. With the direct costs, the first version of the fund presented in this recommended budget indicates the historical level of revenues will not fully cover expenditures over the long term. As a result, fees will need to be increased. As we develop more actual history, this separate fund will assist us in ensuring full cost recovery.

**Development Impact Fees** - The City imposes four development impact fees to mitigate the impact of a development on the community: Park Dedication fees, Transportation Impact fees, Housing Mitigation fees and Sense of Place

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fees. Impact fees have strict requirements, set by state government code, that require fees to be roughly proportional to the impacts of the project and imposed for purposes related to the impacts of the project. Therefore, each of these fees is accounted for separately in its own fund or sub-fund. With development activity in the City currently at record levels, revenue from these fees has been significant. In total, the City collected \$18.6 million in revenue from these four fees in FY 2012/13. Based on year-to-date figures, we estimate collecting \$14 million for FY 2013/14. With the known development projects in the permitting process currently, significant revenue is anticipated for FY 2014/15. Because of the volatile nature of development projects, it is challenging to forecast impact fee revenue beyond the most immediate years. As Figure 5 shows, Park Dedication and Sense of Place fee revenue is expected to remain high through FY 2016/17, based on several large projects triggering these fees, and then a historical average is

**Figure 5**  
Impact Fee Revenue

Revenue Source	2013/14 Projection	2014/15 Budget	2015/16 Plan	2016/17 Plan	2017/18 Plan	2018/19 Plan
Park Dedication Fee	5,878,594	9,516,000	9,516,000	9,516,000	7,560,883	7,560,883
Housing Mitigation Fee	4,390,032	6,815,910	2,475,554	2,525,065	2,575,566	2,627,078
Transportation Impact Fee	3,500,715	5,552,448	1,818,113	1,854,475	1,891,565	1,929,396
Sense of Place Fee	156,128	213,200	362,500	362,500	145,665	148,578
<b>IMPACT FEES - TOTAL</b>	<b>13,925,469</b>	<b>22,097,558</b>	<b>14,172,167</b>	<b>14,258,040</b>	<b>12,173,679</b>	<b>12,265,935</b>

used. We use the historical average starting in FY 2015/16 for the Transportation Impact and Housing Mitigation fees. Because this was not a projects budget development year, the revenue projected above last year's budget is not appropriated and is primarily reflected as increases to fund reserves.

**Golf Fees** - Newly configured in FY 2012/13, the Golf and Tennis Fund has struggled over the last two years to operate as a true enterprise fund, with all activities attempting to be self-supporting. Due to the sudden departure of the restaurant operator for the two golf courses in 2012, golf revenues suffered greatly and the General Fund provided a \$300,000 subsidy to cover anticipated deficits for FY 2012/13 and FY 2013/14. During this time, staff has made good progress in restructuring staffing to reduce expenditures; however growing the golf course revenues has been a challenge. Although the restaurants have re-opened under a

new operator, revenues did not rebound as strongly as anticipated and the new operator is struggling to become profitable. The Fund is anticipated to end FY 2013/14 close to break-even with very little remaining in reserves.

Over the longer term, a combination of greater revenue growth and further expenditure reduction is required for this fund to be structurally balanced and staff continues to explore both areas. An additional longer term pressure is the funding of capital improvements. Current planned capital projects are funded by Park Dedication fees through FY 2032/33, but subsequently the Golf and Tennis Fund is expected to fund its own capital and infrastructure. Given the many challenges, a discussion of the long-term viability of the golf course operations and the current funding model needs to begin in the next year.

### *Other Revenue Sources*

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

**Debt Financing** - We use debt financing as a tool to maintain long-term financial stability by paying for certain expenditures over time. Debt financing is a tool for managing cash flow when large, one-time outlays are required, generally for large infrastructure projects.

The City currently carries debt for both the Water and Wastewater Systems, the SMaRT Station, the Redevelopment Successor Agency and the Government Center property at 505 West Olive Avenue ("Sunnyvale Office Center"). All of the currently held debt is funded by rate revenues, former tax increment or lease payments. The City does not maintain any general obligation debt (commonly called "GO Bonds") and continues to maintain the highest issuer credit rating issued by Standard & Poors (AAA) and Moody's (Aaa).

The recommended budget includes the assumption that we will issue a significant amount of debt to finance the Water Pollution Control Plant (WPCP) renovation. It is anticipated that the first series of bonds may be issued as soon as FY 2014/15, with a financing program to continue for about 10 years. Financing for the WPCP will be secured by revenues from the Wastewater System (sewer rates). We are currently exploring a mix of financing options including the use of State Revolving funds, traditional revenue bonds and short-term cash borrowing rolled into a long-term financing option.

**Sale of Property** - One-time in nature, proceeds from the sale of property go to the fund that owned

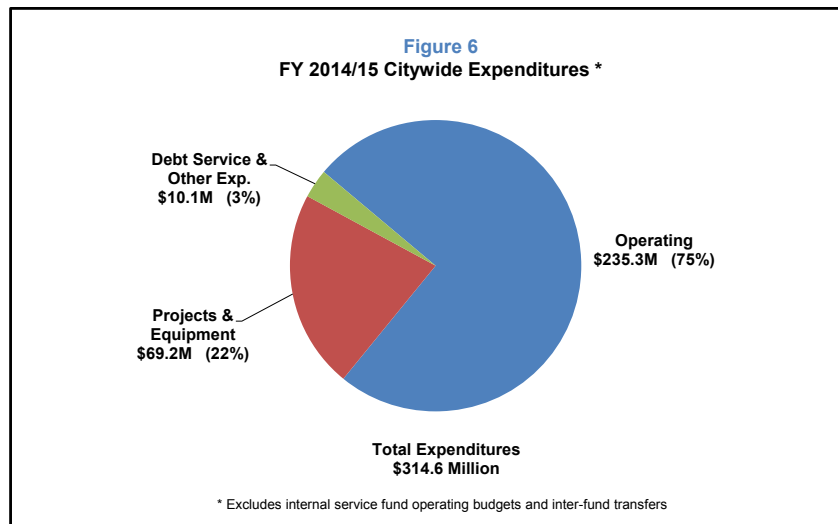
or purchased the property. By City policy, one-time revenues are spent on one-time expenditures. As such, in the General Fund, sale of property revenue is placed in the Capital Improvement Reserve within the Fund. For FY 2014/15, the General Fund reflects updated numbers for the sale of the Raynor Activity Center. Based on the accepted sales price, \$14 million is now anticipated. The budgeted use of these proceeds also has been updated. As detailed in the Report to Council on the sale (RTC 13-275), this recommended budget includes the budget to design and construct a branch library on the Lakewood Park site and accelerate the Washington Pool Expansion project.

# CITY MANAGER'S MESSAGE

## FY 2014/15 Recommended Budget

### City Expenditures

City expenditures fall into three broad categories: operating, projects and equipment, and debt service. As Figure 6 shows, operating expenditures make up most of the City's expenditures.



### Operating Expenditures

Operating expenditures reflect all of the costs to deliver the wide variety of services provided to our community on an ongoing basis. We develop our budget in two-year cycles, alternating between the operating budget and the capital budget. FY 2014/15 is the first year of a two-year operating budget cycle. All departments went through an extensive review of their budget that included a detailed look at both personnel and goods and services budgets. Departments also reviewed their program structures and performance indicators. Changes in these areas are noted in the detailed department sections of this recommended budget.

With the mixed picture we are projecting for our major revenue sources and the many pressures and challenges we see on the horizon, we gave departments the direction to “hold the line” as they developed the two-year operating budget. All departments worked to control or contain costs and, as Figure 7 on the following page indicates, total budgeted operating expenditures are only up a modest 4.2%, which includes assumptions for salary increases and higher costs for benefits.



**Figure 7**

**Budgeted and Actual Operating Costs by Department**

Department	FY 2012/13 Budget	FY 2012/13 Actual	FY 2013/14 Budget	FY 2014/15 Budget	FY 2015/16 Budget	% Change FY 2013/14 to FY 2014/15
Community Development	6,701,900	6,585,094	7,093,713	7,271,984	7,493,872	2.5%
Environmental Services *	71,745,349	74,113,837	75,364,239	79,487,473	85,229,042	5.5%
Finance	8,070,556	7,892,186	8,066,685	8,396,376	8,637,755	4.1%
Human Resources	3,541,072	3,335,356	3,692,299	3,839,779	3,941,492	4.0%
Information Technology	6,068,253	5,828,313	6,557,241	6,949,480	7,108,009	6.0%
Library & Community Svcs	17,234,792	16,295,361	17,392,971	17,364,506	17,829,744	-0.2%
NOVA Workforce Services	7,634,501	7,210,861	7,060,657	8,103,883	7,150,166	14.8%
Office of the City Attorney	2,183,772	2,036,054	2,025,963	1,796,939	1,830,039	-11.3%
Office of the City Manager	4,356,779	4,113,344	4,735,937	4,309,881	4,455,485	-9.0%
Public Safety	76,424,687	75,567,473	80,593,246	84,312,602	88,575,398	4.6%
Public Works	33,430,253	34,678,853	34,438,723	35,481,432	36,282,146	3.0%
<b>TOTAL EXPENDITURES</b>	<b>237,391,914</b>	<b>237,656,732</b>	<b>247,021,674</b>	<b>257,314,335</b>	<b>268,533,148</b>	<b>4.2%</b>

\* Does not include SMaRT Station program expenditures.

**Environmental Services Department (ESD)** is adding over \$4 million in additional cost for FY 2014/15. The department spans four separate funds that account for water services, wastewater services, solid waste and recycling services, and the operation of the SMaRT Station. In water, increases are wholly attributed to the \$1.4 million in costs associated with wholesale water rates. Wastewater operations are increasing significantly due to additional environmental compliance requirements and increases in chemical costs for wastewater treatment. ESD is also adding two new positions (a Principal WPCP Operator and a Systems Control Specialist) related to operating the wastewater treatment plant through the extended period of construction to re-build the WPCP. Resources are also being added due to increased regulatory requirements for keeping trash out of the storm system. For solid waste, increases are being driven by a \$500,000

increase in the garbage collection contract cost for increased labor and vehicle expenses passed on by Specialty Solid Waste and Recycling, additional costs to begin implementation of the Zero Waste Policy and expenses associated with a settlement with Baykeeper over storm water run-off from the Sunnyvale Landfill and SMaRT Station.

**The Department of Public Safety (DPS)** budget is up modestly, with most of the increase due to the estimated 4% increase in salaries for Public Safety Officers and funding for the mid-year addition of a Public Safety Dispatcher. Additionally, the department removed booking fee costs of \$250,000 due to secured State funding; however these savings were partially offset by a \$100,000 increase in contract costs with Santa Clara County for fingerprinting services. This increase is included in the first year of the operating budget, but is then expected to decrease starting in the second year.

# CITY MANAGER'S MESSAGE

## FY 2014/15 Recommended Budget

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DPS is also expecting to have to fill more than 20 new Public Safety Officer vacancies over the next two years due to anticipated retirements as well as to fill the three new positions added in FY 2013/14. Recruitment and training costs are captured separately from the operating budget in special projects and are therefore not reflected in the department's total budget shown in Figure 7. DPS has shifted funding from future project budgets for recruitment into the next two years to meet the current demands. Lastly, DPS maintains a separate equipment replacement fund which includes a new item totaling \$138,000 to replace two compressors that fill oxygen bottles for fire fighters.

**Department of Public Works (DPW)** made moderate additions and adjustments across the board to its budget. Included are items such as increases in electric, gas, and water utility costs, materials and supplies costs, and some minor part-time personnel changes to meet changing demands. The department also includes two internal service programs for facilities and fleet maintenance. Facilities maintenance remains largely flat, continuing the focus on maintaining the City's facilities in working condition pending larger policy decisions on replacement. Fleet also maintains a largely flat budget with the exception of additional budget for rising fuel prices, and the inclusion of two new unmarked police cars for the burglary suppression unit.

More significantly, DPW is adding resources to its budget to increase service levels in several areas. These include funding for one additional Parks Worker for Seven Seas Park that was approved in FY 2013/14 and funds to restore the red curb painting program. It should be noted that the recommended budget also includes an increase of \$1 million over two years in the capital program budget to increase the amount of sidewalk, curb and gutter repairs (to address the growing backlog of work) and a two-year project to provide

supplemental resources for traffic services.

**Library and Community Services (LCS)** is re-allocating resources between the Library and Community Services divisions to meet increasing demands in key areas. A vacant part-time Graphic Artist position is being converted to a part-time Library Specialist III to provide full service on Thursday evenings at the Library. LCS is also adding funding to clean, upgrade or replace furniture and expand its materials and technology resources to bring the Library in line with the average materials expenditure per capita in Santa Clara County. The Recreation Division also is reducing budgeted staff hours to bring them more in line with historical trends. As a result, the overall budget for the department is down from FY 2013/14.

For FY 2012/13 and FY 2013/14, Council provided supplemental funding to temporarily increase service levels for Care Management services. This provided funding for one part-time, unbenefited position to supplement an existing position at that same level. Staff is reviewing the impact of the second position and will be coming back to Council with options and recommendations regarding the ongoing service level for Care Management early in FY 2014/15.

**Community Development Department (CDD)** continues to experience a very high demand for services, reflective of the significant amount of development activity throughout the City. Despite this, they maintain a relatively flat budget. The department is adding approximately \$15,000 in costs related to compliance with tightening storm water regulations, as well as increasing credit card fees to accommodate the increased use of this payment method.

**Finance Department (FIN)** costs are increasing in several areas. Financial services costs are being adjusted upward to reflect increases in the annual

# CITY MANAGER'S MESSAGE

## *FY 2014/15 Recommended Budget*

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financial audit contract and credit card fees are increasing to address the rising use of online payment services provided by the department. However these increases are largely mitigated by savings in other areas.

**The Human Resources Department (HRD)** budget is up modestly, with funding added to address increased activity related to labor negotiations, recruitment and personnel management needs.

**The Information Technology Department (ITD)** is adding a new Programmer Analyst and upgrading one Network Engineer position to Principal Network Engineer. With the growth in the number of computer applications used citywide, demand for maintenance and reporting has increased, requiring additional programming staff to keep up with the workload. The City's network is becoming ever more complex, requiring higher skill level employees.

**NOVA Workforce Services Department (NWS)** receives funding through a portfolio of sources, predominantly Federal and State grant providers. The department does not receive funding from the City of Sunnyvale or any of the six other cities that make up the NOVA Consortium. The Federal budget was passed as a continuing resolution, which kept the resources available to the Workforce Investment Act (WIA) flat year-over-year. Throughout its existence, NOVA has also successfully accessed supplemental WIA Additional Assistance funds from the State. The FY 2014/15 budget is predicated upon a larger allocation from this source than in previous years.

**Office of the City Manager (OCM)** costs are flat with the exception of approximately \$180,000 in savings as a result of moving to even year elections. City Council expenses are also reflected in this budget.

Although the **Office of the City Attorney (OCA)** budget shows a reduction, this is due to a reallocation of funds for outside legal services to other programs. Budgeted funds are moving from OCA to the Property and Liability Insurance Fund for outside legal services related to liability claims. Outside legal services budgets for specialized areas, such as utility operation, are also moving over to the appropriate department.

### *Budget Supplements*

Budget supplements are proposals to increase, decrease or change service levels. Each supplement is presented separately and recommended for inclusion or exclusion from the FY 2014/15 Adopted Budget. This year, the recommended budget includes nine budget supplements. Figure 8 lists the supplements and the City Manager's recommendation. If the supplement is recommended for funding, it has been included in the financial plan of the affected fund. Details of each supplement can be found in the *Budget Supplements* section of this recommended budget.

# CITY MANAGER'S MESSAGE

## FY 2014/15 Recommended Budget

**Figure 8**

**FY 2014/15 Budget Supplements**

No.		Fund	One-Time	On-Going	20-Year Impact	City Manager's Recommendation
1	Funding for Dispute Resolution Services	General Fund	X		\$20,000	Yes
2	Comprehensive Update of the Precise Plan for El Camino Real	General Fund	X		\$80,000	Yes
3	Las Palmas Park/Tennis Center Auxiliary Restroom	Park Ded. Fund	X		\$300,000	Yes
4	Wolfe Road Corridor Traffic Improvement Study – El Camino Real to Homestead Rd	General Fund	X		\$250,000	Yes
5	Captioning for Council Meeting Broadcasts	General Fund		X	\$10,200	Yes
6	Public Access Programming for KSUN2 (Channel 26)	General Fund		X	\$65,800 - \$73,000	No
7	Funding for Leadership Sunnyvale	General Fund	X		\$6,000	Yes
8	Funding for Study of Community Choice Aggregation	General Fund	X		\$30,000	Yes
9	Downtown Sunnyvale Business Improvement District (BID) Funding Request	General Fund	X		\$30,000	No

### Capital Projects and Infrastructure

This year is the second year of the projects budget cycle, so the only changes made to projects were on an exception basis. We categorize our projects into four broad categories: Capital, Infrastructure, Special and Outside Group Funding. Capital projects are efforts to construct new or expanded facilities or infrastructure. Infrastructure projects are to rehabilitate existing infrastructure. Special projects are efforts like special studies or initiatives.

As only minimal changes were made to projects, the following section highlights current progress on some of the City's largest projects as well as projects that are forthcoming within the next several years.

**Traffic and Transportation** - As one of our most significant areas of investment, Traffic and Transportation projects cover a large variety of efforts, from studies to large infrastructure projects. Several significant efforts are underway, funded by Federal grants provided through the State. They include the interchange improvements at Mathilda/237/101, the Fair Oaks Overhead Bridge Rehabilitation and the Calabazas Creek Bridge Replacement. Additionally, the budget includes \$6.5 million for FY 2014/15 for continued pavement rehabilitation.

**Utilities** - We have made great progress improving our utility infrastructure over the last several years. With the 2010 issuance of \$18 million in water bonds and \$22.5 million in wastewater bonds, we have funded and completed a significant amount of

work. To date, we have expended approximately \$35 million of the proceeds from both bond issues directly on pipes, tanks, treatment infrastructure and the beginning design phase for the replacement of the WPCP. Contracts for master planning, design of the primary treatment facilities, and program management have all been awarded and work is underway. Other efforts in the utilities include work to implement our trash management plan to protect our channels and creeks from litter, and efforts to scope and implement the Council's direction on the Zero Waste Policy.

**City Parks, Library, and Facilities** - Over the past several years, we have identified the need to improve or expand our library, administrative facilities and parks. One of the most significant efforts to that end is the impending completion of Seven Seas Park, a brand new addition to our well-regarded parks system. Additionally, with the sale of Raynor Activity Center, we are going to be able to engage in two projects to directly improve service to the community. The Lakewood Branch Library, budgeted at \$11.5 million, will bring needed library services to an underserved section of the city. The second project is to accelerate renovations to the Washington Pool, improving the City's recreational facilities. Other projects underway or beginning shortly include expanding Orchard Gardens Park, improving athletic fields and other park facilities and rehabilitating the Community Center.

### City Reserves

The backbone of our financial planning process is the Twenty-Year Resource Allocation Plan. This planning document provides the framework to maintain a structurally balanced budget by requiring financial discipline in making policy and service level decisions. One of the key components of the financial plans are the various reserves contained within each plan. While the

use of reserves is considered a best practice and many organizations have them, our use of them in this strategic and disciplined way is different and more active than a typical city. We maintain reserves for different purposes; some are restricted in use while others are available for a variety of priorities. Examples of restricted reserves include debt service reserves or reserves of special revenues. Unrestricted reserves are used strategically over the twenty-year planning period to balance each fund. We plan to add to them or take from them as business and economic cycles pass, allowing us to provide a stable and consistent level of service. This is especially critical when so many of our large revenue sources are volatile by nature. Reviewing reserves over a long period forces policymakers, staff and the community to think carefully before adding services that must be sustained through good times and bad.

In the General Fund, the unrestricted reserve is the Budget Stabilization Fund. Disciplined and strategic use of this reserve has allowed us to weather the Great Recession, and is helping us to strategically add back services in a planned way to ensure sustainability over the long run. It will also help us manage our infrastructure needs and other pressures discussed at the beginning of this transmittal.

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

In both these cases, and throughout the budget, reserves also allow us to deal with unexpected expenditures. In the most extreme case, each significant fund carries large contingency reserves

# CITY MANAGER'S MESSAGE

## *FY 2014/15 Recommended Budget*

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for emergencies such as natural disasters; however, reserves also allow us to address projects that may be more expensive than estimated or absorb unanticipated operating costs. In all cases, reserves are one of our most critical tools to achieve and maintain financial sustainability.

### **Conclusion: Staying on the Path of Sustainability**

Sunnyvale has successfully weathered the Great Recession by implementing a plan that provided a path to fiscal sustainability while achieving optimum service levels. With the economy slowly rebounding, our focus on core services and our continued fiscal discipline have us well-positioned despite the pressures we face. This budget not only holds the line on expenses, but restores services, makes investments in the community and adds resources to critical areas such as public safety, environmental management and infrastructure renovation.

It is critical that we stay the course for this and many years to come. We will be faced with tough decisions regarding containment of personnel costs, use of debt for large infrastructure needs and mitigating volatility in our major revenues. Our twenty-year planning allows us to take a balanced approach to evaluate decisions in a long-term fiscal context and plan ahead. To that end, this budget presents a responsible, sustainable and balanced plan for the future of Sunnyvale.



**May 2, 2014**

CONCLUSION