



June 6, 2016

To the Citizens of Cupertino, Honorable Mayor and Members of the City Council:

Cupertino continues to remain financially sound with revenues outpacing expenditures over the next five years. The City is returning to a more stable level of growth after a two-year period of unprecedented short-term development activity. Strong growth is anticipated in the City's sales tax, property tax, and transient occupancy tax revenue in part due to Main Street, Apple Campus 2, and other development projects currently underway.

The short-term windfalls received during this two-year period allowed the City to make strategic one-time investments in capital infrastructure, transportation, and technology upgrades. With healthy reserves, multiple years of budget surplus, and increased demand for service, our focus in last year's budget was meeting operational needs and service enhancements. The City struggled to provide the high level of public service our residents, businesses, and customers have come to expect with limited growth in staffing as demands for service grew. Improved ongoing revenues allowed the City to make strategic investments in service delivery and corresponding staffing. A total of 12.0 new positions were approved last year, which have helped the City keep up with demands for service and enhance services in recreation, senior services, and sustainability.

Due to the cyclical nature of the economy and concerns about development, it is unclear to what extent the City will be able to rely on ongoing one-time development-related revenues. As a result, the budget forecast has been determined conservatively with the expectation that large-scale development activity will not continue at the same pace as the last few years.

The FY 2016-17 Final Budget takes a more conservative approach that reflects this expectation. Budget resources are proposed for maintaining existing service levels and infrastructure with few service level enhancements. The focus for next fiscal year will be on better utilizing existing resources to maximize efficiency in delivering services to our residents, including reorganizations. It's important to note that the City is in the process of negotiating new contract agreements with its bargaining units. I will be returning to request a budget amendment to account for changes to employee compensation once agreements have been reached.

## **Organizational Changes**

Periodically, I review of the City's organizational structure to ensure resources are in place for desired service levels, to identify areas of service enhancement, and to accommodate changing organizational needs. I've made two changes to the organization that will make the City a higher performing organization:

### *New Information Services Department*

In February, the City retained NexLevel Information Technology to assist with an Information Technology Assessment that would address project backlogs and service-level issues. The results of this assessment along with continuing project management issues made clear the need for executive-level leadership in the area of information services, which Council approved in October 2015. I created the Department of Information Services and hired the City's first Chief Technology Officer to oversee the new department, comprised of IT, GIS, and Communications. The CTO's focus will be on meeting the City's growing demand for technology solutions, effective project management, and improving customer service.

### *Recreation Reorganization*

This department-driven reorganization consolidates four divisions into three and creates a new Business and Community Services unit with a focus on marketing and customer engagement. Senior, adult, and youth services are now consolidated under the Recreation and Education Division. Activities in the corridor are now consolidated under the Sports, Safety & Outdoor Recreation Division. The realignment of programs into these three divisions breaks down existing silos and better aligns programs to meet changing demands for service. It also facilitates department succession planning by creating a clear career path for recreation professionals.

## **Organizational Accomplishments & Highlights**

The City is proud of its reputation as a green city. To further its sustainability goals, the following service level enhancements were implemented in FY 2015-16:

### *Environmental Education Center & Blacksmith Shop*

The Environmental Education Center (EEC) and renovated Blacksmith Shop located at McClellan Ranch Preserve opened in October 2015 with tremendous community support. This investment is another example of the City's commitment to sustainability and education. The EEC houses classrooms, a library, and offices to be used for robust environmental educational programming targeting local school children. The renovated Blacksmith shop displays historic artifacts and information.

### *Community Choice Energy*

This past year Cupertino, in partnership with the cities of Sunnyvale and Mountain View and the County teamed up with eight other Santa Clara communities to form the Silicon Valley Clean Energy Authority (SVCEA), which will operate the region's first Community Choice Energy (CCE) program. CCEs enable local governments to pool the electricity demand within their jurisdictions to directly procure or generate electrical power supplies on behalf of the residents and businesses in their communities. Cupertino and its partners' main interest in launching a CCE program is the opportunity to accelerate the shift to renewable and low greenhouse gas (GHG) emitting energy sources in support of climate action objectives. While electric supply is handled by the CCE program, the electricity grid and customer service remain with the incumbent utility, or PG&E in Santa Clara County. Three CCE programs now operate in California - Marin Clean Energy, Sonoma Clean Power and Lancaster Choice Energy. SVCEA hosted its first Board of Directors Meeting, including an appointed representative from Cupertino, in April 2016, and anticipates hiring its first Chief Executive Officers in May 2016. Service to residential customers is scheduled to begin in April 2017. To preview the work of SVCA to date and planned steps for SVCEA visit [www.svcleanenergy.org](http://www.svcleanenergy.org)

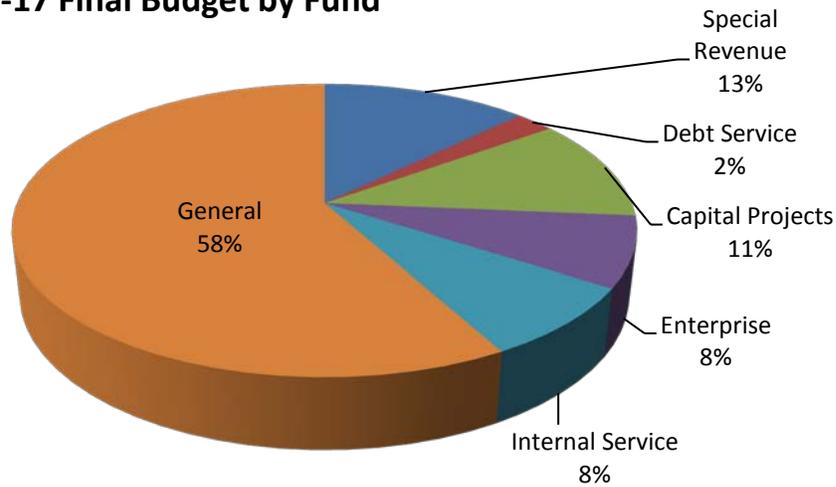
### **FINAL BUDGET OVERVIEW**

I'm pleased to submit a balanced FY 2016-17 Final Budget. The Final Budget reflects a total City budget of \$133.1 million, an increase of \$14.7 million or 12.4% when compared to the FY 2015-16 Final Budget. The City's General Fund is recommended at \$77.2 million, an increase of \$9.6 million or 14% from the FY 2015-16 Adopted Budget. The General Fund is balanced through the use of General Fund revenue of \$79.0 million and is projected to end FY 2016-17 with approximately \$3.7 million dollars in unassigned fund balance that will be transferred to the Capital Reserve per the Reserve and One Time Use Policy as part of the City's year-end process. The transfer is not reflected in the Final Budget.

<b>Fund Type</b>	<b>Total Final Expenditures</b>	<b>Total Final Revenue</b>	<b>Net Balance &amp; One Time Funding Required</b>
<b>General</b>	77,222,458	79,004,004	\$1,781,546
<b>Special Revenue</b>	16,891,094	39,022,824	22,131,730
<b>Debt Service</b>	3,167,538	0	-3,167,538
<b>Capital Projects</b>	15,072,000	5,907,000	-9,165,000
<b>Enterprise</b>	10,312,537	7,517,700	-2,794,837
<b>Internal Service</b>	10,476,727	5,191,403	-5,285,324
<b>Total</b>	<b>\$133,142,354</b>	<b>\$136,642,931</b>	<b>\$3,500,577</b>

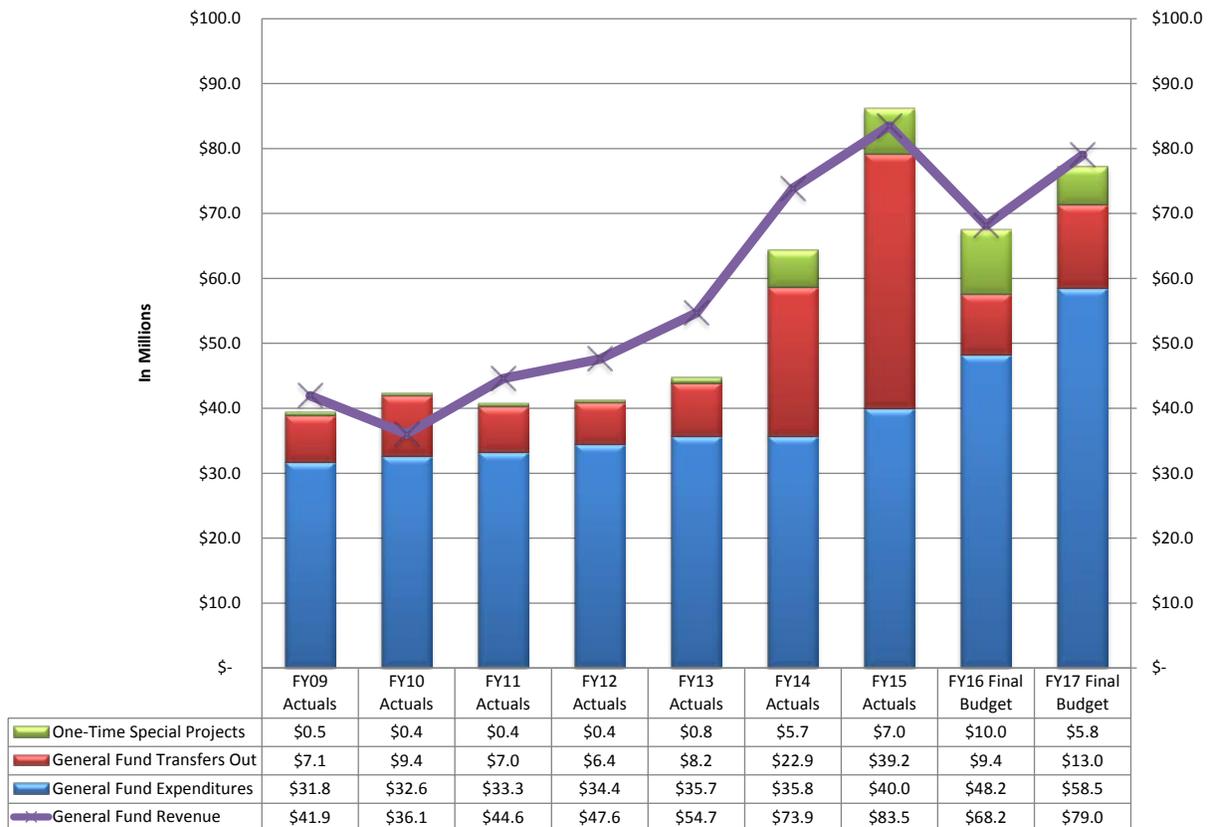
As shown in the chart below, the Final Budget is largely funded by the General Fund (58%).

### FY 16-17 Final Budget by Fund



The graph below summarizes the changes in the City's General Fund for an eight-year period:

### General Fund Revenues Expenditures and Transfers Out



A total of 185.75 positions are budgeted in FY 2016-17 with only three new requests as summarized below. I am requesting 3.0 new positions to: (1) meet the growing demand for GIS technology services (Asset Management Technician); (2) reduce a costly contract service agreement for IT Help Desk services (IT Assistant); and a Limited-Term Special Programs Coordinator to backfill as the Recreation and Community Services Department implements a new recreation management system and completes several staff transitions as a result of its reorganization.

<b>Current Authorized Positions</b>	<b>182.75</b>
<b><i>FY 2016-17 Final Budget Requests</i></b>	
Asset Management Technician – General Fund	1.00
IT Assistant – IT Internal Service Fund	1.00
Special Program Coordinator – General Fund (2-year Limited Term)	1.00
<b>Total Final FY2016-17 Benefitted Positions</b>	<b>185.75</b>

### **Changes to the Budget and Policies**

The FY 2016-17 budget document and process are very similar to those of the past few years. Below are a few highlights from the budget and process:

#### *Revised Fees and Cost Allocation Plan (CAP)*

Council approved a revised fee schedule revised cost allocation plan in April 2016, which is reflected in this budget. The CAP accounts for the full cost of providing specific services to the community by determining indirect (overhead) costs associated with operations. These overhead costs are used to calculate fees and also charged internally to user departments in the budget and credited as revenues to programs (HR, Finance, Facilities, etc.) that provide these indirect services. This new methodology increases the CAP from \$3.1 million to \$12.2 million in revenues and corresponding expenditures, a 294% increase with no net impact to the budget.

#### *Housing Mitigation Fees*

To further support affordable housing and strengthen the City’s Housing Mitigation Program, the City Council adopted updated housing mitigation fees on May 5, 2015. The updated housing mitigation fees officially went into effect on July 6, 2015. These revenues are expected to generate \$15.1 million for affordable housing projects in FY 2016-17.

#### *Performance Measures*

To highlight program effectiveness and showcase productivity beyond financial indices, we changed our approach to performance measures. Staff researched new templates and tools used by innovative cities and hosted performance measure redesign workshops and “office hours”. Staff also looked for opportunities to align ongoing departmental goals with our City’s broader mission statement, noted below, to ensure community-wide objectives are embedded in

the way we evaluate our performance on an ongoing basis. To map this connection to our mission, a key is provided below to share icons included in each department's performance indicators.

*The Mission of the City of Cupertino is to provide exceptional service, encourage all members of the community to take responsibility for one another, and to support the values of education, innovation and collaboration.*

Mission	Icon
Provide Exceptional Service	
Encourage Community to Take Responsibility for One Another	
Support Education	
Support Innovation	
Support Collaboration	

The City also complies with the following additional policies and limits not listed in the Financial Policy section but are updated and/or approved annually:

*Investment Policy*

The City Council annually updates and adopts a City Investment Policy that is in compliance with State statutes on allowable investments. By policy, the Audit Committee reviews the policy and acts as an oversight committee on investments. The policy directs that an external auditor perform agreed-upon procedures to review City compliance with the policy. The full policy is available on the City website as part of the May 16, 2015 City Council agenda packet.

*GANN Appropriations Limit*

The City's appropriations limit for FY 2016-17 is \$91,867,014 this is \$10,887,035, or 13.4% higher than the FY 2015-16 limit of \$80,979,979. If a city exceeds the legal limit, excess tax revenue must be returned to the State or citizens through a process of refunds, rebates, or other means that may be determined at that time. The appropriations limit is not expected to present a constraint on current or future budget deliberations.

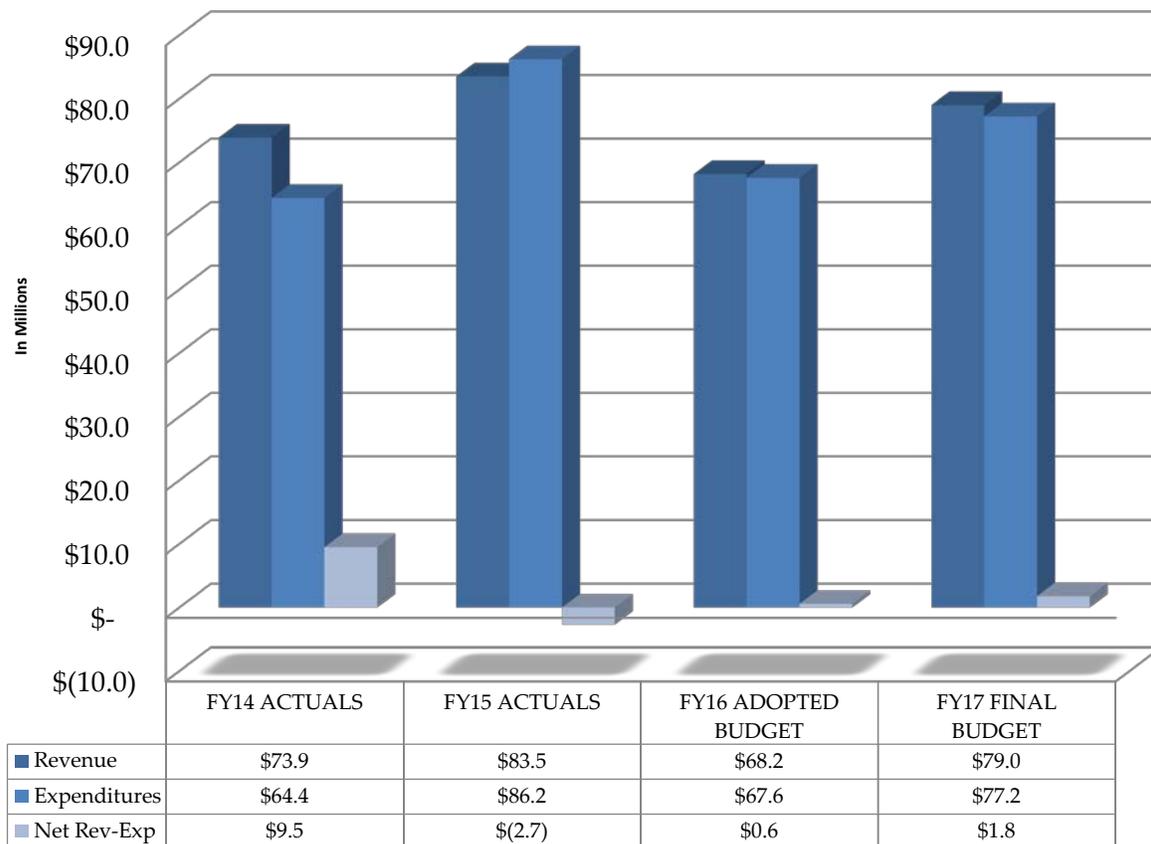
## Final Budget by Fund

### General Fund

The General Fund pays for core services such as public safety, recreation and community services, planning and community development, streets and trees, and a host of other vital services. The revenue used to pay for these services comes primarily from local taxes such as property tax and sales tax, transient occupancy tax, charges for service, and a variety of other discretionary sources. As illustrated in the chart below, the majority of General Fund revenue supports funding for Public Works, Planning and Community Development, and Law Enforcement.

General Fund revenue is estimated at \$79.0 million in the FY 2016-17 Final Budget (excluding fund balance). This is an overall increase of \$10.8 million (16%) when compared to the FY 2015-16 Adopted Budget. It's important to note that a large increase in revenues (\$12 million) is related to the revised CAP, which is offset by corresponding expenditures. The local economic boom has driven strong gains in sales tax, property tax, and transient occupancy tax revenues, which have partially been offset by decreases in development-related fees and charges given the challenging political climate surrounding development in the City. The following chart shows four years of total revenue, expenditures and changes to fund balance for the General Fund:

General Fund Revenue, Expenditures and Changes in Fund Balance

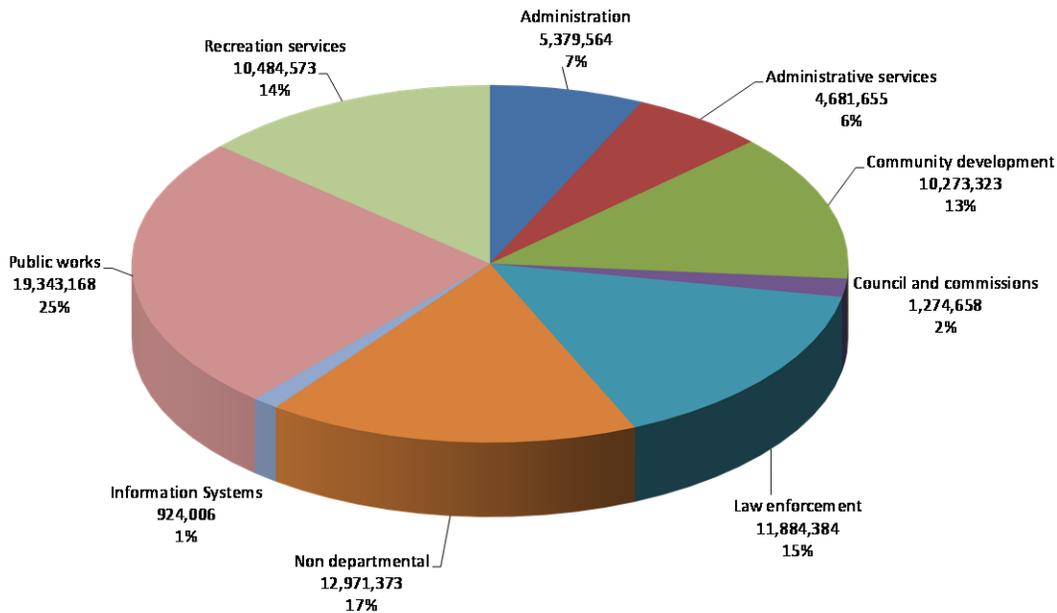


The General Fund unassigned fund balance is projected to increase from the current year estimate of \$1.9 million to \$3.7 million in FY 2016-17. As shown in the chart below, the FY 2016-17 ending fund balance is estimated to be \$33.1 million, or 6% higher than the FY 2015-16 year end estimate. The increase in unassigned fund balance is due to increases in revenue sources and decreases in expenditures mostly related to salary savings, special projects and other financing uses.

GENERAL FUND BALANCE					
Classification	FY 14-15 Actual	FY 15-16 Final	FY 15-16 Estimate	FY 16-17 Final	Percent Change
Unassigned	11,301,702	10,442,537	1,905,680	3,692,979	94%
All other classification	30,549,577	22,831,064	29,360,396	29,360,396	0%
<b>Total Fund Balance</b>	<b>\$41,851,279</b>	<b>\$33,273,601</b>	<b>\$31,266,076</b>	<b>\$33,053,375</b>	<b>6%</b>

As shown in the chart below, the majority of city resources are used to support public works (25%), non-departmental expenses (17%), law enforcement (15%), recreation (14%), and community development (13%).

**Total Expenditures by Department General Fund**



*Special Revenue Funds*

Special Revenue Funds are a fund type used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. Special Revenue Funds account for 8% of the citywide expenditure budget. The largest Special Revenue Fund is the one for streets, roads, and transportation. Other funds account for storm drain management, affordable housing programs, and park development. The Final Budget for Special Revenue

Funds for FY 2016-17 is \$17 million, a decrease of \$3.9 million from FY 2015-16 Adopted Budget. The decrease is primarily due to a decrease in capital project costs.

Budgets within the Special Revenue Funds are funded by \$39 million in restricted department revenue, and \$5.9 million in transfers from the General Fund, bringing total funding sources for the fund to \$44.9 million. This will result in a projected increase to fund balance of \$27.9 million, most of which is from Below Market dollars from developments within the City. The Special Revenue Funds are projected to end the year with fund balances of \$51.9 million.

#### *Capital Projects Funds*

The Capital Improvement Project Fund, Stevens Creek Corridor Park, and Capital Reserve are currently in the Capital Projects Fund type category. This fund type is typically used to account for financial resources that are used for the acquisition or construction of major capital facilities or to provide facilities for City departments, and are identified in the five-year Capital Improvement Program (CIP).

The final budget for the Capital Projects Funds for FY 2016-17 is \$15 million, comprised of \$5.9 million in new capital projects and \$9.2 million in transfers out to the Special Revenue and Enterprise funds to fund capital projects. The \$15 million total budget is \$6 million higher than FY 2015-16 final budget expenditures based on the cost of the recommended capital projects.

#### *Enterprise Funds*

Enterprise Funds are set up for specific services that are funded directly by fees charged for goods or services. Enterprise Funds consist of Resource Recovery for the solid waste collection franchise, Blackberry Farm for the City-owned golf course, the Cupertino Sports Center, and Recreation Programs for cultural, youth, teen, sports, and physical recreation programs.

The Final budget for Enterprise Funds for FY 2016-17 is \$10.3 million, an increase of \$0.7 million from the FY 2015-16 Adopted Budget.

Budgets within the Enterprise Funds are funded by \$7.0 million in program revenue and \$1.8 in transfers from the General Fund. The Enterprise Funds also rely on \$1.5 million of prior year fund balance, bringing total funding sources for the funds to \$10.3 million. The Enterprise Funds are projected to begin the fiscal year with \$7.8 million in fund balances and are projected to end the year with fund balances of \$6.3 million.

### *Internal Service Funds*

Internal Service Funds are used for areas where goods or services are provided to other City departments or governments on a cost-reimbursement basis. Internal Service Funds include funds and programs for information technology, City Channel, website, workers' compensation, equipment, compensated absence, long-term disability, and retiree medical insurance.

The Final budget for the Internal Service Funds is \$10.5 million, which is \$2.1 million higher than the FY 2015-16 Final Budget. This increase is primarily attributed to increased information technology costs and equipment, the purchase of several pieces of replacement equipment and vehicles costs.

Budgets within Internal Service Funds are funded by \$5.2 million in department revenue, \$2.6 from the General Fund, and \$2.6 million from depreciation reserves bringing total funding sources for the funds to \$10.4 million.

### **Special Projects**

The FY 2016-17 Final Budget includes funding for several one-time Special Projects. These projects are identified as part of the Special Project section within each program and are summarized in the table below. This list excludes one-time capital outlays and ongoing pavement management costs.

<b>Program Budget</b>	<b>Project Name</b>	<b>Expenditure</b>	<b>Funding Source</b>
<b>305 Government Channel</b>	Community Hall Upgrade	340,000	General Fund
<b>308 City Web Site</b>	New City Website	51,105	General Fund
<b>701 Current Planning</b>	Apple Campus 2	2,126,800	Pass Thru Revenues
	Planning Records Project	80,000	General Fund
<b>702 Mid Long Term Planning</b>	GPA Implementation	150,000	General Fund
<b>713 General Building</b>	Records Conversion	68,000	General Fund
<b>714 Construction Plan Check</b>	Hamptons	217,000	Pass Thru Revenues
	Marina	30,500	Pass Thru Revenues
<b>715 Building Code Enforcement</b>	Hamptons	217,000	Pass Thru Revenues
	Marina	30,500	Pass Thru Revenues
<b>800 Public Works Admin</b>	Landscape Conversions Rebate Program	115,000	General Fund
<b>806 CIP Administration</b>	Grant Facilitation	40,000	General Fund
<b>807 Service Center</b>	Office Improvements	175,000	General Fund

Program Budget	Project Name	Expenditure	Funding Source
<b>Administration</b>			
<b>812 School Site Maintenance</b>	Resurfacing of Asphalt Pathways	80,000	General Fund
<b>813 Neighborhood Parks</b>	New LED Lights at Linda Vista Park	25,000	General Fund
	Pathway Repairs at Various Locations	50,000	General Fund
<b>825 Street Tree Maintenance</b>	Drought Related Expenses	30,000	General Fund
<b>827 Bldg Maint City Hall</b>	Paint Entry Way	4,500	General Fund
	Repaint Stair Handrails	9,000	General Fund
<b>828 Bldg Maint Library</b>	Card Access System	10,000	General Fund
	Window Upgrade/Replacement	1,000	General Fund
	Granite Floor Restoration	8,500	General Fund
	Aquarium Education	40,000	General Fund
<b>829 Bldg Maint Service Center</b>	Paint Front of Shop	39,614	General Fund
	LED Lights Welding Shop	20,000	General Fund
	Radio Replacement	6,000	General Fund
	Bird Netting	10,000	General Fund
<b>830 Bldg Maint Quinlan Center</b>	Exterior Shutters	3,000	General Fund
	Panic Alarms, Blue Strobes	3,000	General Fund
	Music Room Acoustic	14,000	General Fund
	Social Room Sound Dampening	13,000	General Fund
	Repaint Social Room	18,000	General Fund
	Kitchen Upgrades	25,000	General Fund
	Door Replacement	9,000	General Fund
	Windows Replacement	10,000	General Fund
<b>831 Bldg Maint Senior Center</b>	Replace Front Counter	25,000	General Fund
	New Exterior Lights	2,500	General Fund
	Paint Trash Enclosure	6,000	General Fund
	New Dance Floor	20,000	General Fund
	Replace Fabric on Partitions	50,000	General Fund
<b>832 Bldg Maint McClellan Ranc</b>	New Wood Fencing	6,500	General Fund
	Informational Kiosk	2,500	General Fund
	Cement Pads	2,000	General Fund
<b>833 Bldg Maint Monta Vista Ct</b>	New Bathroom Partitions	12,000	General Fund
<b>834 Bldg Maint Wilson</b>	Repaint Interior	6,000	General Fund
	New Cabinets	3,000	General Fund
	New Sinks and Counter	6,700	General Fund
<b>835 Bldg Maint Portal</b>	Repaint Inside and Out	14,000	General Fund
	White Boards in Classroom	5,000	General Fund
<b>836 Bldg Maint Sports Center</b>	New Gates Between Courts	5,000	General Fund

Program Budget	Project Name	Expenditure	Funding Source
	LED Lights	4,000	General Fund
	Repaint Stair Handrails	9,000	General Fund
	New Carpet	20,000	General Fund
<b>837 Bldg Maint Creekside</b>	Window Film	5,000	General Fund
<b>838 Community Hall Maintenance</b>	Vehicle Charging Station	15,000	General Fund
	Replace Wood/Podium Council Dais	40,000	General Fund
	Carpet Replacement	60,000	General Fund
<b>840 Park Bathrooms</b>	New Partitions	7,000	General Fund
	Repaint Exteriors	11,000	General Fund
	Floor Repairs	8,000	General Fund
<b>841 BBF Facilities Maintenance</b>	Door Threshold/Sweep	5,000	General Fund
	Pool Sweep	6,500	General Fund
<b>844 Traffic Engineering</b>	Apple Traffic Mitigation	850,000	Pass Thru Revenues
<b>848 Street Lighting</b>	Light Pole/Arm Replacement and Upgrades	130,000	General Fund
	Rancho San Antonio Streetlight Upgrade	34,000	General Fund
<b>849 Equipment Maintenance</b>	Racks, Bins and Fire Cabinets	50,000	General Fund
	Fuel Management System	30,000	General Fund
	Oil Filter Crusher	3,500	General Fund
<b>986 GIS</b>	City Works - Add'l Log ins and Metrics API	12,000	General Fund
	<b>Total</b>	<b>5,535,719</b>	

## CURRENT ECONOMIC UPDATE

### *National and State Economic Conditions*

The U.S. economy is continuing to experience slow and steady growth. US Gross Domestic Product (GDP) increased by 2.4% in 2015 according to the Bureau of Economic Analysis, which is equal to the growth experienced in 2014. The increase in real GDP in 2015 primarily reflected positive contributions from personal consumption, residential and nonresidential fixed investment, and private inventory investments, exports, and state and local government spending. However, GDP growth has decelerated with only a 1.4% increase in the fourth quarter of 2015 and 0.5% increase in the first quarter of 2016.

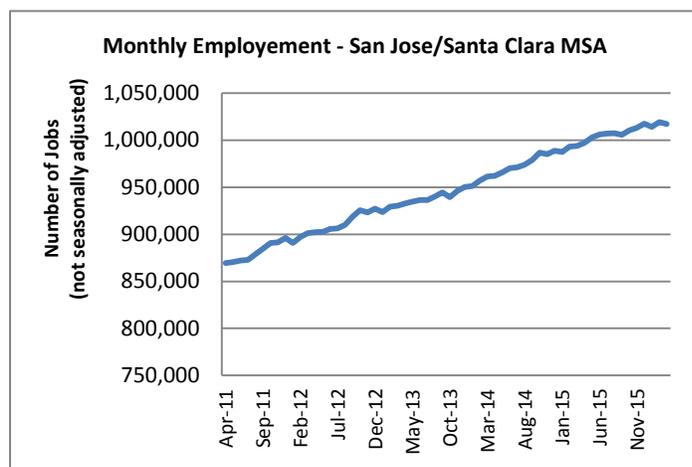
Consumer confidence, as reflected by The Conference Board Consumer Confidence Index, had modest gains in March but declined in April and now stands at 94.2 down from 96.1 last month. This month's retreat was prompted by a softening in current conditions, likely sparked by the recent lackluster performance in the economy.

Unemployment is falling while jobs are being created. The U.S. unemployment rate stood at 5.0% in March 2016 representing a 0.5% percentage point drop compared to the March 2015 unemployment rate of 5.5%, according to the Bureau of Labor Statistics. The unemployment rate has improved significantly from a high of 9.6% in 2010 and is nearing the full employment level of 4-5%.

The California economy is inching towards a full economic recovery. California's unemployment rate fell to 5.4% in March 2016, an improvement compared to last year's unemployment rate of 6.5% and its lowest rate since July 2007. Personal income grew at a faster pace than the nation, 6.3% versus 4.4%, mostly due to faster growth in wages. Growth in the housing market continues with the prices of single family homes up 4.0% and sales up 5.7% compared to March of last year according to the California Association of Realtors.

*Cupertino Economic Conditions*

Strong economic performance continues in Silicon Valley and Cupertino. Data from the State of California Employment Development Department paints a similar picture. Employment in the



San José/Sunnyvale/Santa Clara Metropolitan Statistical Area (MSA) continues to increase. The preliminary estimate of the March 2016 employment level in the MSA was 1.0 million, a 4.1% increase from the March 2013 level of 934,000. The March 2015 unemployment rate of 3.9% has dropped since January and is lower than 4.1% rate experienced a year ago. The March unemployment rate is lower than the national unemployment rate of 5.0%.

Housing prices remain strong compared to the same period in 2015. In March 2016, single family homes sold from a median home price of \$1.6 million, a 4.6% increase from the March 2015 median home price of \$1.5 million. Property Tax revenue is expected to increase compared to last year given the increase in the median home price, reassessments of development projects, and additional TEA property tax share. Construction activity remains strong in Cupertino with Apple Campus 2 driving development growth.

**KEY BUDGET ASSUMPTIONS**

### *Revenue Assumptions*

The FY 2016-17 Budget assumes moderate economic growth. Revenue projections for each category were based upon a careful examination of the collection history and patterns as they relate to such factors as seasonality and performance in the economic environment that the City is most likely to encounter in the coming year. Revenue assumptions are discussed in detail in the Fund Summary section under Financial Policies and Schedules.

### *Personnel Assumptions*

Budgeted personnel expenditures factor in salary step increases for approximately 41% of employees who have yet to reach the top step in their classification's salary range. Typically, a step increase is equivalent to a five percent increase in salary with a range of five salary steps.

Personnel cost assumptions are completed at the employee level. Staff begins with current salaries and adjusts for any anticipated changes in compensation and benefits through the end of the current fiscal year, including anticipated salary step adjustments. Then, benefit changes are added, which include retirement rate increases projected to increase by 5% in 2016-17. This comprises base personnel costs. Applied to this base are new position requests. A total of 185.75 positions are budgeted in FY 2016-17, an increase of 3.0 positions.

No negotiated salary increases are assumed in the FY 2016-17 Final Budget. The City is currently in negotiations with its two bargaining units and will likely be returning to Council in June to ratify new agreements. The budget will be adjusted for any increases in compensation when the agreements are ratified.

### *Non-Personnel Assumptions*

Non-Personnel budgets were developed based on actual expenditures in prior years, and then adjusted for FY 2016-17 funding needs. In addition, one-time projects will be separated out in FY 2016-17 to ensure that expenditure trends reflect ongoing expenditure needs. Contingency budgets are being reduced from 10% to 8% of the total General Fund budget for contractual services and supplies and materials for operating programs. An additional 5% will be allocated to the City Manager's Discretionary Program. Program contingency budgets may be used to cover unanticipated program expenses at the department's discretion, while the use of the City Manager's Discretionary Program will require City Manager approval.

## **ONGOING CHALLENGES**

### *Revenue Volatility*

The City's revenue mix is heavily reliant on volatile business-to-business sales tax, which makes up approximately 19% of the City's annual General Fund revenues, down from 21% a year ago.

Business-to-business sales taxes are very sensitive to economic fluctuations as evidenced by Cupertino's experience during the dotcom bust from 2000-2004. Our heavy reliance on the volatile high tech industry also makes us vulnerable. The loss of one of our top three sales tax producers in FY 2013-14 only made the City more reliant on a single tax producer, making us more vulnerable to its business volatility.

#### *Health Benefits*

There is uncertainty around how the implementation of the Affordable Care Act (ACA) will affect the City. Beginning in 2018, the so called "Cadillac Tax" will impose an excise tax for any employer-sponsored health coverage whose value exceeds \$10,200 per year for individuals and \$27,500 for families. A 40% excise tax will be imposed on the amount that exceeds the predetermined thresholds. Some of the City's current health plans would fall under the definition of a Cadillac plan. While CalPERS has assured cities its plans will remain under the Cadillac Tax level, the Federal Government is signaling that it may treat health reimbursement arrangements (HRAs) as a component of healthcare coverage, which may have implications for Cupertino's current health benefit offerings.

#### *Retirement Benefits*

Significant investment losses experienced by CalPERS during the great recession resulted in the overall funded status of the retirement system dropping to 60.0% for public agencies. Given the recovery, the funded status has improved to 73% for public agencies. The desired goal is 100% funded status, where assets on hand are equal to the desired level of assets needed to pay pension benefits. After a thorough analysis, CalPERS actuaries determined the retirement system was at significant risk of falling to dangerously low funded status levels under existing actuarial policies.

This prompted the CalPERS Board to adopt revised actuarial policies that aim to return the system to 100% funded level within 30 years. The new method includes changing the asset smoothing period from 15 years to 5 years and paying gains and losses over a fixed 30 year period with a 5-year ramp up at the beginning of the 30-year period and a 5-year ramp down at the end. The new method ramped up public agency retirement contributions beginning in FY 2015-16. The CalPERS rate increase for FY 2016-17 is 5%, with an expected additional increase of 5% in FY 2017-18-FY2019-2020 and 2% and 1% for the following 2 fiscal years. In addition to CalPERS actuarial methods, forecasted increases could result from future asset returns, changing demographics, and salary increases.

## UNMET NEEDS

As the City prepared its FY 2016-17 Final Budget, some issues surfaced for which funding had not yet been identified. These items include: Capital Improvement Projects – Several Capital Projects as listed in the unfunded project section of the Capital Improvement Plan (CIP). Current estimate for these unfunded projects is approximately \$17.6 million.

## CONCLUSION

The FY 2016-17 Final Budget is a balanced and fiscally responsible spending plan. As noted, I will be returning to request a budget amendment to account for changes to employee compensation once agreements have been reached with the City's bargaining units.

I want to take this opportunity to thank the budget team for their enormous effort in preparing the budget for Council consideration this year. I also want to thank the department heads and staff for their work on this year's budget. Last but not least, I want to thank the Council for their leadership, guidance and support in making Cupertino the best community to live, work, and enjoy.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'David Brandt', with a long horizontal flourish extending to the right.

David Brandt  
City Manager