



May 1, 2018

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

I am happy to report that the City of Cupertino presently finds itself in a healthy financial position. With revenues continuing to outpace expenditures in the short term, coupled with the City's conservative budgeting approach, the City is able to maintain excellent service, high-quality programs and initiatives, and healthy reserves. The City prides itself on being a financially stable organization, so it is a pleasure to submit a balanced budget for Fiscal Year 2018-2019.

The City's top three sources of revenue continue to be property, sales, and transient occupancy taxes. All three revenue streams are expected to grow, although the pace of that growth will slow. The last five years were a boon to the City's coffers due to major development projects, such as Main Street and Apple Park. However, these were one-off projects that have been completed. As large-scale development begins to decline in Cupertino, the City will see the effects of that in reduced short-term revenue.

This year, for the first time, City staff has included a medium-term (5 year) and a long-term (20 year) budget projection. While long-term projections are inherently less reliable than short-term projections, they can help detect structural budget issues that can be mitigated if identified early. In the next five years, our projections show small operating surpluses, even without additional development-generated revenue.

However, beginning in 2025, the forecast shows that expenditures are projected to exceed revenues at an increasing rate. That is because two of the City's largest sources of revenue, property tax and sales tax, are projected to continue to grow but at a much slower pace. Expenditure growth is being driven by pension liability costs that are projected to increase by more than 80% in the first five years of the forecast. Although pension costs are projected to level off in future years, the City's contract with the Santa Clara County Sheriff's Office is expected to continue increasing at a much faster rate of approximately 4.5% per year.

This budget reflects the interesting position that the City finds itself in. In the short term, the City can target specific programs and initiatives for smart expansion that will immediately benefit our residents and broader community. However, the City is also making decisions now, such as scaling back on certain programs and projects, to better position itself financially in the next five to 20 years. The following sections are snapshots of the decisions being made that fall into those categories.

## **Recreation and Community Service Events and Initiatives**

The City's goal, and the mission of the Recreation and Community Services Department, is to offer opportunities that celebrate Cupertino's diverse culture and varying age groups. We do that by providing events and activities to encourage participation by those with different backgrounds, experiences, and interests.

This year's budget will allow the Recreation and Community Services Department to expand on its ever-popular summer events. This summer will include a full schedule of outdoor concerts, movies, and free fitness activities. This year's offerings differ from previous years in that events will expand into neighborhoods and local parks. New sites will include the Civic Center Plaza, Jollyman Park, Creekside Park, and Main Street Park.

The goal, as always, is to create a sense of community and offer residents a stress-free environment where they can relax and have fun while hanging out with family, friends, and neighbors. To that extent, the City will be partnering with neighborhood leaders and local nonprofits to help organize and host these events. These partnerships will ensure buy-in from our community.

In addition, the City will also be investing in improvements to the popular Memorial Park events. The City will be unveiling a new sound system for concerts and outdoor movie screen and projection system for the Cinema at Sundown event series.

We fully expect that these new events and upgraded equipment will enhance the quality of City-hosted events our residents have come to expect.

## **Pension Liability Funding**

Cupertino, like most California cities, provides retirement benefits for its employees through the California Public Employee's Retirement System (CalPERS), which administers benefits for its more than 1.5 million members. The CalPERS retirement plan is structured as a defined benefit plan. This means the plan provides benefits that are calculated using a formula, rather than accounting for individual member's contributions and earnings in a savings plan, which occurs with a 401k.

During the recession, CalPERS investment assets decreased substantially and actuarial methods and economic and demographic assumptions were adjusted, significantly decreasing asset valuations. Together, the investment decline and actuarial changes created a gap between pension assets and liabilities. This gap is known as an "Unfunded Accrued Liability" (UAL).

Prior to 2014, CalPERS agencies received their retirement rate as a percentage of payroll that included both the normal and UAL costs. In 2014, CalPERS separated the UAL from the normal annual service cost in the annual valuation report, in addition to moving from a percent of pay to a flat amount for UAL, normal cost rates remained unchanged as a percent of pay calculation.

Two years later, in December 2016, the CalPERS Board voted to decrease the rate of return on investments, also known as the discount rate, from 7.5% to 7.0%. Since then, cities across the state have been faced with an unprecedented escalation in employee pension costs. Each city has chosen to confront the challenge in its own way. The City of Cupertino decided last fiscal year to increase our CalPERS retirement reserve from \$500,000 to \$4.8 million. To further prepare the City, the proposed budget recommends funding for this reserve be increased by \$3.2 million to a total of \$8.0 million. This approach, based on a 20-year projection, should allow the City to weather the significant projected increases to employer retirement rates while minimizing its impact on City operations. In addition, should rates exceed those currently forecasted by CalPERS due to investment returns or assumption changes, the City will be able to utilize these dollars to offset any unexpected cost. If rates stabilize, these dollars could be used as a direct payment to offset UAL costs and result in the City reaching an 80% funded status in a shorter time frame.

Although not a problem of our making, the City is doing everything it can to limit the ramifications of rising pension costs. In order to protect the City's valuable assets, and reduce the impact on programs and services, the City will continue to augment the retirement reserve. Although this will help mitigate the effects of the City's pension liability increases, the escalating costs of the Sheriff's contract—mostly due to rising pension costs on their end—is outside of this program. These costs will become increasingly unaffordable without growing revenues through property, sales, and other taxes that have yet to be approved by the electorate.

### **Capital Improvement Projects**

The City has been fortunate over the last five years to have been able to invest in itself. The City focused on major infrastructure projects such as paving roads, upgrading storm drainage systems, and constructing a bicycle network. With the investments made into our Pavement Management Program, as well as focused infrastructure areas of our Capital Improvement Program, the City made noticeable improvements that benefit residents and businesses in their everyday lives. After years of infrastructure investment, the City can scale back on some of these capital projects and focus on less costly infrastructure maintenance.

Through many years of neglect and degradation, much brought about by the recession, the overall pavement condition rating for the City bottomed out in 2013 at rating of 64 on a 1 to 100 scale. This is on the low end of the "good" range, which was mostly kept up by the better condition of our major arterial streets. Unfortunately, many of our neighborhood streets had sunk into the 20s, which is considered "very poor." With the investments made over the past five years, our network rating is anticipated to hit 83 this year, which is on the high end of the "very good" range, closing in on "excellent." This five-year turnaround is believed to be the quickest improvement in the state.

As part of our Pavement Management Program, the City accomplished a significant amount of improvements to our bicycle path network by applying different paint legends and striping after the repaving of roadways were completed. We installed green bike lanes in sensitive merging

locations, and installed bike “buffers,” cross-hatched areas to give some room between bikes and cars, and we installed “sharrows” to indicate where bikes and cars must share the road.

More importantly, we initiated and made great progress with detailed planning, community outreach, and design of three major bicycle trails within the City, two long segments of protected bike lanes on McClellan Road and Stevens Creek Boulevard, and a citywide network of bike boulevards that reduce vehicular speeds and encourage bicycles along neighborhood streets. A plan for a system of wayfinding signage has also been completed. While a lot of this work has not yet been constructed, the initial stage work on many of these projects will occur this fiscal year.

Other major investments have been in our storm drainage system. Over the last few years, we have completed three major storm drainage projects that addressed areas of historical local flooding. These areas are in the Monta Vista neighborhood, on Bubb, Elm Court and McClellan Road, and on North Foothill Boulevard near Cupertino Road.

Despite our progress toward meeting our infrastructure needs, there is still much to be accomplished. There will be a host of improvements coming to our parks, both large and small, which will flow from our Parks and Recreation System Master Plan. Also many of our facilities, not the least being City Hall, need to be replaced or significantly upgraded. Without the infusion of additional one-time revenues, in the form of developer fees or publicly approved debt, these improvements will continue to be deferred.

### **Efficiencies Gained Through Technology**

Along with its investments in physical infrastructure, the City recently focused on four key initiatives:

1. Implementing business applications that provide enhanced accessibility and transparency to its residents
2. Strengthening the City’s cybersecurity posture
3. Enhancing citizen engagement
4. Solidifying business continuity and disaster recovery plans

Over the past few years, the City acquired and implemented new applications to improve operational efficiencies and customer service, including an enterprise resource planning software for budget, payroll, and human resources processes; along with transparency platforms like OpenGov.

Enhancements coming this fiscal year are planned for three major applications: land management, recreation, and asset management. The City fully expects to complete the implementation of land management software within the next year, as well as new Recreation software in the fall or winter of 2018. Additionally, Innovation Technology will pilot two technologies in the coming year: chatbots and augmented reality. The goal of these technologies is to enhance customer experience.

Cybersecurity concerns have magnified over the past year and Cupertino has responded by replacing security systems with next generation technologies. IT will further strengthen our posture by implementing security controls, policies, and procedures that meet best practice guidelines. Next year the City will move to geographically dispersed data locations to store mission critical information thereby increasing both business continuity and disaster recovery for City data.

Citizen engagement, always a priority with Cupertino staff, will be enhanced by the implementation of the Open Town Hall application. This application will be utilized to inform and involve citizens by sharing information more effectively and collecting broader resident feedback. The City's GIS capabilities were significantly expanded through the use of the asset management software.

### **Conclusion**

The near future looks bright for the City's financial picture. With revenues still outpacing expenditures for the next few years, the City can focus on maintaining and improving services and initiatives that will positively affect our residents' lives. But with the knowledge that expenditures are projected to eventually surpass revenues, the City has the ability to make decisions now to scale back on certain programs to ensure that the City remains a financially stable organization well into the future.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "David Brandt". The signature is fluid and cursive, with a long horizontal stroke at the end.

David Brandt  
City Manager

# Budget Highlights

---

## NOTABLE ACCOMPLISHMENTS IN FISCAL YEAR 2017-18

### *Green Prime*

In Spring 2017, Silicon Valley Clean Energy began providing clean, carbon-free electricity to Cupertino residents and businesses. The City opted into its Green Prime service, which provides 100% renewable electricity to our City-owned facilities, buildings, parks, and lights throughout the City. This reduces our overall greenhouse gas emissions and helps bring the City closer to its Climate Action Plan (CAP) goals.

### *Demonstration Garden*

The City transformed the landscape around City hall to a drought tolerant demonstration garden. This demonstration garden implements xeriscaping, a landscaping method that integrates water-conserving techniques such as utilizing low water using plants, mulch, and efficient irrigation to eliminate the need for supplemental watering. A well-designed xeriscape can be a beautiful addition that not only saves water, but also invites wildlife, provides year-round interest, and creates attractive natural spaces.

### *Pogo*

In partnership with the Fremont Union High School District, the City of Cupertino launched a student carpool pilot program in January 2018. The pilot gives Cupertino High parents free access to the Pogo, Inc. mobile platform, which allows Cupertino High parents to connect in a closed group to create and manage walk-, bike-, or carpools. The goal is to make it easy for busy parents to organize convenient, reliable alternative transportation options for their children. An effective parent carpool program has the potential to reduce traffic congestion around schools during peak hours as well as reduce GHG emissions to further the City's CAP goals.

### *Youth Engagement*

The City Manager's Office undertook several youth engagement efforts in Fiscal Year 2017-18. Staff annually hosts DeAnza College's APALI Youth Leadership Academy class at City Hall to inform students about careers in local government. This year, staff also created a local government civics lesson geared for middle school students. Staff spent a day with Miller Middle School students engaging them using fun, interactive activities. These students were later invited to visit City Hall and meet then-Mayor Vaidhyanathan. Lastly, City Manager's Office staff partnered with the Recreation and Community Services Department on a youth job fair and created a presentation on "landing the job" with tips for resume writing and interviewing.

### *Recruitment Software Implementation*

NeoGov, an online system for recruitment and applicant tracking, as well as onboarding, is being implemented to streamline the recruitment and hiring process for all departments. Implementation includes staff training, and inputting recruitment, salary, job specifications into the test module. The system will be more user-friendly for job candidates and hiring managers. Staff will complete implementation of the recruitment and application tracking model by the end of the fiscal year.

### *Establishing a Labor Management Committee*

The City is working with CEA (Cupertino Employees' Association) to establish a Labor Management Committee. The proposal is to meet regularly to explore mutual concerns that will be beneficial between the City and CEA. Such meetings should not be intended to serve as negotiations but as an exchange information or to solve problems and issues.

### *Asset Management Module*

During FY 2017-18, the City's Finance staff began implementation of its Asset Management module. This module will assist in the accounting and financial reporting for the City's capital assets. While system implementations require significant staff resources, recording and maintaining the City's capital asset records within its general ledger will improve efficiency, clarity, as well as transparency. Staff expects to complete the implementation by June 30, 2018.

### *Legal Actions*

The City prosecuted and defended a total of 11 legal actions with favorable results. In *Yanovsky v. City of Cupertino*, a jury found that the City was not liable for traumatic injuries suffered by a motorcyclist who collided with a motor vehicle exiting its residential driveway on to a City street. In *Tefari v. City of Cupertino*, the trial court granted the City's motion for summary judgment, disposing of a personal injury action filed by an 8-year-old girl who sought a damage award for injuries that she allegedly suffered after a fall from a soccer goal. In *City of Saratoga, et al. v. California Department of Transportation, et al.* the City obtained a favorable settlement resolving its CEQA challenge to Caltrans's proposed expansion of toll lanes located on State Route 85. The City Attorney's Office also continued to defend the City's legal position with respect to initiatives.

### *Development Projects*

The Community Development Department oversaw the planning and the City Attorney's Office facilitated the City's approval of three development projects including the following: the Charities Housing Project which consists of 19 residential units, of which 18 are Below Market Rent ("BMR") senior housing units; the Marina Foods Redevelopment, featuring a 122 room hotel and 188 housing units including 18 BMR units; and the Hamptons, a 942 unit apartment complex with 71 BMR units.

### *Contract Templates*

To promote best practices and to streamline the contract review process, the City Attorney's Office developed seven contract templates for use with design professionals, professional consultants, information technology, and for use based on a specific contract amount.

### *Medical Marijuana Ordinance*

In response to voter approval of Proposition 64 at the November 2016 Election, City staff and the City Attorney's Office collaborated on the adoption of an amendment to its Medical Marijuana Ordinance to maintain local control, and to address the changes mandated by the Adult Use of Marijuana Act ("AUMA"). The City also adopted an amendment to update its Municipal Code to reflect the most recent changes in state law to the regulation of Accessory Development Units.

### *Fourth of July Fireworks*

In July 2018, the Recreation and Community Services Department coordinated the return of the 4th of July Fireworks Show to Cupertino. The fireworks were launched from Hyde Middle School to an estimated crowd of 7,500. Spectators gathered at three viewing sites (Creekside Park, Miller Avenue, and Sedgwick Elementary) and throughout the adjacent neighborhoods. The City's Recreation and Public Works staff worked closely with a number of partners to deliver a safe and successful event, including the Santa Clara County Sheriff's Office, Santa Clara County Fire Department, CERT and Citizen Corps volunteers, Cupertino Union School District, Fremont Union High School District, Creekside Community Church of Cupertino, West Valley Presbyterian Church, and local businesses. This collaborative, community event was well-received and is planned to continue.

### *Expanded Hours at the Senior Center*

In September 2017, the Senior Center launched expanded evening and weekend hours and is now open Monday through Thursday 8am-9pm, Friday 8 a.m.-5.p.m., and Saturday 8:30 a.m.-4:30 p.m. The increased hours allow for more programming in the evenings and on Saturdays, improved customer service, and increased access for working adults.

### *YAC Attack*

In March 2018, the Recreation and Community Services Department, in partnership with the Youth and Teens Recreation Services (YTRS) professionals group, coordinated YAC Attack, a biennial teen leadership conference that focuses on empowering youth and teens to promote change by: 1) encouraging greater involvement within their local municipal government, 2) developing positive youth and teen special events and programs in their community, and 3) learning about youth and teen specific health and wellness issues. Participants had the opportunity to attend workshops in health and wellness, college preparation, and debates on



social issues. This marked the first time in the City's history that this event was hosted in Cupertino and a total of 255 youth from the Bay Area registered for the leadership conference. *California Stormwater Quality Association Award for Schools Goin' Green Youth Outreach* The Environmental Programs Division was presented with the "Outstanding News, Information, Outreach and Media Project" by the California Stormwater Quality Association (CASQA) for the interagency collaborative Schools Goin' Green (SGG) program. The goal of the program was to partner with six middle and high schools along the Cupertino-Sunnyvale border and implement student-led campaigns focused on litter removal on and around their campuses, pollution prevention messaging and education, and development of recycling and food waste composting programs. Accomplishments of the program resulted in 98 clean up events totaling over 4,100 pounds of litter collected, student developed branding of the SGG logo and associated educational handbook, and on-going litter reduction around their schools.

#### *EPA Food Recovery Challenge Certificate of Achievement*

The goals of this program are to reduce the amount of wasted food from being disposed to the landfill through source reduction, food donation, and composting. In 2016, these efforts by staff and our participating business partners resulted in a 26% reduction of food waste entering the landfill over 2015 levels. Those efforts translate to a reduction of 1,220 metric tons of CO2 equivalent, which is comparable to removing 257 passenger vehicles from the road for one year.

#### *Safe Routes 2 School (SR2S) Program Receives a Grant and Award*

Cupertino SR2S was awarded the America Walks Community Change Grant of \$1,500 to work with middle school students. The grant will fund student groups at each middle school campus, which are creating and implementing their own walking encouragement program. A truly student-driven initiative. For example- Kennedy Middle School Students plan to host an ongoing walk to school event that will reward students who walk the most with a pizza party, candy, and possibly gift cards if funds permit. In addition, Cupertino SR2S was awarded the "Exemplary City" recognition for its robust Safe Routes to School Program. This award was part of the Healthy Cities Initiative facilitated by the Santa Clara County Public Health Department.

#### *Collaborative Food Diversion & Rescue Initiative Grant Recipient*

A collaborative effort between Joint Venture Silicon Valley, The County of Santa Clara, and City representatives across Santa Clara County to engage stakeholders, collect data, and devise a plan to develop a comprehensive and robustly equipped food rescue project wherein edible surplus food will be transported safely to underserved areas where people can collect the food for their families with dignity. This effort addresses food insecurity in the County while reducing the amount of landfilled organic material that contributes significant amounts of greenhouse gases to our atmosphere. CalRecycle awarded \$313,000 dollars to Joint Venture Silicon Valley to implement the countywide initiative. The grant will provide paid drivers and a

refrigerated food truck that will distribute the food with dignity to people. Stanford University recently signed on as a partner and food donor and, as of April 12th, the Food Rescue Initiative received a grant for \$150,000 from the Sobrato Family Foundation.

#### *California Society of Municipal Finance Officers Budget Award for CIP Program*

While the City's Operating Budget has received an award for many years from the California Society of Municipal Finance Officers, this is the first year that we have applied for a Budget Excellence Award for our Capital Budget. In February we were notified that this initial application was successful.

#### *Gold Level Bicycle Friendly Community Designation*

The City of Cupertino has recently been recognized as a Gold Level Bicycle Friendly Business. The Gold Level Bicycle Friendly Business designation is awarded by the League of American Bicyclists to businesses who have shown a remarkable commitment to bicycling. Creating a bicycle-friendly community and workplace has been shown to improve citizens' health, well-being, and quality of life; improving traffic safety, and reducing pollution, congestion and wear and tear on our streets and roads.

#### *Tree City USA Growth Award Designation*

The City of Cupertino celebrated its 6th straight year as being designated a Tree City USA, and its 4th year of obtaining a Growth Award. The Growth Award recognizes higher levels of tree care by participating Tree City USA communities. The Growth Award highlights innovative programs and projects as well as increased commitment of resources for urban forestry. It also provides an opportunity to share new ideas and successes across the country.

### **NEW INITIATIVES FOR FISCAL YEAR 2018-19**

#### *Economic Development Initiatives*

The Economic Development Division will implement initiatives from the Economic Development Strategic Plan including:

- Develop regulations to encourage and allow for smaller-sized incubator and accelerator space for start-up businesses with shared on-site resources and amenities;
- Develop new regulations and policies to allow mobile vendors to provide services in designated areas of the city as a pilot program; and
- Partner with the Cupertino Chamber of Commerce to develop and launch an "I Love Cupertino" community-focused website to promote civic pride, local events, and local businesses.

#### *Bike Implementation Plan Projects*

The Public Works Department will undertake various bicycle related infrastructure projects in this fiscal year:

- McClellan Road Class IV (separated) Bike Lanes – Begin construction on Phase 1, Imperial to Stelling in summer 2018
- Junipero Serra Trail (I-280 Trail) – Continue to develop design alternatives, work with stakeholders and the community.
- Regnart Creek Trail – After several community workshops, bring design alternatives to City Council for selection and approval.
- UPRR Trail Feasibility Study – Develop alternatives in preparation for working with railroad company.
- Stevens Creek Boulevard Bike Lanes – Initial conceptual design and hold community workshops.
- Carmen Road Bike/Ped bridge – Initiate conceptual design alternatives and hold community meetings, and develop implementation budget.

#### *Upgraded Community Garden*

The Community Garden at McClellan Ranch Preserve has experienced a number of challenges due to unreliable perimeter fencing, insufficient irrigation, pervasive rodents and critters, and inconsistent garden plot sizes. Recreation and Community Services staff met with the gardener community on several occasions from September 2017 to January 2018 to solicit input on important features of a new garden. Staff presented a conceptual design to the Parks and Recreation Commission in March 2018. The conceptual design incorporates features desired by the community, current gardeners, and staff while maintaining the same footprint and includes: more regular-sized garden plots, new irrigation, new fencing, vegetable and hand wash stations, education areas, and composting demonstration areas. The budget for this work is proposed in the 2018/19 CIP plan. The current timeline is to solicit bids for the construction of the improvements in fall 2018 and to complete the project by early spring 2019.

#### *Neighborhood Events Program*

In summer 2018, Recreation and Community Services will present an expanded citywide neighborhood events program to build a heightened sense of community. The expanded events will be held at neighborhood parks and will include a summer movie series, summer concert series, and other events in the future as the program expands and incorporates community input.

#### *Emergency Operations Plan*

An Emergency Services Coordinator was hired in 2017 to prepare the city for any natural disaster or emergency. In FY 2018-19, the Coordinator will complete a new, updated Emergency Operations Plan and a Continuity of Government Plan while focusing on volunteer and employee support and development and greater communication processes.

### *Community Transit Program Planning*

The Public Works Department will begin planning for a Community Transit/Shuttle Program. The City will initiate surveys to determine need and desire for routes to support seniors, schools, and other sectors of the community currently underserved by VTA routes.

### *City Council Election*

The City Clerk, as the Elections Official, oversees Cupertino's General Municipal election in even-numbered years. This entails that the City Clerk or clerk staff meet with each candidate during the Nomination Period to distribute paperwork and go over in detail the requirements to run for City Council. The City Clerk is also the Filing Officer for mandatory Campaign Disclosure Statements in which candidates must disclose funding sources for their election committees. Cupertino will hold its General Municipal election on November 6, 2018 to elect three Councilmembers each to a four-year term. The election is for one open and two incumbent seats.

### *ActiveNet*

Recreation and Community Services will launch a new recreation management system, ActiveNet, at the end of 2018. The web-based software will allow the Department to provide more efficient online and in-person transactions for activity registration, membership management, facility reservations, and point of sale services.

## **NOTABLE OPERATIONAL CHANGES FOR FISCAL YEAR 2018-19**

### *Risk Manager*

Given the increasing complexity and work load involved in the contracting and procurement process as well as the need for specialized expertise in managing the inherent liabilities involved in providing municipal service and advising as to the appropriate types and levels of insurance, management is requesting the addition of a full-time Risk Manager. In addition, to the procurement and insurance responsibilities, the Risk Manager would assume primary responsibility for managing the City's Worker's Compensation Program, assuring the City's compliance with Occupational Health and Safety Act (OSHA) requirements and would assist the City Attorney's Office in tort claims management as needed.

### *City Attorney's Office Outsourcing IT*

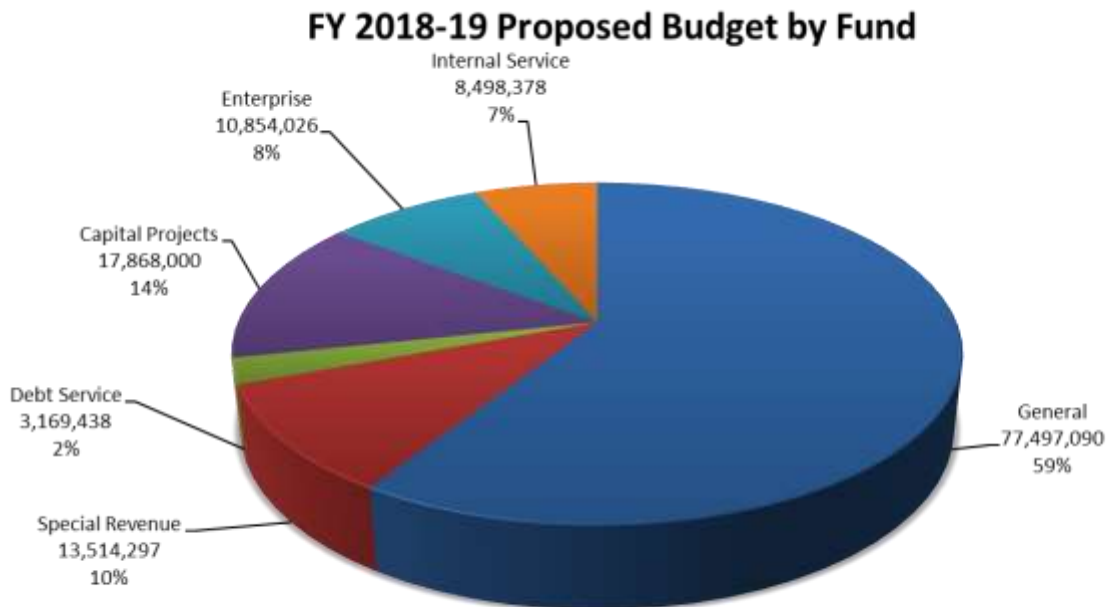
The City Attorney has requested to create a network and email system separate from the City. The City Attorney recommends this new structure to ensure the confidentiality of its communications with clients by contracting out information technology services to a private vendor.

## PROPOSED BUDGET OVERVIEW

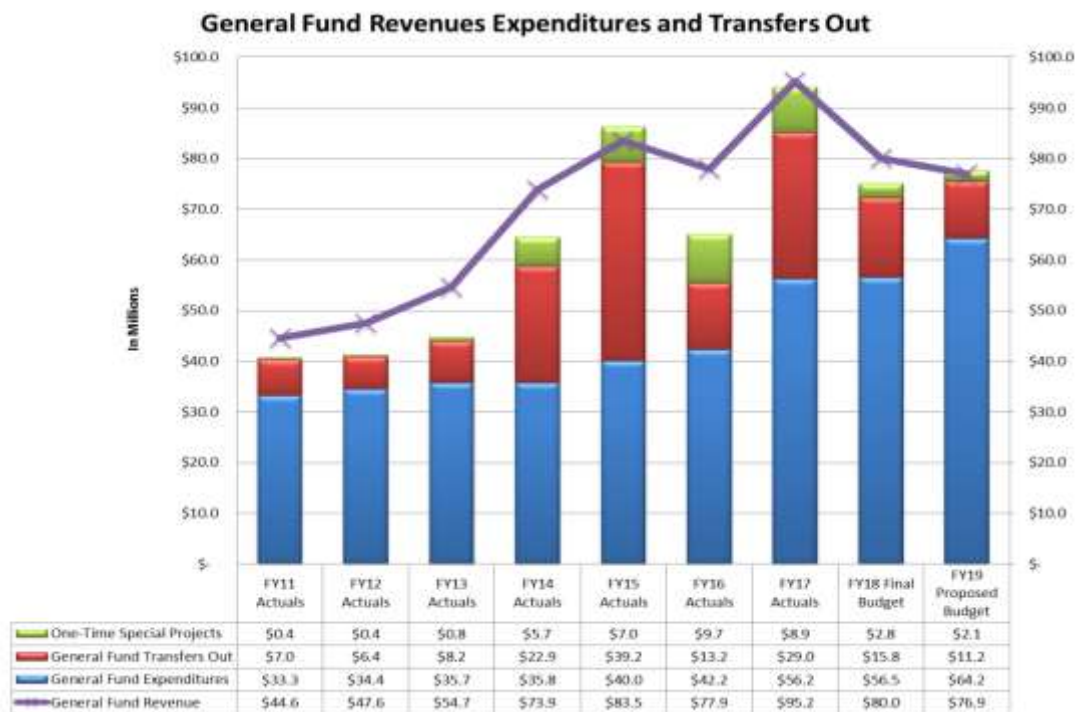
The Proposed Budget reflects a total City budget of \$131.4 million, a decrease of \$17.5 million or 12% when compared to the FY 2018 Adopted Budget. The City’s General Fund is recommended at \$77.5 million, an increase of \$2.4 million or 3.2% from the FY 2018 Adopted Budget. The General Fund is balanced through the use of General Fund revenue of \$76.9 million and is projected to end FY 2019 with approximately \$9 million in unassigned fund balance that may 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 Proposed Budget.

Fund Type	Total Proposed Expenditures	Total Proposed Revenue	Change in Fund Balance/Net Position
General	\$ 77,497,090	\$ 76,888,476	\$ (608,614)
Special Revenue	\$ 13,514,297	\$ 12,390,191	\$ (1,124,106)
Debt Service	\$ 3,169,438	\$ 3,169,438	\$ -
Capital Projects	\$ 17,868,000	\$ 9,051,500	\$ (8,816,500)
Enterprise	\$ 10,854,026	\$ 7,344,400	\$ (3,509,626)
Internal Service	\$ 8,498,378	\$ 7,024,288	\$ (1,474,090)
<b>Total</b>	<b>\$ 131,401,229</b>	<b>\$ 115,868,293</b>	<b>\$ (15,532,936)</b>

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



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



A total of 202.75 positions are budgeted in FY 2019 with five new requests. Staff is requesting 3.0 new positions to: (1) improve the City's contracting and procurement process by managing the inherent liabilities involved in providing municipal service and advising as to the appropriate types and levels of insurance; (2) ensure current analytical and technical projects and system implementations are completed; and (3) assume many already existing duties for Development Services which will allow current staff to allocate resources to additional street maintenance projects and grant management due to SB1 and Measure B. Staff is also requesting the conversion of two positions from Limited Term to Permanent based on a continued need for additional resources.

<b><i>FY 2017-18 Adopted Budget</i></b>	<b>197.75</b>
Senior Assistant Attorney (Council Item)	1.00
Account Clerk I/II (Mid-Year)	1.00
<b><i>Proposed Conversions from Limited Term to Permanent</i></b>	
Environmental Programs Assistant	0.00
Associate Civil Engineer	0.00
<b><i>FY 2018-2019 Proposed Budget</i></b>	
Risk Manager	1.00
Senior Management Analyst, Limited Term	1.00
Engineering Technician	1.00
<b>FY 2018-19 Benefitted Positions</b>	<b>202.75</b>

As in the past, staff continues to recommend adding positions only on a limited term basis unless staff is confident that the needed level of service will be permanent, our ongoing revenues can support the position long term, or staff cannot recruit and/or retain the staff resource on a limited term basis. Staff believe that the need for both the Risk Manager and Engineering Technician will be on a permanent basis.

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

The FY 2019 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)*

Significant shifts in the category of cost allocation changes are primarily due to the following changes. Overall, cost allocation has decreased over prior year due to the correction and removal of a double-counting of Strategic Support charges in fiscal year 2017-2018. Additionally, vehicle and equipment charges decreased due to the winding down of replacements for vehicles and equipment that have surpassed their useful life. Furthermore, I&T charges increased due to additional one-time project expenses and additional changes in methodology. Finance and Human Resources experienced additional charges due to the increased cost and volume of providing related services.

#### *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 1, 2018 City Council agenda packet.

#### *GANN Appropriations Limit*

The City's appropriations limit for FY 2019 is of \$\_\_\_\_\_ is \$\_\_\_\_\_, or \_\_\_% higher than the FY 2018 limit of \$96,028,488. For FY 2019, the City's estimated appropriations of proceeds from taxes, less statutory exclusions, are unchanged as of the Proposed Budget. Data needed to calculate the 2019 appropriations limit will not be available until mid-May. 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. This reflects the prior year limit and will not be updated until the Adopted Budget when the information required for this calculation is available.

### **Budget by Fund**

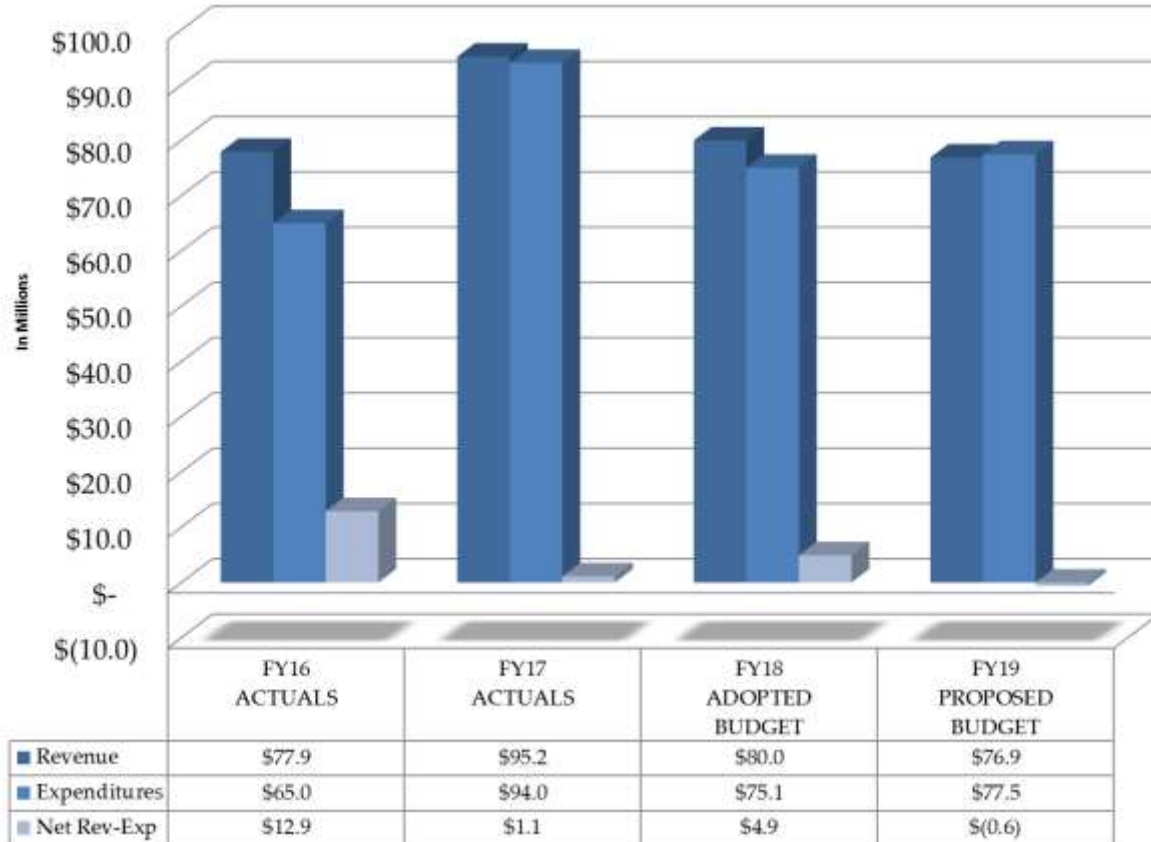
#### *General Fund*

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.

General Fund revenue is estimated at \$76.9 million in the FY 2019 Proposed Budget (excluding fund balance). This is an overall decrease of \$3.1 million (4%) when compared to the FY 2018 Adopted Budget. This decrease is primarily attributable to a change in the methodology for cost allocation. In recent years, the City has experienced local economic boom that had driven strong gains in sales tax, property tax, and transient occupancy tax revenues, which were partially offset by decreases in development-related fees and charges given the challenging political climate surrounding development in the City. With downward trending development activity compared to previous years, the City’s revenues and expenditures are returning to a state of normalcy. 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

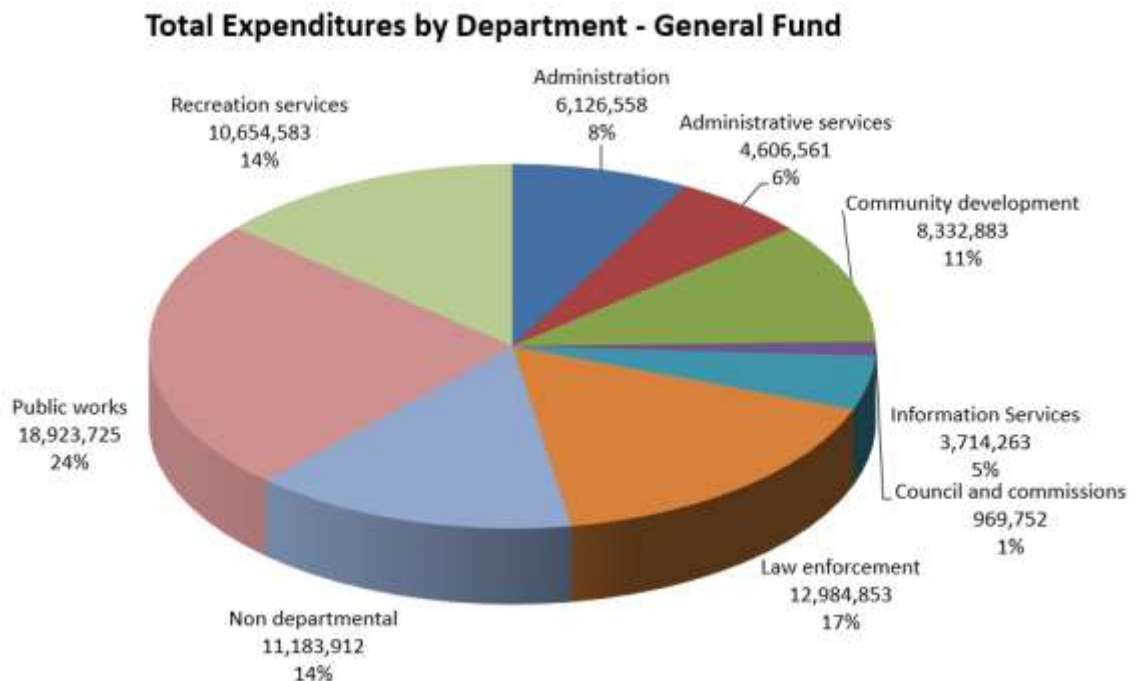


The General Fund unassigned fund balance is projected to decrease from the current year estimate of \$9.6 million to \$9.0 million in FY 2019. As shown in the chart below, the FY 2019 ending fund balance is estimated to be \$45.4 million, or 1% lower than the FY 2018 year end estimate.



GENERAL FUND BALANCE					
Classification	FY 15-16 Actual	FY 16-17 Actual	FY 17-18 Estimated	FY 18-19 Proposed	Percent Change
Unassigned	29,869,085	28,057,799	9,645,226	9,036,612	-6%
All other classification	22,325,755	25,531,891	36,316,546	36,316,546	0%
Total Fund Bal.	\$52,194,840	\$53,589,690	\$45,961,772	\$45,353,158	-1%

As shown in the graph below, the majority of city resources are used to support public works (24%), non-departmental expenses (14%), law enforcement (17%), recreation (14%), and community development (11%).



### *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 17% of the citywide expenditure budget. The largest Special Revenue Fund accounts for streets, roads, and transportation. Other funds account for storm drain management, affordable housing programs, and park development. The Proposed Budget for Special Revenue Funds for FY 2019 is \$13.5 million, which is a 10.6 million decrease from FY 2018 Adopted Budget primarily due to the completion of capital and BMR projects in FY 2017-18.

Budgets within the Special Revenue Funds are funded by \$4.5 million in restricted department revenue, and \$7.9 million transfers from the General Fund, bringing total funding sources for the fund to \$11.2 million. This will result in a projected decrease to fund balance of \$2.3 million. The Special Revenue Funds are projected to end the year with fund balances of \$1.9 million.

### *Capital Projects Funds*

The Capital Improvement Project Fund, Stevens Creek Corridor Park Fund, and Capital Reserve Fund 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 Proposed budget for the Capital Projects Funds for FY 2019 is \$17.9 million, comprised of \$7.2 million in new capital projects and \$10.7 million in transfers out to the Special Revenue and Enterprise funds to fund capital projects. The FY 2019 budget is \$5.6 million lower than FY 2018 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 proposed budget for Enterprise Funds for FY 2019 is \$10.9 million, an increase of \$0.3 million from the FY 2018 Adopted Budget. Budgets within the Enterprise Funds are funded by \$7.3 million in program revenue including \$75,000 in transfers from the General Fund. The Enterprise Funds also rely on \$11.1 million of prior year fund balance, bringing total funding sources for the funds to \$18.4 million. The Enterprise Funds are projected to begin the fiscal year with \$8.2 million in retained earnings and are projected to end the year with retained earnings of \$4.7 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, workers' compensation, equipment, compensated absence, long-term disability, and retiree medical insurance.

The Proposed Budget for the Internal Service Funds is \$8.5 million, which is \$3.2 million lower than the FY 2018 Adopted Budget. This decrease is primarily attributed to the transfer of the City Channel to the General Fund. Budgets within Internal Service Funds are funded by \$5.0 million in department revenue, \$1.6 million from the General Fund, and \$473,000 from a combination of depreciation reserves and retained earnings.

### **Special Projects**

The FY 2019 Proposed 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.

## Special Projects Cont.

Program Budget	Project Name	Expenditure	Funding Source
<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 Administration</b>	Office Improvements	\$ 175,000	General Fund
<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

## Special Projects Cont.

Program Budget	Project Name	Expenditure	Funding Source
<b>836 Bldg Maint Sports Center</b>	New Gates Between Courts	\$ 5,000	General Fund
	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

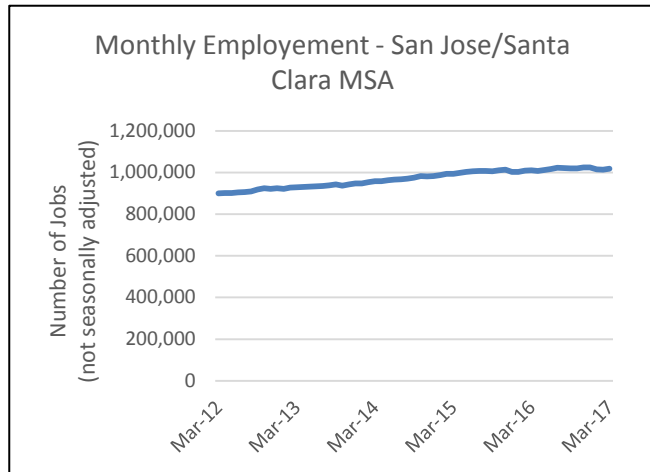
### *National and State Economic Conditions*

The U.S. economy is continuing to show steady growth. U.S. Gross Domestic Product (GDP) increased by 2.9% in 2017 according to the Bureau of Economic Analysis, compared with an increase of 1.6% in 2016. The increase in real GDP in 2017 primarily reflected positive contributions from personal consumption, residential fixed investment, local and federal government spending, and exports that were partially offset by contractions in private inventory investment and nonresidential fixed assets.

Unemployment is continuing to hit record lows while over two million jobs were created in 2017. The U.S. unemployment rate stood at 4.1% in March 2018 representing a 0.4% percentage point drop compared to the March 2017 unemployment rate of 4.5%, according to the Bureau of Labor Statistics. The unemployment rate has improved significantly from a high of 9.6% in 2010 and is at the full employment level.

Consumer confidence, as reflected by the Conference Board Consumer Confidence Index, continued to rise over the previous year and stands at 127.0 as of March 2018, despite a 3.8 point decrease over the previous month. The year-over-year increase is the result of consumers feeling greater optimism regarding the short-term outlook for business, jobs and personal income prospects.

The California economy is inching towards a full economic recovery. California's unemployment rate fell to 4.3% in March 2018, an improvement compared to last year's unemployment rate of 4.9%. Per capita personal income increased 3.5% in 2017 over 2016, mostly due to faster growth in wages. Growth in the housing market continues with the prices of single family homes up 8.8% and sales up 5.4% compared to February of last year according to the California Association of Realtors (CAR). Recognizing that the state has a chronic housing shortage and understanding that inadequate housing has the potential to impede economic growth, state legislators have succeeded in passing a legislative housing package that has the potential to make a difference.



*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 2018 employment level in the MSA was 1.0 million, virtually unchanged from the March 2017 level. The March 2018 preliminary unemployment rate of 2.7% has dropped from the 3.5% rate experienced a year ago. Our local unemployment rate is lower than the national unemployment rate of 4.4%.

Housing prices remain strong compared to the same period in 2018. In March 2019, single family homes sold for a median home price of \$2.3 million, a significant increase over the past year. Property Tax revenue is expected to increase slightly compared to last year given the increase in the median home price, reassessments of development projects, and additional TEA property tax share. Construction activity, although strong in previous years, will begin to flatten out as development projects, particularly Apple Park, begin to wind down.

**KEY BUDGET ASSUMPTIONS**

*Revenue Assumptions*

The FY 2019 Proposed 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*

Negotiated salary increases are assumed in the FY 2019 Proposed Budget. The Council ratified three-year agreements with its two bargaining units in October 2016, including a 5.75% net salary increase and 10% increase in health benefits over the contract period.

In addition, budgeted personnel expenditures factor in salary step increases for approximately 49% 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.

#### *Non-Personnel Assumptions*

Non-Personnel budgets were developed based on actual expenditures in prior years, and then adjusted for FY 2019 funding needs. In addition, one-time projects have been separated out in FY 2019 to ensure that expenditure trends reflect ongoing expenditure needs. Contingency budgets are being reduced to 5% of the total General Fund budget for contractual services and supplies and materials for operating programs. Consistent with past budgets, an additional 5% is allocated to the City Manager's discretionary budget to cover unanticipated program expenses.

## **ONGOING CHALLENGES**

#### *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. The funded status is currently estimated at 68%, down from 69% last year due to lower than expected investment returns. The desired goal is 100% funded status, where assets on hand are equal to the desired level of assets needed to pay pension benefits.

As of February 13, 2018, the CalPERS board voted to decrease the amortization period for new pension liabilities from 30 years to 20 years, effective July 1, 2019 for all agencies. CalPERS estimates that this will result in the normal cost rate increasing by 0% to 0.6% and Unfunded Actuarial Liability (UAL) cost changing by -1.3% to 4.3% for Tier 1 members; for Tier 2 members, it is estimated that the normal cost rate will change by -0.3% to 0% and UAL costs will decrease by -5.5% to -3.1%; for PEPRAs members, the normal cost rate is estimated to change by -0.1% to 0% (CalPERS Circular Letter 200-014-18). Reducing the amortization period is expected to increase future average funding ratios, provide faster recovery of funded status following market downturns, and decrease cumulative interest contributions.

The CalPERS Board adopted revised actuarial policies that aim to return the system to a 100% funded level within 20 years. In December 2016 CalPERS informed agencies that it would be reducing the discount rate of return for investments by 0.5 percentage points to 7.0%. The result of this change is significant and will result in considerable increases in retirement well above what the City had previously forecasted for retirement expenses as noted in the table below. The CalPERS boards met again in December 2017 and decided not to further reduce the discount rate; however, this rate could be subject to further reductions in the future. The FY 2019 Proposed Budget includes these additional expenses and proposes the creation of a Pension Rate Stabilization Program (PRSP), a Section 115 Trust that will act to stabilize pension rate volatility in order to have a less severe impact on the General Fund's operating budget from year to year. The FY 2019 Proposed Budget also includes an increase to the City's

CalPERS Reserve from \$4.8 million to \$8.0 million to achieve this stabilization through the following ramp-up period:

	FY19-20	FY20-21	FY21-22	FY22-23	FY23-24	FY24-25
<b>Projected Payroll</b>	\$17,041,226	\$17,552,463	\$18,079,037	\$18,621,408	\$19,180,050	\$19,755,452
<b>Normal Cost (%)</b>	10.6%	11.6%	11.6%	11.6%	11.6%	11.6%
<b>Normal Cost</b>	\$1,806,370	\$2,036,086	\$2,097,168	\$2,160,083	\$2,224,886	\$2,291,632
<b>UAL Payment</b>	\$3,201,000	\$3,584,000	\$4,029,000	\$4,420,000	\$4,698,000	\$4,940,000
<b>Total Contribution</b>	\$5,007,370	\$5,620,086	\$6,126,168	\$6,580,083	\$6,922,886	\$7,231,632
<b>Total Contribution (%)</b>	29.4%	32.0%	33.9%	35.3%	36.1%	36.6%

*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. 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 potential repeal and replacement of the Affordable Care Act (ACA) and how it would affect health care costs. Rate increases have stabilized with the implementation of the ACA.