

July 1, 2016

**Honorable Mayor and Members of the City Council:**

I am pleased to present to you the fiscal year 2016-17 (FY 17) operating and capital budgets. The adopted budget serves as a policy document, a financial plan, a communications device, and an operations guide, reflecting the policies, goals, programs and service priorities of the City Council and the community. It was developed based on direction provided by the City Council during the budget development process and recommendations made by each department that I've reviewed and approved.

The budget continues to build upon the strength of the economic recovery and expansion which has been ongoing for over seven years. This includes additional staffing requests needed to meet the increased demands for service resulting from new project developments that have created more housing units, commercial and office space as well as increased population and traffic. This budget also incorporates many of the priorities that the Council established through its annual priority workshop conducted in January. Some of the more significant issues surrounding this year's operating budget include development related impacts on the planning review process, building permit review and inspection and process for land development review of public improvements. This new growth creates impacts on public safety and the ability of the City to provide the needed levels of service to an increasing population of residents. The budget seeks to address some of these issues.

The budget is funded with a combination of ongoing revenue and reserves, primarily from the Capital Improvement Program Reserve (CIPR), that will be used to fund expenditures considered to be one-time in nature. All of the limited term positions in the budget are proposed to utilize CIPR as there is a presumption that these positions will end at some point in the near future once the workload and/or economy begins to slow down.

The budget assumes the health of the economy remains positive and addresses major work plan items and Council priorities. City staff continues to shoulder a significant workload consisting of both operating and capital projects requiring additional resources to provide for the level of services needed to keep up with service priority demands.

During the upcoming year, the City will be continuing its comprehensive review and update of the City's General Plan which began in the previous year. Additional emphasis is also being placed on expanding economic development efforts including increased resources devoted to attracting and retaining businesses in the City.

The modestly higher expenditure levels reflect a combination of both ongoing and one-time costs. Accordingly, reserves are generally used to fund one-time expenditures leaving on-going expenditures to be funded from recurring revenue sources. The budgeted level of expenditures is considered necessary for the reliable delivery of public services, taking into consideration the City's Strategic Plan objectives of providing quality services to our residents. Reserve requirements are maintained consistent with established financial policies.

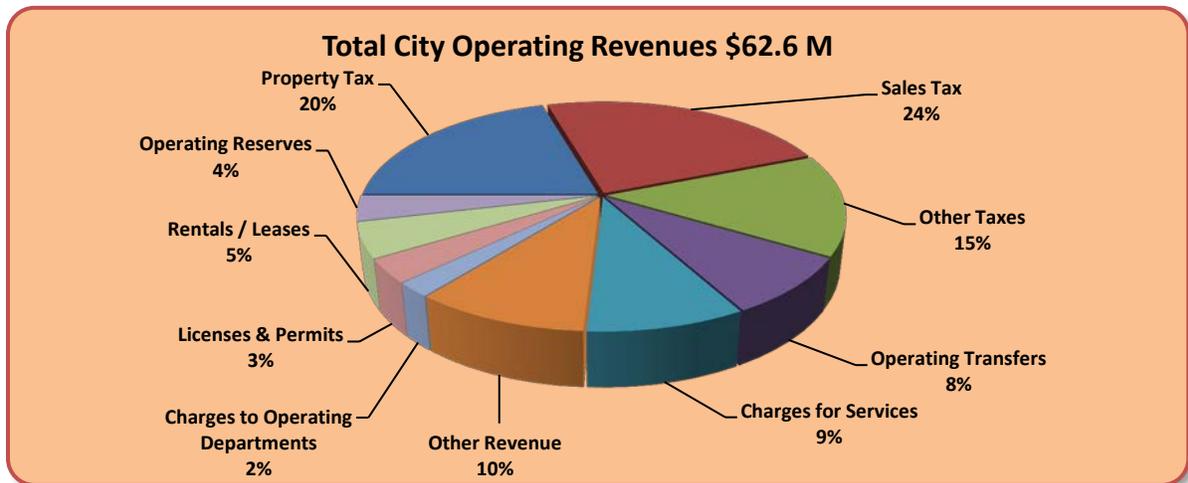
## **BUDGET SUMMARY**

**The combined FY 17 operating and capital budgets total \$71.9 million** including \$4.9 million in capital transfers. Related revenue sources total \$72.4 million indicating a balanced budget in which total revenues, including the use of reserves, meet or exceed total expenditures. The excess of total combined revenue over expenditures represents a surplus reflecting a balanced budget for all the City's funds.

The following table depicts the total operating and capital budget for the City compared to the prior fiscal year:

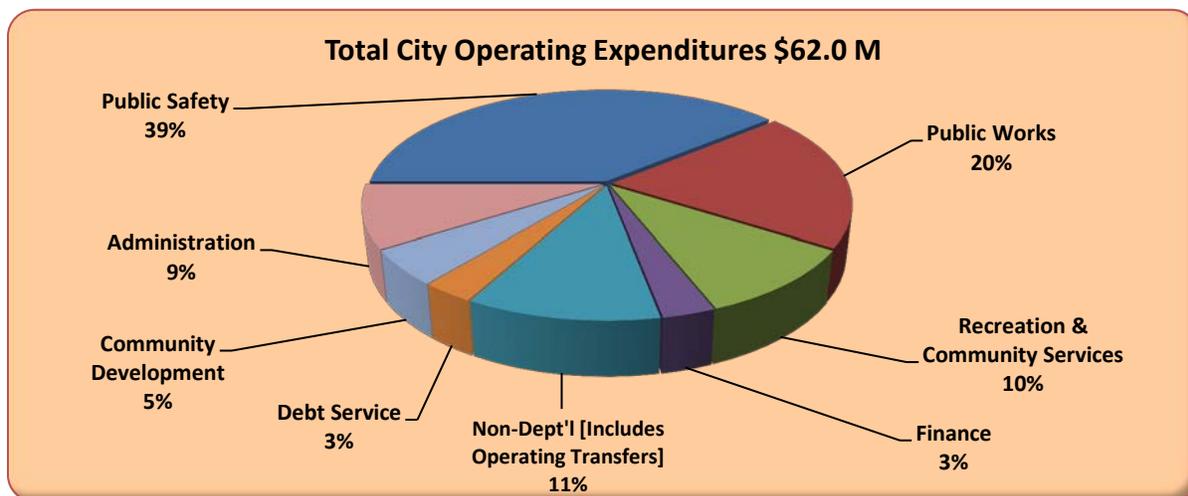
	FY 2016 - 17			FY 2015 - 16			Operating Budget Change	Percent Change
	Operating Budget	Capital Budget	Total Adopted Budget	Operating Budget	Capital Budget	Total Adopted Budget		
<b>Expenditures</b>	\$ 56,658,303	\$ 4,920,000	\$ 61,578,303	\$ 53,467,773	\$ 2,715,000	\$ 56,182,773	\$ 3,190,530	6.0%
<b>Transfers</b>	5,356,555	4,920,000	10,276,555	5,271,899	2,715,000	7,986,899	84,656	1.6%
<b>Total</b>	<b>\$ 62,014,858</b>	<b>\$ 9,840,000</b>	<b>\$ 71,854,858</b>	<b>\$ 58,739,672</b>	<b>\$ 5,430,000</b>	<b>\$ 64,169,672</b>	<b>\$ 3,275,186</b>	<b>5.6%</b>

**Operating Budget:** Overall, the operating budget increased 5.6% from the previous year, attributable to numerous factors, some of which were previously discussed. The total operating portion of the budget is \$62.0 million with related revenue sources of \$62.6 million. The budget reflects expenditures that are expected to recur annually as well as those that may be non-recurring or one-time in nature. Included in this year's budget are additional two-year limited term positions that are being funded with Capital Improvement Plan Reserve (CIPR) funds since they may not continue beyond that timeframe. Other significant contributors to the increased budget are the addition of two Police Officers and a Records Specialist, purchase of new and replacement fleet vehicles and technology equipment and assessments for a new shared regional public safety communications network.

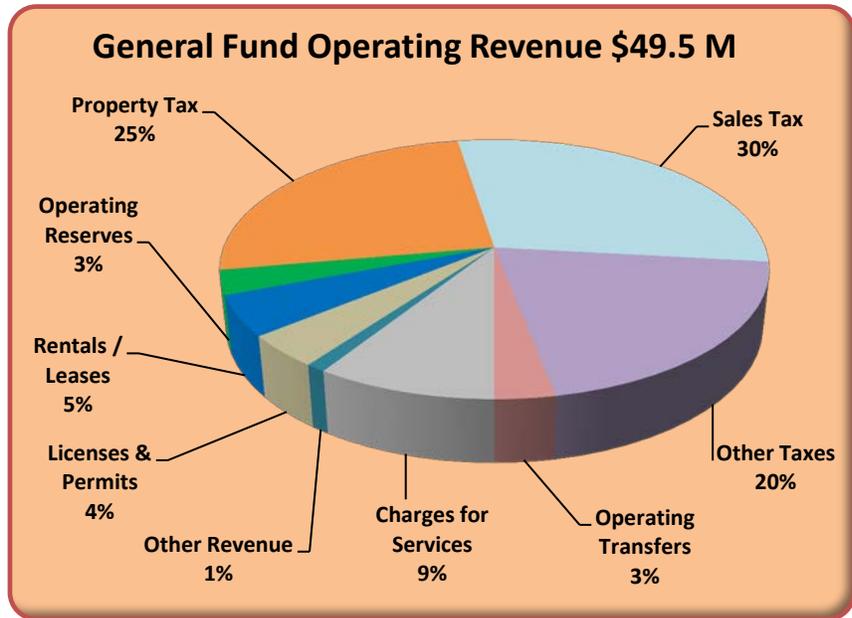


The chart above illustrates the various revenue sources that are collected by the City. Sales tax is the largest component followed by property tax making both of them critical to the City's fiscal health. Unfortunately, these revenues are not always stable, and they are subject to fluctuations from year to year depending on the health of the economy. Other Taxes, such as franchise, transient occupancy and business license, comprise approximately 15% of all revenues. These, too, are impacted by the current business climate and can vary as well.

The chart below illustrates how the City's revenues are spent. The largest percentage of the budget is spent on public safety, composed of police and fire services. Public Works is the next largest component which includes engineering, land development and environmental services as well as parks and streets maintenance. Non-recurring or one-time expenditures are typically funded with a combination of one-time revenues, specific reserves and/or unreserved fund balances, all of which are considered to be revenue sources for purposes of presentation within this document. The FY 17 operating budget relies on a total of \$2.6 million in non-recurring revenues, reserves and fund balances, to fund operating expenditures. The largest component is \$1.5 million in General Fund reserves, which includes \$0.6 million for funding the two-year limited term positions previously discussed, and \$1.1 million in various non-General Fund reserves needed primarily for replacement and upgrade of vehicles and various technology equipment.



**General Fund operating revenues and expenditures are budgeted at \$49.5 million and \$49.0 million, respectively,** indicating an anticipated surplus of approximately \$0.5 million. In recent years, surpluses have been used to maintain the City's Economic Fluctuations Reserve at a targeted policy level of \$6 million. Amounts in excess of this target have been deposited in the City's CIPR reserve for capital and other one-time funding for capital projects per the City's financial policies.



**Capital Budget:** The City's Capital Improvement Plan (CIP) is used both as a short and medium-range plan for the acquisition, improvement and/or renovation of City assets, infrastructure in particular. The CIP is reviewed and updated annually by a committee of senior management staff. It includes projects and equipment items valued in excess of \$25,000. Also included are studies or evaluations that will potentially lead to a capital project. Capital items with a value of less than \$25,000 are included in the operating budget in the appropriate capital outlay line item or as a building maintenance special project if related to facility improvements.

The CIP is presented on a five-year horizon in which project scheduling is dependent upon various factors including the urgency of need, availability of funding and staff workload to name a few. The first year of the CIP is incorporated within the operating / capital budget document, and formally appropriated by the City Council. The remaining years function as a project planning and budgeting tool. Any expected operating budget impacts resulting from the CIP are incorporated into the operating budget.

The City has historically funded many of its capital projects with either General Fund CIPR or Federal, State and local grants. The value of all projects in this year's five-year CIP increased compared to the previous year resulting primarily from several large projects being approved last year.

There are 21 capital projects requiring funding in FY 17. Project expenditures of \$4.9 million plus related inter-fund transfers of an additional \$4.9 million total \$9.8 million in capital appropriations. The largest component of these projects is \$2.0 million for street maintenance projects, \$0.9 million for the Silicon Valley Radio Communications Systems (SVRCS) for the Police Department, and \$0.5 million for Citywide Intelligent Transportation System (ITS) projects. The full CIP, along with details of specific projects, can be found in the Capital Improvement Plan tab of this document.

## **REVENUES**

Revenue estimation is often a challenging task for cities, especially in times of economic downturn and even during periods of economic recovery. In such an environment, past results are often not reliable indicators for predicting future outcomes or the magnitude of change from year to year. In addition, there is often a time lag between when the economy begins to change and the impact is felt by the City. Nevertheless, program managers evaluate comparative historical data and factor in necessary adjustments for inflation, changes in assumptions for anticipated volume of activity, and any fee increases. Lastly, the most current economic outlook is taken into consideration to derive the final and best estimates for the upcoming year. Total estimated revenue for FY 17 is \$72.4 million, including capital funding sources of \$9.8 million. This reflects an increase of \$7.4 million (11.3%) from the previous year. In looking at just the operating budget component, total revenue is estimated at \$62.6 million, an increase of \$3.0 million (5.0%) from the previous year.

It is important to note that the capital project budget can fluctuate significantly from year to year depending upon the number and magnitude of projects that are approved. Capital projects are generally one-time and long-term in nature, and they are funded with non-operating revenue so there is no impact on the operating budget funding sources. The operating and capital budgets contain transfers-in totaling \$5.3 million and \$4.9 million, respectively. Although this has a tendency to make the budget appear higher in total than it actually is, the transfers-in on the revenue side are offset by transfers-out on the expenditure side. Including transfers in the City's adopted budget is done to readily demonstrate that budgets are balanced and match the internal budgeting system.

**General Fund:** Contained within the budget are a variety of funds, each with its own source(s) of revenue. The budget document is organized by operating department, then by program within the department. The General Fund is the City's largest single fund where the majority of services are budgeted. It funds general services such as police, fire, parks, streets, recreation and administration. Therefore, the focus of this section of the budget message is on this fund. General Fund operating revenue, excluding capital funding sources is estimated to be \$49.5 million, an increase of \$2.4 million (5.0%) from the FY 16 adopted budget. The largest component of this increase is attributable to continued growth in property tax from a strong housing market. Second to property tax, rentals and leases are expected to see significant growth from last year due to high demand and increase in rental rates. Other contributors to the increase are sales tax revenue that continues to reflect the growing economy and also Transient Occupancy Tax (TOT) receipts that also continue to do well as the business and leisure travel industry remains robust.

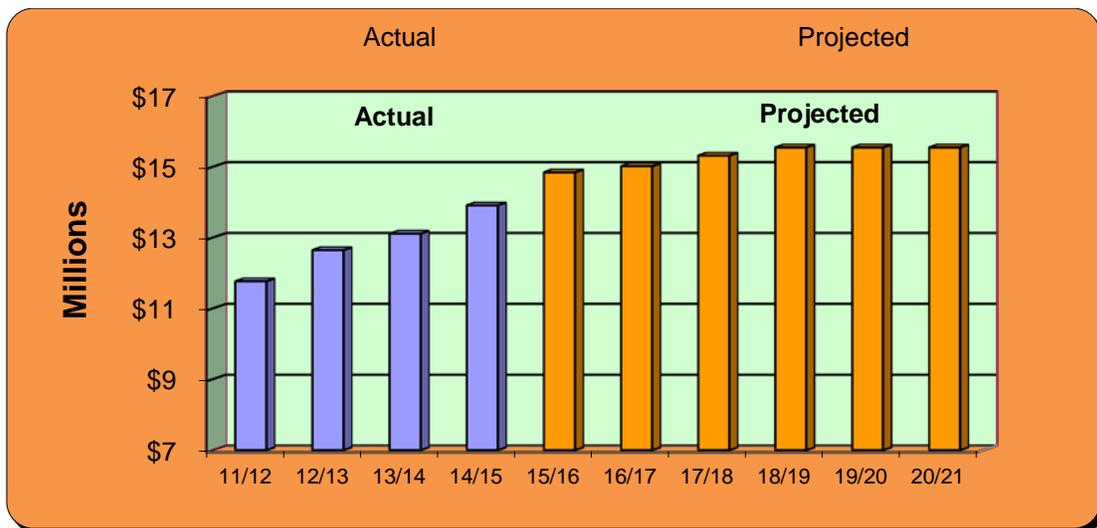
**Sales Tax:** Sales tax, the single largest revenue source for the General Fund, comprises approximately 30% of its net operating revenue base. Net revenues exclude reserves, which are not considered to be an on-going revenue source. The sales tax base is comprised of more than 1,300 diverse businesses throughout the City. While most of the City's largest sales tax producers can be considered stable businesses, they are still subject to fluctuations from regional and national economic conditions which can have a direct impact on the sales tax revenue base. The loss of any one of these top revenue generators could have a significant financial impact to the City.

Growth in the sales tax base is challenging because the City is essentially “built out” with limited space for new and larger retail development. Instead, there is a growing reliance on “in-fill” projects of smaller scale and redevelopment of existing parcels. In addition, increased regional competition and the financial impact of electronic commerce continue to affect the revenues of some of the City’s larger existing sales tax producers. By comparison, other Silicon Valley cities and the State overall have seen higher levels of sales tax growth, on average, due to their capacity to accommodate new retail business when the economy expands. Nonetheless, Campbell continues to enjoy a favorable reputation as a destination for many leisure activities such as shopping, dining and partaking in the many year-round festivals and activities that occur in the City. This has played a significant role in bringing people into the City and continues to have a positive effect on the City’s sales tax revenues.

Consequently, the FY 17 Sales Tax revenue estimate of \$15.0 million is \$0.2 million (1%) higher than FY 16 estimated actual revenue. The anticipated growth is based, in part, on recent performance and forecasts provided to the City by its sales tax consulting firm, MuniServices. Beyond that time, the growth assumption is conservatively estimated at 1% based on continued economic growth in addition to several new retail additions expected to come on line during the next two years.

The graph below reflects actual sales tax performance for the past five fiscal years and projected revenue through FY 21.

**Sales Tax Trend - General Fund**

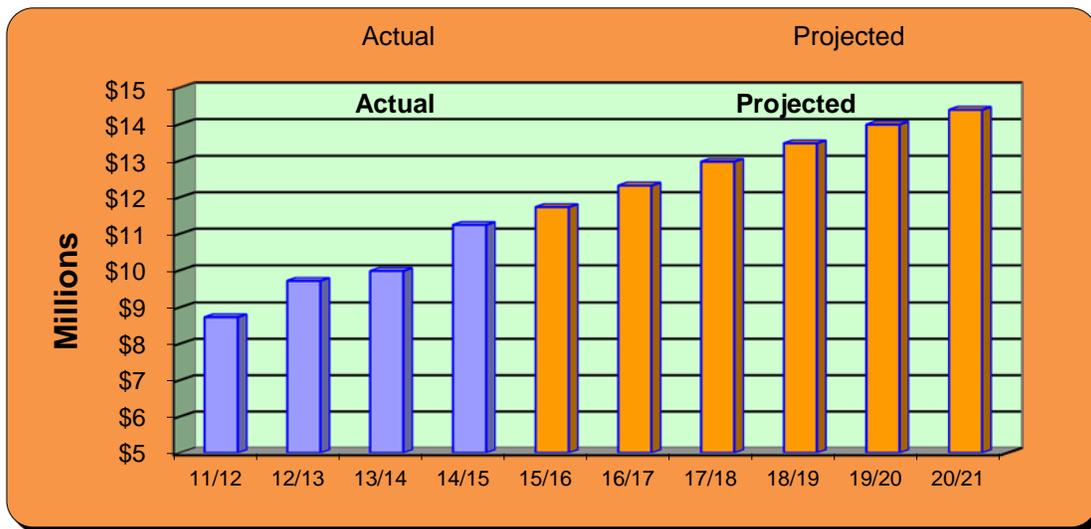


**Property Tax:** Property tax revenue is the second largest source of revenue to the General Fund and one of the most stable revenues over the past several years. Estimated FY 17 revenue is \$12.3 million, or 24% of net operating revenue, and is \$1.1 million (9.7%) higher than adopted FY 16 revenue. Real property continues to appreciate in value as both residential and commercial property markets continue to experience strong demand. To a large degree, this is the result from the continuing strength and growth in and around the Silicon Valley region including notable companies such as Apple, Facebook, Google, LinkedIn, and Tesla, which continue to hire and create additional new jobs while expanding their office facilities to accommodate a larger workforce. Silicon Valley, and the greater Bay Area metropolitan region,

continues to see increasing real estate prices where demand for housing exceeds the supply. Commercial properties, as well, are also seeing increases in value as demand continues for desirable space and location. The overall outlook for property value remains positive for the foreseeable future.

The primary factors used in the projection of revenues are historical growth in assessed valuation and new construction. The County Assessor provides periodic information and estimates of property values to the City upon which the revenue estimates are based. The following graph depicts the historical and projected trend for property tax revenues in the General Fund. Based on continued improvement, future years' revenue is estimated to grow at 4.5% for the next several years.

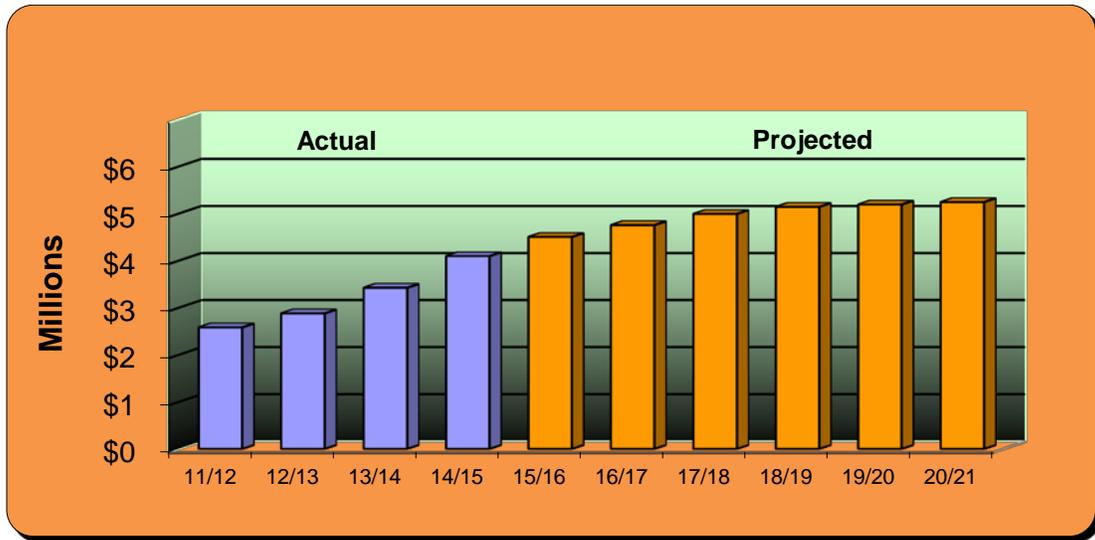
**Property Tax Trend - General Fund**



**Transient Occupancy Tax:** This tax, more commonly referred to as hotel/motel tax, or simply TOT, is derived from a 12% surcharge that is applied to the room rates of the City's hotels/motels. TOT revenue for FY 17 is budgeted at \$4.8 million, reflecting a \$0.3 million (5.5%) increase from revised FY 16 projections. With the continued strength of the business and leisure travel industry, as previously discussed, overall revenues have kept increasing as demand for temporary rooming shows no sign of letting up. Room revenues and occupancies remain high for all business class properties. With limited capacity to construct new hotel rooms, it is expected demand will continue to push revenues higher for the foreseeable future.

Key factors in developing the revenue projections are such things as historical trends, the number of available rooms, the occupancy rate, exemptions, new rooms coming on-line, and the weighted average room rate. For the past several years, Campbell hotels/motels have averaged occupancy rates of close to 90%. The next year is expected to grow approximately 5% and level off around 2% in the years beyond. The following chart depicts historical activity and projections for current and future years.

## Transient Occupancy Tax (TOT) Trend - General Fund

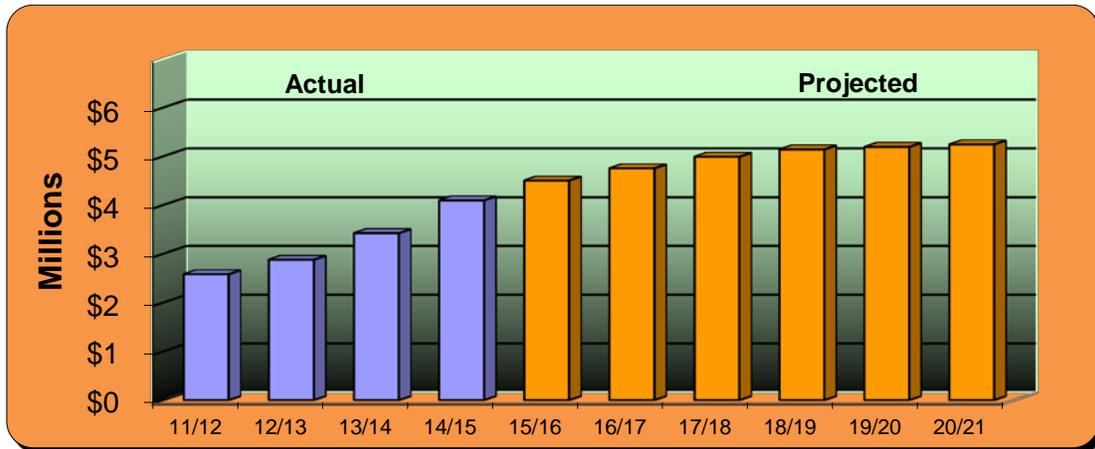


**Charges for Services:** Charges for services include revenues derived from a variety of sources, the largest being Recreation program fees that consist of classes/lessons, trips/tours, preschool and theater revenues. Other fees are charged for Police and Fire services; engineering services; zoning review and business license processing.

The City maintains a cost allocation plan and user fee model, which serves as the basis for assessing and collecting fees and charges. A Council approved User Fee Policy establishes a framework for cost recovery from which fee modifications are proposed and approved annually in conjunction with the budget process. Fees are increased to maintain recovery levels per the policy.

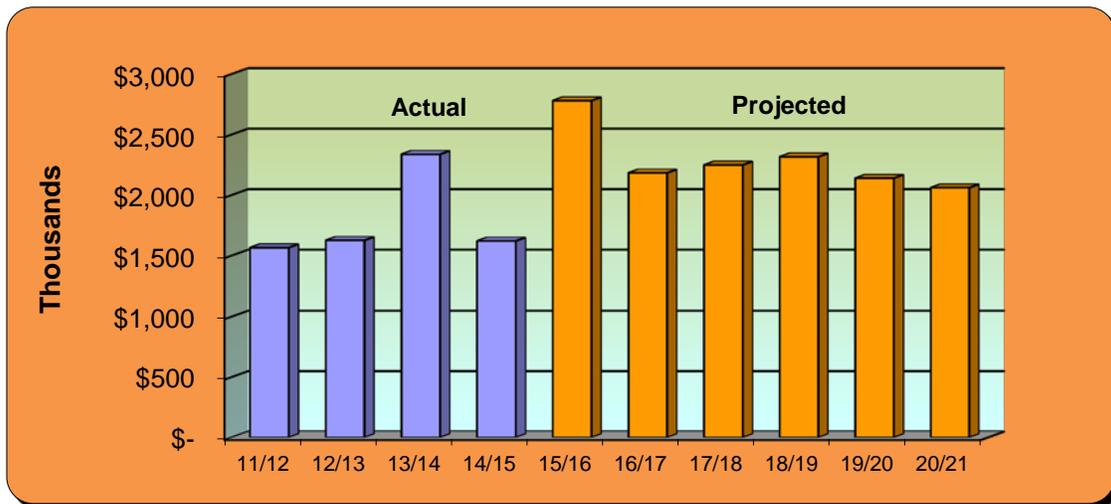
In addition to the cost of providing the service, other factors such as the allowable percentage of recovery, number of participants or attendees, inflationary factor, comparison to other agencies, and the historical trends are analyzed for nearly all fees and charges. The combined revenue for all user fees and charges is anticipated to generate \$4.3 million for the General Fund during FY 17, which is \$0.3 million (7.5%) higher than FY 16 estimated revenues. The following chart depicts historical activity and projections for current and future years:

### Charges for Services Trend - General Fund



**Licenses & Permits:** Revenues in this category are composed primarily of construction permits and advanced plan check fees. Also included are fire permits and other Building Division fee revenues. As can be seen from the chart below, revenues from this category fluctuate significantly with the level of development activity from year to year and are a challenge to estimate. The numbers, however, do serve as a measure of how the local economy is faring. Future estimates are based largely on historical averages adjusted for upcoming projects. Budgeted FY 17 revenues are \$2.2 million representing a \$0.5 million decrease from projected FY 16 revenue. The difference is due to several large projects that made FY 16 a record year for permit revenue. It is expected FY 17 and future activity will trend closer to historical averages.

### Licenses & Permits Trend - General Fund



**Lease Rental Income:** The City collects rental income from leasing out space to tenants at its Community Center as well as from rental of its Theatre and other Community Center buildings, in addition to a small amount from telecommunication antennas. Lease rental income represents approximately 5.3% of net General Fund operating revenues. FY 17 revenue is budgeted to increase 6.9% from FY 16 projections to \$2.7 million. Rental income from this source is generally stable from year to year, which is attributable to having a consistent tenant base. Occupancy is

expected to continue at or near capacity for the next year. However, the City is aware that occupancy levels can change unexpectedly. The revenue projections are based on actual lease contracts and estimated market rates for available space.

**Franchise Tax:** Franchise tax revenue is derived from fees charged to various utilities for doing business within the City. The fee is generally computed as a percentage of the gross income of the utility. This revenue source is estimated to generate approximately \$3.3 million for FY 17, which is an increase of 1% from FY16. The estimate is developed from a combination of increased services/customers plus an inflationary factor averaging 2% on the historical amounts generated by utilities operating within the City limits, e.g. cable, water, garbage, gas and electric. Others are set contractually. Based on recent consumption trends, it is anticipated revenues will continue to see modest growth this year.

**Other General Fund Revenues:** The remaining significant General Fund revenue sources consist of operating transfers-in of \$1.4 million, representing reimbursements from other funds for services provided by the General Fund, and reserves of \$1.5 million used to fund one-time operating expenditures. Where appropriate, other revenue sources are projected to reflect modest inflationary increases and/or changes in activity levels.

### **Revenue - Other Funds**

Various other funds are contained within the budget as discussed below. In summary, each fund's operating revenue meets or exceeds operating expenditures consistent with established financial policies. Exhibit A within each program budget provides a summary of that program's funding sources and all revenues monitored by that program. Narrative descriptions pertaining to the particular revenue sources can be found in the budget reference materials section of this document. Charts and graphs for General Fund revenue as well as total City revenue, in addition to what is presented in this budget message, can be found in the financial summaries section of the budget document. Because this budget is organized by program, funds other than the General Fund are included in the respective operating department's section of the budget along with the General Fund programs. Each program is identified with the fund number at the beginning of each section.

**Special Revenue Funds** consist of Gas Tax; Lighting and Landscape District; Housing and Community Development; Environmental Services; Parkland Dedication; Asset Forfeiture; Supplemental Law Enforcement; Other Grants and Other Special Revenues; Housing Trust; Community Facilities District #1 and Community Facilities District #2.

Gas Tax revenue is considered a State-shared revenue. Projections for this revenue source come directly from the State on an annual basis. Revenue in funds such as the Lighting and Landscape District and Environmental Services are based on rates that are assessed to individual properties depending upon type of service being provided or type of property. Total operating revenues for Special Revenue funds for FY 17 are \$8.9 million, an increase of \$0.4 million (4.5%).

**Debt Service Funds** are incorporated within the budget due to various bond covenant requirements. Certificates of Participation (COP) debt service is funded by the General Fund with a partial reimbursement that is funded from monies provided by the County Redevelopment Property Tax Trust Fund (RPTTF). Effective February 1, 2012, pursuant to State legislation, the City's Redevelopment Agency was dissolved and provision made for tax increment revenue to

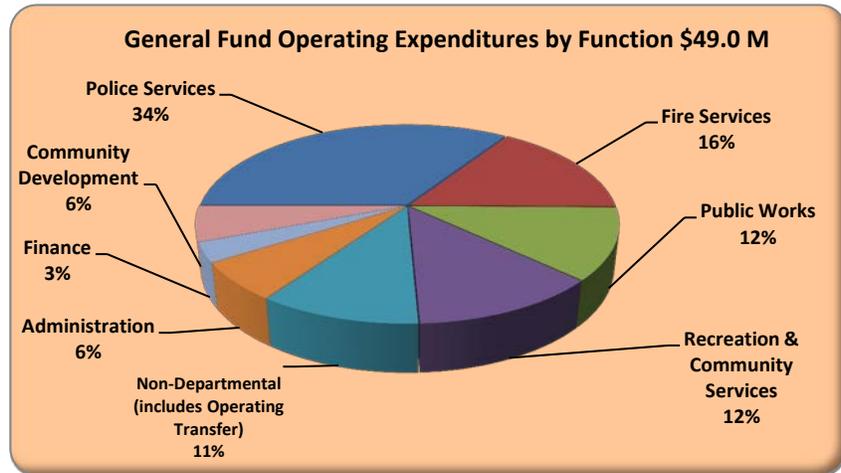
flow through the County with only State-approved expenditures, including the COP debt, being funded via semi-annual payments to the City. Total funding sources for Debt Service funds for FY 17 are \$1.6 million, consistent with the previous year.

Three **Internal Service Funds** (Motor Vehicle, Information Technology and Workers' Compensation) are presented within the City's budget. Revenues in these funds are generated primarily through charge-backs to user departments depending upon the volume of assets and type of service provided by the specific fund. Costs that get recovered include staff time, repair, maintenance, claims payout and replacement of assets managed by the particular fund. Total revenues for Internal Service Funds for FY 17 are \$4.2 million, up \$0.1 million from the previous year, reflecting an increase of funding into worker compensation insurance.

## **EXPENDITURES**

As previously noted, the budget is composed of operating and capital expenditures totaling \$71.9 million. Operating expenditures alone total \$62.0 million.

**The General Fund, which is** the primary operating fund for the City, comprises approximately 73% of total City operating expenditures. Special Revenue funds comprise 9%, Internal Service funds comprise 7% and other funds make up the balance at 11% of the total. Operating expenditures in the General Fund are budgeted at \$49.0 million which is 6.2% higher than the prior year adopted budget.



**Employee Services:** Personnel staffing represents an integral part of the City's annual budget. The combined number of budgeted permanent, permanent part-time, and limited term FTE positions proposed in FY 17 is 169, a net increase of five positions from FY 16. With the increase in service demands and desire for enhanced services to the community, additional staffing was incorporated into this year's budget. Changes to the budget from the prior year include the following - in Community Development, a Senior Planner (1.0 FTE) and a limited term Planning Technician (1.0 FTE) are being added to replace the Planning Manager position and a permanent part-time Project Planner (0.5 FTE), respectively. In Public Safety, two Police Officers (1.0 FTE) and a Police Record Specialist (1.0 FTE) are being added. In Public Works, an Assistant Engineer (1.0 FTE) is being reclassified to Associate Engineer, and a limited term Assistant Engineer (1.0 FTE) is being added.

In addition to these permanent position changes, there are increases in various temporary staffing across departments to help with additional workload including a number of short-term projects.

**Salaries and Benefits:** Salary and benefit summaries including charts can be found within the financial summaries section of this document, and can also be seen in the departmental budget summaries section, or on Exhibit B-1 of each program budget. These summaries reflect FTE's and budgeted expenditures for both permanent full-time, permanent part-time, and temporary staffing. Exhibit B in each program budget summarizes the various salary and benefit line-items contained within that program's budget.

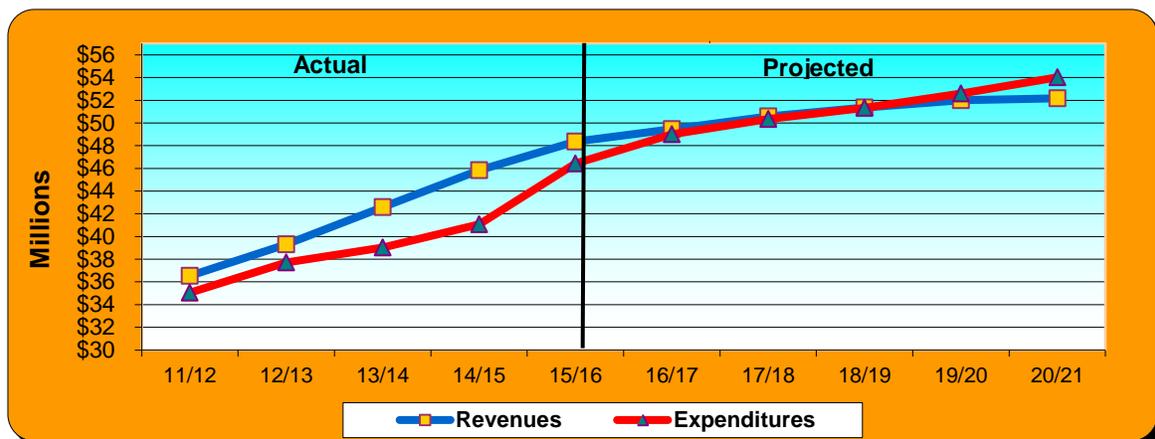
The salaries and benefits category represents all personnel-related costs and makes up the largest component of the General Fund expenditures. In fact, personnel costs are approximately 45% of the total budget. This percentage is relatively low compared to many other cities because fire personnel are provided by contract with the County and, therefore, do not show up as City personnel costs. For FY 17, salaries and benefits in the operating budget total \$32.6 million for all City funds, which is a \$2.3 million (7.4%) increase from the previous fiscal year. The primary reasons for the growth were the increased staffing, described above, as well as modest employee wage increases and anticipated increases for City retirement contributions.

**MULTI-YEAR COMPARATIVE ANALYSIS**

**General Fund - Revenues and Expenditures:** The comparative analysis that follows reflects the historical trend between General Fund revenues and expenditures covering the past five years as well as projections through FY 21. In recent years, the economy has seen modest to strong growth resulting in surpluses of varying amounts for the General Fund during this period. However, it is anticipated that the current business cycle may begin to slowdown and even decline within the next five years. As a measure of prudence, the City has incorporated into its financial projections the possible impact on revenue from a slowdown in the economy in FY 20 and FY 21. The result is modest deficits in these years absent measures to reduce expenditures. It is anticipated, however, as in past economic downturns, budget correction strategies would be enacted by the City, including a combination of reserve utilization and expenditure reductions, thereby, retaining a balanced budget in those years.

The following chart depicts actual and projected operating revenues and expenditures for the years indicated. As is depicted, the City expects to realize a modest surplus in FY 17 with declining surpluses until FY 19 which reflects essentially a breakeven budget. As noted, FY 20 and FY 21 show projected deficits due to the assumed changes in the economy.

**Comparative Analysis: General Fund - Revenues to Expenditures**



**Internal Service Funds:** The City utilizes three internal service funds (more commonly referred to as “pool funds”) to finance and account for goods and services provided by one City department to other City departments on a cost reimbursement basis. These funds are: (1) Motor Vehicle; (2) Information Technology (IT); and, (3) Workers’ Compensation.

The primary funding source for these funds is user charges. City program budgets contain line items for charges from the various pool funds. Included in these charges to other City departments or programs are the prorata share of the cost of operations of the particular fund in addition to a replacement cost factor whenever physical assets such as vehicles and computers belong to the fund. As operating or replacement costs change or as asset inventories grow, the corresponding changes are reflected in the charges to the user departments. For FY 17, revenues and expenditures in these funds total \$4.2 and \$4.1 million, respectively. Expenditures are essentially flat from the previous year’s adopted budget. Annually, any assets scheduled for replacement are funded from reserves within the respective fund. This can and does result in large variances when making year-to-year budgetary comparisons. The various methodologies utilized to determine reserve levels and replacement charges are periodically evaluated and modified. Projections in future years have been estimated using a modest inflationary factor.

**Special Revenue Funds:** Funds in this category are used to account for the proceeds of specific revenue sources that are legally restricted for specified purposes. These are generally created when legally mandated in accordance with State and/or Federal statutes or is otherwise restricted by the funding source. Consistent with the City’s financial and administrative policies, revenues in the special revenue funds must meet or exceed expenditures, and one-time monies are not utilized to fund on-going expenditures. To the extent revenue shortfalls exist in a given year, expenditures would either be amended and/or the fund may receive subsidization from the General Fund. In any case, the goal is a balanced budget in all special revenue funds. Listed below are the major funds in this category:

**Gas Tax Fund:** Gas Tax revenue is derived from State imposed taxes on the purchase of gasoline which, in turn, gets appropriated to cities based on population and other factors. Revenues are restricted for the construction, improvement and maintenance of public streets and roads. Revenue projections are provided annually by the State Controller’s office and future years include an inflationary factor on the current year’s projection and are adjusted for any known variances.

Expenditures in this fund are used for on-going maintenance of the City’s street infrastructure. Revenue and expenditure totals for FY 17 are projected to be \$1.7 million, up slightly from the previous year’s adopted budget. Projections for future years utilize a modest inflationary factor approximating 2% for revenues and expenditures.

**Lighting and Landscape District Fund:** The City provides a range of services, which are eligible for funding through the City-wide Lighting and Landscape District (LLD) as allowed under the Lighting and Landscaping Act of 1972. Annual levies are established and assessments are collected via property tax bills. The County of Santa Clara bills, collects, and remits LLD revenue which is deposited in the Campbell Lighting and Landscape District fund. Services that are provided include the installation, operation, and maintenance of public lighting, including traffic signals, landscaping, parks and recreational improvements, including play equipment and public restrooms, and other equipment for maintenance of the above, including curb, gutters, sidewalks, irrigation, and drainage improvements.

In FY 17, operating and capital revenues and expenditures total \$3.7 million. This includes operating transfers-in of \$1.9 million and transfers-out of \$0.1 million. The General Fund accounts for most of the total transfers-in as a subsidy to this fund. In other words, revenues from the assessment are not sufficient to cover the cost of services funded by the LLD. Details related to transfers-out may be found in Exhibit E of Program 775 in the Lighting and Landscape District Fund budget worksheets. Projections for future years are based on inflationary increases approximating 2%.

**Environmental Services Fund:** This fund budgets and accounts for revenues and costs associated with administration and management of the City's solid waste collection and disposal, storm water management, and other environmental programs as needed or required. The City participates in a Solid Waste Joint Powers Authority (JPA) and utilizes a franchised solid waste and recycling provider who bills, collects, and remits revenues to the City related to services provided to Campbell residents and businesses. Fees remitted to the City include storm water, storm drain, solid waste, hazardous waste, and recycling fees. Operating revenues and expenditures for FY 17 are \$1.5 million, \$0.1 million higher than last fiscal year's adopted budget. Future years' costs are based on inflationary increases approximating 2%.

## **ECONOMIC AND FISCAL ISSUES FACING THE CITY**

Maintaining good fiscal health remains the City's key ongoing priority. Meeting this objective preserves the City's ability to continue providing important programs and services to the community. Through the past decade of economic challenges, solutions were developed to address lost revenues while preserving vital services. The community played a critical role in helping the City to provide the desired services by voting to support several revenue measures over the years. This was combined with expenditure reductions that reduced the City workforce and required shifting of priorities to maintain service levels. These combined efforts provided a needed measure of stability to offset the decline in economic activity. Now that revenues have improved considerably since that time, cost containment efforts are still necessary to ensure the future sustainability of important City programs and services, especially in light of another possible economic downturn.

The unemployment rate is an important economic statistic as to the state of the economy in general. As of May 2016, the State seasonally adjusted unemployment rate was 4.7% compared to 6.2% the prior year. For Santa Clara County, the May unadjusted rate was 3.3%, a 0.7% reduction from last year's rate of 4.0%. Campbell has historically trended better than both the County and the State in its unemployment rate. In fact, as of May 2016, Campbell's unemployment rate was 3.0%, unadjusted, up 0.1% from 2.9% in the prior year. While unemployment statistics represent only one measurement of the total economic landscape, they do provide a comparative indicator of how each area is doing relative to the prior period.

Due to being "landlocked" on its borders, growth and new development within the City pose both opportunities as well as challenges. Campbell is essentially "built out", meaning that areas of undeveloped land in the city limits available for improvement are very limited. Therefore, the challenge is to focus on "in-fill" projects, consisting of smaller individual parcels of land dispersed throughout the City or rebuilding of existing parcels whose current use may be enhanced by new development. The City's goal is to preserve the quality of life for Campbell residents and provide a variety of balanced land uses via established standards for residential, commercial and industrial development. Strategies include meeting with an economic development advisory committee and community business groups to obtain feedback on how best to approach various

issues, maintaining a diversified and stable economic base, and marketing the community to targeted businesses. This year's budget includes increased resources to expand the City's economic development efforts aimed at attracting new businesses and retaining existing ones.

Along the lines of growth and new development, an area of specific concern is limited capacity for long-term retail growth. The City's largest source of revenue is sales tax, which is used to fund a variety of City services such as police patrol and emergency response, fire and paramedic services, road improvements and other amenities such as parks and senior services. The existing sales tax base is expected to see 2% growth, on average, over the next several years and beyond which includes a limited amount of new development.

With an increase in residential and commercial development activity, the City continues to address the overall impacts on the community of future development projects so that they remain manageable and environmentally balanced. While the current economic expansion has seen several large high density development projects come our way, the City is committed to environmental sustainability and preservation, including the creation and enforcement of policies that are consistent with environmental standards. The City is a certified "Green" organization, and continues to explore ways to promote this in the community. One such example of this is the recent formation of the Silicon Valley Clean Energy Authority, a regional effort with numerous cities in Silicon Valley. The Authority will allow participating residents in their community to select from alternative energy types, such as solar, wind and other clean energy sources. It is expected that residents will be able to begin participating by 2018.

The City is also committed to providing reasonable health care coverage to its employees. As the general population ages, more reliance is placed upon the health care system to provide comprehensive coverage for employees and their families. However, the cost of providing health care and other post-retirement benefits coverage continues to escalate each year, often outpacing revenue growth. With the passage of the *Patient Protection and Affordable Care Act*, the City is also challenged with determining the impacts of providing affordable health care coverage to its full-time employees. The City, like all employers, has to consider how to balance the level of on-going benefits it can offer with the cost of providing them. The City is also committed to pre-funding its obligation to provide retiree health benefits and has budgeted \$0.5 million to continue pre-funding this obligation with a goal of full funding over time.

Employee retirement costs have also been an ongoing challenge to maintaining a balanced budget. It is expected future changes in assumptions by CalPERS will result in additional rate increases next year and continue for several years beyond. As a long-term strategy to combat the rising pension costs, several years ago the City enacted pension reform, with the help of its labor groups. Campbell was one of the first cities in the region to implement a lower second tier of retirement benefits for new hires of both its safety and non-safety personnel. As staff retire from the City or move to other employment and new staff is hired, increasingly larger savings are expected to accumulate over time. The State of California also enacted recent legislation to establish a third tier of lower benefits that will result in further cost mitigation.

Another ongoing challenge is the need to maintain the City's infrastructure, particularly its streets and sidewalks. More than \$31 million dollars have been invested in the City's street infrastructure over the past 18 fiscal years, including \$2.6 million in FY 16 alone, and work will continue into this year with additional dollars set aside for this purpose. While the overall condition of streets has been good for the past several years, a significant amount of resources are required to maintain a "good" condition rating on an on-going basis. Consistent funding for

maintaining this level is a challenge as costs continue to increase from year to year. The City plans to apply for various Federal and State grant funds to assist in funding annual needs. However, these are one time funds that are not guaranteed for the future. A vehicle impact fee was instituted a number of years ago to supplement funding of street maintenance needs. The 5-year Capital Improvement Plan (see CIP section of document) continues to commit annual funding dollars for street maintenance to address this important issue. Noteworthy for FY17 was the commitment of \$800,000 in additional funding for street maintenance to bring the 5-year spending commitment to \$6.3 million.

With continued demand for enhancing services for the community, the City's technology equipment remains a critical issue. To maintain the City's current and proposed standards of performance, and to protect systems from ever increasing outside attacks and viruses, additional resources are required to ensure systems remain stable and reliable for all users. Moreover, the City has been facing an aging technology infrastructure for a number of years. Fortunately, over the past few years, additional funding has been made for needed replacements and upgrades. Some of the projects slated for this budget year that address some of these issues are: replacement of the City's storage area network and related infrastructure, implementation of remote backup at a secondary site and continuing the implementation of a new Computer Aided Dispatch system with another jurisdiction.

## **LONG-TERM FINANCIAL PLANNING**

The City incorporates long-term financial planning into its budget process in several ways. First, the City has established a set of financial policies to provide a basis for promoting and safeguarding the City's fiscal health by establishing requirements for budgeting revenues and expenditures, setting minimum or target levels for reserves, as well as guidelines for accounting, cash and debt management. Together, these policies ensure consistent management of the City's fiscal resources, establish criteria in which to evaluate the City's financial condition, create a sound financial basis for City operations, promote public confidence, and increase the City's credibility in the eyes of bond rating agencies and potential investors. These policies promote budget stabilization by providing for various reserves that can buffer short-term economic downturns or emergencies. The policies are reviewed periodically and modified only when deemed necessary to maintain or improve the fiscal health of the City. The financial policies are detailed in Exhibit 2 of this budget message.

Second, the City maintains five year operating projections for revenues and expenditures that are revised during the year and shared with Council. These projections allow management to see what the longer term future may look like given a set of assumptions and known information which then influence budget decisions of the current year. The current budget is evaluated in the context of whether decisions made now will be sustainable over the longer term given what may or may not occur down the road. Combined with the financial policies, the evaluation considers whether the City's fiscal health will continue over a 5 year period, not just a single year. In addition, in 2013, the City engaged an outside consultant to conduct an overall management review including an assessment of the City's fiscal health based on a 10-year projected horizon for revenues and expenditures. The report indicated the City to be in a good financial position over this timeframe, absent any significant events.

Lastly, the City also develops a five-year capital improvement plan (see CIP section of document) that serves as a strategic plan for meeting capital needs over a similar period of time. It incorporates information from the five-year operating projections into the model to know what

internal funding sources may be available in each of the future years. This allows the City to plan and maintain flexibility in how and when capital projects will take place.

### **FY 17 MAJOR WORK PLAN ITEMS**

Departmental work plan items for the upcoming budget year were presented and discussed with the City Council at a study session on April 4<sup>th</sup>. Major work plan items, in addition to a list of the on-going responsibilities of each department, can be found within the department program sections of the budget document.

### **FY 16 SIGNIFICANT ACCOMPLISHMENTS**

The City achieved a significant number of accomplishments during the past year. The key accomplishments, summarized by department, are shown in Exhibit 1 to this budget message.

### **STRATEGIC PLAN AND PERFORMANCE REPORTING**

In addition to allocating necessary resources for the provision of ongoing services and work plan activities, the budget serves as the financial plan for accomplishment of the Strategic Plan vision and objectives, which are summarized within the City and Community Information section of the document.

At the beginning of each program budget section, the individual program mission statement and on-going and major work plan items are listed, and the total program budget is detailed by type of expenditure and by line item. Once the major work plan items have been identified, the departments proceed with development of budgetary resources necessary to accomplish the ongoing objectives and annual work plans. Many of the major work plan items are based on meeting Strategic Plan objectives and, therefore, are the link between the Strategic Plan and the annual budget.

Performance measures, which track and report work input and related outcomes, are located within each respective program budget section of the document and help Council, staff, and the community to assess trends and strive for continual improvement. Performance reporting assists the Council in establishing policies and priorities related to the quantity, quality and appropriateness of municipal services provided by the City of Campbell. Changes in resource levels can often also be articulated in terms of the impact on performance measures.

### **BASIS OF BUDGETING**

The City budgets on a modified accrual basis for all funds except for its internal service funds which are budgeted on a full accrual basis. This is consistent with the City's basis of accounting as reported in its Comprehensive Annual Financial Report (CAFR). The City's *Governmental Funds* consist of the General Fund, special revenue funds, debt service funds, and capital project funds. To summarize, under this basis, revenues are estimated for the fiscal year if they are susceptible to accrual, e.g. amounts can be determined and will be collected within the current period. Principal and interest on general long-term debt are budgeted as expenditures when due, whereas other expenditures are budgeted for liabilities expected to be incurred during the current period or shortly thereafter to pay current liabilities.

*Proprietary fund* budgets are adopted using the full accrual basis of accounting whereby revenue projections are developed recognizing revenues expected to be earned in the period, and expenditure estimates are developed for all expenses anticipated to be incurred during the fiscal year. The City's proprietary fund type consists only of internal service funds, as the City has no municipally owned utilities or other enterprise activities.

**Level of Budgetary Control:** The City's budget is a working document that is utilized throughout the organization. Although the expenditure budget is legally adopted by resolution of the City Council at the total City budget level, it is important to note that the administrative level of accountability is at the line-item level within each program and fund. The City's financial policies authorize budget adjustments within the adopted budget up to \$10,000 or requiring transfers from reserves of less than \$5,000 to be approved by the City Manager. These are referred to as administrative budget adjustments. All budget adjustments that increase appropriations or any adjustments to capital projects must be approved by the City Council.

**Budget Development:** Development of the operating and capital budget is a process that takes place over six months and is summarized by the budget calendar located in the Budget Reference section of this document. The City's financial policies establish a process whereby a budget study session is held with the City Council during the annual budget development process. This meeting is generally held during March/April timeframe. Council is presented with an overview of the City's fiscal condition and proposed work plans for the upcoming year. A study session was held on May 2<sup>nd</sup> to discuss the operating budget and capital improvement plan and the proposed budget was introduced on June 7<sup>th</sup>.

This budget document is arranged by department/function, then by program. Each program budget consists of a series of exhibits that are presented at a summary level followed by additional levels of detail. A flow chart of the budget exhibits and narrative on each exhibit, along with a Program/Department/Fund matrix and other reference information, are contained within the budget reference materials section of the document along with an index to facilitate locating specific information.

The City's budget presentation and format incorporate many of the best features of fund order and program order budgets, and provide a document that is distinctive for its readability as well as its utility as a policy document, an operations guide, a communication tool, and a financial management instrument. It is a working tool that contains a considerable amount of information that is utilized at every level in the City organization throughout the year.

## **BUDGET AND FINANCIAL AWARDS**

For the 23<sup>rd</sup> consecutive year, the City's budget received national recognition by earning the Government Finance Officers Association (GFOA) "Distinguished Budget Award". To receive the Distinguished Budget Presentation Award, a city must publish a budget document that serves as a policy document, a financial plan, a communications device, and an operations guide. We believe the FY 17 budget conforms to GFOA program requirements. Additionally, this is the 18<sup>th</sup> year an award of "Excellence in Budgeting" has been received from the California Society of Municipal Finance Officers (CSMFO). Copies of both awards appear in the Budget Reference Materials section of this document. It also should be noted that the City's Comprehensive Annual Financial Report has also been an award-winning document for excellence in financial reporting at both the State and national levels for many years.

## **CONCLUSION AND ACKNOWLEDGEMENTS**

The development of the FY 17 operating and capital budget was made possible through the cooperation of the City's employees, input and support from our community, and direction of the City Council. Although the City's budget challenges have eased for the time being, difficult economic times can return very quickly. Consequently, we continue to prioritize what is important for the City and to allocate available resources to those programs and services deemed to be critical to improving our community. Our ability to manage scarce resources is a key reason Campbell remains a vibrant and desirable place to live and work.

The development of this budget was made possible through the knowledge and contributions of many individuals on staff. I wish to thank everyone who participated in the budget process this year including the City Council and members of the Executive Team. Finally, I would like to recognize the Finance Department, under the direction of Jesse Takahashi, Executive Assistant, Shannon Brangan, and Senior Accountant, Tran Nguyen, for their dedication and hard work that went into coordinating, developing, and publishing this budget document.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'M. Linder', is written over the typed name.

Mark Linder  
City Manager