TO: HONORABLE CITY COUNCIL

ATTENTION: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: DECEMBER 14, 2004 CMR: 502:04

SUBJECT: ORDINANCE CLOSING THE 2003-04 FISCAL YEAR, INCLUDING TRANSMISSION OF THE CITY’S COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR), REAPPROPRIATION REQUESTS, AND COMPLETED CAPITAL IMPROVEMENT PROJECTS

RECOMMENDATION
Staff recommends that the Finance Committee review, recommend and forward the attached ordinance (Attachment A) and associated exhibits to the City Council for its approval to: close the 2003-04 Budget and authorize re-appropriation of 2003-04 funds into the 2004-05 Budget (Exhibits A & B); close completed capital improvement projects (Exhibit C); and transfer remaining balances to the appropriate reserves (Exhibits D & E for General Fund and Exhibits F & G for Enterprise Funds). In addition, staff is transmitting the City’s Comprehensive Annual Financial Report (CAFR) for review and approval (Attachment B).

BACKGROUND
The attachments to this report provide the necessary documents for closing the 2003-04 fiscal year budget and providing funds for the current fiscal year 2004-05. They also offer detailed information on the City’s financial activities for 2003-04. This cover report highlights the key fiscal issues impacting the City of Palo Alto and identifies pages in the attachments where the reader can find more comprehensive explanations. The Management Discussion and Analysis (MD&A) chapter of the CAFR (Attachment B) provides an easy-to-read, thorough discussion and analysis of the City’s current fiscal health, including financial statements, performance compared to the prior year, capital assets and debt administration. The Long-Range Financial Plan (CMR:492:04), presented to the Finance Committee on December 14, 2004, contains a more comprehensive analysis of the local and national economic factors impacting Palo Alto going forward.

Economy
Toward the end of 2003-04, the local economy showed some signs of improvement in certain areas. County and local unemployment rates decreased and economically sensitive revenue sources, such as sales and transient occupancy tax stopped declining. In spite of these small
Because of the continued, slow economic recovery and the uncertainty of possible future State actions, this is the fourth straight year the City has had to closely monitor revenues and expenditures and make adjustments to maintain a balanced budget without using reserves. For example, the City had a hiring freeze and voluntary furlough this past year. The City also continued to reduce expenditures without impacting services to the public; however, continued maintenance of service levels may be difficult. (MD&A pp. 13-15; Transmittal Letter p. v.)

**Infrastructure**

Even though the economy has been tepid, the City has been able to maintain its commitment to the Infrastructure Management Plan. In 2003-04, $2.5 million was added to the Infrastructure Reserve. The Plan focuses on the backlogged and highest priority projects to ensure that the City’s critical infrastructure remains strong. Construction finished on the new downtown parking structures and has continued with the Homer Avenue undercrossing project. Additional efforts focused on streets, sidewalks, parks, open space, and City facilities. (MD&A pp. 15-18)

**DISCUSSION**

There are several necessary year-end adjustments to the 2003-04 budget. Specific transactions are detailed in Exhibit A of the budget-closing ordinance. Exhibits D and F summarize financial results for fiscal year 2003-04 for the General Fund and Enterprise Funds, respectively. They provide an analysis of the performance of these funds in comparison to the budget as adopted and adjusted by Council. The result of net operations is explained in terms of changes to the various fund reserves authorized by Council.

**Results by Fund**

**General Fund**

By fiscal year end, the City’s financial position remained sound in spite of a slow economic recovery. This is due to a proactive approach to align revenues and expenditures. The General Fund shows a net operating surplus of $0.5 million compared to $2.9 million in the prior year. This result includes recognition of an unrealized loss on investments of $3.6 million that is required by GASB 31 and a $0.8 million transfer from Utilities to the Equity Transfer Stabilization Reserve. At fiscal year-end, the fund balance for the General Fund totaled $66.8 million. This was comprised of: $6.7 million reserved for encumbrances, notes and inventory; $21.5 million for the Budget Stabilization Reserve; $35.9 million for the Infrastructure Reserve; $2.3 million for the Equity Transfer Stabilization and $0.4 million for Reappropriations. (MD&A pp. 13-15)

**Capital Projects Fund**

For fiscal year 2003-04, the Capital Projects Fund reported $28.2 million in expenditures and other uses, which is a decrease of $5.0 million from the prior year. Prior year expenditures were higher due to construction for the parking garages of $18.4 million. Major expenditures in 2003-04 for the Capital Projects Fund included rehabilitation and maintenance of existing infrastructure, such as $4.3 million for streets and sidewalks, $8.6 million for continued construction on garages, and $2.5 million on the Homer Avenue undercrossing project. The
Capital Projects Fund Balance totaled $21.6 million, an increase of $0.6 million from the prior year. (MD&A p. 15)

Enterprise Funds
The Rate Stabilization Reserves (RSRs) for the combined Enterprise Funds decreased by a net $14.1 million. Major changes include a $5.2 million decrease from the Gas Fund, primarily due to a 15% rate decrease and a $4.2 million decrease from the Water Fund, primarily due to increases in wholesale rates and usage. (Exhibit G)

RESOURCE IMPACT
Adoption of the attached budget-closing ordinance (Attachment A) allows for the reappropriation and carryover of funding from the 2003-04 budget so that specific operating programs and capital projects can be completed in the current fiscal year (Exhibit B). In addition, by closing completed capital improvement projects, balances (Exhibit C) are returned to the original funding source for future appropriation. Exhibit E reflects the allocation to major reserves as follows:

- The General Fund BSR has been capped in accordance with the Council policy of 18.5 percent of budgeted expenditures, and shows a closing balance of $21.5 million, an increase of $0.1 million from the prior year.
- The Infrastructure Reserve was increased by $2.5 million and has a closing balance of $35.9 million.
- The Reserve for Equity Transfer Stabilization was increased by $0.8 million for a closing balance of $2.3 million. This is the third of four transfers to reach a $3.0 million funding target.
- Budget transactions included in the attached Ordinance increase General Fund Reserves by $3.8 million (Exhibit A).

Exhibit G provides the balance changes for all reserve categories for the Enterprise Funds. The net decrease in the funds was $9.2 million. Highlights for this change include:

- Transactions in the attached ordinance decrease Electric Fund reserves by $0.6 million, decrease Gas Fund reserves by $0.6 million as detailed in Exhibit A, primarily due to their funding the Equity Transfer Stabilization.
- An increase in the Refuse Fund reserve by $1.3 million as detailed in Exhibit A, from a return of CIP budget.

POLICY IMPLICATIONS
This recommendation is consistent with existing City policies.

ENVIRONMENTAL REVIEW
The action recommended is not a project for the purposes of the California Environmental Quality Act.
ATTACHMENT
Attachment A: Budget Closing Ordinance body text
   Exhibit A – Detailed Changes to the Adjusted Budget
   Exhibit B – 2003-04 Re-Appropriation Requests
   Exhibit C – Capital Improvement Projects Closed in 2003-04
   Exhibit D – General Fund Summary
   Exhibit E – General Fund Reserve Summary
   Exhibit F – Enterprise Summaries
   Exhibit G – Enterprise Reserve Summary

Attachment B: CAFR

PREPARED BY: ____________________________________________
TRUDY EIKENBERRY
Accounting Manager, Administrative Services

__________________________________
LAO PEREZ
Assistant Director, Administrative Services

DEPARTMENT HEAD APPROVAL: _____________________________
CARL YEATS
Director, Administrative Services

CITY MANAGER APPROVAL: _________________________________
EMILY HARRISON
Assistant City Manager