TO: HONORABLE CITY COUNCIL

ATTENTION: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: DECEMBER 12, 2006 CMR: 430:06

SUBJECT: ORDINANCE CLOSING THE 2005-06 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, provide input, and forward the attached ordinance (Attachment A) and associated exhibits to the City Council for its approval to: close the 2005-06 Budget and authorize re-appropriation of 2005-06 funds into the 2006-07 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 2005-06 fiscal year budget and providing funds for the current fiscal year 2006-07. In addition, they provide detailed information on the City’s financial activities for 2005-06. 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. It includes financial statements, performance information that is compared to the prior year, and capital asset and debt administration data.
DISCUSSION

Economy
Fiscal year 2005-06, saw a continuation of the economic recovery that began in 2004-05. Unemployment rates declined from 2.7 percent to 2.3 percent in Palo Alto and from 5.8 percent to 5.0 percent in Santa Clara County. Revenue sources have continued to rebound after years of declines. However, although the economy is stable, growth is slow and the City has potential expense and revenue challenges in the future. The City is proactively making efforts to meet future economic challenges. (MD&A pp 3-4 Transmittal Letter p. vi)

Results by Fund

General Fund
For 2005-06 the General Fund had a net gain of $2.4 million compared to a net operating loss of $35.0 million the prior year. The prior year loss was primarily from the $35.9 million operating transfer to move the infrastructure reserve to the Capital Fund. At fiscal year-end, the fund balance for the General Fund totaled $34.2 million. This was comprised of: $8.0 million reserved for encumbrances, notes, prepaid and inventory; $22.7 million for the Budget Stabilization Reserve; $3.4 million for the Equity Transfer Stabilization; and $0.1 for re-appropriations. (Exhibit E) (MD&A pp. 14-15).

Capital Projects Fund
For fiscal year 2005-06, the Capital Projects Fund reported $13.8 million in expenditures and other uses, a decrease of $8.7 million from prior year. This level of expenditures is consistent with the City’s effort to rehabilitate and maintain its existing infrastructure. The Capital Projects Fund Balance totaled $44.5 million, an increase of $0.4 million. Included in the revenues received by the Capital Projects Fund is an additional transfer of $1.0 million from the General Fund for the Infrastructure Reserve (IR). This transfer fulfilled the total commitment of the General Fund to provide funding of $5.6 million (includes interest earned on the IR balance) to the Infrastructure Reserve. A number of completed and closed projects with remaining balances at the end of fiscal year 2005-06 totaling $403,191 (Exhibit C) were returned to the Infrastructure Reserve. This balance return provided an additional source of revenues to the IR. (MD&A p. 15)

Enterprise Funds
The Rate Stabilization Reserves (RSRs) for the combined Enterprise Funds increased by a net $9.4 million. Major changes include a $19.1 million increase from the Electric Fund, primarily due to a 19.5 percent rate increase and a $6.5 million decrease from the Waste Water Treatment Fund. The rate stabilization reserve for the Waste Water Treatment Fund ended the year with a negative Rate Stabilization Reserve balance of $4.6 million. The reserve has been negatively impacted by the delay in construction for the reclaimed water pipeline project. The delay is primarily due to construction bids coming in over budget. Once construction begins, grant and partner revenues will offset the expense. At that time, the reserve should return to a positive level. If State funding is not received, the project will not proceed. Exhibit G provides the balance changes for all reserve categories for the Enterprise Funds. (MD&A p.16-17)

At the end of fiscal year 2005-06, a number of enterprise fund CIP projects were completed and closed (Exhibit C). The remaining balances of these projects reverted back to the various reserves. Likewise, there were also other enterprise fund CIP projects that though still
outstanding and continuing, returned a portion of their project balance to the reserve because the project managers deemed that the remaining balances are sufficient to complete the projects (Exhibit H).

**RESOURCE IMPACT**
Adoption of the attached budget-closing ordinance (Attachment A) allows for the re-appropriation and carryover of funding from the 2005-06 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. Exhibits D and F summarize financial results for the General Fund and Enterprise Funds, respectively, by providing an analysis of the performance of these funds in comparison to the budget as adopted and adjusted by Council. Certain capital projects that still exist and are continuing have returned a portion of their budget balance to reserves (Exhibit H). These returns have increased the respective reserve balance. Exhibit E reflects the changes to and status of major reserves as follows:

- The General Fund BSR is 18.1 percent of budgeted expenditures. This percentage is within the Council approved guidelines of 15 to 18.5 percent and shows a closing balance of $22.7 million, an increase of $1.6 million from the prior year.
- In FY 05-06, the General Fund transferred an additional $1.0 million to the Capital Fund. The Infrastructure Reserve has a final balance of $20.7 million at the end of fiscal year 2005-06.
- The Reserve for Equity Transfer Stabilization has a final balance of $3.4 million.
- Budget transactions included in the attached ordinance decreased General Fund reserves by $1.03 million (Exhibit A).
- The City is preparing for implementation of GASB 45 which requires that the City recognize any unfunded, earned retiree medical costs. The Retiree Health Benefits Internal Service Fund was established to fund retiree medical costs. As of June 30, 2005 the fund balance was $18.2 million, primarily funded by the General Fund. As of June 30, 2006 the fund balance is $26.5 million. The increase is primarily from transfers in the amount of $8.0 million consisting of: Electric Fund $2.5 million, Gas Fund $1.2 million, Wastewater Treatment Fund $1.0 million, CIP Capital Fund $0.4 million, Water Fund $0.7, Refuse Fund $0.7 million, Technology Fund $0.6 million, Wastewater Fund $0.4, Vehicle Replacement Fund $0.3 million, Storm Drain Fund $0.1 million and Printing Fund $0.1 million. These transfers were made as a partial payment toward the respective funds unfunded retiree medical liability.

**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.
ATTACHMENTS
Attachment A: Budget Closing Ordinance body text
  Exhibit A – Detailed Changes to the Adjusted Budget
  Exhibit B – 2005-06 Re-Appropriation Requests
  Exhibit C – Capital Improvement Projects Closed in 2005-06
  Exhibit D – General Fund Summary
  Exhibit E – General Fund Reserve Summary
  Exhibit F – Enterprise Summaries
  Exhibit G – Enterprise Reserve Summary
  Exhibit H – Capital Improvement Projects Adjustments in 2005-06

Attachment B: CAFR