TO: HONORABLE CITY COUNCIL

ATTENTION: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: DECEMBER 13, 2005 CMR: 447:05

SUBJECT: ORDINANCE CLOSING THE 2004-05 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 2004-05 Budget and authorize re-appropriation of 2004-05 funds into the 2005-06 Budget (Exhibits A & B); and 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); and adjust budget for capital improvement projects (Exhibit H). 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 2004-05 fiscal year budget and providing funds for the current fiscal year 2005-06. In addition, they provide detailed information on the City’s financial activities for 2004-05. 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. The Long-Range Financial Plan (CMR:442:05), presented to the Finance Committee on December 6, 2005, encompasses a more comprehensive analysis of the local and national economic factors impacting Palo Alto going forward.

Economy
Fiscal year 2004-05 brought some signs of an economic recovery. Unemployment rates for Palo Alto declined from 3.4 percent to 2.7 percent. Revenue sources such as sales and transient occupancy tax, which are sensitive to the economy, showed a slow rebound. The City, however,
still faces economic challenges with rising employee benefit costs and the loss of specific revenue sources such as the closing of a hotel and two automobile dealerships. Although the City has closely monitored and controlled expenses through its “Strengthening the Bottom Line” efforts, it has needed to draw on General Fund reserves to fund its obligations. (MD&A p. 4; Transmittal Letter p. vi)

**DISCUSSION**

There are several necessary year-end adjustments to the 2004-05 budget. Specific transactions are detailed in Exhibit A of the budget-closing ordinance. Exhibits D and F summarize financial results for fiscal year 2004-05 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**

For 2004-05 the General Fund had a net loss of $35 million compared to a net operating surplus of $0.5 million in the prior year. In December 2002, the City auditor issued an audit report on the Long Range Financial Plan. The City Auditor recommended a simplification of infrastructure funding by: (1) moving the Infrastructure Reserve from the General Fund to the Capital Projects Fund; and (2) retaining unspent project funds in the Capital Projects Fund. The City Council approved these recommendations and the operating transfer of $35.9 million was completed in 2004-05. It is this transfer that causes the City to report a $35 million net loss in its financial statements. Consequently, in terms of operating performance, the General Fund actually ended 2004-05 with a $0.9 surplus. At fiscal year-end, the fund balance for the General Fund totaled $31.8 million. This was comprised of: $7.3 million reserved for Encumbrances, Notes and Inventory; $21.1 million for the Budget Stabilization Reserve; $3.2 million for the Equity Transfer Stabilization; and $0.4 for Re-appropriations. (Exhibit E), (MD&A pp. 14-15).

**Capital Projects Fund**

For fiscal year 2004-05, the Capital Projects Fund reported $22.5 million in expenditures and other uses, a decrease of $5.6 million from prior year. This is primarily because the prior year included completion of the parking garages. Major expenditures in 2004-05 for the Capital Projects Fund included $4.8 million on streets and sidewalks, $1.9 million on the Homer Avenue under-crossing project and $1.2 million on the fire station improvement project. The Capital Projects Fund Balance totaled $44.1 million, an increase of $23.1 million. This increase is primarily a result of the operating transfer from the General Fund to transfer the Infrastructure Reserve to the Capital Projects Fund, as discussed under the General Fund. Exhibit H is a summary of Capital Improvement Projects which transfer funding between projects within the same fund. These transactions have no impact on reserve balances. (MD&A p. 15)

**Enterprise Funds**

The Rate Stabilization Reserves (RSRs) for the combined Enterprise Funds decreased by a net $17.9 million. Major changes include a $8.4 million decrease in the Electric Fund and a $5.7 million decrease in the Gas Fund. Both of these decreases result primarily from a legal settlement with Enron Corporation. Exhibit G provides the balance changes for all reserve categories for the Enterprise Funds. The net decrease in the funds was $15.0 million. Exhibit H is a summary of
Capital Improvement Projects which transfer funding between projects within the same fund. These transactions have no impact on reserve balances. (MD&A p.16-17)

**RESOURCE IMPACT**
Adoption of the attached budget-closing ordinance (Attachment A) allows for the re-appropriation and carryover of funding from the 2004-05 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 changes to and status of major City reserves as follows:

- The General Fund BSR level is at 17.5 percent of budgeted expenditures. This percentage is within the Council approved guidelines of 15 to 18.5 percent and shows a closing balance of $21.1 million, a decrease of $0.4 million from the prior year.
- The Infrastructure Reserve of $35.9 million was transferred to CIP in FY 04-05.
- The Reserve for Equity Transfer Stabilization was increased, with a final transfer of $0.8 million and a closing balance of $3.2 million.
- Budget transactions included in the attached ordinance increase General Fund Reserves by $0.8 million (Exhibit A).
- Transactions in the attached ordinance decrease Electric Fund reserves by $0.5 million and decrease Gas Fund reserves by $0.2 million. These changes are detailed in Exhibit A and are due to funding the Equity Transfer Stabilization Reserve requirements.

**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.

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ATTACHMENT
Attachment A: Budget Closing Ordinance body text
   Exhibit A – Detailed Changes to the Adjusted Budget
   Exhibit B – 2004-05 Re-Appropriation Requests
   Exhibit C – Capital Improvement Projects Closed in 2004-05
   Exhibit D – General Fund Summary
   Exhibit E – General Fund Reserve Summary
   Exhibit F – Enterprise Summaries
   Exhibit G – Enterprise Reserve Summary
   Exhibit H - Capital Improvement Program Projects

Attachment B: CAFR