



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 05/19/2020

ITEM NO: 6

DATE: May 14, 2020

TO: Mayor and Town Council

FROM: Laurel Prevetti, Town Manager

SUBJECT: Operating and Capital Budgets

- A. Consider the Town of Los Gatos Proposed Operating and Capital Budget for Fiscal Year (FY) 2020/21
 - 1. Consider the Town of Los Gatos Donation Opportunities: FY 2020/21 List of Town Needs
- B. Consider the Town of Los Gatos Proposed Capital Improvement Program for FY 2020/21 – FY 2024/25
- C. Approve Budget Adjustments for FY 2019/20:
 - 1. Authorize a Total Revenue Decrease Adjustment in the Amount of \$1,699,411 [Decrease Sales Tax by \$618,744, Decrease Transient Occupancy Tax (TOT) by \$974,678, and Decrease Business License Tax by \$105,989] and
 - 2. Authorize an Expenditure Decrease Adjustment in the Amount of \$4,232,500 to Reflect that the Additional Discretionary Payment Toward the Unfunded Pension Liability to CalPERS is Scheduled After July 1, 2020.

RECOMMENDATION:

- A. Consider the Town of Los Gatos Proposed Operating and Capital Budget for FY 2020/21
 - 1. Consider the Town of Los Gatos Donation Opportunities: FY 2020/21 List of Town Needs
- B. Consider the Town of Los Gatos Proposed Capital Improvement Program for FY 2020/21 – FY 2024/25.
- C. Approve budget adjustments for FY 2019/20:
 - 1. Authorize a total revenue decrease adjustment in the amount of \$1,699,411 [decrease Sales Tax by \$618,744, decrease Transient Occupancy Tax (TOT) by \$974,678, and decrease Business License Tax by \$105,989] and

PREPARED BY: Stephen Conway
Finance Director

Reviewed by: Town Manager, Assistant Town Manager, Town Attorney, and Finance Director

2. Authorize an expenditure decrease adjustment in the amount of \$4,232,500 to reflect that the additional discretionary payment toward the unfunded pension liability to CalPERS is scheduled after July 1, 2020.

BACKGROUND:

The Proposed Operating and Capital Budget for FY 2020/21 (Attachment 1) is the Town Manager's recommended comprehensive financial plan to provide services to the Town of Los Gatos and address the priorities set by the Town Council. The Proposed FY 2020/21 – 2024/25 Capital Improvement Program (Attachment 2) is a five-year capital improvement plan which identifies projects to construct and maintain the Town's infrastructure.

Both budget documents were prepared with contributions from all Town Departments. Of particular note, the Finance Department took the lead in developing revenue and expenditure forecasts, ensuring that the most current information was used in the preparation of the proposed budgets. In addition, the Department of Parks and Public Works identified high priority projects for inclusion in the Capital Budget based on its familiarity with the Town's facilities, equipment, and infrastructure, and its work with various Town Commissions on these assets.

The Town Council is being asked to consider the elements of the Operating and Capital Proposed Budgets and provide any additional guidance. Any recommended changes and additional direction to the Proposed Operating and/or Capital Budgets provided by Council at the May 19, 2020 budget hearing will be incorporated into the implementing documents to be presented for Council approval on June 2, 2020. In addition, the Council is asked to review the annual list of donations and approve budget adjustments for FY 2019/20. The revenue adjustments reflect decreases in Sales, Business License, and Transient Occupancy Taxes due to the economic impact of the COVID-19 pandemic emergency.

DISCUSSION:

Five-Year Forecast

On January 21, 2020, the Town Council received the following Five-Year Forecast which became the basis of Strategic Priority planning and budgetary considerations. As stated in January, a modest base case revenue growth forecast best reflected the economic environment at the time. As discussed with the Town Council in January, sensitivity analyses with respect to revenues and expenditures demonstrate that the Town organization is vulnerable to changes in forecasted economic conditions.

DISCUSSION (continued):

Original 5 Year Forecast "Base Case"	2020/21 Forecast (\$M)	2021/22 Forecast (\$M)	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)
Total Revenues, Transfers & Use of Reserves	\$45.8	\$47.3	\$48.4	\$49.6	\$51.2
Total Expenses & Allocations	\$45.3	\$45.6	\$46.8	\$47.3	\$48.1
Original Surplus/Deficit	\$0.5	\$1.7	\$1.6	\$2.3	\$3.1

Since the development of that original forecast, the unprecedented economic impacts associated with the local, national, and global mitigation of COVID-19 have necessitated significant revisions to growth projections for the Town's primary revenues of Property Tax, Sales Tax, and Transient Occupancy Tax (TOT). In close consultation with the Santa Clara County Assessor, Town Sales Tax consultant MuniServices, and a review of national and regional hospitality research.

In addition to reassessing revenue growth, the proposed Budget also forecasts anticipated increases in the Town's pension obligations. Given recent volatility in financial markets, it is anticipated that CalPERS will not achieve its assumed investment rate of return of 7% in FY 2019/20. With two months left in the 2019/20 fiscal year, the 0% return scenario most closely approximates CalPERS current return and is used for this Forecast. The combined effects of changing these budget assumptions in conjunction with others is illustrated in the following updated FY 2020/21 Proposed Operating Budget and Five-year Forecast.

COVID-19 Scenario	2020/21 Forecast (\$M)	2021/22 Forecast (\$M)	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)
Total Revenues, Transfers & Use of Reserves	\$53.2	\$45.5	\$46.2	\$47.7	\$48.2	\$48.2
Total Expenses & Allocations	\$53.2	\$45.5	\$46.8	\$47.8	\$48.9	\$49.3
Surplus/Deficit	\$0.0	\$0.0	(\$0.6)	(\$0.1)	(\$0.7)	(\$1.1)

The Town is affected economically by the COVID-19 pandemic and due to the Council's proactive efforts over the years, the Town is expected to be in a position to maintain the Town's high quality services in the short and medium terms. The updated forecast indicates

DISCUSSION (continued):

that for the Proposed FY 2020/21 Operating Budget and the following FY 2021/22 budget projected revenues and expenditures are in balance.

The Town does face projected moderate deficits in the range of \$100K to a maximum of \$1.1M per year in the remaining years of the forecast. The forecasted deficits represent approximately 0.2% to 2.7% of the Town's proposed General Fund operating budget for FY 2020/21 out of a total of \$43,420,8255, (net of capital transfers out, one-time expenses, and pass through expenditures of \$6,358,150). Given that the deficits are currently projected to be relatively modest they are within the Town's demonstrated ability to be absorbed without affecting services. However, the ultimate impact to the organization is not expected to be known until the depth and breadth of the pending recession is fully understood. Given the unknown nature of the transitioning economy, staff anticipates that more definitive information regarding revenue trends and any subsequent necessity to address service levels will be better known at mid-year FY 2020/21.

Positioning the Town for Economic Uncertainty

The proposed Budget addresses the Council identified Strategic Priorities and considers other areas of importance to our community, the Council, and the Town organization. The proposed Budget also acknowledges the current economic realities associated with the global COVID-19 pandemic and continues to position the organization for what will likely be the nation's first recession since 2008. This Budget also provides for limited strategic new investments toward important wildfire vegetation management, critical improvements to evacuation-related roadways, and other necessary infrastructure improvements, as the pandemic is not the only threat to our community's health and safety.

The Town's conservative budgeting practices have historically yielded modest annual surpluses which, among other priorities, has provided the Town Council the latitude over the years to address increases in pension obligations. To date, the Town has allocated or programmed approximately \$35.0 million in additional discretionary payments towards its pension and OPEB obligations.

In addition to conservative budgeting practices and proactive additional funding of pension and OPEB obligations, the Town has also taken a conservative approach to staffing. Since 2001 the Town has reduced its full-time employees by 16.7% to 150 FTE employees.

And lastly, the Town identified early on the threats that economic downturns could pose to the Town's primary revenue sources and service stability. In March 2018, the Town Council received a presentation from staff entitled "*Preparing for the Next Recession.*" Among other things, that presentation precipitated the voters of Los Gatos approving an 1/8 cent sales tax in

DISCUSSION (continued):

2018 which generates approximately \$1.0 million in additional ongoing sales tax revenue annually.

Additionally, in 2019, the Town Council initiated the annexation of 24 unincorporated urban islands within the Town of Los Gatos. In addition to the efficiencies associated with the uniform provision of municipal services to island residents, the annexation ended the diversion of property tax revenue generated within Town limits to the County. The Council initiated annexation resulted in approximately \$1.0 million in ongoing annual property tax revenue for the Town.

The combined effect of retaining a tradition of conservative budgeting practices, maintaining reduced staffing levels, and enhancing ongoing revenue sources prepared the Town well for this pending recession.

FY 2020/21 Operating Budget

Budget Principles

The proposed Operating Budget recognizes the Town's current economic reality and long term fiscal picture, as well as high priority service needs. Key budget principles include:

- Develop and recommend a balanced budget that maintains current, high service levels,
- Position for a multi-year recession,
- Continue to make progress on the Town Council's Strategic Priorities, and
- Identify opportunities to enhance service delivery through new revenue sources, technology, and open government.

Budget Balancing Strategies

The transmittal letter in the Proposed FY 2020/21 Operating Budget provides an executive summary of the budget, including the fiscal outlook, key budget assumptions, and other information (Attachment 1). As previously mentioned, the FY 2020/21 budget is in balance.

For FY 2020/21 the Proposed Operating Budget was balanced utilizing three primary budget balancing strategies. The first was to budget salaries for FY 2020/21 at actual salary plus a one-step increase, which is a departure from previous practice. While 68% of the workforce are already at top step or one step below top step, this strategy provides budgetary savings of approximately \$550,000.

DISCUSSION (continued):

The second strategy reassessed and recalculated the Internal Service Fund charges for the Town's Equipment Replacement and Information Technology Funds. The decreased charges for Equipment Replacement and Information Technology resulted in approximate savings of \$68,000 and \$200,000, respectively.

The third strategy, per the Town's General Fund Reserves Policy, transferred approximately \$800,000 from the Capital/Special Project Reserve. It should be noted that the Capital/Special Project Reserve transfer was from excess funds after recommended capital project additions contained in the Proposed Capital Improvement Program.

Taken together, the FY 2019/20 budget proposes to maintain the Town's existing high levels of service and provide for minimal staffing changes.

Budget Allocations

Page A-11 of the proposed Operating Budget identifies specific allocations for Council consideration. Of particular note, staff is recommending that the expected proceeds from the sale of the Winchester property (\$1.2 M) not be programmed at this time. Staff recommends that it be considered for future Council allocation once the impacts of the COVID-19 pandemic are known for FY 2019/20. In other words, these funds may be needed to make up for potential shortfalls that are not known at this time.

Staff looks forward to the Council's discussion and direction on spending priorities. If the Council wishes to place more resources towards a specific item (e.g., pension payments), a commensurate reduction would be needed elsewhere in the Operating or Capital Budgets. Motions made at the May 19 hearing will be incorporated in a revised budget for consideration in June.

Donation Opportunities - FY 2020/21 List of Town Needs

As part of the budget development process, the List of Town Needs is updated per Town Council Donation Policy to reflect goods, services, and other contributions that would help enhance Town services, programs, and events (Attachment 3).

FY 2020/21 – FY 2024/25 Capital Improvement Program

The FY 2020/21 – FY 2024/25 Capital Improvement Program (CIP) sets forth a five-year plan for proposed streets, parks, and public facility projects (Attachment 2). The transmittal letter contained in the CIP provides a summary of the program including funding sources, recently completed projects, and the proposed projects for FY 2020/21. Only the first year of the plan is formally adopted with funds appropriated by the Town Council as part of the budget process.

DISCUSSION (continued):

During the January 2020 Strategic Priorities discussion, the Town Council stated its priorities to begin to implement the Comprehensive Parking Study, continue mobility improvements for all transportation modes, manage the vegetation on Town lands to protect against wildfire, and advance other needed improvements. These projects as well as others, such as annual street maintenance, are recommended as part of the CIP. The Proposed CIP for FY 2020/21 includes a total budget of \$33.5 million of new and carry-forward funding.

Town staff go through a rigorous process to evaluate all previously funded projects and potential new projects when preparing the CIP. There are more needs than available funding, and staff recommends high priority projects that are consistent with the Strategic Priorities and Core Goals. On May 13, 2020, the Planning Commission reviewed the proposed CIP, found it consistent with the General Plan, and recommended its adoption by the Town Council.

FY 2019/20 Budget Adjustments

Given the economic impact of the COVID-19 pandemic, previous revenue estimates for the current fiscal year are not likely to be realized. For this reason, staff is recommending budget adjustments to Sales, Transient Occupancy, and Business License Taxes. An expenditure adjustment is also needed to reflect that the additional discretionary payment to CalPERS will occur after July 1, 2020.

BUDGET HEARING AND NEXT STEPS:

At its May 19, 2020 meeting, the Council will have an opportunity to listen to public testimony, ask questions, and direct changes to the Proposed Operating and/or Capital Improvement Program Budgets. Any changes to the Proposed Operating and/or Capital Budgets directed by Council or identified by staff will be included for Council consideration in the resolution formally adopting the Budgets to be considered by Council in June.

COORDINATION:

The preparation of the budget documents involved the participation of all Town Departments.

FISCAL IMPACT:

The fiscal impact is presented in summary form in the Financial Summaries chapter of the Proposed Operating and Capital Budget for FY 2020/21. The total proposed budget is \$77.5million, an decrease of \$1.2 million from the FY 2019/20 Adopted Budget.

PAGE 8 OF 8

SUBJECT: Operating and Capital Budgets

DATE: May 14, 2020

ENVIRONMENTAL ASSESSMENT:

This is not a project defined under CEQA, and no further action is required.

Attachments:

1. FY 2020/21 Proposed Operating and Capital Budget
2. FY 2020/21 – FY 2024/25 Proposed Capital Improvement Program Budget
3. Town of Los Gatos Donation Opportunities: FY 2020/2