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Sent: Monday, July 12, 2021 8:02 AM
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Subject: Agenda Item #4 - Explore New Revenue Opportunities

Finance Commission Members,

While it is always reasonable to explore new revenue opportunities, it is equally important to explore cost reduction opportunities. As the attached graph from the FY 2020 Auditor's presentation shows, net total expenditures exceed by \$2.7m total tax revenues for the Town. This is a structural deficit which is not sustainable.

Controlling expenditures has, unfortunately, not been taken seriously enough over the past 5 years. A good example is the salary increases that were given to all labor groups last year when there was no contractual requirement to do so. At the time, many residents recommended deferring all salary adjustments and promotions (this was at the height of the pandemic) until the full fiscal impact of COVID 19 was understood. The Town Council ignored the advice and granted increases largely because the Staff had reported that the increases were in the budget and were paid for. With hindsight, that clearly was not the case. If there had been a greater bias toward fiscal responsibility at the time, the Council most likely would have not approved the salary increases.

Going forward, managing the Town's budget and labor costs will be a critical factor in regaining control over the explosion in the Town's net total expenditures. In FY 2016 net total expenditures were \$20.8m and by FY 2020 had increased by \$12.2m or 58% to \$33.0m. During this same period, total government tax revenue increased \$4.7m or 18.6%. Net total spending increased at 3x the rate of total government tax revenues.

The increase in spending was the result of the implementation of annual budgets, each of which were approved by the Town Council. The majority of the Town's expenditures are labor and benefit costs, which the Town has 100% control over. The point is the increase of \$12.2m in net total expenditures is the result of management decisions as opposed to an external event which caused the Town's expenses to increase. We did this to ourselves.

Achieving a sustainable balance of both personnel and non-personnel expenditures against reasonable revenue projections will continue to require close attention, especially as the Town moves into new labor negotiations. The Finance Commission has an important role in this process and must continue to work with the Staff, Town Council, and community to address the ongoing structural deficits and bring projected expenditures in line with realistic projected revenues. This may involve a combination of expenditure reductions, identification of new service out-sourcing opportunities, identification of new revenues or realignment of current services or programs. All options need to be on the table – not just exploring new revenue opportunities.

The Town needs to face reality – the problem is not a lack of revenue, but rather the explosion in expenditures. If you can't properly define the problem, it is difficult to find the proper solution.

Two other comments I would like to make concern the Staff's comments on commercial cannabis business. Staff states that "local taxation is possible BUT would require the approval of Town of Los Gatos voters at a general election UNLESS it is an agreed upon term of conditions approval". Any business tax is a general tax because the Town could use the tax revenue for any legal municipal purpose. The California constitution requires that the electorate approve a general tax by a majority vote. Therefore, any local taxation of cannabis can only be implemented with the approval of a majority vote of the electorate.

Lastly, the Staff states that a preliminary analysis suggests that a local tax rate between 4% and 6% could potentially generate approximately \$800,000 to \$1.5m in revenue for the Town. This seems highly unrealistic and should be fully vetted by the Finance Commission. Using the higher 6% tax rate, to achieve \$1.5m of tax revenue, total taxable cannabis sales would have to be \$25.0m. To achieve \$800,000, total taxable sales would have to be \$13.3m. Assuming the average annual individual spend on cannabis is approximately \$500, that would suggest between 26,666 and 50,000 people purchasing cannabis in the Town. Given a population of 31,000 and assuming 15% (4,650) of the Town would purchase cannabis, the remaining purchases would have to come from people outside of the Town, which seems overly optimistic. I strongly suggest that the Finance Commission fully vet the fiscal impact of commercial cannabis before moving forward including examining the externality impacts on the Town. This is a complex decision which needs careful consideration.

Thank you.

Phil Koen

Government-Wide Financial Statements

Net Cost of Service to Tax Revenue

