TOWN OF LOS GATOS
COUNCIL AGENDA REPORT

MEETING DATE: 05/16/2023
ITEM NO: 11

DATE: May 11, 2023

TO: Mayor and Town Council

FROM: Laurel Prevetti, Town Manager

SUBJECT: Consider the Recommendations of the Finance Commission and Staff, and Provide Direction on the Town of Los Gatos Proposed Operating and Capital Budget for Fiscal Year (FY) 2023/24 and on the Proposed Capital Improvement Program for FY 2023/24 – FY 2027/28; Including but Not Limited to:

a. Provide direction to Balance the FY 2023/24 Proposed Budget;
b. Provide Direction on the Proposed Operating Budget;
c. Provide Direction on the Proposed Capital Budget; and
d. Consider the FY 2023/24 List of Potential Donations Consistent with the Town's Donation Policy

RECOMMENDATION:

Staff recommends the Town Council consider the recommendations of the Finance Commission and staff, and provide direction on the Town of Los Gatos Proposed Operating and Capital Budgets for Fiscal Year 2023/24 and the Town of Los Gatos Proposed Capital Improvement Program for Fiscal Years 2023/24- 2027/28, including but not limited to:

a. Provide direction balancing the FY 2023/24 Proposed Budget;
b. Provide direction on the Proposed Operating Budget;
c. Provide direction on the Proposed Capital Budget; and
d. Consider the FY 2023/24 List of Potential Donations consistent with the Town's Donation Policy.

BACKGROUND:

On April 17, 2023, the Proposed FY 2023/24 Operating and Capital Budgets were posted to the Town's website and the links were provided to the Finance Commission. For Commissioners who were interested in hard copies, the documents were provided.

PREPARED BY: Gitta Ungvari
Finance Director

Reviewed by: Town Manager and Town Attorney

<u>BACKGROUND (continued)</u>:

Per Measure A, the Finance Commission received the Proposed Budgets 21 business days before May 16, 2023, which is the first meeting at which the Proposed Budgets will be considered by the Town Council.

The Proposed Operating and Capital Budget for FY2023/24 (Attachment 1) is a comprehensive financial plan that reflects the values of the Town, Council priorities, and community expectations for high levels of municipal services provided by the Town of Los Gatos. The Proposed FY 2023/24 – 2027/28 Capital Improvement Program (Attachment 2) is a five-year capital improvement plan which identifies projects to construct and maintain the Town's infrastructure. The Transmittal Letters contained in both the Proposed Operating and Capital Budgets provide an overview of the recommendations for next fiscal year, including the fiscal outlook, key budget assumptions, and other information.

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 input from the Town Council; familiarity with the Town's facilities, equipment, and infrastructure; and the Department's work with various Town Commissions on these assets.

The Proposed FY 2023/ 24 Budget endeavored to maintain essential public services while controlling operational costs. The Five-Year Financial Forecast predicts operating shortfalls in subsequent fiscal years even with a built in vacancy factor of 4%. The loss of previously projected future growth in revenues in conjunction with increasing expenses continues to illustrate persistent deficits in future years. The deficits are on the order of approximately $2.8 to $4.0 million per year and can currently be resolved through a combination of expenditure controls and the use of one-time funds.

Even with areas of continued uncertainty, this Budget positions the organization well for continued excellence in service delivery to the community. However, in the event pre-pandemic revenue growth projections do not return and/or new revenue sources are not identified, the current projected deficits may need to be addressed through service delivery reductions or service outsourcing. If this occurs, the Council will need continued input from the community to identify acceptable organizational changes and service levels. Last year's community survey provides useful insights into community prioritization of service delivery.

In addition to the Proposed Budget, the Town Council is being asked to consider the Finance Commission recommendations contained in Attachment 3. The Town Council is also being asked to consider corrections based on additional review and analysis since publication (Attachment 5). Any recommended changes and additional direction to the Proposed

BACKGROUND (continued):

Operating and/or Capital Budgets provided by Council at the May 16, 2023 budget hearing will be incorporated into the implementing resolution to be presented for final Council approval on June 6, 2023. Finally, the Council is asked to review the annual list of donations (Attachment 7).

To help the Council work through the material, staff recommends that the Council discuss and make individual motions as appropriate on the following items as presented in this staff report:

- Five-Year Forecast (motions are welcome to change any of the assumptions in the Forecast)
- Direction to Balance the Proposed FY 2023/24 Operating Budget
- Finance Commission's four recommendations
- Consideration of any funding requests (as of the date of this report, the Town has received one from the Veterans Foundation, see Attachment 8)
- Any other direction on the Proposed FY 2023/24 Operating Budget
- Any other direction on the Proposed FY 2023/24– 2027/28 Capital Budget
- Consideration the Proposed Donation List

DISCUSSION:

Overview of Proposed Operating Budget and Five-Year Forecast

The FY 2023/24 General Fund Budget (excluding restricted pension trust revenues) programs total revenues and reserve transfers of $56.1 million and expenditures and allocations of $56.1 million. The Budget does not include new programs and does maintain existing service with modest staffing adjustments. This Budget also provides for limited, continued strategic investments toward important wildfire vegetation management as Federal grant funding allows and other necessary infrastructure improvements to protect our community's health and safety.

The Five-Year Forecast takes a forward look at the Town's General Fund revenues and expenditures and is updated regularly. Its purpose is to identify financial trends, potential shortfalls, and other issues so the Town can proactively address them and budget accordingly. It does so by projecting out into the future the fiscal results of continuing the Town's current service levels and policies. This process helps to provide a snapshot of what the future may look like as a result of the decisions made to date.

Revenue forecasts for the current Budget (Attachment 4) have been developed in close consultation with the Santa Clara County Assessor, Town Sales Tax consultant MuniServices, and a review of national and regional hospitality research.

DISCUSSION (continued):

In addition to revenue projections, the Proposed Budget also forecasts anticipated increases in the Town's pension obligation payments and salaries as well as other expenditures (Attachment 4). As a service delivery enterprise, the cost of salaries and benefits are a significant portion of the budget. The delivery of Town services is highly dependent on recruiting and retaining talent which comprises 64.4% of budgeted General Fund expenditures for FY 2023/24. Given the high dependence on labor for service delivery, the Town has helped manage salary escalation (and benefits) through the maintenance of lower staffing levels. However, even with the Town reducing its full-time employees by 15.0% to 153 FTE employees since 2001, costs per employee continue to escalate as evidenced by pension benefit costs having increased 35% in the last five years.

Balancing the Proposed FY 2023/24 Operating Budget

For FY 2023/24 the Proposed Operating Budget was balanced utilizing two primary budget balancing strategies. The first was direction to all Departments to develop a status quo budget. To that end, the Departments programmed existing resources by either maintaining current structures or realigning operations to remain effective. This proved exceptionally difficult as vendor, supply, and other costs rose beyond FY 2022/23 levels. In addition, Departments were provided guidance to enhance capacity where necessary through limit-dated non-benefited personnel options when possible.

The second strategy is the use of $1.6 million of the Town's Other Post-Employment Benefits resources to pay for the retiree medical expenses.

Overview of Proposed Capital Budget

The FY 2023/24 – FY 2027/28 Capital Improvement Program (CIP) sets forth a five-year plan for proposed streets, parks, and public facility projects. 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 2023/24. The proposed $37.8 million in the first year of the CIP is comprised of approximately $27.6 million in carryover funds from FY 2022/23 and approximately $10.1 million in new funding. The $10.1 million of new funding is comprised of

$5.5 million in General Fund Appropriated Reserve (GFAR), $2.4 million in grants and $2.2 million from other sources. Only the first year of the plan is formally adopted with funds appropriated by the Town Council as part of the budget process.

The first year of the five-year CIP (FY2023/24) continues funding for the Town Council Strategic Priorities, including basic infrastructure needs. In January 2023, the Town Council established the 2023-25 Strategic Priorities. In terms of capital projects, the Town Council stated its capital

DISCUSSION (continued):

budget priorities to continue implementation of the Downtown Parking Roadmap, continue mobility improvements for all transportation modes, manage the vegetation on Town lands to protect against wildfire, and advance other needed improvements. All of these efforts support improving and enhancing transportation options, public safety, and quality of life within the context of prudent fiscal management.

Staff is recommending that the residual and current year Measure G proceeds dedicated for capital should be programmed toward the Shannon Road Repair Project. Future year Measure G proceeds dedicated for Capital Improvement Projects should be programmed toward the State Route 17 Corridor Congestion Relief Project. At the time of the budget adoption, a resolution would memorialize the project(s) that are funded by the Measure G proceeds dedicated to the Capital Improvement Program.

On April 26, 2023, the Planning Commission reviewed the proposed CIP, found it consistent with the General Plan, and recommended its adoption by the Town Council.

Finance Commission Recommendations

As previously mentioned, the Finance Commission is tasked with a thorough review of the FY 2023/24 Proposed Operating and Capital Budgets. The Finance Commission had four recommended changes to the Proposed Budget (see Attachment 3).

The Commission's deliberations coalesced around the following goals and observations:

- The Commission's interest in continued enhancement of transparency in budget development, budget assumptions, and budget presentation.
- The higher percentage increases in the primary expenditures of Salary and Benefits relative to revenues is constraining other investments.
- The Forecast projects deficits throughout the forecast period.

The Finance Commission (FC) made four recommendations. For each FC recommendation, potential impacts are identified.

FC Recommendation: Recommend to Council to add a vacancy rate of 4.6% to the budget in order to more realistically forecast expected personnel expenses.

Staff Analysis: Staff understands that the FC would like the Proposed FY 2023/24 Budget to include salary and benefit costs that are most likely to be experienced by the Town based on

DISCUSSION (continued):

past history. The FC also made it clear that it expects that the Town will proceed with recruitments and hiring if the Council agrees with the recommendation.

The actual vacancy rate of Town positions reflects point in time data. In the chart below, the adopted budgeted positions are provided as well as the fiscal year end vacancies for each Department and actual vacancies as of 3/31/2023 and 4/30/ 2023. Notes for specific line items indicate that recruitments are in progress and circumstances of a signed employment offer for future date. Staff anticipates hiring for all vacant positions during FY 2023/24.

Departments	FY 2021/22 Budgeted	FY 2021/22 Filled as of 6/30/2022	FY 2022/23 Budgeted	FY 2022/23 Filled as of 3/31/2023	FY 2022/23 Filled as of 4/30/2023	FY 2022/23 Anticipated Filled as of 6/15/23	FY 2023/24 Proposed	
Town Attorney	2	*2*	2	2	2	2	2	*Fully Staffed*
Town Manager	5.25	*4.25*	5.25	4.25	4.25	5.25	5.25	*Assistant Town Manager Starts in June 2023.*
Human Resources	3	*3*	3	2	2	3	3	*Fully Staffed*
Finance	7	*7*	7	6	6	6	7	*Recruitment in Progress*
Clerk	3	*3*	3	3	3	3	3	*Fully Staffed*
Information Technology	3	*2*	3	3	3	3	3	*Fully Staffed*
Community Development	19.75	*19.75*	20	20	20	19	20	*Recruitment in Progress*
Police Department	60	*50*	60	51	52	52	60	*Police Officer and Communication Dispatcher Recruitment in Progress*
Parks & Public Works	34.75	*31.75*	36.75	32.75	33.75	35.75	35.75	*Recruitment in Progress*
Library	12.5	*11.5*	13.5	13.5	13.5	13.5	13.5	*Fully Staffed*
Total	150.25	134.25	153.5	137.5	139.5	142.5	152.5	

A vacancy factor assumes a certain amount of salary and benefit cost savings for the entire year. The recommendation would decrease the FY 2023/24 operating expenditures by approximately $1.66 million, eliminating a deficit and the need of the anticipated Other Post Employment Benefit (OPEB) Trust Fund withdrawal to close a budget gap. Currently, there is $22.6 million in the OPEB Trust that can only be used for paying post retirement benefits. This anticipated savings is only available if the 4.6% vacancy factor materializes at the close of FY 2023/24.

Council may choose to include a lower vacancy factor, such as 4% ($1.45 million), 3% ($1.08 million), or 2% ($0.72 million). The Five-Year Forecast from FY 2024/25-through FY 2028/29 incorporated 4% vacancy factor per prior Council discussions. If Council chooses not to include a vacancy factor in the Proposed FY 2023/24 budget, staff will anticipate the use of the OPEB Trust. Under any scenario, staff would continue to monitor estimated expenditures and only would withdraw from the Trust if it is needed. The OPEB funding source was identified by Council and by the Finance Commission as the primary budget balancing strategy for FY 2022/23 and as such, it is recommended for FY 2023/24 if needed.

If Council directs staff to include a vacancy factor in the Proposed FY 2023/24 Budget, staff will closely monitor the personnel budget and return periodically (at mid-year and before closing the fiscal year) to Council for budget adjustments as needed if the vacancy savings does not materialize.

DISCUSSION (continued):

In addition, staff recommends that Council establish an unassigned General Fund Reserve to provide funding as needed. If all of the estimated vacancy savings materializes, there is no need to draw down on this reserve and the reserve would be available for the next budget cycle. Staff also recommends updating the General Fund Reserve Policy to memorialize the proposed changes. A potential source of the unassigned balance could be the Residual Measure G Proceeds – Operating, additional funding freed up from the Catastrophic and Budget Stabilization Reserves due to the reduced overall expenditures, and Capital/Special Project Reserve. Please note that every time a salary and benefit budget increase is necessary, the Catastrophic and Budget Stabilization Reserve must be replenished to meet our Reserve Policy requirements.

FC Recommendation: Recommend to Council the fully recognize the Educational Revenue Augmentation Fund (ERAF) for FY 2023/24.

Staff Analysis: The County of Santa Clara Controller – Treasurer's Office provided information on March 2023 regarding the FY 2022/23 ERAF distribution ($2,298,691.60) and the preliminary estimates on the FY 2023/24 ERAF distribution ($2,203,000). The calculations and projections are based on the State February reports with adjustment to the latest property tax revenues. The decline in the next year's preliminary excess ERAF estimate is mainly due to the increase in the funding requirement for the State's special education programs. The County also advised Town staff that, due to the litigation over the Excess ERAF calculation brought by the California School Board Association and the State's revisiting the treatment of Redevelopment agency's dissolution revenue in the calculation (starting FY 2020-21 distribution), about 30% of the provided amounts are considered at-risk.

If Council wishes to proceed with this recommendation, staff suggests that the Council establish a General Fund ERAF Risk Reserve and reserve 30% of the anticipated proceeds in FY 2022/23 and FY 2023/24. Staff recommends continuing to reserve the at risk amount until the lawsuit is finalized. If the result of the lawsuit in unfavorable to the Town, the County will reduce the Town Property Tax distribution by the at risk amount; in this case, this reserve would provide the funding gap. If the lawsuit result is favorable to the Town, staff will come back to Council direction on how to spend the accumulated reserve. Other jurisdictions in Santa Clara County started to reserve the at risk amount. The Town fully recognized the FY 2020/21 and FY 2021/22 ERAF revenue. Since then, staff learned that the unfavorable result will be retroactive to those two fiscal years as well. The potential at risk amount for FY 2020/21 is $612K and $712K for FY 2021/22.

	FY 2020/21 Actuals	FY 2021/22 Actuals	FY 2022/23 Estimated	FY 2023/24 Proposed
ERAF Proceeds	$ 2,043,321	$ 2,371,984	$ 2,298,692	$ 2,203,000
30% at Risk	$ 612,996	$ 711,595	$ 689,608	$ 660,900

DISCUSSION (continued):

If Council wishes to reserve the FY 2020/21 and FY 2021/22 at risk amounts retroactively, the Capital/Special Project Reserve would be reduced by the same amount.

FC Recommendation: Recommend to Council that staff include transparency and the ability to track variance from budget, Schedules C-9, C-10, C-14, C-26 should be adjusted to show the detail of the salaries and benefits broken out major categories such as Salary, Overtime, CalPERS Benefit, All Other Benefits, and OPEB Pay as you Go Benefits.

Staff Analysis: The Financial Summaries provide multiple schedules of the Town Finances by different categorization. The majority of the requested information is also included on page A-7 of the Transmittal Letter. Staff recommends that the staff include a separate stand alone presentation of the requested information in the Proposed FY 2023/24 Budget and redesign the requested table presentation for the FY 2024/25 Proposed Budget.

FC Recommendation: Recommend to Council that staff include a capital outlay budget which forecasts the annual capital outlay for each funded project over the 5-year planning horizon on pages B-5 and B-6 of the Capital Improvement Budget.

Staff Analysis: Staff can provide the information if Council requests it. We recommend that the information be provided outside of the budget book as a stand alone table.

Consideration of Any Funding Requests

As the Council considers individual requests for new spending, the Council should consider these requests in the context of the Proposed Operating Budget and identify the source(s) of funding for the(se) item(s). At the time of the preparation of this report, one request has been submitted to the Town from the Veterans Foundation (see Attachment 8).

Donation Opportunities - FY 2023/24 List of Town Needs

As part of the budget development process, the List of Town Needs is updated annually per Town Council Donation Policy (Attachment 6) to reflect goods, services, and other contributions that would help enhance Town services, programs, and events (Attachment 7).

CONCLUSION AND NEXT STEPS:

At its May 16, 2023 meeting, the Council will have an opportunity to listen to public testimony, ask questions, consider the Finance Commission’s recommendations, deliberate, 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

CONCLUSION AND NEXT STEPS (continued):

staff (see Attachment 5.) will be included for Council consideration in the resolution formally adopting the Budgets to be considered by Council on June 6.

During and after the Budget adoption, staff continues to monitor revenues and expenditures closely and will report to the Town Council actual revenues and expenditures later in the year as the data become available. Any modifications needed will be brought back to the Council as Budget Adjustments.

COORDINATION:

The preparation of the budget documents involved the participation of all Town Departments. The Finance Commission deliberated and provided its recommendations to the Council as discussed in this report.

FISCAL IMPACT:

Under State law, the Town Council is required to enact a balanced budget. The Proposed Operating and Capital Budgets are balanced and as the Council directs changes, the outcome must be a balanced fiscal plan.

ENVIRONMENTAL ASSESSMENT:

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

Attachments Provided to the Council Prior to the Distribution of this Report:
1. FY 2023/24 Proposed Operating Budget
   https://www.losgatosca.gov/2858/Proposed-FY-2023-24-Operating-Budget
2. FY 2023/24 – 2027/28 Proposed Capital Improvement Program Budget
   https://www.losgatosca.gov/2859/Proposed-2023-24-Capital-Budget

Attachments Provided with this Report:
3. FY 2023/24 Finance Commission Operating and Capital Budget Recommendations
4. Revenue and Expense Forecast Assumptions
5. List of updates related to corrections based on staff and Commissioners review and comments
6. Town of Los Gatos Donation Policy
7. Town of Los Gatos Donation Opportunities: FY 2023/24
8. Public Comment Received Before 11 a.m. on May 11, 2023