



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 02/18/2025

ITEM NO: 14

DATE: February 11, 2025
TO: Mayor and Town Council
FROM: Chris Constantin, Town Manager
SUBJECT: Mid-Year Budget Report - July 1 - December 31, 2024:
a. Receive the FY2024-25 Mid-Year Budget Report, including the FY 2024-25 Year End Projections
b. Authorize Budget Adjustments as Recommended in the Mid-Year Budget Report
c. Receive the Town Five Year Financial Projection from FY 2025-26 to FY 2029-30

RECOMMENDATION:

Staff recommends that the Town Council take the following actions regarding the Mid-Year Budget Performance Report - July 1 - December 31, 2024:

- a. Receive the FY 2023-24 Mid-Year Budget Report including the FY 2024-25 Year End Projections (Attachment 1)
- b. Authorize budget adjustments as recommended in the Mid-Year Budget Report
- c. Receive the Town Five Year Financial Projection from FY 2025-26 to FY 2029-30 (Attachment 2)

BACKGROUND:

The purposes of the Mid-Year Report (Attachment 1) are to provide the Town Council with the status of the adopted Fiscal Year (FY) 2024-25 Operating Budget after the first six months and to make any adjustments to ensure the continuity of municipal services and operations for the remainder of the fiscal year. The Report is one of several periodic updates to the Town Council on the status of the current year's revenues and expenditures and the projected financial condition of all Town funds compared with the Adopted Operating Budget. The updates primarily focus on the Town's General Fund. An update to the Town's five-year financial

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

projections from FY 2025-26 to FY 2029-30 (Attachment 2) gives context for the FY 2025-26 budget development process and recommended budget approach.

Finance Commission Review

On February 10, 2025, the Finance Commission received the Mid-Year and Forecast Reports. The Commission discussed both items, and the staff answered the commissioners' questions. The Commission recommended that the Town Council receive the mid-year report, the five-year forecast, and its assumptions. The Commission recommended removing the terms "Greater" and "Base" from the UAL Town Contribution Table (Page 13 of Attachment 2) and identified typographical errors in the CalPERS Compound Annual Rates of Return Table (Page 14 of Attachment 2). The updates are redlined in Attachment 2. The Finance Commission further recommended including the financial condition analysis study results in future forecasts. The financial condition analysis study will not be completed in FY 2024-25, but when the information is available, it will be included in the forecast. There were additional questions regarding the impact of future development on the Town Finances. The Town usually starts estimating the potential property tax amount and timing of collection for bigger development projects when the developer's building permit applications are submitted. According to the Santa Clara Assessor Office's most recent report, a \$5,000,000 property tax roll growth generates \$12,696 annual property tax for the Town.

In addition, further staff review after the Finance Commission meeting identified footing errors in two tables on page 4 and page 9 of Attachment 1. The correct percentages and amount are displayed in red in the tables affected.

DISCUSSION:

FY 2024-25 Mid-Year Budget:

The FY 2024-25 Mid-Year Budget Report focuses on the General Fund and provides analyses of key revenues and expenditures, including historical data by Town Department/Service Area. It contains descriptions of recommended revenue and expenditure budget adjustments and financial summaries of other funds.

For Fiscal Year 2024-25, the budget was balanced by incorporating a 4.6% vacancy factor along with an additional use of \$0.6 million in reserve funds. Furthermore, through December 31, 2025, the Council has pre-authorized an extra \$1.7 million in reserve funds to cover salaries, benefits (for both represented and non-represented employees), and other Town needs.

Current year-end projections, including proposed mid-year adjustments, show an anticipated surplus of \$0.8 million when combining operating revenues and \$3.6 million in planned reserve usage against expenditures and reserve allocations. Of the \$3.6 million in reserve funds that will be used, \$1.1 million will be transferred to capital projects, \$2.3 million will provide one-time

support for ongoing operating expenditures, and a \$300,000 additional pension trust contribution is proposed as a mid-year adjustment per the General Fund Policy.

General Fund expenditure totals are trending in accordance with the Adjusted Budget, with total operational expenditures at the end of the second quarter at or about 44% of the Adjusted Budget.

In addition, departments are requesting \$662,078 General Fund revenue budget adjustments, and \$1,065,724 expenditure budget adjustments. The expenditure requests exceed the revenue adjustments by \$403,646. It is anticipated that year-end savings will be sufficient to cover these costs. As discussed in greater detail in Attachment 1, the primary drivers of the projected deficit are the decreased revenue projection for property tax, sales tax, and franchise fee combined with increases in retiree health care expenditures, legal services related to Builder's Remedy, insurance premiums, and various contractually obligated services.

Refer to Attachment 1 for additional details.

Five-Year Forecast:

The forecast provides summaries and analyses of the Town's major revenues, including property tax, sales tax, business license tax, and transient occupancy tax (TOT). The Town highly depends on these four economically sensitive revenues, comprising 65% of the General Fund forecasted revenues.

Updated growth assumptions are provided for each revenue source and the resultant projected revenues for the new Forecast period. The revenue assumptions provided are informed by the County Tax Assessor, the Town's sales tax consultant, and direct communication with the Town's hospitality industry. In addition, alternative forecast scenarios for these four revenue streams are discussed in the forecast report. Please see Exhibit C to Attachment 2 for a description of all revenue categories with a comprehensive listing of revenue forecast assumptions.

Forecasts of future operating expenditures consider two key factors: cost escalation and new operating expenditures. New operating expenditures refer to costs created by new or enhanced service programs approved during the annual budget process. Cost escalation refers to largely unavoidable increases in the cost of doing business. It includes inflation, multi-year contract costs, health care costs, and unfunded State mandates. Cost escalation also includes other unavoidable cost increases to a government organization, such as a rise in wages consistent with collective bargaining agreements and annual pension payments mandated by CalPERS. The expenditure assumptions are contained in Exhibit D to Attachment 2.

The base case Five-Year Forecast (FY2025-26 – 2029-30) (Exhibit B to Attachment 2) identifies deficits for all future years, using already negotiated salary cost increases (FY 2025-26 and FY 2026-27) and 2% salary increase assumption (beyond FY 2027-28), 4.6% vacancy saving factor and other assumptions (see Exhibits C and D for Attachment 2). The projected deficits start at

\$5.6M in FY 2025-26 and can be mitigated in the short term by expenditure controls and using one-time funds. Revenue projections are not keeping pace with rising costs. Future discussions of revenue capacity to match expenditures and service levels will need to occur to address increasing pressure on Town finances.

Refer to Attachment 2 for additional details.

COORDINATION:

All Town Departments participated in the data collection and analysis that informed the preparation of the Mid-Year Report, proposed budget adjustments, and forecast development.

CONCLUSION AND NEXT STEPS:

Staff is continuing to monitor all revenues and expenditures during the preparation of the Proposed Operating and Capital Budgets for FY 2025-26. Should any additional budget adjustments be necessary to balance operating revenue and expenditures prior to the FY 2024-25 close, Council would be asked to consider appropriate actions.

The preparation of the FY 2025-26 Operating and Capital Budgets is taking into account the Town's current economic reality and long term fiscal picture, as well as maintaining the Town's high level of municipal services. Key budget principles include:

- Develop and recommend a balanced budget that maintains service levels;
- Address projected deficits;
- Continue to make progress on Strategic Priorities identified by the Town Council; and
- Identify opportunities to maintain or enhance service delivery through new revenue sources and technology.

The Draft FY 2025-26 Operating and Capital Budgets will be available on April 22, 2025 with the Council's budget hearing tentatively scheduled for May 21, 2025.

Staff recommends that the Town Council approve the proposed revenue and expenditure budget adjustments, as described in Attachment 1. Staff also looks forward to answering the Town Council's questions.

ENVIRONMENTAL ASSESSMENT:

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

Attachments:

1. Mid-Year Budget Report - July 1 - December 31, 2024
2. FY 2025-26 – FY-2029 – 30 Forecast

Exhibits to Attachment 2:

- A. Annual Budget Process
- B. Base Case Five-Year Forecast
- C. Forecast Revenue Assumptions
- D. Forecast Expense Assumptions