DATE: February 7, 2024

TO: Finance Commission

FROM: Laurel Prevetti, Town Manager

SUBJECT: Consider NBS Revenue Modeling Report and Make Recommendations to the Town Council Regarding the NBS Revenue Modeling Report and Budget Balancing Strategies Including Any Revenue Ballot Measures and Polling for Potential Revenue Ballot Measures

RECOMMENDATION:

Consider NBS Revenue Modeling Report and make recommendations to the Town Council regarding budget balancing strategies including any revenue ballot measures and polling for potential revenue ballot measures.

BACKGROUND:

While costs of providing services and programs for residents have significantly increased over the years, Town revenues have not kept pace. Los Gatos is facing the same economic pressures as many other cities and businesses, including inflation and the uneven recovery from the pandemic. In addition, unfunded mandates by the State have also reduced the Town's available funds.

As a service 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 67.4% of the budgeted expenditures for FY 2023/24.

The Town maintains a relatively stable and low staffing level. Even so, costs per employee continue to escalate as evidenced by pension benefit costs having increased 35% in the last five years. The Town Council has taken several proactive steps to reduce the Town's pension liability, including Additional Discretionary Payments for the Pension Plans and curbing cost escalation in Other Post-Employment Benefits (OPEB).

PREPARED BY: Katy Nomura
                              Assistant Town Manager

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

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BACKGROUND (continued):

Other cost drivers, such as medical benefits, have been fluctuating and increasing in recent years by as much as 11% in a single year. Unfortunately, revenues are not increasing by double digits.

Los Gatos has taken the following proactive cost-cutting measures during major economic downturns to reduce budget expenditures and control costs while maintaining high service levels:
  •   Reduced full-time employees by 15% (since 2001) and did not return to pre-recession staffing levels,
  •   Imposed wage freezes and unpaid furloughs, and
  •   Reduced employee benefit costs.

On November 17, 2022, the Finance Commission reviewed several cost reduction measures and recommended that the Town further work toward operational efficiencies and researching additional revenue options.

On January 24, 2023, the Town Council determined its Strategic Priorities for 2023-2025, which included exploring new revenue opportunities.

On June 20, 2023, the Town Council authorized the Town Manager to issue a Request for Qualifications (RFQ) for revenue ballot measure consulting services. After conducting the RFQ process, the Town selected NBS.

On October 17, 2023, Town Council authorized the Town Manager to enter into an agreement for the initial phase of the work for an amount not to exceed $44,600, with direction to return to Council with revenue modeling prior to beginning any polling.

On December 19, 2023, Town Council reviewed the Revenue Modeling Report prepared by NBS (Attachment 1) and continued the item to February 2024 to consider it at the same time as the five-year forecast. The full report provided from December 19, 2023 can be found in Attachment 2.

This agenda item provides the Finance Commission with an opportunity to discuss the NBS report and provide its recommendations to the Town Council. The Commission's recommendations will be provided to the Town Council for its discussion and consideration at its February 20, 2024 meeting.

While the agenda item includes an opportunity for the Commission to make recommendations to the Town Council regarding the NBS report, the staff does not recommend this because the

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BACKGROUND (continued):

Town does not have the funding to ask the consultant to redo the analysis. The Commission's recommendations to the Town Council are most useful with regard to budget balancing strategies, including any revenue ballot measures and polling for potential revenue ballot measures.

DISCUSSION:

NBS Report

NBS conducted a comprehensive evaluation of options to increase revenue for the Town and associated revenue modeling, with the goal of reducing the annual budget deficits forecasted in the Fiscal Year (FY) 2023/24 Budget. This included an evaluation of a property transfer tax increase, utility user tax (UUT), special assessment districts, transient occupancy tax (TOT), business license tax, sales tax, and parcel tax scenarios. Each of these options is outlined in NBS' revenue modeling report (Attachment 1). Of the options, NBS recommended either a sales tax or a parcel tax.

Sales Tax
As mentioned in the NBS report, "the current sales tax rate in the Town is 9.25%, of which the Town's share is 1% (not including the Measure G sales tax rate of 0.125%). The Town has the capacity to raise its sales tax rate by an additional 0.125%...If structured as a general sales tax, the Town would only need to secure approval from a majority of the registered voters within the Town to increase the sales tax rate. NBS recommends that the Town move quickly on this option, if desired, as the Town's remaining capacity for a sales tax increase could be utilized by another government agency within the County during the next election cycle."

The following table shows NBS' revenue modeling for FY 2025/26 through FY 2028/29:

Potential Sales Tax Increase	Potential New Total Sales Tax %	Additional Revenue 2025/26 Projected	Additional Revenue 2026/27 Projected	Additional Revenue 2027/28 Projected	Additional Revenue 2028/29 Projected
0.125%	9.375%	$ 1,062,500	$ 1,087,500	$ 1,125,000	$ 1,162,500

Parcel Tax
Among other scenarios, NBS explored revenue modeling for a parcel tax with senior/low-income exemptions and a parcel tax on commercial buildings over 25,000 square feet. Any parcel tax would require a two-thirds approval from voters to pass.

In order for a parcel tax with senior/low-income exemptions to generate an estimated $1M annually, it would need to be roughly $97.70 per parcel, $0.0055 per lot square foot, or $0.04 per building square foot.

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DISCUSSION (continued):

In order for a parcel tax on commercial buildings over 25,000 square feet to generate an estimated $1M annually, it would need to be roughly $0.83 per building square foot. Only 35 parcels in the Town have commercial buildings over 25,000 square feet that would be subject to such a parcel tax.

Polling Next Steps
Regarding a revenue measure for the 2024 ballot, the Town is not in a position to determine whether a measure should be placed on the ballot or not as polling has not been conducted. Polling is a targeted effort to survey a statistically representative sample of likely voters to test potential ballot measures, ballot language, and potential services to fund. In other smaller cities, samples sizes as low as 90 likely voters have yielded reliable and ultimately successful results. The results of any polling should give proper guidance for specific recommendations and for the Council to make its decision. After polling is complete, results will be brought to the Finance Commission for a recommendation to the Council as to whether or not to pursue placing a measure on the 2024 ballot.

Other Budget Balancing Strategies

The Commission may also wish to consider other budget balancing strategies.

Cost Reduction Options

One approach is cost reduction, such as the measures considered by the Commission on November 17, 2022 (Attachment 3). At that time, the Commission did not recommend any of these proposed options and instead, recommended that the Town further work toward operational efficiencies and researching additional revenue options.

Efficiencies and continuous improvements are a business imperative for the Town given increased workloads, State unfunded mandates, and unforeseen events, such as responding to winter storms in addition to providing day-to-day services. Employees have modified new work flows, implemented new technological solutions, and streamlined processes to create capacity to continue to provide high quality services.

Measure G

The Finance Commission could recommend to the Town Council to reallocate the Measure G Sales Tax proceeds from capital to operating. This is an ongoing funding source of approximately $600,000 annually.

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DISCUSSION (continued):

One Time Solutions
There are three options which could provide one-time funding; however, as one-time monies, they do not provide solutions to balance the five-year forecast.

- Other Post-Employment Benefits (OPEB) Trust: One option is to make a withdrawal from the Other Post-Employment Benefits (OPEB) Trust for retiree medical expense reimbursements (up to $1.6 million annually).

- Pension Trust Fund: Similarly, there is also an option to withdraw from the Pension Trust Fund for pension expense reimbursement ($1.4 million total available).

- Capital/Special Projects Reserve: The Town Council may also use the Capital/Special Projects Reserve for one-time expenses.

CONCLUSION:

It is recommended that the Commission make recommendations to the Town Council regarding budget balancing strategies including any revenue ballot measures and polling of any revenue ballot measures.

Attachments:
1. NBS Revenue Modeling Report
2. December 19, 2023 Revenue Modeling Report Provided to Council
3. November 17, 2022 Report to the Finance Commission with Cost Reduction Options
4. Commissioner Comments