



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 02/17/2026

ITEM NO: 14

DATE: February 11, 2026
TO: Mayor and Town Council
FROM: Chris Constantin, Town Manager
SUBJECT: **Receive the FY 205-26 Mid-Year Budget Report, including the FY 2025-26 Year End Projections**

RECOMMENDATION: Staff recommends that the Town Council take the following actions regarding the Mid-Year Budget Performance Report - July 1 - December 31, 2025:

- a. Receive the FY 2025-26 Mid-Year Budget Report, including the FY 2025-26 Year End Projections;
- b. Authorize budget adjustments of \$3,581,888 in estimated revenues and \$1,350,141 in increases expenses as recommended in the Mid-Year Budget Report; and
- c. Receive the Town Five Year Financial Projection from FY 2026-27 to FY 2030-31.

FISCAL IMPACT:

As of the mid-year point of the fiscal year staff is recommending budget adjustments to ensure the revenues are reflective of the most current forecasts and expenses end the year within budget authority. Estimated revenues are recommended to increase by \$3,581,888 and expenses are recommended to increase by \$1,350,141.

STRATEGIC PRIORITY:

This initiative supports the Town's strategic priority of ensuring prudent financial management to result in structurally balanced five-year forecasts and fully funded five-year Capital Improvement Plans, managing liabilities such as pension costs and leveraging the Town's assets, efficiencies, partnerships, and revenue streams.

PREPARED BY: Kristina Alfaro
Administrative Services Director

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

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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) 2025-26 Operating Budget after the first six months and to make 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 projections from FY 2026-27 to FY 2030-31 (Attachment 2) gives context for the FY 2026-27 budget development process and recommended budget approach.

Finance Commission Review

On February 9, 2026, 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 asked if the Vehicle Replacement Internal Service Fund expenditure reduction of \$1.8M in deferred purchases should also result in expenditure reductions in the General or other funds that are charged for these expenses. Staff was able to confirm in the meeting that user departments are not charged the full budget amount as shown in the final budget document. Only about half of the vehicle/equipment fund expenses are charged out with existing fund balance/net position, making up the difference. Upon further research, staff does not believe an expenditure adjustment is needed. This is due to how the vehicle fund is budgeted. Vehicles and equipment needing replacement are placed on a replacement schedule for out year expenses. Staff then apply charges to user departments by spreading the cost of replacement over several years. This results in a smoothing expense for departments over the useful life of the vehicle/equipment, with some years resulting in excess collections from the department versus actual costs spent. Excess collections result in additional fund balance/net position that is used in the out years to assist with smoothing costs.

The Commission noted a typo on page two of Attachment 1, which showed recommended expenditures at \$3,575,371 instead of \$3,581,888 that has been corrected.

The Commission asked what revenues made up the "Miscellaneous Other" category that is shown on the table in page 4 of Attachment 1. This category includes various minor miscellaneous revenue, but major revenues include Measure G proceeds, Pension Trust Fund contributions, and the sale of property.

Lastly, staff identified and has made a correction to the table on page 4 of Attachment 1 that had an incorrect adopted budget revenue total due to a double count of the "Debt Service – Entry Eliminated" line of \$1,901,850. This revenue had also been included in the Miscellaneous

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Other category; that line has now been reduced to \$1,893,651 and includes the corrected table as Attachment 5. Total General Fund revenues now match the adopted budget.

DISCUSSION:

The FY 2025-26 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 FY 2025–26, the budget was balanced by incorporating a 4.6% vacancy factor, an additional \$255,000 in pension benefit savings, potential revenue enhancements, tiered departmental reductions, and the use of \$0.9 million in reserve funds. Current year-end projections indicate an anticipated surplus of \$4.3 million when combining estimated operating revenues over expenditures. Of this amount, \$3.0 million represents estimated proceeds from a one-time property sale.

In addition, departments are requesting \$3,581,888 General Fund revenue budget adjustments and \$1,350,141 expenditure budget adjustments. As discussed in greater detail later in this Report, the primary drivers of the projected surplus are increased revenue projections for property tax, sales tax, interest, business license tax, and permit revenues offset by increases in retiree health care expenditures, legal services, 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 about 65% of the General Fund forecasted revenues.

Updated growth assumptions are provided for each revenue source and the resulting 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.

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.

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The expenditure assumptions are contained in Attachment 2, pages 17-19. With changes made to assumptions since December 2025, listed on page 10.

The base case Five-Year Forecast (FY2026-27 – 2029-30) (page 2 Attachment 2) identifies reduced deficits for all future years, driven primarily by increased revenues because of updated sales tax projections. Revenue projections, even with the increased sales tax projections, continue to not keep 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:

This report has been prepared in coordination with the Town Manager's Office and the Town Attorney's Office.

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 2026-27. Should any additional budget adjustments be necessary to balance operating revenue and expenditures prior to the FY 2025-26 close, Council would be asked to consider appropriate actions.

The preparation of the FY 2026-27 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 2026-27 Operating and Capital Budgets will be available on April 20, 2026, with the Council's budget hearing tentatively scheduled for May 19, 2026.

Staff recommends that the Town Council approve the proposed revenue and expenditure budget adjustments, as described in Attachment 1.

ENVIRONMENTAL ASSESSMENT:

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

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Attachments:

1. Town Council FY 2025-26 Mid-Year Budget Report
2. Draft Updated FY 2026-27 Forecast with Forecast History Updated 2-6-2026
3. Revenue Forecast Assumptions
4. Expenditure Forecast Assumptions
5. Correction to General Fund Summary of Revenue and Expenditure Table