



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 02/13/2023

ITEM NO: 6

DATE: February 9, 2023
TO: Finance Commission
FROM: Laurel Prevetti, Town Manager
SUBJECT: Review and Provide Comments to the Town Council Regarding the Five-Year Forecast (FY 2023/24 – 2027/28) and Scenarios and Provide Input for the FY 2023/24 Budget Direction

RECOMMENDATION:

Review and provide comments to the Town Council regarding the Five Year Forecast (Fiscal Years 2023/24 – 2027/28) and scenarios, and provide input for the FY 2023/24 budget direction.

BACKGROUND:

With the passage of Measure A, the Finance Commission has been tasked with several mandated duties as described in the provisions of the adopted Ordinance. Section 2.50.225. – Duties states that:

- (a) The Finance Commission shall:
Serve as an on-going, substantive and expert advisory body to the Town and Town Council so that the Town and Town Council can make informed decisions about the Town's financial, budgetary and investment matters and operations related thereto.

On February 21, 2023, the Town Council will consider the FY 2023/24 Five Year Forecast which is an important component of the annual budget cycle (Attachment 1).

The Commission is welcome to provide comments on the Forecast, its assumptions, and scenarios as well as any comments for consideration in the preparation of the FY 2023/24 Operating Budget. The Finance Commission will have an opportunity to discuss the Capital Program at its March meeting.

PREPARED BY: Gitta Ungvari
Finance Director

Reviewed by: Town Manager

EXECUTIVE SUMMARY:

The base case Five-Year Forecast (FY 2023/24 – 2027/28) (Attachment 2) identifies deficits for all future years, using the recent labor agreements for FY 2023/24 and the 2% salary increase assumption approved by the Town Council for the FY 2024/25 budget and other assumptions (see Attachments 3 and 4). The deficits are on the order of approximately \$3M per year and can currently be resolved through expenditure controls and the use of one-time funds. The persistent presence of a deficit indicates that the Town needs to consider new revenue measures if it wants to maintain high levels of municipal services.

The sensitivity of the Forecast to its assumptions is demonstrated in this report. The Finance Commission can provide recommendations on the assumptions for Council consideration for the FY 2023/24 budget and provide other budget direction as appropriate. The Capital Program is scheduled for a separate discussion at the next Council meeting.

DISCUSSION:

An important aspect of the Town's budget development process is taking a multi-year approach to understand revenue and expenditure trends over time. Serving as the foundation of the budget planning process (Attachment 1), the Town develops a Five-Year Financial Forecast ("Forecast") beginning in the winter of each year. The Forecast enables the Town to evaluate the Town's fiscal condition and to help guide policy, programmatic planning, and budget decisions. Development of a financial forecast as part of the budget development process has been identified as a best practice by the Government Financial Officers Association (GFOA).

The 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.

The initial Forecast (FY 2023/24 – 2027/28) is predicated on estimates derived from the FY 2022/23 Mid-Year review and includes updates to Town revenues and expenditures based on the Mid-Year end of year projections. Like any forecast, the Forecast's revenue estimates for the first year is the most critical in the process as they ultimately define the expenditure limitations for the upcoming budget year.

This report contains detailed information that contributes to the preparation of the annual budget, including the Town's "Base Case" Five-Year Forecast, its data sources, and budget assumptions. This report also provides two additional forecast scenarios utilizing a sensitivity analysis for four of the major revenue assumptions. These additional forecast scenarios

DISCUSSION (continued):

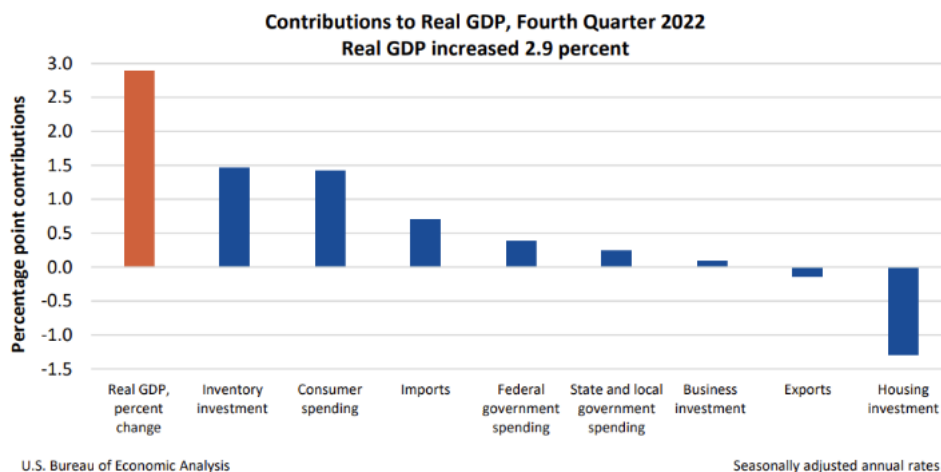
illustrate the effects on future budgets of a more optimistic revenue scenario (“Greater Growth”) and a pessimistic revenue one (“Lower Growth”).

The Five-Year Financial Forecast is not a budget, nor a proposed plan. The Five-Year Financial Forecast sets the stage for the upcoming budget process and is a tool in facilitating both the Town Council and Town Manager in establishing priorities and allocating resources appropriately.

National and Local Economic Backdrop

The UCLA Anderson School of Business publishes an annual economic forecast for the nation and California. The results of the forecast are utilized as a portion of the macroeconomic basis of the Five-Year Forecast development. In their September 2022 Economic Outlook, they mentioned that based on their analysis, the chance of recession in U.S. in the next 12 months is less than 50%. Their assumption is that the economy will grow 1.5% in 2022, 0.3% in 2023, and 2.0% in 2024. Their assessment was backed by their study of strong consumer spending as we ease from COVID related supply chain issues. Another assumption is that business investment is expected to occur domestically rather than internationally due to mounting geopolitical instability over the past year.

In its December 2022 Economic Outlook, Anderson mentioned that the “national economy has proved resilient as consumers continue to spend and businesses continue to invest.” This is demonstrated by the Gross Domestic Product (GDP) increase of 3.2% in the third quarter and 2.9% (advance estimate) in the fourth quarter of 2022. As the graph below illustrates, the 2.9% increase is partly offset by the decrease in housing investment. Inventory investment and consumer spending helped this downturn amidst the inflation, unemployment, and supply-chain issues.



DISCUSSION (continued):

Based on this report, it was noted that the Federal Reserve actions will cushion California's economy. The sectors of logistics, technology, and health care helped California's GDP growth. Its growth has been faster than the U.S. since high-income earners tend to belong in these sectors. In terms of the housing market, the increase of interest rates affected the decline of the median price of single-family homes. According to the report, "the median price was 8.4% below its previous peak but had returned to early 2021 levels." With this assumption, the surge of accessory dwelling units (ADU) and growth in industrial space sector will help shield the state. This in turn makes the 2023 forecast for California more of a moderate slowing than for the U.S. overall.

Operating Revenue Trends and Five-Year Forecast Scenarios

The Town is highly dependent on four economically sensitive revenues comprising 54% of General Fund forecasted revenues. Following are summaries of the Town's major revenues of property tax, sales tax, business license tax, and transient occupancy tax (TOT). To provide context for the development of the Five-Year Forecast (FY 2023/24 – 2027/28), the prior year's growth assumptions and resulting revenue projections are provided. The Base Case Forecast can be found in Attachment 2.

With that context, 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 are discussed in this report for these three revenue streams. Please see Attachment 3 for a description of all revenue categories with a comprehensive listing of revenue forecast assumptions.

Property Tax

Property tax is the single largest revenue source for the Town and comprised approximately 42% of total Town projected revenues for FY 2022/23. As the following table illustrates, Los Gatos has benefited from the economic expansion as evidenced by year-over-year (YOY) roll growth in property assessment since 2013. For the 10-year period, the average annual growth rate was 6.3%.

Los Gatos Assessment Roll Growth (values in billions)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Roll	9.46	9.99	10.63	11.54	12.29	13.15	13.84	14.9	15.6	16.8
Percent Growth	9.06	5.62	6.4	8.56	6.54	6.95	5.23	7.7	4.33	2.7

Source: Santa Clara County Assessors Annual Reports

DISCUSSION (continued):

The County of Santa Clara provides property tax collection updates and projections throughout the year. The following table illustrates the most recent estimates relative to the Adopted FY 2022/23 Budget and FY 2021/22 actuals. The current County estimate indicates \$617,332 more than the Adopted Budget. The increase is a combined effect of higher than expected Redevelopment Agency (RDA) Residual Apportionment, and Vehicle License Fees (VLF), decrease in secured property tax estimates, and no change to property transfer tax and the Educational Revenue Augmentation Fund (ERAF) estimates.

	FY 2021/22 Actual	FY 2022/23 Adjusted Budget	County Estimate with 70% ERAF
Property Tax Revenue & Vehicle License Fee Backfill	\$21.1 M	\$20.9 M	\$21.5 M

The Town has been monitoring ongoing developments regarding the distribution of excess ERAF funds. A portion of property tax revenue goes to the ERAF to support local school districts. When the amount contributed to ERAF is more than the minimum cost of funding local schools, excess funds have traditionally been returned to the county, cities, and special districts. Five counties, including Santa Clara, have been using a redistribution allocation formula that has been contested by the State. The Town received the full amount for FY 2021/22; however, the Santa Clara County Assessor's Office recommends budgeting only 70% of the FY 2022/23 projected number. The Adopted FY 2022/23 Budget included a \$1,5 million ERAF estimate, 70% of the current ERAF base revenue estimate is still the same.

The following table illustrates the growth factors used in the development of the Five-Year Forecast (FY 2022/23 – 2026/27).

Property Tax	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Proposed Growth	3%	3%	3%	3%	3%

For purposes of the Forecast, the "Base Case" utilizes a growth factor of 3.0% and the "Greater Growth" and "Lower Growth" scenarios utilize a 2% differential from the Base Case. In addition to the growth factor, staff continues to assume \$400,000 residual excess ERAF revenue in the base case scenario, 70% of the FY 2022/23 proceeds in the "Greater Growth," and no ERAF revenues and the "Lower Growth" scenarios.

DISCUSSION (continued):

Property Tax (Property Tax & VLF)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Greater Growth Scenario	\$22.40	\$23.50	\$24.60	\$25.90	\$27.30
Base Case Modest Growth	\$20.80	\$21.40	\$22.10	\$22.70	\$23.50
Lower Growth Scenario	\$20.00	\$20.20	\$20.50	\$20.60	\$20.90

Sales Tax

Sales tax is the second largest revenue source for the Town and comprised approximately 16% of total Town projected revenues for FY 2022/23. The following table illustrates the most recent projections from the Town's sales tax consultant MuniServices relative to the Adjusted FY 2022/23 budget and FY 2021/22 actuals.

	FY 2021/22 Actual	FY 2022/23 Adjusted Budget	January 18, 2023 MuniServices Estimate
Base Sales Tax	\$7.2 M	\$7.9 M	\$7.5 M

	FY 2021/22 Actual	FY 2022/23 Adjusted Budget	January 18, 2023 MuniServices Estimate
Measure G – 1/8 District Tax	\$1.3 M	\$1.3 M	\$1.3 M

Current total sales tax estimates include \$7,559,566 (\$301,422 decrease) in proceeds from regular sales tax and \$1,287,690 (\$26,266 decrease) in proceeds from the Measure G one-eighth cent district tax. Actual receipts net of administrative fees collected by the State will be confirmed at the close of the fiscal year and per prior Council direction, the Measure G funds are allocated 50% for capital improvement projects and 50% for operating expenses.

The table below provides the MuniServices Most Likely scenario which staff is utilizing for development of the FY 2023/24 Five-Year Forecast.

Base Sales Tax	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Most Likely	\$7.70	\$8.00	\$8.20	\$8.50	\$8.70

DISCUSSION (continued):

Measure G 1/8 District Tax	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Most Likely	\$1.30	\$1.30	\$1.40	\$1.40	\$1.40

The following tables illustrates MuniServices Most Likely scenario relative to their “Conservative” and “Optimistic” scenarios.

Base Sales Tax	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Conservative	\$7.00	\$7.20	\$7.40	\$7.60	\$7.80
Most Likely	\$7.70	\$8.00	\$8.20	\$8.50	\$8.70
Optimistic	\$8.50	\$8.80	\$9.00	\$9.30	\$9.60

Measure G 1/8 District Tax	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Conservative	\$1.20	\$1.20	\$1.30	\$1.30	\$1.30
Most Likely	\$1.30	\$1.30	\$1.40	\$1.40	\$1.40
Optimistic	\$1.40	\$1.40	\$1.50	\$1.50	\$1.60

Further Information related Sales Tax context are included as Attachment 5.

Transient Occupancy Tax

TOT is an important revenue source for the Town and comprises approximately 4% of total Town estimated revenues in the amount of \$2.0 million for FY 2022/23. The Town levies a 12% transient occupancy tax (TOT) on all hotel and motel rooms within the municipal limits of Los Gatos

The following table illustrates TOT FY 2021/22 actuals, the Adjusted FY 2022/23 Budget, and year-end collection estimates.

	FY 2021/22 Actual	FY 2022/23 Adjusted Budget	Year-end Estimate
TOT	\$1.9 M	\$1.6 M	\$2.0 M

DISCUSSION (continued):

The FY 2022/23 Adopted Budget modeled a 17.3% increase from FY 2021/22 adjusted budget. During the pandemic, TOT experienced the most significant percentage decline relative to historical trends. Due to a significant rebound in leisure “staycation” travel and modest improvements in business travel, current TOT collections are trending higher than anticipated and average occupancy rates are rebounding as well.

The table below illustrates the growth projections utilized for development of the Five-Year Forecast (FY 2023/24 – 2027/28) for TOT and corresponding estimated revenues.

TOT	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Proposed Growth	5%	3%	3%	3%	3%
Estimated Revenues	\$2.1 M	\$2.2 M	\$2.2 M	\$2.3 M	\$2.4 M

For purposes of the Forecast, the “Base Case” utilizes a growth factor as illustrated above and the “Greater Growth” and “Lower Growth” scenarios utilize a 1% differential from the Base Case.

TOT	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Greater Growth Scenario	\$2.1	\$2.2	\$2.3	\$2.4	\$2.5
Base Case Modest Growth	\$2.1	\$2.2	\$2.2	\$2.3	\$2.4
Lower Growth Scenario	\$2.10	\$2.10	\$2.20	\$2.20	\$2.30

Business License Tax

The Town requires all businesses located within Los Gatos and/or those that operate within Los Gatos to obtain a business license. The amount of business license tax paid by each business is based on its business activity. In November 2022, Los Gatos voters approved Measure J, which modernized the Town’s business license tax program. This is the first update to the program since 1991, strengthening funding for core Town services that are enjoyed by Town businesses. Measure J included a 30% increase on flat rate fees, a 40% increase in retailing gross receipts, and a 120% increase in e-commerce, manufacturing, wholesaling, and jobbing gross receipts. Fees for activities such as wholesale sales and manufacturing are charged on a sliding scale based on gross receipts, as is retail, with retail being capped at \$1,365. These gross receipt activities account for approximately 25% of annual business licenses, while the remaining 75% are flat fee businesses. Annual renewal payments are due on January 2 of each year. Payments for new flat-fee-based businesses are prorated by quarter.

DISCUSSION (continued):

Business license tax revenue for the current fiscal year was budgeted at the prior tax rate, current estimates based on the updated tax rate predict a significant increase for the business license tax revenue. Staff is recommending a \$1,056,500 increase to this revenue source as an adjustment to the FY 2022/23 budget.

The following table illustrates Business License FY 2021/22 actuals, the Adjusted FY 2022/23 Budget, and year-end collection estimates.

	FY 2021/22 Actual	FY 2022/23 Adjusted Budget	Year-end Estimate
Business License	\$1.5 M	\$1.4 M	\$2.4 M

Business license tax revenue for the current fiscal year was budgeted at the prior tax rate. Current estimates based on the updated tax rate predict a significant increase for business license tax revenue. Staff is recommending a \$1,056,500 increase to this revenue source and this estimate provides the base for the Five-Year Forecast (FY 2023/24 – 2027/28) as illustrated below.

Business License	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Proposed Growth	2%	2%	2%	2%	2%
Estimated Revenues	\$2.5 M	\$2.5 M	\$2.6 M	\$2.6 M	\$2.7 M

For purposes of the Forecast, the “Base Case” utilizes a growth factor as illustrated above and the “Greater Growth” and “Lower Growth” scenarios utilize a 1% differential from the Base Case.

Business License	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Greater Growth Scenario	\$2.5	\$2.6	\$2.7	\$2.8	\$2.8
Base Case Modest Growth	\$2.5	\$2.5	\$2.6	\$2.6	\$2.7
Lower Growth Scenario	\$2.5	\$2.5	\$2.5	\$2.5	\$2.6

Garbage Franchise Fee

Franchise fees are collected by the Town for the privilege of operating a utility service within Los Gatos, and as a fee in lieu of a business license tax. Franchise fees are currently received

DISCUSSION (continued):

from Comcast for cable television, PG&E for gas and electric services, West Valley Collection and Recycling for solid waste collection services, and AT&T and Comcast for video services. Franchise fees represent 5% of projected General Fund revenues in FY 2022/23.

As the Town previously enclosed in the FY 2021/22 Annual Comprehensive Financial Report (ACFR), the California Supreme Court recently issued an opinion in a case challenging the franchise fees that the city of Oakland charges to certain waste hauling companies. In *Zolly v. City of Oakland*, the court concluded that it did not have enough evidence to rule as a matter of law that the fees are exempt from the voter approval requirements that apply to taxes under Proposition 26, Article XIII C of the California Constitution. However, there are several exceptions to the general rule that a tax must be approved by the voters. One exception (Article IIIC, section 1 (e)(1)) is for “a charge imposed for a specific benefit conferred or privileged granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege.” In the event the Town is unable to utilize one of the exceptions, the potential impact is a loss of approximately \$2.4 million annually.

The following table illustrates total franchise fees collection with and without garbage franchise fees.

Franchise Fees	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
All Franchise Fees	\$2.8 M	\$2.8 M	\$2.9 M	\$3.0 M	\$3.1 M
Franchise Fees without Garbage Franchise Fee	\$0.9 M	\$0.9 M	\$0.9 M	\$1.0 M	\$1.0 M

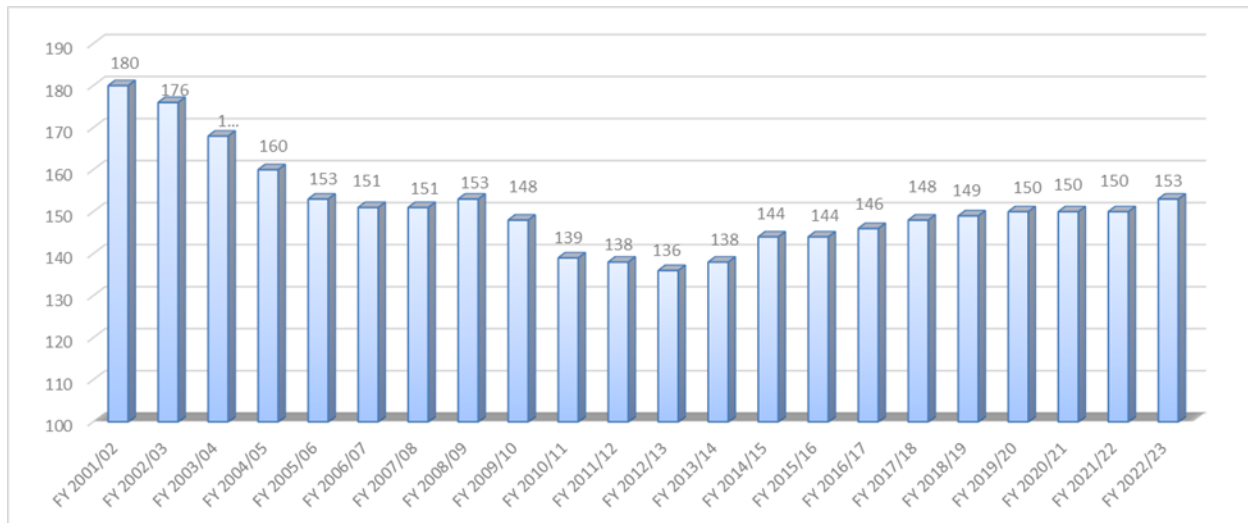
Operating Expense Trends and Five-Year Forecast Scenarios

Forecasts of future operating expenditures take into account 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. Attachment 4 contains the expenditure assumptions.

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 unique to a government organization, such as a rise in wages consistent with collective bargaining agreements and annual pension payments mandated by CalPERS. The Town has three bargaining units, including the Town Employees' Association (TEA), the American Federation of State, County and Municipal Employees (AFSCME), and the Police Officers' Association (POA). The unrepresented groups are Management and Confidential.

DISCUSSION (continued):

For FY 2022/23, General Fund Estimated Operating expenditures (not including debt payment and transfers out) are \$46.9 million. The delivery of Town services is highly dependent on talent which comprises 70% of estimated General Fund expenditures. 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. As the table below illustrates, since 2001 the Town has reduced its full-time employees by 15% to 153 FTE employees.



Mandated pension payments to CalPERS has consistently been one of the major cost drivers for the Town over the past decade with persistent unanticipated increases in pension costs. The Town's plans over the past several decades, like all other CalPERS participants, have experienced unfavorable investment returns, changes in actuarial assumptions, and demographic changes which have outweighed any positive plan experiences. The outcome of these unfavorable economic and demographic results is the development of unfunded pension and Other Post-Employment Benefit (OPEB) obligations for the Town. To address the escalation in pension costs, previous Councils have allocated additional discretionary pension funding, totaling \$10.4 million. These additional discretionary payments will ultimately yield an approximate additional \$12.7 million in contribution savings.

The Town and its bargaining groups have also worked to contain benefit costs. The Town closed the CalPERS retiree Tier 1 benefit for non-safety employees and created a new Tier 2 for non-safety new employees in 2012, implemented the Public Employees' Pension Reform Act (PEPRA) for all new non-classic employees starting in 2013, and participates in the CalPERS discounted prepayment option.

In addition to the management of the Town's pension obligations, prior Councils and the Town's bargaining groups have worked to curb cost escalation in OPEB. In 2009, the Town

DISCUSSION (continued):

initiated prefunding of the retiree healthcare benefit and has since established approximately \$22.6 million in OPEB assets (as of 12/31/2022) from zero in 2009. In 2016, the Town's bargaining groups approved the introduction of dependent cost sharing and a reimbursement cap to Medicare eligible employees, and in 2018 the elimination of the Town's existing retiree healthcare benefit prospectively.

While these collective measures have helped to slow the growth in salary and benefit expenses, the Forecast anticipates continued increases in the Town's pension obligations.

Provided below are the expense assumptions for salary and benefits and alternate case scenarios for pension contributions. The majority of other expenses are assumed to increase at 3% per annum. Detailed expenditure assumptions and factors can be found in Attachment 4.

Salary and BenefitsSalary

The Town has historically budgeted vacant and non-sworn positions at top step of the range for the position. Sworn and management positions are budgeted at one step higher of current step in anticipation of any merit increases expected to be awarded in the upcoming fiscal year. Based on Council's direction for FY 2021/22, salaries were budgeted at actual salary plus a one step increase, which was a significant budgeting methodology change from previous practice. This methodology will be continued for the development of FY 2023/24 budget unless modified by the Town Council.

For the Forecast, positions are budgeted at the actual rate of pay of employees including benefits as of January 2023. Then, by position, salary costs are updated in accordance with the applicable Memorandum of Understanding (MOU) between the Town and its bargaining units. The Memoranda of Understanding that outline the individual agreements between the Town and each unit related to compensation, health benefits, leave time, and grievance procedures will expire with TEA and AFSCME on June 30, 2024. POA's MOU will expire on September 30, 2024. The Management and Confidential groups are unrepresented.

In addition to the economic terms of the MOUs, the Forecast assumes step increases for employees in applicable positions, and merit increases for Management and Confidential employees. In addition, based on prior Council guidance, 2% cost of living wage adjustments (COLA) are included in the Forecast for each year starting in 2024/25.

Salaries (Current MOUs)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Base Case	\$23.10	\$23.62	\$24.09	\$24.63	\$25.17

DISCUSSION (continued):

The following table illustrates the base case forecast compared to a forecast with 4% vacancy saving factor as recommended by the Finance Commission.

Surplus/Deficit	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Base Case	(\$2.70)	(\$3.10)	(\$3.00)	(\$3.10)	(\$3.20)
with 4% Vacancy Factor	(\$1.30)	(\$1.70)	(\$1.50)	(\$1.50)	(\$1.60)

Pension and Other Benefits

For purposes of the Forecast, staff utilizes estimates provided by each plan's most recent actuarial valuation received from CalPERS. The employer contribution rates reflect percentages of covered payroll. Rates shown for FY 2023/24 are actual rates as prescribed by CalPERS. Forecasted rates for FY 2023/24 and subsequent years are based on the most recent CalPERS Actuarial Valuation Reports as adjusted by the impact related to the FY 2021/22 CalPERS negative 7.5% investment return and forecasted payroll.

Beginning in FY 2021/22, the estimates of employer contributions were credited with an anticipated reductions associated with the approximate \$4.8 million additional discretionary payment (ADP) toward the 2016 unfunded amortization base paid off in October 2019 and the total of approximately \$5.8 million in ADPs toward unfunded 2013 and 2015 amortization bases that were paid off in FY 2020/21.

Pension & Other Benefits	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Base Case	\$10.9	\$11.4	\$11.9	\$11.9	\$12.3

Given that investment returns have one of the largest impacts on contribution variability, CalPERS provides projected employer Unfunded Actuarial Liability (UAL) contributions under alternate investment returns. Analysis using the investment return scenarios from the Asset Liability Management process completed in 2021 was performed to determine the effects of various future investment returns on required employer contributions. The projections below reflect the impact of the CalPERS Funding Risk Mitigation policy. The projected normal cost rates reflect that the rates are anticipated to decline over time as new employees are hired into lower-cost benefit tiers. The projections also assume that all other actuarial assumptions will be realized and that no further changes in assumptions, contributions, benefits, or funding will occur. The first table shows projected contribution requirements if the fund were to earn either 3.0% or 10.8% annually. These alternate investment returns were chosen because 90%

DISCUSSION (continued):

of long-term average returns are expected to fall between these levels over the 20-year period ending June 30, 2041.

UAL Town Contributions (Misc & Safety)	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2026/27 Forecast	2027/28 Forecast
Greater Investment Return Scenario (10.8%)	\$4,432,000	\$3,131,000	\$1,613,000	\$56,000	\$0
Base Investment Return Case (3.0%)	\$4,774,000	\$4,587,000	\$4,914,000	\$5,316,000	\$6,128,000

CalPERS Actuarial Valuations as of June 30, 2021

For the year ending June 30, 2022, the Public Employees Retirement Fund (PERF) returned negative 7.5%. The table below illustrates the historic investment returns for five years, ten years, twenty years, and thirty years.

CalPERS Compound Annual Rates of Return (as of June 30, 2021)	5 Years	10 Years	20 Years	30 Years
Compound Annual Return	10.30%	8.50%	6.90%	8.40%

Five-Year Financial Forecast Alternative Scenarios

The tables below present the “Base Case” forecast contrasted against the two alternative revenue scenarios of “Greater Growth” and “Lower Growth.” In addition, the 4% vacancy factor and the elimination of the garbage franchise fees are illustrated compared to the base case. As illustrated in the tables, even modest changes to the “Base Case” forecast can result in either additional surpluses or deficits during the forecast period.

5 Year Forecast "Base Case"	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Total Revenues & Transfers	\$48.9	\$50.1	\$51.4	\$53.1	\$54.5
Total Expenses & Allocations	\$51.6	\$53.2	\$54.4	\$56.2	\$57.7
Surplus/Deficit	(\$2.7)	(\$3.1)	(\$3.0)	(\$3.1)	(\$3.2)

Alternative Scenario "Greater Growth"	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Total Revenues & Transfers	\$51.4	\$53.2	\$55.1	\$57.6	\$59.5
Total Expenses & Allocations	\$51.7	\$53.2	\$54.4	\$56.3	\$57.8
Surplus/Deficit	(\$0.3)	\$0.0	\$0.7	\$1.3	\$1.7

DISCUSSION (continued):

Alternative Scenario "Lower Growth"	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Total Revenues & Transfers	\$47.3	\$47.9	\$48.9	\$49.9	\$50.8
Total Expenses & Allocations	\$51.6	\$53.1	\$54.3	\$56.2	\$57.7
Surplus/Deficit	(\$4.3)	(\$5.2)	(\$5.4)	(\$6.3)	(\$6.9)

Alternative Scenario "4% Vacancy Factor"	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Total Revenues & Transfers	\$48.9	\$50.1	\$51.4	\$53.1	\$54.5
Total Expenses & Allocations	\$50.2	\$51.8	\$52.9	\$54.6	\$56.1
Surplus/Deficit	(\$1.3)	(\$1.7)	(\$1.5)	(\$1.5)	(\$1.6)

Alternative Scenario without Garbage Franchise Fee	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)	2027/28 Forecast (\$M)
Total Revenues & Transfers	\$47.1	\$48.2	\$49.4	\$51.1	\$52.4
Total Expenses & Allocations	\$51.6	\$53.2	\$54.4	\$56.2	\$57.7
Original Surplus/Deficit	(\$4.5)	(\$5.0)	(\$5.0)	(\$5.1)	(\$5.3)

CONCLUSION:

The Finance Commission should review and discuss the elements and assumptions of the initial Five-Year Forecast and other budget considerations. The "Base Case" Forecast estimates deficits at this time. Staff looks forward to answering the Finance Commission questions and receiving any direction for Council consideration for the preparation of the proposed FY 2023/24 Operating Budget that results from the discussion.

The preparation of the FY2023/24 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. This is considered a "status quo" approach with no major new initiatives or staffing. Key budget principles include:

- Develop and recommend a balanced budget that maintains service levels;
- Address projected deficits;

DISCUSSION (continued):

- 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 Capital Improvement Program and direction will be discussed separately at the March meeting. The Finance Commission may also discuss budget assumptions. The Draft FY 2023/24 Operating and Capital Budgets will be available in April for the Finance Commission elaboration with the budget hearing tentatively scheduled for May 16, 2023.

COORDINATION:

This Report was prepared by the Finance Department and the Town Manager Office.

ENVIRONMENTAL ASSESSMENT:

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

Attachments:

1. Annual Budget Process
2. Base Case Five-Year Forecast
3. Forecast Revenue Assumptions
4. Forecast Expense Assumptions
5. Additional Sales Tax Context from MuniServices