



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 02/15/2021

ITEM NO: 13

DATE: February 10, 2022
TO: Mayor and Town Council
FROM: Laurel Prevetti, Town Manager
SUBJECT: Discuss the Five-Year Forecast (Fiscal Years 2022/23 – 2026/27), Provide Direction on Budget Assumptions, and Provide any Specific Direction for the Preparation of the Town's Fiscal Year 2022/23 Operating Budget

RECOMMENDATION:

Discuss the Five-Year Forecast (Fiscal Years 2022/23 – 2026/27), provide direction on budget assumptions, and provide any specific direction for the preparation of the Town's Fiscal Year (FY) 2022/23 Operating Budget.

EXECUTIVE SUMMARY:

The base case Five-Year Forecast (FY 2022/23 – 2026/27) (Attachment 2) identifies deficits for all future years, using the 2% salary increase assumption approved by the Town Council for the FY 2021/22 budget and other assumptions (see Attachments 3 and 4). The deficits are on the order of approximately \$2M 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 Council may wish to modify the assumptions for the FY 2022/23 budget and provide other budget direction as appropriate. The Capital Program is scheduled for a separate discussion at the next Council meeting.

ATTACHMENT 1

PREPARED BY: Arn Andrews
Assistant Town Manager

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

BACKGROUND:

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 2022/23 – 2026/27) is predicated on estimates derived from the FY 2021/22 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 three of the major revenue assumptions. These additional forecast scenarios 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.

DISCUSSION:

National and Local Economic Backdrop

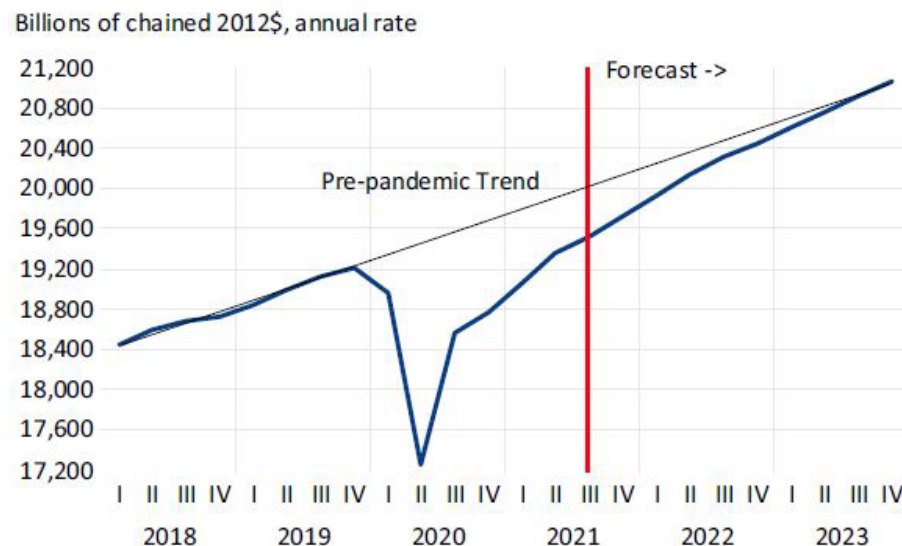
The UCLA Anderson School of Business publishes an annual economic forecast for the nation and California. The results of the forecast are utilized as a portion of the macroeconomic basis of the Five-Year Forecast development. The September 2021 report establishes data for a 2021-2023 forecast period.

DISCUSSION (continued):

Because of plateauing vaccination rates and the emergence of variants, the UCLA Anderson Forecast is projecting slower growth in average annual Gross Domestic Product (GDP) for 2022 of 4.1%, down from their previous forecast of 5.0%. However, for 2023 they have increased their forecast to 3.1% from the previous forecast of 2.2%. The report states that the “...reduction in growth in 2022 and increase in growth in 2023 represent a shifting of consumption and investment further into the future.” Other forecast assumptions include that the economy remains constrained because of COVID, that consumers continue to spend on entertainment, leisure and hospitality, and services, but that they occasionally pull back if there are new variants or if cases increase rapidly. In addition, the report assumes that the impact of COVID on economic activity diminishes through 2023.

As the graph on the next page illustrates, the report states that real GDP surpassed its pre-COVID peak in Q2 2021. However, real GDP is still 2.2% below its pre-COVID trend and the report does not expect real GDP to reach its pre-COVID trend until the third quarter of 2023.

Exhibit 3: Real GDP Levels, 2018Q1-2023Q4



Source: U.S. Bureau of Economic Analysis, UCLA Anderson Forecast.

The Report notes, “although California began a significant recovery later than some other states due to the public health interventions in the state, they expect the California recovery to ultimately be, once again, faster than the U.S. The authors attribute this to two reasons. First, variants notwithstanding, the better public health outcomes should result in a more rapid return to normalcy. Second, the move to new ways of work and social interaction will disproportionately impact California through its technology laden sectors. The leisure and

DISCUSSION (continued):

hospitality sector will be the last to recover due to the depth of the decline in this sector, the slower return of restaurant and bar services demand, and the sub-sectors dependent upon international tourism demand. The recovery will be considerably faster in higher income technical services and faster in residential construction as California's shortage of housing relative to demand drives new developments."

Operating Revenue Trends and Five-Year Forecast Scenarios

The Town is highly dependent on three economically sensitive revenues comprising 65% of General Fund forecasted revenues. Following are summaries of the Town's major revenues of property tax, sales tax, and transient occupancy tax (TOT). To provide context for the development of the Five-Year Forecast (FY 2022/23 – 2026/27), 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 34% of total Town projected revenues for FY 2021/22. 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 2012. For the 10-year period, the average annual growth rate was 6.4%.

Los Gatos Assessment Roll Growth

(values in billions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Roll	8.68	9.46	9.99	10.63	11.54	12.29	13.15	13.84	14.90	15.6
Percent Growth	3.67	9.06	5.62	6.40	8.56	6.54	6.95	5.23	7.70	4.33

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 2021/22 Budget and FY 2020/21 actuals. The current County estimate indicates a modest deviation from budget of approximately \$400,000. The decrease is attributed to the combination of lower than expected secured property tax estimates and increases to Vehicle License Fees, property transfer tax, and Educational Revenue Augmentation Fund (ERAF) estimates.

	FY 2020/21 Actual	FY 2021/22 Adjusted Budget	County Estimate with 70% ERAF
Property Tax Revenue & Vehicle License Fee Backfill	\$19.9 M	\$20.0 M	\$19.6 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 2020/21; however, the Santa Clara County Assessor's Office recommends budgeting only 70% of the FY 2021/22 projected number. The Adopted FY 2021/22 Budget included a \$1.45 million ERAF estimate, 70% of the current ERAF base revenue estimate is \$1.5 million.

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

Property Tax	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 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 \$372,000 additional North 40 revenue in FY 2021/22 and an additional \$711.320 in FY2022/23 due to the project's construction and sales schedule. Base non-residual excess ERAF revenue is forecasted at \$400,000 annually until

DISCUSSION (continued):

further direction received annually from the County. FY 2022/23 also anticipates an additional \$500,000 Redevelopment Agency residual allocation representing the current allocation calculation of Santa Clara County.

Property Tax (Property Tax & VLF)	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Greater Growth Scenario	\$20.2	\$21.0	\$22.0	\$23.0	\$24.2
Base Case Modest Growth	\$19.9	\$20.2	\$20.7	\$21.4	\$22.0
Less Growth Scenario	\$19.4	\$19.4	\$19.7	\$19.8	\$20.0

Sales Tax

Sales tax is the second largest revenue source for the Town and comprised approximately 12% of total Town projected revenues for FY 2021/22. The following table illustrates the most recent projections from the Town's sales tax consultant MuniServices relative to the Adjusted FY 2021/22 budget and FY 2020/21 actuals.

	FY 2020/21 Actual	FY 2020/21 Adjusted Budget	January 10, 2022 MuniServices Estimate
Base Sales Tax	\$6.8 M	\$7.2 M	\$7.0 M

	FY 2020/21 Actual	FY 2020/21 Adjusted Budget	January 10, 2022 MuniServices Estimate
Measure G – 1/8 District Tax	\$1.1 M	\$1.0 M	\$1.2 M

The current estimate indicates a total improvement from budget of approximately \$64,000; however, staff will continue to monitor MuniServices updates into the close of the fiscal year and adjust as appropriate. The table below provides the MuniServices Most Likely scenario which staff is utilizing for development of the FY 2022/23 Five-Year Forecast.

DISCUSSION (continued):

Base Sales Tax & District Tax	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
MuniServices COVID Scenario	\$8.7	\$8.9	\$9.2	\$9.4	\$9.6

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

Base Sales Tax	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Conservative	\$ 6.7	\$6.9	\$7.1	\$7.3	\$7.4
Most Likely	\$7.5	\$7.7	\$7.9	\$8.1	\$8.2
Optimistic	\$8.2	\$8.5	\$8.7	\$8.9	\$9.1

Measure G 1/8 District Tax	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Conservative	\$1.1	\$1.1	\$1.1	\$1.2	\$1.2
Most Likely	\$1.2	\$1.2	\$1.3	\$1.3	\$1.4
Optimistic	\$1.3	\$1.3	\$1.3	\$1.4	\$1.5

Transient Occupancy Tax

TOT is an important revenue source for the Town and comprised approximately 3% of total Town projected revenues of \$1.4 million for FY 2021/22. The following table illustrates TOT FY 2020/21 actuals, the Adjusted FY 2021/22 Budget, and year-end collection estimates .

DISCUSSION (continued):

	FY 2020/21 Actual	FY 2021/22 Adjusted Budget	Year-end Estimate
TOT	\$1.0 M	\$0.9 M	\$1.4 M

The FY 2021/22 Adjusted Budget modeled a slight increase to \$900,000 in anticipated TOT revenues from \$700,000 the prior year during the budget process; however, actual FY 2020/21 TOT proceed was \$1.0 M. The slight increase reflected significant uncertainty around the return of corporate travel and a continuation of slower leisure travel. Due to a significant rebound in leisure “staycation” 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 2022/23 – 2026/27) for TOT and corresponding estimated revenues.

TOT	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Proposed Growth	3%	3%	3%	3%	3%
Estimated Revenues	\$1.4 M	\$1.5 M	\$1.5 M	\$1.6 M	\$1.6 M

Unlike sales tax forecasts which continue to predict a return to pre COVID levels in the next several years, the Town’s TOT revenue has historically been primarily driven by business travel. Given the uncertainty around physical business travel resuming at prior levels, as opposed to a continuation of remote work and online meeting forums, staff is recommending modest growth for base case development of the FY 2022/23 Five-Year Forecast. However, given the significant reduction to the revenue base compared to prior revenue history staff is providing a base growth scenario and an additional more optimistic growth scenario.

DISCUSSION (continued):

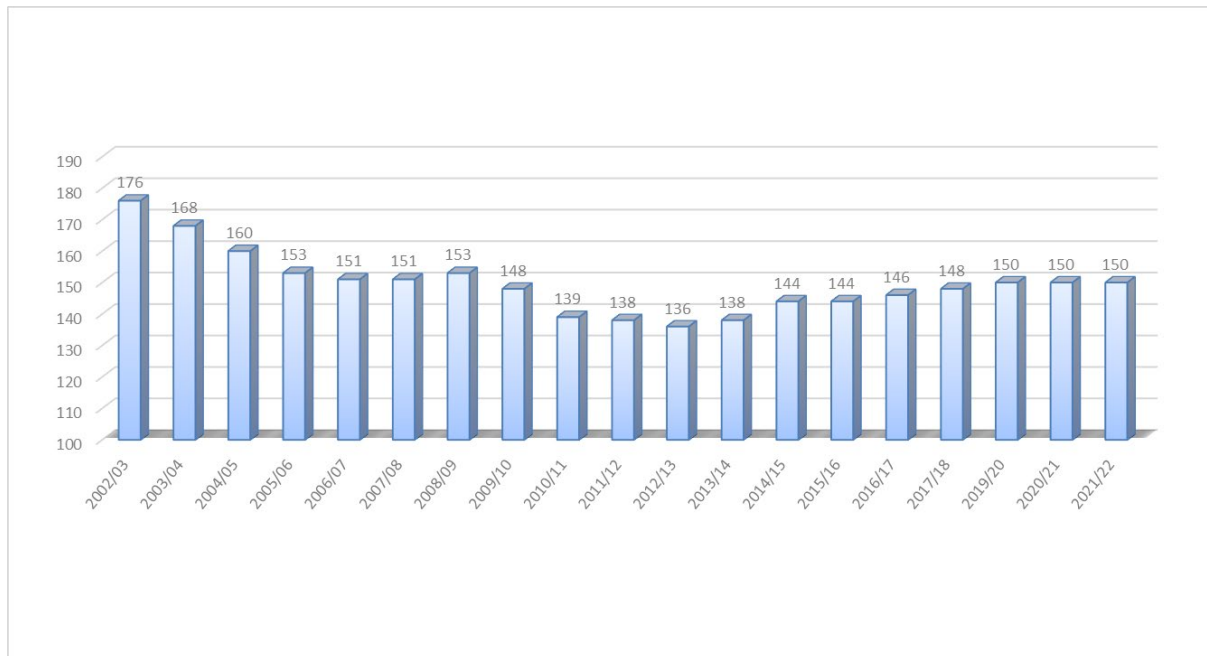
TOT	2021/22 Forecast	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Base Growth Scenario	20%	20%	3%	3%	3%
Estimated Revenues	\$1.7 M	\$2.0 M	\$2.1 M	\$2.1 M	\$2.2 M
Base Growth Scenario	30%	20%	3%	3%	3%
Estimated Revenues	\$1.8 M	\$2.2 M	\$2.2 M	\$2.3 M	\$2.4 M

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. See Attachment 4 for 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.

For FY 2021/22, General Fund Estimated Operating expenditures (not including debt payment and transfers out) were programmed at \$43.8 million. The delivery of Town services is highly dependent on talent which comprises 64% 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 16.7% to 150 FTE employees.

DISCUSSION (continued):

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 \$10,400,000 million. These additional discretionary payments will ultimately yield an approximate additional \$12,700,000 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. The Town's bargaining groups participated in wage freezes and unpaid furloughs for several years to assist in achieving balanced budgets after the 2008 recession.

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 initiated prefunding of the retiree healthcare benefit and has since established approximately \$27.4 million in OPEB assets from zero in 2009. In 2016, the Town's bargaining groups

DISCUSSION (continued):

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 Benefits

Salary

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 2022/23 budget.

For the Forecast, positions are budgeted at the actual rate of pay of employees including benefits as of December 2021. 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, 2022. POA's MOU expired on September 30, 2021 and negotiations are currently in process. 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 2022/23.

DISCUSSION (continued):

Salaries (Current MOUs)	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Base Case with 2% COLA	\$20.6	\$21.2	\$21.8	\$22.3	\$22.8

In comparison, the table below illustrates what the salary forecast would be utilizing the prior practice of not including assumptions outside of current MOUs or 0%.

Salaries (Current MOUs)	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Base Case with 0% COLA	\$20.2	\$20.4	\$20.6	\$20.7	\$20.8

Pension and Other Benefits

For purposes of the Forecast, staff utilizes estimates provided by each plan's most recent actuarial valuation received from CalPERS. Beginning in FY 2021/22, the estimates of employer contributions were credited with an anticipated reduction associated with the \$5.6M additional discretionary payment (ADP) toward the 2015 unfunded amortization base paid off in early 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

As we move closer to the final development of the Proposed FY 2022/23 Operating Budget, staff will further refine these estimates taking into account CalPERS recent assumption changes, changes to the discount rate, and the 21.3% positive return experienced in FY 2020/21. Any update will not impact the initial years of the forecast due to lags in actuarial reporting but will be exhibited starting in the third year of the forecast.

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. The following alternative return scenarios assume that the return was experienced for FY 2020/21 through FY 2023/24. As the table below illustrates

DISCUSSION (continued):

returns higher than the expected return of 7% result in lower future UAL contributions and returns lower than 7% result in higher future UAL contributions.

UAL Town Contributions (Misc & Safety)	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Greater Investment Return Scenario (12%)	\$5,037,000	\$5,065,000	\$4,428,000	\$3,903,000
Base Investment Return Case (7%)	\$5,213,000	\$5,598,000	\$5,518,000	\$5,769,000
Less Investment Return Scenario (1%)	\$5,446,000	\$6,297,000	\$6,919,000	\$8,105,000

CalPERS Actuarial Valuations as of June 30, 2020

For the year ending June 30, 2021, the Public Employees Retirement Fund (PERF) returned 21.3%. 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, 2020)	5 Years	10 Years	20 Years	30 Years
Compound Annual Return	6.3%	8.5%	5.5%	8.0%

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.” 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.

Original 5 Year Forecast “Base Case” with 2% Salary Increase	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Total Revenues, Transfers & Use of Reserves	\$45.6	\$46.6	\$47.6	\$48.9	\$50.1
Total Expenses & Allocations	\$47.2	\$48.6	\$50.0	\$51	\$52.4
Original Surplus/Deficit	(\$1.6)	(\$2.0)	(\$2.4)	(\$2.1)	(\$2.3)

DISCUSSION (continued):

Original 5 Year Forecast “Base Case” with 0% Salary Increase	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Total Revenues, Transfers & Use of Reserves	\$45.6	\$46.6	\$47.6	\$48.9	\$50.1
Total Expenses & Allocations	\$46.7	\$47.5	\$48.4	\$48.7	\$49.5
Original Surplus/Deficit	(\$1.1)	(\$0.9)	(\$0.8)	\$0.2	\$0.6

Alternative Scenario “Greater Growth” with 2% Salary Increase	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Total Revenues & Transfers	\$45.7	\$47.6	\$61.8	\$50.6	\$52.6
Total Expenses & Allocations	\$47.2	\$48.6	\$50.0	\$51	\$52.4
New Surplus/Deficit	(\$0.1)	\$0.4	\$1.6	\$1.1	\$1.7

Alternative Scenario “Lower Growth” with 2% Salary Increase	2022/23 Forecast (\$M)	2023/24 Forecast (\$M)	2024/25 Forecast (\$M)	2025/26 Forecast (\$M)	2026/27 Forecast (\$M)
Total Revenues & Transfers	\$44.1	\$44.9	\$45.6	\$46.3	\$47.0
Total Expenses & Allocations	\$47.2	\$48.6	\$50.0	\$51	\$52.4
New Surplus/Deficit	(\$3.0)	(\$3.7)	(\$4.4)	(\$4.6)	(\$5.3)

CONCLUSION:

The Town Council should review and discuss the elements and assumptions of the initial Five-Year Forecast and other budget considerations. While the “Base Case” Forecast estimates deficits at this time, it is based on assumptions that are subject to change given the significant unknowns related to COVID and as shown with the alternative growth scenarios. As the Forecast is not a budget, there are no specific budget balancing recommendations being

CONCLUSION (continued):

proposed at this time. The Town Manager will bring forward for Council consideration in May a balanced proposed FY 2022/23 budget.

At this time, the preparation of the FY 2022/23 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;
- 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.

Staff looks forward to answering the Town Council's questions and receiving any direction for the preparation of the proposed FY 2022/23 Operating Budget that results from the discussion. The Capital Improvement Program and direction will be discussed separately at the next Town Council meeting. The Council may also discuss budget assumptions. The Finance Commission is meeting on February 14 and its comments on the Forecast will be provided to the Town Council in a Desk Item on February 15, 2022. The Draft FY 2022/23 Operating and Capital Budgets will be available in May with the budget hearing tentatively scheduled for May 17, 2022.

COORDINATION:

This Report was prepared by the Town Manager's Office in coordination with the Finance Department.

ENVIRONMENTAL ASSESSMENT:

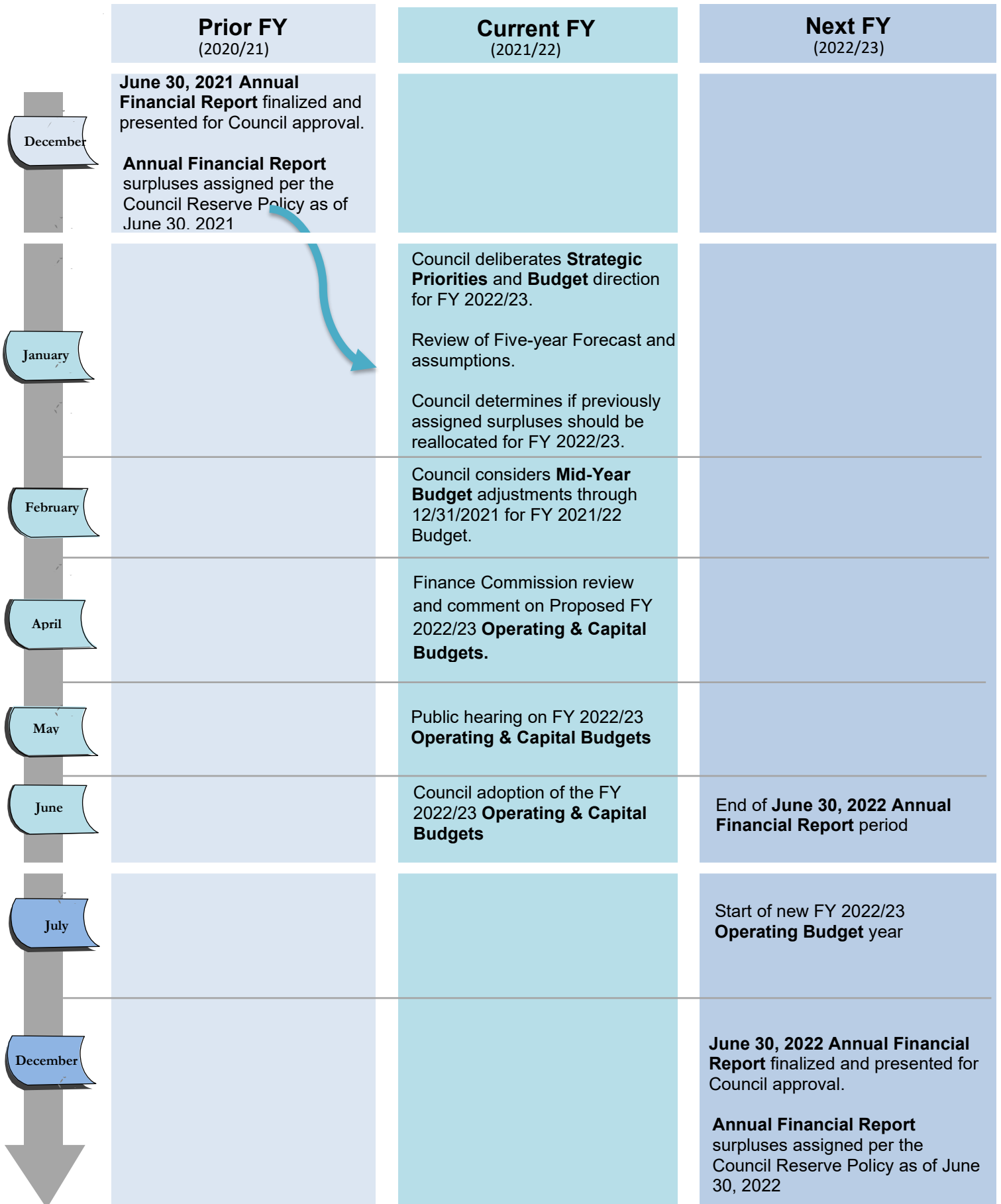
This is not a project defined under CEQA, and no further action is required.

Attachments:

1. Annual Budget Process
2. Base Case Five-Year Forecast
3. Forecast Revenue Assumptions
4. Forecast Expense Assumptions

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BUDGET PROCESS DIAGRAM



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BASE CASE

Town of Los Gatos General Fund 5-Year Forecast
(in \$ million)

Account	Revenue Category	2020/21 Actuals	2021/22 Adjusted Budget	2021/22 Estimates	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
4100	Property Tax	\$ 15.8	\$ 15.9	\$ 15.4	\$ 15.5	\$ 15.7	\$ 16.1	\$ 16.6	\$ 17.1
4110	VLF Backfill Property Tax	4.1	4.2	4.2	4.4	4.5	4.6	4.8	4.9
4200	Sales & Use Tax	6.8	7.2	7.0	7.5	7.7	7.9	8.1	8.2
4200	Measure G District Sales Tax	1.1	1.0	1.2	1.2	1.2	1.3	1.3	1.4
4250	Franchise Fees	2.5	2.6	2.5	2.6	2.7	2.7	2.8	2.9
4251	Transient Occupancy Tax	1.0	0.9	1.4	1.4	1.5	1.5	1.6	1.6
4400	Business License Tax	1.4	1.3	1.3	1.3	1.4	1.4	1.4	1.4
4400	Licenses & Permits	3.1	2.7	3.2	2.8	2.9	3.0	3.0	3.1
4500	Intergovernmental	1.6	4.4	1.6	1.0	1.0	1.0	1.0	1.1
4600	Town Services	4.6	3.6	3.9	3.4	3.5	3.6	3.7	3.7
4700	Fines & Forfeitures	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
4800	Interest	0.1	0.4	0.4	0.2	0.2	0.2	0.2	0.2
4850	Other Sources	3.7	2.3	2.5	2.2	2.2	2.2	2.2	2.3
4900	Fund Transfers In	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5
TOTAL OPERATING REVENUES & TRANSFERS*		\$ 46.6	\$ 47.3	\$ 45.4	\$ 44.2	\$ 45.2	\$ 46.2	\$ 47.4	\$ 48.6
	Capital	3.4	0.6	0.6	0.8	0.8	0.8	0.8	0.8
	Use of Pension/OPEB Reserve	4.5	-	-	-	-	-	-	-
	Other	-	-	0.3	-	-	-	-	-
	Use of Property Surplus Reserve	-	1.2	1.2	-	-	-	-	-
	Use of Measure G Reserve	-	0.6	0.6	0.6	0.6	0.6	0.7	0.7
	ARPA Replacement Revenue	-	-	1.4	-	-	-	-	-
TOTAL REVENUES, TRANSFERS, AND USE OF RESERVES		\$ 54.5	\$ 49.7	\$ 49.2	\$ 45.6	\$ 46.6	\$ 47.6	\$ 48.9	\$ 50.1
Account	Expenditure Category	2020/21 Actuals	2020/21 Budget	2021/22 Estimates	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
5110	Salary	20.2	20.8	20.6	20.6	21.2	21.8	22.3	22.8
5120	CalPERS Benefits	6.4	7.3	6.6	6.9	7.3	7.7	7.6	7.9
5200	All Other Benefits	3.7	4.2	3.8	4.0	4.1	4.2	4.3	4.4
6211	OPEB Payas You Go	1.3	1.3	1.5	1.5	1.6	1.8	1.9	1.9
6000	Operating Expenditures	5.7	6.2	6.6	6.3	6.3	6.5	6.5	6.8
7200	Grants & Awards	0.3	1.0	1.1	0.2	0.2	0.3	0.3	0.3
7400	Utilities	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7
8060	Internal Service Charges	2.3	2.7	2.6	2.9	3.1	3.2	3.5	3.6
8900	Debt Service	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
TOTAL OPERATING EXPENDITURES		\$ 42.4	\$ 46.1	\$ 45.3	\$ 45.0	\$ 46.5	\$ 48.0	\$ 48.9	\$ 50.3
	GASB 45 Retiree Medical Actuarial	0.6	0.1	0.1	0.4	0.3	0.2	0.2	0.2
	Additional Discretionary Payment - Pension	5.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4
TOTAL OPERATING & DISCRETIONARY EXPENDITURES		\$ 48.6	\$ 46.6	\$ 45.8	\$ 45.8	\$ 47.2	\$ 48.6	\$ 49.5	\$ 50.9
	Capital Transfers Out to GFAR	3.4	2.8	2.8	1.4	1.4	1.4	1.5	1.5
AMOUNTS AVAILABLE FOR RESERVE ALLOCATIONS									
	Stabilization/Catastrophic	0.1	-	-	-	-	-	-	-
	Allocate to Compensated Absences	0.1	-	-	-	-	-	-	-
	Allocate to Property Surplus Reserve	1.2	-	-	-	-	-	-	-
	Allocate to CalPERS/Pension	0.3	-	-	-	-	-	-	-
	Allocate to Measure G - Capital	-	0.5	0.6	-	-	-	-	-
	Allocate to ARPA Reserve	-	-	-	-	-	-	-	-
TOTAL EXPENDITURES & RESERVE ALLOCATIONS		\$ 53.7	\$ 49.9	\$ 49.2	\$ 47.2	\$ 48.6	\$ 50.0	\$ 51.0	\$ 52.4
NET REVENUES RESERVE TRANSFERS LESS EXPENDITURES & RESERVE ALLOCATIONS FOR FINAL ALLOCATION AFTER YEAR END CLOSE		\$ 0.8	\$ (0.2)	\$ -	\$ (1.6)	\$ (2.0)	\$ (2.4)	\$ (2.1)	\$ (2.3)

* Due to rounding of individual categories FY 2021/22 Total Expenditures and Reserve Allocations includes \$0.1 million.
General Fund (111) Forecast does not include Pension Trusts activities. (\$37,810 in interest proceeds in FY 2020/21)

Town of Los Gatos General Fund Historical Year-End Results
(in \$ million)

Account	Revenue Category	2015/16 Actuals	2016/17 Actuals	2017/18 Actuals	2018/19 Actuals	2019/20 Actuals
4100	Property Tax	\$ 10.8	\$ 11.5	\$ 12.5	\$ 13.6	\$ 14.5
4110	VLF Backfill Property Tax	3.0	3.2	3.4	3.7	3.9
4200	Sales & Use Tax	7.5	9.2	7.6	20.8	6.5
4200	Measure G District Sales Tax	-	-	-	0.2	1.0
4250	Franchise Fees	2.3	2.4	2.5	2.5	2.5
4251	Transient Occupancy Tax	1.9	2.3	2.6	2.7	1.9
4400	Business License Tax	1.5	1.7	1.7	1.5	1.4
4400	Licenses & Permits	3.5	3.0	3.0	3.1	2.8
4500	Intergovernmental	1.0	0.9	1.0	26.6	1.0
4600	Town Services	4.0	3.3	4.4	30.0	4.2
4700	Fines & Forfeitures	0.9	0.9	0.7	0.5	0.3
4800	Interest	0.6	0.2	0.2	1.4	2.2
4850	Other Sources	2.3	4.4	3.2	132.9	2.8
4900	Fund Transfers In	2.4	0.3	0.8	14.4	0.6
TOTAL OPERATING REVENUES & TRANSFERS*		\$ 41.7	\$ 43.3	\$ 43.6	\$ 253.9	\$ 45.6
	Capital	-	1.4	3.2	2.8	8.0
	Use of Pension/OPEB Reserve	-	-	-	-	-
	Other	-	-	-	-	-
	Use of Almond Grove Reserve	-	5.9	-	-	-
TOTAL REVENUES, TRANSFERS, AND USE OF RESERVES		\$ 41.7	\$ 50.6	\$ 46.8	\$ 256.7	\$ 53.6
Account	Expenditure Category	2015/16 Actuals	2016/17 Actuals	2017/18 Actuals	2018/19 Actuals	2019/20 Actuals
5110	Salary	14.5	14.8	16.0	17.9	19.3
5120	CalPERS Benefits	3.6	3.9	4.3	5.3	6.1
5200	All Other Benefits	3.2	3.2	3.3	3.6	3.6
6211	OPEB Pay as You Go	0.9	1.0	1.1	1.2	1.2
6000	Operating Expenditures	4.7	4.8	5.0	5.6	5.1
7200	Grants & Awards	0.7	0.2	0.2	0.3	0.3
7400	Utilities	0.4	0.6	0.5	0.5	0.5
8060	Internal Service Charges	3.5	3.6	3.9	2.5	2.2
8900	Debt Service	1.9	1.9	1.9	1.9	1.9
TOTAL OPERATING EXPENDITURES		\$ 33.6	\$ 34.0	\$ 36.2	\$ 38.8	\$ 40.2
	GASB 45 Retiree Medical Actuarial	1.5	2.6	1.6	1.1	1.1
TOTAL OPERATING & DISCRETIONARY EXPENDITURES		\$ 35.1	\$ 36.6	\$ 37.8	\$ 39.9	\$ 41.3
	Capital Transfers Out to GFAR	0.5	7.3	2.6	2.3	7.0
	Operating Transfer Out	0.1	-	0.6	0.5	1.1
	Fixed Assets/ Equipment	0.4	-	-	-	0.1
	Fund	-	-	1.2	3.6	0.4
AMOUNTS AVAILABLE FOR RESERVE ALLOCATIONS		\$ 5.6	\$ 6.7	\$ 4.6	\$ 210.4	\$ 3.7
	Allocate to Almond Grove Reserve	2.5	-	-	-	-
	Allocate to Market Fluctuations Reserve	0.3	0.3	-	-	1.2
	Allocate to CalPERS/Pension Reserve	-	1.8	-	-	-
	Allocate to Measure G Reserve	-	-	-	-	1.2
	Allocate to VM & Stores Surplus Reserve	-	-	-	1.0	-
	Allocate to Authorized Carryforwards	0.1	-	-	-	-
	Sales Tax Prior - Year Adjustments	-	0.4	-	-	-
	Allocate to Property Surplus Reserve	-	-	-	1.9	-
TOTAL EXPENDITURES & RESERVE ALLOCATIONS		\$ 39.0	\$ 46.4	\$ 42.2	\$ 49.2	\$ 52.2
NET REVENUES RESERVE TRANSFERS LESS EXPENDITURES & RESERVE ALLOCATIONS FOR FINAL ALLOCATION AFTER YEAR END CLOSE		\$ 2.7	\$ 4.2	\$ 4.6	\$ 207.5	\$ 1.4
* Due to rounding of individual categories Total Expenditures and Reserve Allocations may include \$0.1 million.						
General Fund (111) Historical presentaiton does not include Pension Trusts activities.						

Revenue Baselines and Projection Factors

Type of Revenue	Base Line Estimate	FY 2022/23 Forecast	FY 2023/24 Forecast	FY 2024/25 Forecast	FY 2025/26 Forecast	FY 2026/27 Forecast
Property Tax/VLF Backfill	Current baseline set by SCC Assessor Office 2/4 2022 report	3%	3%	3%	3%	3%
North 40 Property Sales	Starting in 2021/22	North 40 Phase 1 Sales	3%	3%	3%	3%
ERAF	Current baseline set 70% of SCC Assessor Office 2/4 2022 report	\$400K	\$400K	\$400K	\$400K	\$400K
Sales Tax	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates
Sales Tax - Measure G	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates	MuniServices 1/11/2022 Most Likely Estimates
Franchise Fee	Current baseline set by FY 2021/22 Estimates	3%	3%	3%	3%	3%
Transient Occupancy Tax	Current baseline set by FY 2021/22 actual estimated proceeds	3%	3%	3%	3%	3%
Business License Tax	Current baseline set by FY 2021/22 Estimates	5%	5%	0%	0%	0%
License & Permits	Current baseline set by FY 2021/22 Estimates	3%	3%	3%	3%	3%

Revenue Baselines and Projection Factors

Town Services	Current baseline set by FY 2021/22 Estimates	3%	3%	3%	3%	3%
Fine & Forfeitures	Current baseline set by FY 2021/22 Estimates	Varies	Varies	Varies	Varies	Varies
Interest	Based on Portfolio Analysis and Current and Expected Yields during the forecast period	\$217K	\$222K	\$227K	\$232K	\$237K
Other Sources	Current baseline set by FY 2021/22 Estimates	Varies	Varies	Varies	Varies	Varies

EXPENDITURE BASELINE AND PROJECTION FACTORS

Beginning in FY 2020/21, the Town started budgeting salaries at the actual salary plus a one-step increase. In the Five-Year Forecast, positions are forecasted at the actual rate of pay including salaries and benefits as of February 1, 2022, and rate is increasing in the actual anniversary date.

Type of Expenditure	FY 2022/23 Forecast	FY 2023/24 Forecast	FY 2024/25 Forecast	FY 2025/26 Forecast	FY 2026/27 Forecast
Salaries*	2%	2%	2%	2%	2%
Benefit - Medical**	3%	3%	3%	3%	3%
Operating Expenditures***	3%	3%	3%	3%	3%
Grants & Awards	0%	0%	0%	0%	0%
Utilities***	3%	3%	3%	3%	3%
Internal Service Charges***	Based on operating cost and scheduled replacement	Based on operating cost and scheduled replacement	Based on operating cost and scheduled replacement	Based on operating cost and scheduled replacement	Based on operating cost and scheduled replacement
Debt Service	Debt Service Schedules				

**Salary increases are based on actual step increases and approved Memoranda of Understanding with the bargaining units plus the Council's assumption of 2% per year cost of living adjustment.*

*** Benefit increase estimates are provided by CalPERS/Public Employees' Medical and Hospital Care Act (PEMHCA)*

**** Based on historical trends.*

The Town's required employer contribution rate estimates were developed using estimates provided by each plan's most recent actuarial valuation received from CalPERS. The employer contribution rates illustrated below reflect percentages of covered payroll. Beginning in FY 2021/22, the estimates of employer contributions were credited with an anticipated reduction associated with the approximate \$5.6M 2015 unfunded amortization base were paid off in early FY 2020/21.

Type of Expenditure	FY 2022/23 Forecast	FY 2023/24 Forecast	FY 2024/25 Forecast	FY 2025/26 Forecast	FY 2026/27 Forecast
Safety POA	69.44%	72.01%	74.61%	75.68%	76.66%
Safety Management POA	72.44%	75.01%	77.61%	78.68%	79.66%
Safety POA - PEPR	14.62%	14.65%	13.78%	13.75%	13.76%
Miscellaneous TEA/Confidential/Management	29.43%	30.04%	30.64%	28.45%	28.73%
Miscellaneous TEA/Confidential/Management PEPR	29.43%	30.04%	30.64%	28.45%	28.73%

**Safety Classic Rate reflects 3% decrease in employer's contribution rate to reflect 3% contribution as negotiated with the Town's POA during the collective bargaining process effective FY 2019/20.*