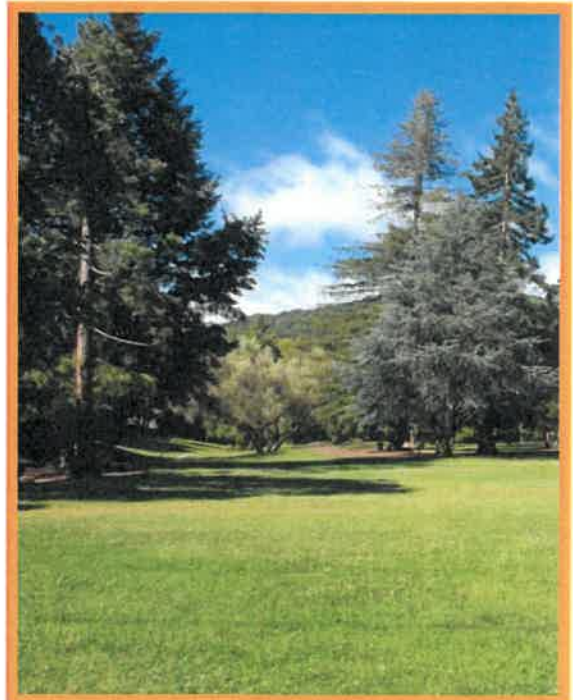
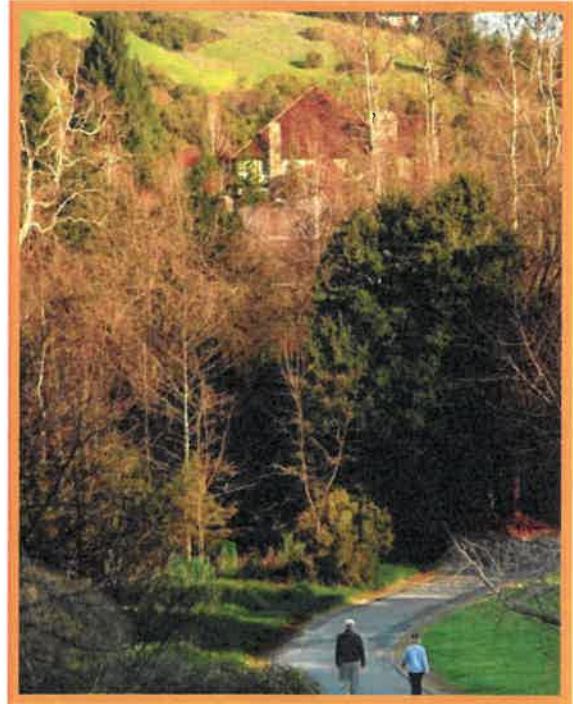




# TOWN OF LOS GATOS

## CALIFORNIA



## Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2020 ATTACHMENT 1



## **Management's Discussion and Analysis**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Town of Los Gatos's Comprehensive Annual Financial Report (CAFR) presents management's discussion and analysis of the Town's financial performance during the fiscal year that ended on June 30, 2020. This analysis should be read in conjunction with the Transmittal Letter at the front of this report and the accompanying Basic Financial Statements.

### FINANCIAL HIGHLIGHTS

- Town assets exceeded liabilities at the close of FY 2019/20 by \$114,851,031 (total net position).
- The Town's total net position increased by \$32,000 during the fiscal year largely as a result of a small excess of total governmental activities revenues above governmental expenses and uses of financial resources.
- Reported unrestricted net position is negative (\$3,967,178) compared to (\$4,642,167) the prior year. The improvement in unrestricted net position resulted largely from the use of approximately \$8.0 million in unrestricted cash balances in the Town's General Fund Appropriated Reserve (GFAR) fund during the year to invest in the Town's infrastructure and equipment. Unrestricted net position represents all resources not included as net investment in capital or restricted assets.
- The Town's economically sensitive major revenues of sales tax and transient occupancy taxes (TOT) were negatively impacted by the COVID-19 pandemic and its related disruptions to normal local economic activity. Sales taxes declined \$0.6 million from the prior year while TOT declined \$0.8 million from the prior period. The impacts to revenues began in March 2020, as shelter-in-place orders were instituted and continued through the end of the fiscal year. Revenue impacts have continued into FY 2020/21 primarily evidenced by TOT revenue declines relative to prior years. For more information on COVID-19 impacts, please refer to Note 15.
- The decline in sales taxes and TOT was partially offset by continued growth in property tax revenues (\$1.0 million).
- Total expenses as reported in the Statement of Activities increased \$3.8 million from the prior year. The increase was driven by a combination of different factors detailed under the Government Activities Expenditures Discussion. A primary contributing factor was the increasing cost of negotiated salary and related benefit increases offered to all Town bargaining units during the fiscal year and lower amounts of vacant positions primarily in the public safety function.

- The cost of all governmental activities this year was \$48.0 million. However, as shown in the Statement of Activities, the amount that the taxpayers ultimately supported for these activities was \$33 million. This is because those who directly benefited from the programs paid \$10.3 million, and other governments and organizations subsidized certain programs with operating grants and contributions of \$3.8 million and capital grants and contributions of \$0.9 million. Overall, the Town's governmental program revenues were \$15.0 million. The Town paid for the remaining "public benefit" portion of governmental activities with \$33 million in taxes and general revenues including interest and miscellaneous revenues. This \$33 million in net cost of governmental activities is an approximate 9% increase from the prior fiscal year, resulting largely from the increasing cost of negotiated salary and related benefit increases offered to all Town bargaining units during the fiscal year and lower amounts of vacant positions primarily in the public safety function.
- At the end of FY 2019/20, General Fund balance was \$29,335,497 compared to \$38,343,155 in the prior year. The ending fund balance of \$29,335,497 represents approximately 66.3% of General Fund expenditures for the current fiscal year excluding transfers-out to the Town's capital projects funds and internal service funds. The reduction in General Fund ending fund balances was primarily from:
  - \$4.8 million of General Fund restricted cash balances for an additional discretionary payment (ADP) made to CalPERS in October 2019. The ADP to CalPERS was to pay down a portion of the Town's actuarially determined unfunded pension liability beyond the mandated annual payments.
  - Additionally, the General fund transferred approximately \$7.0 to the Town's capital projects fund to provide funding for Town infrastructure improvements.
  - \$1.0 million transfer to the Town's workers compensation internal service fund from General Fund reserves to provide additional funding available to meet ongoing claims activity.
  - This reduction of General fund balance was partially offset by an approximate \$3.1 million excess operating revenues above operating expenditures (excluding the ADP payment and transfers out to other funds) for the year.
- Total fund balances for all governmental funds at year end were \$50,170,882, a decrease of approximately \$3.4 million or (6.4%) from the prior year. Governmental fund balances decreased primarily due to:
  - \$7.8 million of capital outlay expenditures made from the Town's capital projects funds.
  - \$4.8 million ADP payment made to CalPERS in October 2019 from the General fund.
  - These uses were partially offset by the Town's capital projects funds recording approximately \$2.2 million in increases from the prior year's level of receipts of intergovernmental (grants) revenues during the fiscal year.
- At fiscal year end, the Town's General Fund restricted cash assets included \$669,978 placed in its recently established Town's IRS Section 115 Pension Trust.

- The Town's total capital assets increased by \$4,157,637 to \$111,700,225 net of depreciation.

## **OVERVIEW OF THE FINANCIAL STATEMENTS**

The financial section of the CAFR contains the following information: Independent Auditor's Report, Management's Discussion and Analysis (this section), the Basic Financial Statements, and the Required Supplementary Information. The CAFR also includes a Supplementary Information section, which presents combining and budgetary schedules for individual non-major funds. The Basic Financial Statements are comprised of three components: 1) Government-Wide Financial Statements, 2) Fund Financial Statements, and 3) Notes to the Financial Statements. The Management's Discussion and Analysis is intended to be an introduction to the Basic Financial Statements.

### **Government-Wide Financial Statements**

The Government-Wide Financial Statements present the financial picture of the Town from an economic resources measurement focus using the accrual basis of accounting. An economic resources measurement focus is when a body of financial statements report all inflows, outflows, and balances affecting or reflecting an entity's net position.

The Statement of Net Position presents information on all of the Town's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Town is improving or deteriorating.

The Statement of Activities presents information showing how the Town's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this Statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the Government-Wide Financial Statements distinguish functions of the Town that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activity*). The governmental activities of the Town include public safety, parks and public works, community development, library, community services, debt service, and general government. The Town has no business-type activities for accounting purposes.

### **Fund Financial Statements**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Town, like other local governments,

uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The funds of the Town are segregated into three categories: governmental funds, proprietary funds, and fiduciary funds.

*Governmental funds* – The Town’s basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using the modified accrual basis of accounting, which measures cash and other financial assets that can readily be converted to cash. The Governmental Fund Statements provide a detailed short-term view of the Town’s general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Town’s operations. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

*Proprietary funds* – The Town maintains one type of proprietary fund: Internal Service Funds. Proprietary funds are reported using the accrual basis of accounting. Internal Service Funds are an accounting tool used to accumulate and allocate costs internally among the Town’s various functions. The Town uses Internal Service Funds to account for its fleet of vehicles, computer equipment, risk management activities, and other items. Internal Service Funds help smooth the variability of certain expenses and insulate the Town from large unanticipated costs. The Internal Service Funds are included within governmental activities in the Government-Wide Financial Statements.

*Fiduciary funds* – Fiduciary funds are used to account for resources held for the benefit of parties outside the Town. Fiduciary funds are not reflected in the Government-Wide Financial Statements because the resources of those funds are not available to support the Town’s own programs.

Included in fiduciary funds is the Redevelopment Successor Agency private-purpose Trust Fund created upon the dissolution of the former Redevelopment Agency (RDA) in 2012. The Trust Fund was created to hold the assets of the former Redevelopment Agency until they are transferred for governmental purposes to other entities or distributed to the underlying taxing jurisdictions in Santa Clara County after the payment of enforceable obligations. Additional information on the dissolution of the RDA and this fiduciary fund can be found in Note 12 in the notes to basic financial statements.

## **Notes to Basic Financial Statements**

The notes provide additional information to facilitate a full understanding of the data provided in the Government-Wide and Fund Financial Statements. The notes to the Basic Financial Statements can be found on pages 60-98 of this report.

## ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Government-Wide Financial Statements provide long-term and short-term information about the Town's overall financial condition. This analysis addresses the financial statements of the Town as a whole, utilizing data from throughout the CAFR to describe the changes between 2019 and 2020.

### Net Position Discussion

As shown below, the Town's combined net position for the year ended June 30, 2020 was \$114.85 million, reflecting a small increase of approximately \$30K to the prior years' net position of \$114.82 million. In general, net position can serve as an important indicator of whether the Town's overall financial condition is improving or deteriorating over time.

|                                   | 2020                  | 2019                  |
|-----------------------------------|-----------------------|-----------------------|
| Current and other Assets          | \$ 75,995,161         | \$ 79,464,869         |
| Capital Assets                    | 111,700,225           | 107,542,588           |
| Total Assets                      | <u>\$ 187,695,386</u> | <u>\$ 187,007,457</u> |
| Deferred Outflows - Pension/OPEB  | 17,441,310            | 13,521,349            |
| Current Liabilities               | 18,093,199            | 17,002,972            |
| Long-Term Liabilities Outstanding | 69,465,025            | 66,521,231            |
| Total Liabilities                 | <u>\$ 87,558,224</u>  | <u>\$ 83,524,203</u>  |
| Deferred Inflows - Pension/OPEB   | 2,727,441             | 2,185,494             |
| Net Position                      |                       |                       |
| Net Investment in Capital Assets  | 111,700,225           | 107,542,588           |
| Restricted                        | 7,117,984             | 11,918,688            |
| Unrestricted                      | (3,967,178)           | (4,642,167)           |
| Total Net Position                | <u>\$ 114,851,031</u> | <u>\$ 114,819,109</u> |

Current and other assets decreased \$3.5 million from the prior year, primarily due to an approximate \$4.8 million decrease in restricted cash deposits. The decrease is primarily related to the budgeted October 2019 additional discretionary payment (ADP) made by the Town to CalPERS to reduce the Town's actuarial unfunded pension liability beyond the mandated annual payments. Capital assets increased \$4.2 million net of depreciation expense totaling approximately \$3.9 million for the year, much of which is related to the infrastructure investments made throughout the Town including:



- Approximately \$5.8 million in street repair and resurfacing and curb and gutter work Town-wide,
- Approximately \$0.7 million to complete the Almond Grove Street Rehabilitation project,
- \$0.3 million in bicycle and pedestrian improvements, and
- \$0.2 million in energy efficiency upgrades made to the Town's facilities among other current year capital projects.

Deferred Outflows increase of \$3.9 million was primary due to the additional discretionary payment made in October 2019 to reduce the Town's unfunded pension liability.

Current liabilities increased \$1.1 million from the prior year primarily due to increases in accounts payable (\$400K) and accrued payroll (\$285K), claims payable (\$141K), and unearned revenue (\$403K), offset by an decrease in deposits payable and amount due to other governments (\$161K).

Long-term liabilities increased \$3.0 million. The increase is primarily due to the \$3.6 million increases in pension liabilities measured as of June 30, 2019. Due to the actuarial measurement date the ADP payment of approximately \$4.8 made by the Town in October 2019 will be reflected in the subsequent actuarial valuation. There was an additional increase of \$343K for compensated absences from the prior year. These increases were offset by a \$900K reduction in net other post employment benefits (OPEB) liabilities due to the continued additional discretionary funding of the unfunded OPEB liability. See Note (9) and Note (10) of Notes to the Financial Statements for more information on Town's pension and other post retirement benefit plans.

Deferred Inflows increased by \$0.5 million resulting primarily from the difference between projected and actual earnings on investments.

The largest segment of the Town's net position, representing \$111.7 million of net position, reflects the net investment in capital assets (e.g., land, buildings, infrastructure, and equipment) less accumulated depreciation and related outstanding debt used to acquire those assets. The Town uses these capital assets to provide infrastructure and services to our residents. Therefore, they do not represent a liquid financial resource to the Town and consequently are not readily available for funding current obligations.

Restricted net position totaled approximately \$7.1 million representing approximately \$6.4 million for capital projects and \$670K placed in trust for unfunded pension/OPEB obligations.

As of June 30, 2020, unrestricted net position reports an approximate \$675K increase from a deficit of approximately (-\$4.64 million) the prior year to an ending deficit balance of approximately (-\$3.97 million). The deficit in governmental unrestricted net position is primarily due to the Town's outstanding long term pension and OPEB liabilities. It is not uncommon for governments with these types of long term liabilities to report a deficit in unrestricted net

position. A deficit in unrestricted net position is not the only measure to assess the Town's fiscal health, other factors can also be important to consider such as an expanding and growing property tax base and the condition of the Town's infrastructure including streets, parklands, civic center and library, police operations building , neighborhood center, corporation yard and other improvements.

### **Governmental Activities**

Governmental activities are generally financed through taxes, intergovernmental revenues, and other non-exchange revenues. The Statement of Activities is intended to illustrate how the cost of governmental activities is financed and determine the annual change in net position.

**Town of Los Gatos  
Statement of Activities  
For the Year Ended June 30, 2020**

|                                    | 2020           | 2019           |
|------------------------------------|----------------|----------------|
| <b>Revenues:</b>                   |                |                |
| Program revenues:                  |                |                |
| Charges for Services               | \$ 10,288,351  | \$ 11,350,345  |
| Operating Grants and Contributions | 3,854,188      | 2,175,277      |
| Capital Grants and Contributions   | 850,113        | 146,792        |
| General Revenues:                  |                |                |
| Property Taxes                     | 18,330,426     | 17,321,347     |
| Sales Taxes                        | 7,531,425      | 8,158,152      |
| Franchise Taxes                    | 2,495,792      | 2,475,916      |
| Other Taxes                        | 1,911,774      | 2,726,743      |
| Motor Vehicle in Lieu              | 24,526         | 14,689         |
| Investment Earnings                | 2,428,470      | 1,809,128      |
| Miscellaneous                      | 323,940        | 2,407,840      |
| Total Revenues                     | 48,039,005     | 48,586,229     |
| <b>Expenses:</b>                   |                |                |
| Police Department                  | 20,446,188     | 16,635,726 (1) |
| Parks and Public Works             | 11,803,005     | 10,627,716     |
| General Government                 | 7,405,368      | 8,163,991 (1)  |
| Community Development              | 5,001,958      | 5,064,637      |
| Library Services                   | 3,347,523      | 3,059,294      |
| Sanitation                         | 3,041          | 684,673        |
| Total Expenses                     | 48,007,083     | 44,236,037     |
| Change in Net Position             | 31,922         | 4,350,192      |
| Net Position, beginning            | 114,819,109    | 110,468,917    |
| Net Position, Ending               | \$ 114,851,031 | \$ 114,819,109 |

*(1) In staff's review of the prior year's Statement of Activities it was discovered an error had been made in the reversal of current year OPEB contributions which was allocated across all departments in error. The credit should have only been charged to general governmental expenses in the prior year. This correction has no effect on net position but changes the expense totals by function but no effect on total expenses on the Statement of Activities for the prior fiscal year ending June 30, 2019.*

## Governmental Activities Revenue Discussion

The Statement of Activities shown above details how the \$48.0 million in Governmental Activities revenue was derived. As categorized in the Statement of Activities as program revenues, approximately \$10.3 million or 21.4% of the revenues were recorded from those who directly benefited from the program as a charge for service. Another \$4.7 million or 9.8% of the revenues were sourced from operating/capital grants and contributions. The remaining \$33.0 million or 68.8% represents general revenues of the Town, including taxes, intergovernmental revenues, and other miscellaneous revenues.

Program revenues increased by approximately \$1.3 million from the prior year. This is largely due to the Town's effort to qualify for a number of new operational and capital grants from the federal and state government.

The Town's revenues related to Governmental Activities decreased by approximately \$1.9 million from the prior year, a combination of approximately \$1.0 million increase in property taxes and \$620K increase in investment earnings offset by approximately \$630K declines in sales taxes, \$815K in other taxes the majority of the decline coming from loss of transient occupancy taxes, and a \$2.0 million reduction in miscellaneous revenues explained largely by the \$1.8 million one-time gain on the sale recorded to miscellaneous revenues in the prior fiscal year associated with the Winchester land sale.

Property tax is the largest individual revenue source for the Town and collections finished the year \$1.0 million higher than the previous year. This increase was mostly due to an increase in secured taxes as strong demand for residential Town property continued, the approval of the annexations of County pockets with tax revenues accruing to the Town effective FY 2019/20, and new developments driving property values higher. It's important to note that assessed valuations for FY 2019/20 were established on the tax roll in January 2019 and collected in FY 2019/20 and accordingly do not reflect COVID-19 impacts to secured or unsecured property.

At \$7.5 million, sales taxes represent the second largest individual revenue source for the Town. Sales taxes decreased \$0.6 million from the previous year largely due to the economic impacts related to COVID-19 which began in March 2020. The decline was slowed by the receipt for the full fiscal year of FY 2019/20 of a new additional 1/8 cent District Sales Tax approved by the Los Gatos voters in the fall of 2018.

Franchise taxes, the Town's third largest revenue source, finished the year at \$2.5 million, reflecting only a very small increase \$20K from the previous fiscal year.

Investment earnings increased \$619K from the prior year. The primary factor responsible for this growth was the increase in the value of portfolio investments due to the dramatic reduction in prevailing interest rates as a result of the market's reaction to COVID-19. As interest rates decline interest bearing investments increase in value which led to year end (\$1.2M of which approximately \$600K had been recognized in the previous fiscal year) additional investment

gains. These non-cash or paper gains are recognized as investment income as a result of the “mark to market value” procedure required by GASB 31.

Miscellaneous revenues decreased by approximately \$2.1 million from the prior year. The substantial decrease is due to a gain on sale of property recognized the prior fiscal year, the largest segment of which was the approximate \$1.9 million gain on sale of the Winchester land sale finalized in May 2019.

### Governmental Activities Expenses Discussion

The Town provides residents and visitors with the following functional services: General Government is comprised of six departments (Town Council, Town Clerk, Town Manager, Town Attorney, Human Resources, Information Technology, and Finance) providing services in general governance, information technology, executive management, economic vitality, legal, records management, risk management, human resources, finance, and accounting. The Town’s Police Department (public safety) provides general law enforcement, crime prevention, dispatch and responses to emergency and non-emergency calls for services. Parks and Public Works provides engineering, construction and maintenance of public streets, street lighting, Town owned buildings, parks, and related infrastructure; as well as traffic engineering and engineering evaluation of private development proposals. Community Development provides planning and zoning services; and building plan check and inspection; and code enforcement services. The Library Department provides library, local history and cultural services to the community.

Total expenses increased \$3.8 million from the prior year. The increase was driven largely by the combination of the following factors:

- Negotiated salary increases and subsequent benefit increases. All non-sworn and management employees received a 3% across the board salary increase and sworn employees received a 4% across the board salary increase.
- General Government expenses increased \$1.2 million from the prior year. The largest share of this increase is a result of a \$416K allocation of this cost center’s share of Internal Service Fund expenses over revenues in FY 2019/20 for which the prior year allocation was a decrease to this cost center of \$346K for its share of Internal Service Fund revenue above expenses. The net difference between fiscal years for this allocation is approximately \$762K between fiscal years.
- Public safety expenses grew by approximately \$2.7 million from the prior year. There are three chief drivers of this increase. First, \$1.9 million of the increase is the pension expense calculated for the Town’s safety risk pool pension plan for the current fiscal year of \$5,646,706 compared to \$3,706,313 expensed in the prior fiscal year. Second, lower position vacancies throughout the fiscal year compared to the prior year added to the increase. Third, the cost of negotiated salary increases and related benefits including the

increased pension contributions for miscellaneous or “non-safety” pension plan positions contributed.

- Parks and Public Works expenses grew by approximately \$0.7 million from the prior year driven primarily by negotiated salary increases and related benefits, increased required employer pension contributions, and increases to depreciation expenses for Town infrastructure.
- Community Development expenses decreased by \$360K for the year due to approximately \$221K lower volume in “pass-through” expenditures for private development activity offsetting cost increases from negotiated salary increases and related benefits and increased required employer pension contributions.
- Library Services expense increased approximately \$288K from the prior year primarily from negotiated salary increases and related benefits and increased required employer pension contributions.
- Sanitation expenses for urban runoff decreased approximately \$682K from the prior year. In the prior fiscal year, the Town received program management fees from the West Valley Sanitation District and expensed those fees for program management. Effective fiscal year 2019/20, the West Valley Clean Water Authority receives its funding through property tax bill assessments and related expenses are paid through the Authority.

## **FINANCIAL ANALYSIS OF THE TOWN’S FUNDS**

### **Governmental Funds**

Recognizing the financial resources measurement focus, the Town’s Governmental Funds provide information on near-term inflows and outflows, and balances of spendable resources. This information is useful in assessing the Town’s financing requirements and may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year. Unlike the Statement of Activities which does not include transfers, the Governmental Funds Balance Sheet does include transfers in and out.

**Fund Balance** – As discussed below, the Town’s Governmental Funds Balance Sheet reports the following fund balances.

**Restricted Fund Balance** – The Town has \$7.2 million in fund balance classified as restricted to indicate that it has an externally imposed restriction on how the money may be spent. Of the \$7.2 million restricted fund balance, \$0.7 million is in the General Fund representing amounts placed in an IRS Section 115 trust dedicated as to use for pension expenses. \$6.3 million is restricted for capital projects, and \$0.2 million for maintenance and repairs.

**Committed Fund Balance** – The Town has \$15.4 million in fund balance classified as committed to indicate that the Town Council previously committed how the money will be spent. Of the \$15.4 million committed fund balance, \$15.1 million is committed to the General Fund, of which \$10.9 million is for budget stabilization and catastrophe response and \$4.5 million is for additional discretionary payments toward pension and OPEB unfunded liabilities.

**Assigned Fund Balance** – The Town has \$27.5 million in fund balance which is not restricted or committed and is classified as assigned to indicate the Town Council’s intent to be used for specific purposes. The largest assigned fund balance is the Reserve for Capital and Special projects with a balance of approximately \$10 million which is the primary funding source for the Town’s five-year capital improvement plan and special projects as budgeted by the Town.

Additional information on the Town’s Fund Balance can be found in Note (8) of the Notes to the Financial Statements.

Major Governmental Funds results for the year included the following:

**TOWN OF LOS GATOS**  
**TOTAL GOVERNMENTAL FUNDS REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES**  
**FOR THE YEAR ENDED JUNE 30, 2020**

| <b>REVENUES</b>                            | <b>2020</b> | <b>2019</b> |
|--|-------------|-------------|
| Property Taxes                             | 18,368,466  | 17,359,435  |
| Sales Taxes                                | 7,531,425   | 8,158,152   |
| Other Taxes                                | 1,911,774   | 2,726,742   |
| Licenses & Permits                         | 4,818,671   | 5,173,876   |
| Intergovernmental                          | 4,292,453   | 2,310,655   |
| Charges for Services                       | 5,309,470   | 5,584,504   |
| Fines and Forfeitures                      | 271,117     | 510,266     |
| Franchise Fees                             | 2,495,792   | 2,475,916   |
| Interest                                   | 2,428,453   | 1,809,164   |
| Use of Property                            | 31,039      | 32,960      |
| Other                                      | 376,922     | 579,755     |
|  | <hr/>       | <hr/>       |
| Total Revenues                             | 47,835,582  | 46,721,425  |
|  | <hr/>       | <hr/>       |
| <b>EXPENDITURES</b>                        |             |             |
| Current:                                   |             |             |
| Public Safety                              | 15,793,815  | 14,945,407  |
| General Government                         | 13,024,146  | 8,004,254   |
| Parks and Public Works                     | 8,168,599   | 7,962,135   |
| Community Development                      | 4,473,790   | 4,577,495   |
| Library Services                           | 2,700,802   | 2,493,617   |
| Sanitation and Other                       | 162,837     | 628,240     |
| Capital Outlay                             | 7,861,972   | 7,888,914   |
|  | <hr/>       | <hr/>       |
| Total Expenditures                         | 52,185,961  | 46,500,062  |
|  | <hr/>       | <hr/>       |
| Excess Revenues over Expenditures          | (4,350,379) | 221,363     |
|  | <hr/>       | <hr/>       |
| Proceeds from sales of assets              | 1,566       | 1,912,316   |
| Transfers in                               | 8,935,260   | 4,264,131   |
| Tranfers out                               | (8,628,719) | (3,323,756) |
| Total Other Financing Sources (Uses)       | 308,107     | 2,852,691   |
|  | <hr/>       | <hr/>       |
| Net Changes in Fund Balances               | (4,042,272) | 3,074,054   |
| Beginning/Ending Fund Balances As Restated | 54,007,454  | 50,560,772  |
| Ending Fund Balances                       | 49,965,182  | 53,634,826  |



Overall, Total Governmental Funds revenues finished \$1.3 million or 2.8% higher than the prior year, while total expenditures finished \$5.7 million or 12.2% higher than the prior year. The net result is that Governmental Funds income before transfers and other financing sources and uses decreased by \$3.8 million. Of Total Governmental Funds revenues, General Fund revenues totaled \$42. million or nearly 89% of the total \$48.0 million. Total General Fund operating revenues decreased by \$900K, resulting from the net effect of:

- \$1.0 million increase in property tax collections,
- \$600K increase in investment income,
- \$150K increase in intergovernmental revenues for the year,
- \$800K decreases in other taxes,
- \$600K decrease in sales tax, and
- \$500K decrease in licenses and permits.

The declines in revenues from the prior year were impacted by the COVID-19 pandemic and its related restrictions which began in March 2020 and continued through the end of the fiscal year. COVID-19 and its associated economic impacts are expected to continue across the entire spectrum of economic activity both locally and nationally.

General Fund expenditures represent approximately \$44.3 million of the Total Governmental Fund expenditures of \$52.2 million compared to \$38.0 million of total Governmental Funds expenditures of \$46.5 million in the prior year. The increase in governmental funds expenditures was led by an approximate \$5.0M increase in general governmental and an \$850K increase in public safety expenditures from the prior year. The increase in general governmental expenditures was largely attributable to a \$4.8 million ADP paid in October 2019 to pay down an additional portion of the Town's actuarial unfunded pension liability beyond mandated annual payments. Increases in public safety expenditures from the prior year were influenced by lower levels of staff vacancy savings and associated increases in salary and benefits from the prior year. Additionally, salary and benefit cost increases resulting from labor negotiations and mandated increases in employer pension contribution rates were also a contributing factor to increases to all Town departments and services.

### **Proprietary Funds**

The Town's Proprietary Funds (Internal Service Funds) presented in the Fund Financial Statements section basically provide the same type of information in the Government-Wide Financial Statements and include individual segment information.

Total net position in the Internal Service Funds decreased \$0.7 million in the current year. This decrease reflects the use of approximately \$788K transferred from the Town's Facilities Maintenance Fund to provide a funding source for the Town's Capital projects for the Civic center and Recreation building restroom renovations, waterproofing, deck railing repairs, and fire suppression for the Town's IT server room. Equipment Replacement net position was reduced by scheduled fleet and equipment replacements totaling approximately \$540K and transfers out

of approximately \$580K to be used as a funding source for the computer aided dispatch system for the Police department (\$525K) and the purchase of a new patrol vehicle (\$55K). These uses of net position were offset by an approximate \$1.1 million transfer from the Town’s General Fund to the Town’s Workers Compensation Internal Service fund.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

**Changes to the Original Budget**

Comparing the FY 2019/20 original budget (or adopted) General Fund expenditures of \$43,256,352 (excluding budgeted transfers-out and debt payments that are reimbursed) to the final adjusted budget of \$47,997,219 indicates a net increase of approximately \$4.7 million. Additions to the original expenditure budget included adjustments approved by Town Council throughout the fiscal year.

| Original Budget<br>GF Expenditures | +   | =               |
|------------------------------------|---|-----------------|
|                                    | Misc. Adjustments &<br>Mid-Year Adjustments | Final<br>Budget |
| \$43,256,352                       | \$4,740,867                                 | \$47,997,219    |

The increase in General Fund appropriations occurred primarily from the following selected budget adjustments made during the fiscal year.

- Use of \$4,232,500 of Pension/OPEB Reserve to make additional discretionary payments (ADPs)
- \$122,820 expenditure budget adjustment for Transportation Analysis Guideline development consultation services from available General Plan Deposit Account
- \$102,000 expenditure budget adjustment for police safety equipment utilizing grant received by the Town
- \$54,797 budget expenditure for tasers and cameras from available Equipment Replacement Fund balance
- \$50,000 expenditure budget increase due to increased water utility costs for Town Parks.
- \$47,000 for tree service expenses from available Tree Replacement account
- \$24,219 increase expenditures for Youth Collection to utilize Library Grant received by the Town
- \$22,677 expenditure budget adjustment traffic signal controller’s equipment and service
- \$22,669 increase to salary and benefits for the Town Manager and the Town Attorney
- \$16,165 expenditure budget increase to move temporary FTE hours inadvertently budgeted in the Facilities Maintenance Internal Service Fund.
- \$15,000 to fund additional services by the Town of Los Gatos Chamber of Commerce
- \$10,800 expenditure budget increase for Emergency Operation Center equipment utilizing grant received by the Town

- \$20,220 miscellaneous budget increase in various programs

### **Variance with the Final General Fund Budget**

The General Fund Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual (GAAP) for Fiscal Year Ended June 30, 2020 reports an approximate overall favorable variance with the final budget of approximately \$2.1 million. This favorable variance was created largely by the net effect of the following factors:

- Approximately \$661K of expenditures below budget for FY 19/20 work paid from General Plan Update fees (a dedicated revenue source which funds this expenditure). All savings in this budget are carried over to the next fiscal year to be continue the General Plan Update project.
- Actual revenues ended the fiscal year at \$1.6 million below final budgeted revenues. Unfavorable variances from budget were experienced beginning in March 2020 related to the COVID-19 pandemic and its related restrictions. The following economically sensitive revenues experienced declines:
  - An unfavorable variance of (\$1.2 million) sales tax collections
  - An unfavorable variance of (\$1.0 million) Transient Occupancy Tax collections
  - An unfavorable variance of (\$619K) in licenses and permits
  - An unfavorable variance of (213K) in fines and forfeitures
  - An unfavorable variance of (202K) in charges for services
- A favorable variance of \$1.6 million in investment earnings for year. The Town received additional investment earnings for the year in its pension/OPEB trust which was not anticipated during FY 19/20 budget development and a positive trend of interest rates leading to additional interest accrued in year end mark to market valuations.

Significant factors affecting actual expenditures include:

- Community Development expenditures reflected a \$1.3 million favorable variance explained largely by staff vacancies with salary and benefit savings of approximately \$332K, and the General Plan Update expenditures being approximately \$661K lower than budgeted because the budget reflected the entire contract amount which has not been fully executed through the end of the fiscal year. An additional \$208K favorable variance reflects the fiscal year actual activity in the Department pass through program that depends on the timing and the volume of the development projects.
- Public safety expenditures had a favorable variance of approximately \$1.2 million. An \$839K saving is reflecting limited term vacancies in Police Officer, Police Record Specialist,

and Dispatcher positions, and savings of \$363K due to decreased service cost of crossing guards and parking violation services, and travel activity due to the Shelter in Place order.

- Administrative Services reflected a favorable balance of approximately \$501K in large measure due to savings in salary and benefits due to partial year vacancies in the Finance and Clerk Departments positions and savings in special events cost due to cancellation of events.
- Parks and Public Works reflects a favorable variance of approximately \$190K reflecting partial vacancies during the year.
- Library services reflected a favorable variance of \$260K due mainly to salary and benefit savings from staff vacancies in the Library Technology Specialist position and other temporary vacancies.

## **CAPITAL ASSETS**

As of June 30, 2020, the Town's investment in capital assets for its governmental activity is recorded at \$111,700,225 (net of accumulated depreciation). The investment in capital assets includes land, buildings and improvements, infrastructure, construction in progress, and machinery and equipment. Capital assets increased \$4.2 million net of depreciation expense totaling approximately \$3.9 million for the year.

During FY 2019/20, the Town's approximate \$7.8 million investment in capital assets for the current year represented approximately 4.1% of total assets for governmental activities. Major capital asset events during the current fiscal year include the following:

- \$5.8 million in street repair and resurfacing and curb and gutter work Town-wide, approximately \$0.7 million to complete the Almond Grove Street Rehabilitation project;
- \$0.7 million in equipment purchases, including \$0.5 million in vehicle fleet replacements, and \$0.2 million in mobile cash barriers, license plate recognition system, and other building improvements;
- \$0.4 million in traffic signal improvements;
- \$0.4 million expended on building improvements, retaining walls, park improvements, and parking lot improvement projects;
- \$0.3 million in bicycle and pedestrian improvements; and
- \$0.2 million in energy efficiency upgrades made to the Town's facilities among other current year capital projects.

**Town of Los Gatos**  
**Net Investment in Capital Assets**  
**For the Year Ended June 30, 2020**

|                          | Governmental<br>Activities |
|--------------------------|----------------------------|
| Infrastructure           | \$ 63,337,364              |
| Buildings                | 23,341,210                 |
| Land                     | 20,294,810                 |
| Equipment                | 2,682,698                  |
| Construction in Progress | 2,044,143                  |
|                          | <b>\$ 111,700,225</b>      |

Additional information on the Town’s capital assets is found in Note 5 of this financial report.

**ECONOMIC FACTORS AND NEXT YEAR’S BUDGETS AND RATES**

A product of an ongoing examination of how the Town provides cost-effective services, the Town’s budget emphasizes outcomes or results for the community and allows for longer-term financial planning decisions.

During the development and adoption of the Town’s FY 2020/21 budget, the Town Council and management considered the following factors:

- In response to the economic impact of COVID-19 pandemic, the Town modified its revenue forecast downward in the FY 2020/21 Budget. For additional details, see Note 15. The FY 2020/21 operating budget is a balanced budget, with the use of General Fund reserves dedicated for one-time uses. The FY 2020/21 Budget reflect maintaining high service levels with little to no increases in the employee headcount. The budget identified contingencies should revenues come in below projected amounts. The Town is carefully monitoring its revenues sources and will identify any modification at the mid-year budget discussion.
- The Town continues to focus on priority issues that involve maintaining public safety and Town infrastructure including streets and parks; and providing library, community development, and other services. These priorities are coordinated with other Core Goals that protect the Town’s fiscal health and ensure cost efficient and effective delivery of Town-wide administrative services. The Town’s proactive approach to reducing operating expenditures, identifying revenue enhancements, and implementing operating efficiencies has been an effective fiscal approach.
- Specific trends affecting the fund balance forecast include:
  - General property tax collections represent approximately 32.1% (not including the State’s property tax “backfill” shifts) of the Town’s General Fund revenues. Property tax collections are expected to increase 3.9% in FY 2020/21 from the prior year’s tax

collections. This increase is primary due to the additional tax collection from the recently annexed parcels. This forecast is based on data from the Santa Clara County Tax Assessor's Office. The Town closely monitor its actual collection and other legislative changes regarding property tax. See Note 16 for more detail.

- The Town anticipates a decrease in general sales tax for FY 2020/21. Sales tax estimates of \$7.9 million for FY 2020/21 were budgeted reflecting a 0.2% decrease from the prior year's adopted sales tax budget.
- The Town's investment portfolio experienced a slight decrease in its overall weighted average annual yield, reducing from 2.05% at June 30, 2019 to 1.86% at June 30, 2020. Prevailing interest rates at the end of fiscal year were at historic lows due to economic impacts of the COVID-19 pandemic and were anticipated to remain at these low levels for the foreseeable future which will likely lower yields on the investment portfolio in the future.
- Transient Occupancy Tax (TOT) revenues are expected to be significantly lower in FY 2020/21 as personal and business-related travel are susceptible to the economic impact of Covid-19 pandemic.
- The Town's pension plans over the past several decades, like all other CalPERS participants, have experienced unfavorable investment returns, changes in actuarial assumptions, and demographic shifts which have outweighed any positive plan experiences. To address this unfunded status, the Town took proactive steps including initiating the prefunding of OPEB obligations, budgeting and programming additional discretionary pension payments to accelerate reduction of unfunded liabilities, and recently partnering with the Town's employee groups to eliminate the existing retiree healthcare benefit for new employees. Even with these proactive steps, the Town continues to be impacted by the continuing rising cost of pension related benefits. Over the next five fiscal years, the Town's five-year forecast includes increasing pension costs due to further changes in actuarial assumptions or lowering the discount rate. The Town's net pension liability is \$24.7 million for the safety cost sharing plan and \$32.5 million for the miscellaneous plan based upon data from CalPERS. To illustrate the sensitivity of the net pension liability to changes in the discount rate, CalPERS estimates that a 1 % reduction in the discount rate from 7.15% to 6.15% would increase the total net pension liability for both Miscellaneous and Safety by \$26.7 million. Conversely, an increase in the discount rate from 7.15% to 8.15% would decrease the total net pension liability for both Miscellaneous and Safety by \$22.0 million.
- In addition, CalPERS provides a hypothetical termination liability estimate of the plans should the contract with CalPERS be terminated. The plan liability on a termination basis is calculated differently from the plans' ongoing funding liability. Since no future employer contributions would be made in the hypothetical termination, benefit payments are secured by risk-free assets. For the Miscellaneous plan, a 3.25%

termination return rate results in a \$103.1 million termination liability. For the Safety plan, a 3.25% termination return rate results in a \$91.9 million termination liability.

- For detailed information about the Town employees' retirement plan please refer to Note 9 of the Notes to Basic Financial Statements Section.

### **Requests for Information**

This financial report is designed to provide residents, taxpayers, customers, investors, and creditors with a general overview of the Town's finances and to demonstrate the Town's accountability for the money it receives. Questions about this report or requests for any additional information, should be directed to Stephen Conway, Director of Finance, at 110 East Main Street, Los Gatos, California, 95030; email at [sconway@losgatosca.gov](mailto:sconway@losgatosca.gov); or phone at (408) 354-6828.

