



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 12/17/2024

ITEM NO: 14

DATE: December 11, 2024
TO: Mayor and Town Council
FROM: Chris Constantin, Town Manager
SUBJECT: Receive Annual Comprehensive Financial Report for the Fiscal Year Ended June 30, 2024, and Adopt a Resolution Confirming June 30, 2024 Fund Balances in Accordance With Fiscal Year 2023/24 Final Audit and Town Council General Fund Reserve Policy

RECOMMENDATION:

Town staff recommend the Town Council

- a. Receive the Annual Comprehensive Financial Report (ACFR) for the Fiscal Year Ended June 30, 2024 as recommended by the Finance Commission (Attachment 1), and
- b. Adopt a Resolution Confirming June 30, 2022 Fund Balances in Accordance with Fiscal Year 2023/24 Final Audit and Town Council General Fund Reserve Policy. (Attachment 2)

BACKGROUND:

The Town contracts with an independent certified public accountant to examine the books, records, inventories, and reports of all officers and employees who receive, handle, or disburse public funds each fiscal year (FY). The FY 2023/24 audit was performed by Chavan and Associates, LLP an experienced firm specializing in audit services for California public agencies. The firm also assisted with the Draft ACFR for the Town of Los Gatos.

The information contained in the ACFR provides detailed financial information which the Los Gatos community and others can use to better understand the fiscal standing of the Town. In addition, the financial information contained in the document is one element that the credit rating agencies review annually to affix a credit rating for the Town's outstanding debt obligations.

PREPARED BY: Gitta Ungvari
Finance Director

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

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:

(3) Review the Town Manager's draft Annual Comprehensive Financial Report (ACFR) for the preceding fiscal year and provide written comments and recommendations to the Town Manager.

(A) The Town Manager shall respond in writing to the Finance Commission providing his or her rationale for accepting or rejecting each of the Finance Commission's comments and recommendations prior to presenting the ACFR to the Town Council for formal consideration.

(B) The Town Manager may not present the ACFR to the Town Council for formal consideration unless or until he or she considers and responds in writing to all of the Finance Commission's comments and recommendations.

DISCUSSION:

On November 25, 2024, the Draft FY 2023/24 Annual Comprehensive Financial Report (ACFR) was posted to the Town's website, and a link was provided to the Finance Commission. Finance Commissioners were given the opportunity to submit written questions to staff. Questions and comments received from Commissioners by 11:00 a.m. on December 2nd were compiled into Desk Items for the December 2nd Special Finance Commission meeting.

At the Finance Commission meetings on December 2, 2024 and December 9, 2024, the Town's independent auditor and staff addressed the Commissioners' questions and comments, which are included in Attachment 4.

The Finance Commission concluded its review of the draft ACFR and unanimously recommended that the Town Council receive the Annual Comprehensive Financial Report (ACFR) for the Fiscal Year Ended June 30, 2024 with recommended modifications (see Attachment 3 for redlined version).

Independent Auditor's Report

The auditor has given the Town's financial statements a "clean" audit opinion for the year ended June 30, 2024 giving reasonable assurance that the financial statements are "free of material misstatement" (Attachment 1).

Purpose of the Budget and Annual Comprehensive Financial Report

Our Town's budget is more than just numbers—it is a plan that ensures we use our resources efficiently and effectively, prioritizing our most important goals. Through this budget, the Town

Council shapes our community's direction and priorities by allocating financial resources. The Annual Comprehensive Financial Report reflects the activities and financial condition of the previous year, serving as an essential document for residents, taxpayers, and other stakeholders to assess the Town's financial standing. While both documents are critical, they do not provide the complete picture of the financial or operational reality of the Town.

Forecasting Our Finances

The FY 2024/25 budget projections are based on economic trends and forecasts specific to our area. These estimates, informed by local data from the County of Santa Clara and consultants such as Avenu Insights & Analytics, help predict revenue from sources like taxes and government grants. Expenditures are carefully reviewed by departments and the Finance Department and are incorporated into the budget with a vacancy savings factor of 4.6%, reflecting the Town's historical trend of not fully expending predicted salaries and benefit costs. Overall, the Town is financially stable and secure for the foreseeable future. During the FY 2023/24 fiscal year, the Town-wide Statement of Activities reported an increase in net position of \$5,883,955—a measure of the change in the value of assets impacted by Town operations during the year. This net position includes \$3,129,616 from investment earnings, driven by high interest rates and unrealized gains due to the requirement to value current investments at market value as of June 30. Additionally, revenue exceeding budget estimates and expenditures coming in below projections contributed to this positive change.

This increase in net position reflects a broader trend, with eight of the last nine years showing positive net position growth. In the General Fund—the primary operating fund for Town operations—the available resources for the next fiscal year have also increased. While encouraging, the increase in net position can be significantly influenced by market interest rate fluctuations, liability payments (including pension costs), and operational and capital expenditures. Additionally, accounting standards do not account for future capital costs beyond depreciation, meaning deferred capital needs could substantially impact future financial performance. Rising costs in key Town operations and contracted services also pose challenges that could outpace revenue growth.

Despite our stable position and financial cushion, maintaining this stability will require fiscal prudence and foresight to address future challenges.

Emerging Financial Challenges

Although we have experienced financial gains, we are facing significant cost pressures. Rising costs for basic services—including salaries, benefits, and contracting—are compounded by volatile pension costs, which have fluctuated dramatically in recent years. The competitive Silicon Valley market and increasing regulatory requirements on local governments also drive up the cost of services and materials.

A major concern is the lack of preparation to fully fund or quantify the liabilities and annualized costs for maintaining our infrastructure – such as roads, parks, and buildings. These deferred maintenance needs could add millions to future expenses. The cost per mile of infrastructure repair continues to rise, leading to tradeoffs between non-capital and capital priorities. While progress has been made in identifying some of our needs, the Town is quite a ways from achieving a sustainable investment to address its substantial capital liabilities.

Sales tax, our second-largest revenue source, is expected to stagnate or decline due to reduced consumer spending capacity, higher costs, and the loss of high-tax businesses like car dealerships. In FY2023/24, sales tax revenue dropped 8.3% from the previous year to approximately \$8 million, aligning with the Town's historical average over the past decade. This flat revenue trajectory, combined with increasing operational and capital costs, poses a significant budgetary challenge.

Additionally, the region's economy is heavily influenced by industries affected by geopolitical dynamics. These dynamics could impact employment, property and transfer tax revenue, fees, occupancy taxes, and sales taxes, further adding uncertainty to the financial outlook.

Proactive Financial Strategies and Sustainable Financial Planning

It is essential for us to continuously monitor and evaluate our long-term financial sustainability, balancing major capital needs with the provision of essential services. Los Gatos is currently in a relatively strong financial position, supported by significant reserves. However, we must remain vigilant and prepared to address rising operational and capital costs that could outpace revenue growth. Our goal is to preserve the exceptional quality of life in our community through prudent and strategic financial management.

To achieve this, the Town must work to fully identify the true costs of basic operations as well as additional programs and services, comparing these costs to our capacity to sustain such activities over the long term. While our overall financial position is balanced, our focus must shift to achieving a sustainably balanced budget that ensures efficient and effective delivery of services at a level supported by available resources.

Key efforts in this direction should include:

- Establishing a shared understanding of our current and projected financial condition.
- Defining the basic and enhanced services provided to residents and businesses.
- Taking deliberate steps toward long-term financial sustainability.
- Identifying system and process improvements that reflect careful planning in how Town activities are delivered, ensuring accountability to those who fund these services.

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These initiatives require a multi-year approach, and I am confident we can make meaningful progress in the years ahead.

Fund Balance Resolution

The Governmental Accounting Standards Board (GASB) Statement No. 54, Fund Balance and Governmental Fund Type Definitions requires that the Town Council of the Town of Los Gatos classify governmental fund balances as restricted, assigned, or committed fund balances with formal actions. Staff is requesting the Town Council adopt a resolution confirming June 30, 2024 Fund Balances in accordance with FY 2023/24 Final Audit as listed Attachment 2.

CONCLUSION:

As noted in the auditor's opinion, the ACFR fairly presents the fiscal year ending June 30, 2024 financial activity for the Town of Los Gatos.

FISCAL IMPACT:

There is no fiscal impact associated with this item.

Attachments:

1. Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2024
2. Fund Balance Resolution Establishing June 30, 2024 Fund Balances
3. Redlined Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2024
4. Town Manager's Responses to Commissioners' Questions and Comments