

Comments and questions on the FY 2024-25 Draft Annual

The following are comments, questions, and recommendations made by members of the Finance Commission. In accordance with Section 2.50.225 (a)(3), the Finance Commission is to review the [Annual Comprehensive Financial Report] and the Town Manager is to respond in writing regarding their rationale for accepting or rejecting each comment and recommendation. The following responses as well as the changes proposed in Attachment 1 represent the Town Manager's written response.

In addition to the written comments submitted before the meeting, the Commissioners requested further clarification and a more detailed explanation of the Transmittal Letter, the Management Discussion and Analysis (MD&A), and other sections of the Annual Comprehensive Financial Report (ACFR). In addition, questions were raised that were either answered at the meeting verbally or were not relevant to the ACFR.

Questions, Comments related to the Transmittal Letter

1. On page 16, Letter of Transmittal, a comment is made that "current and previous Councils have allocated additional discretionary pension funding totaling \$10.4 million". It may be helpful to provide a schedule of payments made in Note 11. There is reference on the Town website but the latest entry appears to be in June 2014. If there has been more recent activity it should be noted.

Added. Staff removed the obsolete language from the Transmittal Letter. Staff will update the website with all the relevant information. All the CalPERS actuarial reports are available on the Town website.

~~To address the escalation in pension costs, current and previous Councils have allocated additional discretionary pension funding totaling \$10.4 million. These additional discretionary payments should ultimately yield an approximate \$12.7 million in pension contribution savings. In addition to the management of the Town's pension obligations, prior Councils have worked to curb cost escalation in Other Post Employment Benefits (OPEB). In 2009, the Town initiated prefunding of retiree healthcare benefits and has since established approximately \$30.3 million in OPEB assets from zero in 2009.~~

2. Along the same lines in the Letter of Transmittal, there is reference to the Town providing "extensive information on pension and OPEB information on the Town's website". Can you confirm the Town website is up to date? When I viewed the Town Pension and OPEB Plans Information on the website the Unfunded Accrued Liability data was as of 2021.

Not Added. Staff will review and update the website to ensure that the most up-to-date information is available.

3. Transmittal Letter - Provide a year-over-year comparison and remove any reference to the current year.

Added. Please see the updated language below.

As with most municipalities, services are provided directly by employees to the Town's residents, businesses, and visitors. As a service delivery enterprise, the cost of salaries and benefits are a significant portion of the Town's expenditures. Salaries are largely dictated by regional market forces as evidenced by fierce competition for talent in the San Francisco Bay Area, and inflationary pressures nationwide. During the Summer 2024, the Town successfully completed negotiations with all bargaining units for three fiscal years. Salaries increased \$0.8 million from the prior year. ~~While important for the consistent delivery of high quality services for the Town, these actions impact the balance between ongoing revenues and expenditures. Due to conservative fiscal practice and significant salary savings, General Fund expenditures were lower due to salary savings; however, not every department was able to achieve the targeted 4.6% vacancy savings. As the Town continues successful hiring, tradeoffs to achieve projected savings will be necessary should a 4.6% vacancy factor not be achievable.~~ In addition, non-pension benefits increased by \$0.7 million, primarily due to rising costs associated with health insurance, and related employee benefit programs. These increases are reflected in the overall personnel expenditures and contribute to the year-over-year variance.

4. Transmittal Letter – Clarify the Sales Tax year-over-year comparison; the explanation is not consistent.

Added. Staff removed non-relevant language. See updated information.

The Town also depends on sales tax revenues to fund General Fund operations, which made up about 14.4% of total General Fund revenues in FY 2024–25. Sales tax receipts for the year reached \$8.3 million, a \$0.3 million increase from the previous year, indicating modest growth. ~~This trend reflects broader changes in the local economy and shopping habits, such as increased use of electric vehicles, which has led to decreased fuel purchases.~~

5. Transmittal Letter – Add information related to the growth in the pension expense.

Added. See updated information.

The Town also continues to adjust and prepare for pension employer costs to continue to be a primary expense in conjunction with salaries. Pension-related benefits increased by \$0.8 million compared to the previous year. For the year ended June 30, 2025, the Town recognized a pension expense of \$12 million compared to \$11.2 million in the prior fiscal year. The Town's pension plans over the past several decades, like all other CalPERS participants, have experienced changes in actuarial assumptions, demographic changes, and volatile investment returns which have outweighed any positive plan experiences. The outcome of these unfavorable economic and demographic conditions is the creation of unfunded pension and Other Post-Employment Benefits (OPEB) obligations for the Town. According to the 2024 CalPERS actuarial valuations, the unfunded actuarial liability for pensions was \$ 62.2 million and \$7.5 million for OPEB, as determined by an actuarial valuation as of June 30, 2023.

Questions, Comments related to the MD&A

6. MD&A – Net Position Change – Provide a more detailed explanation.

Added. See updated information.

- The Town's total net position increased by \$7.3 million in FY 2024-25. The overall increase of \$7.3 million is primarily due to the combined effects of ~~the \$7.5 million increase in Capital Assets infrastructure capitalization and changes in pension expense,~~ \$7.8 million decrease in Deferred Outflows, and \$1.8 million decrease in Deferred Inflows related to Pension and OPEB expenses; and \$5.3 million decrease in liabilities. These combined changes reflect the Town's continued investment in infrastructure and the impact of variability in net pension and OPEB obligations. This variability is influenced by the difference between the plans' actual investment earnings and the assumed rate of return during the measurement period.

7. MD&A – Statement of Activity - Charges for Services - Provide a more detailed explanation.

Added. See updated information.

Total Government-Wide Revenues increased by \$5.5 million.

Program revenues increased by approximately \$4.9 million compared to the prior fiscal year. A key component of this increase—\$1.5 million—is due to a reclassification of fees collected from the garbage hauler company. In FY 2023–24, these fees were reclassified from franchise fees to license and permit fees as a result of changes in the JPA agreement, and are now reported under the Charges for Services category in the Statement of Activities. This reclassification resulted in a \$1.5 million decrease in franchise fees and a corresponding \$1.5 million increase in Charges for Services, with no net change in total collections from the garbage hauler company; however, it does affect year-over-year comparability. The remaining \$2.9 million increase in program revenues is primarily attributable to a \$1.5 million increase in business license tax collections, due to timing differences in license payments crossing fiscal years, and a \$1.7 million increase from increased development activity, partially offset by a \$0.3 million decrease in revenues from street sweeping and crossing guard services, which were contracted out in FY 2024–25.

~~The majority of this increase, \$4.4 million, was due to higher charges for services driven by a rise in development activity and increased encroachment fee collections from the Town's garbage hauler.~~

The Town's general revenues related to governmental activities increased by approximately \$0.6 million compared to the prior year. This increase was primarily driven by a \$1.0 million rise in property tax revenues, a \$0.7 million increase in investment earnings, including mark-to-market adjustments on the Town's investment portfolio—and a \$0.3 million increase in sales tax collections. These gains were partially offset by a \$1.5 million decrease in franchise fee collections. ~~Starting in March 2024, due to a change in the JPA agreement, Garbage Franchise Fees were categorized as Licenses and Permits under Charges for Services.~~ The total amount of the Encroachment Fee was \$2.3 million in FY 2024-25 and \$0.8 million in FY 2023-24.

Property tax is the Town's largest individual revenue source, and collections for the year were \$1.0 million more than the previous year. This increase was primarily due to a \$0.8 million rise in general property tax collection and a \$0.2 million increase in the Vehicle License Fee (VLF) Property Tax In-Lieu fee. It is important to note that assessed valuations for FY 2024-25 were established on the tax roll in January 2024 and collected during FY 2024-25.

Sales taxes totaled \$8.3 million for the fiscal year, making them the second-largest individual General Fund revenue source for the Town. This represents an increase of \$0.3 million from the prior year. The modest growth reflects stable sales tax collections from business-to-business transactions. ~~Additionally, reduced activity at gas service stations, attributed to the growing adoption of electric vehicles—also contributed to the slower pace of sales tax growth.~~

~~Franchise taxes finished the year at \$1.1 million, reflecting a decrease of \$1.5 million from the previous fiscal year. Franchise fee collected from the garbage hauler company was reclassified as license and permit fees during FY 2023-24. In the statement of activity, the license and permit fees are categorized as charges for services.~~

8. MD&A – Break out the \$2.3 million Salaries and Benefits increases components

Added. See updated information. Please note, information included in multiple areas, all of these were updated.

Total Governmental Funds revenues increased by \$8.9 million, or 14.5%, compared to the prior year, primarily due to higher capital grant activity and increased collections from property taxes, interest income, sales taxes, and business license taxes. On the expenditure side, total spending rose by \$6.3 million, or 10.2%, mainly driven by a \$3.2 million increase in capital outlay, a \$2.3 million rise in salaries (\$0.8 million) and benefits (\$1.5 million) costs, and \$0.9 million in additional internal service charges combined with operational changes.

9. MD&A – Expand and clarify the interest income comparison, emphasize the non-spendable nature of the mark-to-market adjustment.

Added. See updated information.

Investment earnings for the fiscal year ended June 30, 2025, totaled \$2.6 million, representing an increase of \$1.2 million from the prior year. This growth reflects improved interest income from the Town's investment portfolio, due to a higher interest rate environment. Additionally, the Town recorded \$1.2 million in unrealized gains from mark-to-market adjustments, which, while positive, were \$0.5 million lower than the prior year's unrealized gains of \$1.7 million. ~~Overall, the combined increase in realized earnings and moderate unrealized gains contributed positively to the Town's general revenues and financial position.~~ The \$1.2 million unrealized gain is an increase in the value of the asset that has not been sold and is not available for spending.

10. In the MD&A section regarding the change in the JPA agreement, is there any further explanation that can be provided? Because this generates a significant increase in License & Permits, it may be useful to offer some additional details for the shift in contract or policy.

Added. Staff rewrote sections of the explanation to ensure that the reclassification and related year-over-year change explanation is clear. Please see the redlined version under Question 7.

11. Further down the MD&A discussion, there is comments made on investment earnings. Given the potential for variability in this category, it might be beneficial to include a disclosure addressing the non-spendable nature and the risk of reversal of this item. Expand and clarify the interest income comparison, emphasizing the non-spendable nature of the mark-to-market adjustment.

Added. Staff clarified the language regarding the item's non-spendable nature. Please note that the Market fluctuation reserve is explained in Note 10. See redlined version below.

Investment earnings for the fiscal year ended June 30, 2025, totaled \$2.6 million, representing an increase of \$1.2 million from the prior year. This growth reflects improved interest income from the Town's investment portfolio, due to a higher interest rate environment. Additionally, the Town recorded \$1.2 million in unrealized gains from mark-to-market adjustments, which, while positive, were \$0.5 million lower than the prior year's unrealized gains of \$1.7 million. ~~Overall, the combined increase in realized earnings and moderate unrealized gains contributed positively to the Town's general revenues and financial position.~~ The \$1.2 million unrealized gain is an increase in the value of the asset that has not been sold and is not available for spending.

12. There is an entry for “Miscellaneous Revenue” in the Statement of Activities on page 35. I was not able to determine the components. Would staff be able to provide a breakdown of the items included or direct me to the appropriate disclosure? The amount seems material enough to specify.

Added. Please see the added language.

Miscellaneous Revenue increased by \$0.1 million from the prior year. This category includes many different items, primarily \$0.5 million in revenue recognized for Capital Projects, received through developer contributions and cost-sharing agreements with local governments and utility companies. Additionally, the Town received \$0.4 million in insurance reimbursements related to property damage and workers’ compensation claims. Another \$0.2 million was contributed by nonprofit organizations, including the Friends of the Library and the Police Foundation.

13. Provide clarification regarding the total expenses change in the Statement of Activities

Added. Please see the added language.

Total expenses for the year, as reported in the Statement of Activities, were \$62.7 million, an increase of \$4.1 million from the prior year’s total of \$58.6 million. The primary driver of this increase was in \$3.5 million ~~in-capital~~ expenses in the capital program that ~~did not meet the criteria for capitalization~~ is not capitalizable and reported under Parks and Public Works expenses in the Statement of Activities. These expenditures included costs related to vegetation management, implementation of the parking program, and the creation of storm drain system maps.

Questions, Comments related to the Required Supplementary Information

14. Page 111, Schedule of Pension Plan Contributions, details the Safety Plan and a substantial increase in the "Contributions as a % of Covered Payroll". Can staff explain the primary drivers of this increase and how these factors are reflected in the Town’s long-term financial projections?

Not added. The covered payroll figure reflects the actual payroll reported to CalPERS. The Pension Plan Contribution includes both the normal cost and the CalPERS-required lump sum payment. It is important to note that the Police Department experienced significant vacancies, which contributed to a decrease in the covered payroll. However, despite the reduction in payroll, both the normal contribution rate and the required lump sum payment have increased. The Town anticipates that pension costs will increase in the future, as highlighted in the ACFR.

Additional Questions

15. Were there any adjustments or reclassifications to the statements as prepared by the Town's staff in the accounting department?

Not added. The Independent Auditor addressed the Commissioner's question, and there were no significant adjustments or reclassifications per the Auditor.

16. Were there any recommendations for improving the internal accounting controls?

Not added. The Independent Auditor confirmed that there were no recommendations for improving internal accounting controls by the Auditor

17. In Note 13, I learned we have two JVs. These are PLAN JPA and LAWCX. These are not integrated into our financial statements because different boards administer them. However, we, as the Finance Commission, we are advising on the size and purpose of the catastrophic and stabilization reserves... so it would be very helpful to understand how these JVs could protect us in a crisis... such as in the case of a forest fire?

Not Added. Staff addressed this question verbally during the meeting. This is essential information, and staff will review it with the Consultant and the Finance Commission during the Asset Liability Management (ALM) Study.

18. Why only 0.75 FTE in economic development? I'd welcome the chance to see what this person is working on whether a more robust ED team might find ways to increase town revenues. IE Can we think of an economic development person (FTE) as an investment in the future? With an expected return in terms of future revenues?

Not Added. This is not relevant to the ACFR. The Town verbally addressed this question at the meeting. The Town FY 2025-26 Adopted Budget, starting on page D-51, describes the Town's Economic and Community Vitality Department Work. Together with the Community Development Department and other Town Departments, Economic Vitality staff strives to provide high-quality customer assistance and cross-departmental coordination that is tailored to the needs of individual businesses with the end goal of assisting each business with finding a successful path forward in Los Gatos. Additionally, Economic Vitality staff facilitates contact for services with the Los Gatos Chamber of Commerce for the implementation of Visit Los Gatos, the Town's visitor information center, website, and destination marketing program; and coordinates and implements the Town's Leadership Los Gatos program. Increasing the team and effort is a good question to consider in future budgetary planning.

Changes recommended by additional staff review.

Staff identified additional updates to the draft ACFR to ensure consistency throughout the document. One such update corrects the 2024–25 Contractually Required Contribution to \$3,929,739 on page 98, aligning it with the presentation on page 82. This correction was previously shared with the Finance Commission in the December 1, 2025, Desk Item.

Another update adjusts the Market Fluctuation Reserve from \$1,340,098 to \$1,201,824 and increases the Pension/OPEB Reserve from \$1,000,000 to \$1,300,000, in accordance with the General Fund Reserve Policy. The Unassigned Fund Balance is also revised—reflecting both an increase of \$238,274 and a decrease of \$300,000—resulting in a new total of \$10,211,049. These changes are reflected across multiple schedules, including the Governmental Funds Balance Sheet (page 41), Note 11 – Fund Balance, the Governmental Funds Statistical Schedule (page 131), and related graphs and references in the MD&A. Additionally, footnotes in the Statistical Section – Net Position by Component were updated to match the prior year’s schedule, correcting a portion of the footnote that was unintentionally omitted on page 127. All updates have been redlined in the attached ACFR.