
Subject: Agenda Item #7
Attachments: City of Irvine Budget Development Cycle.pdf; Council letter - June 2-final.docx

From: Phil Koen
Sent: Sunday, May 31, 2020 4:31 PM
To: Marcia Jensen; Marico Sayoc; BSpector; Rob Rennie
Cc: Laurel Prevetti; Rick Van Hoesen; Jak Van Nade; Lee Fagot; Catherine Somers; Matthew Hudes; Heidi Owens; Maria Ristow; Rob Stump; Peter Hertan
Subject: Re: Agenda Item #7

Dear Honorable Mayor and Council Members,

Agenda Item 7 requests the Council to adopt a resolution approving the FY 2020/21 operating and capital budgets, including making new appropriations, carryforward appropriations and a second resolution approving commitment of fund balances under GASB 54. We have requested that this agenda item be removed from the consent calendar due to the importance of both resolutions and we believe further public discussion is required before voting on any budget related resolutions. The Mayor has assented to this request, and that is why you will be able to discuss the budget in open session.

We want to remind the Council that the 746-page budget document was released for the first time to the public on May 11, and publicly deliberated at one Council meeting on May 19 for 2 ½ hours. The Council made no changes to the proposed budget at that meeting. At a second Council meeting on May 26, the Council discussed the specific need to establish funding for economic recovery and community vitality in response to the COVID 19 crisis and directed the Staff to “repurpose” funds in an existing capital project. That is the total extent of public review of the FY 21 budget.

The Council never requested the Finance Committee, which consists of three non-voting resident financial experts, to provide any recommendations or comments regarding the FY 21 budget. Many cities that have active Finance Committees hold joint Council/Finance Committee Study Sessions to openly discuss the proposed operating and capital budgets. For whatever reason, the Council has not adopted this approach.

Furthermore, the Staff never scheduled nor held any community budget meetings which would have allowed residents to review and discuss a baseline budget and provide community-based input prior to the budget being fully developed. The only public input we are aware of was a “Monkey Survey” that was posted on the Town’s website asking a hypothetical question regarding the use of a theoretical \$1m surplus from the prior year. Frankly, this felt like a publicity stunt rather than a legitimate public outreach for ideas and input.

The Staff has not provided any explanation as to how this survey was used to establish FY 21 spending priorities, especially against the backdrop of the COVID 19 crisis. It is within this context that we are requesting the Council to discuss the appropriateness of the proposed budget after considering the recommendations we have made.

We again draw your attention to how other cities, such as the City of Irvine, approach the budget development cycle. We have attached a document which outlines the process that the City of Irvine

uses. We recommend that the Council as part of the approval process for the FY 21 budget, pass a resolution adopting a budget development process like the one outlined by the City of Irvine. This process could then be used in the development of the FY 22 budget. We believe the current process is broken and needs overhaul.

In closing, we respectfully request the Council discuss each of the recommendations we have made and to consider making the changes to both the budget and enabling resolutions we have identified.

We will not be attending the virtual Council meeting on June 2 because we have (under separate cover) provided you with detailed analysis and recommendations in advance of that meeting. We do not feel it would be a productive use of the precious little time for public comment saying what already has been said. We believe the time we have invested in preparing our written communication speaks for itself.

Thank you.

Los Gatos Community Alliance

Phil Koen

Rick Van Hoesen

Jak VanNada

May 31, 2020

Re: Agenda Item #7

Dear Honorable Mayor and Council Members,

The Staff recently posted the following “claim” on the Town’s website:

“Over the years, the Town’s conservative budgeting practices have resulted in healthy reserves and frequent annual budgetary surplus. Those reserves and surpluses are now paying the Town huge dividends”.

Setting aside the question of whether such obviously self-congratulatory statements are appropriate on the Town’s website, the statements are simply not accurate. We have been warning this Council for some time that the budgeting practices employed by the Staff consistently result in the misallocation of the Town’s precious financial resources. To steal a phrase often used by our Town Manager, the budgeting practices are “irresponsible”.

We do not have to go any further than to point to the escalating unfunded pension and OPEB liabilities that have added over \$65 million in debt to our statement of net position as proof of this misallocation. If the budgeting practices have been so conservative over the years, why has the Town’s unrestricted net position (think of this as “equity”) gone from a positive \$47.2m in FY 2010 to a negative \$4.6m in FY 2019? That is a decline of over 51 million dollars in just 10 years! The Town has been digging a hole of over \$5 million per year for the last decade.

We would argue that this year’s budget is the most important decision you will ever make about the financial condition of this Town given the economic havoc that COVID 19 is causing at the local and state level. The Council must get this budget right.

Recommendations regarding the budget:

We have several specific recommendations we would like to make regarding the proposed budget:

1. The budget for salary and benefits is purposely inflated by approximately \$1.5m. This is because the budget does not include a vacancy factor, and the salaries used for budgeting purposes are not the actual projected pay rates for the positions. This is not a “conservative budgeting” practice and is absolutely counter to the best practices recommended by the Government Finance Officers Association (GFOA). We recommend that the budget be adjusted to reflect a vacancy rate of at least 5%, which is substantially below the projected vacancy rate of 10% and below historical vacancy rates experienced by the Town. In addition, actual pay rates plus an allowance for promotions should be used and not the inflated top-of-range pay rates currently shown in the draft budget.

2. Because salary and benefit expenses are purposely inflated, the FY 21 budget is in a “structural deficit” of approximately \$1.7m. This has resulted in the Staff recommending that the Council use \$769,308 from the Capital/Special Project Reserve to help “balance” the budget and provide funding for the one-time staff bonuses that were just approved, along with critical services such as tree maintenance and engineering services. This is an irresponsible use of this reserve and would not be required if the budget for salary and benefits were properly constructed. We recommend that the Council “fix” the source of this structural imbalance and not appropriate any funds from the Capital/Special Project Reserve, which the Town Manager has constantly reminded us is the only source of funds available for future capital projects.
3. The Council has received considerable public input regarding the need to invest in Hillside fire fuel reduction. Fire protection has been identified as one of the strategic priorities for FY 21. And yet the proposed budget includes only \$250,000 for hillside fuel reduction. Here again if the salary and benefit expenditures were budgeted accurately, the budget savings could be shifted to hillside fire fuel reduction. After taking into consideration the \$769,308 discussed above, an additional \$500,000 could be allocated to this project. We recommend that the above budget adjustments be made.

There are other areas where the proposed budget has inflated estimates for FY 21 expenditures. For sake of brevity we have focused only on the most obvious example, salary and benefit expense. But to put this in perspective, the budget the Town Manager has recommended to you contemplates general fund operating expenditures increasing 10%, or \$4.6m, over the projected FY 20 spending level. Considering COVID 19, does this make any sense to you? Why is this prudent? We know of no other city in the Bay Area projecting that level of spending increase when comparing prior year estimates to the FY 21 budget. Palo Alto for example is planning for budget cuts of over \$38 million in the coming year. What can possibly be the justification for Los Gatos planning on a spending *increase* of \$4.6 million in this environment? Fixing the salary and benefit budget issue will make a considerable improvement in this proposed budget, but much additional work remains to be done.

Recommendations regarding the proposed resolutions:

The resolutions being proposed by staff to approve the operating and capital budget and fund balance under GASB 54 have several problems we feel you should be aware of and address before adopting these resolutions:

1. At the May 26 special Council meeting, the Council directed staff to “repurpose” the \$1,972,384 allocated to the downtown streetscape revitalization capital project. The Council repeatedly discussed the importance of maintaining flexibility to redirect the use of these funds given the uncertain nature of the programs discussed to provide economic relief for our local businesses. The proposed resolution does not achieve this goal, because the Staff retained these funds in the GFAR whereby definition they can only be spent on capital items such as installation of barriers or signage. We recommend that these funds be transferred from the GFAR to the General Fund and placed in a committed reserve. This is exactly what the Council did when they earmarked funds for the Almond Grove street project. By doing

this, the Council will have the maximum flexibility to spend these funds not only on capital projects but other programs such as a marketing promotion to encourage people to visit the Town. The resolution as proposed does not appear to be aligned with the Council's direction to provide maximum flexibility.

2. The proposed fund balance resolution grants the Staff authority to use the \$1.2m funds placed in the Surplus Property Reserve to alleviate COVID 19 impacts including revenue declines or unanticipated expenditure cost increases. We believe this is an inappropriate use of these funds since the reserve was established to receive monies from the sale of Town property with the intent to be reinvested in long term capital assets. The Town already has \$5.4m in a reserve for Budget Stabilization, so there is no conceivable reason for the Council to approve an additional \$1.2m for this need. We recommend that the resolution be revised to allow the use of these funds only for investment in long-term capital projects or other purposes as directed by the Council. We should also point out that the Staff is currently projecting a FY 20 surplus of \$2.7m. While we are surprised Staff has not reduced this projection in light of the COVID-19 crisis, the Staff is in the best position to know the current financial situation, and these funds could also be available for budget stabilization in FY 21.
3. The fund balance resolution also authorizes the appropriation of \$769,308 from the Capital/Special Project Reserve for "one-time" funding for staff bonuses, tree maintenance and engineering services. We were surprised to see the inclusion of staff bonuses since this had not been previously disclosed in the budget document. We recommend that the resolution be revised to eliminate the use of this reserve based on our previous discussion regarding the proper budget for salary and benefits. This use will not be required if the budget adjustment is made.

Recommendation regarding establishing various revenue scenarios to stress test the FY 21 Plan:

In our view the proposed operating revenue budget is overly optimistic. The budget assumes on an adjusted basis a **\$600,000 revenue increase from FY 20 estimated revenue**. Considering the economic impact that other cities throughout the Bay Area are projecting on their FY 21 revenue streams, it is hard to believe that the Town will not be equally impacted and experience a year-over-year revenue decline.

While we hope that such an event does not occur, it would be prudent for the Council to instruct the Staff to run several alternative revenue scenarios. For example, what does Staff suggest, and what is the Council prepared to do if the actual revenues are \$3m below the budget or \$5m below the budget? The Council should provide Staff with broad direction as to how the Town should respond to these events. This is a critical time for the Council to adopt a leadership stance and not simply adopt Staff suggestions.

The current budget is a point forecast and offers no insight as to the trigger points and the type of corrective actions the Town would take to respond to a \$3m or \$5m revenue decrease. At what point would the Council determine to draw upon the budget stabilization reserve vs. making spending cuts or even furloughing staff. A prudent FY 21 operating plan would address these potential outcomes. Many

city budgets that we have reviewed have developed various scenarios and have potential identified actions to be taken if the unthinkable occurs. This is a budgeting best practice and we recommend that the Council do exactly that.

Without going through this exercise, it is impossible for the Council to have an informed view as to whether future reductions in service levels will be required. And yet the Staff has clearly established the expectation that there will not be any service reductions when they posted the following on the Town's website:

“In addition, on May 19, 2020, the Town Council moved forward a balanced Operating Budget for fiscal year 2020-2021 with no reductions to service, despite significant revenue and other economic impacts from shelter-in-place.”

We have already pointed out the misleading nature of the “balance budget” claim. But here the Staff are saying they expect “significant revenue and other economic impacts.” Where are these impacts reflected in the proposed budget?

Recommendation regarding monitoring and measuring FY 21 budgetary performance:

The GFOA has published specific recommendations regarding evaluating the actual financial performance relative to the adopted budget. They have made the following recommendation:

Regular monitoring of budgetary performance provides an early warning of potential problems and gives the Council time to consider actions that may be needed if major deviations in budget to actual results become evident. This is an essential input in demonstrating accountability.

We recommend that the Council adopt this practice by holding, at a minimum, a quarterly review of budget to actual operating results. Currently the Council's only mechanism for monitoring budgetary performance is through a mid-year budget performance report that is normally delivered in mid-February. This is almost 8 months into the fiscal year and does not provide the critical time horizon necessary to have an “early warning system” for potential problems.

Consistency and timeliness are particularly important when implementing an effective monitoring process. It is essential that reports are prepared on a routine, widely publicized basis. In addition to monitoring budget to actual results, reasons for deviations should be evaluated. These factors are important in assessing the significance of variations, including whether they are expected to be temporary or longer-term in duration. A properly defined Finance Commission would be the perfect venue to having these quarterly review sessions.

Please let us know if you have any questions on the above. We truly hope that you will act on these recommendations.

Los Gatos Community Alliance

Budget Development Cycle



For more information about the City's budget, join us at Community Budget Meetings.

Community Budget Meetings		
March 5	Lakeview Senior Center	4–5 p.m.
March 6	Orange County Great Park Artist Studios	6–7 p.m.
March 13	Quail Hill Community Center	6–7 p.m.
March 20	Portola Springs Community Center	6–7 p.m.

Visit cityofirvine.org/budget for additional details and to view our budget video.





Irvine Transitions to a Two-Year Budget

Developed in the Context of a Five-Year Plan

Join the City of Irvine in 2019 on its journey to enhance long-term financial planning by transitioning to a two-year budget developed in the context of a comprehensive five-year financial plan.

Why Change the Budget Cycle?

Multi-year financial planning, ongoing monitoring, frequent reporting, and prompt corrective actions when necessary are central elements of sound financial management.

The two-year budget process allows for a more stringent approach to analyzing data, tracking trends and potential problems, and calling for corrective budget action much earlier than in years past. This new enhanced financial planning approach will improve the City's long-term financial management, while also strengthening community engagement.

How Will It Work?

The City currently utilizes a multi-year forecast through the preparation of the five-year Strategic Business Plan and updates the forecast annually as part of the City's budget process. The forecast will be enhanced with greater department details and will continue to provide a long-term look at the City's financial condition and guidance for the two-year budget.

The two-year budget will be developed within the longer-term context of the five-year Strategic Business Plan. During the first year of the two-year cycle, the City Council will receive quarterly revenue and expenditure updates, bringing forward any areas of concern. At the conclusion of the first year of the two-year cycle, the City Council will receive a mid-cycle review of year-end financials. The mid-cycle review process will provide the mechanism to:

1. Ensure that revenue and expenses forecasted at the beginning of the first year remain accurate;
2. Amend the budget to address any significant revenue shortages and/or unknown and unforeseeable expenses; and
3. Allow departments to carryover first-year balances from discretionary savings.

Who Will Review the Budget?

The creation of the City's two-year budget will begin with the Finance Commission reviewing the initial baseline budget in January, followed by the City Council. After receiving input from the community, departments will present detailed and balanced budgets, along with longer-term plans to the Finance Commission in April. Following Commission input, the citywide two-year budget and five-year plan will be presented to the City Council in May for adoption in June 2019.

How Can I Get Involved?

1. Engage with us at a Community Budget Meeting. Please view the back page.
2. Visit cityofirvine.org/budget to view additional materials, including an informational budget development video.
3. Contact the Budget Office with questions at budget@cityofirvine.org.
4. Learn more about the City's continued efforts of fiscal responsibility at our Transparency Portal, cityofirvine.org/transparency.

Subject: Item 7 - Council Meeting
Attachments: Reply to Holly Zappala v2.docx

From: Jak Van Nada; Jak Van Nada
Sent: Monday, June 1, 2020 10:45 AM
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Subject: Item 7 - Council Meeting

Laurel,

Attached in my letter for June 2,2020 Council meeting. It was a response to the Nextdoor posting by the town giving themselves credit for Town's positive cash position.

Council Meeting

6-2-20

Item 7

The Town is taking credit for getting us through the Covid Crisis with “conservative budgeting practices” What they have not told the public is that a major source of the cash is due to making only the minimum payments on the pension debt. The town’s posting, to be completely forthright should have also mentioned that to have that cash available, In the past 5 years the pension and health debt has increased from \$53.1 Million to \$63.7 Million.

In 2001, we did not owe CalPERS anything. Since then, it has been constantly neglected by the Town until it has reached nearly \$64 Million dollars.

The Town has also neglected to tell the citizens that since the early 2000’s, they’ve made minimum payments with only one small exception. Think of what happens on your credit card when you only make “minimum payments”.

While the town only made the mandatory minimum payments on pension and health benefits, they squirreled away the “cash” they did not pay. It was shoveled into many various town accounts – all hidden in plain sight. However, by only paying the minimum every year, the result of that “conservative budgeting practice” has **raised our pension and health benefits by \$10.6 million in the past 5 years!** Every citizen can have more cash in their bank account if they only pay the minimum required on their credit card! The Town will pay much more because they still owe the original amount, plus interest and pension expenses will climb as the pension balance climbs. There is no free lunch.

What is a killer is that the Town has squirrelled this money into various accounts earning around 1.5%. Meanwhile, the debt kept increasing by 7%! This is what the Town calls “conservative budgeting practice”.

One more thing: You have not mentioned that the Town also has **pension expenses which cost us over \$9 Million in 2019 alone!** Conservatively, that is just over **\$40 million** over 5 years. This is another result to the town’s “conservative budgeting practices”.

When the Town posts to NextDoor, please don’t be selective with the facts. Tell the public the whole truth. Be transparent and be honest with the Los Gatos Citizens.

Los Gatos Community Alliance