



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 12/19/2023

ITEM NO: 19

DATE: December 11, 2023
TO: Mayor and Town Council
FROM: Laurel Prevetti, Town Manager
SUBJECT: Review the Revenue Modeling Report Prepared by NBS and Provide Direction on Any Ballot Measures to Consider for Polling.

RECOMMENDATION:

Review the revenue modeling report prepared by NBS and provide direction on any ballot measures to consider for polling.

BACKGROUND:

While costs of providing services and programs for residents have significantly increased over the years, Town revenues have not kept pace. Los Gatos is facing the same economic pressures as many other cities and businesses, including inflation and the uneven recovery from the pandemic. In addition, unfunded mandates by the State have also reduced the Town's available funds.

Los Gatos has taken the following proactive cost-cutting measures during major economic downturns to reduce budget expenditures and control costs while maintaining high service levels:

- Reduced full-time employees by 15% (since 2001) and did not return to pre-recession staffing levels,
- Imposed wage freezes and unpaid furloughs, and
- Reduced employee benefit costs.

Town budgets are reviewed annually by an independent auditor. Los Gatos has earned recognition for its fiscal responsibility with the highest credit rating (AAA bond rating by Moody's) and annual awards by the Government Finance Officers Association for its high quality and transparent budgeting practices.

PREPARED BY: Katy Nomura
Assistant Town Manager

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

BACKGROUND (Continued):

The Town faces a budget deficit of \$3 to \$4 million per year for the projected future. On May 17, 2022, Council acknowledged the Finance Commission's finding that a structural financial deficit exists and requested recommendations on how to cure the deficit.

On November 17, 2022, the Finance Commission reviewed several cost reductions measures and recommended that the Town further work toward operational efficiencies and researching additional revenue options.

On January 24, 2023, the Town Council determined its Strategic Priorities for 2023-2025, which included exploring new revenue opportunities and addressing the forecasted deficit.

In addition to cost containment over the years, the Town has also added the following revenues in an incremental and diversified way:

- November 2016 Measure T increased the Transient Occupancy Tax (TOT) from 10 percent to 12 percent. The 2% increase raises approximately \$400,000 annually in additional revenue.
- November 2018 Measure G creates a 1/8-cent dedicated district sales tax for a 20-year period. The adoption of the dedicated tax provides approximately \$1,000,000 annually in additional revenue.
- In February 2019, Council approved an Ordinance allowing regulated short-term rentals subject to TOT. Approximately \$80,000 of additional TOT is collected annually.
- In June 2019, Council voted to annex 24 unincorporated County pockets. This action results in approximately \$1,000,000 in property taxes remaining in the Town instead of being diverted to the County.
- November 2022 Measure J increased business license taxes for the first time since 1991, raising approximately \$1,100,000 annually in additional revenue.

In an effort to explore new revenue opportunities to address the forecasted deficits, the Town may want to consider a revenue ballot measure in 2024. On June 20, 2023, the Town Council authorized the Town Manager to issue a Request for Qualifications (RFQ) for revenue ballot measure consulting services. After conducting the RFQ process, the Town selected NBS.

On October 17, 2023, Council authorized the Town Manager to enter into an agreement for the initial phase of the work for amount not to exceed \$44,600, with direction to return to Council with revenue modeling prior to beginning any polling.

There was also a request to review efficiencies, cost reduction measures, and the Annual Comprehensive Financial Report (ACFR). An extensive overview of efficiencies was reviewed by Council on August 16, 2022, and staff continues to implement efficiency improvements to address increased workloads, new State unfunded mandates, and

BACKGROUND (Continued):

little to no increases in headcount, without reducing the high quality of work product, internal controls, or the high level of customer service the Los Gatos community expects of the Town. The Town does not have the staff capacity to quantify cost savings associated with these efficiencies and continue to provide expected municipal services.

As described earlier, cost reduction measures were considered by the Finance Commission on November 17, 2022. Another item on this agenda presents the draft ACFR for Council's receipt. It is important to note that the surplus at the close of Fiscal Year 2022/23 represents one-time funds.

DISCUSSION:

NBS conducted a comprehensive evaluation of options to increase revenue for the Town and associated revenue modeling, with the goal of reducing the forecasted annual budget deficits ranging from \$2.8 million in Fiscal Year (FY) 2025/26 to \$3.8 million in FY 2028/29. This included an evaluation of a property transfer tax increase, utility user tax (UUT), special assessment districts, transient occupancy tax (TOT), business license tax, sales tax, and parcel tax scenarios. Each of these options is outlined in NBS' revenue modeling report (Attachment 1). Of the options, NBS recommended either a sales tax or a parcel tax.

Sales Tax

As mentioned in the NBS report, "the current sales tax rate in the Town is 9.25%, of which the Town's share is 1% (not including the Measure G sales tax rate of 0.125%). The Town has the capacity to raise its sales tax rate by an additional 0.125%...If structured as a general sales tax, the Town would only need to secure approval from a majority of the registered voters within the Town to increase the sales tax rate. NBS recommends that the Town move quickly on this option, if desired, as the Town's remaining capacity for a sales tax increase could be utilized by another government agency within the County during the next election cycle." An 1/8-cent sales tax increase would not necessarily cover the Town's ongoing budget deficit but would serve as a good first step.

The following table shows NBS' revenue modeling for FY 2025/26 through FY 2028/29:

Potential Sales Tax Increase	Potential New Total Sales Tax %	Additional Revenue 2025/26 Projected	Additional Revenue 2026/27 Projected	Additional Revenue 2027/28 Projected	Additional Revenue 2028/29 Projected
0.125%	9.375%	\$ 1,062,500	\$ 1,087,500	\$ 1,125,000	\$ 1,162,500

Parcel Tax

According to NBS, "the parcel tax option is the only reliable way to correct the Town's projected deficits with one funding mechanism, however attaining two-thirds approval from voters at the rates that meet that objective may be difficult."

DISCUSSION (Continued):

NBS explored revenue modeling for a parcel tax without senior/low-income exemptions, a parcel tax with senior/low-income exemptions, and a parcel tax on commercial buildings over 25,000 square feet. For the purposes of this analysis, the following revenue targets were used and are referenced as High, Consensus, Middle, and Low:

Revenue Target	Amount
High	\$ 4,000,000
Consensus	\$ 3,500,000
Middle	\$ 2,000,000
Low	\$ 1,000,000

NBS determined the Consensus Revenue Target to show a target that would conservatively address the forecasted deficit. Staff is not recommending this target for a potential revenue measure. It is presented here for illustrative and discussion purposes only.

The following tables show the illustrative results for each scenario.

A. Parcel Tax without Senior/Low-Income Exemptions

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Parcels - per Parcel	\$ 356.19	\$ 311.67	\$ 178.09	\$ 89.05
Taxable Parcels - per Lot Square Foot	\$ 0.0203	\$ 0.0178	\$ 0.0102	\$ 0.0051
Taxable Parcels - per Building Square Foot	\$ 0.14	\$ 0.12	\$ 0.07	\$ 0.03

Average Annual Taxes on Single-Family and Condo Parcels in the Consensus Revenue Target in the Scenario without the Senior/Low-Income Exemptions:

Average of Parcel Tax - By Parcel	Average of Parcel Tax - By LotSqFt	Average of Parcel Tax - By BldgSqFt
\$ 311.67	\$ 254.10	\$ 262.08

B. Parcel Tax with Senior/Low-Income Exemptions

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Parcels - per Parcel	\$ 390.82	\$ 341.96	\$ 195.41	\$ 97.70
Taxable Parcels - per Lot Square Foot	\$ 0.0219	\$ 0.0192	\$ 0.0110	\$ 0.0055
Taxable Parcels - per Building Square Foot	\$ 0.15	\$ 0.13	\$ 0.07	\$ 0.04

DISCUSSION (Continued):

Average Annual Taxes on Single-Family and Condo Parcels in the Consensus Revenue Target in the Scenario with the Senior/Low-Income Exemptions (note that the average is higher for the non-exempt parcels in order to meet the same Consensus Revenue Target):

Average of Parcel Tax - By Parcel (SLI)	Average of Parcel Tax - By LotSqFt (SLI)	Average of Parcel Tax - By BldgSqFt (SLI)
\$ 341.96	\$ 273.89	\$ 283.18

C. Parcel Tax on Commercial Buildings Over 25,000 Square Feet

Description	Rate - High	Rate - Consensus	Rate - Mid	Rate - Low
Taxable Commercial/Office/Industrial Parcels - per Building Square Foot > 25K	\$ 3.31	\$ 2.90	\$ 1.66	\$ 0.83

Only 35 parcels in the Town have commercial buildings over 25,000 square feet and would be subject to such a parcel tax. For illustrative purposes only, the total annual tax per owner for this scenario at the \$3.5M Consensus Revenue Target would range from approximately \$4,600 to \$612,000.

CONCLUSION AND NEXT STEPS:

Staff looks forward to Council's discussion and direction on which potential revenue measures should be included in a poll. NBS recommends that no more than two options should be polled. Polling is a targeted effort to evaluate whether a potential measure would be viable and would include a small number of likely voters (e.g., 100 to 200 interviews) to obtain statistically valid results. Once polling is completed, staff would provide a summary of the results to the Finance Commission for a recommendation to Council on whether to pursue any of the options. Staff would then return to Council for direction on whether to proceed with any of the options.

If Council decides to proceed, Phase 2 of the contract with NBS would need to be authorized to continue the work. Phase 2 includes public education and outreach, ballot measure language refinement, and a final resolution for the Town Council to place the measure on the 2024 ballot.

COORDINATION:

The preparation of this report was coordinated with the Town Manager, Town Attorney, and Director of Finance.

FISCAL IMPACT:

PAGE 6 OF 6

SUBJECT: Potential Revenue Ballot Measure Options

DATE: December 11, 2023

On October 17, 2023, Council authorized the Town Manager to enter into an agreement for the initial phase of the work for amount not to exceed \$44,600. The cost for polling for potential revenue ballot measures was already included in this amount. After polling is complete, Council will have the option to decide whether to allocate additional funding to pursue placing a measure on the 2024 ballot.

ENVIRONMENTAL ASSESSMENT:

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

Attachment:

1. NBS Revenue Modeling Report