



**TOWN OF LOS GATOS
COUNCIL AGENDA REPORT**

MEETING DATE: 11/04/2025

ITEM NO: 6

DATE: October 16, 2025
TO: Mayor and Town Council
FROM: Chris Constantin, Town Manager
SUBJECT: **Approve Modifications to the Town's General Fund Reserve Policy as Recommended by the Finance Commission**

RECOMMENDATION: Approve modifications to the Town's General Fund Reserve Policy as recommended by the Finance Commission and redlined in Attachment 1

FISCAL IMPACT:

There is no fiscal impact of reviewing and modifying the General Fund Reserve Policy.

STRATEGIC PRIORITY:

This initiative supports the Town's strategic priority of ensuring prudent financial management.

BACKGROUND:

The Town of Los Gatos has historically maintained a strong General Fund reserve position, contributing to its fiscal stability and high credit ratings. The current General Fund Reserve Policy was last updated in 2021 and outlines a combined minimum reserve of 25% of General Fund ongoing operating expenditures, split evenly between a Catastrophic Reserve and a Budget Stabilization Reserve.

DISCUSSION:

In light of evolving best practices and benchmarking against peer jurisdictions, staff prepared a revised policy to enhance clarity, structure, and long-term resilience.

The Finance Commission discussed the General Fund Reserve Policy at its meetings on March 10 and September 8, 2025, and recommended that the Town Council approve the recommended changes.

PREPARED BY: Gitta Ungvari
Finance Director

Reviewed by: Town Manager and Town Attorney

In addition, the Finance Commission requested staff to research the following three areas:

- Best practices, staff's finance experience, and how other cities establish an unassigned fund balance reserve target, including whether the targets are based on a percentage or dollar amount.
- The process for establishing assigned funds, and a review of current assigned fund balances in the General Fund to determine if they remain relevant.
- Evaluate the need to have a committed fund balance for specific large, multiyear capital projects that would otherwise be in assigned fund balances.

Staff returned to the Finance Commission with the following analysis and updated redlined version of the General Fund Reserve Policy (Attachment 1) at its October 13, 2025, meeting.

Set percentage or dollar target for Unassigned Fund Balance:

In governmental accounting, under GASB 54, the Unassigned Fund Balance represents the portion of the General Fund balance that has not been restricted, committed, or assigned to specific purposes. It provides the Town with the greatest degree of flexibility to respond to unexpected financial needs, manage cash flow timing, and maintain fiscal stability during periods of uncertainty.

Historically, the Government Finance Officers Association (GFOA) has recommended that general-purpose local governments maintain a minimum unrestricted fund balance in the General Fund equivalent to two months of regular operating revenues or expenditures, or approximately 16.7% of annual General Fund expenditures. It should be noted that the GFOA includes restricted funds that would otherwise be funded with unassigned fund balances (e.g., contingency reserves) as part of the calculation of the two-month target. This benchmark serves as a prudent minimum for ensuring liquidity and stability during routine fluctuations in revenues and expenditures.

While City Managers have responsibility for overall city operations, the City Managers rely heavily on the Finance Directors and finance practices to govern fund balance target decisions. To place this recommendation in context, staff reviewed General Fund Reserve policies across Santa Clara County jurisdictions. The following table summarizes each agency's reserve targets, structure, and notable practices.

Jurisdiction	Target(s) & Structure
Los Gatos (Town)	Combined minimum 25% of GF operating expenditures: 12.5% Catastrophic + 12.5% Stabilization

Jurisdiction	Target(s) & Structure
Santa Clara (City)	Budget Stabilization Reserve = 3 months (~25%) of GF budget; FY 24/25 minimum = 15%
San José (City)	Aggregate goal = 10% of GF expenditures across Contingency, Stabilization, Catastrophic
Sunnyvale (City)	Budget Stabilization Fund \geq 15% of GF revenues
Mountain View (City)	General Fund Reserve = 20–25% of GF net expenditures
Palo Alto (City)	Budget Stabilization Reserve = 15–20% of GF expenses; separate Budget Uncertainty Reserve
Cupertino (City)	Economic Uncertainty Reserve at least 25%
Campbell (City)	Economic Fluctuations Reserve = 16.67%; Emergency Reserve = 10% of revenues; \$1M cash reserve
Milpitas (City)	Contingency Reserve \geq 16.67% of GF expenditures; Stabilization Reserve = 16.67%
Gilroy (City)	Minimum GF fund balance = 30%
Morgan Hill (City)	Minimum reserve threshold = 25% of GF expenditures
Los Altos (City)	References GFOA “two months” guidance; recent ACFR notes 20% GF reserve
Saratoga (City)	Current 6/30/2024 \$9.1 million GF Unassigned Fund Balance
Los Altos Hills (Town)	Emergency Contingency \geq \$1.25M; Operating Contingency \approx 1 year of personnel costs
Monte Sereno (City)	GF reserve at least 20% to 25% annual GF expenditures, \approx “nearly two years” of operating costs (practice)

While the GFOA’s traditional guidance offers a sound baseline, the Association’s 2023 report, *Rethinking Reserves*, recommends that local governments move beyond a fixed-percentage approach and adopt a risk-based, range-based strategy for setting reserve targets. The report

emphasizes that the appropriate reserve level depends on a community's specific risk profile, including exposure to economic cycles, disaster vulnerability, and reliance on volatile revenue sources—rather than a uniform national standard. Interestingly, the GFOA is currently exploring the conversion of the best practice to an advisory, which eliminates explicit targets for reserve balances and puts in place a guidance-based advisory.

Under this modern framework, reserves are best understood not merely as a savings account but as a form of self-insurance, a financial tool for managing uncertainty and maintaining service continuity in the face of disruptions. The *Rethinking Reserves* approach encourages establishing a target range rather than a fixed point. The lower bound serves as a minimum to preserve fiscal stability, while the upper bound identifies a ceiling beyond which funds may be reallocated to other community priorities or one-time investments.

Applying these principles, the Town of Los Gatos currently maintains a combined minimum reserve of 25% of General Fund operating expenditures, which is divided equally between the Catastrophic Reserve (12.5%) and the Budget Stabilization Reserve (12.5%), and an Unassigned Fund Balance Reserve of \$4,000,000, representing approximately 6.35% of annual General Fund operating expenditures. Together, these reserves total roughly 31.35% of General Fund operating expenditures, placing the Town well above the GFOA baseline and within the upper range of comparable jurisdictions.

In light of the GFOA's *Rethinking Reserves* recommendations and the Town's already strong reserve position, staff recommend maintaining the existing Unassigned Fund Balance Reserve of \$4,000,000 as a flexible tool for cash flow management and minor contingencies, rather than establishing a fixed percentage target. A rigid percentage requirement for unassigned fund balance could unnecessarily limit the Town's ability to respond to needs or take advantage of short-term fiscal opportunities. For example, the Town has planned to use some of the unassigned fund balance to balance the 2025-26 budget.

Instead, staff recommend that the Town's General Fund Reserve Policy initially reflect a risk-informed reserve range approach that:

- Treats the Town's existing reserves collectively as a form of self-insurance against identified fiscal and operational risks;
- Expresses initial reserve goals as 25% of General Fund operating expenditures, reflecting current contingency and catastrophic reserves balances as a minimum, but also accepting the establishment of the \$4,000,000 Unassigned Fund Balance;
- Upon funding the reserve levels pursuant to the Town's General Fund Reserve Policy, any remaining surplus of fiscal year revenues above expenditures shall be placed in the Unassigned Fund Balance; and
- Commits to periodic risk-based reassessment of the available Unassigned Fund Balance adequacy in light of changing fiscal, environmental, or operational conditions, including

consideration of lifecycle capital assets which may not be identified and funded.

This adaptive approach maintains the Town's longstanding commitment to prudent fiscal management while aligning with modern best practices in public finance, ensuring that Los Gatos remains well-positioned to navigate both anticipated and unforeseen financial challenges.

Together, these updates position the Town's reserve policy to balance prudence with adaptability, anchored in established GFOA best practices while responsive to the Town's specific risk environment. However, given the projected structural deficit, the Town needs to consider alternatives and not rely on current fund balances to address such deficits on an ongoing basis.

The following section reviews the Town's current assigned fund balances to ensure that they remain relevant and aligned with this updated framework for long-term financial resilience.

Review Current Assigned Fund Balances in the General Fund and Determine if they Remain Relevant

Under the principles established by GASB Statement No. 54, assigned fund balances represent resources that the Town intends to use for specific purposes but that have not been formally committed by the Town Council. These balances provide flexibility to manage planned projects, address operational contingencies, and respond to emerging needs while preserving the Town's overall financial stability. Assignments are typically authorized by the Town Manager or Finance Director and ratified annually by the Town Council as part of the budget adoption or year-end closing process.

Consistent with the Government Finance Officers Association (GFOA) *Fund Balance Guidelines for the General Fund*, assigned fund balances serve as an important component of the Town's fiscal strategy by providing earmarked but adaptable funding sources. The GFOA emphasizes that governments should maintain clearly defined policies that establish how assigned resources are created, used, and replenished, and should periodically reassess the purpose of each assignment to ensure that it remains aligned with current community needs, risk exposure, and financial priorities. Additionally, the GFOA recommends that assigned or unrestricted fund balances be reserved primarily for one-time or nonrecurring expenditures, rather than ongoing operational costs, to promote long-term structural balance.

As of June 30, 2025, the Town's estimated Assigned Fund Balances in the General Fund, as adopted by the Town Council in the June 3, 2025, Fund Balance Resolution, are summarized on the next page:

Reserve Name	Purpose	Estimated Balance (FY 2024–25)
Capital/Special Projects Reserve	Funds infrastructure and capital projects identified in the Town’s five-year Capital Improvement Program (CIP) or other Council priorities.	\$1,506,449
Compensated Absences Reserve	Provides funding for 50% of all vested sick leave, vacation, and compensatory time, per the Town’s General Fund Reserve Policy.	\$1,555,478
Carryover Encumbrances	Holds funds for approved purchase orders and contracts not finalized by fiscal year-end.	\$85,861
Sustainability Reserve	Established from the closure of the Solid Waste Management Fund in FY 2008–09, dedicated to conservation, recycling, and sustainability initiatives.	\$140,553
Market Fluctuation Reserve	Captures unrealized investment gains of \$10,000 or more per GASB 31, to manage volatility in investment income, per Town General Fund Reserve Policy.	\$1,712,246
Open Space Reserve	Set aside for the preservation of open space, trail connections, and protection of natural features and scenic areas.	\$410,000
ERAF Risk Reserve	Held 30% of anticipated ERAF proceeds pending litigation; excess balance moved to Unassigned Fund Balance during FY 2024–25.	\$0
Council Priorities – Economic Recovery	Temporary reserve established to support economic recovery efforts; fully expended in FY 2024–25.	\$0

Together, these assigned balances total approximately \$5.41 million, reflecting the Town’s proactive approach to managing future financial commitments, existing obligations, and one-time initiatives.

In line with GFOA guidance, staff conducted a review of the assigned reserves to ensure they remain relevant and aligned with current Town goals. Two balances, the Sustainability Reserve (\$140,553) and the Open Space Reserve (\$410,000), have been identified as potential candidates for reassignment. These funds were originally designated for specific purposes that are no longer active or that may now be more effectively supported through ongoing programmatic funding or capital allocations.

Staff recommends that the Town Council consider these reserves during the 2026–27 Operating Budget process. Options include realigning the Sustainability Reserve with the Town’s Environmental Services Program to fund energy efficiency and waste reduction initiatives, or

reallocating the Open Space Reserve to supplement approved projects in the Town's Capital Improvement Program. Alternatively, both balances could be reassigned to the Unassigned Fund Balance, enhancing financial flexibility and liquidity to address future operational or strategic needs.

By maintaining clearly defined assigned reserves while periodically reviewing their purpose and funding levels, the Town ensures that resources are managed transparently and used efficiently. This approach aligns with GFOA best practices and demonstrates the Town's ongoing commitment to prudent fiscal management, accountability, and adaptability to changing conditions.

While assigned fund balances provide flexibility for planned or intended uses, committed fund balances represent a higher level of Council designation. Under GASB 54, committed funds are constrained by formal action of the Town Council, typically through resolution or ordinance, and cannot be reallocated without equivalent formal action. These reserves are designed to support major long-term obligations or specific risks identified by the governing body, such as disaster recovery, economic stabilization, or pension liabilities.

The following section outlines the Town's committed fund balance structure, including the Catastrophic Reserve, Budget Stabilization Reserve, and Pension/OPEB Reserve, and how each supports the Town's broader strategy of maintaining financial resilience and continuity of services.

Guideline for Committed or Assigned Fund Balance for Capital Projects

Under GASB Statement No. 54, governmental fund balance can be classified as committed (formal constraint by governing body) or assigned (reflecting intent by management or authorized officials). Because capital projects often involve long time horizons, cost uncertainties, and evolving priorities, placing large general fund dollars into a committed status prematurely can reduce flexibility and make adaptation harder in response to new opportunities. Consistent with prevailing practices among California municipalities and GFOA guidance, the Town will continue to classify these funds as assigned unless a project is fully authorized and construction-ready, where the Town may consider committing such funds.

Current Practice and Rationale

As of June 30, 2025, the Town maintains a Capital/Special Projects Reserve of \$1,506,449 as part of the assigned fund balances. This reserve is intended to support infrastructure or facility projects identified in the Town's five-year Capital Improvement Program (CIP) or other Council priorities. Rather than converting this into a committed balance, which would legally restrict its use absent further Council action, staff proposes to keep all capital project funding in the assigned category until specific projects satisfy stringent readiness criteria.

Keeping capital funds in assigned status provides these benefits:

- **Flexibility to respond to changing priorities or shifting funding landscapes** – If a grant is withdrawn, a project is delayed, or an urgent need arises elsewhere, the Town retains discretion to reallocate or reprioritize the funds, subject to Council oversight.
- **Avoids overcommitment risk** – Committing too early can lock the Town into certain paths before design, cost, or funding risks are fully vetted.
- **Simplicity in internal management and reporting** – The Town can treat the reserve as a pool or pipeline of capital funding, shifting to projects when ready, rather than needing to reclassify large sums repeatedly. This fits our new tiered structure for capital projects.
- **Consistency with GFOA's concept of reserves as buffers, not rigid lockboxes** – The GFOA guidance encourages managing fund balance designations in light of risk, volatility, and the unique financial structure of each government.

In a review of peer city reserve policies across California, staff did not locate solid examples in which municipalities routinely move general fund capital reserves into committed status as a default practice. Some jurisdictions do establish committed reserves for very specific risks (e.g., debt service, catastrophe, pension liabilities), but capital funding is more often left in flexible, assigned categories until fully scoped and funded.

These practices are consistent with GFOA's guidance that fund balance designations should be linked to a government's capital planning process, with the highest level of constraint applied only when a project has reached a committed and executable stage. Premature commitment can unnecessarily restrict flexibility, while delayed commitment can lead to uncertainty in funding availability or project delivery.

RECOMMENDATION:

The revised policy incorporates feedback from the Finance Commission and GFOA guidance while retaining the Town's core reserve structure. It also formally establishes the General Fund Unassigned Fund Balance Reserve with the 2025–26 Adopted Budget, reflecting available resources that are not allocated for other uses and can support temporary revenue shortfalls or one-time expenditures. This Reserve is intended to represent available resources that are not allocated for other uses and can be used to address changes in the current year's net revenue. Changes may include net revenue that falls to the bottom line or additional expenditures that are not covered by revenue or transfers into the General Fund. In addition, staff recommends removing obsolete language related to the Almond Grove Reserve, as it is no longer in use. Staff recommends establishing a clear order for year-end surplus deposits. The recommended changes are redlined in Attachment 1.

Staff is recommending that the Town Council approve the changes redlined in Attachment 1 as recommended by the Finance Commission.

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SUBJECT: Approve the General Fund Reserve Policy

DATE: October 28, 2025

COORDINATION:

This item was developed in coordination with the Town Manager's Office and the Finance Department.

Attachments:

1. General Fund Reserve Policy-Redlined
2. Fund Balance Resolution June 3, 2025