TOWN OF LOS GATOS
COUNCIL AGENDA REPORT

MEETING DATE: 01/21/2020
ITEM NO: 12
DESK ITEM

DATE: January 21, 2020

TO: Mayor and Town Council

FROM: Laurel Prevetti, Town Manager

SUBJECT: Discuss the Five-Year Forecast, Provide Direction on the Other Budget Assumptions, and Provide any Specific Direction for the Preparation of the Town's Fiscal Year 2020/21 Operating and Capital Budgets

REMARKS:

The summary table on page 2 of the staff report was not updated prior to posting to reflect the pension scenario analysis. The base case scenario was reflected correctly but the less growth and greater growth summaries have been revised. The summary tables on page 13 of the report were correct.

(values in millions)

Scenario Surplus/Deficit	2020/21 Forecast	2021/22 Forecast	2021/22 Forecast	2023/24 Forecast	2024/25 Forecast
Greater Growth Scenario	$1.0	$2.9	$3.6	$5.2	$7.0
Base Case Modest Growth	$0.5	$1.7	$1.6	$2.3	$3.1
Less Growth Scenario	($0.4)	$0.2	($0.6)	($1.2)	($1.0)

In addition to the above revision, a Councilmember requested that staff respond to public comment received to date. Following are staff responses to the comments which directly relate to Item #12 as it appears on the agenda. Public comments not directly related to the item are not be addressed at this time in conformance with the Brown Act.

PREPARED BY: Stephen Conway
Finance Director

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

REMARKS (continued):

Why does the Town build a 5-year forecast using a format which presents expenses by natural expense category (such as salary, benefits, utilities, etc.) as opposed to the format presented in the Comprehensive Annual Financial Report (CAFR) where expenses are presented by government activity (such as public safety, general government, etc.)? If the 5-year forecast used the CAFR format, Council could compare historical actuals by government activity to the projections. The 5-year forecast format that is being used does not present any historical information. Only a budget vs budget view is presented. Furthermore the 5-year format is not used in the CAFR and therefore it is impossible to track audited numbers with this format. Why not adopt the CAFR format to develop a 5-year forecast? I have attached the relevant page from the 2019 CAFR which compares the original adopted budget to actuals. This in itself is enlightening.

The 5 Year Forecast is a planning tool compiled at a higher summary level intended to provide the Council with a forward glimpse of total General Fund anticipated revenues above or under expenditures for the next five years. This tool enables the Council to understand any potential constraints/opportunities for multi-year policy initiatives or staffing augmentation. The nature of the forecast presentation is intended to differ from the more detailed line item/departmental summaries as provided in the annual budget and CAFR documents. The Forecast helps establish the context for the more detailed presentations compiled for the proposed budgets. To illustrate the difference between document intent, there are certain items such as lease payments and debt service between the Town and the Town's Redevelopment Successor Agency that are eliminated for the CAFR presentation, making comparisons confusing, with multiple reconciling items. While the Town can forecast salaries and benefits in total for all Town staff in the 5-Year Forecast, staff does not know the allocation of actual staffing (Full Time Equivalent allocations to Town's budgeted programs) until the FY 1920-21 proposed budget is compiled and adopted by Council.

Why does the 5-year forecast not show the "beginning" and "ending" General Fund Balance for each forecast year? How does the Council know the impact on the General Fund Balance over the 5-year period?

The Forecast was not developed for this purpose. The Forecast's primary purpose focuses on the question of whether or not there are anticipated surpluses or deficits that will be added to the fund balances in the future based upon current projections of total revenues and expenditures. Ending audited fund balances are actually reported in the Town's CAFR and projections of fund balances for the next year also presented in the Town's annual proposed budget in the Financial Summaries section.

REMARKS (continued):

Why does the format not show an "excess/(deficit) of operating revenues over operating expenditures" as shown in the CAFR format? The format that is presented makes it difficult to determine if the forecast period is "balanced" by drawing down general fund reserves as opposed to having operating revenues exceeding operating expenditures (i.e. structurally balanced).

The Forecast is not intended to be a multi-year budget balancing tool. The Forecast helps the Council understand any potential constraints/opportunities for multi-year policy initiatives or staffing augmentation. The Town Manager is legally required to present a balanced proposed budget annually. The Forecast does provide total operating revenues and total operating expenditures as distinct line items in the forecast. The current base case scenario indicates revenues above expenditures in each of the five years.

How does the Council know that the 5-year forecast will deliver the priorities the Council established at the January 14 meeting? How are the strategic priorities outcomes linked to the 5-year forecast?

The Town Council's annual Strategic Priorities deliberations in conjunction with the Five-Year Forecast tool help inform areas of potential budgetary emphasis consistent with those priorities when budgetarily permissible. .

Why does the 5-year forecast assume no salary increases starting in FY 2021/22? Salary expense is the Town's single largest expense and not including any increase will overstate the forecasted "surplus". The future pension contributions provided by CALPERS, which are in the forecast, were built using an assumed 3% per year salary increase. If CALPERS includes a 3% salary increase in determining the future pension contributions, shouldn't the same assumption be used in projecting salaries over the 5-year forecast?

Staff does not assume salary increases unless approved by Town Council through the negotiation process. The Town has had in recent history periods of no raises for certain bargaining units, such as after the recent Great Recession of 2008. While CalPERS actuarial variables are informative, they are subject to revision by the CalPERS Board based on actuarial experience studies.

Why do "total expenditures and allocations" increase at a faster rate in a "lower growth" scenario versus the "base case" scenario? Is this a reasonable assumption?

REMARKS (continued):

The lower growth scenario indicates a slowing economy which staff expects to result in CalPERS not meeting its investment targets which would result in higher pensions contributions for the Town. The higher pension costs associated with missing the expected rate of investment return incurred in those years impacts the forecast at faster rates of expenditure growth than in the base case scenario.

In computing the $4,010,185 which Staff is suggesting is available to the Council to reassign from the Capital/Special Project Reserve, why aren't projected future surpluses which would be added to the Capital/Special Project Reserve according to the existing reserve policy be included in the calculation? The base case forecast is projecting a cumulative surplus of $9.3m over the five-year period which exceeds the annual transfer of $550k per year by $6.7m. This would suggest that all of the future annual transfers can be safely covered by future surpluses thus allowing the Council to reassign up to $6.8m (the $4.0m plus $2.8M) to other critical needs such as making an additional discretionary payment to CALPERS.

The forecasted surpluses are estimates based on information available at this time and are not intended to be perceived as actual expendable surpluses. . In addition, as the sensitivity analysis illustrates, the base case scenario is subject to a high degree of variability based on the economic circumstances encountered in the coming years.

Adopt Government Finance Officers Association (GFOA) recommended best practices in budgeting for salary & wages in the 2021-2022 budget. Breakout Salary & Benefit costs into the following 3 components in all reporting to Town Council & the public; Salary & wages, Pension benefit costs, OPEB benefit costs.

The Town staff has a long history of implementing GFOA practices, resulting in successive budget and CAFR awards from GFOA. The five-year forecast incorporates many of GFOA's recommendations including: start dates, step dates, etc. and uses only actual salaries. One item not included is assumed raises in future years unless they are part of a multi-year collective bargaining agreement.

The Town's current practice is to budget only "non-public safety positions" at top step. Sworn and management positions are budgeted at one step higher than the current step in anticipation of potential merit increases in the upcoming fiscal year. Staff has calculated that approximately 65% of all Town employees including management are currently at the top step of their salary ranges. The salary savings achieved by budgeting non-public safety positions are currently estimated to be approximately $175,000 per year for salaries and assuming a 65% benefit allocation for these salary savings, the total approximate amount of savings would be $283,500. This indicates that the bulk of salary savings the Town achieves each year results

REMARKS (continued):

primarily from unanticipated vacancies occurring during the year. The Town currently has no frozen positions that are funded in the budget.

The Town could alter its historical practice to budget at actual step for all employees. The downside to that practice is there would be no built-in anticipated salary and benefit savings which are the main funding source for the Town's capital improvement funding plan for which the Town has few dedicated revenues available to fund. Staff could also budget an assumed vacancy factor also potentially leading to overspending in budgeted line items should no vacancies or very few occur.

The forecast could accommodate a further breakout of salary, pension, and OPEB costs, but the intent was to keep costs at a high level for presentation purposes.

I would like to see the Town change from a "budget to budget" comparison as a performance measure. There is nothing on the internet nor in GASB nor FASB that I can find that endorses "budget to budget" as a way to measure business performance…

Comparing actuals to budget is presented in many of the Town's financial documents, including the budget and the Comprehensive Annual Financial Report. Comparing budget to budget is a standard practice when explaining changes to budgeted line items that change between fiscal years.

Budget comparison information is usually more relevant. For instance, in comparing adopted budgets, it is important to see the changes scheduled for salaries and benefits. For example purposes, let say a city has an adopted FY 2019/20 budget of $10,000,000 for salaries and benefits in its current year. For the following fiscal year, the Council has approved an increase of 2% for FY 2020/21 for a total of $10,200,000. This example indicates a 2% salary and benefit increase for the next fiscal year as Council has approved:

If the Town were to compare actuals to actuals, then for the above example let us assume there were unanticipated vacancies leading salary and benefit actuals for the year to finalize at $9,700,000. Let us further assume that in the following FY 2020/21 only $100,000 of unanticipated vacancies occur. Using the suggested approach above, the real raises would be distorted. Comparing actuals to actuals would lead to following result:

- FY 19/20 Actuals: $9,700,0000 ($10M salary less vacancy savings)
- FY 20/21 Actuals: $10,100,000 ($10.2 M budgeted salary and benefits less $100K vacancy savings)

REMARKS (continued):

As the above example illustrates, a $400,000 increase between fiscal years would result if expressed as a percentage (4% increase from the prior year). This example also demonstrates using actuals indicates a 4% increase due to the vacancy savings incurred each fiscal year when in fact the actual raises for FY 20/21 approved by the Council amounted to a 2% increase from the prior year's budgeted amount. This is confirmed by comparing budgeted salaries and benefits for each fiscal year.

Attachments previously distributed with the Staff Report:

1. Budget Process Timeline
2. Major Revenue Categories
3. Revenue Baseline and Projection Factors
4. Expenditure Baseline and Projection Factors
5. Community Survey Comments
6. Fiscal Year Surplus Flow of Funds and Capital Improvement Program
7. Public Comment Received before 11 a.m. on January 17, 2020

Attachment distributed with this Desk Item:

8. Public Comments Received after 11 a.m. on January 17, 2020 before 11 a.m. on January 21, 2020