Dear Council Members and Members of the Finance Commission,

Congratulations on being appointed to the first Finance Commission for the Town of Los Gatos. And congratulations for taking this very important step in holding a joint study session to begin the process of encouraging open, diverse, and transparent dialogue between the residents and the Town Council. This is exactly what we, the proponents of Measure A, had hoped to see happen. We are thrilled.

We also would like to thank the Staff for assembling the list of reference materials for the newly appointed members of the Finance Commission and the newly elected members of the Town Council. Obviously, there were many reports and topics reviewed over the last four years by the former Finance Committee. There was good work done, for sure, and it is on display.

However, there is much more to do, and the Town is now facing the most significant economic uncertainty it has experience since the "great depression." It is the forward-looking issues that the Finance Commission has been chartered to address and provide expert financial advice to aid the Council in their decision-making process. The Town needs smart solutions if we are to successfully navigate these challenging economic times.

We would respectfully like to suggest a few important topics this joint study session may wish to discuss and develop an action plan for. These are timely since the Town is entering the period when annual budgets and a five-year forecast are being prepared by Staff for Council's consideration:

How should the Town monitor the financial status of the adopted budget so corrections can be made on a timely basis? The Town used to prepare a quarterly review, but this ceased some time in 2017. The Finance Commission may wish to request copies of the old quarterly reports for its review. Having a quarterly review is a recognized best practice for managing a municipality's fiscal affairs. Currently the Town uses a mid-year review that occurs in mid-February, nearly 8 months through the fiscal year as the primary tool to review the actual vs budget performance of the annual operating plan and consider formal budget adjustments. Given the economic uncertainty facing the Town, delaying the first formal review until nearly three-quarters of the fiscal year has elapsed may not provide sufficient time for meaningful course corrections.

Should the Town adopt a rolling two-year operating budget that would conform with the multi-year priorities the Council has established? Currently the Town prepares a one-year operating budget. The City of Los Altos, for example, and several other cities, produces, and operates on a two-year budget horizon. While there may be additional work to adopt a two-year budget, the downstream benefits are substantial. This is a topic that this study session may wish to discuss.

How will the Council provide the Finance Commission and Staff relevant input to the five-year plan? Specifically, what assumptions does the Council want included in the five-year plan? A major problem with the current five-year planning process is that realistic assumptions regarding salary and bonus increases and funding required to meet the long-term capital needs and pension debt reduction needs of the Town are not included in the five-year plan. What is the best practice to build a five-year plan that will provide the Council with a longer view of the financial opportunities and challenges facing the Town?

ATTACHMENT 2

Are there any major capital programs, such as the pedestrian bridge, building a new senior center or recreation center, that Town wishes to undertake that might require public financing? Interest rates have never been lower, which favors big infrastructure projects. If the Town is truly interested in making a substantial investment in the Town's infrastructure, this is the time to investigate public financing options. The Town has a strong credit rating and a very low net direct debt to full value ratio (0.1%) which is materially below the U.S. mean. Offsetting this is the unfavorable net pension liability to operating revenues ratio, but the Town should still be able to access capital markets at very reasonable rates. Along with this, the Town may want to explore re-financing its current COP debt at a lower interest rate. That would yield immediate savings.

We will stop here, but these are just some of the major forward-looking topics that this joint study session might wish to discuss or at least become familiar with. Lastly, the joint session may wish to discuss a proposed Finance Commission annual work plan so there is a common view of how the Finance Commission will address its many duties. We have attached the annual work plan for the City of Los Altos Finance Committee which should serve as a good template as this Commission develops their own work plan.

In closing, we would like to thank the residents of the Town who believed in the value of a resident led Finance Commission and overwhelmingly voted for Measure A. From a historical point of view, Measure A received more votes than 2018 Sales Tax Measure G. The residents of the Town have high expectations for this Commission.

Thank you for stepping forward and serving the needs of the Town. Good luck to all of you.

The Proponents of Measure A

Phil Koen

Rick VanHoesen

Jak VanNada

Financial Commission 2020/2021 Work Plan

Goal	Projects	Description	Frequency	Target Date(s)	Status
Recurring Goals					
#1	Investment Performance	Review investment performance	Quarterly	Q2 – February 2021 Q3 – May 2021 Q4 – August 2021 Q1– November 20	Last reviewed Q1 on 11/16/20
#2	Operating Budget	Quarterly budget review	Quarterly	Q2 – Jan 2021 Q3 – April 2021 Q4 – Aug 2021 Q1– Oct 2021	Last reviewed 6/22/20
#3	Financial Communication	Review new financial system and financial dashboard. Finance staff to provide Commission with status update and software demonstration. To analyze and create financial dashboard for the City to provide additional oversight on financial resources.	Quarterly	Q2 – Jan 2021 Q3 – April 2021 Q4 – Aug 2021 Q1– Oct 2021	Last reviewed 11/16/20
#5	Comprehensive Annual Financial Report	Review draft CAFR	Annually	January 2021	Last reviewed 2/27/2020
#6	Financial Communication	Review PAFR	Annually	February 2021	Last reviewed 11/15/2018
#7	Unfunded Liability (PERs, pre-payment Community Center Loan, etc.)	Evaluate all unfunded liability and recommend and determine annual payment amount for unfunded liability.	Annually	March 2021	Subcommittee last reviewed June 2019
#8	Capital Improvement Budget	Review 5-Year CIP budget	Annually	May 2021	Last reviewed 5/15/2019
#9	5 Year Projection and Analysis	Review long-term fiscal projection of City's financials.	Annually	September 2021	Last reviewed 4/20/20
#10	Financial Policies	Review/update City's financial policies.	Annually	June/July 2021	Last reviewed 4/24/2019 Last updated 1/20/2015
#11	Investment Policy	Review/update City's Investment Policy.	Annually	May 2021	Last updated 4/15/2019

#12	Cross Commission Collaboration	Finance Commission responds to requests from other commissions.	Ad hoc	As needed	N/A
Non-recurring Goals					
#13	Park in Lieu Financing	Analyzing Park in Lieu funds policy, definition, and provide Council with recommendations on use of funds on infrastructure.	Non-recurring	Feb/March 2021	

From: Phil Koen
Date: January 28, 2021 at 7:57:00 AM PST
To: Marico Sayoc <MSayoc@losgatosca.gov>, Rob Rennie <RRennie@losgatosca.gov>, Matthew Hudes <MHudes@losgatosca.gov>, mristow@losgatosca.gov, mbadame@losgatosca.gov, Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Rick Tinsley, Ron Dickel, Jak Van Nada, Rick Van Hoesen
Subject: Special Meeting of Town Council with Finance Commission

Laurel,

Could you please include this in the meeting material as well.

BEST PRACTICES

Achieving a Structurally Balanced Budget

Adopt rigorous policies, for all operating funds, aimed at achieving and maintaining a structurally balanced budget

Most state and local governments are subject to a requirement to pass a balanced budget. However, a budget that may fit the statutory definition of a "balanced budget" may not, in fact, be financially sustainable. For example, a budget that is balanced by such standards could include the use of non-recurring resources, such as asset sales or reserves, to fund ongoing expenditures, and thus not be in structural balance. A true structurally balanced budget is one that supports financial sustainability for multiple years into the future. A government needs to make sure that it is aware of the distinction between satisfying the statutory definition and achieving a true structurally balanced budget.

GFOA recommends that governments adopt rigorous policies, for all operating funds, aimed at achieving and maintaining a structurally balanced budget. The policy should include parameters for achieving and maintaining structural balance where recurring revenues are equal to recurring expenditures in the adopted budget.

As a first step, the government should identify key items related to structural balance. These include: *recurring and non-recurring revenues, recurring and non-recurring expenditures, and reserves.*

Recurring revenues are the portion of a government's revenues that can reasonably be expected to continue year to year, with some degree of predictability. Property taxes are an example of recurring revenue. A settlement from a lawsuit is a good example of non-recurring revenue.

Some revenue sources may have both non-recurring and recurring components. These sources require finance officials to exercise judgment in determining how much of the source is truly recurring. For instance, a government may regularly receive sales tax revenues, but a large part of its base may be made up of retailers with highly volatile sales. In this case, it may be prudent to regard unusually high revenue yields as a non-recurring revenue under the assumption that such revenues are unlikely to continue, making it imprudent to use them for recurring expenditures. Another example might be building permit revenues in a period of high growth in the community. Governments should review their revenue portfolio to identify non-recurring revenues and revenues with potentially volatile components, such as the examples above.

Recurring expenditures appear in the budget each year. Salaries, benefits, materials and services, and asset maintenance costs are common examples of recurring expenditures. Capital asset acquisitions are typically not thought of as recurring because although some capital assets may be acquired every year, they are not the same assets year after year. In general, recurring expenditures should be those that you expect to fund every year in order to maintain current/status quo service levels. In general, a government has a greater degree of flexibility to defer non-recurring expenditures than recurring ones.

Reserves are the portion of fund balance that is set aside as hedge against risk. The government should define a minimum amount of funds it will hold in reserve.2 This serves as a "bottom line measure" to help determine the extent to which structural balance goals are being achieved. If reserves are maintained at their desired levels, it is an indication that the organization is maintaining a structurally balanced budget. If reserves are declining, it may indicate an imbalance in the budget (e.g., if reserves are being used to fund on-going expenditures). It should be noted that reserves levels are not a perfect measure of structural balance, but are a good and readily available measure.

With the forgoing terms defined, a government should adopt a formal policy calling for structural balance of the budget. The policy should call for the budget to be structurally balanced, where recurring revenues equal or exceed recurring expenditures. The policy should also call for the budget presentation to identify how recurring revenues are aligned with or not aligned with recurring expenditures.3

For a variety of reasons, true structural balance may not be possible for a government at a given time. In such a case, using reserves to balance the budget may be considered but only in the context of a plan to return to structural balance, replenish fund balance, and ultimately remediate the negative impacts of any other short-term balancing actions that may be taken. Further, the plan should be clear about the time period over which returning to structural balance, replenishing reserves, and remediating the negative impacts of balancing actions are to occur.4

Notes:

- Note that this Best Practice excludes non-operating funds like capital and debt funds. While governments should ensure that these funds are financially sustainable as well, the specific recommendations found in this Best Practice may not always be a match to the circumstances of non-operating funds.
- Please note that the best practice is not advocating that recurring revenues be formally allocated or "earmarked" to recurring expenditures, but rather is advocating that the budget presentation provide transparency as to whether recurring revenues and recurring expenditures are balanced.