



TOWN OF LOS GATOS
FINANCE COMMISSION REPORT

MEETING DATE: 08/05/2024

ITEM NO: 1

DATE: July 31, 2024
TO: Finance Commission
FROM: Laurel Prevetti, Town Manager
SUBJECT: Discuss the Draft Resolution and Correspondence from the Finance Commission Chair dated June 29, 2024 that was Presented to the Town Council Regarding a Proposed Tax Measure, Including the Finding that Town Revenues Have Not Kept Pace with the Costs of Providing Town Services and Programs to Residents and to Review Staff's Documentation which Supports this Finding.

RECOMMENDATION:

Discuss the Draft Resolution that was presented to the Town Council regarding a potential tax measure, including the statement that revenues have not kept pace with Town expenses.

BACKGROUND:

The Finance Commission Chair requested the topic as described in the subject line above on the agenda for this Finance Commission Special Meeting.

Consistent with its Strategic Priorities for Fiscal Years (FY) 2023 through 2025, the Town Council has been discussing a potential revenue ballot measure for over a year. On July 1, 2024, the Council decided not to move forward. The July 1st meeting information can be found at :

<https://mccmeetings.blob.core.usgovcloudapi.net/losgatos-pubu/MEET-Packet-f28b4d8d27984eb1a497d3481f1fad0b.pdf>

The Chair has requested documentation for the statement in the proposed ballot measure resolution that "revenues have not kept pace with expenditures" (see Attachment 1, correspondence from the Chair). This report reviews the data that have been presented to the Finance Commission and Town Council previously regarding this topic.

PREPARED BY: Gitta Ungvari
Finance Director

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

BACKGROUND (continued):

The Chair has also requested the link to the most recent Annual Comprehensive Financial Report (ACFR): (<https://www.losgatosca.gov/DocumentCenter/View/37241/FY-202223-ACFR?bidId=>) and the Government Financial Officers Association (GFOA) information related to Governmental Accounting Standards Board Statement (GASB) #34: (<https://www.gasb.org/page/PageContent?pageId=/standards-and-guidance/pronouncements/summary-statement-no-34.html>).

The Town's ACFR for the period ending June 30, 2023 received the Government Finance Officers Association Distinguished Award. This award signifies that the Town's Report meets and exceeds the GFOA standards of financial reporting. The Town has been awarded the distinction every year since 1994.

The ACFR displays strong fiscal management of the Town's resources, living within our existing means. The ACFR assesses actual past performance of a given fiscal year. This past perspective does not inform future trends.

DISCUSSION:

The resolution language is based on professional analyses of the Town's finances, forecast information provided by qualified agencies (such as the Tax Assessor, CalPERS, etc.), and other data. The Finance Commission and Town Council have multiple opportunities each year to review revenue and expenditure trends, including and not limited to the Annual Budget, Mid-Year Budget, Five-Year Forecast, and the Annual Comprehensive Financial Report (ACFR). Staff has repeatedly disclosed its concerns about the Town's revenues not keeping pace with expenditures.

The Town is highly dependent on economically sensitive revenues (property tax, sales tax, and Transient Occupancy Tax (TOT) comprising 62.5% of General Fund forecasted revenues. The delivery of Town services is highly dependent on employee talent, which comprise 67.4% of the FY 2024/25 General Fund expenditures. The following high-level review focuses on analyzing the trend of the above-mentioned key drivers.

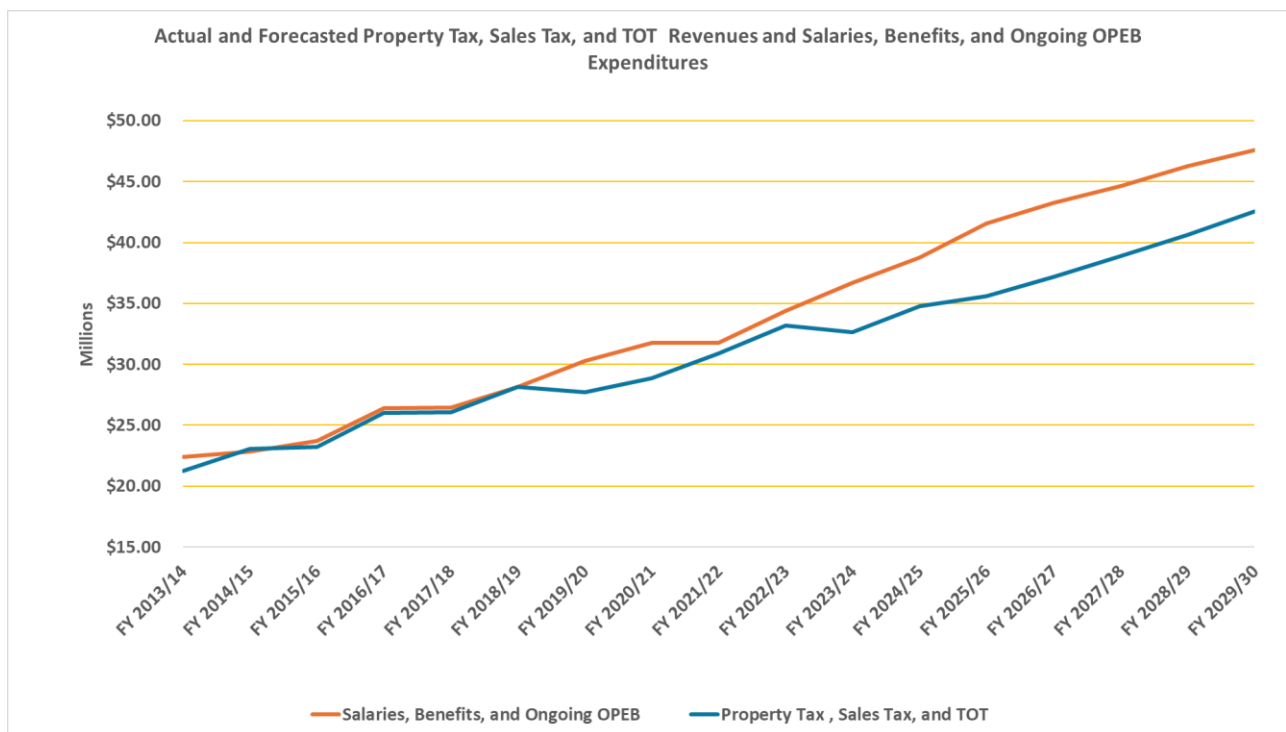
Focusing on the key drivers prevents the fluctuations of one-time revenues and expenditures from skewing the trend data, as fiscally responsible agencies aim to ensure ongoing expenditures can be covered with recurring revenues rather than one-time revenues. While one-time solutions can solve near term shortfalls, the best practice is to build a structurally balanced forecast where recurring revenues (the portion of the Town's revenues that can reasonably be expected to continue year to year with some degree of predictability) equal or exceed recurring expenditures (salaries, benefits, and other operational expenditures).

DISCUSSION (continued):

This report covers past and future trends, General Fund Reserves, and other liabilities.

Past Trends

The following graph shows actual major revenues (property tax, sales tax, and Transient Occupancy Tax) revenues and major expenditures (salaries, benefits, and Post Employment Benefits) from FY 2013/14 through FY 2022/23, and projected revenues and expenditures to FY 2029/30.



The orange line represents salaries, benefits, ongoing Other Post Employment Benefit (OPEB), and pension-related costs. It is important to note that the increase is not due to hiring significant numbers of new employees; it is that the cost per employee is increasing. In particular, mandated pension payments to CalPERS have consistently been one of the major cost drivers for the Town over the past decade with persistent unanticipated increases in pension costs (see Attachment 2).

The expense line has been moderated by the proactive actions of the Town Council to make Additional Discretionary Payments (ADPs) to address the Town's unfunded pension liability. Specifically, in FY 2013/14, the Council directed the payment of a Safety side fund valued at

DISCUSSION (continued):

\$4.5 million. In FY 2019/20, the Council paid an ADP of \$4.8 million and in FY 2020/21, an ADP of \$5.6 million was authorized.

While the early years on the graph show revenues and expenditures tracking closely together, consistently since FY 2019/20, the major revenues have not kept pace with the major expenditures.

Future Trends

The revenue and expenditure trends are explained in every Town Operating Budget. In addition, the Town Council discusses the Five-Year Forecast prior to the preparation of the Operating Budget. Projected revenues and expenses are discussed based on data from the Tax Assessor, sales tax consultants, CalPERS information, and other credible sources. It is a municipal best practice to complete a forecast to understand trends, identify potential headwinds, and anticipate future challenges. In this way, the Town Council can understand how the budget decisions of today impact the budgets of tomorrow.

Since 2019, staff has analyzed the sensitivity of the major revenues and expenses as part of the Forecast. In this way, the Town Council could decide the level of optimism or pessimism it would like to assume in the Forecast. In recent years, the Finance Commission has also had the opportunity to review the sensitivity analysis and provide recommendations to the Town Council.

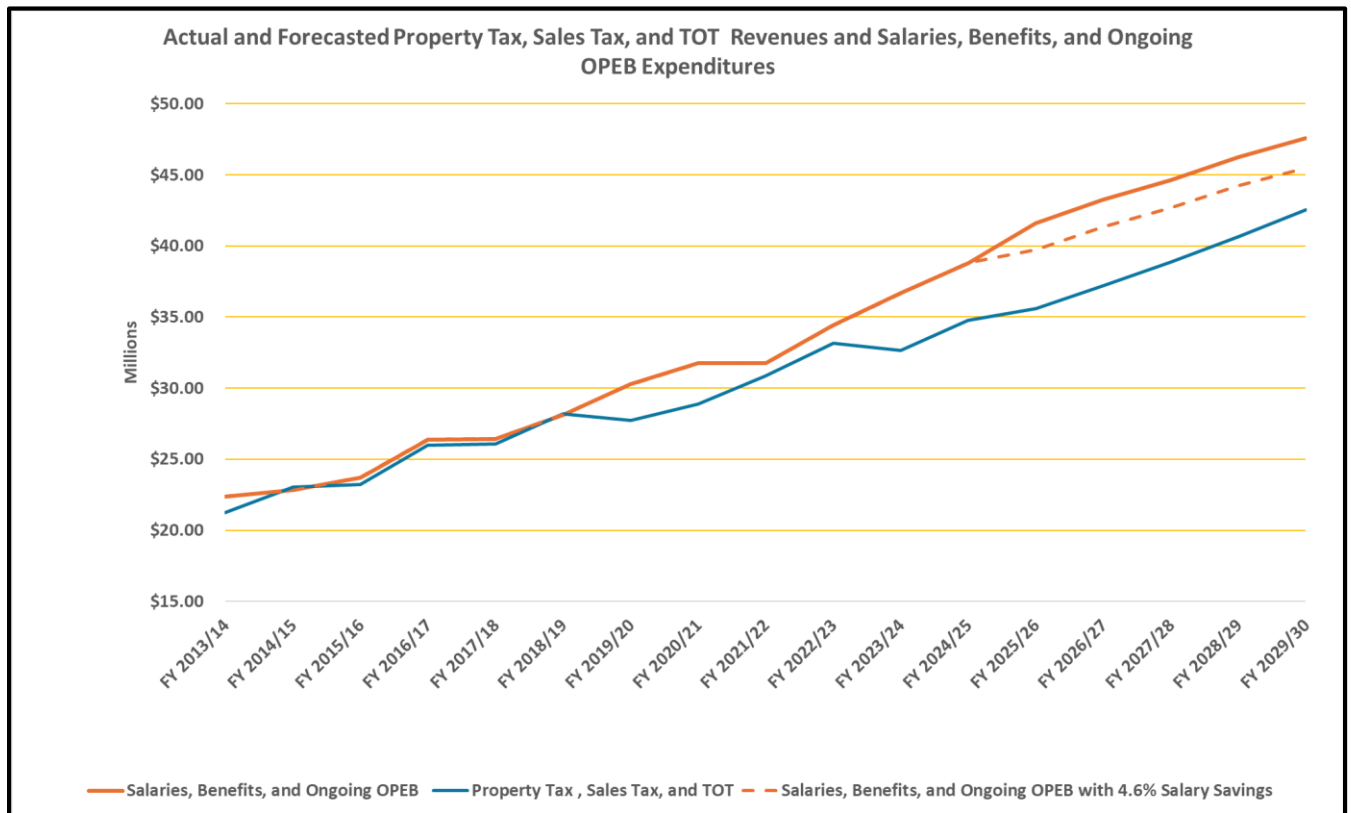
It is very important that the approach to the Forecast and the underlying assumptions are clear, analyzing the risk between being objective versus conservative.

During the last couple of years, the Town Council changed elements of the budgeting and forecasting methodology. Starting FY 2020/21, the salaries are budgeted and forecasted at actual salary plus one step higher. Beginning FY 2023/24, the Budget and the Forecast included a 4.6% vacancy factor, moving toward a less conservative approach. In addition, for FY 2024/25, the Council directed that the growth assumption for regular property tax and Vehicle in Lieu change from 3% to 6.6% based on the Finance Commission's recommendations.

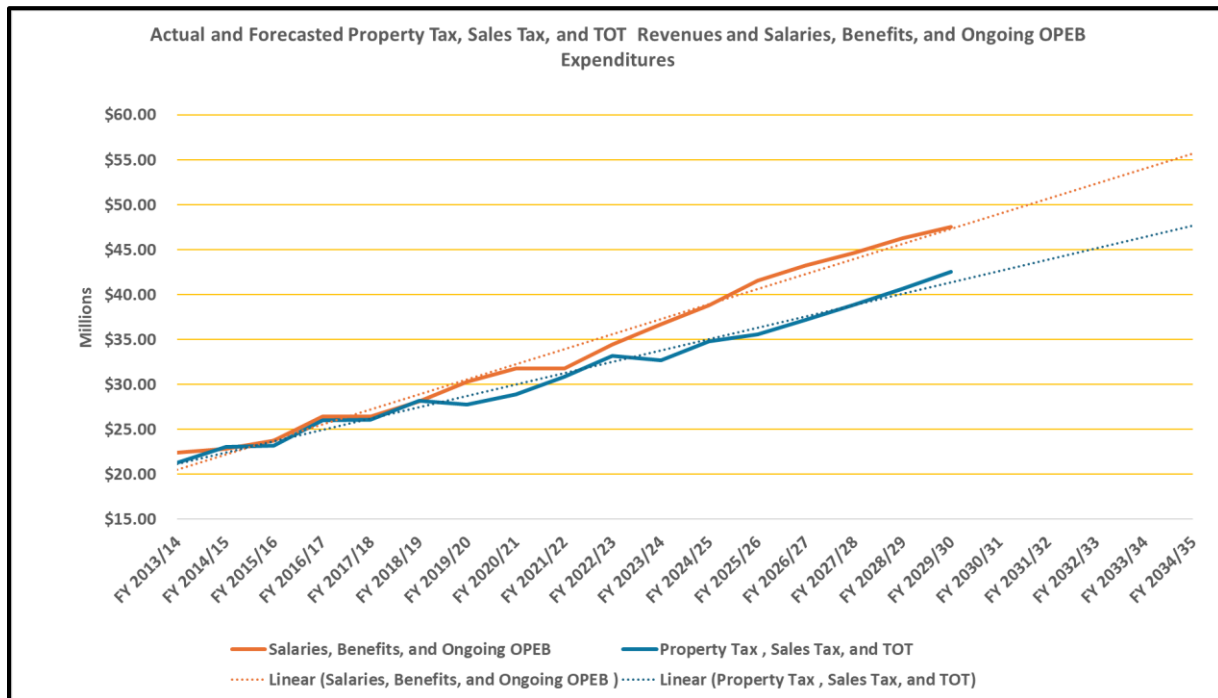
The FY 2024/25 Adopted Budget reflects the recently updated three-year contract with the Police Officers Association, including salary increases and annual cost of living increases. The Adopted Budget does not include cost of living or other adjustments for the Town's other two bargaining units or the non-represented groups. After the labor agreements are considered by Town Council, the salary and benefit expenditures will be adjusted for the current year and in the Forecast to reflect the applicable increases.

DISCUSSION (continued):

The following graph depicts the past actual major revenues (blue line) and expenditures (orange line) along with the budgeted (FY 2024/25) and forecasted major revenues and expenditures. The dotted orange line shows the effect of the 4.6 % vacancy savings factor that was incorporated into the budget beginning FY 2023/24. These are the same data presented in the Forecast contained in the FY 2024/25 Adopted Budget.



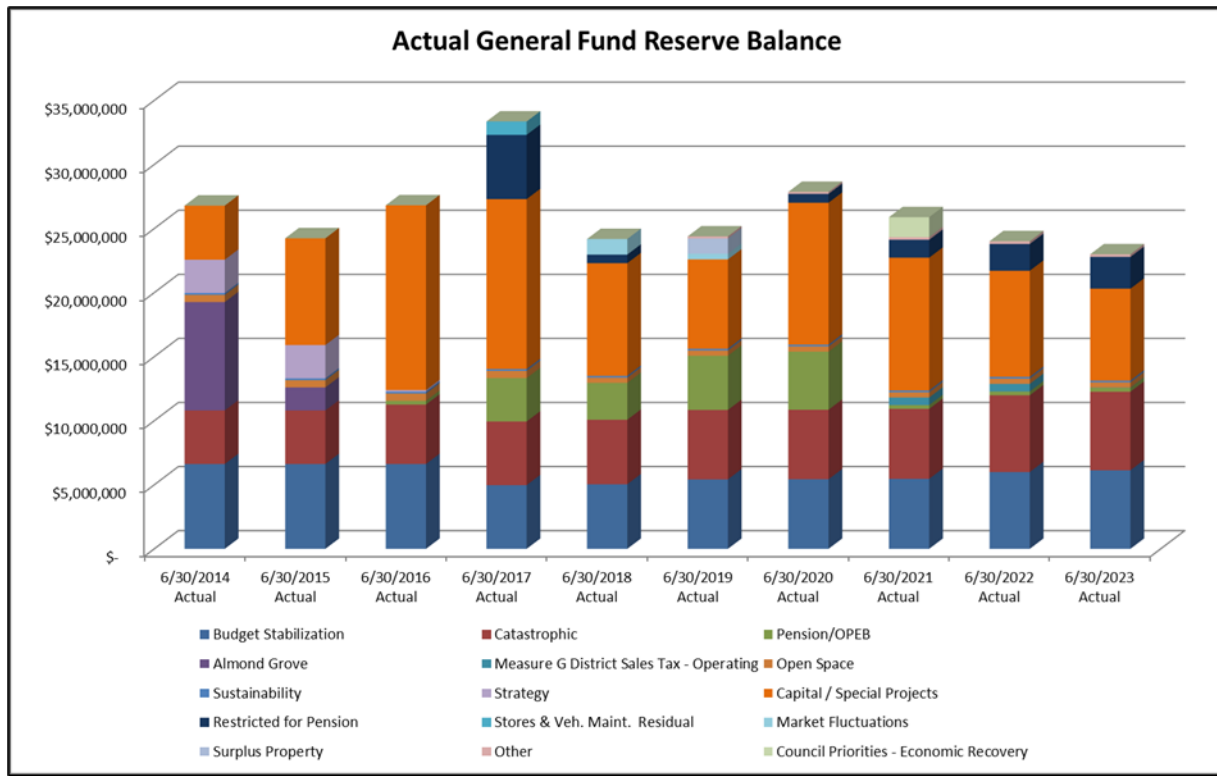
In the next chart, trendlines are fitted to the graphs to determine the slope of the actual growth projections for major revenues (blue) and expenditures (orange). The trendline shows expenditures outpacing revenues.

DISCUSSION (continued):General Fund Reserves

Local governments are required by law to have balanced budgets. Deficit spending is not a legal option. The Town manages its budget during the year, including budget adjustments considered by the Town Council throughout the year to ensure adequate resources for the consistent delivery of services and to cover unforeseen expenses. Because the Town only spends what has been budgeted, surpluses result every year. Larger surpluses are also due to vacancy savings and stronger revenues than budgeted.

The Town uses the Capital/Special Projects General Fund Reserve to pay for most budget adjustments. This is also the Reserve that contributes to the Town's annual Capital Improvement Program. The General Fund Reserve balances are shown in the chart below, showing a total downward trend since June 30, 2020.

General Fund Reserves were established by Town Council action and are governed by the General Fund Reserve Town Council Policy. The Reserves are categorized as legally restricted, committed, and assigned. Each Reserve has a specific purpose as described in the Adopted Budget. One-time uses are appropriate for the Reserves and not ongoing expenditures.

DISCUSSION (continued):Other Liabilities

In addition to salary, benefits, pension, and OPEB as key drivers for the Town's expenses, the Town is also experiencing increased general liability insurance premiums and workers' compensation claims costs. Over the last year, the Town has made significant progress to contain its workers' compensation costs by increasing worker safety programs and resolving cases. We continue to monitor these cases and implement other mechanisms to reduce risk of injury to employees. These costs are built into the Operating Budget and the Five-Year Forecast.

As resources allow and Council priorities direct, the Town is very slowly working through its infrastructure backlog and the maintenance needs for Town facilities and other assets (not including life cycle replacements). The current total estimate of this work is \$76.5 million, broken down as follows:

- Americans with Disability Needs: \$27.0 million
- Town Facilities Maintenance: 23.6 million
- Stormwater Infrastructure: 16.5 million
- Pavement Maintenance: 9.4 million

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SUBJECT: Discussion of the Draft Resolution of a Tax Measure

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CONCLUSION:

Staff continues to closely monitor expenditures and revenues throughout the year. In considering past and future trends, it is staff's responsibility to alert the Finance Commission and the Town Council of potential concerns.

Staff looks forward to the Commission's questions and discussion.

Attachments:

1. Communications from the Chair
2. Pension Information