From: Phil Koen
To: Mary Badame; Matthew Hudes; Rob Rennie; Rob Moore; Maria Ristow
Cc: Linda Reiners; Laurel Prevetti; Gitta Ungvari; Wendy Wood; Gabrielle Whelan
Subject: Agenda item #14 - 5 year forecast
Date: Sunday, February 18, 2024 5:13:55 PM
Attachments: adopted Resolutions - Item # 4.docx
General Fund Exepnditure Analysis - FY 22 - FY 29.xlsx
General Fund Exepnditure Analysis - FY 22 - FY 29 - Adjusted Case.xlsx

[EXTERNAL SENDER]

Dear Honorable Mayor and Town Council Members,

I am writing to you in my capacity as Chair of the Finance Commission. Unfortunately, because of the timing of the Council meeting, the entire Commission has not had an opportunity to review and comment on this memo. I take full responsibility for its content. I believe the major points expressed by the Finance Commission have been captured and the memo is accurate.

Summary Comments

The Finance Commission discussed for over an hour the Staff's 5 Year Forecast, analyzing the forecast as a whole and carefully listening to the Staff's presentation and comments. The agenda called for the Finance Commission to make a recommendation to the Town Council to either accept or reject the forecast as presented. The Finance Commission's role was not to opine on individual assumptions but rather to review and determine whether the Council should rely on the Staff's work product taken as a whole.

There was considerable discussion and comments provided to Staff regarding the underlying assumptions and the reasonableness of the forecast. It is important to note that based on the 5 Year Forecast, Staff concluded "**the persistent presence of a deficit** indicates that the Town needs to consider new revenue measures if it wants to maintain high levels of municipal services" (Executive Summary, page 1 of the Staff report). Given this conclusion the Finance Commission took extra care to probe the reasonableness of the 5 Year Forecast.

Additionally, the Finance Commission considered in FY 22 and FY 23 the Town's General Fund had an operating surplus of $4.4 million and $5.7 million. It was difficult for the Finance Commission to bridge from a $5.7 million operating surplus in FY 23 to an operating deficit of $1.5m by FY 25. That would be a negative turnaround of $7.2m in two years, which was never adequately explained by Staff.

In a unanimous decision, the Finance Commission made a finding the 5 Year Forecast total tax revenues were too conservative compared to historic growth rates, and operating expenditures could be managed through cost containment and productivity measures to reduce the forecasted growth rates. If adjustments were made to property tax and sales tax growth rates to align with more closely, but remain below, historic growth rates and cost containment and productivity measures were reasonably applied to internal service costs to reduce the projected growth rate from 10.8% to 7.1%, the Town would realize **persistent future surpluses and not deficits**.

Based on the above, the Finance Commission unanimously **voted not to recommend** the Staff's 5 Year Forecast to the Town Council and **did not agree** with Staff's conclusion that "the persistent presence of a deficit indicates that the Town needs to consider new revenue measures if it wants to maintain high levels of municipal services".

Additional Detail Comments

Attached are two schedules which the Finance Committee referenced in making its finding but were not included in the Town Council package.

The first schedule – **General Fund Expenditure Analysis – FY 22-FY 29** – presents in a simplified format the Staff's 5 Year Plan. As you can see the Staff has assumed a compounded annual growth rate (CAGR) of 3.7% for property taxes. During the discussion Staff confirmed the 6-year historical growth rate has been approximately 7.4%. Additionally, the Staff's forecast has assumed a 10.8% CAGR in internal service charges which reflect the growth in operating expenses for equipment replacement, workers compensation, self-insurance, information technology and facilities maintenance. There are no salary and pension expenses included in internal service charges.

The second schedule – **General Fund Expenditure Analysis – FY22-FY29 – adjusted case** – presents an alternative to the Staff forecast which increases the property tax CAGR to 5.5%, slightly increases sales tax growth rate to 1.7% CAGR and moderates the forecasted growth rate in internal service charges to 7.1% CAGR. The result is operating surpluses for every year starting at $1.2m in FY 25 and growing to $3.2m by FY 29.

Additionally, the Staff report does not disclose that two resolutions were approved by the Finance Commission. Both resolutions are attached. The report includes the second resolution but omits the first resolution which was equally important. This resolution addressed a fundamental weakness in the Town's reporting of financial information. The Finance Commission found that a lack of consistency in the reporting formats used to report actual results, mid-year updates, and five-year forecasts makes it very difficult for the Town Council and members of the public to understand the financial information presented. This prohibits the ability to compare results between reports, decreases transparency and inhibits the ability to draw reasonable conclusions. The Finance Commission's recommendation is to adopt a consistent format in reporting financial results such as the format used in the

ACFR.

Comments regarding ERAF not discussed by the Finance Commission during the February 12 meeting.

Staff has provided additional comments in their February 14 report about excess ERAF that were not provided to the Finance Commission at the February 12 meeting. For example, the comment that "there is no guarantee for funding in the future" is not based on any independent analysis or known facts. Excess ERAF has been around for decades. In a report by the Legislative Analyst's Office dated March 20, 2020, it was reported that:

> "In 2006-07 counties reported excess ERAF totaling about $100m – equating to about 1.5% of all property tax revenue allocate from ERAF accounts statewide. Over the next decade, excess ERAF grew steadily. Within the past three years, however, growth in excess ERAF has accelerated. Preliminary reports show excess ERAF totaling $820 million in 2018-19 equating to about 8% of all funding allocated from ERAF statewide".

The reason excess ERAF has grown substantially over the past few years is because the acceleration in property valuations. The ERAF was created in 1992 and redirects a share of property taxes statewide from cities, counties, and special districts to K-14 schools. ERAF offsets funding K-14 schools would otherwise receive from the State General Fund. It is very difficult to see how $94.9m that is currently projected to be distributed in FY 24 excess ERAF to the cities in Santa Clara County would go to zero. How exactly this would happen was not explained in the Staff report.

For FY 24, Santa Clara County has already indicated the Town will receive $2.5m in excess ERAF which is an 8.7% increase over FY 23 ERAF of $2.3m received. Staff did not explain why it would be reasonable to assume receiving a 50% reduction in excess ERAF revenue in FY 25 of $1.25m (option b) and holding at revenue level through FY 29.

The February 14 Staff report mentions "the Governor's most recent budget assumes the approval of legislation allocating ERAF to charter schools, potentially reversing the recent appellate decision that charter schools do not get ERAF". It is correct the budget proposes statutory changes that would clarify that charter schools are eligible for funding from the ERAF. Charter Schools were established the same year as ERAF, and it had never been clarified if they are eligible for this funding until the ruling **California School Boards Association vs Malia M Cohen** dated July 31, 2023, which determined that charter schools were not intended to be included in the calculation or allocation of excess ERAF. This concluded the legal challenge brought by CSBA.

-

If the Governor's proposal is adopted, it would be on a "go forward" basis and would modify the calculation of future excess ERAF so charter schools would receive an automatic allocation of property tax revenue. The Staff has reported the potential impact could be an annual reduction of approximately 8% of the excess ERAF the Town is projected to receive.

Please let me know if you have any questions. The Finance Commission takes seriously its responsibility to serve as an on-going substantive and expert advisory body to the Town Council so that the Council can make informed decisions about the Town's financial matters.

Thank you.

Phil Koen

Adopted Resolutions – Item #4

- The Finance Commission recommends the Town Council request Staff to adopt a consistent format for reporting revenues, expenditures and change in fund balance which will be used in the annual plan, the 5-year forecast and the mid-year update reports to improve visibility and comparability. All reports must be prepared in accordance with GAAP.
- The Finance Commission recommends the Town Council not accept, nor rely upon the current version of the FY 24 5-Year Plan. Given the importance of the 5-Year forecast in establishing tax policy, the Finance Commission makes a finding the draft forecast of a 2.9% CAGR in total tax revenue is too conservative compared to historic growth rates and the 4.9% CAGR in operating expenditures needs to be reduced through cost containment and productivity measures. The Finance Commission does not agree with Staff's conclusion that "the persistent presence of a deficit indicates that the Town needs to consider new revenue measures if it wants to maintain high levels of municipal services" as stated on page 1 of the Staff report.

General Fund Model - FY 22 - FY 29	FY 22	FY 23	FY 24	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29	CAGR
Town's Base Case - no $1.9 payment	Act	Act	adopted	Feb 12 Est		Feb 12 2024 5 Year Forecast				FY 23 - FY 29
Revenues										
Property Tax	21.1	22.7	22.6	23.9	23.5	24.7	25.8	27.0	28.3	3.7%
Sales Tax	8.5	8.8	9.2	8.2	8.3	8.5	8.6	8.7	8.9	0.2%
TOT Tax	1.9	2.2	2.4	2.3	2.3	2.4	2.5	2.5	2.6	2.8%
FranchiseTax	2.8	3.1	2.1	3.3	3.4	3.5	3.6	3.7	3.8	3.5%
Business License	1.5	2.4	2.4	2.4	2.5	2.6	2.7	2.7	2.8	2.6%
>Total Tax Revenue	35.8	39.2	38.7	40.1	40.0	41.7	43.2	44.6	46.4	2.9%
Use of Money	(1.4)	0.8	1.0	1.6	1.7	1.6	1.5	1.4	1.3	8.4%
Functional Revenue	12.2	10.6	8.4	10.2	8.4	8.6	8.9	9.0	9.2	-2.3%
other Sources			1.7	2.2	1.2	1.2	1.3	1.4	1.3	
Total Revenue - Agrees to ACFR	46.6	50.6	49.8	54.1	51.3	53.1	54.9	56.4	58.2	2.4%
Expenditures										
Salaries and Benefits	20.1	21.9	23.2	22.7	23.8	24.3	24.8	25.4	25.9	2.8%
4.6% Vacancy Savings			(1.7)		(1.8)	(1.8)	(1.9)	(1.9)	(2.0)	
Calpers Benefits	6.5	7.1	8.2	7.3	9.0	9.1	9.7	10.3	11.2	7.9%
ADP to Calpers			0.4	0.7	0.4	0.4	0.4	0.4	0.4	
All other benefits	5.1	5.3	6.3	5.8	7.4	7.7	8.0	8.2	8.4	8.0%
Operating Expenditures	8.2	6.9	9.6	11.7	9.4	9.5	10.0	10.2	10.5	7.2%
Fixed Assets	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Grants and Award	0.6	0.6	0.8	0.9	0.4	0.3	0.3	0.3	0.3	-10.9%
Principal	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Internal Service Charges	2.6	2.6	3.4	3.3	4.0	4.2	4.4	4.6	4.8	10.8%
Total Expenditures - Agrees to ACFR	43.3	44.9	50.4	52.6	52.8	53.9	55.9	57.7	59.7	4.9%
Excess (Deficit) Revenues over Expenditures	3.3	5.7	(0.6)	1.5	(1.5)	(0.8)	(1.0)	(1.3)	(1.5)	
Gain from asset sale	0.1	0.1	0.0	0.0						
Transfers - In	4.0	4.1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
Transfers - Out	4.4	7.2	1.6	1.6	1.1	1.1	1.1	1.1	1.1	
Net Changes in Fund Balance	3.0	2.7	(1.7)	0.4	(2.1)	(1.4)	(1.6)	(1.9)	(2.1)	

General Fund Model - FY 22 - FY 29	FY 22	FY 23	FY 24	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29	CAGR
Adjusted Case	Act	Act	adopted	Feb 12 Est		Feb 12 2024 5 Year Forecast				FY 23 - FY 29
Revenues										
Property Tax	21.1	22.7	22.6	23.9	25.2	26.6	28.1	29.6	31.2	5.5%
Sales Tax	8.5	8.8	9.2	8.2	8.5	8.8	9.1	9.4	9.7	1.7%
TOT Tax	1.9	2.2	2.4	2.3	2.4	2.4	2.5	2.5	2.6	2.8%
FranchiseTax	2.8	3.1	2.1	3.3	3.5	3.5	3.6	3.7	3.8	3.5%
Business License	1.5	2.4	2.4	2.4	2.5	2.6	2.7	2.7	2.8	2.6%
>Total Tax Revenue	35.8	39.2	38.7	40.1	42.1	43.9	46.0	47.9	50.2	4.2%
Use of Money	(1.4)	0.8	1.0	1.6	1.7	1.6	1.5	1.4	1.3	8.4%
Functional Revenue	12.2	10.6	8.4	10.2	8.4	8.6	8.9	9.0	9.2	-2.3%
other Sources			1.7	2.2	1.2	1.2	1.3	1.4	1.3	
Total Revenue - Agrees to ACFR	46.6	50.6	49.8	54.1	53.4	55.3	57.7	59.7	62.0	3.4%
Expenditures										
Salaries and Benefits	20.1	21.9	23.2	22.7	23.8	24.3	24.8	25.4	25.9	2.8%
4.6% Vacancy Savings			(1.7)		(1.8)	(1.8)	(1.9)	(1.9)	(2.0)	
Calpers Benefits	6.5	7.1	8.2	7.3	9.0	9.1	9.7	10.3	11.2	7.9%
ADP to Calpers			0.4	0.7	0.4	0.4	0.4	0.4	0.4	
All other benefits	5.1	5.3	6.3	5.8	7.4	7.7	8.0	8.2	8.4	8.0%
Operating Expenditures	8.2	6.9	9.6	11.7	9.4	9.5	10.0	10.2	10.5	7.2%
Fixed Assets	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Grants and Award	0.6	0.6	0.8	0.9	0.4	0.3	0.3	0.3	0.3	-10.9%
Principal	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Internal Service Charges	2.6	2.6	3.4	3.3	3.4	3.5	3.7	3.8	3.9	7.1%
Total Expenditures - Agrees to ACFR	43.3	44.9	50.4	52.6	52.2	53.2	55.2	56.9	58.8	4.6%
Excess (Deficit) Revenues over Expenditures	3.3	5.7	(0.6)	1.5	1.2	2.1	2.5	2.8	3.2	
Gain from asset sale	0.1	0.1	0.0	0.0						
Transfers - In	4.0	4.1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
Transfers - Out	4.4	7.2	1.6	1.6	1.1	1.1	1.1	1.1	1.1	
Net Changes in Fund Balance	3.0	2.7	(1.7)	0.4	0.6	1.5	1.9	2.2	2.6	

From: [redacted]
To: Wendy Wood; Town Manager; Gitta Ungvari
Subject: Please include the attached for tonight"s Council meeting - Item 14
Date: Tuesday, February 20, 2024 10:45:49 AM
Attachments: letter for 2-20-24 meeting.pdf

[EXTERNAL SENDER]

Thanks Wendy!

For Town Council Meeting 2-20-24

Item 14

Dear Councilmembers,

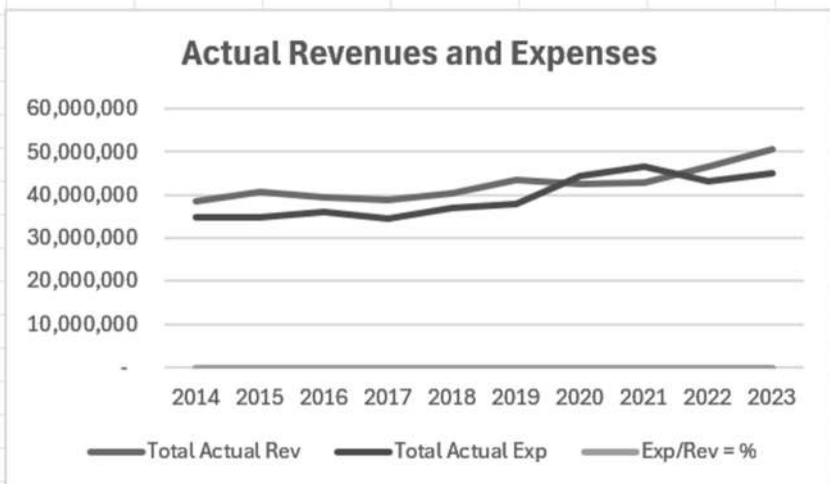
As you know, the Finance Commission unanimously voted that the Five-Year Forecast is wrong. It is wrong because the Town knew, and still used, old, outdated numbers. You should ask yourself why they did that. The incorrect Five-Year Forecast has been issued to you with misinformation. How are you to make an intelligent decisions for this town of 33,000 when you are fed bad information? Mr. Koen gave you a lot of data and below are a couple more observations I have made.

One additional item that Ms Prevetti stated that the town has incurred, and implies will continue to incur, will be **”unfunded state mandates”**. If that is true, one could reasonably expect that expenditures could exceed revenues over time. In the 10 year analysis, that hasn't happened. If it hasn't happened in 10 years, what is going to happen in the future that will increase de cits and where is Ms Prevetti's justi cation for this statement?

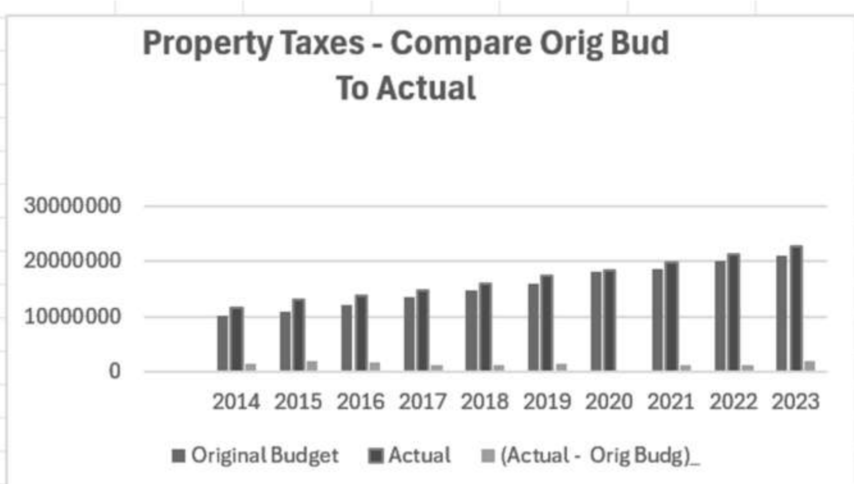
Here are two “views” of the Town's nancial condition using data from the audited Annual Comprehensive Financial Report (ACFR). One example is in numbers from the ACFR showing that expenses as a percent of revenue **actually decreased** in 2023:

Fiscal Year		Total Actual Rev	Total Actual Exp		Surplus (Deficit)	Exp/Rev = %	
2014		38,468,192	34,902,195	$	3,565,997	91%	
2015		40,710,141	34,861,895	$	5,848,246	86%	
2016		39,516,979	36,165,995	$	3,350,984	92%	
2017		38,746,123	34,542,602	$	4,203,521	89%	
2018		40,529,416	37,014,345	$	3,515,071	91%	
2019		43,622,934	37,993,949	$	5,628,985	87%	
2020		42,715,907	44,270,043	$	(1,554,136)	104%	Payments made to CalPers
2021		42,739,761	46,612,586	$	(3,872,825)	109%	Payments made to CalPers
2022		46,623,452	43,332,557	$	3,290,895	93%	
2023		50,609,731	44,890,847	$	5,718,884	89%	
Expense as a percent of revenue over a 10 year av						93%	
Average Surplus over 10 years				$2,969,562			
Note that 20/21 were covid years and we made a total of a $10.4M payment							
	to reduce unfunded liabilites						

Below is a visual graphic perspective that shows how expenses track to revenues for 10 years. The one increase of expenses over revenues was incurred by the large $10.4M ADP to CalPers that eventually will save the town over $12M:



Lastly, below is a graph of the property taxes for the past 10 years and ask yourself why the Town's reduction from an annual Compounded Annual Growth Rate of 7.7% to 3.7% is a reasonable reduction given the 10 year CAGR?



Jak Van Nada -
Los Gatos Community Alliance
Facts Matter; Transparency Matters; Honesty Matters