

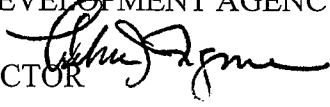


MEETING DATE: 2/7/05
ITEM NO. 10

COUNCIL/AGENCY AGENDA REPORT

DATE: February 3, 2005

TO: MAYOR AND TOWN COUNCIL/
CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY

FROM: TOWN MANAGER/EXECUTIVE DIRECTOR 

SUBJECT: 2004/05 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2004.

A. ACCEPT 2004/05 MID-YEAR SECOND QUARTER BUDGET
PERFORMANCE STATUS REPORT, INCLUDING FY 2005-10 FIVE-
YEAR FINANCIAL PROJECTIONS.

B. AUTHORIZE BUDGET ADJUSTMENTS AS RECOMMENDED IN
THE ATTACHED SECOND QUARTER BUDGET PERFORMANCE
REPORT

RECOMMENDATION:

1. Accept 2004/05 Mid-Year Budget Performance and Status report.
2. Authorize budget adjustments as recommended in the attached second quarter budget performance report.

PURPOSE:

The purpose of this report is twofold, the first is to inform the Town Council on the status of the Town's FY 2004/05 adopted budget at the mid year point, the second is to provide the Town Council with staff's most recent information regarding the evolving budget situation for FY 2005/06 and

PREPARED BY: **STEPHEN CONWAY** 
Finance & Administrative Services Director

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Reviewed by: PS Assistant Town Manager OK Town Attorney _____ Clerk Administrator
_____ Finance _____ Community Development Revised: 2/3/05 4:30 pm

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CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY

SUBJECT:- 2004/05 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX
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- A mid-year FY 2004/05 budget update focusing on revenue and expenditure trends and financial projections for the current fiscal year.
- An update to the Town's five year financial projections (FY 2005-10) to provide a framework for understanding the estimated size of the budget challenges in future years that underlie the necessity for budget recommendations that are being developed for discussion with Town Council on March 7, 2005.

THE REPORT:

This report comprehensively examines the current year budget status for FY 2004/05, expected fiscal outlook and the evolving process of budget development for FY 2005/06 and beyond. Items for Town Council consideration include:

- A review of the Town's FY 2004/05 Mid Year Budget Performance and Status Report;
- An update to the Town's five-year financial projections through FY 2009/10;
- An historical briefing of the Town's budget reduction efforts to date that have been implemented since FY 2001/02;
- A briefing on the budgetary actions taken to date, and a conceptual discussion of preliminary budget proposals for FY 2005/06 that will be reviewed with the Town Council on March 7, 2005 to meet FY 2005/06 budget challenges.

DISCUSSION:

FY 2004/05 MID YEAR BUDGET STATUS:

The attached Budget Performance Report (Attachment 1) is the mid year report covering the six months beginning July 1, 2004 and ending December 31, 2004. The Budget Performance Report presents analysis and recommendations related to key General Fund revenues by category and expenditures by fund.

Staff provides to Town Council periodic updates on the status of the current year's adopted budget revenues and expenditures and the projected financial condition of Town funds, concentrating primarily on the Town's General Fund. Though the financial results are limited to the first six months, staff has more information available than at the time of the first quarter report presented to Council on October 18, 2004, allowing an update based on revenue trends for the current fiscal year. Information is provided regarding vital revenues to the Town such as Sales Tax, Property Tax,

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Transient Occupancy Tax, Vehicle License fees (Car Tax), Business License Tax, Fees and Charges and Interest Income. This information aids staff in providing the status of the revenues adopted to support the FY 2004-05 operating budget. Furthermore, the Town Council is advised of any recommended changes to estimated revenues or expenditure appropriations included in the Town's FY 2004/05 adopted budget.

There are some favorable developments in the Town's General Fund adopted revenues. Overall, total General Fund estimated operating revenues, excluding reserve funds, for the current year are anticipated to be higher by a net of \$767,745 than the adopted budget estimates. Highlights of some of these changes include a recommended \$200,000 budget increase in estimated Sales Tax from \$6,900,000 to \$7,100,000. Property tax receipts are also trending ahead of estimates, resulting in a recommended increase in this vital source from \$4,952,000 to \$5,101,668 for the current year. Additionally, building permits are recommended to be increased \$200,000 for the current year. Other revenue with recommendations for increase combine in total for the remaining \$428,970 of net increases to General Fund revenues for the fiscal year. Included in the gain in other revenues are in the category of Intergovernmental Revenues whereby the Car Tax (VLF) backfill is recommended to be adjusted by a \$172,000 net increase from prior year estimates. Also, the Supplemental Law Enforcement Grant (SLESF) revenue is recommended to be increased by \$138,870. Partially offsetting but not eliminating the gains mentioned above are recommended reductions to estimates in other General Fund revenues totaling approximately \$210,000. The decrease is derived from a number of key revenues experiencing declining revenue. The estimate for planning permits is recommended to be lowered by approximately \$100,000 due to lower than expected planning activity for the year. Transient Occupancy taxes are also recommended to be adjusted slightly lower by \$20,000 from \$900,000 to \$880,000. The attached Budget Performance and Status Report provides additional details and analysis regarding revenue and expenditure activity and the recommended budget adjustments for principal General Fund revenue sources. The mid-year budget projections contained in Attachment A reflect the revised revenue projections as described in this report.

On a positive note, staff is encouraged by the fact that expenditures in many Town departments are trending 3% below the expected 50% of budget level (expected level halfway through the fiscal year). If this trend continues, there may be potential for departmental budget savings to be an additional resource available for budgetary balancing or designation for specific purposes such as future capital needs.

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Though the trends at mid-year are positive overall netting a \$767,745 increase in operating revenues, there may be additional revenue impacts that need to be addressed in the remaining six months. Additionally, there always remains a looming threat of additional State revenue "takes." At this time, there is no verifiable information of proposed additional state takes beyond the scheduled second year of the two year "take" of approximately \$480,000 in property taxes slated for implementation in FY 2005/06. This means that state revenues such as booking fees and supplemental law enforcement grant monies, among others, which were not specifically protected by Proposition 1A may still be vulnerable to future state revenue "takes."

The availability of excess balances resulting from fiscal year expenditure reductions or increases in revenue estimates is one important part of potential funding for future budgets that the Town is describing as "bridge funding." Bridge funding is conceptualized as a funding source to be used as dollars available to move to more efficient organizational structures, ferret out and understand new service delivery options, and allow time for new initiatives and programs to become more fully formed. Bridge funding will allow more time to ramp up or bring new programs "on-line," providing some resources for "start-up" costs until the programs can be sustained by operating revenues. Normally, the Town's policies provide that any excess revenues over expenditures in the fiscal year not specifically designated for other uses is set aside in a reserve for future capital improvements. This year, as in years past, the staff will recommend that Council consider some or all of these revenues be used as potential sources of bridge funding for next fiscal year, if warranted.

The availability of bridge funding provides the Town a longer planning horizon to develop appropriate organizational structures that align with the new fiscal reality, to inform the Town's employees of potential reductions in the workforce, inform the community about potential service level impacts, and to establish appropriate service levels that balance with revenues projected for next fiscal year.

Sources of potential bridge funding include:

- Excess Revenues Over Expenditures. As discussed above, if there are excess balances at the close of the fiscal year, the balances not designated by Town Council for specific purposes are designated for future capital improvements by Town policy. This year the Town may desire to designate some of this potential funding for bridging purposes. This strategy is being used for backfill revenues for the two year State property tax "take."
- General Fund Reserves. FY 2004/05 beginning fund balance consists of approximately \$10.6 million of total "available" reserves. The bulk of these reserve are "committed" or designated for specific purposes like parking, open space, and other uses. Included in this

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total is the Reserve for Economic Uncertainty intact at \$3,678,000. However, there are some funds labeled as undesignated (\$1.7 million), the bulk of which is likely to be committed to capital needs, but some portion of these funds could be used for bridge funding.

- Internal Service Fund Reserves. Staff believes there may be a moderate amount of additional capacity to absorb some additional transfers from these funds to repay the General Fund for prior year overcharges. Staff believes each fund is adequately funded, and there remains some modest ability to tap some of this surplus for appropriate bridging uses.
- Public Employees Retirement System (PERS) Set-Aside. The Town has accumulated approximately \$3 million in its General Fund liability account to be used to buffer future Retirement System rate increases by continuing to charge itself the Non-Sworn employer PERS contribution of 7% even when the official PERS rate charged to the Town was 0% due to the Town's surplus at PERS. This prudent fiscal decision which we have been continuing since 1999 is proving to be very valuable now with PERS rates rising rapidly due to stock market losses and in light of a forecast received by the Town in January 2005 from PERS actuaries in which employer costs for FY 2005/06 are expected to be increased approximately \$310,000 above the expected rate built into the Financial Plan in the fall of 2004.

Using reserves or other sources of bridge funding needs to be done strategically, ensuring that these funding sources are not used to fund ongoing cost and service delivery structures that are not eventually supported by forecasted future operating revenues.

FIVE YEAR FINANCIAL PROJECTIONS UPDATE:

Setting the stage for FY 2005/06 budget development, staff recently updated the Town's Five Year Financial Plan spanning fiscal years 2005/06 through 2009/10. The updated scenarios continue to demonstrate the need for the Town to take action to maintain the Town's fiscal health. Projected FY 2005/06 revenue shortfalls prior to any budget actions taken to align operating costs to operating revenues are forecasted to be \$928,000 net of use of authorized reserves. The shortfall is based upon conservative revenue growth estimates in key revenue categories, forecasted expenditure increases in expected salary and benefits, including the unexpected increase in employer PERS retirement benefit costs, and conservative estimates for increases to supplies and services and utilities operating costs based upon current year actual expenditure activity. The predicted shortfall is dependent upon the level of recovery in local economically sensitive revenues such as sales tax and the confirmation that the additional State revenue "take" remains at \$480,000 as agreed in the State two-year budget agreement between the State of California and local government.

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The updated five year forecast as presented in the following pages assumes approximately \$480,000 in additional State "takes" of property tax in FY 2005/06 similar to the amount the Town experienced this fiscal year. This scenario also assumes that the State property tax swap or "back-fill" of approximately \$1.2 million in Car Tax for local property tax will continue in future years as promised by the State to be implemented "permanently" in the FY 2004/05 budget bill. Revenues are optimistically presented with varying growth rates, on average 5% for tax revenues and 3% for charges for services. Expenditures are derived from a database using actual costs and adjusting for future known increases in labor costs if multi-year labor agreements are in effect, and actuarial updates for retirement and other benefit costs as provided by PERS or other information sources available to the Town.

Each of the years presented in the plan assume that fixes made to the budget to eliminate the revenue shortfall in FY 2005/06 and beyond are "permanent" fixes, thereby reducing the level of shortfall in the following fiscal years. The amounts fixed permanently in the Town's operating costs are assumed to carry forward cumulatively each year, lessening the reduction required in subsequent years. It is possible to make some adjustments through one-time solutions or prudent use of bridge funding on a year-to-year basis. However, these solutions recognize that problems that are truly structural should be addressed eventually with new revenue sources or reduced expenditures in an ongoing way.

The following pages present the plan. A terminology guide follows as an aid to understanding the Updated Five Year Financial Projections data that is presented in each scenario.

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Town of Los Gatos							
Five Year Financial Plan FY 2005/06 Through FY 2009/10							
Summary Data	ACTUAL	ADOPTED	PROJECTED	PROJECTED	PROJECTED	PROJECTED	PROJECTED
Revenue Summary	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Sales Tax	6,914,526	6,900,000	7,245,000	7,607,250	7,987,613	8,386,993	8,806,343
Property Tax	5,207,381	5,428,893	5,754,627	6,099,904	6,465,898	6,853,852	7,265,083
Charges for Services	2,526,198	2,758,725	2,837,846	2,997,484	3,172,418	3,306,118	3,446,503
Car Tax/VLF Prop Tax Swap	1,298,455	1,700,000	1,796,334	1,898,165	2,005,808	2,119,597	2,239,885
Other Lic. and Permits	936,313	1,276,055	1,314,337	1,353,767	1,394,380	1,436,211	1,479,297
Intergovernmental Rev.	1,914,766	1,194,135	1,299,730	1,803,727	1,833,633	1,865,120	1,897,657
Business Licenses	1,071,865	1,080,000	1,112,400	1,145,772	1,180,145	1,215,550	1,252,016
Franchise Tax	930,997	957,000	1,005,655	1,055,938	1,108,735	1,164,171	1,222,380
Investment Earnings	37,407	931,836	912,619	932,974	953,838	980,145	1,007,232
Hotel/Motel Tax	829,026	900,000	870,000	913,500	959,175	978,359	997,926
Transfers	1,425,019	809,920	605,938	454,076	364,738	325,448	314,994
Miscellaneous	194,445	473,078	488,682	513,416	539,337	566,504	594,979
Fines & Forfeitures	214,232	144,950	150,858	157,020	163,450	168,955	174,656
Total Revenues	23,500,630	24,554,592	25,394,025	26,932,993	28,129,167	29,367,022	30,698,951
Town Expenditures							
Salaries	11,469,874	12,143,287	12,820,561	13,375,535	13,898,008	14,429,285	14,961,480
Benefits	3,277,273	4,290,300	5,196,506	5,607,872	5,984,094	6,430,348	6,501,127
Temporary Sal & Ben.	428,163	331,300	397,781	411,286	425,396	439,573	454,949
Paid Overtime	341,814	346,800	417,461	438,334	460,250	480,710	504,746
Total Sal. & Ben.	15,517,124	17,111,687	18,832,308	19,833,026	20,767,748	21,779,916	22,422,302
Grants & Awards	186,431	175,380	175,380	175,380	175,380	184,149	193,356
Training	104,511	190,625	196,344	202,234	208,301	218,716	229,652
Employee Retiree Med.	131,586	153,100	211,000	290,000	363,000	381,150	400,208
Animal Control Oper.	173,553	168,200	185,020	203,522	223,874	235,068	246,821
Supplies and Services	2,424,379	3,123,170	3,216,865	3,313,371	3,412,772	3,583,411	3,762,581
Utilities	402,503	380,215	351,477	369,051	387,503	406,879	427,223
Capital Purchases	90,378	20,400	21,012	21,642	22,292	23,406	24,577
Internal Service Funds	3,056,215	2,699,700	2,780,691	2,864,112	2,950,035	3,097,537	3,252,414
Debt Service/Transfers	1,203,947	1,152,265	1,152,265	1,152,265	1,152,265	1,231,626	1,236,684
Storm Drains	-	-	-	-	-	-	-
Road Maintenance/Rep.	-	-	-	-	-	-	-
Total Expenditures	23,290,627	25,174,742	27,122,362	28,424,603	29,663,170	31,141,857	32,195,818
*Authorized Use of Reserves		620,150	800,150	-	-	-	
Ongoing Shortfall Mitigation				928,188	563,423	970,580	804,225
Revenues Over (Under) Exp.	210,003	-	(928,188)	(563,423)	(970,580)	(804,255)	(692,642)

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Terminology Guide in Reviewing Five Year Financial Plan

Total Revenues - Total of principal General Fund revenues, FY 2003/04 presents revenue actuals, FY 2004/05 the adopted revenue budget, and the other years use an average 3-6% growth rate from adopted budget levels for economically sensitive revenues such as Sales Tax.

Total Expenditures - Total of principal General Fund expenditures by expenditure type, FY 2003/04 uses expenditure actuals, FY 2004/05 the adopted expenditure budget and the other years use an average 3-5% growth rate in future years depending on the expenditure type.

Ongoing Shortfall Mitigation 05-06 (Assumes Permanent Fix) - A dollar amount appears first in FY 2006/07. This amount is added back to revenues in that year because it assumes that the fixes the Town makes to its operating cost structure are fixed permanently, thereby reducing costs on an ongoing basis in future years. The degree of fix needed depends on whether operating revenues like property taxes or VLF property tax backfill are intact or lost and whether a full permanent fix is made each year. It is in this situation where staff will need to evaluate whether partial offsets with excess reserves could be used to buy the time needed to implement solutions that save costs yet require time to implement.

Revenues Over (Under Expenditures) - Compares General Fund Operating Revenues plus Permanent Fix dollars minus General Fund Operating Expenditures.

Revenue Shortfall as a % of Operating Revenues - In FY 2005/06, the projected reduction percentage required to align operating expenditures with revenues. In FY 2006/07 and beyond, the percentage reductions required take into account the Permanent Fix occurring in the prior year.

Both updates to the long term Five Year financial scenarios indicate the Town was wise to begin strategic cost reductions dating back to FY 2001/02, with cumulative reductions of approximately \$4.5 million in Town operating expenditures since that time. These efforts have been a multi-pronged approach to achieve operational efficiencies, cost reductions, and exploration of alternative methods of service delivery options by the Town.

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Continuing Vulnerabilities

The Town continues to be impacted by operating revenue and expenditure challenges that must be monitored and addressed. Progress or lack thereof in these vulnerabilities will unavoidably affect Town-wide service delivery goals in future years. Staff sees challenges in both the ongoing revenue and cost structure as described below:

Revenues

Recovery in Economically Sensitive Revenues. The financial projections assume that a modest recovery and growth will be experienced by the Town in revenues such as Sales Tax, Business License Tax and Hotel Tax, among others. If this recovery does not materialize, then the revenue shortfall could exceed the forecasted amounts under both scenarios.

The Town's Sales Tax collections are of continuing concern. Though the FY 2004/05 projections are encouraging, the sales tax mix continues to be a concern. An example is the Town's auto dealerships which experienced an average 9% decline in annual sales tax collections in the past year, compared to the average 1% growth state-wide dealerships experienced in the same time period. The Town's auto dealerships account for approximately 30% of the Town's total annual Sales Tax. Another concern is the importance of retaining the technology sector businesses which contribute to the Town's collections, one of which is now one of our largest providers of sales tax annually. The importance of having a well balanced sales tax base continues to be an important objective.

State Budget Impacts to the Town are also unknown. The Governor's budget delivered in January 2005 retains the Car Tax "back-fill" but proposes a property tax shift (ERAF) of approximately \$400,000 from the Town and approximately \$303,000 from the Redevelopment Agency in FY 2005/06. No additional state "takes" are known are expected at this time for FY 2005/06, but that threat is a constant reality for local government. A significant mitigating factor to preserve the Town's revenues from further takes was the successful November ballot measure passed overwhelmingly by California voters to protect local tax revenues for local services.

Drivers of Town Cost

Salary & Benefits- Town government is in the business of providing services which depend on people to deliver. Consequently, the most significant driver of cost for service delivery is the cost of labor. Salaries and benefits of employees comprise the largest share of the Town's General Fund operating expenditures (approximately 70%). In order for the Town to remain competitive in the labor market

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in a high cost region, the Town's labor costs have continued to grow. In particular, significant public safety salary increases throughout the region have influenced the Town's public safety labor costs. In addition, consistent with public safety statewide, Los Gatos sworn public safety employees were provided an enhanced retirement formula (3% @ 50) in 2000 under the State Public Employees Retirement System (PERS).

As mentioned earlier, the Town recently received unanticipated negative news from the PERS actuaries. The Town was informed that costs associated with the new retirement formula and several years of negative investment returns in the pension system have resulted in significant changes in retirement contributions required to be paid by the Town. Based upon estimates obtained in the summer of 2004 from PERS and the Town's actuarial consultant, the Town's contribution toward retirement for Sworn Personnel was expected to rise from the current FY rate of 28.3% for sworn and 8.0% for non-sworn to 30.3% and 10.1% respectively. The new rate now forecasted by PERS actuaries anticipates the rate to be 32.5% for sworn and 13.8% for non-sworn payroll in FY 2005/06. More recent information factored into the Five Year Forecast indicates this cost may rise to 35% of covered safety payroll and up to 15% for non-sworn miscellaneous employees in FY 2009/10. The negative development in employer PERS costs alone have added approximately \$350,000 in benefit costs for FY 2005/06, causing the revenue shortfall projected for FY 2005/06 to increase from approximately 2.66% to 3.66%.

Health care costs are also trending upward, with increases of 16-20% annually over the past several years. Recent agreed upon changes in labor contracts and with non-represented groups such as management are "holding the line" against automatic escalation of health costs, leading to progress in capping maximum cash back allowances that were based upon health premiums, providing for expected significant savings in future years of the plan. The Town will need to continue to explore ways to contain the escalation of salary and benefit cost while concurrently remaining competitive to attract and retain a qualified workforce.

Energy Costs-Town-wide cost increases have exceeded the general inflation rate. This increase is due in part to the rise in electric and gas charges resulting from the recent Statewide energy crisis and global fluctuations in gasoline prices. Energy costs continue to be monitored by staff. Steps are already underway to examine Town-wide energy costs and look for ways to manage energy use and control costs.

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Internal Service Charges-The Town prudently charges itself on an annual basis internal services charges that provide funds used to replace rolling stock, provide information services and technology replacements, perform building maintenance, and maintain workers compensation and general liability programs, among others. Though the Town could eliminate this practice and go on a "pay-as-you-go" basis, staff believes this would not be a best practice in financial management. However, we should continue to ensure that our internal rate setting practices are in line with projected internal service funding needs.

Performance Measures-The Town is actively developing and implementing service delivery performance measures linked to key program services that aim to measure the results of providing the service. This information will aid the Town in better aligning scarce resources with service delivery outcomes, providing a more efficient organization with increased accountability to the public.

REVENUE ENHANCEMENTS AND COST CONTAINMENT:

Realizing the vulnerabilities in the Town's ongoing stream of revenues and its limited revenue base, it is essential that the Town ensure that it is charging adequate fees and charges to recover the cost of services so as not to create public subsidies for private development and other specialized services provided to the Town's customer base. In that regard, staff is examining and bringing forward for Town Council approval a comprehensive fee review and update as part of the FY 2005/06 preliminary budget process scheduled for March 7, 2005. The Town is also evaluating internal costs related to Town support of special events and will discuss with the Council the desired policies regarding objectives of cost recovery. The Town is also monitoring developments in neighboring communities regarding the viability of implementing a 911 system fee.

Review of the FY 2005/06 budget proposals will reveal some new revenue opportunities that the Administration will be bringing forward for discussion with the Town Council in a creative approach to develop additional appropriate and sustainable revenue streams for Town services. In looking forward to future years, management intends to review with the Town Council other revenue options such as tax measures, assessments or bond issues that could provide funding for community assets such as a police facility, a new library, and/or ongoing street surfacing and other infrastructure needs. Since proceeding with any such measure would need to be carefully analyzed, early education and review of options would be an important first step in this decision process.

On the cost side, many ideas are being explored and analyzed by the Town and will continue to evolve through the budget cycle and employee bargaining process.

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BUDGET REDUCTION EFFORTS TO DATE:

Since FY 2000/01 the Town has been actively addressing the budget challenges facing the Town in recent years. The Town has been pro-actively taking steps that have kept the Town's operating revenues in balance with operating expenses since that time. These steps included:

- In early FY 2001/02 the Town began expenditure reductions across all departments in response to the developing recession, including strategically delaying or slowing down operating expenditures, de-funding authorized positions, enacting selected hiring freezes, and extending equipment replacements, where practical. To date, approximately 15 full time equivalent positions have been de-funded from the Town's budget totaling nearly \$1.7 million dollars to date, comprising a substantial part of the approximately \$3.0 million cumulative cost reductions made through this fiscal year.
- In February 2003, the Town implemented expenditure reductions across all Town services of nearly \$1.5 million dollars of expenditure reductions (approximately 6% of General Fund FY 2002/03 budgeted expenditures). The objective was to limit the effects on service delivery to the public by utilizing, where available, salary savings due to vacancies and hiring freezes, salary step savings and selected departmental cost saving initiatives.
- The Town's adopted budget for FY 2003/04 was developed in an environment where flat revenue growth of economically-sensitive revenues was conservatively projected. Specifically, the adopted budget incorporated approximately \$1.3 million of additional reductions (internally referred to as "Tier I" and described in the FY 2003/04 adopted budget transmittal message) from the prior year's adopted budget to balance operating expenditures with operating revenues.

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- The Town's adopted budget for FY 2004/05 incorporated approximately \$800,000 in reductions Town-wide, and \$700,000 in revenue enhancements to align revenues more closely with the cost of service. Staff also prepared a second round of reduction proposals (internally referred to as "Tier II" and also described in the FY 2004-05 adopted budget transmittal message) of approximately \$1.2 million in Town-wide expenses in anticipation of any further reductions made necessary by additional State takes due to the possible failure of the ballot measure protecting local revenues and its attendant potential for unanticipated further state "takes," or other unanticipated reductions in economically sensitive revenues such as Sales Tax or Transient Occupancy Tax. These reduction proposals have been developed with the same strategies used to arrive at the FY 2004/05 Tier I reductions, but to a deeper level.

The measures taken in prior years have contributed to a cumulative savings or revenue enhancements of to the Town of approximately \$4.5 million to date.

As stated earlier, operational savings in FY 2004/05 can be used to mitigate projected revenue shortfalls in economically sensitive revenues such as Sales Tax, and Transient Occupancy Tax (Hotel Tax) beyond that anticipated for remainder of the fiscal year. Expenditure savings and any excess revenue obtained this fiscal year can also be used as a funding source necessary to bridge the organization to its recommended adopted budget levels in FY 2005/06, which are respectively targeted at a level of approximately four per cent below the FY 2004/05 adopted budget levels adjusted for salary and benefit cost increases, partially offset by any revenue enhancements that are implemented next year.

PROPOSED BUDGET REDUCTIONS & REVENUE ENHANCEMENTS FY 2005/06

As presented earlier in the Five Year Financial Plan, the projections for next year indicate the need for approximately \$988,000 or 4% permanent budget reductions or revenue enhancements to align the Town's services with its forecasted ongoing stream of revenues depending upon the Town's local economic fortunes and developments at the state level.

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MAYOR AND TOWN COUNCIL/

CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY

SUBJECT: 2004/05 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX
MONTHS ENDING DECEMBER 31, 2004.

FEBRUARY 3, 2005

Many of the reductions taken in the past two years have resulted from selected hiring freezes and other operational efficiencies departments have been able to develop. These reductions, though difficult, were achieved with increases in efficiency and productivity by Town staff so that the implementation of these reductions was made fairly seamless to the community in terms of service level impacts. The planning for FY 2005/06 reductions is made more difficult because most of this operational "low hanging fruit" has in large measure been harvested in the cumulative \$4.5 million dollar cost reductions or revenue enhancements already implemented by the organization over the past four fiscal years.

Staff is in the process of crafting a comprehensive response to the budget FY 2005/06 budget challenges as presented in the Five Year Financial Plan update. Preliminary budget proposals will be brought forward for Town Council review and direction on March 7, 2005. In staff's judgment, a prudent course of action is for Town departments to begin developing budget reduction and revenue enhancement proposals sufficient to address a range of forecasted revenue shortfalls in FY 2005/06 of approximately \$988,000 or 4%.

ENVIRONMENTAL ASSESSMENT:

This budget report is not a project defined under CEQA, and no further action is required.

FISCAL IMPACT:

The Second Quarter Budget Performance Report includes a number of recommended budget adjustments necessary to balance operating revenues with operating expenditures for FY 2004/05. Upon approval of the recommended budget adjustments by Town Council, current projections forecast a small surplus of operating revenues over operating expenses for the fiscal year ending June 30, 2005 (excluding a one-time use of General Fund reserves for the two year budget agreement between the state and local governments, and one-time costs such as capital costs for the San Jose animal shelter and continuing start-up costs for the new Parking Enforcement program). As detailed in this report, staff is currently engaged in FY 2005/06 budget development process which incorporates plans for a 4% overall expenditure reduction and/or revenue enhancements depending on the performance of the local economy and any further actions taken by the State of California to balance its budget deficit.

Attachments:

Budget Performance Report for the Three Months Ended December 31, 2004



TOWN OF LOS GATOS

MID-YEAR BUDGET PERFORMANCE REPORT

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004

February 07, 2005

FINANCIAL OVERVIEW-EXECUTIVE SUMMARY

Status of FY 2004/05 Adopted Budget:

As discussed in the First Quarter Budget Performance Report presented to Town Council on October 14, 2004, financial results for the first six months are more solid than earlier in the year and indicate some positive movement in the Town's economically sensitive revenues such as Sales Tax and Property Tax. Sales Tax collections through December are trending positively, with our current forecast to exceed revenue estimates by approximately \$200,000 for this fiscal year. The increase is due to increases in the general retail category, led by continued growth of NETFLIX, an internet commerce company, now the Town's largest provider of sales tax revenues. The gain in this area helped offset the average 9% decline in sales tax collected from the Town's auto dealers in the third quarter of calendar year 2004. The decline is a concern because auto dealers constitute approximately 30% of the Town's total Sales Tax. Other positive trends were seen in the License & Permits, Intergovernmental and Other Revenue categories. While General Fund revenues are recommended to be increased overall, certain other key revenues are recommended to be adjusted lower. For example Transient Occupancy Tax (Hotel Tax) second quarter collections are trending lower than second quarter collections received in the prior year, leading staff to recommend a \$20,000 dollar reduction from the adopted budget estimate.

It should be noted that revenues for FY 2004/05 included approximately \$520,000 of transfers to the Town's General Fund from Internal Service Fund excess balances that the Town is using to supplement revenues until operating revenues align with operating expenditures. Unfortunately, these transfers cannot be sustained on an ongoing basis. The Town's five-year plan assumes decreasing amounts of this revenue available through FY 2009/10. If these transfers were reduced, operating revenues would be reduced accordingly. Scheduled labor cost increases, including the unanticipated increase in PERS benefit costs and other operating expenditure increases forecast for FY 2005/06 and future fiscal years will continue to require an improvement in the Town's economically sensitive revenues to offset the cost increases likely to occur. The FY 2005/06 budget proposals and revenue enhancement efforts now being developed for discussion with the Town Council will aid in balancing ongoing revenues with the Town's organizational structure and its accompanying cost of providing services and potentially provide discretionary funding for other initiatives such as funding future capital improvements.

Another positive development since the presentation of the First Quarter Budget Performance Report was the successful passage of the Local Taxpayers Revenue Protection Proposition 1A in November by a large majority of California voters. Unless a financial emergency is declared by the Governor, property tax revenues and sales taxes are now protected from additional state "takes" beyond the two-year "one-time" take of additional property taxes in FY 2004/05 and FY 2005/06. The success of this measure greatly aids the Town in making

more realistic long-range financial projections as more stability is built into the revenue structures that deliver local government services to the community.

GENERAL FUND-KEY REVENUE ANALYSIS FY 2004/05

The following presentation provides a recap of significant General Fund revenue sources as of the second quarter ending December 31, 2004. Staff is monitoring each revenue source closely, and at this time are most concerned about two revenue sources: Transient Occupancy Tax and Business License Fee Tax Income, which are recommended to be adjusted lower for the fiscal year. Property Tax appears to be tracking favorably at nearly 6% growth, outperforming estimates of 4% growth used for the adopted budget estimates for FY 2004/05. The current year's growth in property tax estimates reflects the 6-8% growth rate experienced a few years ago. As stated in the agenda item attached to this report, there is no verifiable information of proposed additional state revenue "takes" beyond the scheduled second year of the two year "take" of approximately \$480,000 in Property Taxes slated for implementation in FY 2005/06. This means that State revenues such as Booking Fees and Supplemental Law Enforcement Grant monies, among others, which were not specifically protected by Proposition 1A may still be vulnerable to future State Revenue "takes".

◆ Sales Tax Revenue ◆

Description

Sales Tax is collected on taxable sales and services by merchants and remitted to the State for distribution to schools, counties, and local government entities. The Sales Tax revenue received by the Town is our largest General Fund revenue source, comprising slightly more than 28% of FY 2004/05 total budgeted General Fund revenues. Sales Tax revenue receipts are classified as General Fund revenue for unrestricted use.

Under Proposition 57, known as the California Economic Recovery Bond Act, the legislature enacted provisions, known as the "triple flip" that changes how sales and use taxes are distributed effective July 1, 2004. These changes will remain in effect until the State's bond obligations are satisfied.

With the implementation of the "triple flip," the portion of the 1 cent allocated to local government will decrease by $\frac{1}{4}$ of 1 cent, and the State's portion will increase by $\frac{1}{4}$ of 1 cent. In turn, the State is replacing the reallocated Sales Tax monies with Property Tax to local governments. The Town's remaining $\frac{3}{4}$ of the 1

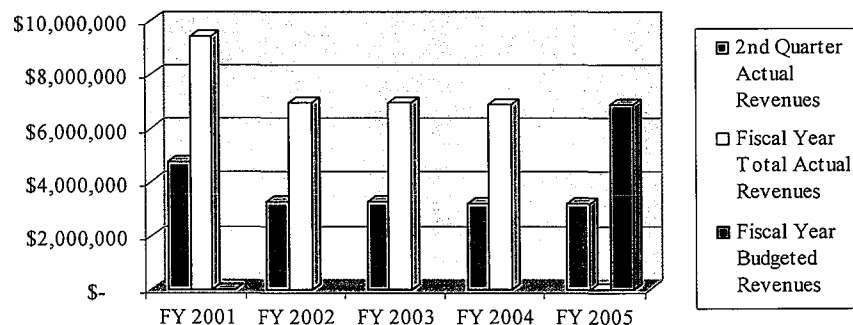
cent of local sales tax revenue continues to be remitted to the Town on a monthly basis; while the reclassified $\frac{1}{4}$ of 1 cent portion known as "Sales Tax in Lieu" is remitted with other Property Tax on a semi-annual basis.

Analysis

Staff continues to analyze the Town's Sales Tax receipts in conjunction with our research consultant, MBIA. Quarterly tax revenues and business sector earnings are monitored to determine revenue trends and vulnerabilities. Of particular note is that while total Sales Tax revenues continue to increase (primarily due to one highly successful enterprise), the continued drop in auto sector revenues remains a specific concern as this sector is a large proportion of the business mix.

Another vulnerability is the Town's increasing dependency (currently 14% of Sales Tax revenue) on this one business. While the business continues to grow at a phenomenal rate (compelling staff to recommend a \$200,000 budget increase at mid-year), economic vitality efforts are focused on strengthening the Town's overall business base.

**Quarterly and Annual Revenues
5-Year History**



	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
2nd Quarter Actual Revenues	\$ 4,759,276	\$ 3,288,885	\$ 3,237,902	\$ 3,217,070	\$ 3,179,238
Fiscal Year Total Actual Revenues	\$ 9,429,256	\$ 6,953,880	\$ 6,928,817	\$ 6,914,526	
Fiscal Year Budgeted Revenues					\$ 6,900,000
2nd Quarter Percent of Total	50.47%	47.30%	46.73%	46.53%	46.08%

Recommended Budget Revision	\$200,000 Increase
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◆ *Property Tax Revenue* ◆

Description

Property Tax is one of the Town's largest revenue sources, accounting for 20.2% of the Town's budgeted General Fund revenue for FY 2004/05. Tax distributions are largely received in the third and fourth quarters of the fiscal year, meaning revenue receipts are not reflected proportionately in the chart below, by quarter.

Property Tax is levied at one percent of the assessed value of the property, of which the Town currently receives approximately 9.5 cents on each dollar paid to the County Assessor's Office.

With the passage of Proposition 13 in 1978, voters amended the state constitution to limit property tax rates to 1% of the property's 1975/76 market value and restricted valuation growth to not more than a 2% inflation factor per annum. When property changes hands or new construction occurs, property is reassessed to its current market value, and also

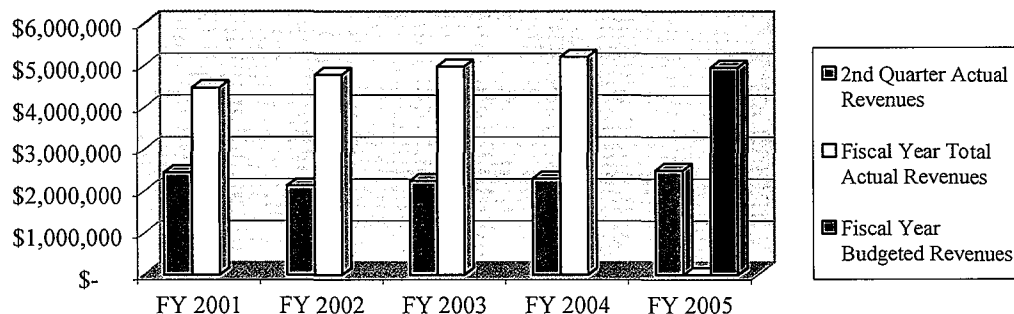
adjusted by a two percent inflation factor thereafter. As a result, real property values critically impact revenues: the higher the aggregate property value, the higher the revenue generated.

Analysis

According to the County Assessor's FY 2004/05 assessed valuations, Los Gatos experienced an overall 6.53% growth in assessed value from the prior year tax rolls. This larger than expected rise in property values will increase current year tax revenues approximately \$150,000 more than previously projected, therefore staff is recommending an adjustment at mid-year.

In addition to the increased valuation revenues, the State's "permanent" realignment of VLF backfill funding to property tax induces a reclassification of revenues from VLF Fees to Property Tax and is reflected in the recommended adjustment below.

**Quarterly and Annual Revenues
5-Year History**



	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
2nd Quarter Actual Revenues	\$ 2,450,173	\$ 2,127,714	\$ 2,246,511	\$ 2,297,420	\$ 2,497,953
Fiscal Year Total Actual Revenues	\$ 4,472,583	\$ 4,784,476	\$ 4,977,119	\$ 5,207,381	
Fiscal Year Budgeted Revenues					\$ 4,952,893
2nd Quarter Percent of Total	54.78%	44.47%	45.14%	44.12%	50.43%
Recommended Budget Revisions:					
Property Tax Revenue Increase					\$148,775 Increase
"Permanent" Realignment of VLF to Property Tax					\$421,542 Increase
Total Recommended Budget Revisions:					\$570,317 Increase

◆ *Transient Occupancy Tax Revenue* ◆

Description

The Town of Los Gatos levies a Transient Occupancy Tax in the amount of ten per cent (10%) of the rent charged by the hotel/motel operator within Town limits. This tax helps to fund Town services provided to transient lodgers.

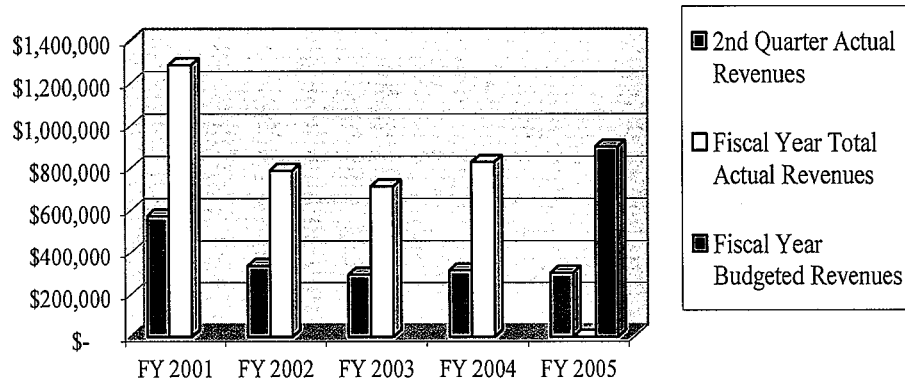
Analysis

According to Smith Travel Research, the leader in lodging industry tracking, industry occupancy was up 3.7 percent in 2004 nationwide. However, the

Town's Transient Occupancy Tax revenues received through the second quarter of the fiscal year continue to reflect an ongoing occupancy slump for nearly all Town hotels and motels.

While receipts trail last year's revenues at mid-point, expectations for the remainder of the year remain conservatively optimistic based on mild strengthening in some of the Town's other local economic indicators. A small revenue decrease of \$20,000 is recommended to adjust the budget to revised expectations

**Quarterly and Annual Revenues
5-Year History**



	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
2nd Quarter Actual Revenues	\$ 572,874	\$ 334,858	\$ 293,570	\$ 312,998	\$ 301,725
Fiscal Year Total Actual Revenues	\$ 1,286,276	\$ 788,408	\$ 713,064	\$ 829,025	
Fiscal Year Budgeted Revenues					\$ 900,000
2nd Quarter Percent of Total	44.54%	42.47%	41.17%	37.75%	33.53%

Recommended Budget Revisions:	\$20,000 Decrease
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◆ Interest Income Revenue ◆

Description

The Town earns Interest Income revenue by investing cash not immediately required for daily operations in a number of money market instruments. These investments are made by the elected Town Treasurer within parameters as stated in the Investment Policy approved by the Town Council. The Town's goal is to achieve a competitive rate of return while protecting the safety of those funds.

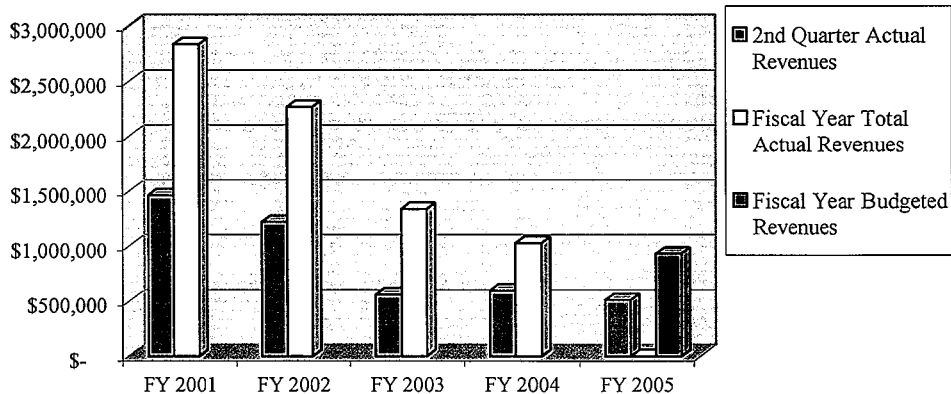
Interest Income revenue for the Town is primarily dependent upon two factors: the cash balance in the Town's investment portfolio, and the yield on those funds.

Analysis

The Town's Interest Income earnings have been impacted negatively in recent years by both a decrease in cash balances from the Town's aggressive Capital Improvement Program and from historically low interest rates.

There are encouraging indicators however as Local Agency Investment Fund (LAIF) has risen to 2.134% at December 31st, 2004 from its record low of 1.42% in May of 2004. In addition, short term treasury bills have risen to their highest level in more than three years. The Town's Interest Income is following along projected levels, therefore no change to budget is recommended at this time.

Quarterly and Annual Revenues 5-Year History



	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
2nd Quarter Actual Revenues	\$ 1,461,312	\$ 1,220,984	\$ 562,609	\$ 594,001	\$ 513,339
Fiscal Year Total Actual Revenues	\$ 2,835,006	\$ 2,267,979	\$ 1,336,711	\$ 1,027,554	
Fiscal Year Budgeted Revenues					\$ 931,836
2nd Quarter Revenue Percent of Total	51.5%	53.8%	42.1%	57.8%	55.1%
Recommended Budget Revision	No Change				

◆ **Business License Tax Revenue** ◆

Description

The Town of Los Gatos requires businesses to obtain a business license if a business is located within Town limits, or if an agent of a business conducts operations within Town limits.

The Business License Tax is based on the type of business activity. Activities such as retail sales, wholesale, and manufacturing are based on estimated gross receipts, on a sliding scale. Other Business License Tax revenues are based on flat fees as set forth in the Town Code.

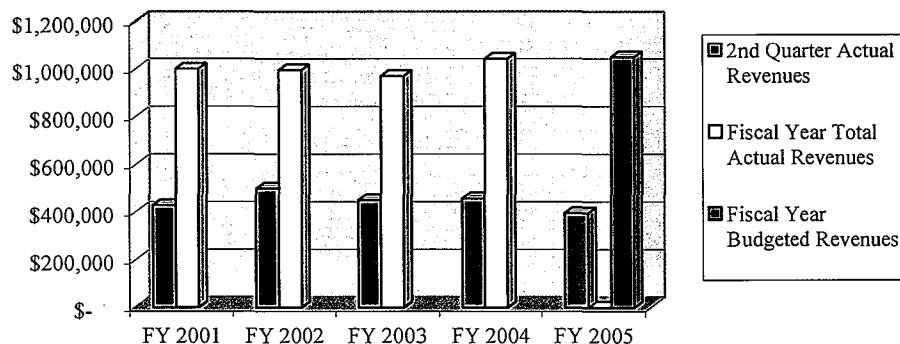
Annual business license renewals are due and payable in advance on January 2nd of each year. New business license applications for flat-fee based businesses are pro-rated by quarter, from the date of application to the end of the year.

Analysis

Business License Tax revenue received in the second quarter is primarily comprised of renewal fees. "Gross Receipt" based revenues comprise approximately 40% of the Business License Tax fees while "Flat Fees" make up the other 60% of tax revenue.

Tax receipts are tracking behind last year's revenues at December 31st, however strong January receipts have reduced the shortfall. Although the local economy is strengthening and indicates this revenue will grow, staff conservatively recommends a \$65,000 revenue budget decrease to more accurately align budget with revised projections under current receipt levels.

**Quarterly and Annual Revenues
5-Year History**



	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
2nd Quarter Actual Revenues	\$ 428,772	\$ 499,446	\$ 450,284	\$ 458,003	\$ 396,773
Fiscal Year Total Actual Revenues	\$ 1,000,281	\$ 995,699	\$ 970,554	\$ 1,041,865	
Fiscal Year Budgeted Revenues					\$ 1,050,000
2nd Quarter Revenue Percent of Total	42.87%	50.16%	46.39%	43.96%	37.79%
Recommended Budget Revision	\$65,000 Decrease				

◆ *Franchise Fee* ◆

Description

Franchise Fees are collected by the Town for the privilege of operating a utility service within Town limits, and in lieu of collecting a business license tax.

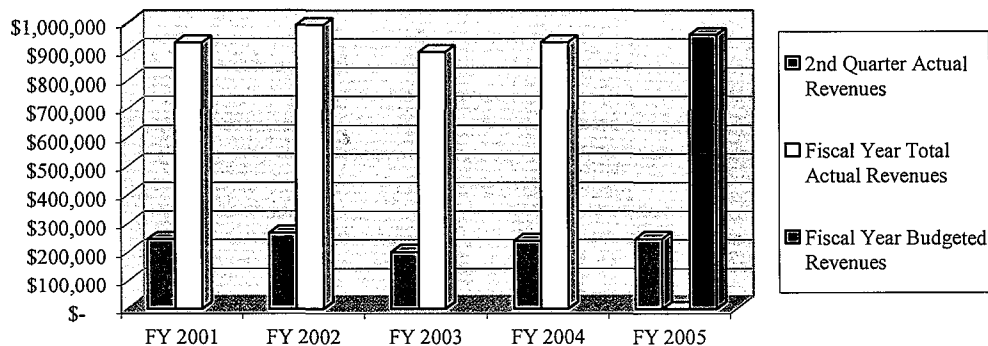
Franchise Fees are currently received from Comcast for cable television services, PG&E for gas and electric service, and Green Valley for solid waste collection services.

Analysis

Second quarter results are trending moderately higher than the prior year, another encouraging indicator in the recovery of the local economy as franchise fees are collected as a percentage of total sales for garbage, cable television, electric and gas utilities.

No change to budgeted revenue is recommended as fees are tracking as expected.

**Quarterly and Annual Revenues
5-Year History**



	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
2nd Quarter Actual Revenues	\$ 245,116	\$ 267,296	\$ 200,819	\$ 239,294	\$ 246,980
Fiscal Year Total Actual Revenues	\$ 929,865	\$ 990,861	\$ 897,157	\$ 930,997	
Fiscal Year Budgeted Revenues					\$ 957,000
2nd Quarter Revenue Percent of Total	26.36%	26.98%	22.38%	25.70%	25.81%
Recommended Budget Revision	No Change				

RECOMMENDED BUDGET ADJUSTMENTS

FY 2004/05

General Fund budget adjustments are recommended for the following revenues and expenditures:

GENERAL FUND	FY 2004/05 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2004/05 Revised Budget
Revenue:			
Sales Tax	\$ 6,900,000	\$ 200,000	\$ 7,100,000
Property Tax	4,952,893	148,775	5,101,668
Motor Vehicle In Lieu (State)	1,133,390	421,542	1,554,932
VLF Property Tax Backfill (State)	566,610	(249,542)	317,068
Hotel Tax	900,000	(20,000)	880,000
Passport Revenues	60,000	(25,000)	35,000
Business License	1,050,000	(65,000)	985,000
Building Permits	1,084,045	200,000	1,284,045
Planning Permits	540,000	(100,000)	440,000
SLESF funding	61,130	138,870	200,000
Insurance Claim Reimbursement	-	31,100	31,100
Encroachment Permits	60,000	70,000	130,000
Below Market Price Housing	48,100	17,000	65,100
Total Revenue Adjustments	\$ 17,356,168	\$ 767,745	\$ 18,123,913
Expenditures:			
Legal Expenses (Buske Contr)	-	25,000	25,000
Transfer to Parking Management	124,150	100,000	224,150
Personnel Recruitment	-	40,000	40,000
Labor Relations Service	-	35,000	35,000
Insurance Claim Reimbursement	-	31,100	31,100
Below Market Price Housing	11,900	17,000	28,900
Total Expenditure Adjustments	\$ 136,050	\$ 248,100	\$ 384,150
Net General Fund Adjusted Budget		\$ 519,645	

Recap of General Fund Revenue Adjustments:

The suggested adjustments to Sales Tax, Property Tax, and Hotel Tax were explained earlier in this report. Adjustments to other revenues shown above are explained below:

Motor Vehicle In Lieu (State) & VLF Property Tax Backfill (State): This adjustment is necessary to properly reflect the division of the approximate \$1.8 million of total Car Tax received by the Town into its two categories, the Car Tax and the property tax "backfill" paid by the State. The State is using a portion of the Town's remaining 1/3 of the Car Tax for county realignments, thereby lessening the amounts of VLF Car tax revenue received but the loss is replaced by a equal increase in property tax "backfill" revenue.

Passports: The Town Clerks office recommends reducing this revenue estimate. Much of this reduction is due to the US Postal Service now offering the same service to the community.

Business Licenses: The lowered estimate reflects activity for the first six months indicating a slower than expected recovery to many gross receipts businesses located in the Town.

Building & Planning Permits: There is a recommended increase in these revenues to reflect increased revenue received by the Community Development Department due to some larger projects coming on line in this fiscal that have exceeded earlier staff estimates. Another factor was the adjustment to valuations used to establish fees which was adjusted closer to actual construction costs as part of the 2004 Town User Fee update process.

Supplemental Law Enforcement Grant (SLESF): Staff anticipated the State would make a large reduction to this grant funding source for public safety. Due to the efforts of local government officials, this vital source of funds for public safety was restored to levels in the prior year of \$200,000. This amount is composed of \$100,000 for Los Gatos and \$100,000 for Monte Sereno.

Insurance Claim Reimbursements, Encroachment Permits, Below Market Price Housing: Each adjustment recommended here for increase is due to receipts trending above staff estimates made in the FY 2004/05 adopted budget process.

Recap of General Fund Expenditure Adjustments:

Legal Expense Buske Contract: Staff recommends this increase to appropriations of \$25,000 which is necessary to assist in the re-organization planning for the KCAT Board of Directors. Funds are available from a prior year cable television lawsuit settlement.

Transfer to Parking Program: Citation revenue is trending lower than staff estimates for FY 2004/05. Lower revenues in this program necessitate a corresponding increase in General Fund subsidy, as this fund is on a self balancing basis from year to year.

Personnel Recruitment and Labor Negotiations: These adjustments are necessary to fund the recruitment of the Economic Vitality Manager and Human Resources Director positions. Additionally the Town utilized an outside labor negotiator to reach a successful conclusion in the fall of 2004 approving Memorandums of Understanding with two of the Town's employee bargaining units.

Below Market Priced Housing and Insurance Reimbursements: This adjustment is necessary to reflect unanticipated legal and administrative costs associated with the repossession of a below market priced home (108 Sierra Linda) and insurance claim expenditures. There is a matching offset in revenues that is recommended to be increased to provide funding for this adjustment to expenditures.

Recap of Other Fund Revenue Adjustments:

OTHER FUNDS	FY 2004/05 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2004/05 Revised Budget
<i>Parking Management Fund:</i>			
Parking Citation Revenues	\$ 500,000	\$ (100,000)	\$ 400,000
Transfer Revenue from Gen. Fund	\$ 124,150	\$ 100,000	\$ 224,150
<i>Library Trust Fund:</i>			
Hooked on History Donations	\$ -	\$ 50,000	\$ 50,000
Hooked on History Project Expenses		\$ 50,000	\$ 50,000
<i>Grant Fund:</i>			
State Park Grant Revenues	\$ -	\$ 597,331	\$ 597,331
<i>Traffic Mitigation Fund:</i>			
Traffic Mitigation Revenues	\$ -	\$ 70,000	\$ 70,000

Parking Management Fund: Citation revenue is trending lower than staff estimates for FY 2004/05. Lower revenues in this fund necessitate a corresponding decrease in citation revenue estimates and a corresponding increase in General Fund subsidy, as this fund is on a self balancing basis from year to year.

Library Trust Fund: The Town received unanticipated donations to the Library Trust for the Hooked on History project. Staff recommends adjusting budget to reflect increased revenue from this source and an increase to budgeted expenditures in like amount to fund the Hooked on History project.

Grant Fund: The increase in revenues reflects carry-forward necessary to bring forward State parks grant revenues remaining from the prior fiscal year.

Traffic Mitigation Fund: Staff recommends increasing revenues recognized in this fund from deposits made to the fund to fund Town-wide staff efforts in administering the traffic mitigation program.

FINANCIAL SUMMARIES, PROJECTIONS AND RECOMMENDATIONS

General Fund

As stated earlier in this report, the attached *Schedule of FY 2004/05 General Fund Operating Revenues vs. Operating Expenditures* presents budget to actual data for the second quarter and comparison information from the prior year. In the last column, the Finance Department projects final balances for the fiscal year based upon the trends observed through the second quarter.

Town of Los Gatos Schedule of General Fund Operating Revenues vs. Operating Expenditures December 31, 2004

	FY03/04 Final Balance	FY03/04 Adjusted Budget	FY03/04 2nd Qtr Actuals	FY03/04 % YTD	FY04/05 Adopted Budget	FY04/05 Adjusted Budget	FY04/05 2nd Qtr Actuals	FY04/05 % YTD	FY04/05 Finance Projection
Revenues									
General Property Tax	5,207,381	5,338,006	\$ 2,297,420	43%	\$ 4,952,893	\$ 4,952,893	\$ 2,497,953	50%	\$ 5,101,668
Prop Tax Car Tax Backfill	-	-	-	-	-	\$ 1,133,390	-	0%	\$ 1,554,932
Sales & Use Tax	6,914,526	6,650,000	3,217,070	48%	6,900,000	6,900,000	3,179,238	46%	\$ 7,100,000
Franchise Fees	930,997	896,400	239,295	27%	957,000	957,000	246,980	26%	\$ 967,000
Transient Occ Tax	829,026	830,000	312,998	38%	900,000	900,000	301,725	34%	\$ 880,000
Business License Tax	1,041,865	1,035,000	458,003	44%	1,050,000	1,050,000	396,773	38%	\$ 985,000
Licenses & Permits	980,242	974,000	603,823	62%	1,317,055	1,317,055	910,289	69%	\$ 1,567,050
Motor Vehicle In Lieu	1,298,455	1,232,000	572,331	46%	1,700,000	566,610	251,898	44%	\$ 317,068
Intergovernmental	1,914,766	1,878,252	728,946	39%	1,670,135	1,754,135	715,639	41%	\$ 1,912,293
Charges for Services	2,526,197	2,310,186	1,434,071	62%	2,734,725	2,734,725	1,977,825	72%	\$ 2,585,855
Fines & Forfeitures	211,232	168,900	66,923	40%	174,950	174,950	66,252	38%	\$ 151,055
Interest	1,027,554	1,153,000	594,001	52%	931,836	931,836	513,339	55%	\$ 931,836
GASB investment to market per audit	(990,147)	-	-	-	-	-	-	-	-
Miscellaneous/Other	180,515	133,000	72,711	55%	156,078	156,078	156,623	100%	193,774
Fund Transfers	368,322	318,820	300,326	-	289,920	289,920	285,119	-	329,920
Total Revenues	22,440,931	22,917,564	10,897,917	48%	23,734,592	23,818,592	11,499,652	48%	24,577,451
Authorized Use of Reserves	273,770	274,580	-	-	620,150	920,150	920,150	-	1,020,150
PERS Liability Reserve	-	-	-	-	300,000	300,000	300,000	-	300,000
Use of Internal Service Reserves - Yr 3	650,000	650,000	650,000	-	520,000	520,000	520,000	-	520,000
Total Use of Reserves	923,770	924,580	650,000	-	1,440,150	1,740,150	1,740,150	-	1,840,150
Total Revenues plus Reserves	\$ 23,364,701	\$ 23,842,144	\$ 11,547,917	-	\$ 25,174,742	\$ 25,558,742	\$ 13,239,802	-	\$ 26,417,601
Expenditures (includes c/f but no encumbrances)									
Mayor & Council	136,865	143,700	65,159	45%	143,500	143,500	63,514	44%	140,630
Clerks	333,185	363,160	161,025	44%	335,410	335,410	165,219	49%	328,702
Attorney	221,414	230,060	114,547	50%	232,550	232,550	97,113	42%	227,899
Treasurer	76,668	56,560	24,097	43%	89,360	89,360	39,644	44%	87,573
Manager	1,839,812	1,911,740	923,562	48%	1,844,900	1,844,900	881,116	48%	1,908,002
Comm Development	2,263,190	2,455,768	1,200,451	49%	2,743,110	2,743,110	1,251,322	46%	2,688,248
Parks & Public Works	4,638,683	4,945,684	2,324,112	47%	4,441,290	4,446,290	2,116,607	48%	4,388,364
Police	9,160,567	9,062,584	4,510,103	50%	9,928,675	9,928,675	4,688,556	47%	9,730,102
Community Services	931,909	978,263	548,584	56%	934,430	934,430	379,668	41%	927,941
Library	1,833,387	1,805,470	918,429	51%	1,816,365	1,816,365	826,297	45%	1,780,038
Total Dept Expenses	\$ 21,435,680	\$ 21,952,989	\$ 10,790,070	49%	\$ 22,509,590	\$ 22,514,590	\$ 10,509,054	47%	\$ 22,207,498
Non-Dept Expenditures and other uses									
General Government	1,918,358	2,197,221	576,545	26%	2,665,152	2,960,152	709,171	24%	3,060,152
Total Non-Dept Expenses	\$ 1,918,358	\$ 2,197,221	\$ 576,545	26%	\$ 2,665,152	\$ 2,960,152	\$ 709,171	24%	\$ 3,060,152
Total Operating Expenditures	\$ 23,354,038	\$ 24,150,210	\$ 11,366,615	47%	\$ 25,174,742	\$ 25,474,742	\$ 11,218,225	44%	\$ 25,267,650
Net Operating Revenues Before Capital Trsfers & Budgeted Beg Fund Balance	\$ 10,663	\$ (308,066)	\$ 181,302	-	\$ -	\$ 84,000	\$ 2,021,577	N/A	\$ 1,149,951
Authorized Use of Reserves									
2 Yr One-time State Take	-	-	-	-	421,000	421,000	421,000	-	421,000
Parking Management Program	198,770	199,580	-	-	124,150	124,150	124,150	-	224,150
Capital Projects	75,000	75,000	-	-	75,000	75,000	75,000	-	75,000
Animal Shelter	-	-	-	-	-	300,000	300,000	-	300,000
Total Budgeted Use of Reserves	273,770	274,580	-	-	620,150	920,150	920,150	-	1,020,150
Net Surplus or (Use) of Reserves	(263,107)	(582,646)	181,302	-	(620,150)	(836,150)	1,101,427	-	129,801

All Other Funds

Guide to Presentation:

Each of the following presentations groups financial summaries by governmental fund type-the types being Special Revenue Funds, Capital Projects Funds, Internal Service Funds, and Redevelopment Agency Funds. In each of the following projections a similar format is presented. The fund information starts with beginning fund balances and adds current year revenues and subtracts current year expenditures resulting in ending fund balance. Budget amounts are also provided for revenues and expenditures, useful for comparing actual amounts received or spent to date versus budget for FY 2004/05.

Special Revenue Fund – Special Revenue Funds, which account for the proceeds derived from specific revenue sources that are legally restricted to special purposes include the Town's Parking Fund, Solid Waste Fund, Community Development Block Grant Fund, Non Point Source Fund, Sewer Maintenance Fund, Landscaping and Lighting District Funds, and the Operating Grants Fund.

As discussed in the adopted budget, FY 2004/05 is the third year of implementation of the parking program. Citation revenues are trending below estimates, necessitating an approximate \$100,000 increased subsidy from the Town's General Fund. Staff is continuing to evaluate and fine-tune this program, as any shortfall in this fund must be covered at year-end with a transfer from the Town's General Fund.

Special Revenue Funds Budget to Actuals Comparisons							
	Parking Fund	Solid Waste	CDBG Grants	Non Point Source	Sewer Maint.	LIDs	Operating Grants
Beginning Fund Balance (Pre-audit)	-	319,109	1,014,995	170,019	-	81,726	22,047
Budgeted Revenues	669,750	149,585	135,416	158,570	543,590	44,050	9,496
Actual Revenues - 2nd Qtr	191,314	63,964	15,074	156,573	543,590	37,975	14,160
Budgeted Expenditures	669,750	331,738	336,716	158,570	543,590	52,713	42,535
Total Actual Expenditures - 2nd Qtr	291,557	120,377	42,469	85,301	292,597	25,356	9,259
2nd Quarter Ending Fund Balance	(100,243)	262,696	987,600	241,290	250,993	94,345	26,948

Capital Projects Funds – Capital Projects Funds are utilized to account for resources used for acquisition and construction of capital facilities by the Town. Funds included in this category are the GFAR Fund (General Fund Appropriated Reserve), Traffic Mitigation Fees Fund, Grant Funded CIP's Fund, Storm Drains Fund, Utility Undergrounding Fund, and the Gas Tax Fund. Capital Project Funds are tracking in accordance with the FY 2004/05 adopted budget. Staff is recommending no changes at this time.

In developing the FY 2004/05 capital program, staff reviewed scheduled projects for potential strategic slowdowns of expenditure activity. This slowdown will aid cash balances available for General Fund investment earnings, in light of the aggressive capital-spending plan over the past two years. If operating revenues will support it, staff still intends to maintain the General Fund's current year \$75,000 commitment to the Town's Capital Improvement Plan for this year.

The Grant Funded CIP fund displays a deficit balance because this grant fund expends Town dollars first, then provides documentation of these expenditures to the State of California or other granting agencies and is reimbursed for those costs, which eventually should result with the fund "breaking even" or a zero fund balance (Dollars expended equal dollars received back in grant reimbursements). Traffic Mitigation fund deficits will be erased by recognition of revenues held on deposit used for Town-wide traffic mitigation activities.

Capital Project Funds
Budget to Actuals Comparisons

	GFAR Fund	Traffic Mitigation	Grant Fund CIP's	Storm Drains	Utility Undergd	Gas Tax
Beginning Fund Balance	4,002,603	40,704	35,403	780,312	1,873,570	498,238
Budgeted Revenues	156,500	5,000	805,000	132,400	102,000	442,000
Actual Revenues - 2nd Qtr	70,201	-	-	98,301	39,614	292,103
Budgeted Expenditures	1,606,467	50,000	1,596,035	127,574	-	550,475
Total Actual Expenditures - 2nd Qtr	307,387	58,860	342,271	-	-	123,183
2nd Quarter Ending Fund Balance	3,765,417	(18,156)	(306,868)	878,613	1,913,184	667,158

Internal Service Funds - Internal Service Funds are used to finance and account for special activities and services performed by a designated Town department for other departments on a cost reimbursement basis. Included in this fund type are the Equipment Replacement Fund, Worker's Compensation Fund, General Liability Self Insurance Fund, Stores Fund, Management Information Systems Fund, Vehicle Maintenance Fund, and the Building Maintenance Fund.

Internal Service Funds are tracking in accordance with the adopted FY 2004/05 adopted budget. No revision to adopted revenues or expenditures is required at this time. Staff believes there is still some potential for further operating transfers in future years from these funds as excess balances exist in amounts needed for funding in a number of these funds.

Internal Service Funds
Budget to Actuals Comparisons

	Equipment Replacemt	Workers Comp	Self Insurance	Office Stores	Mmgt Info Systems	Vehicle Maint.	Building Maint.
Beginning Fund Balance	3,268,727	1,719,090	1,822,304	218,253	2,225,583	165,812	750,811
Budgeted Revenues	442,165	575,515	472,200	92,000	755,300	459,100	1,028,400
Actual Revenues - 2nd Qtr	221,100	286,979	250,511	40,981	410,949	229,550	497,143
Budgeted Expenditures	1,013,940	696,024	591,100	92,000	1,211,900	459,245	1,028,530
Total Actual Expenditures - 2nd Qtr	536,594	447,622	479,328	32,990	231,599	206,295	359,253
2nd Quarter Ending Fund Balance	2,953,233	1,558,447	1,593,487	226,244	2,404,933	189,067	888,701

Trust and Agency Funds - Town Trust and Agency Funds have fund balances as of June 30, 2004 of \$301,302 for Parking District #88 and \$249,376 in the Library Trust Funds. One budget adjustment was recommended for the Library Trust Fund for donations to the Hooked on History project.

Redevelopment Agency - The Agency's FY 2004/05 and FY 2004/05-2008/09 Capital Improvement Plan adopted budgets are incorporated into the Redevelopment Agency's financial statements and year-to-date actuals as presented below. The Capital Projects Fund balances include approximately \$2.4 million dollars of remaining unexpended funds from the Agency's \$10.7 million dollar 2002 COP issue. The remaining proceeds of the bond issue are being used and appropriated for their intended purpose, eligible capital projects in the downtown project area such as the Downtown Street Reconstruction (\$1.6 million), Downtown Parking Management Plan (\$240K), Alley Improvements (\$150K) and Santa Cruz Avenue/Wood Road Gateway (\$50K).

**Redevelopment Agency Funds
Budget to Actuals Comparisons**

	Capital Projects	Debt Service	Low/Mod Housing	Total RDA Funds
Beginning Fund Balance	3,500,385	4,144,431	3,356,098	11,000,914
Budgeted Revenues	590,750	3,360,970	972,165	4,923,885
Actual Revenues - 2nd Qtr	305,397	1,403,517	460,154	2,169,068
Budgeted Expenditures	3,000,752	3,518,184	261,650	6,780,586
Total Actual Expenditures - 2nd Qtr	477,385	957,156	194,410	1,628,951
1st Quarter Ending Fund Balance	3,328,397	4,590,792	3,621,842	11,541,031

Since 1992 redevelopment agencies across the state have been required to make Educational Revenue Augmentation Fund (ERAF) payments to the State. In accordance with the State budget agreement, the ERAF payment was increased for FY 2004/05 & FY 2005/06. The Agency's ERAF payment for this year and next year is estimated to be \$303,000 annually, compared to \$209,975 due to the State the prior year. The ERAF payment is anticipated to be made from RDA fund balance.

Proposition 1A did not contain specific protections for redevelopment agencies. They were not included because there are existing legal opinions that conclude that redevelopment agency tax increment revenue is constitutionally protected from state revenue takes. There still exists however the potential for the State to reallocate revenues at its sole discretion, though agencies would probably raise a legal challenge were the State to implement additional "takes." Some experts have speculated that the estimated payments currently at \$303,000 could escalate to nearly \$700,000 annually in the years following FY 2005/06.

It is important that the Town continue to monitor developments in the state budget process to discourage the legislature from further State takes from Redevelopment Agency Tax Increment. It is essential to preserve the Agency's tax increment revenue as any take from this source will reduce the annual revenue stream. If a larger revenue take is enacted, the lowered revenue stream will reduce the total amount of bonds the Agency can issue in the future.

CONCLUSION

Second Quarter 2004/05 revenue trends are certainly encouraging, with net revenues forecast to add a small surplus at year end. However, based on the recent update of the Town's Five-Year Financial Plan the Town is once again facing a challenge in aligning FY 2005/06 operating revenues and expenditures. The Town anticipates using a multi-pronged effort involving cost reduction, revenue enhancements, bridge-funding for "one-time" uses, and potential re-structuring of service delivery/program cost centers to achieve cost efficiencies and potentially increasing service levels to the community. The Town continues to possess strong reserve fund balances in the General Fund with \$10.6 million in designated reserves, including the Reserve for Economic Uncertainty which remains intact in the amount of \$3,678,000.

The Town's overall financial strength enables it to effectively manage the current economic downturn and its associated revenue reductions through careful monitoring of revenue and expenditure trends and acting pro-actively before a financial crisis presses upon the Town. Staff continues to closely monitor all current year revenue and expenditure activity, mindful of the necessity to balance operating revenues with operating expenditures. The Town must also be aware of the need to develop appropriate revenue sources for on-going operating and capital needs of the community for the future.