



MEETING DATE: 10/17/05
ITEM NO. 10

COUNCIL AGENDA REPORT

DATE: October 17, 2005

TO: MAYOR AND TOWN COUNCIL

FROM: DEBRA J. FIGONE, TOWN MANAGER

SUBJECT: 2005/06 FIRST QUARTER BUDGET PERFORMANCE AND STATUS REPORT- AT THREE MONTHS ENDING SEPTEMBER 30, 2005.

A. ACCEPT 2005/06 FIRST QUARTER BUDGET PERFORMANCE STATUS REPORT.

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

RECOMMENDATION:

1. Accept FY 2005/06 first quarter budget performance and status report.
2. Authorize budget adjustments as recommended in the attached first quarter budget performance report.

BACKGROUND:

The attached Budget Performance Report covers the first three months of the fiscal year beginning July 1, 2005 and ending September 30, 2005. The Budget Performance Report presents analysis and recommendations related to key General Fund revenues by category and expenditures by fund. A Capital Improvement Plan Status Report that provides an update on capital project activities through the first quarter, is scheduled for presentation to Town Council at a later date.

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 on the Town's General Fund. Though financial results are limited to the first three months, staff is able to provide an update based on early revenue trends for the current fiscal year.

PREPARED BY:


STEPHEN D. CONWAY

Finance & Administrative Services Director

Reviewed by: PSS Assistant Town Manager OK Town Attorney Clerk Finance
 Community Development

Revised: 10/14/05 9:31 am

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FY 2005/06 introduces some significant developments in Town revenues as a result of the State budget process completed in July 2005. State initiated structural changes to local government revenues such as the Sales Tax "Triple Flip," first introduced in FY 2004/05, are presented again in this report for clarity and comparison purposes in the attached First Quarter Budget Performance Report. This report also informs the Town Council of the status of revenues in the FY 2005/06 Adopted Operating and Capital Budget, and advises on potential future revenue challenges which may materialize during the fiscal year.

Last fiscal year, as part of the state and local government's budget agreement process, changes to the local government revenue structure reduced two major revenues dedicated to the Town - Sales Tax and Vehicle License Fees (Car Tax), but incorporated replacement revenues to local governments for these lost revenues. In addition, the passage of Proposition 1A in November 2004 secured the current revenue structure and state "backfills" at the FY 2004/05 level. The base level of local government revenues are protected from any future reductions subject to two-thirds legislative approval. The effects of Proposition 76, should it be passed by the voters in November, are not clear as local governments were not involved in its drafting as occurred with Proposition 1A.

DISCUSSION:

This year's first quarter budget report reflects a mix of positive news about last year fiscal results, matched with a concern that the recovery in the Town's economically sensitive operating revenues such as Sales Tax, TOT and Property Taxes will be negatively impacted by the recent hurricane and rise in energy costs and their attendant inflationary pressures. There exists concern among some national economists that due to the large rise in energy costs, consumers will have less dollars available for discretionary spending. If this is true, then the moderate recovery which appeared to be materializing in the Town's operating revenues last year and early this fiscal year may be negatively impacted. In a recent report on the effect of rising gas prices, Goldman Sachs estimated that higher gasoline, heating oil, and natural gas prices are expected to reduce consumer spending growth by .5 to 1.5 percentage points into the first quarter of 2006. The report also concluded that if we experience a colder than normal winter, with its associated natural gas shortages resulting from Hurricane Katrina, a more serious problem could result, leading to more recessionary pressures. Despite the concern about the economy, many economic fundamentals remain positive. There is some evidence that the effects of the hurricane are smaller than feared and that the economy remains strong. The Wall Street Journal (October 8th 2005) also reports that despite the bad news on the energy front, "surveys show that manufacturing orders remained brisk in September across the country."

In the FY 2005/06 budget process, the Town conservatively forecasted a cautious recovery of local revenues, incorporating modest revenue growth in economically-sensitive revenues such as sales tax, franchise fees, business license and transient occupancy taxes. The adopted budget also incorporated a combination of approximately \$930,000 in reductions and revenue enhancements made Town-wide to balance operating expenditures with operating revenues. Staff also began implementing additional efforts to prioritize services delivered to the community. In light of the

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moderate revenue shortfall indicated for FY 2006/07 in the update to the Town's Five Year Financial plan discussed later, staff believes this effort will inform budget decisions necessary for FY 2006/07. It should also inform other budgets adjustments that may be necessary in the future due to State local revenue "takes" from local government or unanticipated reductions in economically sensitive revenues such as Sales Tax or Transient Occupancy Tax.

At the first quarter end of FY 2005/06, revenue trends are tracking in line with projections made at budget preparation time in the spring of 2005. Expenditures are trending slightly ahead of the pace set last year at the first quarter.

Service delivery in FY 2005/06

In preparing the adopted FY 2005/06 budget, the Town's goal was to identify reductions that would have the least impact on vital Town services and the organization's workforce. The recommended expenditure reductions were achieved through a combination of operational efficiencies, salary savings from vacancies, strategic staffing defundings, and reductions in overtime, service and supplies, training, and postponement of equipment replacement.

While avoiding major impacts on services and the organization, the reductions made have affected FY 2005/06 operations overall. Holding vacancies, reducing staffing and overtime results in the current workforce absorbing more of the workload, and thus affects the ability to get the work done and limits the flexibility to respond to new ideas and/or increased service demands. Response times associated with non-public safety requests have increased. Park and street maintenance cycles have been extended or reduced, as well. Over the longer-term, the reductions made in the FY 2005/06 budget continue the strain on the organization's ability to deliver services to the community and are not sustainable without incurring more significant impacts on services. New policies may need to be implemented to align resources with community demands for service.

Outstanding Issues for FY 2005/06 Mid-Year Review

Contributing to the positive fiscal results last year were Town-wide expenditure reductions and the cumulative effect of strategic de-fundings that have been implemented in the past four fiscal years. The current budget year carries forward a total of 29.15 defunded positions made across all Town departments.

The current year includes the defunding of two vacant Police Officer positions through at least the mid-year fiscal review point. The Town Council was advised at the time of budget adoption that staff would be revisiting the question of funding status for these two positions based upon funding availability and the review of the impacts either positive or negative of the Police Department's new shift implementation.

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FY 2006/07 AND BEYOND: CHALLENGES AHEAD

In October, 2005, staff updated the Town's five-year General Fund financial operating plan. With the ongoing uncertainty of developments at the state level, a longer term planning horizon is not reliable. Current projections continue to indicate more balancing steps will be necessary during the next five years. However, the current update does indicate two important points. The first is that the hard work the Town has accomplished in the past four years have generated positive fiscal results in spite of a lingering soft local economy. Secondly, if recoveries continue in economically sensitive revenues, the shortfalls are slightly less than projected in the most recent updates (from an FY 2006-07 shortfall of \$563,000 to the current projection of \$485,000 or 1.76% of the total budget). At this time downward adjustments to the Town's operating budget are forecasted to be necessary in FY 2006/07 unless the Town's operating revenues increase more than expected in future years.

The updated plan used assumptions based upon estimated costs of labor and benefits which represent approximately 70% of General Fund operating costs, and modest increases in revenues based upon an assumption of gradual economic recovery from the downturns experienced in recent years. The plan continues to project revenue shortfalls ranging from \$485,000 to \$606,000 in future years (assuming the fix in FY 2006/07 is done with "permanent" fixes) that must be managed pro-actively by the Town. To address this, the Town is continuing its multi-prong efforts to achieve operational efficiencies, cost reductions, non-vital service level reductions, and revenue enhancement efforts to balance ongoing revenues with expenditures in future years. As the budget tightens each fiscal year, the ability to reduce operational expenditures without serious impacts becomes increasingly challenging. This year staff is undertaking an in-depth service inventory and prioritization effort in order to thoroughly explore service delivery approaches for best practices, efficiencies, and where resources could be redirected. An analysis of fees for cost recovery levels will also be undertaken as in years past. This information will be used to develop the FY 2006/07 budget balancing proposals for Council's consideration in Spring 2006.

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 in FY 2004/05. 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 adjustments made to the budget to eliminate the revenue shortfall in FY 2005/06 and beyond are "permanent" adjustments, thereby reducing the level of shortfall in the following fiscal years. The amounts adjusted permanently in the Town's

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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 page presents the Five Year Financial Plan.

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Town of Los Gatos							
Five Year Financial Plan FY 2006/07 Through FY 2010/11							
Summary Data	ACTUAL	ADOPTED	PROJECTED	PROJECTED	PROJECTED	PROJECTED	PROJECTED
Revenue Summary	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Sales Tax	7,904,130	7,313,000	7,678,650	8,062,583	8,465,712	8,888,997	9,333,447
Property Tax	5,302,061	5,352,190	6,149,321	6,518,281	6,909,378	7,323,940	7,763,377
Charges for Services	3,085,334	3,112,360	3,289,858	3,490,252	3,649,368	3,815,978	3,990,443
Car Tax/VLF Prop Tax Swap	1,868,973	1,780,410	1,885,752	1,997,340	2,115,545	2,240,761	2,373,404
Other Lic. and Permits	1,307,224	1,523,180	1,569,021	1,616,245	1,664,894	1,715,009	1,766,637
Intergovernmental Rev.	1,996,230	1,987,450	1,752,414	1,783,523	1,815,416	1,848,398	1,882,781
Business Licenses	1,086,814	1,030,000	1,060,900	1,092,727	1,125,509	1,159,274	1,194,052
Franchise Tax	942,648	983,450	1,032,623	1,084,254	1,138,466	1,195,390	1,255,159
Investment Earnings	768,204	1,018,750	1,041,758	1,065,341	1,094,436	1,124,380	1,155,203
Hotel/Motel Tax	868,908	870,000	913,500	959,175	978,359	997,926	1,017,884
Transfers	312,381	673,060	581,323	490,703	450,092	438,277	438,538
Miscellaneous	503,993	506,900	525,195	551,705	579,490	608,614	638,145
Fines & Forfeitures	190,549	135,500	141,175	147,101	152,021	157,114	162,387
Total Revenues	26,137,449	26,286,250	27,621,490	28,859,229	30,138,684	31,514,059	32,971,456
Town Expenditures							
Salaries	11,712,432	12,277,600	12,877,790	13,420,849	13,933,153	14,440,921	14,972,852
Benefits	4,005,186	5,221,200	5,431,267	5,830,115	6,260,144	6,329,187	6,492,196
Temporary Sal & Ben.	352,274	366,800	441,709	459,509	478,059	497,114	515,752
Paid Overtime	493,481	361,000	444,916	456,344	492,063	512,113	537,634
Total Sal. & Ben.	16,563,373	18,226,600	19,195,682	20,166,818	21,163,420	21,779,335	22,518,433
Grants & Awards	177,579	176,415	176,415	176,415	185,236	194,498	204,222
Training	182,296	195,020	200,871	206,897	217,242	228,104	239,509
Employee Retiree Med.	130,075	159,600	290,000	363,000	381,150	400,208	420,218
Animal Control Oper.	164,000	178,212	196,033	215,637	226,418	237,739	249,626
Supplies and Services	2,616,028	3,419,285	3,521,864	3,627,519	3,808,895	3,999,340	4,199,307
Utilities	415,993	370,567	389,096	408,551	428,978	450,427	472,948
Capital Purchases	300,000	176,000	20,000	21,000	22,050	23,153	24,310
Internal Service Funds	2,758,942	2,790,300	2,874,009	2,960,229	3,108,241	3,263,653	3,426,835
Debt Service/Transfers	1,188,585	1,239,300	1,243,250	1,247,317	1,251,878	1,257,551	1,263,421
Storm Drains	-	-	-	-	-	-	-
Road Maintenance/Rep.	-	-	-	-	-	-	-
Total Expenditures	24,496,871	26,931,299	28,107,218	29,393,383	30,793,508	31,834,006	33,018,831
*Authorized Use of Reserves	620,150	800,150	-	-	-	-	-
Ongoing Shortfall Mitigation	-	-	-	485,729	48,425	606,399	-
Revenues Over (Under) Exp.	2,260,728	155,101	(485,729)	(48,425)	(606,399)	286,452	(47,374)
Revenue Shortfall as a % of Oper	-8.65%	-0.59%	1.76%	0.17%	2.01%	-0.91%	0.14%

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The Town continues to communicate with Town residents, Town staff, and the Town's employee bargaining units to increase understanding of the fiscal situation and to solicit ideas. The goal is to minimize the impact on Town services, maintain the community's quality of life and remain a competitive employer while sustaining the Town's fiscal health. For FY 2005/06, the Town is using approximately \$500,000 of one-time funding sources to address the additional property tax State "takes" that local government representatives and the Governor agreed upon in developing the state budget.

To be fiscally responsible, the Town uses conservative estimates for economically-sensitive revenue projections in its long-term planning tools. If the economic rebound is sooner or stronger than projected, expenditure reductions will be re-evaluated and brought to the Town Council to identify priorities for reinstating past service reductions.

FORMAT OF THE REPORT

The attached Budget Performance Report includes a financial overview comprised of: a brief discussion of the Town's financial condition; the FY 2005/06 financial outlook; a summary of the performance of the Town's primary General Fund revenue sources and necessary budget adjustments; and a look ahead at the FY 2006/07 budget process.

ENVIRONMENTAL ASSESSMENT:

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

FISCAL IMPACT:

The attached First Quarter Budget Performance Report includes a section providing a detailed list of recommended expenditure and revenue budget adjustments recommended for the first quarter of FY 2005/06. Upon approval of the recommended budget adjustments by Town Council, the adopted appropriations for the fiscal year will be adjusted accordingly.

Attachments:

Budget Performance Report for the Three Months Ended September 30, 2005



TOWN OF LOS GATOS BUDGET PERFORMANCE REPORT FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005

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FINANCIAL OVERVIEW – EXECUTIVE SUMMARY

Status of FY 2005/06 Adopted Budget:

First Quarter results are trending positively overall, while at the same time the Town continues to experience fluctuations in the amount of recovery in certain key revenue categories that comprise the Town's General Fund operating revenues. One decline noted in comparing first quarter FY2004/05 to first quarter FY2005/06 is in the Town's largest revenue category, Sales Tax. Sales Tax actual revenues are trending slightly below the amounts received the first quarter last year, but the bulk of this decline is explained by the transition of the one quarter of one percent sales tax now paid by the County tax collector to the Town in two installments during the fiscal year, (the first payment for this year is expected January 2006) with a "clean up" adjustment made after fiscal year end. Positive trends for the first quarter include the Transient Occupancy Tax (TOT). First quarter TOT collections are trending 22% ahead of first quarter collections received in the prior year's first quarter. On another positive note, the first quarter Property Tax collections, comprised of mostly Property Transfer Taxes, continue to trend positively in comparison to the first quarter of the prior year.

Department expenditure totals for the first quarter FY 2005/06 appear to be favorable, with spending at the end of the first quarter averaging 22% expended, or 3% below the 25% benchmark level used for three months of 12 months operations. With only three months of data available and the uncertainty of the economic effects of Hurricane Katrina on energy costs which may impact consumer behavior, it is difficult to predict revenues and expenditures for the whole year. Consequently, further adjustments may be necessary during the fiscal year. In light of this uncertainty and being fully aware that the local economy's recovery remains tentative, staff continues to be cautiously optimistic while monitoring fiscal developments very closely. Any mid-year course corrections or budget adjustments necessary will be brought to Town Council's attention at the earliest opportunity to balance operating revenue and expenditures.

State Budget Fiscal Impacts to Town for FY 2005/06:

The FY 2005/06 State budget package incorporates the major changes first introduced last year to the structure and amount of Town General Fund operating revenues. Specifically, the budget package approved by the legislature and the Governor includes these key elements:

Proposition 1A and its Effect on the State Budget Process –With the successful passage in November 2004 of Proposition 1A restrictions exist on future legislative authority to reduce or reallocate local revenues from the sales tax, property tax, or vehicle license fee (VLF). Namely, the state is prevented from:

- Reducing local sales tax rates or altering the method of allocation
- Shifting property taxes from the Town to fund other state programs
- Decreasing VLF revenues without providing replacement funding
- Enforcing unreimbursed mandates (with certain exceptions)

As background, Proposition 1A prohibits further state revenue “takes” from local government as itemized above. However, Proposition 1A still contains provisions for additional state revenue “takes.” Specifically, starting in FY 2008/09, in an emergency and by a vote of two-thirds of both houses of the Legislature and the approval of the Governor, the Town’s share of property tax could be “taken” or shifted to other state programs, but it must be repaid, with interest, within three years. The state could also approve voluntary exchanges of sales and property tax revenues among local governments within a county. These transfers of taxes and funds would not need voter approval. With this in mind, it is important to note that currently it is staff’s understanding the State is facing a projected \$7 billion shortfall for FY 2006/07.

Shifts Property Taxes to K-14 Districts – The FY 2005/06 state budget bill implements the second year of the \$1.3 billion of property tax shifts from cities, counties, special districts, and redevelopment agencies to K-14 district schools in for the fiscal benefit of the state. The estimated Town share of the \$1.3 billion shift was approximately \$490,000 for FY 2004/05 and the same amount for FY 2005/06. The \$490,000 for this year was considered by the Town in its FY 2005/06 budget to be the final “one-time” additional state revenue take as part of the two-year budget agreement between the State and local governments. This judgment was made under the assumption that further takes are now disallowed under Proposition 1A.

Eliminates the Statutory VLF Trigger and Backfill – The FY 2005/06 State budget sets the VLF rate at 0.65 percent of vehicle value (the former rate was 2.0 percent, and the difference was made up to local governments in the form of a VLF “backfill”) and eliminates the trigger mechanism that increases the VLF rate in the event that the state’s General Fund has insufficient funds to make the required backfill payments to cities and counties. As a reminder, last year’s state budget permanently replaced the Town’s VLF “backfill” revenues with an additional amount of property taxes equal to the former “backfill” amount. This was accomplished by reducing the Town’s contribution to ERAF (Educational Revenue Augmentation Fund).

Provides No Funding for Most Mandates – Similar to FY 2004/05, the FY 2005/06 budget bill provides very limited funding available to reimburse the Town for most state-mandated local programs. The state estimates these deferred reimbursements total over \$1.5 billion state-wide to local governments, including more than \$200 million for local agency compliance with mandated requirements in FY 2005/06.

Reduces Booking Fee Authority and Reimbursements – The prior year budget package prohibited counties from increasing their booking fees in 2004/05. Beginning in 2005/06, counties may impose booking fees to local governments and offset one-half (rather than all) of their administrative costs associated with booking and processing of arrestees. In 2005/06, the Town will no longer be receiving booking fee reimbursements (Town share is approximately \$84,000 per year) through a continuous appropriation from the State. The budget package eliminated this continuous appropriation effective July 1, 2005. There is still the open question of whether or not the County will be billing the Town for booking fees this fiscal year or whether booking fee revenue to local governments will be restored by the State. Staff recommends no budget action on booking fees until more information becomes known, most likely at the Town’s FY 2005/06 mid-year update.

One-Time Repayment-\$490,000 Vehicle License Fee Backfill Gap Loan

In FY 2004/05, the state budget eliminated VLF "backfill" payments for 3 months that was due to the Town in that year, with a promise to repay later. The action was taken by the State to address its revenue shortfall in that year. The State was scheduled to repay the amount owed to the Town in August 2006. The amount of backfill owed to the Town was approximately \$490,000.

Because of concern that the State would be unable to fulfill its obligation to repay local governments in 2006, many cities participated in a VLF Gap Financing Plan offered by the brokerage community, at a cost of approximately 9% of the total amount owed to the city by State. Town staff was convinced that the State was constitutionally obligated to meet its repayment obligation and therefore did not finance this amount due.

The FY 2005/06 State Budget package included early repayment of the back fill Gap Loan ahead of the scheduled August 2006 repayment date. By waiting to collect the full amount, the Town saved approximately 9% of the principal amount owed of \$493,170. This means that the Town received 100% of the backfill revenue it was due. By waiting for our backfill payment and not financing the amount due at an earlier date, the Town avoided approximately \$44,400 in estimated financing costs.

Effects of State Budget Package on FY 2005/06 Operating Revenues:

The changes to Town revenue structure first implemented as budget adjustment in FY 2004/05 are recapped below for purposes of clarification and comparison:

Sales Tax – Sales Tax for the Town was adopted at \$7.3 million for FY 2005/06. The state's Economic Recovery Bonds, approved by the voters in March 2004, are secured by a pledge of revenues from an increase in the state's share of the sales and use tax of one-quarter cent beginning July 1, 2004. The Town's share of the tax will be reduced by the same amount and, in exchange, the Town will receive an increased share of the local property tax shifted from state property tax (ERAF) during the time the one-quarter cent is being used to pay off the bonds (estimated to be between 9 and 14 years). Effects on the current year budgeted amounts are shown below:

Revenue Type	FY 2005/06 Adopted	FY 2005/06 Post State Budget After Implementation of "Triple Flip" Effective 7/1/2004
Sales Tax	\$5,678,000	Rate of 1% of 8.25% changed under budget bill to (.75% of 8.25% sales tax rate) for a period of between 9 and 14 years.
Sales Tax Replaced With Property Tax	\$1,635,000	(.25% of 8.25% sales tax rate) This amount now is dedicated to the state, but the "triple flip" provisions of the state budget bill (SB 1096) replaces the lost Town sales tax with additional state property tax to make the Town "whole." The amounts are paid twice annually by County of Santa Clara with a final settlement paid in August following the fiscal year.
Totals	\$7,300,000	Total Sales Tax and Replacement Property Tax

Motor Vehicle License Fees (Car Tax) –The budget package permanently replaces the Town’s backfill revenues with an equal amount of property taxes paid out of the state General Fund.

Revenue Type	FY 2005/06 Budgeted	FY 2005/06 Post State Budget After Implementation of “Triple Flip” Effective 7/1/2004
Car Tax-Remaining Town Share	\$148,300	Rate reduced legislatively to 2/3rds of the former rate (2.0%). This tax is constitutionally dedicated to local government. The Town continues to receive the tax collected, but at the reduced 1/3 rd level (.65%).
Car Tax Backfill Eliminated and Replaced By an Equal Amount of Property Tax	\$1,632,110	The budget package permanently replaces the Town’s VLF backfill revenues with an equal amount of property taxes paid “in lieu” of car tax revenue out of the property taxes forwarded by the County to the State’s General Fund.
Totals	\$1,780,410	Total Car Tax and Replacement Property Tax

Prior Fiscal Year Closing Results:

The FY 2004/05 closing financial results confirm the positive effects of the Town’s pro-active budgetary actions taken in response to the continuing flat revenue growth or downturns in key operating revenues experienced in the past four fiscal years. In developing the FY 2004/05 budget, Town Council approved a combination of budgetary reductions and revenue enhancements for FY 2004/05 totaling nearly \$1.4 million (\$800,000 in reductions and \$600,000 in revenue enhancements). These adjustments and Town-wide expenditure reduction strategies such as strategic hiring freezes, coupled with one-time revenue gains and upturns in sales tax generated a favorable General Fund closing balance of approximately \$1.6 million of available revenues over expenditures at year end June 30, 2005.

The Town’s General Fund reserves closed the year (unaudited) at a total of approximately \$12.2 million (including the Town’s Reserve for Economic Uncertainty intact at \$3,678,000), compared to \$10.6 million balance upon the close of the prior year. Actual operating revenues for FY 2004/05 exceeded operating expenditures by approximately \$1.3 million (net of \$300,000 in PERS rebate revenue) for the fiscal year. The final results favorably exceeded the mid-year 2004-05 report forecasted revenues by approximately \$1.2 million in total General Fund revenues (not including transfers and authorized reserves). General Fund expenditures for the year were approximately \$140,000 less than the amount estimated at FY 2004/05 mid-year.

General Fund expenditures totaled \$25.0 million compared to the adjusted FY 2004/05 budget of \$25.7 million. General Fund operating revenues (not including use of reserves of approximately \$980,000) for FY 2004/05 amounted to approximately \$26.1 million, closing the year with a favorable variance from the 2004/05 adjusted revenue budget of \$25.4 million. Included in the revenues last year was a one-time payment of sales tax due to the Town of approximately \$200,000. This payment was made by the State Board of Equalization as the result of a successful appeal and recovery of sales tax due to the Town that had been mistakenly diverted to another jurisdiction in 2002.

It should be emphasized that operating revenues for FY 2004/05 included approximately \$300,000 in funds which had accumulated as a liability from prior years but were not used for PERS costs (PERS rebate revenues). These revenues were used to offset the large PERS increases which have occurred during the recent downturn in the economy. Currently the Town's strategy is to use these accumulated PERS rebate funds (if needed) to establish our own cost/revenue smoothing effect over the next 5 to 10 years.

Scheduled labor cost increases and other operating expenditure increases in FY 2004/05 and future fiscal years will continue to necessitate an improvement in the Town's economically sensitive revenues to offset the cost increases likely to occur. The Town's efforts in the past four years including expenditure reductions, alignment of user fees to cost of service delivery, operational reviews and service level adjustments, along with the ongoing efficiency efforts being implemented by the Town are anticipated to reduce the pressure on the Town's revenue base to keep pace with the cost of providing services and provide discretionary funding for other initiatives such as funding future capital improvements.

General Fund Reserve Status-June 30, 2005

As stated above the total General Fund Reserves closed at a balance of approximately \$12.2 million at June 30, 2005. In addition to the the approximate \$4.3 million of General Fund Reserves set aside for restricted purposes, the Town has the following designated reserves established in accordance with Town financial policies and operating & capital budget requirements. The Designated Reserves presented below include the newly established Revenue Stabilization Reserve created by the Town upon the adoption of the FY 2005/06 budget. The purpose of the Revenue Stabilization Reserve is to mitigate or smooth out cyclical ups and downs in locally generated revenues due to temporary downturns in the local economy or "one-time" revenue losses where recovery of the revenue base is deemed likely to be restored in the near future.

Designated for Economic Uncertainty	\$3,678,001
Designated for Capital & Special Projects	\$2,421,843
Designated for Revenue Stabilization	\$1,921,843

GENERAL FUND-KEY REVENUE ANALYSIS FY 2005/06

The following presentation is the status of significant General Fund revenue sources as of the first quarter ending September 30, 2005. Staff monitors each revenue source closely and at this time recommends certain revenue adjustments based on revenue actuals or state budget actions. Any other adjustments necessary (if any) will be brought forward to Town Council for approval at mid-year (approximately February 2006), when more revenue data is available.

◆ Sales Tax Revenue ◆

Description

The State Board of Equalization, with the implementation of the "triple flip," now allocates .75 cents of the 8.25 cents of local sales tax collected by merchants on retail sales and taxable services transacted within the Town of Los Gatos. This .25 cents of local sales tax is being replaced by the state with an equal amount of property tax. Revenues are remitted to the Town on a monthly basis. This revenue is placed in the General Fund for unrestricted uses.

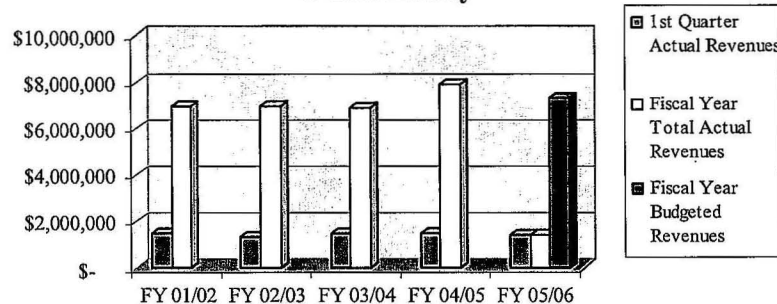
Analysis

According to California's Department of Finance, California's economy has continued to expand, with a fairly broad-based growth outpacing the nation's rate. The latest unemployment figures from July, 2005 show the

lowest rates since May 2001. What is unknown at this time is the possible braking of this economic momentum by the recent spike in energy costs. More data will become available as the fiscal year progresses.

First quarter revenues however, reveal a slight decrease from prior year's 1st quarter receipts. This is more a result of receipt timing as the Town's primary sales tax vendors continue to demonstrate sales stability, and the Town's primary Sales Tax generator continues phenomenal growth. While this is very positive, a concern about this growth is that the Town should not be depending on one primary sales tax generator; instead it should continue to seek a more balanced portfolio of business sectors that generate sales tax.

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



	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Actual Revenues	\$ 1,490,292	\$ 1,336,124	\$ 1,515,570	\$ 1,514,045	\$ 1,392,150
Fiscal Year Total Actual Revenues	\$ 6,953,880	\$ 6,928,817	\$ 6,914,526	\$ 7,904,130	\$ 1,392,150
Fiscal Year Budgeted Revenues					\$ 7,313,000

FY 2004/05 forward will reflect the Sales Tax In Lieu paid by Santa Clara County

1st Quarter Percent of Total	21.43%	19.28%	21.92%	19.16%	19.04%
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Recommended Budget Revision

No Change

◆ Property Tax Revenue ◆

Description

Property Tax is one of the Town's largest revenue sources, accounting for 20.8% of the Town's budgeted General Fund revenue for FY 2005/06.

Property 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.

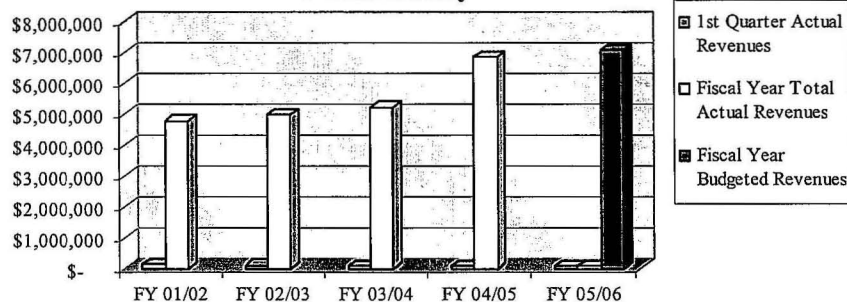
Property Tax is levied at 1% of a property's assessed value, of which the Town currently receives approximately 9.5 cents on each dollar paid to the County Assessor's Office. The assessed value of real property appraised by the County Assessor is the 1975-76 assessment role value, adjusted by a two percent inflation factor thereafter. However, when property changes hands or new construction occurs, property is reassessed at its current market value.

Real property values critically impact revenues. With the passage of Proposition 13, voters in California limited the tax rate that can be imposed by the Town on property. With this limitation on rates, the higher the aggregate property value, the higher the revenue generated.

Analysis

With the timing of property tax receipts later in the fiscal year, 1st quarter tax receipts do not provide ample data for analysis, although we can observe that receipts are tracking consistent with prior years. Of note however, is that the Santa Clara County Assessor provided a positive outlook in its FY2005/06 Annual Report. All cities are showing positive growth, with Los Gatos experiencing an overall 10.55% increase in assessed value.

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



	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Actual Revenues	\$ 141,085	\$ 126,035	\$ 86,045	\$ 102,035	\$ 105,270
Fiscal Year Total Actual Revenues	\$ 4,784,476	\$ 4,977,119	\$ 5,207,381	\$ 6,856,993	\$ 105,270
Fiscal Year Budgeted Revenues					\$ 7,091,890

FY 2004/05 forward will reflect an increase in Property Tax due to "Permanent" Realignment of VLF

	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Percent of Total	2.95%	2.53%	1.65%	1.49%	1.48%

Recommended Budget Revision	No Change
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◆ **Transient Occupancy Tax** ◆

Description

The Town of Los Gatos levies a 10 per cent Transient Occupancy Tax on all hotel/motel rooms within Town limits as a method to help fund Town services provided to transitory lodgers.

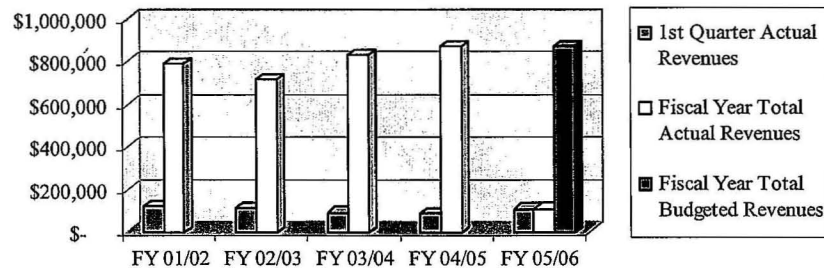
Analysis

The Transient Occupancy Tax revenues received in the first quarter of FY 2005/06 reflects a growth in occupancy rates for nearly all Town hotels and motels. This is in line with reports from the State that both business and

leisure travel has edged up in the last year. Statewide occupancies during the first six months of 2005 were reported to be up an average of 3.2%, although the highest average occupancies for the month of June were in Southern California.

Overall, the Town expects the occupancy rates to continue improving with the re-establishment of air travel and normal business activity, subject to the possible negative effects of the unexpected rise in travel costs due to increases in the cost of energy.

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



	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Actual Revenues	\$ 122,227	\$ 113,874	\$ 91,170	\$ 87,668	\$ 107,529
Fiscal Year Total Actual Revenues	\$ 788,408	\$ 713,064	\$ 829,025	\$ 868,908	\$ 1,075,290
Fiscal Year Total Budgeted Revenues					\$ 870,000

1st Quarter Revenue Percent of Total	15.50%	15.97%	11.00%	10.09%	12.36%
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Recommended Budget Revision	No Change				
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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.

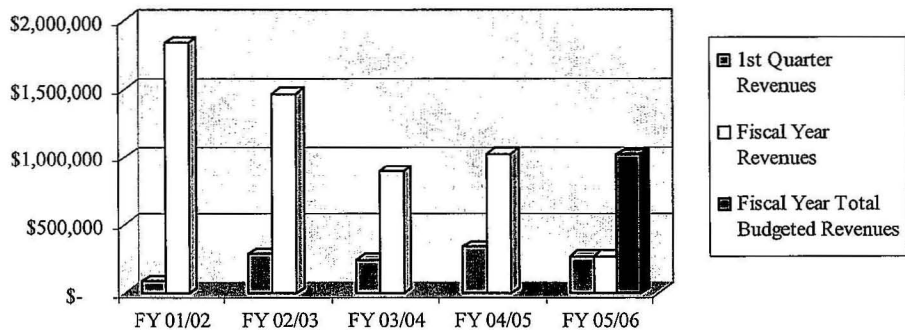
Interest Income revenue for the Town is primarily dependent upon two factors: the cash balance in the Town's investment portfolio, and the yield on those funds.

Analysis

The Town's Interest Income earning 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) continues to rise, having grown to a 3.179% rate in August 2005, from its record low of 1.42% in May of 2004.

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



	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Revenues	\$ 90,608	\$ 290,191	\$ 242,485	\$ 338,779	\$ 272,324
Fiscal Year Revenues	\$ 1,834,191	\$ 1,461,677	\$ 894,153	\$ 1,021,703	\$ 272,324
Fiscal Year Total Budgeted Revenues					\$ 1,018,750
1st Quarter Revenue Percent of Total	4.9%	19.9%	27.1%	33.2%	26.7%
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, and comprise approximately 40% of the Business License Tax revenue. Other Business License Tax revenues are based on flat fees as set forth in the Town Code, and make up the remaining 60% of revenue.

Annual business license renewals are due and payable in advance on January 2nd of each year.

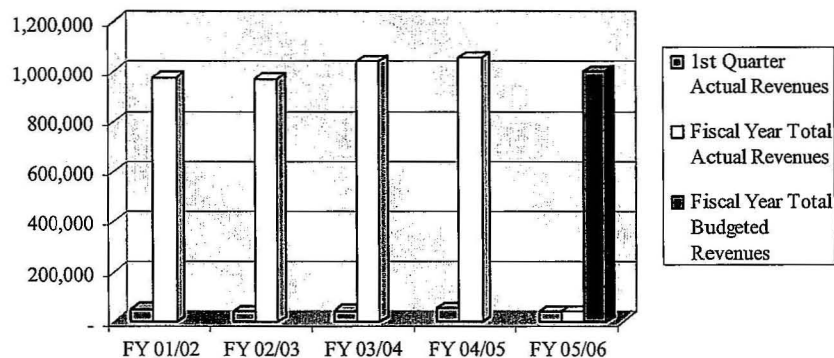
New business license applications for flat-fee based businesses are pro-rated by quarter, from the date of application to the end of the year.

Analysis

The Business License Tax revenue received in the first quarter is primarily comprised of new Business License fees. The majority of revenues come from renewals, which are received in the second and third quarters.

As the FY 2004/05 includes some prior year's business license tax revenue, the FY 2005/06 budget was adjusted to reflect current year receipts only, and under anticipation that the economy would continue at current levels. While current receipts are tracking lower than prior year receipts, there is not enough revenue data for adequate analysis in the 1st quarter.

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



	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06
1st Quarter Actual Revenues	50,655	40,683	45,619	56,632	41,773
Fiscal Year Total Actual Revenues	\$ 978,350	\$ 970,554	\$ 1,041,865	\$ 1,056,814	\$ 41,773
Fiscal Year Total Budgeted Revenues				\$ 1,000,000	
1st Quarter Revenue Percent of Total	5.18%	4.19%	4.38%	5.36%	4.18%

Recommended Budget Revision

No Change

◆ **Franchise Fee** ◆Description

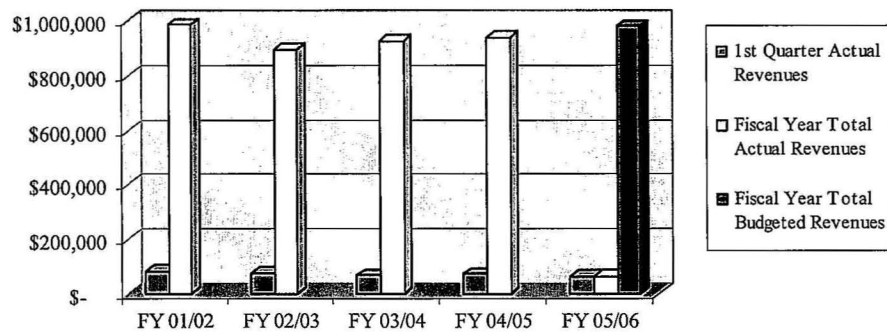
Franchise Fees are collected by the Town for the privilege of operating a utility service within Town limits, and as a fee in lieu of business license tax.

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

First quarter results are trending slightly below budget estimates. Franchise Fees are paid as a percentage of gross receipts, and with service rates increased by Green Valley Disposal Company, Inc in August 2005, and higher electricity bills, revenues are expected to rebound over the fiscal year.

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



	<u>FY 01/02</u>	<u>FY 02/03</u>	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>
1st Quarter Actual Revenues	\$ 82,327	\$ 76,389	\$ 66,174	\$ 74,273	\$ 65,271
Fiscal Year Total Actual Revenues	\$ 990,861	\$ 897,158	\$ 930,997	\$ 942,647	\$ 65,271
Fiscal Year Total Budgeted Revenues					\$ 983,450
1st Quarter Revenue Percent of Total	8.31%	8.51%	7.11%	7.88%	6.64%

Recommended Budget Revision
No Change

RECOMMENDED BUDGET ADJUSTMENTS

FY 2005/06 Expenditure Appropriations

Police Department Program (Fund 400 GFAR)

The Police Department has requested replacement of the servers that support critical systems including the Records Management System, Computer Aided Dispatch, Mobile Data System, and Automated Reporting System. Existing servers are not able to handle the current demand from these software systems, resulting in unacceptable downtime, and will not be able to handle required upgrades to the software. Replacement of the servers is more cost effective over the long-term than options to maintain the status quo or to upgrade the servers. The appropriation request is for \$130,000, which is available in the Town's Management Information System (MIS) Fund. If approved by Council, the funds will be transferred from the MIS Fund to the capital budget to support this project.

Vehicle Maintenance Fund & Building Maintenance Fund (Town-wide Energy Cost Increases)

Because of the impacts of Hurricane Katrina on fuel and natural gas supply and energy costs, an increase is needed in the Vehicle Maintenance Pool (fuel) and Building Maintenance Fund (natural gas). The Parks and Public Works Department is recommending an \$140,000 increase at this time. Staff recommends the increase be funded by the partial use of the VLF Gap Loan Backfill Repayment added to the General Fund operating revenues.

FY 2005/06 Estimated Revenues

Non Departmental 1111

VLF Backfill Gap Revenue:

The FY 2005/06 State Budget package included early repayment of the back fill Gap Loan ahead of the scheduled August 2006 repayment date. The amount to be paid to the Town is \$493,170.

Miscellaneous Revenue:

The Town received its final equity share distribution upon its withdrawal from the Silicon Valley Animal Control Authority (SVACA) in the amount of \$47,660.

State Mandated Costs:

The State budget package has restored some partial funding for mandated cost reimbursements. Staff recommends increasing this estimated revenue source by \$28,000 to account for this late budget development.

Police Department Program 4040/4050

The Police Department has confirmed to staff that the Community Oriented Policing (COPS) Grants originally thought to be either de-funded or reduced in the FY 2005/06 state budget were in added back in the late stages of the budget process. The COPS Grant estimate had been reduced two thirds. Staff recommends restoring this revenue source to its full amount of \$200,000, a \$139,000 increase from the adopted budget.

Parks and Public Works 5050

The Town has received reimbursement from the Town of Monte Sereno for street work done by the Town as part of its street repair and resurfacing work that was in the City of Monte Sereno. The recommended revenue adjustment increases Charges for Services in the amount of \$18,000.

Storm Basin Fees Fund 4462

Staff recommends increasing this estimated revenue source in this storm drain fee area by \$150,000 to reflect increased revenues resulting from the major projects on Winchester Boulevard.

Grants Fund (CERT Grant)

Staff recommends shifting \$7,782 from the Town's General Fund to the General Fund Operating Grants Fund. The amount was initially established last year in the General Fund to account for the Community Emergency Response Team (CERT) Grant received from the state. To facilitate better reporting and tracking of the CERT grant monies, staff recommends these funds be recorded in the Town's Operating Grants Fund.

FINANCIAL SUMMARIES, PROJECTIONS AND RECOMMENDATIONS

General Fund

As stated earlier in this report, the attached *Schedule of FY 05/06 General Fund Operating Revenues vs. Operating Expenditures* presents budget to actual data for the first 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 first quarter.

Town of Los Gatos
Schedule of General Fund
Operating Revenues vs. Operating Expenditures
For the period ended September 30, 2005

	Unaudited FY04/05 Final Balance	FY04/05 Adjusted Budget	FY04/05 1st Qtr Actuals	FY04/05 % YTD	FY05/06 Adopted Budget	FY05/06 Adjusted Budget	FY05/06 1st Qtr Actuals	FY05/06 % YTD	FY05/06 Finance Projection
Revenues									
General Property Tax	\$ 5,302,061	\$ 5,101,668	\$ 102,035	2%	\$ 5,459,780	\$ 5,459,780	\$ 105,271	2%	\$ 5,459,780
Prop Tax Car Tax Backfill	1,554,932	1,554,390	-	-	1,632,110	1,632,110	-	0%	\$ 1,632,110
Sales & Use Tax	7,904,130	7,100,000	1,514,045	21%	7,313,000	7,313,000	1,392,151	19%	\$ 7,313,000
Franchise Fees	942,648	957,000	74,273	8%	983,450	983,450	65,272	7%	\$ 983,450
Transient Occ Tax	868,908	880,000	87,668	10%	870,000	870,000	107,529	12%	\$ 870,000
Business License Tax	1,056,814	985,000	56,632	6%	1,000,000	1,000,000	42,403	4%	\$ 1,000,000
Licenses & Permits	1,347,521	1,589,055	509,490	32%	1,564,180	1,564,180	645,230	41%	\$ 1,564,180
Motor Vehicle In Lieu	314,041	317,600	209,019	66%	148,300	148,300	48,142	32%	\$ 148,300
Intergovernmental	2,002,922	1,893,015	218,368	12%	1,987,450	1,987,450	726,991	37%	\$ 2,424,620
Charges for Services	2,920,356	2,624,725	1,510,866	58%	2,973,570	2,973,570	984,321	33%	\$ 2,991,570
Fines & Forfeitures	190,549	174,950	25,797	15%	166,700	166,700	23,653	14%	\$ 166,700
Interest	1,021,703	931,836	338,779	36%	1,018,750	1,018,750	309,824	30%	\$ 1,018,750
GASB investment to market per audit	(115,999)	-	-	-	-	-	-	-	-
Miscellaneous/Other	214,482	187,178	110,812	59%	195,900	195,900	170,660	87%	243,560
Fund Transfers	312,381	289,920	143,801	-	361,060	361,060	123,502	-	361,060
Total Revenues	25,837,449	24,586,337	4,901,585	20%	25,674,250	25,674,250	4,744,949	18%	26,177,080
Authorized Use of Reserves	977,784	1,020,150	496,000		702,650	702,650	571,000		702,650
PERS Liability Reserve	300,000	300,000	300,000		300,000	300,000	300,000		300,000
Use of Internal Service Reserves - Yr 3	-	520,000	-		312,000	312,000	-		312,000
Total Use of Reserves	1,277,784	1,840,150	796,000		1,314,650	1,314,650	871,000		1,314,650
Total Revenues plus Reserves	\$ 27,115,233	\$ 26,426,487	\$ 5,697,585		\$ 26,988,900	\$ 26,988,900	\$ 5,615,949		\$ 27,491,730
Expenditures (includes c/f but no encumbrances)									
Mayor & Council	137,760	143,500	30,719	21%	153,490	153,490	33,435	22%	151,960
Treasurer	82,756	89,360	18,578	21%	97,250	97,250	19,798	20%	96,280
Attorney	213,307	232,550	42,620	18%	233,700	233,700	62,204	27%	231,360
Manager and Clerks	2,150,319	2,255,310	457,855	20%	2,290,310	2,290,310	482,496	21%	2,267,410
Comm Development	2,547,748	2,743,110	462,324	17%	3,016,850	3,016,850	589,159	20%	2,986,680
Police	9,971,461	9,928,675	1,977,114	20%	11,012,350	11,012,350	2,389,098	22%	10,902,230
Parks & Public Works	4,385,068	4,477,390	904,265	20%	4,666,190	4,666,190	1,064,874	23%	4,619,530
Community Services	848,475	916,630	151,891	17%	905,065	905,065	193,105	21%	896,010
Library	1,784,842	1,816,365	388,190	21%	1,903,860	1,903,860	425,111	22%	1,884,820
Total Dept Expenses	\$ 22,121,737	\$ 22,602,890	\$ 4,433,558	20%	\$ 24,279,065	\$ 24,279,065	\$ 5,259,280	22%	\$ 24,036,280
Non-Dept Expenditures and other uses									
General Government	2,372,206	3,119,952	149,764	5%	2,594,077	2,594,077	311,439	12%	2,568,140
Total Non-Dept Expenses	\$ 2,372,206	\$ 3,119,952	\$ 149,764	5%	\$ 2,594,077	\$ 2,594,077	\$ 311,439	12%	\$ 2,568,140
Total Operating Expenditures	\$ 24,493,943	\$ 25,722,842	\$ 4,583,322	18%	\$ 26,873,142	\$ 26,873,142	\$ 5,570,719	21%	\$ 26,604,420
Net Operating Revenues Before Capital Trsfers & Budgeted Beg Fund Balance	\$ 2,621,290	\$ 703,645	\$ 1,114,263		\$ 115,758	\$ 115,758	\$ 45,231	N/A	\$ 887,310
Authorized Use of Reserves									
2 Yr One-time State Take	421,000	421,000	421,000		421,000	421,000	421,000		421,000
Parking Management Program	181,784	224,150	-		131,650	131,650	-		131,650
Capital Projects	75,000	75,000	75,000		150,000	150,000	150,000		150,000
Animal Shelter	300,000	300,000	-		-	-	-		-
Total Budgeted Use of Reserves	977,784	1,020,150	496,000		702,650	702,650	571,000		702,650
Net Surplus or (Use) of Reserves	1,643,506	(316,505)	618,263		(586,892)	(586,892)	(525,769)		184,660

Guide to Presentation:

Each of the following groups of financial summaries present data 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.

Of special note here is the Parking Fund, which despite de-funding of 1.8 FTE positions in FY 2005/06 continues to indicate revenue shortfalls wherein costs of parking administration and enforcement are exceeding citation revenues, due largely to employee injuries and less aggressive enforcement during the Downtown Street Reconstruction Project this summer. The budgeted General Fund subsidy for this program for the fiscal year is \$131,650 to provide a revenue source in this fund to balance operating revenues with operating expenditures. Staff is continuing to evaluate 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)	-	250,037	1,149,730	154,127	-	106,647	28,278
Budgeted Revenues	577,250	381,420	191,421	176,330	601,120	39,020	12,000
Actual Revenues - 1st Qtr	48,978	13,225	7,154	173,670	102,781	37,770	57
Budgeted Expenditures	577,250	389,300	391,421	176,330	601,120	40,700	32,467
Total Actual Expenditures - 1st Qtr	116,378	39,690	33,927	61,569	102,781	13,578	-
1st Quarter Ending Fund Balance	(67,400)	223,572	1,122,957	266,227	-	130,839	28,335

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 2005/06 adopted budget. Staff is recommending no changes at this time.

In developing the FY 05/06 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 three years. If operating revenues will support it, staff still intends to maintain the General Fund's current year \$150,000 revenue commitment to the Town's Capital Improvement Plan.

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).

Capital Project Funds
Budget to Actuals Comparisons

	GFAR Fund	Traffic Mitigation	Grant Fund CIP's	Storm Drains	Utility Undergd	Gas Tax
Beginning Fund Balance	3,812,640	45,131	(4,024)	1,138,871	1,973,183	929,546
Budgeted Revenues	245,000	180,000	1,706,732	139,000	95,000	444,000
Actual Revenues - 1st Qtr	207,347	-	24,975	179,368	19,753	141,244
Budgeted Expenditures	1,432,049	70,000	1,673,653	415,000	-	956,231
Total Actual Expenditures - 1st Qtr	48,895	1,515	27,028	222,386	-	30,797
1st Quarter Ending Fund Balance	3,971,092	43,616	(6,078)	1,095,853	1,992,936	1,039,993

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 2005/06 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 Replacem	Workers Comp	Self Insurance	Office Stores	Mmgt Info Systems	Vehicle Maint.	Building Maint.
Beginning Fund Balance	3,491,310	1,817,055	1,939,958	230,219	2,401,732	152,274	1,000,995
Budgeted Revenues	430,700	601,420	492,600	86,000	805,600	512,900	991,000
Actual Revenues - 1st Qtr	107,675	167,790	134,875	16,407	211,255	128,225	237,186
Budgeted Expenditures	388,199	664,680	549,750	86,000	1,293,900	531,222	1,333,170
Total Actual Expenditures - 1st Qtr	-	222,571	313,300	12,066	99,871	115,598	268,176
1st Quarter Ending Fund Balance	3,598,985	1,762,275	1,761,532	234,560	2,513,116	164,901	970,005

Trust and Agency Funds - Town Trust and Agency Funds have fund balances as of June 30, 2005 of \$323,371 for Parking District #88 and \$292,903 in the Library Trust Funds. No budget revisions are contemplated at this time for these funds.

Redevelopment Agency - The Agency's FY 05/06 and FY 2005-10 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 \$2.1 million dollars of remaining unexpended funds at July 1, 2005 from the Agency's \$10.7 million dollar 2002 COP issue. Approximately \$850,000 of the \$2.1 million was spent through August, most of which was for the Downtown Street Reconstruction project. There remains as of September 1, 2005 approximately \$746,000 or funds available for other phases of the project (Main Street). The other remaining proceeds of the bond issue are being used and appropriated for their planned purpose, eligible capital projects in the downtown project area such as the Downtown Parking Management Plan (\$121K), and Santa Cruz Avenue/Wood Road Gateway (\$65K). However, staff's recommendation is that completion of Main Street be viewed as the priority project among these three.

**Redevelopment Agency Funds
Budget to Actuals Comparisons**

	Capital Projects	Debt Service	Low/Mod Housing	Total RDA Funds
Beginning Fund Balance	3,320,273	4,481,846	4,335,193	12,137,311
Budgeted Revenues	50,000	4,336,440	1,103,460	5,489,900
Actual Revenues - 1st Qtr	527,312	(350,048)	38,728	215,992
Budgeted Expenditures	2,588,243	3,785,240	50,000	6,423,483
Total Actual Expenditures - 1st Qtr	927,206	619,632	118,307	1,665,145
1st Quarter Ending Fund Balance	2,920,379	3,512,166	4,255,614	10,688,159

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 is estimated to be \$303,000. The ERAF payment is anticipated to be made from RDA fund balance.

Proposition 1A does 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.

It is important that the Town continue to monitor developments regarding Redevelopment Agencies to discourage the legislature from further State takes from Redevelopment Agency Tax Increment. Protecting Redevelopment Agency funds for all cities is also a strategic priority for the League of California cities. 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

First Quarter 2005/06 point towards a cautious optimism that the Town's economically sensitive revenues may be starting to recover and trend towards future growth. Though the Five Year Financial Plan continues to project moderate future revenue shortfall challenges, these challenges

will be made less so if the Town's economically sensitive revenues can sustain their recovery. Local economic developments are likely to influence any additional budget adjustments during the fiscal year.

It is the overall financial strength of the Town that enables the Town to effectively manage the current economic recovery. The Town continues to carefully monitor revenue and expenditure trends and react to them 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 continues its efforts to develop appropriate revenue sources for ongoing operating and capital needs of the community for the future. It is equally important to ensure that the Town's limited resources are allocated to meet the basic priority service needs of the community.