



MEETING DATE: 3/19/2007

ITEM NO: 12

COUNCIL/AGENCY AGENDA REPORT

DATE: MARCH 13, 2007

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

FROM: DEBRA J. FIGONE, TOWN MANAGER/EXECUTIVE DIRECTOR 

SUBJECT: 2006/07 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2006

- A. ACCEPT 2006/07 MID-YEAR SECOND QUARTER BUDGET PERFORMANCE STATUS REPORT, INCLUDING FY 2007-12- FIVE-YEAR FINANCIAL PROJECTIONS
- B. AUTHORIZE BUDGET ADJUSTMENTS AS RECOMMENDED IN THE ATTACHED SECOND QUARTER BUDGET PERFORMANCE REPORT

RECOMMENDATION:

- 1. Accept the 2006/07 Mid-Year Budget Performance and Status report, including FY 2007/12 Five-Year Financial Projections
- 2. Authorize budget adjustments as recommended in the attached second quarter budget performance report (Attachment 1).

PURPOSE:

The purpose of this report is threefold. First, to inform the Town Council on the status of the Town's FY 2006/07 Adopted Budget at the mid-year point. Second, to provide the Town Council with staff's most recent five year budget forecast which informs the evolving budget status for FY 2007/08 and beyond. Third, to provide a FY 2007/08 proposed budget development preview that includes a current financial status update and highlights of issues arising out of the budget development meetings held in recent months with each department which are being considered for service level changes or funding recommendations that are anticipated to be included in the proposed budget scheduled for a public hearing on May 7, 2007.

PREPARED BY:


STEPHEN CONWAY

Finance & Administrative Services Director

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Reviewed by: PS Assistant Town Manager/Deputy Director OK Town Attorney/General
Counsel Clerk Administrator/Secretary SC Finance
 Community Development

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THE REPORT:

The report includes the following:

- A Mid-Year FY 2006/07 budget update focusing on revenue and expenditure trends and financial projections for the current fiscal year.
- A discussion of the Town's current year financial condition, including a briefing on the current General Fund reserve status.
- An update to the Town's five-year financial projections (FY 2007-12) to provide a context for FY 2007/08 budget development.
- A FY 2007/08 proposed budget preview centering on key issues that staff addressed during preliminary budget discussions and considerations taken into account when making funding recommendations for the FY 2007/08 budget.

DISCUSSION:

FY 2006/07 MID YEAR BUDGET STATUS:

Budget Performance Report

The Budget Performance Report (Attachment 1) is a mid-year report covering the six months beginning July 1, 2006 and ending December 31, 2006. 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. At midyear staff has more information available than at the time of the first quarter report presented to Council in the fall of 2006, 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, Transient Occupancy Tax, Vehicle License fees (Car Tax), Business License Tax, Fees and Charges and Interest Income. This information provides the status of the revenues adopted to support the current year's operating budget. Furthermore, the Town Council is advised of any recommended changes to estimated revenue or expenditure appropriations included in the Town's FY 2006/07 Adopted Budget.

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General Fund Revenue Highlights

Overall General Fund revenues continue to remain strong in most key categories of revenues such as sales tax, property taxes and charges for services. The attached budget report includes recommended changes to budgeted revenues at mid-year. Highlights of some of the significant proposed revenue increase changes include:

- A \$500,000 increase in estimated Investment Income from \$1,205,700 to \$1,705,700.
- A \$454,140 increase in estimated Sales Tax from \$7,646,000 to \$8,100,140.
- A \$225,440 increase in estimated Franchise Fee revenue from \$1,013,500 to \$1,238,940.
- A \$100,000 increase in estimated Property Tax from \$6,369,900 to \$6,469,900.
- A \$70,000 increase in Transient Occupancy Taxes from \$930,000 to \$1,000,000.
- Other revenue increases include a \$150,000 increase to Licenses & Permits and a \$111,050 increase in Vehicle License Fee (VLF) property tax backfills for the fiscal year.

Operating revenue decrease recommendations include:

- A decrease of \$51,100 in Auto Task Force reimbursements and a \$11,500 decrease in Business License Recycle fees.

More detailed information and analysis of each of the above revenue highlights are presented in the Budget Performance Report (Attachment 1).

General Fund Operating Budget Current Year Expenditure Trends

Staff is encouraged that expenditures in many Town departments are trending 4-5% below the expected 50% of budget level (expected level halfway through the fiscal year). If this trend continues, there may be departmental budget savings at year end in addition to excess operating revenue above budget estimates. Though the trends at mid-year indicate the potential for a positive increase in unspent operating revenues, staff continues to monitor key revenues and will bring forward any material changes to operating revenue estimates for Town Council approval should these be necessary for the remainder of the fiscal year. At this time, no additional revenue estimate changes are deemed necessary other than those brought forward as part of this report.

The attached Budget Performance and Status Report (Attachment 1) includes 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 1 titled "General Fund Operating Revenues Versus Operating Expenditures" reflect the revised revenue projections as described in this report.

FIVE-YEAR FINANCIAL PROJECTIONS UPDATE:

Setting the stage for FY 2007/08 budget development, staff recently updated the Town's Five-Year Financial Plan spanning fiscal years 2007/08 through 2011/12. The five-year plan is presented on the following page. A presentation guide is attached as Exhibit A that can be used as an aid to understand the projections data that is presented in each fiscal year. The updated plan forecasts a balanced scenario for the next three years and revenue shortfalls approaching approximately \$600,000 in FY 2010/11 and approaching \$1,000,000 in FY 2011/12 in year five of the plan. The Five-Year Financial Plan is an independent financial tool that is based upon current costs and revenue forecasts, but is designed to be more fluid in nature, allowing staff to build various funding scenarios and "what if" assumptions with more immediate turnaround of financial data regarding options presented in the FY 2007/08 budget proposals. As such, the FY 2007/08 projections in the Five-Year Financial Plan have been updated by staff to reflect the preliminary budget assumptions made during the review of all departmental proposals, but as data is still being refined at the time of this report, the FY 2007/08 projections are subject to change before the budget is presented on May 7, 2007.

The future shortfall projections in FY 2010/11 and 2011/12 are based upon conservative but realistic revenue growth estimates using key current revenue categories and forecasting increases in the costs to deliver current services to the community based upon actual expenditure patterns. As in every year, the revenue forecast is dependent upon the stability of economically sensitive local revenue sources such as sales tax, and assumes no significant loss of major sales tax contributors during the forecast period, other than those anticipated in the projections based upon current information.

The updated five-year forecast of revenues is presented optimistically with varying growth rates, on average 5% for tax revenues and 3% for fees for services, with some provisions made for changing dynamics in the Town's local economic revenue base. Expenditures are derived from a database using actual costs adjusted for future known increases in labor costs if multi-year labor agreements are in effect, assumptions for labor costs yet unknown, and actuarial updates for retirement and other benefit costs as provided by PERS or other information sources available to the Town.

In any given year of the plan in which a shortfall is projected, the plan assumes that budget actions will be taken to eliminate the revenue shortfall through the use of "permanent" fixes. A permanent fix would reduce the level of shortfall in the following fiscal years on an ongoing basis. It is possible to make some adjustments through one-time solutions or prudent use of bridge funding on a year-to-year basis. However, as has occurred over the last four years, these solutions recognize that problems that are truly structural should be addressed eventually with new revenue sources or reduced expenditures in an ongoing way.

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MARCH 19, 2007Town of Los Gatos General Fund
Five Year Financial Plan FY 2006/07 Through FY 2011/12

Summary Data

Revenue Summary

	EST. 2006-07	PROJ. 2007-08	PROJ. 2008-09	PROJ. 2009-10	PROJ. 2010-11	PROJ. 2011-12
Sales Tax	\$8,100,140	\$8,231,100	\$8,490,400	\$8,745,100	\$9,007,400	\$9,277,600
Property Tax	6,469,900	6,727,220	6,976,200	7,244,500	7,523,900	7,814,300
Charges for Services	3,127,390	2,994,100	3,026,000	3,060,300	3,097,100	3,136,100
Business Licenses	1,000,000	1,000,000	1,015,000	1,030,200	1,045,700	1,061,400
Car Tax/VLF Prop Tax Swap	1,989,500	2,030,360	2,069,900	2,111,300	2,153,500	2,218,100
Intergovernmental Rev.	2,215,132	2,207,583	2,234,085	2,273,563	2,319,650	2,367,575
Other Lic. and Permits	1,686,000	1,721,700	1,754,800	1,788,500	1,823,000	1,858,200
Investment Earnings	1,705,700	1,622,700	1,639,900	1,657,300	1,674,800	1,692,500
Franchise Tax	1,238,940	1,603,380	1,618,400	1,661,500	1,705,800	1,751,400
Hotel/Motel Tax	1,000,000	1,000,000	1,030,000	1,060,900	1,092,700	1,125,500
Fines & Forfeitures	455,900	456,900	465,300	473,800	482,500	491,500
Miscellaneous	220,300	220,300	221,700	223,200	224,700	226,200
Transfers/Other Sources	1,025,885	1,081,450	1,406,450	1,406,450	1,206,450	1,206,450
Total Revenues	\$30,234,787	\$30,896,793	\$31,948,135	\$32,736,613	\$33,357,200	\$34,226,825
Town Expenditures						
Salary	\$12,936,252	\$13,927,094	\$14,482,650	\$14,636,889	\$15,183,718	\$15,698,356
Elected Officials	23,340	23,340	23,340	23,340	23,340	23,340
Temporary Employees	484,431	468,245	496,579	513,959	531,948	550,566
Overtime	405,509	444,282	436,476	451,753	467,564	483,916
Other Salary	173,437	195,909	201,591	206,955	213,414	218,968
Benefits	5,270,870	5,579,912	5,855,647	6,222,903	6,626,042	7,094,757
Supplies, Materials, & Services	4,293,441	4,158,390	4,278,725	4,402,850	4,564,200	4,739,000
Grants & Awards	181,415	176,415	176,410	176,410	176,410	176,410
Utilities	352,880	355,080	370,600	386,960	404,200	422,410
Fixed Assets	-	-	-	-	-	-
Internal Service Charges	3,123,200	3,250,000	3,347,500	3,447,925	3,551,363	3,657,904
Debt Service	931,080	931,100	931,850	931,100	929,050	932,100
Operating Transfers Out	141,825	310,000	310,000	310,000	310,000	310,000
Solid Waste Fund Transfers Out	-	300,000	300,000	300,000	300,000	300,000
GFAR Capital Transfers Out	382,210	525,000	650,000	650,000	650,000	650,000
Total Expenditures	\$28,699,890	\$30,644,767	\$31,861,368	\$32,661,045	\$33,931,249	\$35,257,728
Net Rev & Other Sources Over Expend.	\$ 1,534,897	\$ 252,026	\$ 86,767	\$ 75,568	\$ (574,049)	\$ (1,030,903)
Ongoing Shortfall Mitigation					574,049	1,030,903
Revenues Over (Under) Exp.	\$ 1,534,897	\$ 252,026	\$ 86,767	\$ 75,568	\$ -	\$ -
Revenue Shortfall as a % of Operating Revenues					-1.69%	-2.92%

Status of Projected FY 2006/07 General Fund Year End Balances

Referring to the chart above, projections for FY 2006/07 as displayed in the "Estimated" column of the Five-Year Financial Plan anticipate an excess of operating revenues above operating expenditures of approximately \$1.5 million. If the projections hold true, the Town's current reserve policy provides that once legally restricted reserves such as Reserve for Open Encumbrances are funded as required, the remaining reserves are designated equally to the Reserve for Future Capital and Special Projects and the Town's Revenue Stabilization Reserve.

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As Council is aware, the availability of excess balances resulting from fiscal year expenditure reductions or increases in revenue estimates beyond the adopted budget is one important funding source for future operating and capital budgets.

The Revenue Stabilization Reserve was first established in the FY 2005/06 budget as a funding source for the Town to pro-actively implement more efficient organizational structures, explore new service delivery options, provide "bridge" funding during short term transitions of businesses that may temporarily reduce sales taxes until a new use is in place, and to allow time for new initiatives and programs to become more fully formed. As the FY 2007/08 is being developed, staff will continue to consider the use of some Revenue Stabilization Reserve Funds which will be recommended to Council as potential sources of bridge funding for next fiscal year. The availability of bridge funding from the Revenue Stabilization Reserve enables the Town to use a longer planning horizon to bring services in line with ongoing available resources. This strategy has been used by the Town in recent years and has served as a vital tool in preserving basic services to the community while simultaneously making incremental organizational adjustments to align services with revenues over time.

The Town's guiding philosophy is that the use of reserves or other sources of bridge funding needs to be done strategically, ensuring that these funding sources are not used to fund the ongoing cost of services that are not eventually supported by ongoing operating revenues.

FIVE-YEAR PLAN UPDATE IMPLICATIONS -TRENDS & CHALLENGES

The update to the Five-Year financial forecast validates the Town's decision to begin strategic cost reductions dating back to FY 2001/02, with cumulative salary and benefit savings totaling approximately \$2.8 million for 23.7 full-time equivalent de-funded positions. The efforts have taken a multi-pronged approach to achieve operational efficiencies, cost reductions, and exploration of alternative methods of service delivery options by the Town. Though the Town remains strong fiscally, challenges still exist as explained in the following discussion of available operating revenues and the cost of delivering services to the community.

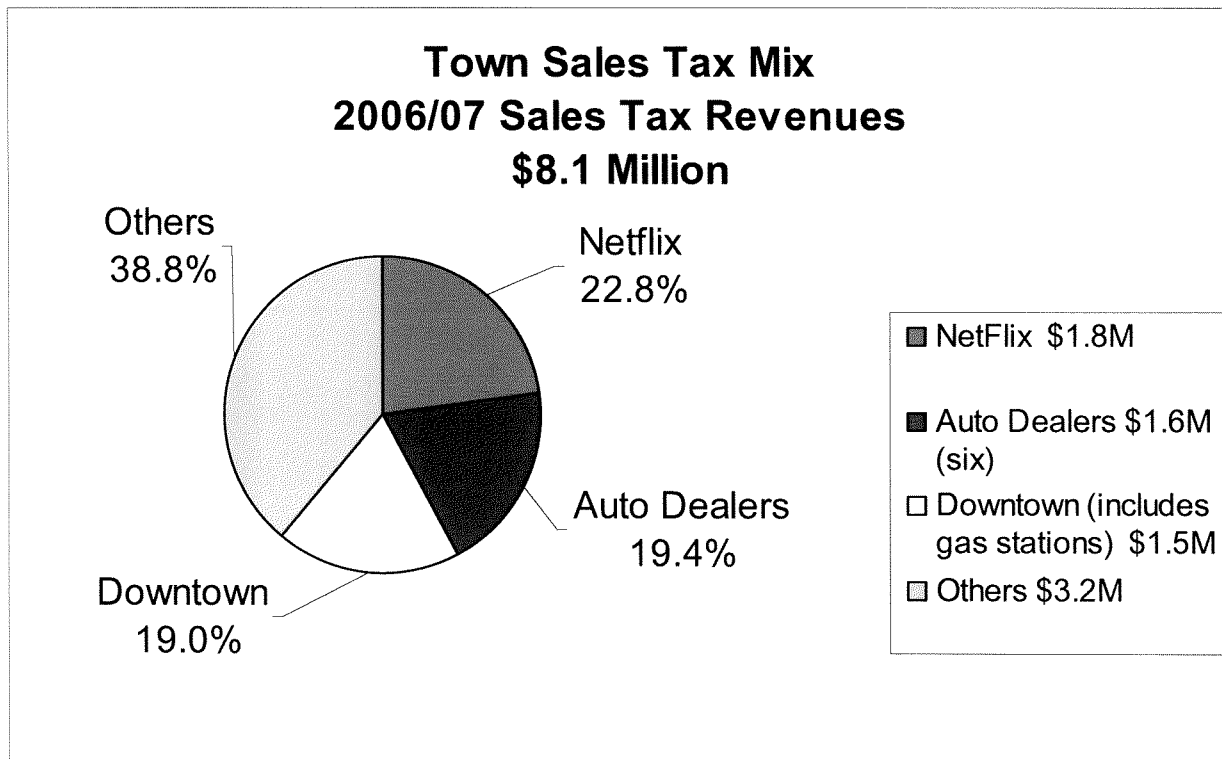
Revenue Trends

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

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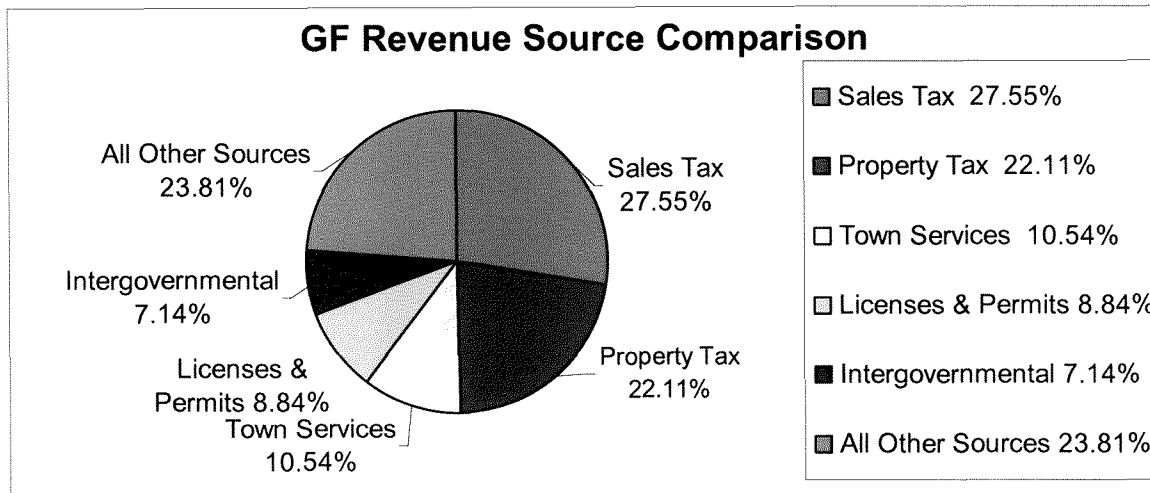
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The Town's Sales Tax base diversity is a continuing concern. Though the five-year projections are encouraging, the Town's current lack of diversity in its portfolio of sales tax producers continues to be a concern for the future. The current sales tax generators by category are presented in the pie chart below:



A challenge to the sales tax base is the portion attributable to the Town's auto dealerships, one which closed last fiscal year and another has moved its dealership out of Los Gatos. As depicted above in the first chart, the Town's auto dealerships account for approximately 19% of the Town's total annual Sales Tax. This percentage has fallen from five years ago when this sector provided approximately 30% of the annual sales tax collections. Another concern is the importance of retaining the technology sector businesses which contribute to the Town's collections, one of which is now our largest provider of sales tax annually, contributing nearly 23% of the Town's sales tax collections. Having a well balanced sales tax base continues to be an important objective so the Town can better weather the effects of economic cycles and their impact on the ability to deliver services to the community.

Shown below is a breakout of the top five General Fund revenue categories. These top five sources provide the majority of funding for all Town services:



State Budget Impacts to the Town are also unknown. The Governor's budget delivered in January 2007 did not propose any additional state "takes" in the State's FY 2007/08 budget, which is positive news for local government. But the potential for state "takes" is a constant reality for the Town each fiscal year. Proposition 42 state gasoline taxes were proposed in the Governor's January 2006 budget to be fully funded in 2006/07, however allocations are suspended for FY 2007/08 and begin again in FY 2008/09. A significant mitigating factor to preserve the Town's revenues from further takes was the successful approval of propositions in 2004 and in 2006 which were passed overwhelmingly by California voters to protect local tax revenues for local services and local transportation projects.

Fees & Charges- 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 to recover the cost of specialized services. This will ensure that public subsidies are not created for private development and other specialized services provided to the Town's customer base. In that regard, staff annually examines and brings forward for Town Council approval a comprehensive fee review as part of the budget process.

Service Delivery Costs- While the Town's operating revenues are starting to show improvement and modest growth in most categories, the update to the Five-Year Plan continues to point out that the costs to provide services to the community must continue to be managed effectively with an eye to the future.

Salary & Benefits- Town government is responsible for providing services to residents which depend on people to deliver them through Town employees or service contracts. As typical in either the public or private sectors, a large percentage of the costs in a service industry is attributable to labor. Labor costs comprise the largest share of the Town's General Fund operating expenditures (approximately 70%). In order for the Town to remain competitive in the

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labor market in a high cost region, the Town's labor costs have continued to grow. In particular, significant public safety salary and benefit increases throughout the state have influenced the Town's public safety labor costs.

In recent years, the Town, like all California cities, has experienced a significant increase in the employer's share of its public retirement system contributions. The adoption in 2000 of a new safety employee's retirement formula (3% at 50) and several years of negative investment returns in the State of California PERS pension system have resulted in increases in retirement contributions paid by the Town. Based upon estimates obtained in the summer of 2005 from PERS and the Town's actuarial consultant, the Town's contribution toward retirement for sworn personnel was expected to remain at historically high levels. Rates anticipated for non-sworn employees are forecasted to be slightly higher than the current year, rising from 12.663% of covered payroll to 12.990%. Conversely, the rates for sworn employees are expected to lower slightly next year from 33.990% to 33.549% of covered payroll. The Five-Year Forecast assumes this ongoing level of higher rates into the foreseeable future, which is an important factor in the Town's inability for operating revenues to keep pace with operating expenditures.

Employer Health Costs-Again consistent with national trends, health care costs continue their upward trend, with increases of 16-20% annually over the past several years. Recent agreed upon changes in labor contracts between the Town and its represented employees and with non-represented groups such as management are "holding the line" against automatic escalation of health costs. This is reflected by the capping of 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 benefit costs while concurrently remaining a competitive employer in order to attract and retain a qualified workforce.

Post Retirement Health Care Costs (Governmental Accounting Standards Board Statement #45)- GASB 45 will require the Town to accrue an annual expense on its financial statements for the cost of providing post retirement health care costs. The annual cost of this benefit will essentially be determined in the same way as annual pension costs are charged using an actuarial study as its basis. The Town will soon be reviewing proposals from actuaries to begin an actuarial study of the Town's post retirement health care benefits. GASB 45 requires the Town to accrue an expense for this cost beginning in FY 2008/09. If the Town's experience is similar to other cities, it can expect this cost will grow beyond the approximate \$190,000 budgeted this fiscal year. The Five-Year Plan assumes a 25% increase from year to year. The Town will not know if this is sufficient until the actual evaluation is complete. Because the Town has a cap on the annual growth of this benefit, this will be a positive element for the actuarial study, but since the cap is linked to the growth in health care premiums, actuaries have told city officials to be prepared for "big numbers." GASB 45 does allow for a "phase in" (amortization period- essentially a 20 to 30 year payment plan) thereby allowing some flexibility in determining the amount of annual funds placed in an irrevocable trust (which can be invested in generally higher earning investments than is allowed for the Town's standard investments) to provide the

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calculated future cost of benefits. The earnings accruing in the trust are then taken as a offset against the calculated future costs of the post retirement benefits.

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

Internal Service Charges-The Town prudently charges itself on an annual basis for 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, the administration should continue to ensure that the Town's internal rate setting practices are in line with projected internal service funding needs.

Infrastructure- An important point to note is that because of prior year budget savings and increased revenues, the Five-Year Plan includes a yearly transfer of \$550,000 in FY 2007/08 rising to \$650,000 annually in FY's 2008/09 thru 2011/12, from the General Fund for the Town's capital program. This annual transfer is funded by the \$4.2 million in the General Fund Appropriated Reserve for Future and Special Projects. Though the additional funding has increased the Town's ability to implement the capital program, the level of annual funding still falls short of fully funding the Town's need for infrastructure maintenance or to build new facilities. For example, the street resurfacing program requires an approximate annual investment of \$1.5 million dollars to keep the Pavement Condition Index from declining. However, the Town's only ongoing source of street maintenance funding is the Town's Gas Tax fund. Gas taxes receipts are approximately \$500,000 per year which is not sufficient to maintain the Town's street condition at acceptable levels. The gap between gas tax and the desired funding level must now be filled with excess General Fund revenue or State grants and /or bond funds. A reliable, dedicated source of funding for basic capital improvements beyond these means remains a goal for the Town.

FY 2007/08 BUDGET PREVIEW

PROPOSED STATUS QUO BUDGET TARGETS FY 2007/08

As presented in the Five-Year Financial Plan, the projections for next year indicate a moderate excess of operating revenues over expenditures and a longer-term outlook for an imbalance in expenditures and revenues. Consequently, except for some limited service restoration, staff will be recommending a "status quo" budget for FY 2007/08.

The proposed FY 2007/08 budget will reflect a number of principles that take into account the current and long-term fiscal picture as well as high priority service delivery needs. The key principles include:

- To the extent possible, recommend a "status quo" budget;
- Consider budget augmentations in cases where prior year budget reductions have resulted in service deficiencies in high priority areas;
- Make progress on or initiate transitions to ensure cost-effective and high-performing organizational structures; and
- Identify opportunities for enhancing service delivery through technology.

Following are brief summaries of the issues which have surfaced in the budget discussions with the departments, and which may be addressed in the proposed Operating and Capital Budgets scheduled for consideration by the Town Council on Monday, May 7, 2007.

Police Department

Budget discussions with the Police Department have focused on service levels in the patrol area. The department is exploring alternatives to address the goal of providing adequate patrol staffing that accounts for vacancies due to turnover, illness, disabilities or vacations. In the current fiscal year, the department has reassigned one officer from the Regional Auto Theft Task Force to patrol to address the need for minimum staffing, and will be recommending to continue that redeployment. While the reassignment results in a loss of \$90,000 in reimbursement from the regional task force, it adds one patrol officer to meet minimum shift requirements. Additionally supplemental funding alternatives are being explored to ensure minimum staffing levels in the event of vacancies, in particular the vacancies occurring between the time an officer resigns and a new one is hired from the academy.

Another area being discussed is a transition in the parking control function to align staffing resources with needs. An upcoming retirement of a Parking Control Officer presents an opportunity to consider the most appropriate staffing needed to deliver the services associated with the parking control function and other departmental needs.

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Parks and Public Works

In the Parks and Public Works (PPW) department, budget discussions have focused on transitions to align staffing resources with service needs and on ensuring adequate capacity to deliver priority core services. Restructuring opportunities being explored are in the administrative and engineering areas. In the administrative area, restructuring will better align staff positions with customer service, work order, and general administrative demands.

Assessment of the administrative function will continue and may result in further restructuring.

In the engineering area, an upcoming retirement will allow the restructuring of a position to meet the increased level of professional skills needed. Additional engineering support for both private development (fee supported) and public infrastructure activities will be proposed to meet the growing demand.

In the maintenance area, realignment of work assigned to temporary employees will be proposed to address the need for enhanced garbage pick-up and steam cleaning in the downtown.

Additional non-personnel costs will be included for enhanced steam cleaning, as well. In addition, the restoration of a maintenance worker position to permanent status is anticipated to address the gap in maintenance capacity needed as a result of the transition of sewer services to West Valley Sanitation District.

Community Development Department

Service demand generated by development activity remains high this fiscal year and is expected by the department to continue into the foreseeable future. In addition, the department anticipates ramping up efforts on the General Plan and housing element updates. To staff the department with the experience needed for the complex special projects and the heightened workload, staff will propose reclassifying positions to create opportunities for higher level professional staff that can provide management level, policy development work and oversight. The cost of the classification changes will be supported by development fees.

The department is also exploring alternatives for streamlining and enhancing the noticing process, which may result in a budgetary change supported by development fees.

Library

The proposed budget will recommend maintaining the current model of the library open to the public 54 hours/7 days per week, and the materials budget at the restored level included last year. While no significant changes will be proposed to the library's operating budget, staff is exploring technology alternatives to address the self-check service at the library. The current equipment is not functioning consistently, and is no longer supported by its vendor. Any proposed technology improvements will be included in the capital budget.

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Community Services

Budget discussions in the Community Services Department have focused on reorganizations to align service responsibilities with staff resources, and with reclassifications to better reflect job responsibilities. Proposed reorganizations will result in more consistent coverage for customer service and better alignment of work assignments with staff positions. Proposed reclassifications will provide consistency in job classes delivering services at similar levels.

Town Manager's Office

The Town Manager's Office anticipates proposing further restructuring to align staff resources with work demands throughout the department. The restructuring is designed to promote seamless service delivery across administrative functions. One proposed change will reallocate existing funding from vacant paraprofessional positions to an analyst position to provide technical and professional support to both the human resources function and to the Town Manager's Office. In addition, temporary hours will be proposed for the human resources function to meet the demand for job studies associated with reclassification and restructuring proposed throughout the organization. Recognizing the increasing workload generated as the Town increases reliance on technology, staff will propose additional technical support in the information systems program and restructuring to better align administrative staff support with the needs throughout the department. A portion of the additional technical support will be fee-supported as the new permit tracking system will require additional technical expertise.

Other Town-Wide Issues

Other issues that will be addressed in the FY 2007-08 budget include funding requests from community organizations, such as the Chamber of Commerce, and the United Way 2-1-1 program. The capital budget will include funding for addressing some of the deferred maintenance needs of Town facilities, such as the neighborhood center kitchen. In addition, the proposed capital budget will reflect an emphasis on core infrastructure such as streets and retaining walls as stated by Council at the Council Retreat on March 9 and 10, 2007.

CONCLUSION

The Town finds itself today in sound financial condition as a result of strategies undertaken to manage through the downturns experienced in recent years. If the Five-Year Financial Forecast holds true, the Town has an opportunity over the next few years to implement further strategies such as cost containment, organizational realignments, efficiency measures, strategic public and private partnerships, and revenue enhancement to enable the Town to continue to provide quality public services. Any significant change in the forecast, with regard to either revenues or expenditures, will require the implementation of additional strategies to maintain service levels. In particular, the Town should continue to pursue acceptable opportunities to diversify and strengthen the Town's economic base, as emphasized by the Town Council at the March 9 and 10 Council Retreat.

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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 for FY 2006/07. Upon approval of the recommended budget adjustments by Town Council, current projections forecast a moderate surplus of operating revenues over operating expenses for the fiscal year ending June 30, 2007. As detailed in this report, staff is currently engaged in FY 2006/07 budget development process which incorporates plans for a status quo budget plan, contingent upon the performance of the local economy and any unforeseen budgetary actions taken by the State of California to balance its budget.

Attachments:

Attachment 1- Budget Performance Report for the Six Months Ended December 31, 2006

Distribution:



TOWN OF LOS GATOS

BUDGET PERFORMANCE REPORT

FOR THE SIX MONTHS ENDED DECEMBER 31, 2006

March 17, 2007

FINANCIAL OVERVIEW – EXECUTIVE SUMMARY

Status of FY 2006/07 Adopted Budget:

Taken collectively, second quarter General Fund revenues continue to trend positively. Despite the closure of two automobile dealerships the prior year and one in the current year, sales tax receipts for the second quarter are trending moderately ahead of collections for the prior year. The current forecast expects Sales Tax to exceed revenue estimates by approximately \$454,100 this fiscal year. The increase is due to growth in the general retail category, led by continued growth of NETFLIX, an internet commerce company, the Town's largest provider of sales tax revenues. The gain in the general retail category helped offset the trend of decline in sales tax collected from the Town's auto dealers. Auto dealerships as a whole have declined to approximately 19% of total Town sales tax, compared to approximately 30% five or more years ago. The success of Netflix has allowed the Town to sustain the loss of three of the top ten businesses in the Town's portfolio of sales tax generators, without a drastic decline in sales tax. Another favorable trend is the continued economic recovery of the downtown. Sales tax collections, excluding new car sales but including auto service stations, were up 3.57% for the year for the quarter ending September 30, 2006 (the most recent quarter available). Restaurant sales taxes for the period were the highest generated in the past two years, up 8.1% from the prior year.

Property tax collections are also exceeding budget estimates, with current forecasts exceeding budgeted estimates by approximately \$100,000. Property Tax appears to be tracking favorably at nearly 10% growth, outperforming estimates of 4% growth used for the adopted budget estimates for FY 2006/07. The growth is largely attributable to the turnover of local housing stock, reflecting the continuing desirability of the Town's housing stock and new commercial developments being added to the property tax rolls.

Department expenditure totals for the second quarter FY 2006/07 are also favorable, with spending at the end of the second quarter averaging 43% expended, or 7% below the 50% benchmark level used for six months of 12 months operations. With six months of data available it is easier to predict revenues and expenditure trends for the entire fiscal year. However, the uncertainty of the economic effects of potential rises in energy costs or a more dramatic downturn in the local real estate market may impact consumer behavior. In light of this uncertainty and being fully aware that the local economy's recovery remains vulnerable, staff continues to be cautiously optimistic while monitoring fiscal developments very closely. Consequently, further adjustments may be necessary during the fiscal year. Any further course corrections or budget adjustments necessary will be brought to Town Council's attention at the earliest opportunity to balance operating revenue and expenditures.

The cost to provide services to the community for FY 2006/07 and future fiscal years will continue to require strong performance in the Town's economically sensitive revenues to offset

the cost increases likely to occur. The FY 2007/08 "status quo" budget and fee update proposals are being developed to protect critical public services while limiting operating cost escalation in light of the fiscal forecast which predicts operating revenue shortfalls in the later years of the five year plan.

State Budget Fiscal Impacts to Town for FY 2007/08:

Another positive development since the presentation of the First Quarter Budget Performance Report was the announcement in the Governor's January 2007 Budget in which no additional State local revenue "takes" were proposed for the State Budget in FY 2007/08. The successful passage of the Local Taxpayers Revenue Protection Proposition 1A in November 2004 by a large majority of California voters makes future State takes more difficult. 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 Reserve Status -June 30, 2006

General Fund reserves are classified into two categories-Restricted and Designated. Restricted reserves are those which are restricted in use by accounting standards or legal agreements and are not considered as available for use for another purpose. Designated reserves are established by Council policy for an intended purpose. Current Restricted Reserves are presented below:

<i>Restricted General Fund Reserves:</i>	<i>Amount</i>
Reserved for RDA Loan	\$1,500,000
Reserved for LT Notes Receivable	478,873
Reserved for Advances to Urban Runoff	150,000
Total Restricted General Fund Reserves	\$2,207,380

As stated earlier the total General Fund Reserves closed at a balance of approximately \$18.1 million at June 30, 2006. In addition to the approximate \$2.2 million of General Fund Reserves set aside for restricted purposes, the Town has approximately \$15.9 million in designated reserves established in accordance with Town financial policies and operating and 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.

<i>Designated Reserves:</i>	
Designated for Capital & Special Projects	\$4,143,889
Designated for Revenue Stabilization	4,048,887
Designated for Economic Uncertainty	3,678,001
Designated for Sewer Asset Proceeds	2,438,660
Designated for Civic Center Improvements	663,086
Designated for Open Space	562,000
Designated for Mgr's Contingency & Prod.	200,000
Designated for Parking	186,930
Designated fro Grants Funds & Carryovers	79,650
Total Designated Reserves	\$15,921,450

The Reserve for Capital and Special projects, whose source is derived from half of the annual available General Fund budget savings, serves as the primary source for replenishment to the Town's Capital Improvement Fund (GFAR) in addition to the annual budgeted transfer from the General Fund's operations of \$150,000 in the current fiscal year. As such it represents the potential source for a large number of unfunded needs identified during the annual capital improvement plan process. This reserve also functions as a potential funding source for new capital projects or augmentations to authorized projects funded through the Town's Five-Year Capital Improvement Program (CIP). The Town continues to be challenged in identifying an ongoing source of funds to meet the annual \$1.5 million recommended street repair and maintenance program and other priority infrastructure improvements like sidewalk repair and replacement.

In its public communications, staff will refer to the \$15.9 million in Designated General Fund reserves as the Town's "reserves" since these reserves are established by Council policy for their intended purpose. The availability of approximately \$15.9 million in Designated General Fund reserves provides the Town with resources to manage through future fiscal challenges and opportunities, mindful of the many competing priorities for resource allocation, ranging from restoration of core services to the community and a large amount of unfunded capital improvements.

GENERAL FUND-KEY REVENUE ANALYSIS FY 2006/07

The following presentation provides a recap of significant General Fund revenue sources as of the second quarter ending December 31, 2006. Sales Tax and Property Tax collections show positive trends for the current year. Staff is monitoring developments in each major revenue source closely for potential adjustments to budgeted revenues as recommended in this report.

◆ 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.

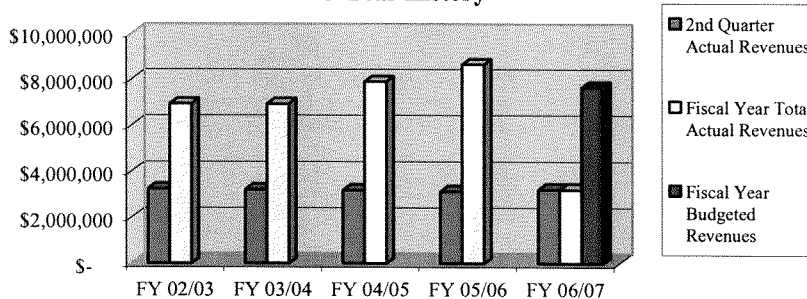
Analysis

According to a recent update from the Bay Area Council, the regional economy is strong enough that nearly five times as many company managers are preparing to recruit for new employees than those who are planning on reducing their staffing level. California's economy continues to expand, with a fairly broad-based growth outpacing the nation's rate.

What is unknown at this time is the possible slowing of this economic momentum by the recent reoccurrence of spikes in energy costs. More data will become available as the fiscal year progresses.

Second quarter Sales Tax revenues are slightly above last year at the mid year point. Upon the closure of two auto dealers who were "top ten sales tax" generators last year, staff's projections were for sales tax to decline in FY 2006/07. However, the continued success of Netflix has generated sufficient additional revenues to not only prevent a decline in sales tax projections for the current year, but to provide some growth in sales tax as noted below. While this is very positive, staff remains concerned as it is aware that more diversification is necessary. The Town continues to seek more balance in business sectors that generate sales tax.

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



	<u>FY 02/03</u>	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>	<u>FY 06/07</u>
2nd Quarter Actual Revenues	\$ 3,237,902	\$ 3,217,070	\$ 3,179,238	\$ 3,131,898	\$ 3,214,488
Fiscal Year Total Actual Revenues	\$ 6,928,817	\$ 6,914,526	\$ 7,904,130	\$ 8,655,565	\$ 3,214,488
Fiscal Year Budgeted Revenues					\$ 7,646,000

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

2nd Quarter Percent of Total	46.73%	46.53%	40.22%	36.18%	42.04%
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Recommended Budget Revision (includes FY05/06 & FY06/07 State Adjustments)	\$ 454,140
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◆ 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 by quarter in the chart below.

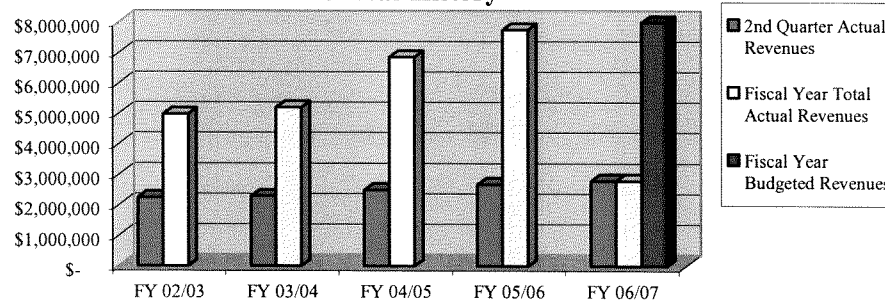
Property Tax is levied at 1% of a property's assessed value, of which the Town currently receives approximately 9.5 cents on each dollar paid to the County Assessor's Office. The assessed value of real property appraised by the County Assessor is the 1975-76 assessment role value, adjusted by a two percent 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

Property tax receipts through the second quarter indicate that taxes revenues are moderately exceeding budget estimates and a budget revision upwards is recommended. Though according to recent press reports that home sales have slowed in Santa Clara County, demand for available housing stock in Los Gatos appears to be strong. The Santa Clara County Assessor's Office provided a positive outlook in its FY2006/07 Annual Report. All cities in the county are showing positive growth. The Town of Los Gatos reflects a 8.81% increase in assessed value for FY 2006/07.

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



	FY 02/03	FY 03/04	FY 04/05	FY 05/06	FY 06/07
2nd Quarter Actual Revenues	\$ 2,246,511	\$ 2,297,420	\$ 2,497,953	\$ 2,678,416	\$ 2,806,731
Fiscal Year Total Actual Revenues	\$ 4,977,119	\$ 5,207,381	\$ 6,856,993	\$ 7,755,200	\$ 2,806,731
Fiscal Year Budgeted Revenues					\$ 8,249,400

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

2nd Quarter Percent of Total	45.14%	44.12%	36.43%	34.54%	34.02%
Recommended Budget Revision (Property Tax)					\$ 100,000
Recommended Budget Revision (VLF Backfill)					\$ 110,000

◆ 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.

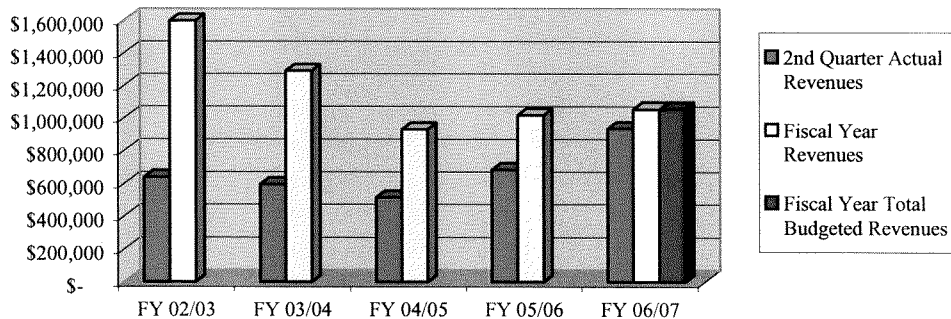
Interest Income revenue for the Town is primarily dependent upon two factors: the cash balance in the Town's investment portfolio, and the yield on those funds.

Analysis

The Town's Interest Income earning has 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.

Current year interest revenues reflect significantly higher first quarter earnings than in previous years due to increases in investment returns and the Local Agency Investment Fund (LAIF) rate, resulting in a recommended budget revision. LAIF yields have risen to an average yield of 5.129% in December 2006, from 3.808% in December 2005, and from its record low of 1.42% in May 2004.

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



	FY 02/03	FY 03/04	FY 04/05	FY 05/06	FY 06/07
2nd Quarter Actual Revenues	\$ 638,036	\$ 594,001	\$ 513,338	\$ 684,427	\$ 936,081
Fiscal Year Revenues	\$ 1,596,850	\$ 1,290,100	\$ 931,836	\$ 1,018,750	\$ 1,055,700
Fiscal Year Total Budgeted Revenues					\$ 1,055,700
2nd Quarter Percent of Total	40.0%	46.0%	55.1%	67.2%	88.7%
Recommended Budget Revision					\$ 500,000

◆ 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.

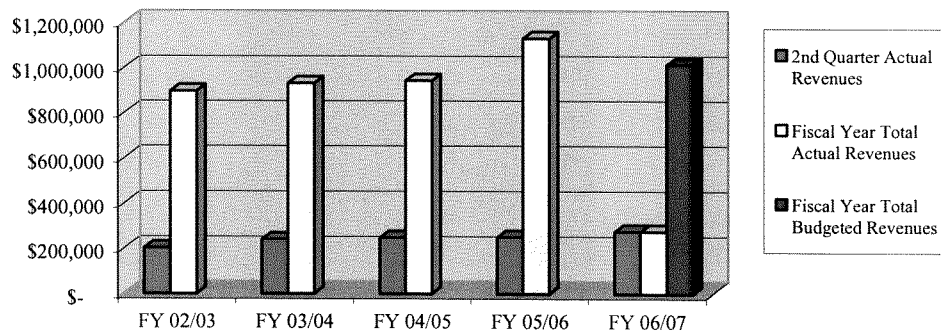
Franchise Fees are currently received from Comcast for cable television services, PG&E for gas and electric service, and Green Valley for solid waste collection services.

payment received. With the transition to the new garbage contract, the franchise fees effective for the new contract were established at 16%. The prior contract provided for a 10% franchise fee and approximately \$300,000 in annual surcharge fees for solid waste program expenses. The new contract increases the franchise fee but eliminates the solid waste surcharge fees. Staff recommends a \$225,440 increase in franchise fees for the period March through June 2007.

Analysis

Second quarter results slightly exceed the budget estimates due to timing of actual

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



	<u>FY 02/03</u>	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>	<u>FY 06/07</u>
2nd Quarter Actual Revenues	\$ 200,819	\$ 239,295	\$ 246,980	\$ 248,860	\$ 274,603
Fiscal Year Total Actual Revenues	\$ 897,158	\$ 930,997	\$ 942,647	\$ 1,130,189	\$ 274,603
Fiscal Year Total Budgeted Revenues					\$ 1,013,500

FY 2005/06 Total Actual Revenues reflect increased revenue based on Audit for Prior Years performed by Town

2nd Quarter Percent of Total	22.38%	25.70%	26.20%	22.02%	27.09%
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Recommended Budget Revision	225,440
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◆ **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

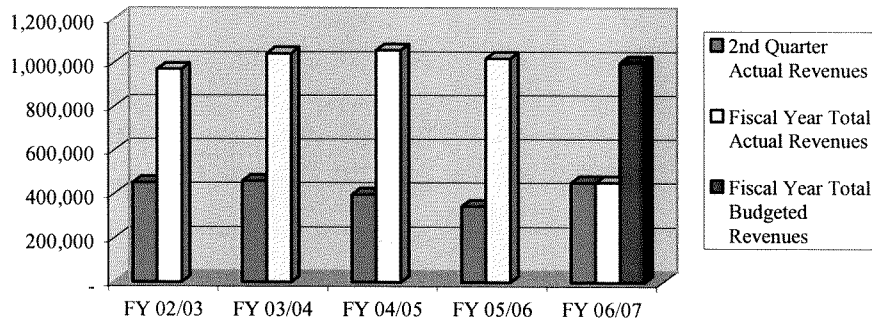
based businesses are pro-rated by quarter, from the date of application to the end of the year.

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.

The favorable second quarter collections rate, which is approximately \$108K ahead of the prior year, is partially the result of staff's additional audit efforts conducted recently which netted approximately \$75K in additional revenue from unlicensed businesses that were performing services in Town this fiscal year.

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



	FY 02/03	FY 03/04	FY 04/05	FY 05/06	FY 06/07
2nd Quarter Actual Revenues	450,284	458,003	396,773	343,358	452,346
Fiscal Year Total Actual Revenues	\$ 970,554	\$ 1,041,865	\$ 1,056,814	\$ 1,019,386	\$ 452,346
Fiscal Year Total Budgeted Revenues				\$ 1,000,000	
2nd Quarter Percent of Total	46.39%	43.96%	37.54%	33.68%	45.23%

Recommended Budget Revision

No Change

◆ *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.

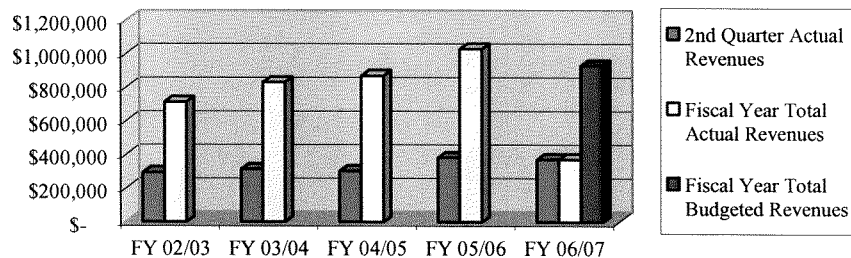
Analysis

The Transient Occupancy Tax revenues received in the second quarter of FY 2006/07 reflects a small decrease in collections compared to the prior year, but the trends indicate that the estimated revenues can be increased by \$70,000 for the fiscal year. State projections show a 7.6 percent increase in travel spending for 2006, with steady gains at an annual rate of 7.1 percent since 2003. These gains reflect the strongest travel market rebound

since 1999-2000 when travel spending had an annual 8% growth rate. The travel industry attributes these gains to higher room rates and gasoline rates.

Overall, the Town expects the occupancy rates to continue improving with projected increases in tourism statewide, completed and upcoming property re-investments, and local trends demonstrating a strong increase in corporate and leisure travel during the first and fourth quarters. Local hotels have experienced a moderate rebound in corporate events, leisure travel related to the wedding industry, and agricultural tourism related to the California Wine industry.

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



	<u>FY 02/03</u>	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>	<u>FY 06/07</u>
2nd Quarter Actual Revenues	\$ 293,570	\$ 312,998	\$ 301,725	\$ 382,190	\$ 371,333
Fiscal Year Total Actual Revenues	\$ 713,064	\$ 829,025	\$ 868,908	\$ 1,028,664	\$ 371,333
Fiscal Year Total Budgeted Revenues					\$ 930,000
2nd Quarter Percent of Total	41.17%	37.75%	34.72%	37.15%	39.93%
Recommended Budget Revision					\$ 70,000

FY 2006/07 RECOMMENDED BUDGET ADJUSTMENTS

Budget adjustments are recommended for the following revenues and expenditures at the first quarter as described below:

GENERAL FUND	FY 2006/07 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2006/07 Revised Budget
Revenue:			
Interest Earned	1,205,700	500,000	1,705,700
Sales Tax	\$ 7,646,000	\$ 454,140	\$ 8,100,140
Franchise Fees	1,013,500	225,440	1,238,940
VLF Property Tax Backfill (State)	1,879,500	111,050	1,990,550
Building/Planning Various Permit Fees	1,547,500	150,000	1,697,500
Property Tax	6,369,900	100,000	6,469,900
VLF Property Tax Backfill (State)	1,879,500	110,000	1,989,500
Hotel Tax	930,000	70,000	1,000,000
Intergovernmental	3,178,490	(51,100)	3,127,390
Booking Fees (Intergovtl.)	-	42,777	42,777
Other Miscellaneous	Various	22,056	22,056
Total Revenue Adjustments	\$ 24,444,390	\$ 1,734,363	\$ 25,678,753

Expenditures:

Storm Flooding Expenses	-	42,100	42,100
Repairs to Backflow Preventers	-	16,000	16,000
Misc Maint Services - Steam Cleaning	-	7,100	7,100
Transfer to CIP - Retaining Walls	-	150,000	150,000
Transfer to CIP - Curbs, Gutters, & Sidewalks	-	20,000	20,000
Transfer to CIP - CDD Project	-	15,000	15,000
Below Market Price Program Expense	-	24,000	24,000
Homeland Security	-	4,552	4,552
CERT Supplies	-	11,005	11,005
Total Expenditure Adjustments	\$ -	\$ 289,757	\$ 289,757

Net General Fund Adjusted Budget

\$ 1,444,606

	FY 2005/06 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2005/06 Revised Budget
OTHER FUNDS			
<i>GFAR Capital Projects Fund</i>			
Villa Avenue Retaining Wall	\$ -	\$ 150,000	\$ 150,000
Curb, Gutter & Sidewalk	\$ -	\$ 20,000	\$ 20,000
Community Development Automation		\$ 15,000	\$ 15,000
Reallocate Grant Revenues to Park Projects	\$ 125,000	\$ -	\$ 125,000
<i>Internal Service Funds</i>			
MIS Fund Transfers Out (Rev & Exp)	\$ -	\$ 15,000	\$ 15,000
Building Maintenance Personnel Costs	\$ -	\$ 6,500	\$ 6,500

Recommended Budget Adjustments

General Fund

Revenues

Interest Income-Due to an unexpected recovery in interest rates and larger than anticipated cash balances, staff recommends an increase to estimated revenues of \$500,000 for the fiscal year.

Sales Tax-Actual receipts are running ahead of estimates, primarily due to the general retail (internet commerce) category. Staff recommends an increase of \$454,100 in estimated revenues for the year.

Franchise Fees-The new garbage contract provides for increased franchise fees and eliminates solid waste program funding reimbursements, Staff recommends an adjustment of \$200,000 in garbage franchise fees for the period of March through June 2007, and an additional \$25,440 in other franchise fees for the fiscal year.

Vehicle License Fees VLF Property Tax Backfills-Staff recommends increasing this estimated revenue by \$111,050 based upon documentation received by the Town from the State of California.

Building and Planning Permit Fees-Staff recommends an increase of \$150,000 for the year based upon current year fees collected and the trends for the remaining months of the fiscal year.

Property Tax-Staff recommends a \$100,000 increase to this revenue source based upon the December 2006 property tax installments paid to the Town by the County which trended ahead of estimates done during the prior year budget preparation.

Hotel Tax- Staff recommends a \$70,000 increase to this revenue source based upon the actual six months of receipts through December 2006 which are trending ahead of estimates done during the prior year budget preparation.

Intergovernmental Revenues-Staff recommends a reduction in this revenue source of \$51,100 to reflect the reassignment of one police officer from the regional auto theft task force (which provided partial reimbursement to the Town) to the Town's patrol function.

Booking Fees -Staff recommends an increase of \$42,777 for booking fees reimbursements restored this fiscal year through the efforts of California local government and public safety officials.

Miscellaneous Revenues-Staff recommends an adjustment of \$22,056 net increase in various other General Fund revenues such as small safety grants, below market price home program fees and business license recycle fees.

General Fund

Expenditures

Villa Avenue Retaining Walls Emergency Repairs-Staff recommends a \$150,000 increase to General Fund and GFAR fund transfers to fund the Villa Avenue Retaining Wall Project. The project is required due to the recent failure of the existing retaining wall that requires emergency repairs to stabilize the hillside and protect the public road.

Storm related repairs-Staff recommends a \$42,100 budget increase to the General Fund streets program to fund the emergency road repairs required due to the winter storm activity which caused the road to fail. The repairs were done on various sections of streets in the Belwood Gateway neighborhood and the entire roadway of Fairview Avenue. All repairs required digout, base repairs and new asphalt roadway.

Curbs, Gutters, and Sidewalks-Staff recommends a \$20,000 increase to the General Fund transfers and a corresponding increase to GFAR fund transfers-in and to the related project expenditure appropriations to provide funding for a pilot project using new methods for curb and gutter repair. The repairs will take place in several neighborhoods town-wide, including Howes Dr, Hershner Dr, Los Gatos Blvd & Hernandez Avenue.

Community Development Department –Accela Automation Software-Staff recommends an addition of \$15,000 for the automation project in the Town's MIS fund. The increase is necessary to provide funding for new servers and software customization. The costs are reimbursable from funds paid through development fees and set aside in the Town's GFAR fund for support of development related technology improvements.

Staff recommends a \$6,500 increase to the Building Maintenance Fund for installation of high pressure release valves for the compressed natural gas station as required by law once the valves have been in use for 1400 hours and a \$16,000 increase to the Town's park program to install backflow prevention devices at various park locations which were destroyed during the winter 2007 freeze.

Staff recommends a \$7,100 increase to the Town's Streets program for additional contract steam cleaning of downtown banners and a more extensive high pressure cleaning operation applied in November to the downtown sidewalks to ready them for the holiday shopping season.

Staff recommends a \$24,000 increase in appropriations for legal and Below Market Price (BMP) program costs related primarily to the litigation, acquisition, rehabilitation, and ongoing ownership costs for four BMP units at Villa Capri. These costs are fully funded by BMP In-Lieu Fees, paid by developers as dictated by BMP Program regulations; these costs are not borne by the General Fund.

Other Funds

Grant Fund

Staff recommends a \$11,005 increase in authorized budget related to the 2005 Community Emergency Response Team (CERT) for citizen's grant fund appropriations and a \$4,552 increase in Homeland Safety Grant expenditures for emergency preparedness.

FINANCIAL SUMMARIES, PROJECTIONS AND RECOMMENDATIONS

General Fund

The following page presents the *Schedule of FY 06/07 General Fund Operating Revenues vs. Operating Expenditures* 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 early trends observed through the first quarter.

Town of Los Gatos
Schedule of General Fund
Operating Revenues vs. Operating Expenditures
For the period ended December 31, 2006

	FY05/06 Final Balance	FY05/06 Adjusted Budget	FY05/06 2nd Qtr Actuals	FY05/06 % YTD	FY06/07 Adopted Budget	FY06/07 Adjusted Budget	FY06/07 2nd Qtr Actuals	FY06/07 % YTD	FY06/07 Finance Projection
Revenues									
General Property Tax	\$ 5,831,822	\$ 5,668,510	\$ 2,678,416	47%	\$ 6,369,900	\$ 6,369,900	\$ 2,806,732	44%	\$ 6,469,900
Prop Tax Car Tax Backfill	1,923,378	1,923,380	-		1,879,500	1,879,500	-	0%	\$ 1,989,500
Sales & Use Tax	8,655,566	7,800,000	3,131,898	40%	7,646,000	7,646,000	3,214,488	42%	\$ 8,100,140
Franchise Fees	1,130,190	983,450	248,860	25%	1,013,500	1,013,500	274,603	27%	\$ 1,238,940
Transient Occ Tax	1,028,664	950,000	382,191	40%	930,000	930,000	371,333	40%	\$ 1,000,000
Business License Tax	1,019,386	1,000,000	343,358	34%	1,000,000	1,000,000	452,346	45%	\$ 1,000,000
Licenses & Permits	1,584,662	1,564,180	977,737	63%	1,547,500	1,547,500	1,329,615	86%	\$ 1,686,000
Motor Vehicle In Lieu	173,326	148,300	81,574	55%	152,700	152,700	112,624	74%	\$ 152,700
Intergovernmental	2,606,356	2,563,620	1,295,430	51%	1,937,080	2,019,655	825,333	41%	\$ 2,062,432
Charges for Services	3,006,634	2,819,370	2,094,989	74%	3,178,490	3,178,490	2,083,058	66%	\$ 3,127,390
Fines & Forfeitures	210,888	166,700	68,182	41%	455,900	455,900	224,330	49%	\$ 455,900
Interest	1,596,949	1,128,750	684,428	61%	1,205,700	1,205,700	936,981	78%	\$ 1,705,700
GASB investment to market per audit	(189,685)	-	-		-	-	-		-
Miscellaneous/Other	2,738,297	2,702,610	2,786,046	103%	210,300	210,300	204,318	97%	210,300
Fund Transfers	430,839	603,780	189,671	31%	221,850	221,850	174,757		221,850
Total Revenues	31,747,272	30,022,650	14,962,780	50%	27,748,420	27,830,995	13,010,519	47%	29,420,752
Authorized Use of Reserves	281,650	281,650	150,000		281,825	514,035	382,210		514,035
PERS Liability Reserve	300,000	300,000	300,000		300,000	300,000	300,000		300,000
Use of Internal Service Reserves - Yr 3	-	-	-		-	-	-		-
Total Use of Reserves	581,650	581,650	450,000		581,825	814,035	682,210		814,035
Total Revenues plus Reserves	\$ 32,328,922	\$ 30,604,300	\$ 15,412,780		\$ 28,330,245	\$ 28,645,030	\$ 13,692,729		\$ 30,234,787
Expenditures (includes off but no encumbrances)									
Mayor & Council	148,595	153,490	70,914	46%	161,130	161,130	68,078	42%	161,130
Treasurer	75,184	97,250	40,668	42%	98,150	98,150	44,006	45%	98,150
Attorney	228,744	233,700	114,612	49%	245,450	245,450	100,283	41%	245,450
Administrative Services	2,214,363	2,293,021	1,032,327	45%	2,338,010	2,338,010	1,077,524	46%	2,338,010
Comm Development	2,916,068	3,016,850	1,382,136	46%	3,231,500	3,231,500	1,200,530	37%	3,231,500
Police	10,855,241	10,865,860	5,088,897	47%	10,949,660	10,949,660	5,295,961	48%	10,949,660
Parks & Public Works	4,766,536	4,813,240	2,158,653	45%	4,902,150	4,902,150	2,241,063	46%	4,902,150
Community Services	866,027	907,565	393,293	43%	955,565	955,565	419,857	44%	955,565
Library	1,879,184	1,903,860	918,802	48%	1,989,660	1,989,660	957,194	48%	1,989,660
Total Dept Expenses	\$ 23,949,943	\$ 24,284,836	\$ 11,200,301	46%	\$ 24,871,275	\$ 24,871,275	\$ 11,404,497	46%	\$ 24,871,275
Non-Dept Expenditures and other uses									
General Government	2,240,216	2,909,476	600,517	21%	3,082,370	3,314,580	810,598	24%	3,314,580
Total Non-Dept Expenses	\$ 2,240,216	\$ 2,909,476	\$ 600,517	21%	\$ 3,082,370	\$ 3,314,580	\$ 810,598	24%	\$ 3,314,580
Total Operating Expenditures	\$ 26,190,159	\$ 27,194,312	\$ 11,800,819	43%	\$ 27,953,645	\$ 28,185,855	\$ 12,215,095	43%	\$ 28,185,855
Net Operating Revenues Before Capital Trsfrs & Budgeted Beg Fund Balance	\$ 6,138,762	\$ 3,409,988	\$ 3,611,961		\$ 376,600	\$ 459,175	\$ 1,477,634	N/A	\$ 2,048,932
Authorized Use of Reserves									
Capital Projects	150,000	150,000	150,000		150,000	382,210	382,210		382,210
Parking Management Program	131,650	131,650	-		16,430	16,430	-		16,430
Revenue Stabilization Fund	-	-	-		16,795	16,795	-		16,795
Sewer Assets Proceeds Reserve	-	-	-		98,600	98,600	-		98,600
Total Budgeted Use of Reserves	281,650	281,650	150,000		281,825	514,035	382,210		514,035
Net Surplus or (Use) of Reserves	5,857,112	3,128,338	3,461,961		94,775	(54,860)	1,095,424		1,534,897

Guide to Presentation:

Each of the following groups of financial summaries present data by governmental fund type. These funds are Special Revenue Funds, Capital Projects Funds, Internal Service Funds, and Redevelopment Agency Funds. In each of the following projections similar format is presented. The fund information starts with beginning fund balances and adds current year revenues and subtracts current year expenditures which gives the ending fund balance. Budgeted amounts are also provided for revenues and expenditures, these are useful for comparing actual amounts received or spent to date versus budgeted for FY 2006/07.

Special Revenue Funds – Special Revenue Funds, which account for the proceeds derived from specific revenue sources that are legally restricted or assigned to special purposes including the Town’s Parking Fund, Solid Waste Fund, Community Development Block Grant Fund, Non Point Source 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 2006/07 continues to indicate revenue shortfalls. Due in large measure to employee injuries and less aggressive enforcement during the Main Street Reconstruction Project last summer, the costs of parking administration and enforcement are exceeding citation revenues. The budgeted General Fund subsidy for this program for the fiscal year is \$284,400 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	LIDs	Operating Grants
Beginning Fund Balance (Pre-audit)	-	250,037	1,149,730	154,127	106,647	28,278
Budgeted Revenues	661,000	381,420	189,310	174,060	35,950	12,000
Actual Revenues - 2nd Qtr	172,178	172,593	21,853	172,066	38,164	-
Budgeted Expenditures	661,000	384,802	389,310	174,060	56,230	32,467
Total Actual Expenditures - 2nd Qtr	273,780	130,752	38,798	91,938	19,889	4,616
2nd Quarter Ending Fund Balance	(101,602)	291,878	1,132,785	234,254	124,922	23,662

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 2006/07 adopted budget. Staff is recommending no changes at this time.

In developing the FY 2006/07 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 will be received back in grant reimbursements in equal amounts).

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	2,473,423	275,000	4,539,262	130,800	95,000	562,700
Actual Revenues - 2nd Qtr	1,448,866	-	-	67,255	56,294	240,568
Budgeted Expenditures	3,439,475	40,430	4,493,586	242,614	-	646,000
Total Actual Expenditures - 2nd Qtr	998,313	21,949	391,754	50,000	-	82,308
2nd Quarter Ending Fund Balance	4,263,193	23,182	(395,779)	1,156,126	2,029,477	1,087,807

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 FY 2006/07 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	3,491,310	1,817,055	1,939,958	230,219	2,401,732	152,274	1,000,995
Budgeted Revenues	362,730	595,700	482,300	86,000	838,200	597,800	1,119,300
Actual Revenues - 2nd Qtr	178,850	300,333	290,754	35,042	432,818	298,900	584,663
Budgeted Expenditures	550,500	600,540	496,100	83,350	1,829,060	597,600	1,232,632
Total Actual Expenditures - 2nd Qtr	126,945	264,386	355,163	36,909	968,895	230,731	428,342
2nd Quarter Ending Fund Balance	3,543,215	1,853,001	1,875,549	228,352	1,865,656	220,443	1,157,315

Trust and Agency Funds - Town Trust and Agency Funds have fund balances as of June 30, 2006 of \$320,349 for Parking District #88 and \$305,218 in the Library Trust Funds. No budget revisions are contemplated at this time for these funds.

Redevelopment Agency - The Agency's FY 06/07 and FY 2006-11 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 \$362,000 dollars of remaining unexpended funds at February 28, 2006 (taken from current bank trustee statements) from the Agency's \$10.7 million dollar 2002 COP issue. The remaining funds (including accrued interest earnings) are available for their planned purpose including eligible capital projects in the downtown project area such as the remaining Street Reconstruction project funds (191K) Santa Cruz Avenue/Wood Road Gateway (\$65K) and the

Downtown Parking Management Plan (\$25K) and for related contingencies as per Town contractual agreements.

**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	5,494,780	1,197,430	6,742,210
Actual Revenues - 2nd Qtr	50,406	2,380,792	615,790	3,046,988
Budgeted Expenditures	1,847,533	4,224,800	451,050	6,523,383
Total Actual Expenditures - 2nd Qtr	1,424,271	751,526	348,392	2,524,190
2nd Quarter Ending Fund Balance	1,946,408	6,111,111	4,602,590	12,660,109

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 \$303,000 for FY 2004/05 & FY 2005/06. The FY 2006/07 Budget Bill eliminated the approximately \$303,000 increased ERAF payment, allowing the Agency to retain this amount of tax increments to be used for important future Agency projects.

Proposition 1A approved in 2004 does not contain specific protections for redevelopment agencies. These 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

The financial results from the prior fiscal year and data collected through the second quarter of FY2006/07 point towards a cautious optimism that the Town's economically sensitive revenues will continue their positive trends. This is especially important in light of the recent loss of three auto dealerships which were in the top ten sales tax providers of last fiscal year. 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 momentum and the cost of delivery of core services can be kept in check.

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 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. Staff continues its efforts exploring options for enhancing revenue sources for ongoing operating and capital needs of the community for the future. It is equally important to ensure that the Town's current limited resources are allocated to meet the basic priority service needs of the community.