



MEETING DATE: 2/19/2008

ITEM NO: 13. A.

COUNCIL/AGENCY AGENDA REPORT

DATE: FEBRUARY 14, 2008

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

FROM: GREG LARSON, TOWN MANAGER/EXECUTIVE DIRECTOR

A handwritten signature in black ink, appearing to be "G. Larson", written over the printed name.

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

- A. ACCEPT 2007/08 MID-YEAR SECOND QUARTER BUDGET
PERFORMANCE STATUS REPORT, INCLUDING FY 2008/13 -
FIVE-YEAR FINANCIAL PROJECTIONS
- B. AUTHORIZE BUDGET ADJUSTMENTS AS RECOMMENDED IN
THE ATTACHED SECOND QUARTER BUDGET PERFORMANCE
REPORT

RECOMMENDATION:

- 1. Accept the 2007/08 Mid-Year Budget Performance and Status report, including FY 2008/13 Five-Year Financial Projections
- 2. Authorize budget adjustments as recommended in the attached Second Quarter Budget Performance Report.

PURPOSE:

The purpose of this report is threefold. First, to inform the Town Council on the status of the Town's FY 2007/08 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 2008/09 and beyond. Third, to provide a preview of the FY 2008/09 proposed budget that includes a current financial status update and highlights of early issues and priorities arising out of staff's "status quo" budget development efforts. The report discusses current service level issues under consideration for change and funding recommendations that are anticipated to be included in the proposed budget scheduled for a public hearing on May 19, 2008. A related economic vitality report is provided separately for Council's review. Updates of

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

A handwritten signature in black ink, appearing to be "S. Conway", written over the printed name.

N:\MGR\AdminWorkFiles\Annual Budget\2008 Mid Year Budget Report.doc

Reviewed by: PSJ Assistant Town Manager/Deputy Director _____ Town Attorney/General
Counsel _____ Clerk Administrator/Secretary _____ Finance
_____ Community Development

PAGE 2

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

Town fees and charges to capture recovery of current service costs effective July 1, 2008 (FY 2008/09) are also presented separately for approval by Town Council in a public hearing.

THE REPORT:

The report includes the following:

- A mid-year FY 2007/08 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 and projected General Fund reserve status.
- An update to the Town's five-year financial projections (FY 2008-13) to provide a context for FY 2008/09 budget development.
- A preview of the FY 2008/09 proposed budget highlighting key issues that staff is addressing during preliminary budget discussions and development of the FY 2008/09 budget.

DISCUSSION:

FY 2007/08 MID YEAR BUDGET STATUS:

Budget Performance Report

The Budget Performance Report (attached) is a mid-year report covering the six months beginning July 1, 2007 and ending December 31, 2007. 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, which is simultaneously the most vulnerable and flexible of all Town funds. At midyear staff has more information available on financial 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 and expenditure trends are also analyzed at the mid year point. Furthermore, the Town Council is advised of any recommended changes to estimated revenue or expenditure appropriations included in the Town's FY 2007/08 Adopted Budget. The report includes recommended mid-year budget adjustments for all Town fund revenues and expenditure categories. The mid-year budget projections contained in the attached report titled "General Fund Operating Revenues Versus Operating Expenditures" reflect the revised revenue projections as described in this report.

PAGE 3

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

General Fund Revenue Highlights FY 200708

Overall, General Fund revenues continue to remain strong in most key categories such as sales tax, transient occupancy taxes and franchise taxes, with a few recommended changes. Highlights of some of the significant proposed revenue increase changes include:

- A \$550,000 increase in estimated Sales Tax from \$8,231,100 to \$8,781,100.
- A \$100,000 increase in estimated Transient Occupancy Taxes from \$1,000,000 to \$1,100,000.
- A \$100,000 increase in estimated Franchise Fee revenue from \$1,603,180 to \$1,703,180.
- Other revenue increases include a \$7,500 increase to reflect the new massage permit fees collected in accordance with the Massage Ordinance approved by the Town Council in November 2007.

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

General Fund Expenditure Highlights FY 2007/08

Staff is encouraged that expenditures in many Town departments are trending 5-6% 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.

General Fund Projected Year End Balances June 30, 2007

Current fiscal year end projections for FY 2007/08 anticipate an excess of operating revenues above operating expenditures of approximately \$1.3 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.

As Council is aware, the availability of excess balances resulting from the current fiscal year expenditure reductions or revenue increases beyond the adopted budget is one important funding source for the Reserve for Future Capital and Special Projects and the Revenue Stabilization Reserve.

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.

PAGE 4

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

FIVE-YEAR FINANCIAL PROJECTIONS UPDATE:

Setting the stage for FY 2008/09 budget development, staff recently updated the Town's Five-Year Financial Plan spanning fiscal years 2008/09 through 2012/13. The five-year plan is presented on the following page. 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 test "what if" assumptions.

The updated plan forecasts balanced scenarios for the next two fiscal years and operating deficits approaching approximately \$525,000 beginning in FY 2010/11 and approaching \$1,500,000 in FY 2012/13 in year five of the plan. The first year of the plan (FY 2008/09) has been updated to include preliminary budget assumptions and estimates but not a more detailed review of all departmental proposals. Farther updates and changes to the FY 2008/09 projections will be made before the proposed budget is presented on May 19, 2008.

The future deficit projections in FY 2010/11 through 2012/13 are based upon conservatively realistic revenue projections and the increased operating costs based on past and projected expenditure patterns. As in prior years, 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 (such as a significant internet retailer) during the forecast period. However the projections do include the potential loss of an auto dealership.

The updated five-year forecast of revenues is presented using varying growth rates, on average 4% 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.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

TOWN OF LOS GATOS - GENERAL FUND
Five Year Financial Plan FY 2008/09 Through FY 2012/13

Revenue Summary	ACTUAL 2006-07	ESTIMATED 2007-08	PROJECTED 2008-09	PROJECTED 2009-10	PROJECTED 2010-11	PROJECTED 2011-12	PROJECTED 2012-13
Sales Tax	\$ 9,253,891	\$ 8,781,100	\$ 8,612,861	\$ 8,886,000	\$ 9,104,500	\$ 9,329,100	\$ 9,559,900
Property Tax	6,594,056	6,727,220	7,045,300	7,299,100	7,562,600	7,851,300	8,151,300
Charges for Services	3,967,735	3,371,470	2,991,600	3,061,000	3,106,200	3,152,400	3,199,500
Business Licenses	1,189,138	1,060,000	1,133,500	1,178,400	1,225,100	1,273,700	1,324,200
Car Tax/VLF Prop Tax Swap	1,990,555	2,030,360	2,071,000	2,112,400	2,154,600	2,197,700	2,263,600
Intergovernmental Rev.	2,252,682	2,168,025	2,197,885	2,238,085	2,279,763	2,328,150	2,378,575
Other Lic. and Permits	1,503,014	1,927,900	1,575,380	1,632,800	1,692,400	1,754,300	1,818,600
Investment Earnings	2,576,062	1,498,300	1,290,800	1,303,700	1,316,700	1,329,900	1,343,200
Franchise Tax	1,162,038	1,703,180	1,756,100	1,805,100	1,852,600	1,901,500	1,951,700
Hotel/Motel Tax	1,108,257	1,100,000	1,210,000	1,246,300	1,283,700	1,322,200	1,361,900
Fines & Forfeitures	214,565	525,405	526,400	535,400	544,600	554,100	563,700
Transfers & Use of Reserves	114,470	184,110	184,640	206,450	216,450	226,450	236,450
Miscellaneous	299,015	267,230	267,200	268,500	270,400	272,300	274,200
Total Revenues	\$ 32,225,478	\$ 31,344,300	\$ 30,862,666	\$ 31,773,235	\$ 32,609,613	\$ 33,493,100	\$ 34,426,825
Town Expenditures							
Salary	\$ 12,580,452	\$ 14,149,680	\$ 14,819,428	\$ 15,311,278	\$ 15,921,886	\$ 16,565,519	\$ 17,201,223
Overtime	663,992	420,900	423,686	437,957	454,634	473,077	492,000
Benefits	4,698,961	5,441,800	5,704,547	5,904,440	6,237,724	6,578,260	6,744,494
Supplies & Services	7,690,739	8,205,415	7,756,750	7,888,740	8,092,165	8,299,515	8,505,459
Grants & Awards	184,329	204,722	186,615	186,610	186,610	186,610	186,610
Utilities	458,385	377,130	377,130	392,660	409,010	426,230	444,400
Debt Service	931,078	930,790	930,790	931,850	931,100	929,050	932,100
GASB 45 Retiree Medical	-	-	400,000	550,000	820,000	1,090,000	1,400,000
Operating Transfers Out	230,827	295,110	247,980	260,500	263,000	265,500	268,100
Operating Transfers Out ISF Repay	-	300,000	120,000	120,000	120,000	-	-
GFAR Capital Transfers Out	4,194,094	525,000	650,000	650,000	650,000	650,000	650,000
Total Expenditures	\$ 31,632,857	\$ 30,850,547	\$ 31,616,926	\$ 32,634,035	\$ 34,086,129	\$ 35,463,761	\$ 36,824,386
Net Revenues Less Expenditures	\$ 592,621	\$ 493,753	\$ (754,260)	\$ (860,800)	\$ (1,476,516)	\$ (1,970,661)	\$ (2,397,561)
**Authorized Use of Reserves							
PERS	\$ 300,000	\$ 300,000	\$ 300,000	\$ 300,000	\$ 300,000	\$ 300,000	\$ 300,000
GFAR Capital Funding	-	525,000	650,000	650,000	650,000	650,000	650,000
Retiree Medical GASB 45	-	-	-	-	-	-	-
Revenues Over (Under) Exp.	\$ 892,621	\$ 1,318,753	\$ 195,740	\$ 89,200	\$ (526,516)	\$ (1,020,661)	\$ (1,447,561)

In any given year of the plan in which a deficit is projected, the plan presents that budget actions will need to be taken to eliminate the projected operating deficits through the use of “permanent” fixes which would reduce the operating deficits in the following fiscal years as well. 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 ongoing should be addressed as soon as possible with new revenue sources or reduced expenditures in an ongoing way.

FIVE-YEAR PLAN UPDATE IMPLICATIONS - TRENDS & CHALLENGES

This update to the Five-Year financial forecast validates the Town’s prior decisions to make strategic cost reductions dating back to FY 2001/02. The current FY 2007/08 includes a net 21.2 full time equivalent “de-funded” positions with annual salary and benefit savings of approximately \$2.3 million dollars. 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

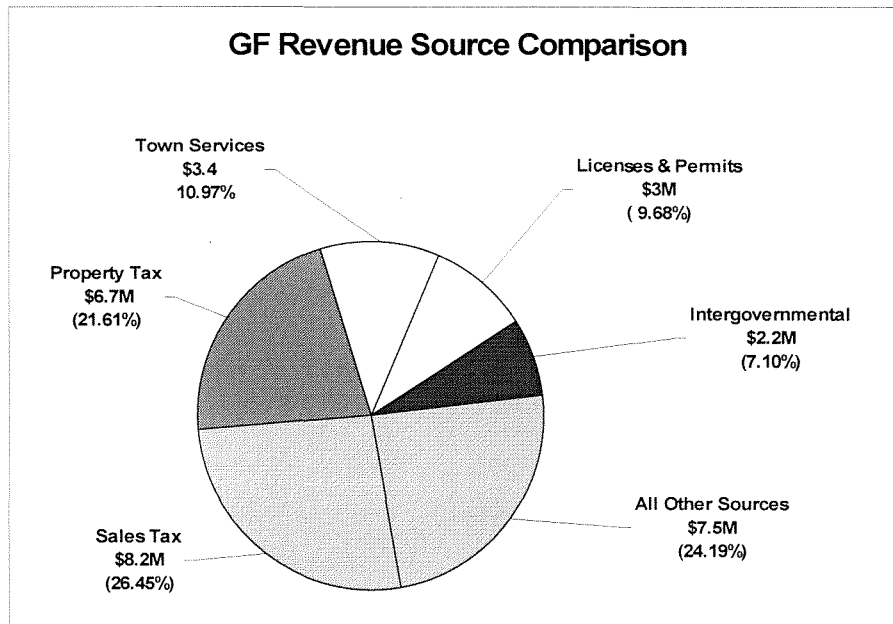
FEBRUARY 14, 2008

explained in the following discussion of available operating revenues and the cost of delivering services to the community.

OPERATING REVENUE CHALLENGES

Recovery in Economically Sensitive Revenues- The five-year financial projections assume that conservatively 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.

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

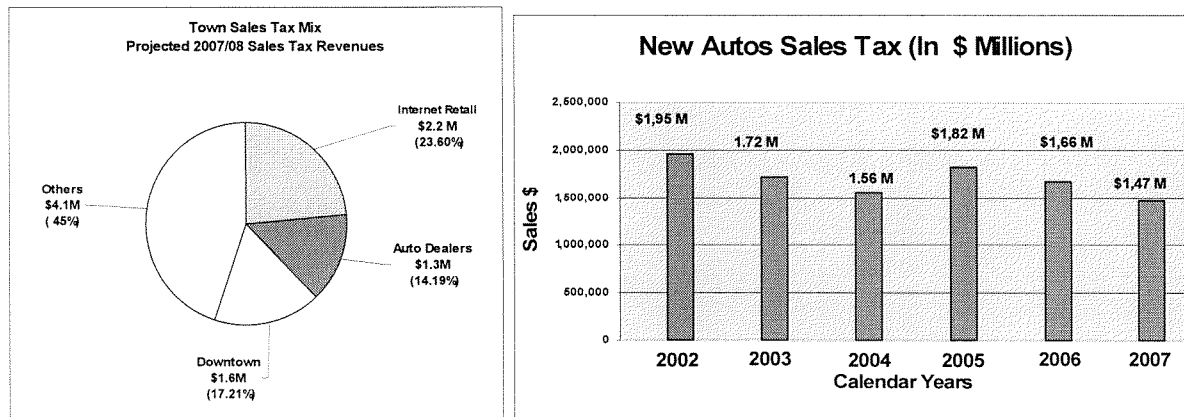


MAYOR AND TOWN COUNCIL/CHAIR AND MEMBERS OF THE REDEVELOPMENT AGENCY

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

The Town's Sales Tax base diversity is a continuing concern. Though the five-year projections are encouraging, the Town's declining 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:



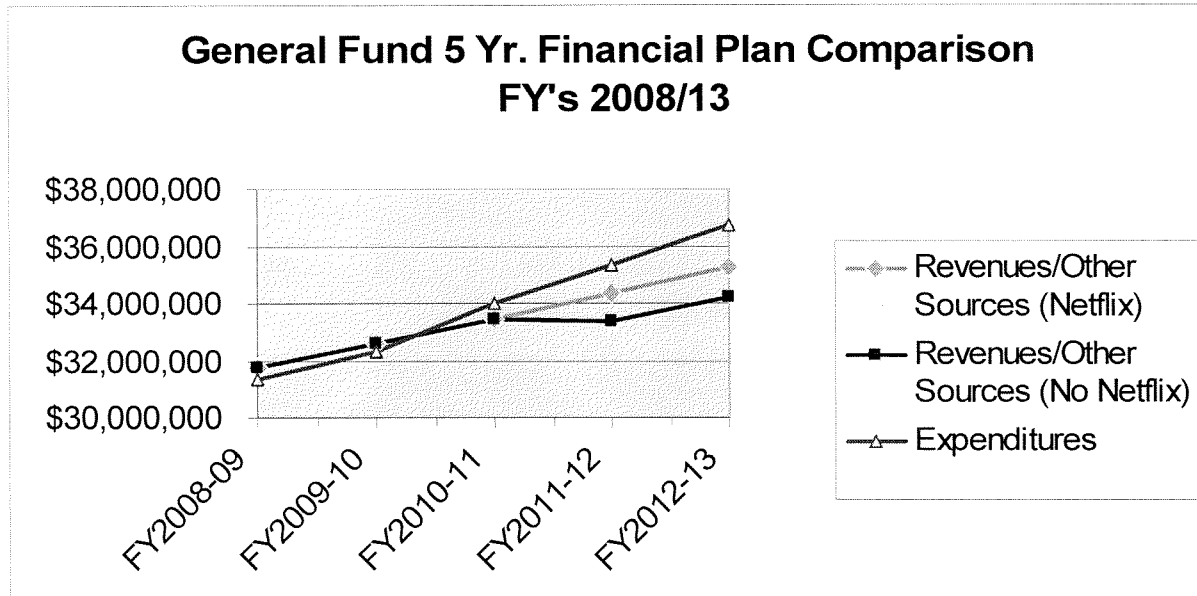
A challenge to the sales tax base is the portion attributable to the Town's auto dealerships. As depicted above in the first chart, the Town's auto dealerships account for approximately 14% of the Town's total annual Sales Tax. This percentage has fallen from five years ago when this sector provided 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 20% 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.

As part of its financial planning efforts, staff also prepared an alternative scenario that assumed that the revenue used for providing services from Netflix is gone. The following graph visually depicts the effects of the loss of this revenue to the future revenue shortfalls presented earlier which are continue assuming ongoing revenues for Town services from Netflix.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008



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.

FIVE YEAR PLAN OPERATING AND CAPITAL EXPENDITURE CHALLENGES

Service Delivery Costs- 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 largely depend on people to deliver them through Town employees or service contracts. As typical in either the public or private sectors, 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 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.

PAGE 9

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

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 of approximately 34% of payroll.

Rates anticipated for non-sworn employees are forecasted to be higher than the current year, rising from 12.663% to 15% of covered payroll, dependent upon a new PERS formula (2.5% @ 55) being considered in labor negotiations is adopted by the Town for non-sworn PERS employees.

The Five-Year Forecast assumes this ongoing level of generally higher rates for both employee groups 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 trend upwards, with increases of 10-14% annually over the past several years. Recent agreed upon changes in labor contracts between the Town and its represented and non-represented employee 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").

Town costs incurred for post retirement medical benefits will be significantly impacted in FY 2008/09 due to two major developments, (1) increases to the "Pay-As-You-Go" medical payments due to recent legislation, and (2) the effects of implementing Governmental Accounting Standards Board Statement #45 (GASB 45) as explained below:

Legislative Rate Increases to "Pay-As-You Go" Retiree Medical Payments. On September 3rd, 1991 the Town passed resolution 1991-194 electing to be subject to the Public Employees Medical and Hospital Care Act (PEHMCA). The resolution established a formula for the Town's required contribution towards retired employees medical care premiums. The formula generally capped the employer annual contribution to no more than 5% of the increased premium each year for active employees until such time as the contributions for actives and retirees were

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

equal. Because health insurance premium increases have been averaging in the double digits for many years, the formula for the Town share for retirees lagged the increased premiums for active employees, averaging approximately 41.5% of the monthly premium for retirees medical for calendar year 2008. In 2007, the California Legislature approved AB2544, which changed the PEHMCA formula significantly. Effective January 2008, the Town's share of monthly premiums increased to an average of 52.1% of the monthly premium. The table below provides a six year comparison of forecasted costs based upon the current employee retirement population:

	<u>Before Passage of AB 2544</u>		<u>After Passage of AB 2544</u>		<u>Added Cost Next 6 FY's</u>
	<u>Town's Ave. Share (%)</u>	<u>Town's Annual Costt</u>	<u>Town's Ave. Share (%)</u>	<u>After AB 2544</u>	
FY 08/09	41.5%	\$ 259,625	52.1%	\$ 334,715	\$ 75,090
FY 09/10	43.0%	293,597	61.4%	415,115	121,518
FY 10/11	44.0%	330,744	68.6%	495,515	164,771
FY 11/12	45.0%	371,090	74.9%	575,915	204,825
FY 12/13	47.0%	414,607	80.3%	647,059	232,452
FY 13/14	48.5%	461,221	81.3%	708,385	247,164
Total		<u>\$ 2,130,884</u>		<u>\$ 3,176,704</u>	<u>\$ 1,045,820</u>

As demonstrated above, over the next six years, due to AB2544 the Town will be required to fund over \$1 million dollars in additional retiree medical expenses. By FY 2013/14, the average Town share of the monthly premiums is expected to rise from 48.5% prior to AB2544, to 81.3% after AB2544. The new formula contains a \$100 per month annual growth cap for the employers's contribution. This scenario is anticipated to achieve 100% employer paid retiree medical premiums by 2012 for single retiree coverage. For two party or family coverage the average share of employer paid coverage rises from 52% in 2002 to 82% in 2022 for two party, and from 48% in 2008 to 67% in 2022 for family. The combination of two party and family coverage categories currently represents approximately 52% of the Town's retiree population. As demonstrated above, AB 2544 accelerates the implementation of higher employer paid portions of monthly premiums. Staff believes there remains a possibility future new legislation to change the PEHMCA formula again at some future date with likely higher employer costs.

GASB 45. Effective next year, 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 actuarial analysis currently being completed will determine an amount termed "the Annual Required Contribution" or ARC. The actuaries preliminary estimates for the Town's ARC are in the range from \$1.7 million (assuming the Town elects to pre-funding 100% of the ARC by paying the difference between the annual ARC less the annual "Pay-as-You-Go" amount into an irrevocable trust account) to \$2.5 million which assumes no pre-funding.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

The ARC is calculated using the following elements:

- Normal Cost which represents the annual cost assigned, under the actuarial funding method, to current and subsequent plan years (i.e. value of the benefit “earned” during the year). Sometimes referred to as “current service cost.”
- Amortization of the Unfunded Accrued Liability Amortized Over a Period Not to Exceed Thirty Years
- Interest Adjustment

Once the ARC is determined, the Town will be required to report its net Other Post Retirement Benefits (OPEB) obligation, which represents the cumulative difference between the ARC and the employer’s actual contribution. If the Town contributes an amount less than the ARC, a liability will be recorded on the accrual based financial statements. Simply put, ARC is the value of benefits earned during the year plus (or minus) some contribution to move the plan towards being on track for funding. Over time (the amortization period), the goal for an actuarially determined contribution (the ARC) is to balance the OPEB plan’s assets (investments) with the projected liabilities (future payments to retirees) of the plan. This amortization period means that after a 20 or 30 years, the unfunded accrued liability will be reduced to zero.

Funding strategy for AB2544 and GASB 45. The Five Year Financial Plan anticipates a “phased approach” to funding the GASB 45 liability. The phased approach uses a goal of a 5 to 10 year “phase-in” as follows:

- Year One (FY 2008/09) “Pay-As-You-Go” + 25% of (ARC minus Pay-As-You-Go)- Approximately \$400K.
- Year Two (FY 2009/10) “Pay-As-You-Go” + 30% of (ARC minus Pay-As-You-Go)- Approximately \$550K
- And so on through Year 10
- Year 11 fund the full ARC
- The Town should also consider establishing a targeted funding level in the trust of some percentage (i.e. 80%) of the Actuarial Liability in 25 or 30 years.

The additional payments made above the annual “Pay-As-You-Go” amounts are required by GASB 45 to be placed in an irrevocable trust (which can be invested in generally higher earning investments than is allowed for the Town’s standard investments because it can have a legally separate investment policy) to provide the calculated future cost of benefits. The earnings accruing in the trust are then calculated by the actuary as a credit against the calculated future costs of the post retirement benefits.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

The chief disadvantage of the phased pre-funding (paying any amount less than 100% of the ARC) is that the difference between the annual ARC amount less the "Pay-As-You-Go" amounts and the amount paid under the phased approach (i.e. for example, for FY 2008/09 the Town would pay 25% of the ARC less "Pay-As-You-Go") becomes a reportable liability on the Town's financial statements that is added to the following years calculation of the ARC. This means that the ARC will grow each year until more substantial payment percentages are achieved.

Advantages of the phased approach are that it provides the opportunity for the Town to budget capacity for the increased expenses due to GASB 45 over the annual "Pay-As-You-Go" costs. This approach will allow time to adjust service deliveries and budgeted operations to align with ongoing operating revenues. Another advantage is the phased approach will likely be acceptable for bond rating agencies, as it will be a very common funding strategy for similar sized California local governments.

Staff anticipates bringing forward to Town Council a resolution as part of the adoption of the FY 2008/09 budget authorizing establishment of an irrevocable trust account to receive the GASB 45 advance funding payments under the recommended "phased" approach strategy.

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. Current efforts in the green

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 good financial management practice. 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 FY 2007/08 General Fund budget includes a yearly transfer of \$550,000 from the Reserve for Future and Special Projects, a significant increase from the prior's years budgeted level of \$150,000. The Five-Year Financial Plan provides a planned investment of \$650,000 annually in FY's 2008/09 thru 2012/13, 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 or replace facilities

FEBRUARY 14, 2008

when necessary. 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 \$540,000 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.

Legislative Factors Influencing the Five Year Financial Plan

State Budget Impacts to Local Governments Gov. Arnold Schwarzenegger released his proposed FY 2008/09 budget January 10, 2008. He began by declaring a fiscal emergency and calling for "true reform" of the budget process to provide the state with a permanent solution to the systemic structural deficit.

In the FY 2007-08 State budget passed by the Legislature last August, the Governor projected a \$4 billion surplus at the end of the year. However, because of the housing slump and sub-prime mortgage crisis, state revenues have dropped to such a level that there is no surplus, and the state lacks funding to fulfill its current financial obligations. To close this gap, the Governor announced the State will sell the remaining \$3.3 billion in Economic Recovery Bonds (ERB) by February 2008. For local governments, the effect is that the anticipated sunset of the triple flip mechanism will be delayed several years, to 2012 or beyond. The triple flip mechanism was established by Proposition 57 (2004), the Economic Recovery Bond Act. It involves taking a quarter-cent of the local sales tax to repay these bonds and reimburses local governments' losses on a dollar-for-dollar basis with property tax.

As another means to address the projected shortfall, the Governor proposed cutting \$217 million from state agencies. The 10 percent across the board to state agencies and programs cuts Gov. Schwarzenegger proposed will take effect March 1, 2008. He is also seeking to delay payments on \$6.24 billion in funding intended for a variety of existing programs including; K-12 schools, state teachers' supplemental benefits and various Medi-Cal and other health programs.

Highlighted below by Town service areas are potential impacts from the FY 2008/09 State Budget development:

Public Safety

Booking Fees - Payments to counties for Local Detention Facilities have also been reduced by 10 percent to \$31.5 million. Current law stipulates that in any year the budget appropriates less than \$35 million, counties may impose booking fees on cities in proportion to the under appropriation. No information is available at this time regarding what, if any, booking fees will be assessed to the Town.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

Citizens Option for Public Safety (COPS)/Juvenile Justice Crime Prevention Act Program -The proposed budget includes \$23.8 million for the. This amount would reduce the local law enforcement discretionary grants by 10 percent. Town staff will be monitoring developments in Santa Clara County as more information becomes available. This data will be incorporated into the proposed FY 2008/09 budget.

Parks & Public Works

Gas Tax-The Governor is proposing to delay payment of approximately \$500 million of payment of Highway Users Tax (per gallon Gasoline Excise Tax) payments to local governments. Cities and counties receive about \$100 million per month of these revenues. The Governor has proposed to suspend these payments for a five-month period (April-August 2008) to be paid in full without interest in September 2008. The League is analyzing this proposal for impacts on cities. The Town currently receives approximately \$45,000 in monthly Gas Tax payments from the State which may be suspended by the State.

Proposition 42 (State Gasoline Taxes-Local Street and Road Improvements) - Following two Proposition 42 gap years, cities and counties will statutorily receive these funds again beginning in FY 2008-09. The Governor has proposed fully funding the program including \$594.2 million specifically for cities and counties. Current estimates for the Town are approximately \$283,000 for FY 2008/09 and \$293,000 for FY 2009/10 that can be used for local street and road improvements.

Proposition 1B(Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006) - Current estimates of funds set aside for eligible Town transportation projects are currently estimated at \$446,000 for FY 2008/09 and \$474,000 for FY 2009/10.

General Government

Property Tax "Takes" Fortunately, the Governor's budget delivered in January 2008 proposed no additional state property tax "takes" in the State's FY 2008/09 budget. Additionally, some limited funding for reimbursing State locally mandated costs was also recommended in the Governor's budget. However, with the Governor's declaration of a fiscal emergency, the potential for them remains a possibility each budget development year. A significant mitigating factor to preserve the Town's revenues from further takes was the successful approval of ballot measures in 2004 and 2006 to protect local tax revenues for local services and local transportation projects.

FY 2008/09 BUDGET PREVIEW

Proposed Status Quo Budget for FY 2008/09

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 operating

FEBRUARY 14, 2008

deficit. Consequently, staff will be recommending a “status quo” budget for FY 2008/09, with the possible exception of limited service restoration in critical areas.

The proposed FY 2008/09 budget will reflect 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;
- Continue to make progress on Council priorities identified at the 2007 Town Council retreat;
- Consider limited 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 is a recap of the goals and priorities identified by the Council at the 2007 retreat and brief summaries of the issues which may be addressed in the proposed Operating and Capital Budgets scheduled for consideration by the Town Council on Monday, May 19, 2008.

Council Priorities

At the 2007 Town Council retreat, the Council affirmed six goals and identified priority projects for FY 2007/08. The goals were in the categories of Community Character, Good Governance, Fiscal Stability, Public Infrastructure, Civic Enrichment, and Public Safety. Priority projects included:

Community Character

- Developing a work plan and timeline for the 2010 General Plan update.

Good Governance

- Expanding the availability of eGovernment services available through the Town’s website.

Fiscal Stability

- Seeking long-term fiscal stability through diversification and providing full-service goods and services.

Public Infrastructure

- Addressing funding needs for street maintenance, sidewalks and retaining walls.

Civic Enrichment

- Determining and implementing action plan for the development of the new library.

Public Safety

- Determining and implementing an action plan to address police department facility needs.

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

- Expanding the Los Gatos Prepared campaign to maximize the number of individuals, families and businesses who are self-sufficient in the event of an emergency.

Given that the timeline for these priority projects carry over into FY 2008/09 and that staff will be recommending basically a status quo budget, it is anticipated that these projects will remain the priorities for the Town for FY 2008/09.

Operational Issues

The cost reductions made since FY 2001/02 to address budget shortfalls underpin the Town's current stable fiscal position and minimize the projected deficits in the Five-Year forecast. Unless significant revenue increases occur in the future, it is important to acknowledge that additional ongoing expenditures will result in greater forecasted deficits.

At the same time, the budget process needs to take into account service deficiencies in critical areas, staffing reorganizations to align with service needs, new or expanded operational demands, opportunities to use technology to increase productivity and services available to the public, and changing and increasing needs in the community. Following are issues in these areas that the administration is exploring at this time during the development of the FY 2008/09 budget. In that staff is in the early stages of budget development, it is possible that other issues could yet arise. In analyzing each of these issues, staff will consider their impacts on both current and future budgets, alternative approaches to meeting the needs, and/or phasing options to spread costs over time.

Service Deficiencies and Staffing

Two areas are being discussed regarding service deficiencies resulting from previous budget reductions. These include field services staffing in the Parks and Public Works Department (PPW) and the school resource officer assignment in the Police Department (PD). In PPW, staff has been undertaking an assessment of staffing resources and service needs in parks, streets and maintenance, and administration. The assessment will identify how resources are allocated to deliver core services, any gaps in staff resources, opportunities for reorganization to align with service needs, and service delivery standards that may need to be adjusted to align with resources. It is anticipated that the findings of the assessment may be addressed in some manner in the FY 2008/09 budget.

The second service deficiency being discussed in the school resource officer (SRO) position in PD. This assignment was converted from a dedicated position to a collateral assignment for a patrol officer in a previous budget. Staff is exploring partnerships with the school districts to fund a position that could be dedicated once again to the SRO assignment. Consideration for reinstating this position will take into account the extent to which non-Town funding sources can be committed for this purpose.

PAGE 17

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

Staffing Reorganization

Staff continues to assess organizational structures to align staff resources with work demands. At present, staff is exploring restructuring opportunities to ensure that staff resources providing Town administrative and legal services are appropriately allocated to support the organization in delivering services to the community. It is a goal for any changes in the area to be cost neutral or to have minimal cost impacts.

Operational Demands

Staff is analyzing two regional issues that will affect the Town's budget. One is the likely need for additional resources to comply with the new regional storm water permit which is being issued by the San Francisco Regional Water Quality Control Board (SFRWQCB). Discussions are still occurring among municipalities, the Santa Clara Valley Urban Runoff Pollution Prevention Program staff, and the SFWQCB to determine the specific impacts of this change. It is likely that a portion of the additional costs attributable to this program can be recovered by development fees in the future.

The other regional funding demand regards the Silicon Valley Regional Interoperability Project (SVRIP), which aims to integrate public safety data and communication systems in the Valley. This is a long-term project with multiple components for which federal funding is being pursued. While it is likely that federal funding will be received, the project will require local matches and ongoing support. The impact to the FY 2008/09 budget will likely be the local share of an executive director position and related costs. Greater impacts are expected in future budget years.

Town-specific operational costs that may need to be adjusted in the FY 2008/09 budget are various costs of maintenance and utilities, areas that were reduced in previous years. These reductions may not be sustainable going forward. Another anticipated cost increase is the cost of operations and maintenance (O& M) associated with the new police facility on Los Gatos Boulevard, specifically utilities, telecommunications, custodial, and building maintenance. Although the building is targeted for completion in spring 2009, any increases are likely to be recommended for the FY 2009/10 budget. A related cost will be any necessary reconfiguration that will need to occur in the existing police space to accommodate remaining staff including staff moving from the offices in the house on Vista Way. Unlike the O & M costs for the new facility, these costs would not be ongoing.

Technology Opportunities

In addition to the potential ongoing costs noted above, staff is exploring one-time expenditures for updated or new technology that will increase staff productivity and/or enhance services provided to the public. These projects will be considered as part of the capital budget.

PAGE 18

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

SUBJECT: 2007/08 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2007

FEBRUARY 14, 2008

Other capital projects are being considered for inclusion in the 5-year Capital Improvement Plan (CIP). Given the limited sources of funding for capital projects, it is likely that any addition will require re-prioritization of the current CIP. One project that will be included in the CIP is the library development project as directed previously by the Town Council.

Community Needs

As the Town conducts the community grant process through the Community Development Block Grant (CDBG) program and the Town's own General Fund grant program, staff may receive requests from local non-profits for increased funding. In addition, the Town has been informed that its CDBG allocation is \$3,000 less this year due to federal funding cuts.

CONCLUSION

Overall the financial position of the Town finds itself in the current year with revenues moderately higher and expenditures lower than estimated in the adopted budget. This may result in the Town having the possibility to increase its General Fund operating and capital reserves. However, current projections indicate the possibility of operating deficits within two years. In an atmosphere of potential recessionary impacts to revenues and potential dramatic increases to Town operating costs, particularly employer retiree medical costs, among others, the necessity to contain the Town's operating costs is of the highest priority. Accordingly, as mentioned in budget preview, staff anticipates recommending a "status quo" FY 2008/09 budget with a judicious use of augmentations to service considered only in special circumstances, such as safety or outside funding enhancements.

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 2007/08. 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, 2008. As detailed in this report, staff is currently engaged in FY 2008/09 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.

Attachment: Budget Performance Report for the Six Months Ended December 31, 2007



TOWN OF LOS GATOS

BUDGET PERFORMANCE REPORT

FOR THE SIX MONTHS ENDED DECEMBER 31, 2007

February 5, 2008

FINANCIAL OVERVIEW – EXECUTIVE SUMMARY

Status of FY 2007/08 Adopted Budget:

Overall, 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 \$550,000 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 17% 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 2.12% for the year for the quarter ending September 30, 2007 (the most recent quarter available). Restaurant sales taxes for the period were the highest generated in the past two years, up 11.39% from the prior year.

Despite concerns relating to the real estate sector rising from the "sub-prime" lending problems, property tax collections are trending slightly ahead of budget estimates. Property tax appears to be tracking at approximately 4% growth, as projected during the development of the FY 2007/08 budget. Due to the small amount of growth above estimates, no change to budget is recommended at this time. The sustained 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 2007/08 are also favorable, with spending at the end of the second quarter averaging 44% expended, or 6% 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.

Providing services to the community in this 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 2008/09 "status quo" budget, including updated fees, will be prepared mindful of protecting 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.

General Fund Reserve Status -June 30, 2007

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	\$4,220,000
Reserved for LT Notes Receivable	512,394
Total Restricted General Fund Reserves	\$4,732,394

As stated earlier the total General Fund Reserves closed at a balance of approximately \$21.1 million at June 30, 2007. In addition to the approximate \$4.7 million of General Fund Reserves set aside for restricted purposes, the Town has approximately \$16.4 million in designated reserves established in accordance with Town financial policies and operating and capital budget requirements. The Designated Reserves presented below include the 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	\$4,325,011
Designated for Revenue Stabilization	4,817,445
Designated for Economic Uncertainty	3,678,001
Designated for Compensated Absences	2,128,758
Designated for Civic Center Improvements	663,086
Designated for Open Space	562,000
Designated for Mgr's Contingency & Prod.	200,000
Designated for Grants Funds & Carryovers	31,910
Total Designated Reserves	\$16,406,211

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 \$550,000 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 designated programmed 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 \$16.4 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 \$16.4 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 2007/08

The following presentation provides a recap of significant General Fund revenue sources as of the second quarter ending December 31, 2007. 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.

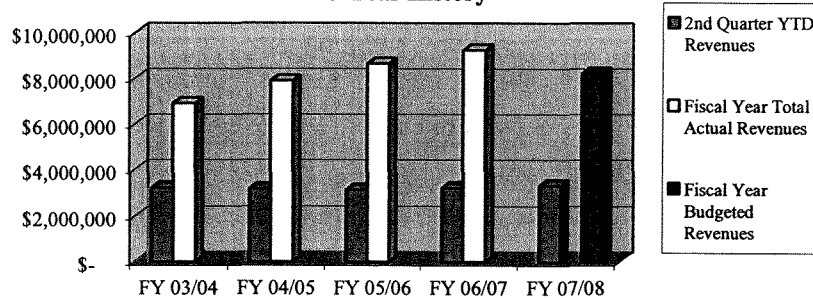
Analysis

According to a recent update from the Town's sales tax analysis consultant, jurisdictions across California experienced slowdowns or declines in sales tax revenue in the third quarter of 2007. Many economists predict a year or two of flat to negative economic growth. After adjusting for inflation, the Town experienced a negative

(-2.5%) growth rate as compared to a negative (-2.8%) growth rate for the Northern California region for the year ended September 30, 2007. The Town's actual revenue collections do not reflect these % declines because of the timing of cash receipts and advances made by the State which are adjusted in "true-ups" twice a year.

With the closure of three auto dealerships in recent years that were "top ten sales tax" generators, the fact that sales tax collections are slightly ahead of the prior year's pace is very encouraging. The continued success of Netflix and the addition of some new sales tax contributors have helped to prevent a decline in sales tax projections for the current year. While sales tax collections remain strong, more diversification of the revenue base continues to be vital for this revenue category. The Town continues to seek more balance in business sectors that generate sales tax.

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



	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08
2nd Quarter YTD Revenues	\$ 3,217,070	\$ 3,179,238	\$ 3,131,898	\$ 3,214,488	\$ 3,326,298
Fiscal Year Total Actual Revenues	\$ 6,914,526	\$ 7,904,130	\$ 8,655,565	\$ 9,253,891	
Fiscal Year Budgeted Revenues					\$ 8,231,100

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

2nd Quarter Percent of Total	46.53%	40.22%	36.18%	34.74%	40.41%
------------------------------	--------	--------	--------	--------	--------

Recommended Budget Revision	No Change				
------------------------------------	------------------	--	--	--	--

◆ **Property Tax Revenue** ◆

Description

Property Tax is one of the Town's largest revenue sources, accounting for 21.7% of the Town's budgeted General Fund revenue for FY 2007/08.

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.

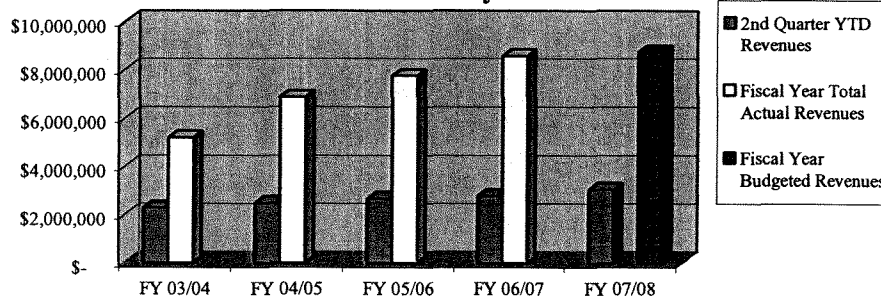
Property Tax is levied at 1% of a property's assessed value, of which the Town currently receives approximately 9.5 cents on each dollar paid to the County Assessor's Office. The assessed value of real property appraised by the County Assessor is the 1975-76 assessment role value, adjusted by a two percent 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 but because of uncertainty resulting from the fallout from the sub-prime lending problems experienced in other locales, no budget revision upwards is recommended at this time. A recent review of the Santa Clara County Assessor's roll for July 1, 2008 lien date indicates a 4.6% growth in total assessed value for the Town. Los Gatos is near the top of the range of cities in the county anticipating positive assessed valuation growth for FY 2008/09.

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



	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08
2nd Quarter YTD Revenues	\$ 2,297,420	\$ 2,497,953	\$ 2,678,416	\$ 2,806,731	\$ 3,054,138
Fiscal Year Total Actual Revenues	\$ 5,207,381	\$ 6,856,993	\$ 7,755,200	\$ 8,584,612	
Fiscal Year Budgeted Revenues					\$ 8,757,580
<i>FY 2004/05 forward will reflect an increase in Property Tax due to "Permanent" Realignment of VLF</i>					
2nd Quarter Percent of Total	44.12%	36.43%	34.54%	32.69%	34.87%

Recommended Budget Revision

No Change

◆ **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.

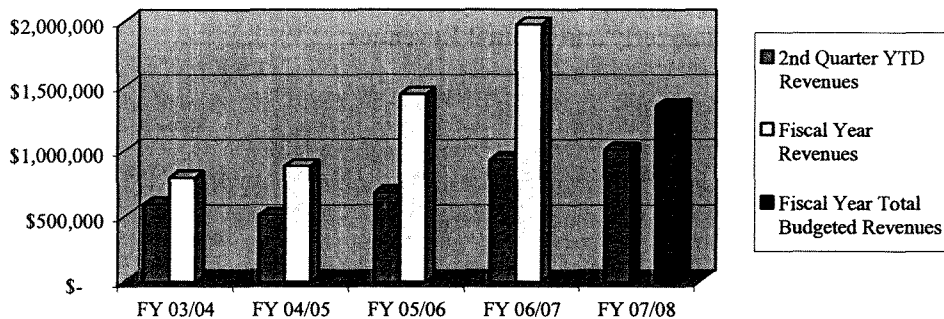
Analysis

The Town's Interest Income earning has been impacted this fiscal year by use of Town

funds to make significant investments in Town infrastructure, most notably the purchase of land for the new police services building, among others infrastructure investments made in carrying out the Town's approved capital improvements plan.

Current year interest revenues are tracking very well against budget estimates. The Local Agency Investment Fund (LAIF) rate had been trending upwards but has backed off from recent highs. Actual LAIF yields have declined moderately to an average yield of 4.96% in December 2007, from 5.12% in December 2006, and but is still well above the LAIF record low of 1.42% in May 2004.

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



	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08
2nd Quarter YTD Revenues	\$ 594,001	\$ 513,338	\$ 684,427	\$ 936,081	\$ 1,011,756
Fiscal Year Revenues	\$ 795,488	\$ 884,203	\$ 1,439,685	\$ 1,977,233	
Fiscal Year Total Budgeted Revenues					\$ 1,348,300
2nd Quarter Percent of Total	74.7%	58.1%	47.5%	47.3%	75.0%
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.

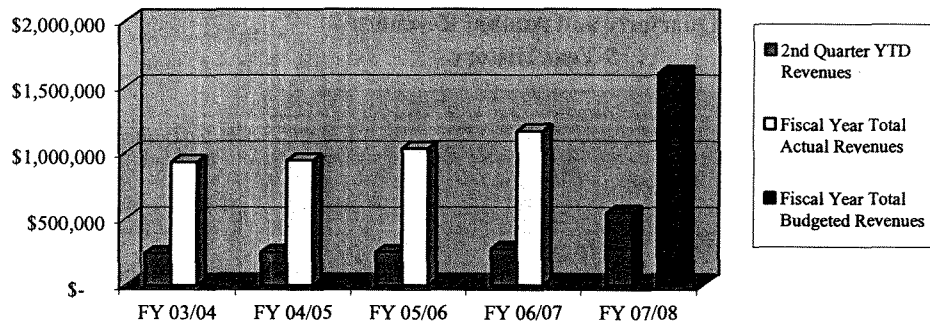
Analysis

Second quarter results are pacing ahead of the budget estimates at mid-year and are significantly higher than the prior year due to

the change in way franchise fees are collected. With the transition in the spring of 2007 to the new garbage contract, the franchise fees 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 fees but eliminated the solid waste surcharge fees.

Due to solid waste franchise tax revenues exceeding estimates for the current fiscal year, staff recommends a \$100,000 increase to this revenue source.

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



	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>	<u>FY 06/07</u>	<u>FY 07/08</u>
2nd Quarter YTD Revenues	\$ 239,295	\$ 246,980	\$ 248,860	\$ 274,603	\$ 547,508
Fiscal Year Total Actual Revenues	\$ 930,997	\$ 942,647	\$ 1,030,189	\$ 1,162,037	
Fiscal Year Total Budgeted Revenues					\$ 1,603,180

FY 2007/08 Increase Due to new contract for Garbage Franchise Fees

2nd Quarter Percent of Total	25.70%	26.20%	24.16%	23.63%	34.15%
------------------------------	--------	--------	--------	--------	--------

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

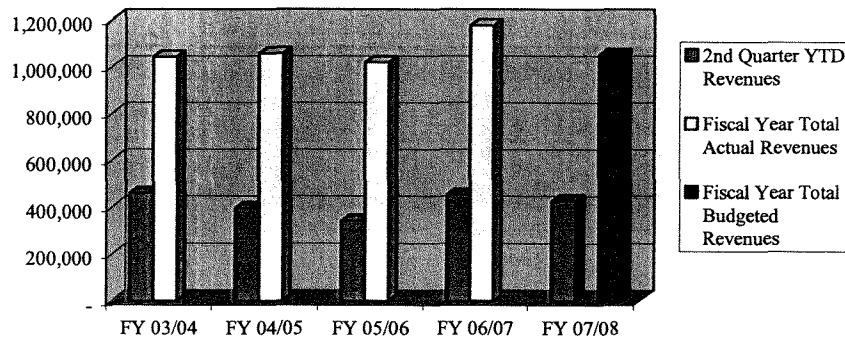
based businesses are pro-rated by quarter, from the date of application to the end of the year.

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.

The actual second quarter collections trail the year before but the % of budget is slightly ahead of the prior year. Actual collections for the prior year benefitted in part from additional audit efforts conducted by staff which netted approximately \$75K in additional "one-time" revenue from unlicensed businesses operating fiscal year. Staff intends on conducting additional audit efforts again this fiscal year.

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



	<u>FY 03/04</u>	<u>FY 04/05</u>	<u>FY 05/06</u>	<u>FY 06/07</u>	<u>FY 07/08</u>
2nd Quarter YTD Revenues	458,003	396,773	343,358	452,346	428,095
Fiscal Year Total Actual Revenues	\$ 1,041,865	\$ 1,056,814	\$ 1,019,386	\$ 1,176,422	
Fiscal Year Total Budgeted Revenues					\$ 1,050,000
2nd Quarter Percent of Total	43.96%	37.54%	33.68%	38.45%	40.77%

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.

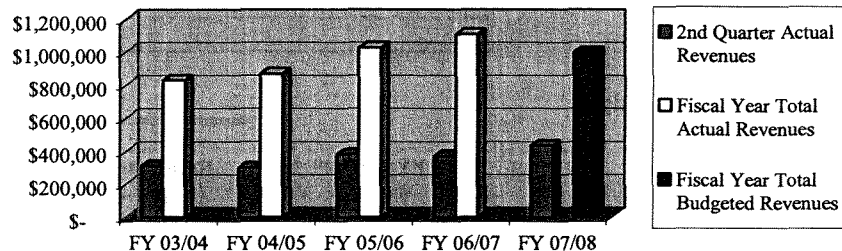
Analysis

The Transient Occupancy Tax revenues received in the second quarter of FY 2007/08 reflects an increase in collections compared to the prior year, reflecting general increases in room rates in recent years and some recovery in the local travel in the past two years. This year the State of California is projecting flat to modest growth in domestic and international

visitation compared to the prior year. However, statewide room rates were up an average of 8.9 per cent as of November 2007, leading statewide to the generation of higher gross room revenues.

Overall, the Town expects the occupancy rates to continue improving with modest increases in tourism statewide, completed and upcoming property re-investments, and local trends demonstrating some recovery in corporate and leisure travel in recent years. Local hotels are considering modest room rate increases that should provide future additional transient occupancy taxes for the Town.

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



	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08
2nd Quarter Actual Revenues	\$ 312,998	\$ 301,725	\$ 382,190	\$ 371,333	\$ 435,890
Fiscal Year Total Actual Revenues	\$ 829,025	\$ 868,908	\$ 1,028,664	\$ 1,108,257	
Fiscal Year Total Budgeted Revenues					\$ 1,000,000
2nd Quarter Percent of Total	37.75%	34.72%	37.15%	33.51%	43.59%
Recommended Budget Revision					\$ 100,000

FY 2007/08 RECOMMENDED BUDGET ADJUSTMENTS

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

GENERAL FUND	FY 2007/08 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2007/08 Revised Budget
Revenue:			
Sales Tax	\$ 8,231,100	\$ 550,000	\$ 8,781,100
Franchise Fees	1,603,180	100,000	1,703,180
Hotel Tax	1,000,000	100,000	1,100,000
Project Revenues-From Deposit		20,000	20,000
Other Miscellaneous	Various	7,500	7,500
Total Revenue Adjustments	\$ 10,834,280	\$ 777,500	\$ 11,611,780
Expenditures:			
Finance-Printing Services	4,500	10,000	14,500
BMP Expenditures	33,000	4,500	37,500
Internal Service Fund Loan Repayment	-	300,000	300,000
PPW Winter Storm Damage-Operating	-	46,500	46,500
PPW Budget Correction -Utilities	-	75,000	75,000
Total Expenditure Adjustments	\$ -	\$ 436,000	\$ 473,500
Net General Fund Adjusted Budget		\$ 341,500	

	FY 2007/08 Current Budget	Recommended Adjustment Increase (Decr.)	FY 2007/08 Revised Budget
OTHER FUNDS			
<i>Grants Fund</i>			
Emergency Mngmt Program Grant	\$ 4,444	\$ 4,009	\$ 8,453
Self Insurance Fund			
Claims Against the Town	\$ 50,000	\$ 30,000	\$ 80,000
<i>GFAR, CDBG, Storm Drain, & Grants Capital Projects Fund</i>			
Oak Meadow Turf Rehabilitation	\$ -	\$ 20,000	\$ 20,000
ADA Improvements	\$ 41,500	\$ 9,654	\$ 51,154
Winter Storm Damage	\$ -	\$ 245,000	\$ 245,000
Wedgewood Avenue Storm Drain	\$ 267,430	\$ 25,000	\$ 292,430

Recommended Budget Adjustments

General Fund

Revenues

Sales Tax - Actual receipts are running ahead of estimates, primarily due to the general retail (internet commerce) category. Staff recommends an increase of \$550,000 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 \$100,000 in

garbage franchise fees for the year due to higher than anticipated gross garbage collection revenues estimated to be collected through the fiscal year end.

Hotel Tax - Staff recommends a \$100,000 increase to this revenue source based upon the actual six months of receipts through December 2007 which are trending ahead of estimates done during the prior year budget preparation.

Miscellaneous Revenues - Staff recommends an adjustment of \$27,500 increase in various other General Fund revenues such as small safety grants, Americans with Disabilities Act Rehabilitation below market price home program fees and massage licensing fees.

Expenditures

Below Market Priced (BMP) Homes Expenditures - Staff recommends a \$4,500 increase paid from the BMP fees account for increased program costs due to the recent foreclosure and Town reacquisition of three units from the developer, to be sold at future date.

Finance Printing Services - Staff recommends an increase of \$10,000 for the current year for printing services. With the implementation this fiscal year of the Pentamotion Upgrade Project, staff needed to establish a new inventory of printed forms, such as purchase orders, business licenses, etc. The request will provide adequate funding for this effort to be completed.

Storm Related Repairs - Staff recommends a \$46,500 increase to various Parks and Public work expenditure line items such as signal controllers, chain link fencing replacement, and emergency tree removals due to the recent winter storm. Staff currently anticipates that some of this amount may be recoverable from damage to property claims soon to be filed with the Town's property insurer.

Parks & Public Works Utility Cost Correction - Staff recommends a \$75,000 increase to the Town's utility budget for electricity (\$50K) and water (\$25K). These were reduced in prior years to lower levels that assumed new technologies would lower usage and related costs. Actual costs for the year indicate this has not materialized. Staff is currently analyzing this situation and more data is expected in the coming months that will inform the adequacy of future budget allocations.

Other Funds

Grant Fund

Staff recommends a \$4,009 increase to the Homeland Safety Grant revenues and expenditures for Emergency Management Grant Program.

Self Insurance

Staff recommends a \$30,000 increase for claims against the Town due to the successful settlement of an outstanding class action lawsuit.

GFAR, CDBG, Storm Drain, & Grants Capital Projects Funds

- Staff recommends a \$20,000 increase for the Oak Meadow Turf Rehabilitation project paid for from developer deposits.
- Staff recommends a \$9,654 increase to the Americans with Disabilities Act Improvements project funded by an increase allocation available from federal grant revenue.
- Staff recommends a \$245,000 project funded by General Fund revenues and Storm Drain Funds to repair or replace capital assets destroyed in the recent winter storms. This project encompasses replacement of the Howe's playlot (\$41K) playground equipment,

storm drain culverts at Shannon (\$55K) and Highland (\$80K), and embankment repair (\$15K) and retaining wall replacements (\$45K) along the Los Gatos Creek trail. A substantial portion of this cost will be potentially be recovered from the Town's property insurer.

- Wedgewood Storm Drain. Staff recommends a \$25,000 increase charged to Storm Drain Basin #1 Fund for increased costs due to delay of the start date of the project because of legal issues that surfaced during the project planning phase. It should be noted this funds cash balance is currently in a deficit. After the project is completed, the fund is not expected to be in a positive cash position until FY 12/13, according to staff estimates. This means that the other Town funds are providing a temporary loan until they can be repaid out of the Storm Drain fees fund.

FINANCIAL SUMMARIES, PROJECTIONS AND RECOMMENDATIONS

General Fund

Presented below is the *Schedule of FY 07/08 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, 2007

	Unaudited FY06/07 Final Balance	FY06/07 Adjusted Budget	FY06/07 2nd Qtr Actuals	FY06/07 % YTD	FY07/08 Adopted Budget	FY07/08 Adjusted Budget	FY07/08 2nd Qtr Actuals	FY07/08 % YTD	FY07/08 Finance Projection
Revenues									
General Property Tax	\$ 6,594,058	\$ 6,469,900	\$ 2,806,732	43%	\$ 6,727,220	\$ 6,727,220	\$ 3,054,138	45%	\$ 6,727,220
Prop Tax Car Tax Backfill	1,990,555	1,990,550	-	-	2,030,360	2,030,360	-	0%	\$ 2,030,360
Sales & Use Tax	9,253,891	8,100,140	3,214,488	40%	8,231,100	8,231,100	3,326,299	40%	\$ 8,781,100
Franchise Fees	1,162,038	1,238,940	274,603	22%	1,603,180	1,603,180	547,508	34%	\$ 1,703,180
Transient Occ Tax	1,108,257	1,000,000	371,333	37%	1,000,000	1,000,000	435,891	44%	\$ 1,100,000
Business License Tax	1,176,442	1,000,000	452,346	45%	1,050,000	1,050,000	428,095	41%	\$ 1,060,000
Licenses & Permits	1,541,302	1,616,000	1,329,615	82%	1,930,400	1,930,400	1,179,754	61%	\$ 1,937,900
Motor Vehicle In Lieu	194,104	152,700	112,624	74%	163,200	163,200	67,959	42%	\$ 163,200
Intergovernmental	2,058,576	2,062,432	825,333	40%	2,004,825	2,004,825	614,389	31%	\$ 2,005,325
Charges for Services	3,967,735	3,221,390	2,083,058	65%	3,371,470	3,371,470	1,824,184	54%	\$ 3,370,970
Fines & Forfeitures	561,665	455,900	224,330	49%	525,405	525,405	172,599	33%	\$ 525,405
Interest	2,127,234	1,705,700	914,083	54%	1,498,300	1,498,300	1,011,756	68%	\$ 1,498,300
GASB investment to market per audit	448,828	-	-	-	-	-	-	-	-
Miscellaneous/Other	320,614	206,800	204,318	99%	267,230	267,230	220,245	82%	267,230
Fund Transfers	114,471	221,850	174,757	79%	184,110	184,110	146,469	-	184,110
Total Revenues	32,619,770	29,442,302	12,987,621	44%	30,586,800	30,586,800	13,029,288	43%	31,354,300
Use of Other Funding Sources:									
Reserves	4,179,094	-	382,210	-	525,000	525,000	525,000	-	525,000
PERS Liability Account	300,000	300,000	300,000	-	300,000	300,000	300,000	-	300,000
Use of Internal Service Reserves - Yr 3	-	-	-	-	-	-	-	-	-
Total Other Funding Sources	4,479,094	300,000	682,210		825,000	825,000	825,000		825,000
Total Revenues plus Reserves	\$ 37,098,864	\$ 29,742,302	\$ 13,669,831		\$ 31,411,800	\$ 31,411,800	\$ 13,854,288		\$ 32,179,300
Expenditures (includes c/f but no encumbrances)									
Mayor & Council	150,379	161,130	72,485	45%	169,500	169,500	72,485	43%	169,500
Treasurer	102,713	98,150	42,966	44%	106,650	106,650	42,966	40%	106,650
Attorney	234,828	245,450	113,777	46%	257,750	257,750	113,777	44%	257,750
Administrative Services	2,307,354	2,338,010	1,086,951	46%	2,442,300	2,442,300	1,086,950	45%	2,442,300
Comm Development	2,936,351	3,246,500	1,335,002	41%	3,656,585	3,656,585	1,335,003	37%	3,656,585
Police	11,628,108	11,625,576	5,502,864	47%	11,958,720	11,966,180	5,502,863	46%	11,966,180
Parks & Public Works	4,988,746	4,967,350	2,311,077	47%	5,255,750	5,255,750	2,311,076	44%	5,255,750
Community Services	1,943,843	982,065	447,162	46%	1,032,772	1,032,772	447,162	43%	1,032,772
Library	1,914,247	1,989,660	908,097	46%	2,056,810	2,066,260	908,096	44%	2,066,260
Total Dept Expenses	\$ 26,206,569	\$ 25,653,891	\$ 11,820,381	46%	\$ 26,936,837	\$ 26,953,747	\$ 11,820,378	44%	\$ 26,953,747
Non-Dept Expenditures and other uses									
General Government	6,031,556	6,659,148	1,052,142	16%	3,571,800	3,586,800	1,052,142	29%	3,886,800
Total Non-Dept Expenses	\$ 6,031,556	\$ 6,659,148	\$ 1,052,142	16%	\$ 3,571,800	\$ 3,586,800	\$ 1,052,142	29%	\$ 3,886,800
Total Operating Expenditures	\$ 32,238,125	\$ 32,313,039	\$ 12,872,523	40%	\$ 30,508,637	\$ 30,540,547	\$ 12,872,520	42%	\$ 30,840,547
Net Operating Revenues Before Capital Trsfers & Budgeted Beg Fund Balance	\$ 4,860,739	\$ (2,570,737)	\$ 797,308		\$ 903,163	\$ 871,253	\$ 981,768	N/A	\$ 1,338,753
Authorized Use of Reserves									
Capital Projects	4,179,094	4,179,094	382,210	-	525,000	525,000	525,000	-	525,000
Total Budgeted Use of Reserves	4,179,094	4,179,094	382,210		525,000	525,000	525,000		525,000
Net Surplus or (Use) of Reserves	681,645	(6,749,831)	415,098		378,163	346,253	456,768		813,753

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	-	338,850	802,076	108,289	97,491	(5,818)
Budgeted Revenues	555,860	346,384	210,643	172,010	36,170	-
Actual Revenues - 2nd Qtr	99,506	14,157	15,485	166,660	34,956	10,896
Budgeted Expenditures	555,860	396,384	421,293	180,940	43,290	-
Total Actual Expenditures - 2nd Qtr	190,044	100,327	12,108	102,558	19,000	70
2nd Quarter Ending Fund Balance	(90,538)	252,680	805,453	172,391	113,447	5,008

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 2007/08 adopted budget. Staff is recommending no changes at this time.

If operating revenues will support it, staff intends to maintain the General Fund’s current year \$575,000 revenue commitment to the Town’s Capital Improvement Plan.

Capital Project Funds
Budget to Actuals Comparisons

	GFAR Fund	Traffic Mitigation	Grant Fund CIP's	Storm Drains	Utility Undergd	Gas Tax
Beginning Fund Balance	6,245,816	93,491	(141,453)	805,284	2,269,147	903,833
Budgeted Revenues	1,210,240	50,000	3,864,244	132,470	140,220	565,710
Actual Revenues - 2nd Qtr	775,558	-	269,146	76,579	54,478	249,047
Budgeted Expenditures	8,853,060	50,000	3,956,895	301,930	-	1,057,447
Total Actual Expenditures - 2nd Qtr	2,554,552	12,359	292,080	-	-	127,138
2nd Quarter Ending Fund Balance	4,466,822	81,132	(164,387)	881,863	2,323,625	1,025,742

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).

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 2007/08 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	2,511,895	2,158,057	1,889,627	241,342	1,925,761	190,878	738,656
Budgeted Revenues	414,100	613,500	506,800	86,000	925,530	611,600	1,189,500
Actual Revenues - 2nd Qtr	200,280	309,334	286,390	35,301	432,325	305,800	573,385
Budgeted Expenditures	641,910	604,440	541,400	84,600	1,381,800	597,050	1,179,600
Total Actual Expenditures - 2nd Qtr	315,486	261,334	459,497	31,042	579,028	261,494	432,053
2nd Quarter Ending Fund Balance	2,396,689	2,206,057	1,716,520	245,601	1,779,058	235,184	879,988

Trust and Agency Funds - Town Trust and Agency Funds have fund balances as of June 30, 2007 of \$319,716 for Parking District #88 and \$313,024 in the Library Trust Funds. No budget revisions are contemplated at this time for these funds.

Redevelopment Agency - The Agency's FY 07/08 and FY 2007-12 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 \$258,000 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 (\$80K) available for the Almond Grove Street Reconstruction pilot project, (\$80K) available for Santa Cruz Avenue/Wood Road Gateway, (\$65K) available for the North Santa Cruz Lighting project and (\$81K) unexpended 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	4,316,921	4,307,048	6,556,978	15,180,947
Budgeted Revenues	600,000	6,597,990	1,676,800	8,874,790
Actual Revenues - 2nd Qtr	607,715	2,796,255	702,471	4,106,441
Budgeted Expenditures	3,658,091	5,034,400	497,420	9,189,911
Total Actual Expenditures - 2nd Qtr	1,723,958	1,544,489	366,630	3,635,077
1st Quarter Ending Fund Balance	3,200,678	5,558,814	6,892,819	15,652,311

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 FY2007/08 point are encouraging in terms of the Town's economically sensitive revenues. 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. The Five-Year Financial Plan continues to project some challenging future revenue shortfalls. 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.

