



MEETING DATE: 2/17/2009

ITEM NO: 11

COUNCIL/AGENCY AGENDA REPORT

DATE: FEBRUARY 10, 2009

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

FROM: GREG LARSON, TOWN MANAGER/EXECUTIVE DIRECTOR 

SUBJECT: FY 2008/09 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-
SIX MONTHS ENDING DECEMBER 31, 2008

- A. ACCEPT 2008/09 MID-YEAR SECOND QUARTER BUDGET
PERFORMANCE STATUS REPORT, INCLUDING FY 2008/09-
FISCAL YEAR FINANCIAL PROJECTIONS
- B. AUTHORIZE BUDGET ADJUSTMENTS AS RECOMMENDED IN
THE ATTACHED SECOND QUARTER BUDGET PERFORMANCE
REPORT

RECOMMENDATION:

1. Accept the FY 2008/09 Mid-Year Budget Performance and Status report, including FY 2008/09 Fiscal 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 to provide the Town Council with a status of the FY 2008/09 Adopted Budget at the mid-year point, including an overview of revenue and expenditure trends and financial projections for the current fiscal year. The report also includes a brief discussion on the Town's current year General Fund Reserve status and an update of the FY 2009/10 budget development process and recommended budget approach.

PREPARED BY:


STEPHEN CONWAY

Finance & Administrative Services Director

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

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

SUBJECT: FY 2008/09 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2008

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DISCUSSION:

FY 2008/09 MID YEAR BUDGET STATUS

Budget Performance Report

The Budget Performance Report (Attachment 1) is a mid-year report covering a six month period beginning July 1, 2008 and ending December 31, 2008. The Budget Performance Report provides an analysis and recommendations related to the current year's adopted budget revenue and expenditures and the projected financial condition of all Town funds.

General Fund Revenue Highlights FY 2008/09

An analysis of FY 2008/09 General Fund revenue confirms that the Town is not immune from the current economic recession. Key economically sensitive revenues such as sales tax, property tax, transient occupancy tax, franchise tax, and fees and services have been impacted by the economy. As a result, staff proposes a \$1.1 million net reduction in adopted budget levels. The proposed revenue changes include:

- A \$858,300 decrease in estimated sales tax from \$9,058,300 to \$8,200,000.
- A \$295,223 decrease in estimated revenues for charges for services (mostly building plan check fees) from \$2,271,678 to \$1,976,455.
- A \$188,720 decrease in licenses and permits (mostly building permit fees) from \$2,350,150 to \$2,161,430.
- A \$168,980 decrease in property taxes from \$7,093,300 to \$6,924,320.
- A \$110,000 decrease in estimated transient occupancy taxes from \$1,210,000 to \$1,100,000.
- A \$100,000 decrease in estimated franchise fee revenue from \$1,756,100 to \$1,656,100.
- Revenue increases above estimates include a \$6 million increase in sale of land revenues related to the Vasona land sale, \$130,000 increase in parking citation revenue, and a \$470,138 increase to estimated investment earnings, reflecting higher revenues on greater than anticipated average investment balances.

General Fund Expenditure Highlights FY 2008/09

Current expenditures are trending below the expected 50% of budget level, which could result in expenditure savings at year end. This savings may help alleviate potential impacts of adjusting adopted budget revenues downward as a result of the slow economy.

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

SUBJECT: FY 2008/09 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2008

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General Fund Projected Year End Balances June 30, 2009

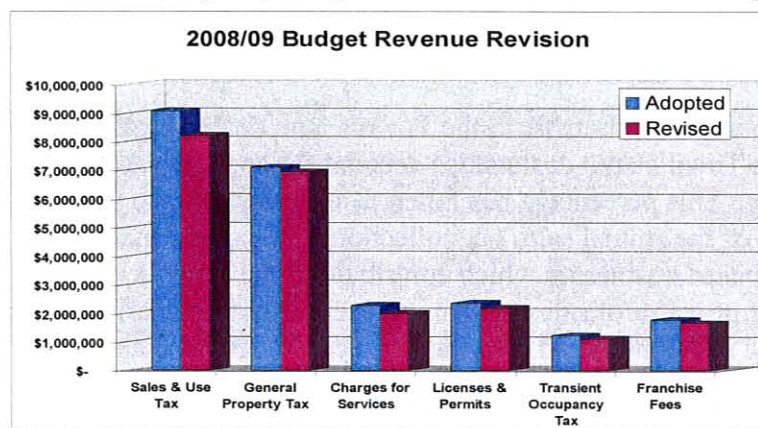
Current fiscal year end projections for FY 2008/09 anticipate an excess of operating revenues above operating expenditures of approximately \$498,000. This amount does not include the \$6 million sale of Town-owned property in Vasona Park. The Town Reserve policy provides that once legally restricted reserves are funded as required, excess General Fund year end balances are to be designated equally to the Reserve for Future Capital and Special Projects and the Town Revenue Stabilization Reserve. As Council is aware, the availability of excess balances resulting from current fiscal year expenditure reductions or revenue increases beyond the adopted budget is an important funding source for the Future Capital and Special Projects Reserve and Revenue Stabilization Reserve. This is particularly important for the Future Capital and Special Projects Reserve as it has limited alternative sources of funding.

FY 2008/09 MID-YEAR BUDGET UPDATE TRENDS

The FY 2008/09 mid-year budget update validates the Town's prior decisions to make strategic cost reductions dating back to FY 2001/02. The current FY 2008/09 adopted budget includes 23 full time equivalent "de-funded" positions with an annual salary and benefit savings of approximately \$2.7 million dollars. Though the Town has been fiscally conservative, challenges still remain as explained in the following discussion.

Operating Revenue Trends

The FY 2008/09 mid-year update reflects reductions in estimates across most of the large sources of economically sensitive revenues including Sales Tax, Property Tax, Franchise Fee Tax, Transient Occupancy Tax, and Licenses and Permits/Charges for Services, among others.



Cumulatively, the FY 2008/09 mid-year budget estimates that the General Fund total revenues, not including the \$6 million sale of Town-owned property in Vasona Park or use of other funding sources, will need to be adjusted approximately \$1.1 million lower than the adopted budget estimates as shown in the graph to the left. Two of the more significant revenue reductions include sales

and use tax and licenses and permits and charges for services.

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

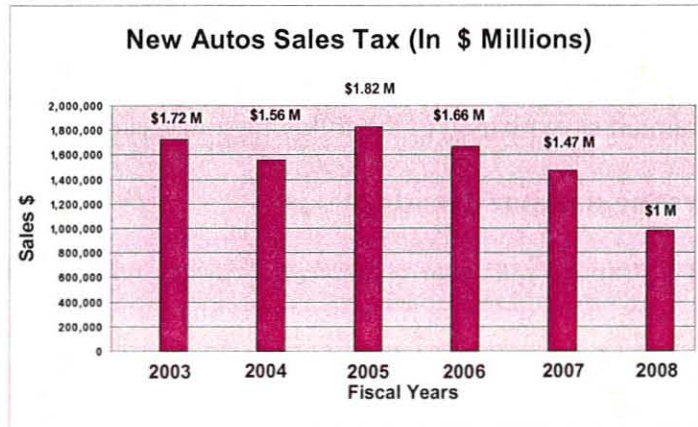
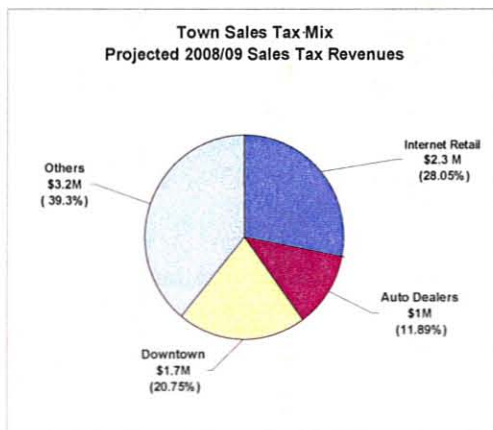
SUBJECT: FY 2008/09 MID-YEAR BUDGET PERFORMANCE AND STATUS REPORT-SIX MONTHS ENDING DECEMBER 31, 2008

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Sales and Use Tax

Due to the slow economy, staff recommends revising sales and use tax approximately \$860,000 lower than the adopted budget. Revenues are down across a number of segments of the economy, with auto sales recording record lows for the fiscal quarter ending September 30, 2008. Auto parts and auto repairs have also recorded low revenues in the last three years. On a positive note, internet retail experienced a 7% gain, and service station sales tax revenue is at a three year high due to the high summer 2008 gas prices.

The new revised sales tax of approximately \$8.2 million is a very important component of the Town's revenue sources, representing approximately 30% of the Town's General Fund operating revenues. However, 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 in the Sales Tax Mix Chart, the Town's auto dealerships account for approximately 12% 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 technology-based businesses which contribute to the Town's revenue, one of which is now our largest provider of sales tax annually, contributing nearly 28% of the Town's sales tax revenue. 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 delivery of services to the community.

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Licenses & Permits and Charges for Services

The mid-year budget update also includes a reduction of approximately \$483,000 in licenses and permits and charges for services. The majority of this reduction comes from decreased fees for private development activity and related fees and permits. Given its limited revenue base, the Town must charge 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. In that regard, staff is intending to bring forward for Council approval, a fee review/update this spring as part of the budget process.

Operating Expenditure Trends

Anticipating that the Town's economically sensitive revenues would be impacted by recession, staff proactively implemented strategic cost reduction strategies this fiscal year, including targeted hiring freezes, redeployment of staff, and reduction in materials and supply costs. These efforts were in addition to the 23 positions defunded in prior years.

Current estimates of the Town's General Fund expenditures anticipate actual expenditures will be approximately \$780,000 below the FY 2008/09 adjusted budget. Given the decreased operating revenue streams, the expected savings will be crucial in maintaining a balanced budget for the fiscal year. Staff anticipates that despite the reduction in revenues, the General Fund will still be able to capture a small surplus of approximately \$498,000 at the close of the fiscal year.

State Budget Impacts to Local Governments

Although California State legislators appear to have reached agreement on the State budget, details are not yet available. Local government remains concerned that revenue such as property tax and other funding sources are at risk for reduction or elimination. While Proposition 1A provides some protections for local agencies, the State has the ability to declare a "fiscal emergency" which would allow the state to take local revenue sources like property tax for a limited time. The Town should consider property taxes and Redevelopment Agency tax increment to be at risk until the state can make ongoing structural changes to its budget. Other funding sources such as the \$100,000 Community Oriented Policing (COPS) grant, vehicle license fees, and the state mandated cost reimbursements also remain at risk. Staff is working proactively with the League of Cities, legislators, and professional organizations such as the Association of California Police Chiefs to protect these vital revenue sources.

GENERAL FUND RESERVE STATUS

As of June 30, 2008, Town's FY 2007/08 General Fund balance was approximately \$19.3 million, all of which is legally reserved or designated for special purposes by Council. Included in this amount are approximately \$3.7 million in reserves for Economic Uncertainty, \$4.4 million

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in reserves for Future Capital and Special Projects, and \$4.4 million in Revenue Stabilization reserves that remain intact and available at the mid year point of FY 2008/09.

FY 2009/10 BUDGET DEVELOPMENT PROCESS

Concurrent with the update of the Five Year Financial Plan and in anticipation that service reductions would be necessary for the FY 2009/10 budget, staff began the budget process for next year in early January 2009. This process includes the development of conceptual budget reduction proposals for the Town Manager and Council consideration. Limited revenue enhancements will also be considered to offset reductions. Staff is currently evaluating the feasibility and impact of the proposals before they are brought forward to Council for discussion at the March 7, 2009 Council Retreat.

FIVE-YEAR FINANCIAL PLAN UPDATE

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.

Last Fall, staff updated the Five-year Financial Plan which included preliminary budget work based on an assumption of a deficit gap in FY 2009/10 of approximately \$800,000 rising to approximately \$1.5 million in FY 2010/11. That projected gap was not due primarily to the recession, which was just beginning to be felt at a national level. Rather, the gap was due to projected expenditures growing at levels above projected revenues, leading to ongoing future deficits if structural and ongoing adjustments were not made.

The scheduling of the Five Year Plan for presentation at the Council retreat in early March will allow staff to incorporate more reliable data into the revenue estimates as more "actual" numbers on economically sensitive revenues become known. It may also provide more time to determine what, if any, effects will be felt by the Town resulting from the State of California's budget deliberations.

CONCLUSION

Overall, for the current year, the Town is in the enviable position of having moderately higher revenues than expenditures when fully accounting for all internet-based retail sales. This could result in a small increase in General Fund operating and capital reserves. However, due to projected flat and or declining revenue growth, staff is developing budget reduction and limited revenue enhancement options for FY 2009/10 and beyond. Given the potential recessionary impacts to Town revenues and anticipated increases in Town operating costs, particularly employer retiree medical costs and other personnel costs, the Town's highest fiscal priority should be to contain its operating costs on an ongoing basis.

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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 2008/09. 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, 2009. As discussed earlier in this report, staff is currently engaged in FY 2009/10 budget development process which incorporates plans for a moderate level of budgetary rightsizing, 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, 2008



TOWN OF LOS GATOS

BUDGET PERFORMANCE REPORT

FOR THE SIX MONTHS ENDED DECEMBER 31, 2008

February 17, 2009

FINANCIAL OVERVIEW – EXECUTIVE SUMMARY

Status of FY 2008/09 Adopted Budget:

Second quarter General Fund revenues confirm that the broader economic recession has impacted the Town. Overall, General fund revenues are recommended to be adjusted lower by a cumulative amount of approximately \$1.1 million from adopted budget estimates. The closure of two automobile dealerships the prior year and another this fiscal year, along with a dramatic slump in new car sales, led to record lows in sales tax collected on new automobiles. The current forecast expects Sales Tax to be lower than revenue estimates by approximately \$860,000 this fiscal year. The decrease is moderated by the growth in the general retail category, led by continued growth of an internet commerce company, the Town's largest provider of sales tax revenues. Auto dealerships as a whole have declined to approximately 12% 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 four of the top ten businesses in the Town's portfolio of sales tax generators in recent years without a dramatic decline in sales tax. Restaurant sales taxes for the period ending September 30, 2008 were the highest generated in the past three years, up 5% from the prior year.

Despite concerns relating to the real estate sector rising from the "sub-prime" lending problems and the recession, property tax collections are tracking very close to the adopted budget estimates. Property tax appears to be tracking at approximately 3% growth, approximately 1% lower than projected during the development of the FY 2008/09 budget. Based on current year receipts, staff recommends a \$168,980 decrease to property tax revenues for this year from the adopted budget estimates. Despite a very slow real estate market, the sustained positive growth is largely attributable to the turnover of local housing stock, and new construction/remodels 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 2008/09 are also favorable, with spending at the end of the second quarter averaging 48% expended, or 2% below the 50% benchmark level used for 6 months of operations. Because of expected lower operating revenues, staff began strategic cost reductions to constrain the rise of operating costs. With six months of data now available, staff can better predict the next six months of expenditure trends, but unexpected costs can arise outside of the norm. Consequently, further adjustments may be necessary during the fiscal year. Any further course corrections or budget adjustments necessary to balance operating revenue and expenditures will be brought to Town Council's attention at the earliest opportunity.

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 likely cost increases. The FY 2009/10 budget preparation, including updated fees, will try to protect essential public services while limiting operating cost escalation in light of the five-year fiscal forecast update in March which is likely to predict operating revenue shortfalls in the coming fiscal years.

General Fund Reserve Status -June 30, 2008

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	548,261
Total Restricted General Fund Reserves	\$2,048,261

As stated earlier the total General Fund Reserves closed at a balance of approximately \$19.2 million at June 30, 2008. 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	\$4,351,921
Designated for Revenue Stabilization	4,369,355
Designated for Economic Uncertainty	3,678,001
Designated for Compensated Absences	2,154,952
Designated for Year End Budget Adjustments	1,432,000
Designated for Open Space	562,000
Designated for Market Fluctuation	456,430
Designated for Mgr's Contingency & Prod.	200,000
Designated for Grants Funds & Carryovers	31,910
Total Designated Reserves	\$17,236,569

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 \$1,100,000 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 refers to the \$17.2 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 \$17.2 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 2008/09

The following presentation provides a recap of significant General Fund revenue sources as of the second quarter ending December 31, 2008. 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.

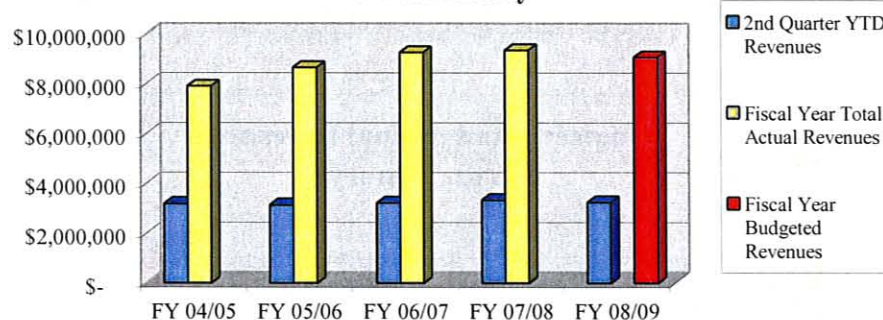
Analysis

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 2008. ABAG economists predict a continued slowdown or flat to negative economic growth for the next two fiscal years. After adjusting for

inflation, the Town experienced a negative (-1.5%) growth rate as compared to a negative (-2.8%) growth rate for the Northern California region for the year ended September 30, 2008.

With the closure of four auto dealerships in recent years that were "top ten sales tax" generators, the fact that sales tax collections are down only moderately from 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 more dramatic decline in sales tax projections for the current year. However, relying on one major source of sales tax for service delivery is not recommended. 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 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter YTD Revenues	\$ 3,179,238	\$ 3,131,898	\$ 3,214,488	\$ 3,326,298	\$ 3,236,975
Fiscal Year Total Actual Revenues	\$ 7,904,130	\$ 8,655,565	\$ 9,253,891	\$ 9,345,432	
Fiscal Year Budgeted Revenues					\$ 9,058,300

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

2nd Quarter Percent of Total	40.22%	36.18%	34.74%	35.59%	35.73%
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Recommended Budget Revision	\$ (860,000)				
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◆ Property Tax Revenue ◆

Description

Property Tax is one of the Town's largest revenue sources, accounting for 21.8% of the Town's budgeted General Fund revenue for FY 2008/09.

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.

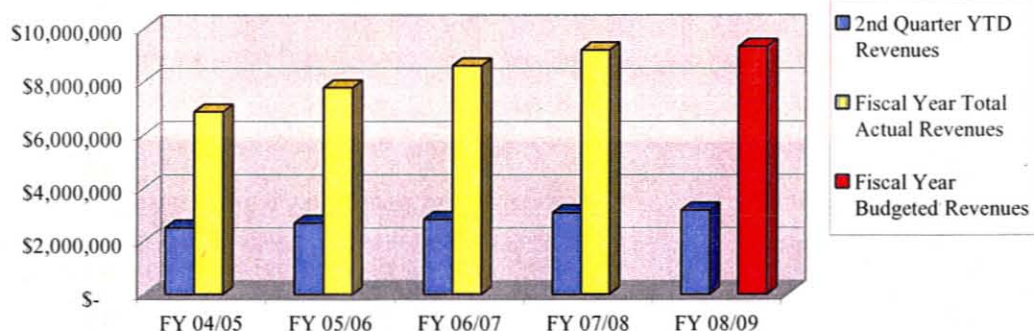
Real property values critically impact revenues. With the passage of Proposition 13, voters in California limited the tax rate that can be imposed by the Town on property. With the limitation on rates, the higher the aggregate property value, the higher the revenue generated.

Analysis

Property taxes are moderately lower than budget estimates but because of uncertainty resulting from the fallout from the sub-prime lending problems experienced in other locales, further reductions to estimates may be necessary. The Santa Clara County Assessor's roll for July 1, 2008 lien date indicates a 3.06% (1% below adopted budget estimates) growth in total assessed value for the Town. Los Gatos is near the top of the range of cities in the county still anticipating positive assessed valuation growth for FY 2008/09.

PROPERTY TAX

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



	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter YTD Revenues	\$ 2,497,953	\$ 2,678,416	\$ 2,806,731	\$ 3,061,873	\$ 3,160,810
Fiscal Year Total Actual Revenues	\$ 6,856,993	\$ 7,755,200	\$ 8,584,612	\$ 9,178,869	
Fiscal Year Budgeted Revenues					\$ 9,299,500
<i>FY 2004/05 forward will reflect an increase in Property Tax due to "Permanent" Realignment of VLF</i>					
2nd Quarter Percent of Total	36.43%	34.54%	32.69%	33.36%	33.99%
Recommended Budget Revision					\$ (168,980)

◆ 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 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

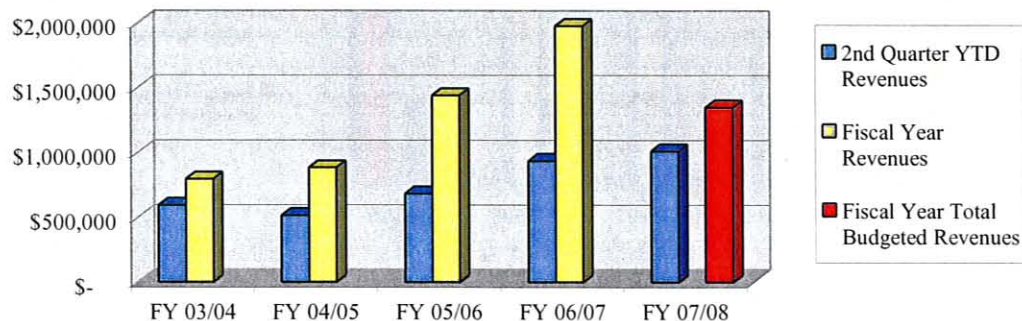
The Town's Interest Income earning has been impacted this fiscal year years by use of Town funds to make significant investments in Town

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

Current year interest revenues are tracking positively against budget estimates. Actual LAIF yields have declined moderately to an average yield of 2.353% in December 2008, from 4.801% in December 2007, and but is still above the LAIF record low of 1.42% set in May 2004. Despite very low yields available in the market, there is more average dollar balances available for investment than staff had estimated in the spring of 2008. Staff recommends an increase of \$400,000 to interest revenue.

Interest Income

**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					\$ 400,000

◆ 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.

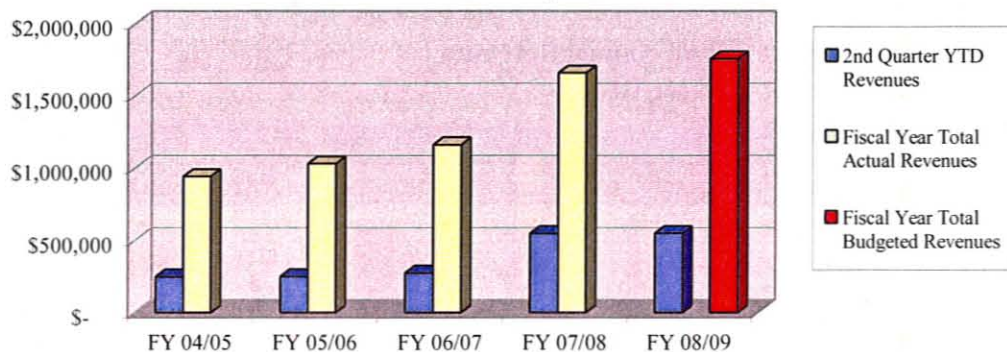
Analysis

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 the 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**



	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter YTD Revenues	\$ 246,980	\$ 248,860	\$ 274,603	\$ 547,508	\$ 548,795
Fiscal Year Total Actual Revenues	\$ 942,647	\$ 1,030,189	\$ 1,162,037	\$ 1,659,829	
Fiscal Year Total Budgeted Revenues					\$ 1,756,100

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

	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter Percent of Total	26.20%	24.16%	23.63%	32.99%	31.25%

Recommended Budget Revision	(100,000)
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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

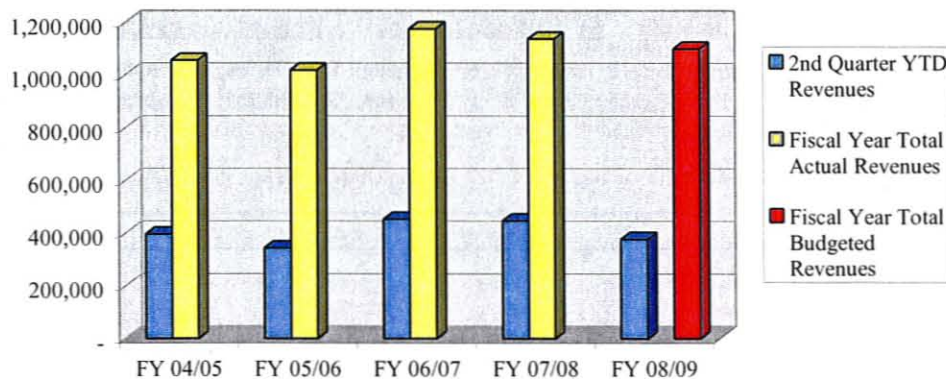
based businesses are pro-rated by quarter, from the date of application to the end of the year.

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 actual second quarter collections trail the year but this is likely due to timing issues resulting from the financial system upgrades impact to the normal billing cycle. 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**



	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter YTD Revenues	396,773	343,358	452,346	447,514	376,704
Fiscal Year Total Actual Revenues	\$ 1,056,814	\$ 1,019,386	\$ 1,176,422	\$ 1,138,057	
Fiscal Year Total Budgeted Revenues					\$ 1,100,000
2nd Quarter Percent of Total	37.54%	33.68%	38.45%	39.32%	34.25%
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.

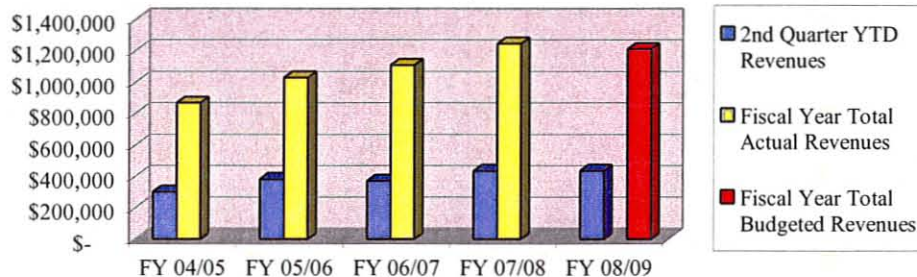
Analysis

The Transient Occupancy Tax revenues received in the second quarter of FY 2008/09 reflect a small increase in collections compared to the prior year, a positive development in light

of the current recession. This year the State of California is projecting flat to modest growth in domestic and international visitation compared to the prior year.

Overall, the Town expects the occupancy rates to remain comparable to the first six months of the fiscal year. However, due to reports from local hoteliers of lower occupancy rates, staff recommends a moderate revision of \$110,000 less in TOT revenues for the fiscal year.

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



	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09
2nd Quarter YTD Revenues	\$ 301,725	\$ 382,190	\$ 371,333	\$ 435,891	\$ 436,515
Fiscal Year Total Actual Revenues	\$ 868,908	\$ 1,028,664	\$ 1,108,257	\$ 1,245,078	
Fiscal Year Total Budgeted Revenues					\$ 1,210,000
2nd Quarter Percent of Total	34.72%	37.15%	33.51%	35.01%	36.08%
Recommended Budget Revision					\$ (110,000)

FY 2008/09 RECOMMENDED BUDGET ADJUSTMENTS

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

General Fund Revenues

Sale of Vasona Land	\$	6,000,000
Interest	\$	400,000
Parking Tickets	\$	130,000
Property Taxes	\$	(168,930)
Sales Tax	\$	(860,000)
TOT	\$	(110,000)
Garbage Fees	\$	(100,000)
Permit Fees	\$	(165,000)
Charge for Services	\$	(289,000)
Other Sources	\$	(26,100)
Intergovernmental	\$	(22,000)
	\$	<u>4,788,970</u>

- * Increase both revenues and expenditures on Pass Thru and Property Damage Accounts to equal amount received - approx \$95K

Other Funds Revenues

RDA

ERAF Shift	\$	(456,910)
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CDBG

- | | | |
|--|----|-------|
| * ADA Curb Cuts - reallocate old bal Admin | \$ | 2,801 |
|--|----|-------|

Grant Funds

* ADA Public Facilities - reallocate old balance	\$	2,801
* ADA Public Facilities - reallocate to Curb Cuts	\$	(7,942)
* Curb Cuts - reallocate from ADA Public Facilities	\$	7,942
	\$	<u>2,801</u>

- * Per transfer requested to the County. Reallocation of unspent S's on outstanding projects to be redirected to on-going ADA project.

Other Funds Expenditures

Vehicle Maintenance

Air Compressor	\$	7,000
Fuel System - Fixed Asset	\$	9,000
Fuel System - Fixed Asset	\$	(9,000)
	\$	<u>7,000</u>

Workers Compensation

	\$	10,000
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GFAR

Town Beautification - Turf @ Plaza	\$	50,000
Railroad Crossing @ Winchester- Fund Balance	\$	50,000
	\$	<u>100,000</u>

Grant Funds

* ADA Public Facilities - reallocate old balance	\$	2,801
* ADA Public Facilities - reallocate to Curb Cuts	\$	(7,942)
* Curb Cuts - reallocate from ADA Public Facilities	\$	7,942
	\$	<u>2,801</u>

Recommended Budget Adjustments

General Fund Revenues

Sale of Vasona Land. Staff recommends a \$6,000,000 revenue adjustment to Sale of Land for the Vasona land sale. This amount will be held in a designated reserve in the General Fund for future acquisition and maintenance of open space. Any interest earned on this balance will accrue to this reserve.

Sales Tax-Actual receipts are running below adopted budget estimates, primarily due to the decline in new automobile sales and smaller decreases in other categories. Staff recommends a decrease of \$860,000 in estimated revenues for the year.

Interest-Actual receipts are running ahead of adopted budget estimates largely due to higher average balances available for investment than staff had projected for the FY 2008/09 adopted budget.

Parking Citations. Actual receipts indicate a need to increase this revenue source by an additional \$130,000 for the fiscal year.

Property Taxes-Actual tax collections through December 2008 indicate a need to lower budget estimates for all categories of Town property tax by \$168,930.

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

Hotel Tax- Staff recommends an \$110,000 decrease to this revenue source based upon reports of lower occupancy from local hoteliers, however the actual six months of receipts through December 2008 are trending at the same pace as the prior year.

Permit Fees and Charges for Services. Staff recommends lowering these revenues by a total of \$454,000 reflecting a slowdown in private development activity due to the national recession.

Miscellaneous Revenues-Staff recommends a decrease of \$48,100 in various other miscellaneous General Fund revenues.

Other Funds

RDA Fund

Staff recommends a \$456,910 decrease to RDA tax increment to reflect the State of California's FY 2008/09 budget Educational Reallocation Augmentation Fund (commonly referred to as "ERAF take" from the Town's RDA

Vehicle Maintenance. Staff recommends a budget adjustment of \$7,000 for an Air Compressor and \$9,000 for a new fuel system funded by replacement funds set aside in the Vehicle Maintenance Fund.

Workers Compensation. The Town was awarded an ABAG grant of \$10,000 in recognition of the Town's risk reduction efforts. The funds will be appropriated in the safety administration program to be used for new security alarms and panic alarms in Town facilities.

GFAR, CDBG Capital Projects Funds

- Staff recommends a \$2,801 and \$7,942 remaining balance of CDBG funds to be reallocated to the ADA Curb Cuts project.
- Staff recommends a \$50,000 increase to the Turf Repair at Town Plaza project to be funded by a transfer of \$50,000 from the Town Beautification Project.

- Staff recommends a \$50,000 project for improvements at the Railroad Crossing at Winchester to be funded by available fund balance in the Town's GFAR fund. This project will repair Winchester Avenue after the railroad has impacted it from its improvement of its railroad crossing on Winchester.

FINANCIAL SUMMARIES, PROJECTIONS AND RECOMMENDATIONS

General Fund

Presented below is the *Schedule of FY 08/09 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, 2008									
	Unaudited FY07/08 Final Balance	FY07/08 Adjusted Budget	FY07/08 2nd Qtr Actuals	FY07/08 % YTD	FY08/09 Adopted Budget	FY08/09 Adjusted Budget	FY08/09 2nd Qtr Actuals	FY08/09 % YTD	FY08/09 Finance Projection
Revenues									
General Property Tax	\$ 7,036,876	\$ 6,775,220	\$ 3,061,873	45%	\$ 7,093,300	\$ 7,093,300	\$ 3,160,810	45%	\$ 6,924,320
Prop Tax Car Tax Backfill	2,141,994	2,030,360	-	-	\$ 2,206,250	2,206,250	-	0%	2,302,186
Sales & Use Tax	9,345,432	8,781,100	3,326,299	38%	\$ 9,058,300	9,058,300	3,236,975	36%	\$ 8,200,000
Franchise Fees	1,659,829	1,703,180	547,508	32%	\$ 1,756,100	1,756,100	548,795	31%	\$ 1,656,100
Transient Occupancy Tax	1,245,078	1,100,000	435,891	40%	\$ 1,210,000	1,210,000	436,515	36%	\$ 1,100,000
Business License Tax	1,138,057	1,050,000	447,514	43%	\$ 1,100,000	1,100,000	376,704	34%	\$ 1,100,000
Licenses & Permits	2,457,418	2,669,250	1,502,133	56%	\$ 2,350,150	2,350,150	1,101,608	47%	\$ 2,161,430
Motor Vehicle In Lieu	137,330	163,200	67,959	42%	\$ 168,100	168,100	38,042	23%	\$ 141,450
Intergovernmental	691,289	692,789	310,226	45%	\$ 695,980	695,980	232,036	33%	\$ 671,873
Charges for Services	1,851,638	2,067,620	1,432,096	69%	\$ 2,271,678	2,271,678	1,287,284	57%	\$ 1,976,455
Fines & Forfeitures	369,292	477,120	153,145	32%	\$ 412,400	412,400	227,119	55%	\$ 497,180
Interest	2,371,338	1,498,300	1,333,438	89%	\$ 1,290,800	1,290,800	1,042,369	81%	\$ 1,760,938
GASB investment to market per audit	752,154	-	-	-	-	-	-	-	-
Miscellaneous Other	1,711,558	2,180,505	1,296,083	59%	\$ 2,378,225	2,427,025	7,809,144	322%	\$ 8,492,655
Fund Transfers	148,369	184,110	146,469	80%	\$ 184,370	184,370	137,892	-	\$ 144,370
Total Revenues	33,057,650	31,372,754	14,060,635	45%	32,175,653	32,224,453	19,635,292	61%	37,128,957
Use of Other Funding Sources:									
Reserves	6,099,894	5,269,086	525,000	-	1,100,000	1,105,000	1,105,000	-	1,105,000
PERS Liability Account	-	300,000	300,000	-	300,000	300,000	-	-	300,000
C/F Reserves Sustainability/YE savings	-	-	-	-	194,500	194,500	-	-	1,006,000
Total Other Funding Sources	6,099,894	5,569,086	825,000		1,594,500	1,599,500	1,105,000		2,411,000
Total Revenues plus Reserves	\$ 39,157,544	\$ 36,941,840	\$ 14,885,635		\$ 33,770,153	\$ 33,823,953	\$ 20,740,292		\$ 39,539,957
Expenditures (includes c/f but no encumbrances)									
Mayor & Council	150,247	169,500	72,485	43%	183,800	183,800	73,286	40%	172,133
Treasurer	94,753	106,650	42,967	40%	109,050	109,050	43,371	40%	64,486
Attorney	251,654	257,750	113,777	44%	247,900	247,900	110,164	44%	250,913
Administrative Services	2,433,868	2,462,300	1,086,951	44%	2,510,800	2,510,800	1,143,779	46%	2,333,907
Comm Development	3,037,483	3,656,585	1,335,002	37%	3,941,520	3,947,520	2,366,725	60%	3,592,528
Police	12,232,464	11,978,234	5,502,934	46%	12,917,130	12,965,930	6,211,578	48%	12,983,414
Parks & Public Works	5,241,603	5,392,125	2,311,077	43%	6,091,240	6,091,240	2,753,250	45%	5,680,138
Community Services	1,009,005	1,037,272	447,162	43%	1,375,510	1,375,510	567,977	41%	1,207,490
Library	1,948,016	2,066,260	908,097	44%	2,111,060	2,111,060	977,761	46%	2,016,880
Total Dept Expenses	\$ 26,399,094	\$ 27,126,676	\$ 11,820,451	44%	\$ 29,488,010	\$ 29,542,810	\$ 14,247,893	48%	\$ 28,301,889
Non-Dept Expenditures and other uses									
General Government	8,532,707	8,262,411	1,733,672	21%	4,281,840	4,280,840	2,318,247	54%	4,739,908
Total Non-Dept Expenses	\$ 8,532,707	\$ 8,262,411	\$ 1,733,672	21%	\$ 4,281,840	\$ 4,280,840	\$ 2,318,247	54%	\$ 4,739,908
Total Operating Expenditures	\$ 34,931,801	\$ 35,389,087	\$ 13,554,123	38%	\$ 33,769,850	\$ 33,823,650	\$ 16,566,139	49%	\$ 33,041,797
Net Operating Revenues Before Capital Trsfes & Budgeted Beg Fund Balance	\$ 4,225,743	\$ 1,552,753	\$ 1,331,512		\$ 303	\$ 303	\$ 4,174,152	N/A	\$ 6,498,160
Authorized Use of Reserves									
Capital Projects	6,099,894	5,269,086	525,000	-	1,100,000	1,105,000	1,105,000	-	1,916,500
Total Budgeted Use of Reserves	6,099,894	5,269,086	525,000		1,100,000	1,105,000	1,105,000		1,916,500
Net Surplus or (Use) of Reserves	(1,874,151)	(3,716,333)	806,512		(1,099,697)	(1,104,697)	3,069,152		4,581,660

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 give 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 Solid Waste Fund (moved to the General Fund in FY 2008/09), Community Development Block Grant Fund, Non Point Source Fund, Landscaping and Lighting District Funds. CBDG Grant Fund revenues reflecting below budget at mid-year is a timing issue, the revenues received are largely based on reimbursements of expenditures that occurred in the prior quarter.

**Special Revenue Funds
Budget to Actuals Comparisons**

	Solid Waste	CDBG Grants	Non Point Source	LIDs
Beginning Fund Balance (Pre-audit)	296,553	815,147	88,550	100,685
Budgeted Revenues	-	165,994	135,000	36,090
Actual Revenues - 2nd Qtr	-	12,958	135,000	35,020
Budgeted Expenditures	-	354,124	184,100	43,290
Total Actual Expenditures - 2nd Qtr	-	57,114	96,031	19,356
2nd Quarter Ending Fund Balance	296,553	770,991	127,519	116,349

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	11,946,384	79,232	(305,711)	890,626	2,375,244	640,219
Budgeted Revenues	2,788,861	50,000	3,007,156	428,855	-	-
Actual Revenues - 2nd Qtr	2,715,640	-	378,278	-	-	-
Budgeted Expenditures	25,637,274	50,000	2,663,127	428,443	-	839,224
Total Actual Expenditures - 2nd Qtr	877,567	3,521	183,497	-	-	-
2nd Quarter Ending Fund Balance	13,784,457	75,711	(110,930)	890,626	2,375,244	640,219

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 Budget to Actuals Comparisons							
	Equipment Replacem	Workers Comp	Self Insurance	Office Stores	Mmgt Info Systems	Vehicle Maint.	Building Maint.
Beginning Fund Balance	3,090,851	2,584,056	1,855,443	237,928	2,124,082	231,302	968,509
Budgeted Revenues	421,470	652,800	518,400	124,480	1,074,970	637,100	1,138,200
Actual Revenues - 2nd Qtr	208,260	314,282	267,742	78,718	522,781	327,371	565,534
Budgeted Expenditures	320,900	663,640	610,900	144,530	1,528,200	639,300	1,596,500
Total Actual Expenditures - 2nd Qtr	142,696	316,046	488,938	59,514	613,528	285,766	884,177
2nd Quarter Ending Fund Balance	3,156,415	2,582,292	1,634,247	257,132	2,033,335	272,907	649,866

Internal Service Funds are tracking in accordance with the FY 2008/09 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.

Trust and Agency Funds - Town Trust and Agency Funds have fund balances as of June 30, 2008 of \$213,451 for Parking District #88 and \$313,425 in the Library Trust Funds. No budget revisions are contemplated at this time for these funds.

Redevelopment Agency - The Agency's FY 08/09 and FY 2008-13 Capital Improvement Plan adopted budgets are incorporated into the Redevelopment Agency's financial statements and year-to-date actuals as presented below:

Redevelopment Agency Funds Budget to Actuals Comparisons				
	Capital Projects	Debt Service	Low/Mod Housing	Total RDA Funds
Beginning Fund Balance	2,997,775	6,291,675	7,198,501	16,487,950
Budgeted Revenues	672,850	7,409,970	1,743,660	8,840,140
Actual Revenues - 2nd Qtr	614,092	3,505,014	757,320	5,862,766
Budgeted Expenditures	2,360,626	6,194,890	403,630	8,959,146
Total Actual Expenditures - 2nd Qtr	624,932	2,161,462	267,702	3,054,096
2nd Quarter Ending Fund Balance	2,986,935	7,635,227	7,688,119	19,296,620

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 State suspended this "take" for FY's 2006/07 & 2007/08, but the FY 2008/09 Budget Bill reintroduced a new ERAF payment of approximately \$456,910, disallowing 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 FY2008/09 are encouraging in terms of the Town's economically sensitive revenues and how they have performed despite a very trouble national economy. This is especially important in light of the recent loss of four auto dealerships which were in the top ten sales tax providers of last fiscal year. Staff expects the Five-Year Financial Plan update scheduled for March 2009 to continue to project challenging future revenue shortfalls. These challenges will be made less so if the Town's economically sensitive revenues can recover 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 recession. The Town continues to carefully monitor revenue and expenditure trends take pro-active steps 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 to explore 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.