MANAGEMENT'S DISCUSSION AND ANALYSIS

This analysis of the Town of Portola Valley's (Town) financial performance provides an overview of the Town's financial activities for the fiscal year ended June 30, 2020. Please read it in conjunction with the accompanying financial statements.

FINANCIAL HIGHLIGHTS:

 Including the deferred inflows and outflows of pension resources, the assets of the Town exceeded its liabilities as of June 30, 2020 by \$46.4 million. Total net position decreased by \$66,874. The decrease in net position is primarily due to capital depreciation (\$967,156) and increased obligations for pensions (\$166,166) and Other Post Employment Benefits-OPEB (\$137,576), largely offset by increases in Fund Balance (\$1,214,744).

The Town has taken active steps to reduce the GASB 75 Other Post-Employment Benefits (OPEB) liability by establishing a trust account through the California Employers' Benefit Trust CalPERS (CERBT), a Section 115 trust maintained by the California Public Employees' Retirement System (CalPERS). The Town Council approved and authorized the trust agreement on August 12, 2020.

• The total liabilities increased 3.1% to \$4.04 million, primarily due to increased obligations for pensions, OPEB and accrued compensated absences.

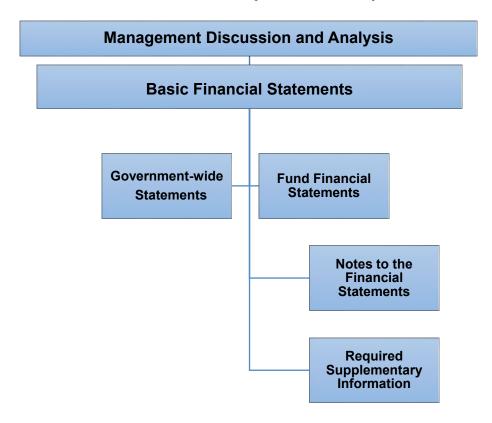
OVERVIEW OF THE FINANCIAL STATEMENTS:

This discussion and analysis serves as an introduction to the Town's basic financial statements that are comprised of three components:

- 1. Government-Wide Financial Statements Provides both *short-term and long-term* information about the Town's overall financial status.
- 2. Fund Financial Statements Focuses on *individual parts* of the Town's financial information reporting these operations in *more detail* than the government-wide financial statements.
 - The governmental funds statements and the agency funds statements tell how basic services such as operations, administration, and restricted funds were financed in the short-term as well as what remains for future spending.
- 3. Notes to Basic Financial Statements Provides explanation of the information contained in the basic financial statements.

The basic financial statements also include notes that explain some of the information in the statements and provide more detailed data analysis. Figure A-1 shows how the various parts of this annual report are arranged and relate to one another.

Figure A-1
Organization of the Town of Portola Valley's Financial Report



Government-Wide Financial Statements:

The government-wide financial statements present the financial picture of the Town and provide readers with a broad view of the Town's finances. The current year's revenues and expenses are considered, regardless of when cash is received or paid.

The first of the government-wide statements is the *Statement of Net Position*. The *Statement of Net Position* reports the difference between the Town's total assets and total liabilities and includes all the Town's capital assets and all its long-term debt.

Although the *Statement of Net Position* reports a total net position of \$46.4 million, the Town has restrictions over the use of these funds. The investment in land, buildings, and equipment (capital assets, net of related debt) is necessary for the successful operation of the Town. Governmental laws segregate funds and place restrictions on spending. This should be considered when reviewing the report.

The second of the government-wide financial statements is the *Statement of Activities*. This statement shows the result of operations that caused net position to change from the prior year to the amount reported on the *Statement of Net Position* as of June 30, 2020. This change in net position is important because it tells the financial statement user whether the financial position has improved or diminished for the Town. The causes of this change may be the result of many factors. To assess the Town's overall health, consideration should be given to additional non-financial factors such as building and land improvements, governmental mandates and staffing levels.

The Statement of Activities classifies expenses by functional area. The report also shows corresponding charges for services and restricted grants for each function that help support the expenses. The resulting Net Revenue/(Expenses) and Changes in Net Position for OPEB, Pension, Fund Balance, Capital and other assets shows the remaining expenses not supported by charges for services and restricted grants. General revenues are then applied to the remaining expenses resulting in the total change in net position.

Fund Financial Statements:

The fund financial statements provide detailed information about the Town's major funds, defined as funds having significant activities and balances in the current year. Non-major funds are combined in a single column, referenced in the Supplemental section of this report.

Funds are accounting devices used to keep track of specific sources of funding and spending on particular programs. These are not reflective of the Town as a whole. It is important to note that:

- Some funds are required to be established by State law.
- The Town establishes other funds to help it control and manage money for specific purposes or to show that it is meeting legal responsibilities for using certain taxes, grants and other money.

The fund financial statements include statements for governmental funds only. These are considered major funds and include:

- The General Fund Most of the Town's basic services and financial resources are contained in this fund.
- Open Space Restricted Fund This fund accounts for monies accrued from special voter-approved utility tax. It is used to support services for open space within the Town.
- Inclusionary-in-Lieu Fund This fund accounts for fees that can only be used for affordable housing.
- Measure A Fund This fund accounts for sales revenue that is restricted for the improvement of local transportation and road maintenance services.

The governmental funds statements provide a detailed *short-term* view that helps determine whether there are more or fewer financial resources that can be spent in the future to finance the Town's programs. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. Reconciliations are provided for both the governmental funds Balance Sheet and Statement of Revenues, Expenditures, and Changes in fund balances to facilitate this comparison.

With the implementation of GASB-54 in 2011, the usefulness of fund balance information has been enhanced by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. In the case of the Town's statements, fund balances within the General Fund that were formerly classified as "designated" by the Council are now reclassified as "assigned" fund balances. In the case of the Town's loan receivable, these have now been reclassified as "non-spendable" fund balance.

Notes to Basic Financial Statements:

The notes provide additional information that is essential for a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information:

In addition to the basic financial statements, this report also presents certain Required Supplementary Information including the Town's budgetary comparison schedules for the General, Open Space Restricted, Inclusionary-in-Lieu and Road Impact Fee funds.

Other Supplementary Information:

Supplementary schedules concerning balance sheets and changes in fund balances for all other funds are presented immediately following the Required Supplementary Information. Financial activity related to the Town's agency funds (maintenance districts) is also presented separately in this section.

GOVERNMENT-WIDE FINANCIAL ANALYSIS:

Statement of Net Position:

The Town's net position has remained stable as of June 30, 2020 compared to prior year, decreasing 0.1% from \$46.5 million to \$46.4 million. The following are major components of the Town's net position:

Town of Portola Valley Condensed Statement of Net Position

	Fiscal Year Ended			
	06/30/19	06/30/20	<u>Amount</u>	<u>Percent</u>
Assets:				
Other Assets	18,058,195	19,069,120	1,010,925	5.6%
Capital Assets, Net	32,033,472	31,066,316	(967,156)	-3.0%
Total Assets	50,091,667	50,135,436	43,769	0.1%
Deferred Outflows	484,210	517,118	32,908	6.8%
Liabilities:				
Accounts Payable	2,036,316	1,832,497	(203,819)	-10.0%
Long-term Liabilities	1,884,406	2,211,160	326,754	17.3%
Total Liabilities	3,920,722	4,043,657	122,935	3.1%
Deferred Inflows	189,744	210,360	20,616	10.9%
Net Position:				
Invested in Capital Assets,	32,033,472	31,066,316	(967,156)	-3.0%
Restricted	10,507,986	11,311,160	803,174	7.6%
Unrestricted	3,923,953	4,021,061	97,108	2.5%
Total Net Position	46,465,411	46,398,537	(66,874)	-0.1%

The Town's net position of \$46.4 million consists of \$31.1 million net investment in capital assets, \$11.3 million in restricted net assets, and \$4.0 million in unrestricted assets. Restricted net assets are restricted by State law, municipal code and contractual obligation to be utilized for public works, safety and open space. Unrestricted assets are not restricted by law; however, \$3.1 million of these funds remain assigned by the Town for special programs.

The increase in Long-Term Liabilities is primarily due to increases of \$166,166 (or 24.8%) in pension liabilities and \$137,576 (or 12.3%) in OPEB liabilities. OPEB liabilities should decline as the Town begins to fund the CalPERS OPEB trust.

The Town uses capital assets to provide services to the Town's populace; consequently, these assets are not available for future spending.

Statement of Activities:

The Town's total overall revenues for FY 2020 decreased by \$801,775 (or 10.8%) from the prior year. The expenses increased by \$630,284 (or 10.4%), which included adjustments for capital depreciation of \$967,156 and adjustments to OPEB and pension liabilities totaling \$303,742. These are offset by an increase in Fund Balance of \$1,214,744. Taken together these adjustments result in a small decrease in the Town's Net Position of \$66,874 (or 0.1%).

Town of Portola Valley
Condensed Statement of Activities

	Fiscal Year Ended 06/30/19 06/30/20		Change Amount	Percent
Revenues:				
Program Revenues				
Charges for Services	1,120,052	784,651	(335,401)	-29.9%
Grants and Contributions	1,318,258	630,802	(687,456)	-52.1%
General Revenues				
Property Taxes	3,058,184	3,158,836	100,652	3.3%
Agency Revenues	302,720	449,377	146,657	48.4%
Franchise Fees	311,471	246,226	(65,245)	-20.9%
Utility Users Tax	951,600	939,261	(12,339)	-1.3%
Investment Earnings	357,834	407,168	49,334	13.8%
Miscellaneous	10,909	12,932	2,023	18.5%
Total Revenues	7,431,028	6,629,253	(801,775)	-10.8%
Expenses:				
General Government	3,313,111	3,841,246	528,135	15.9%
Parks and Recreation	324,723	283,571	(41,152)	-12.7%
Town Center Facilities	638,788	619,639	(19,149)	-3.0%
Public Safety	1,149,440	1,244,971	95,531	8.3%
Public Works	639,781	706,700	66,919	10.5%
Total Expenses	6,065,843	6,696,127	630,284	10.4%
Change in OPEB Liability	(295,992)	(137,576)	158,416	-53.5%
Change in Pension Liability	42,381	(166,166)	(208,547)	-492.1%
Change in Fund Balance	1,874,397	1,214,744	(659,653)	-35.2%
Change in Capital Assets	(235,020)	(967,156)	(732,136)	311.5%
Change in Other Assets	(20,581)	(10,720)	9,861	-47.9%
Net Position - Beginning	45,100,226	46,465,411	1,365,185	3.0%
Net Position - Ending	46,465,411	46,398,537	(66,874)	-0.1%

Other Observations for 2020:

The most significant variances in revenue occurred in Grants and Contributions, Agency Revenues, Charges for Services, Franchise Fees and Investment Earnings.

- Grants and Contributions decreased by 52.1% primarily due to a one-time contribution of \$588,646 to the Open Space Fund and various grants totaling \$65,500 in the previous fiscal year.
- Agency Revenues increased by 48.4% primarily due to the first allocation of Measure W Half-Cent Sales Tax proceeds of \$109,229 for road improvements.
- Charges for Services decreased by 29.9% primarily due to the Covid-19 lockdown, which resulted in lower revenues from most charges for services, including Town Planning Fees, Building Permits, Plan Check Fees, Inspection Fees, and Class Fees.
- Franchise Fees decreased by 20.9% as budgeted revenues from California Water Service Company of \$45,000 and Comcast of \$25,000 were not booked until FY 2020-21.
- Investment earnings increased by 13.8% due to the Town's investment in Schwab securities coupled with higher returns on funds invested in the Local Agency Investment Fund (LAIF).

The most significant variances in expenditures occurred in General Government, Parks and Recreation and Public Works.

- General Government increased by 15.9% primarily due to adjustments to pension and OPEB liabilities, negotiated salary increases, the promotion of a Maintenance Worker II to a Recreational Facilities Coordinator, and the addition of an Assistant Planner position.
- Parks and Recreation decreased by 12.7% due to the Covid-19 lockdown, which resulted in lower expenditures for Class Instructors and Parks & Field Maintenance.
- Public Works (which includes Capital Improvement Projects-CIP) increased by 10.5% due to the allocation of change in capital assets, which is annual depreciation expense net any new capital purchases or CIP projects completed during the fiscal year. There were capital purchases and CIP projects totaling \$732,136 in FY 2018-19 and none in FY 2019-20, resulting in a significant year-over-year change. Expenditures for Public Works and CIP actually decreased by \$559,680 in FY 2019-20, but those savings were more than offset by the annual depreciation expense.

FUND FINANCIAL STATEMENT ANALYSIS

As the Town completed the year, its governmental funds (General Fund, Open Space Restricted Fund, Inclusionary-in-Lieu Fund, Measure A Fund, and Other Governmental Funds) reported combined fund balances of \$17.2 million, an increase of \$1.2 million from last year's ending fund balances of \$16.0 million. The increase is attributable to revenues in excess of expenditures. Revenues for the year totaled \$6.6 million, while expenditures were \$5.4 million.

The following assigned fund balances, totaling \$3.1 million, can be used for their specific purposes within the General Fund; however, these funds can be reassigned at the Council's discretion. These assignments are consistent with prior years:

Assigned for unfunded pension reserve \$712,486
Assigned for OPEB \$34,871

•	Assigned for emergency capital reserve	1,400,000
•	Assigned for equipment replacement	100,000
•	Assigned for legal contingency	100,000

The General Fund had unassigned fund balance of \$2.7 million at fiscal year-end. The remaining \$11.4 million in restricted funds can only be used for projects within the intended purpose of the funds.

Additional detail on specific fund balances can be found in the notes to the financial statements.

Fund Budgetary Highlights:

Overall, for FY 2019-20, Town revenues were under budget by \$724,491. Shortfalls were largely due to the Covid-19 pandemic lockdown which took effect March 16, 2020. Some of the more impacted revenue sources include Town Planning Fees of \$143,027, Building Permits of \$52,569, Plan Check Fees of \$43,758, Inspection Fees of \$36,002, Site Development Permits of \$10,127, Class Fees of \$50,112, and Sales and Use Tax of \$26,112. There were also items appropriated but not realized during FY 2019-20, most notably contributions from the Town Library of \$84,603 and Measure M Sales Tax Revenue of \$75,000. The Library Fund has a surplus and an agreement was reached with the Library to reimburse the Town for maintenance and janitorial services on a pay-as-go basis once the surplus is exhausted. Measure M is a reimbursement program based on completed road related eligible expenditures. The unrealized Measure M revenue was due to no completed CIP projects in FY 19-20.

Town expenditures were under budget by \$2,102,175. Salaries and Benefits savings were under budget by \$229,383 due to staff vacancies and lower than anticipated Employee Health Insurance costs. The primary reason for the budget savings was due to the Covid-19 pandemic lockdown as non-staff operating expenditures were under budget by \$563,272 and capital expenditures were under budget by \$1,199,548, as most major projects were deferred during the lockdown. Some of the significant budget savings that resulted from the lockdown include Miscellaneous Consultants of \$119,999, Engineering Services of \$30,068, Plan Check Services of \$44,488, Tree Trimming and Mowing of \$60,908, Landscape Supplies and Services of \$40,533, Parks and Fields Maintenance of \$32,185, Instructors and Class Refunds of \$18,722, and Town Committee expenditures of \$27,926.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets:

As of the end of fiscal year 2020, the Town had invested \$31.1 million (net of depreciation) in a broad range of capital assets including buildings, land and technology upgrades. The Town's gross capital assets decreased by \$967,156 during the fiscal year, which was entirely due to depreciation expense for the year. Depreciation expense is allocated to the fund and category in which the capital asset has been recorded. No new assets came online during FY 2019-20.

Additional information on the Town's capital assets can be found in Note 3.

Town of Portola Valley Condensed Statement of Capital Assets

	Fiscal Year Ended		<u>Change</u>	
	06/30/19	06/30/20	<u>Amount</u>	Percent
Land	6,690,959	6,690,959	0	0.0%
Construction in Progress	564,653	564,653	0	0.0%
Infrastructure	10,769,254	10,769,254	0	0.0%
Land Improvements	3,070,430	3,070,430	0	0.0%
Buildings & Improvements	19,838,406	19,838,406	0	0.0%
Equipment	<u>462,688</u>	<u>462,688</u>	<u>0</u>	0.0%
Total Capital Assets	41,396,390	41,396,390	0	0.0%
Accumulated Depreciation	(9,362,918)	(10,330,074)	967,156	-10.3%
Total Net Capital Assets	32,033,472	31,066,316	<u>967,156</u>	3.0%

Long-Term Debt:

The Town's long-term liabilities is made up of three components: Net Pension Liability of \$836,271, Net OPEB obligations of \$1,257,439, and compensated balances (unpaid vacation leave) of \$117,450. No new debt was incurred during the fiscal year.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET:

The factors that most significantly impact the Town and its budget are driven by property values, building activity, and labor costs. The local real estate market and housing demand in the region remained steady. These two factors directly impact property taxes, which are the Town's largest revenue source.

In this fiscal year 2019-20, the COVID-19 pandemic crisis fundamentally altered how government interacts with its constituency and how its services are delivered. Some of these changes are frustrating and counter to how Portola Valley's staff and the residents we serve have traditionally enjoyed; other changes are positive and provide service more responsively. As we are still in the early stages of this pandemic, staff will continuously assess the longer-term financial impacts of COVID-19 as they relate to the Town.

The Town recognizes its contractual obligations to employees for vacation and benefits payable. As of June 30, 2020, the Town had accumulated obligations totaling \$117,450 for unpaid vacation leave. Funding for this liability has not occurred since it is not payable currently. The annual expected payout of vacation leave is reflected in the current operating budget of the General Fund. The Town also provides post-employment benefits other than pensions such as health insurance to their retirees, more commonly known as Other Post-Employment Benefits (OPEB). The Town's OPEB obligation increased from

\$1,119,863, to \$1,257,439, an increase of 12.3%. The increase was largely driven by the implementation of GASB 75, which includes sweeping disclosure changes and fundamental overhauls in the standards for reporting OPEB. Most impactful is the recognition of a liability for OPEB obligations, known as the net OPEB liability (NOL) to be fully recognized on the balance sheet with a corresponding OPEB expense recognized in the income statement. Under the former GASB 45, the unfunded accrued liability (UAAL) for OPEB was reported in the notes for the plan. There are some technical differences between UAAL and NOL, but the most significant impact of GASB 75 is the move from the note disclosures section of the financial statements to the balance sheet.

The Town entered into an agreement with CalPERS in December 2020 for OPEB trust services. Future obligations should decline as the Town begins to fund the CalPERS OPEB trust.

The Town is currently evaluating the impact of GASB 84, issued during January 2017. The pronouncement includes numerous changes for reporting fiduciary activities in governmental financial statements and is effective for fiscal years ending on or after December 31, 2019. Staff is currently evaluating the impact of this pronouncement. If applicable, changes will be reflected in the Fiscal Year 2021 financial statements.

The Town is also evaluating the impact of GASB 87, issued during June 2017. The pronouncement seeks to increase the usefulness of governments' financial statements by requiring the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provision in the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this pronouncement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. This pronouncement is effective for fiscal years beginning after December 15, 2019. Staff anticipates that the impact should be negligible given the Town's current lease agreements.

CONTACTING THE TOWN'S FINANCIAL MANAGEMENT:

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the Town's finances and to show the Town's accountability for the money it receives. If you have questions about this report or would like additional financial information, please contact the Finance Director at the Town of Portola Valley, 765 Portola Road, Portola Valley, California 94028.