



State of the City, 2004

Opening

Good Evening. Thank you for joining us tonight for the 2004 State of the City address.

Great City, Auditor's Data

Before I share my thoughts with you on the Great City of Palo Alto, I'd like to highlight what you think of our City. Last November, our City Auditor, Sharon Erickson, conducted a survey of you, the residents of Palo Alto, and asked your opinion about our town. Here's an overview of what you said:

- 90 percent of you think Palo Alto is a good or excellent place to raise children – putting us at the 95th percentile of cities across the nation.
- 88 percent think that your neighborhood is a good or excellent place to live – the 91st percentile.
- 87 percent rate City services overall as good or excellent – the 80th percentile.
- 69 percent agree that you receive a good value for the taxes you pay, putting us in the 89th percentile.
- And a striking 94 percent of you believe that Palo Alto is a good or excellent place to live.

I share with you the belief that Palo Alto is one of the best cities in the country. But, that said, we face continuing challenges as a community in being able to maintain and improve on what we have today.

Tonight, I will talk about challenges in keeping Palo Alto as good as it is and in improving it. These challenges include the budget and how we fund much of what you appreciate. I also will talk about threats to our retail services and about Palo Alto's process.

Budget

Since the economic downturn began in spring 2001, we have balanced our budget without impacting delivery of services. We've kept our budget reserve at its target level. We've cut \$14.5 million in expenses over the past three years. We've eliminated nearly 40 positions through attrition and restructuring.

But the outlook is still unclear, with unresolved challenges ahead.

At the State level, fiscal uncertainty in the budget will persist. Last week's passage of Props 57 and 58 makes the short term a bit more manageable. But the State still suffers a massive deficit and will require controversial structural reform over the next several years.

We should expect the State to cut programs that support Palo Alto and the county. And we should expect them to look for new, creative ways to take our resources. As a jurisdiction, the City is not alone. Our pre-eminent school district may need to fend off more attempts by the State to raid our "basic aid" funding.

At our local level too, we face significant uncertainty. Silicon Valley lags the state in recovering from the recession, with full recovery perhaps 5 to 7 years away.

At the same time, the City has been hit with major involuntary cost increases. Pension and medical costs have gone up in the past two years despite of our reducing direct salary costs. Union and wage pressures continue. Finally, hundreds of thousands of dollars of unfunded mandates are imposed on us annually by the State.

By now it is clear that state officials have been living beyond our means. Here at home, even with our balanced City budget, we must consider whether we are living beyond our long-term means.

Much of our infrastructure was built between 50 to 100 years ago and now needs rebuilding. The City Council here tonight has supported ongoing investment in our infrastructure. In the past five years, we have doubled our annual capital expenditures. Over the past four years, we have committed \$40 million to general fund capital projects.

But we must do more. Our financial plan funds \$73 million of capital projects over the next 10 years. This is insufficient to maintain the parks, streets, and facilities that comprise our City's half billion dollars in material assets. In order to maintain these assets, we need to spend, on average, \$10 million per year into the future. And that number does not include anything new, such as the new downtown park, police building improvements, or storm drains.

To meet this continuing need, I challenge my colleagues and the community to develop and support a long-term budget that fully funds our existing and future infrastructure requirements, even at the cost of reductions in services.

How can we pay for it?

How can we pay for it all?

As we look to balancing the budget and supporting our infrastructure, we must consider not only service cuts but also how we raise the funds to pay for our needs. In our net general fund, we spend \$1,400 annually per resident. That's about \$3,000 per household or family.

Where does this money come from?

The average Palo Alto family in 2000 had a household income of \$107,000 and paid a total of \$31,500 in Federal, State and local taxes. The City of Palo Alto received just 3 percent of these taxes. That is, we received \$1,048 from the average family.

So where does the money come from?

Our top two revenue sources are sales tax and property tax.

Let me talk first about property taxes. Broadly speaking, we receive nearly half our property tax from commercial properties.

For residential properties, let's consider two families:
The first is a family that bought a million dollar home last year. Of the \$10,000 they pay in property taxes, the City receives just \$950.

The second is a family with the good fortune to have lived in a similar home since 1975. With an assessed value of \$60,000 at that time, under Prop 13, the City receives \$99 in property taxes. For the year. For the family.

So where does the money really come from?

Sales Tax

Our largest source of City revenue is sales tax.

We receive \$3.7 million from the Stanford Shopping Center. And \$2 million from our eight auto dealerships. Fry's Electronics, one of our largest retailers, likely provides around \$1 million annually in sales tax. But it's not just the major retailers that are important to us. We have roughly 2000 retailers and service providers of all types in the City. At the peak, our sales tax revenues were \$25.8 million. This year they are projected as \$17.4 million.

This decline reflects more than the Bay Area recession. A decade ago, the Stanford Shopping Center was pre-eminent in the region, even in the nation. Today, while still successful, it is challenged by an upgraded Valley Fair and by the new Santana Row with many similar retailers. Our Fry's Electronics store is now their oldest facility. Our auto dealerships are under intense pressure from

larger, more modern competitors. We've recently lost our Porsche and Nissan dealerships: one moving to Redwood City; the other going out of business.

Much of Palo Alto, including our retail facilities, was built in the 50's and 60's. All things have cycles. Like anything else, retail must adapt or it will die.

When I came to Palo Alto in 1973, University Avenue was moribund. My first memory of downtown was the hole in the ground where we once had a Penney's Department Store. University Avenue had been decimated. In part, it was because of the then-new Stanford Shopping Center.

The City worked to encourage retail in the downtown and made two very successful decisions. One was adopting an ordinance protecting ground floor retail stores. The second was creating a parking assessment district, which consolidated and reduced the overall cost of parking. University Avenue has now cycled around to be arguably the best downtown in the Bay Area.

But the cycles continue.

Our 2000 retailers and service providers are surrounded on three sides by big box discounters – Costco to the north and south, Home Depot and Ikea to the east. And they surely would be out west if they could find a way. It's not by chance that big box discounters surround us. And the Internet will have a profound and growing impact on our retail environment.

If we ignore the challenges around us, our retailers, large and small, may again perish.

Two years ago, then-mayor Vic Ojakian established a committee on economic vitality that reached out to businesses and retailers. As part of the City's ongoing efforts, staff and committee members met with more than 100 businesses across town to ask for their feedback on how well we, the City, support them. Their candor has inspired a fresh look at how Palo Alto's process impacts their ability to do business.

Last year, then-mayor Dena Mossar, inaugurated the "Shop Palo Alto" Campaign that private retailers continue today.

This year, I am convening a retail committee that includes retailers, service providers and neighbors from across the City. This committee will recommend to the Council a set of policies to enhance the vitality and survivability of our retailers and service providers. We cannot change the forces of competition around us. But we must work with our retailers to respond and adapt effectively to the competition.

The Challenge of Palo Alto's Process

Now let's consider Palo Alto's process. Over the years, we have created a tangled web of process that brings prolonged delay, economic hardship, and mounting tension.

We've heard from residents, from businesses and from staff that our process is out of control.

- Residents wanting to remodel their homes complain about the time and cost of our review process.
- Developers complain of costly delays that may run to years before they can break ground.
- Merchants and businesses complain they lose revenue while they wait and wait for City Hall permits.

When development projects are proposed, stakeholder's talk, debate and may attend meetings for years before decisions are reached. Moderate voices tend to drop out. Staff members – feeling under attack - throw up their hands, unable to identify any solution that the community seems willing to accept.

We fight our battles too long and too fiercely. Our ill-defined, unbounded planning process fosters a community divide and does not necessarily result in a better outcome.

Last year, the Council asked the City Auditor to evaluate our development review process. She identified 15 planning processes, with no way to know at the start, which will apply. In fact, our process web has become so tangled that even charting each of our processes is impossible.

The Audit Report made 34 recommendations for simplifying our planning processes. Staff members are working to implement many of these now. Policy and ordinance changes will be recommended to the Council for action in the next few months. This Council must be resolute in establishing clear, simple processes. All must know when and how they can participate to ensure that their voices are heard. And all must be assured of a reasoned, timely decision.

The Challenge of Working Together

As we address the issues that face us this year, we must learn to work together better.

I have great admiration for my colleagues. There is a strong, renewed interest among us in forging better working relationships. We, of course, have our differences but we share a new level of mutual respect and a willingness to talk with and listen to each other. A recent closed session meeting was marked by the most respectful and considered discussion by the Council that I can recall. At

our last Council meeting, even with a heated moment or two, it was something of a breakthrough to hear members talking with each other as we discussed what we should do.

I believe this Council has the potential to be the most productive Council in many years. Now, with hope, I ask the community to watch our renewed efforts where strong individuals with divergent views work together to identify the best solutions for Palo Alto.

Let me propose one additional challenge to my colleagues: that is to increase our participation with and in the community. Often, by the time an issue finally comes to this Council, groups have taken fixed positions. By that time, we can merely make the decision – it is too late to lead the community together to a solution.

There are appropriate constraints on what elected officials can do. Yet, while honoring these limitations, we Council Members cannot be community leaders if we are disengaged from our constituents and above the fray. We must work with our constituents, during the community process, to bring them together. We do not lead by staying in these chambers.

Goals for 2004

As we consider tonight the state of our City, our question should not be where are we but where are we going?

During the next year:

- For our City budget, we must continue to balance revenues and expenditures. But the real challenge will be reducing services to establish a 10-year budget that fully addresses our infrastructure needs.
- For our retailers and service providers, we must identify and implement actions to preserve and enhance their vitality.
- For our citizens, residential and commercial, we must address our Auditor's recommendations and simplify our process. We must provide certainty of process and certainty of a timely, reasoned decision.

Here's a final number from the Auditor's survey. Last November, she asked you if you were pleased with the direction the City is taking. Fifty-four percent of you said yes. Compared to other cities, that's not bad. But we must do better.

The most important step to achieve these goals is that we Council Members must accept differences of opinion and style. Our priority must be to work with each other for the City's benefit. Equally important is that the community do the same. No matter what the issue we debate today or tomorrow, we should

remember that we likely would remain neighbors and, hopefully, friends for the rest of our lives.